

Bulgaria



Expanding ProCredit's Operations in Rural Areas

Study Supported Under the Balkan Region Special Fund



Food and Agriculture Organization
of the United Nations



European Bank
for Reconstruction and Development

BULGARIA

EXPANDING PROCREDIT'S OPERATIONS IN RURAL AREAS

TABLE OF CONTENTS

CURRENCY EQUIVALENTS/ABBREVIATIONS	i
EXECUTIVE SUMMARY	ii-ix
1. INTRODUCTION	1
2. THE BULGARIAN AGRICULTURAL SECTOR.....	3
A Summary of Key Features	3
Positive Factors for Rural Investment.....	3
Negative Factors for Rural Investment	6
3. DEMAND ASSESSMENT.....	8
Introduction	8
Potential Borrowers.....	8
Priority Regions.....	11
Comparison of Some Sub-Sectors.....	16
Diversity of Productive Enterprise Types	16
Dairy Sector.....	16
Vegetable/Fruit Sector.....	17
Pork Meat Sector	19
Wine and Grapevine Sector	19
4. EXISTING SUPPLY OF BANK FINANCE TO FARMERS	21
Farmers Do Not Have Ready Access to Bank Credit.....	21
The Supply of Agricultural Finance – The Constraints.....	21
The Supply of Agricultural Finance – The Lenders.....	22
The Farmers' Perception of the Existing Sources of Finance	25
5. CONCLUSIONS AND RECOMMENDATIONS	26
General Recommendations (for EBRD).....	26
A. Enriching Banking Services.....	26
B. Downstream Investments	27
Recommendations for ProCredit Bank	27
A. Products and Operational Principles.....	27
B. Target Clientele	30
C. Marketing Issues.....	31
D. Staffing Issues.....	34
E. Collaboration between ProCredit and Other Actors in Rural Development.....	35

ANNEXES:

Annex 1	Characteristics of the Potential Demand for Rural Finance
Annex 2	The Supply Market for Agricultural Credit
Annex 3	Special Features of Bulgarian Agriculture (in summary)
Annex 4	Agro Processing
Annex 5	Sustainable Livelihoods Study of Haskovo and Dobrich Regions
Annex 6	Contact Details of Potential Partners in Bulgaria

Currency Equivalents

(2003)

USD 1 = BGN 1.55 BGL

EUR 1 = BGN 1.99 BGL

Abbreviations

BGN	Bulgarian Leva
dca	Decare (1000 square metres)
EUR	European Euro
GOB	Government of Bulgaria
ha	Hectare
JOBS	Job Opportunities through Business Support
LSP	Livelihoods Support Programme
MAF	Ministry of Agriculture and Forestry
PMRCA	Private Mutual Rural Credit Associations
SAPARD	Special Accession Programme for Agriculture and Development
SFA	State Fund for Agriculture
SME	Small and Medium Enterprises
UNDP	United Nations Development Programme
US\$	United States Dollar

ACKNOWLEDGEMENTS

This report was commissioned by the European Bank for Reconstruction and Development (EBRD) and carried out by the Investment Centre of the Food and Agriculture Organisation of the United Nations (FAO), under the co-operation agreement between the two institutions. The field mission took place between 16 and 29 August 2003 and was composed of Richard Roberts (Consultant), Vlaho Kojakovic (FAO), Frank Hollinger (FAO) and Magdalena Kaloianova (Consultant). Two further missions funded by the FAO Livelihoods Support Programme (LSP) of a duration of ten days took place in October and November 2003 to the regions of Haskovo and Dobrich. These missions were composed of Ida Christensen (FAO) and Albena Miteva (consultant).

The missions would like to extend its warm thanks for the kind assistance it received from the National Agricultural Advisory Service (NAAS), especially from Margarita Nikolova (Executive Director) and Stanimir Stoycheff (General Secretary) and the regional staff in Plovdiv and Veliko Turnovo. Many thanks to Vitosha Research, especially to Alexander Stoyanov (Director) and Andrey Nonchev (Vize Director) for conducting a survey and accessing additional primary data from the field. The collaboration with ProCredit Bank, particularly by Susanne Decker, is highly appreciated. Many thanks also to Michail Halvadjiew (advisor of the PMRCAs) and Albena Mitova (national consultant) for the logistical support and useful information provided during and after the field work.

EXECUTIVE SUMMARY

General Findings

(i) *The focus of this exercise was on issues connected with a possible substantial increase in the agricultural loan asset portfolio of ProCredit Bank. This summary outlines the type of client who could be targeted by the bank – the core borrowing group, the ways in which the bank could market its services to the desired core clientele, the type of loans for which a demand is clear, the enterprise types for which credit-financed investment appears to be most profitable, the regional considerations and, finally, the personnel requirements within the bank.*

(ii) *Some more general findings, listed at the end of the Executive Summary, could indicate areas where EBRD may want to investigate further, with a view to more substantial investments in Bulgarian primary industry, and downstream sectors.*

(iii) *Agricultural sector investment opportunities exist in Bulgaria, but continuing structural problems, especially in the areas of land tenure and marketing, constrain the extent to which the full potential of the sector can be realised through investment in agricultural production alone. These problems will not remain as permanent features of Bulgarian agriculture; the investment climate can be expected to improve over time.*

(iv) *Land tenure problems are being addressed, albeit slowly, and through gradual processes. The land restitution process is nearly completed since most entitled persons have already received individual ownership titles, and a unified register / cadastre system has been introduced. However, as a consequence of restitution, land ownership is highly fragmented constraining the emergence of a commercially viable farm sizes. The land purchase market is currently not active, for two principal reasons: firstly, owners are reluctant to sell, as they feel that land is currently under-valued (with an eye on EU accession). Moreover, there might be non-economic reasons constraining the supply. Secondly, potential buyers lack financial resources. Land rental markets, in turn, are quite active and most commercial farms operate mostly on rented land. As this trend will probably continue in the nearer future, constraints related to land rental markets merit special consideration. In this regards, two key problems should be flagged out: Land fragmentation causes high transaction costs for farmers, interested in leasing larger plots and investing in farm machinery/livestock, who currently have to deal with numerous small owners. The second is the difficulty of arranging leases for more than five to seven years, which is a necessary pre-condition for investment in long term farm enterprises, especially tree crops and vines. With an appropriate legal and administrative framework in place, lease contract could also serve as a collateral for loans, given the high level of transactions.*

(v) *Marketing to the former Soviet bloc was the norm until a decade ago. Structures in Bulgaria have not adjusted to the change. The decrease in purchasing power following the crisis in 1997 has reduced the domestic demand for agricultural products reinforcing the traditional orientation towards export market. A continuation of the economic recovery process may reverse this trend and, in view of the high income elasticity of food demand, provide more scope to producers of the items which are always in demand when incomes rise from a low level i.e. meat, dairy products, fresh fruits and vegetables. Also, quality requirements, currently a major hurdle for export into the EU (especially for small and medium sized farmers), are lower on the domestic*

markets. However, there are still considerable inefficiencies in the domestic marketing system, as witnessed by the lack of marketing infrastructure such as grading, sorting and packaging facilities, wholesale markets, etc. Only 2 of the 28 regional main centres have large wholesale markets for fruit and vegetables. These wholesale markets might also function as retail markets when smaller quantities are traded. As a result of this lack of the necessary infrastructure, many farmers are forced to rely on itinerant buyers who purchase products at the farm. Lack of a proper market information systems, illegal imports and limited competition further depress farm gate prices and limit the transmission of higher prices for higher product qualities to farmers. Development of wholesale market infrastructure and more effective market information system, with prices broadcast over the radio, morning and evening, would allow farmers with crops maturing to have a choice of selling their produce in urban retail and wholesale markets where the demand is greater and price higher.

(vi) The usefulness of collateral to lenders is adversely affected by: (a) slow and uncertain legal procedures for foreclosure and sale of collateral and (b) thin markets for rural assets such as agricultural land, houses in the villages, farm machinery (partly a result of the absence of medium term finance facilities). This is particularly problematic in case of larger investment loans with longer maturities. However, the Credit Cooperatives established under the EU-PHARE-project, illustrate that there is considerable scope for using rural assets with a high personal value for the borrower as collateral for smaller loans up to BGL 2,000. The suitability of joint liability mechanisms might be explored, especially in situations where farmers are already engaged in joint marketing activities. The strengthening of producer organisations is a priority of the Bulgarian government and supported under the EU-SAPARD programme and under a bi-lateral technical cooperation project with GTZ.

(vii) There are very marked differences in peoples' circumstances, aspirations and command of resources (land, labour and capital). There is a need for this variety to be matched with variety in banks serving the sector. However, currently the supply of loans for small and medium sized farmers from formal sources is mainly limited to the 33 Credit Cooperatives: These, however, only provide loans to their members and face legal and regulatory problems which constrain their growth and access to additional capital. Public sector programmes such as SAPARD and State Fund for Agriculture are mainly targeted at medium to large scale farmers. Despite their subsidised interest rates, there are high hidden costs related to the extensive documentation requirements and the strict provisions regarding loan collateral. Moreover, the policies are also skewed towards term finance. This leaves an opportunity gap for a ProCredit Bank for providing short term finance to smaller farmers.

Recommendations for ProCredit Bank

Core Borrowing Group

(viii) The bulk of the rural population are rather senior in age (average 61 years) and although these older people usually own land, those who farm it as opposed to renting it out, do so more as home gardeners than as commercially oriented producers targeting a market. By contrast there is a second, much smaller group who are typically in the age range 20-50 years, who see farming for the market as being a means of earning a worthwhile income. It is this second group who should be identified and targeted by ProCredit. This group already accounts for nearly 60 percent of total crop sales in the country. The potential for production increases is in their hands.

(ix) According to the survey conducted by MAF in 2000, within a total of 760,000 farms, there are about 42,000 market-oriented farmers consisting of 36,200 physical persons and 5,400 legal persons. The first category includes small, medium and large scale farmers, which control about 226,000 ha or 6% of the total agricultural land in Bulgaria. The average size of farms registered as physical persons is 6,2 ha. Thus, the majority of subsistence oriented farmers only operates on 14% of the total agricultural land. About 450, 000 small land owners have rented out their land either to cooperatives or to individual farms.

(x) Many interviewed farmers belonging to the potential core borrowing group of younger, commercially oriented farmers, own not only rural land and buildings, but also assets such as an urban apartment and a vehicle. However, there is a strong reluctance to mortgage urban real estate, which underlines the importance of innovative and flexible solutions for securing loans. The net income of many of the interviewed farmers from their current farming operation was often of the order of 5,000 BGN per annum. This net income level, backed by a variety of assets, means that many in this group should be in a position to borrow from ProCredit with the bank having the comfort of a borrowing client with an established track record of profitable operations.

Marketing – Attracting Desirable Clients

(xi) Banks in rural areas do not have a good image. Almost all of those interviewed indicated their aversion to banks, and many also expressed a disinclination to borrow from any of the banks now operating in rural areas, with the exception of the Credit Cooperatives. Thus it is essential for Pro-Credit Bank to position itself as a financial partner with a difference. The bank can attract the desired type of borrowing client by being very much what it is in urban areas. Elements of this difference would include: private sector image; attractive branded product range based on real needs (see 'flagship products, below); conditions for loans which are in line with collateral position and cash flows of borrowing clients; speed and friendliness in dealing with loan applicants.

(xii) A further element in the attraction of the desired type of client is to build on what is in rural areas by way of 'people institutions'. The orthodox church is one type. Municipalities are another. Producers' associations are a third. Municipal authorities and/or producers' associations could provide suitable entry points for a carefully crafted publicity campaign, once a core loan product range is established. From interviews conducted in Veliko Tarnovo there is strong reason to believe that many mayors would welcome an opportunity to act as a conduit for information on services such as financial services which would assist investment in their villages.

Types of Loans

(xiii) Competition in the provision of short term loans from formal sources is limited: Apart from the Credit Cooperatives, short term loans are offered by State Fund for Agriculture ("SFA"). However, these loans are targeted to specific purposes such as purchase of improved seeds, require complicated application procedures and are provided in kind. Moreover, under an agreement with the World Bank, the GOB agreed to phase out SFA's short term credit lines by 2003. The real competition for short-term loans comes from informal sources such as friends, family and traders, in the latter case often at high costs. Thus, there might be considerable scope for introducing highly flexible short term loan products with streamlined application and fast approval procedures, a major strength of ProCredit Bank.

(xiv) A first entry point would be the design of a working capital loan, covering costs of labour, fuel, seasonal chemical inputs etc. This Crop Loan is the classic type of seasonal loan commonly extended to cropping farmers in order to cover the costs of production, harvest and holding the crop for a favourable selling moment. It would help ProCredit to build up its knowledge on the client base and the production and marketing conditions of agricultural products, before contemplating longer term lending is.

(xv) Another suitable entry level product would be the provision of short term loans which would enable the core group of borrowers to take advantage of month-to-month price differences in some key inputs, for example fodder and feed grains. These prices can fluctuate as much as 60% during the year. Since fodder makes up 60–70% and at least 70% of the costs of dairy and pig breeding operations respectively, the ability to buy feed at low (at harvest) prices is clearly one that is advantageous. Such a Agri-Bridge-Loan might also be used for financing storage of produce to be sold out of the peak season. Such loans would, however, need to be based on a thorough market and price analysis. Warehouse receipts might be used as collateral.

(xvi) The third type of short term loan is one that is hard for farmers to access at present. It is an emergency or Safety Net Loan to permit farming operations to continue and the operation to survive in the face of a drastic reduction in the terms of trade for the farming enterprise. This adversity might be caused by natural disaster, by a cyclical reduction in yield (common with some tree crops), by a sharp rise in input costs (e.g. animal fodder) or a big drop in product prices. Product price drops tend to be cyclical, even when over time price levels are such that they permit profitable operations. Emergency loans to farmers temporarily in financial distress, due to adverse physical events or price changes, might be offered as overdraft facilities, particularly to clients with a successful track record as borrowers.

(xvii) Sequencing of loan product introduction will be important, with short term production loans providing the best opportunity to build knowledge on the clientele, specific agricultural sub-sectors and local conditions. Agri-bridge or emergency loans should first be restricted to clients who have built up a track record with ProCredit. Medium term loans should be considered in a sub-sequent phase.

(xviii) Interest rate sensitivity is less with short term loans. By contrast, farmers investing in longer term ventures, such as establishment or rehabilitation of vineyards and orchards, are likely to be very sensitive to interest rates, and to therefore seek financing from SFA, which has been offering loans at 6% (3% for qualifying younger farmers). There seems to be little point in ProCredit competing in this arena, unless the situation with this concessional lending programme changes.

(xix) In between the short term and long term loans there is an important sector of lending, from 18 months to 5 years. Trends in Bulgarian agriculture indicate a growing demand for these medium term loans. This demand is driven by the inevitable move towards enlargement of farming units. Already a large proportion of the farmers interviewed were farming their own land plus land which they had rented, often from absentee owners. Such greater use of farm managerial ability is laudable, but it does need financing. Many of these farmers, whose scale of operation is growing, have managed to do so to date by utilising funds released from the sale of other businesses. Others have met the costs from savings and/or regular income from non-farm sources. However, as wages rise, pressure will mount to improve labour productivity, leading in turn to a wish to make greater use of machinery. Medium term loans will be in demand for the

improvement and upgrading of equipment and machinery, as well as the cost of buying out neighbours' livestock¹ and other assets in the consolidation process.

(xx) Other examples of medium term loans would include those to clients whose operations are being intensified, perhaps through establishing irrigation based on direct river drawing or on groundwater, and/or converting existing (old cooperative) buildings to intensified livestock or indoor crop production. Examples were seen during the mission of this type of development. It is likely that borrowing demand will come from existing clients who have borrowed for short term purposes. The absence of hidden costs and less bureaucratic documentation with ProCredit for medium term loans would make the bank an obvious first choice partner. Above all, the Pro-Credit approach to collateral will convey a comparative advantage over other banks, and could be exploited as long as this situation lasts.

(xxi) However, medium term loans are more risky and should only be considered once ProCredit has gained some experience with short term lending and established reliable pool of borrowers. Moreover, the future development of subsidised lending schemes by SFA, which are modified each year, should be closely monitored to take advantage of upcoming opportunities.

Enterprise Types

(xxii) The Government of Bulgaria has certain production priorities among the various options open to Bulgarian farmers. Thus dairy, livestock for meat, grapevine, fruit and vegetable production is encouraged, together with the production of ancillary products such as fodder and livestock feedstuffs. Since policy making and delivery for the agricultural sector is likely to favour these priorities, banks lending to the sector would have a higher degree of comfort with investments in these enterprises than might otherwise be the case. The implications for ProCredit Bank are summarized in the following table. It is recommended that the bank focus its rural lending primarily on the named enterprise types.

¹ Cattle and other large animals are ear tagged, aiding identification and eventual use for collateral purposes.

Enterprise Types – Implications for ProCredit Bank

Sub-Sector	Potential	Constraints/Risks	Potential for ProCredit
<i>Dairy</i>	<i>Labour intensive Profitable (suitable for family farms) possibly link to fodder production (for medium farms)</i>	<i>Quality problems Oligopolistic market structures (low prices). Several processing plants may go out of business in the next few years (see paragraph below).</i>	<i>Frequent cash flow favours frequent loan repayment Relatively small investment sizes (animals, equipment) Investments to improve quality and farm returns</i>
<i>Vegetables</i>	<i>Profitable short term crops</i>	<i>marketing problems</i>	<i>Good entry point: suitable in peri urban areas Working and investment loans (irrigation, transport)</i>
<i>Livestock for meat production</i>	<i>Growing domestic demand Profitable for small/medium farmers</i>	<i>Wide fluctuations in fodder cost (up to 70% of production cost)</i>	<i>Seasonal loans to enable fodder to be bought at harvest, at minimum price. Loans to facilitate consolidation of holdings</i>
<i>Orchards / wine</i>	<i>Highly profitable Comparative advantages Labour intensive</i>	<i>Cyclical price fluctuations gestation periods Capital intensive Sometimes low producer prices (wine)</i>	<i>Require long-term finance May become viable in the medium term, especially with consolidation Scope for seasonal finance</i>

Regional Considerations

(xxiii) *Focus on certain regions in the early stages will be important for ProCredit. In this connection the market situation for the potential borrower's produce will be vital. The FAO team has identified three regions with a higher potential for agricultural lending: Plovdiv, Veliko Turnovo and Haskovo. Plovdiv is most suitable for vegetables and fruit production, while Haskovo has significant potential for livestock production and orchard growing. Veliko Turnovo is in livestock production and increasingly, crops for the production of essential oils.*

(xxiv) *Plovdiv offers a factory buying point for fresh fruit and vegetable produce, as does the wholesale market in Sofia. The milk buying situation varies over the country and is changing fairly rapidly. In this connection ProCredit should note that many of the smaller milk buying/processing plants are likely to be forced out of business in the coming years, on hygiene grounds. The bank should therefore probe any dairy loan application in this respect. This would need review on a region by region basis where and when loans are contemplated. Meat packing plants are in a similar situation, and given the likelihood of substantial investments in abattoirs in order to meet standards now applying, Pro-Credit Bank could usefully follow developments in this area in order to assist in future decision making on regions in which the bank's marketing could be focussed.*

Personnel Issues

(xxv) *Appraisal of rural loans will need new skills on the part of Pro-Credit. Serious entry into the rural loans market should be preceded by the bank taking on staff with the necessary agricultural training and background. These officers could usefully prepare for the new product range by researching the available types of collateral in rural areas, using inter alia various sources such as the UNDP rural survey (field work completed but report not yet released) and the forthcoming World Bank survey (field work starting autumn 2003) and the Ministry of Agriculture and Forestry Census (data collection completed, report due for release May 2004). ProCredit officers will be invited to participate in the workshops which are integral part of the capacity building project for technical advisors to market-oriented farmers, currently run jointly by FAO and Bulgarian National Agricultural Advisory Services. Workshops will take place later this year within selected farmer communities of Veliko Turnovo, Schumen and Stara Zagora.*

(xxvi) *Further preparation should be investigation, within priority regions, of market outlets for various types of produce (see Recommendation 13 above). This would enable the bank to focus its efforts in the first instance on the most propitious areas of the country.*

Recommendations for EBRD

(xxvii) *Two broad areas for further investigation present themselves, namely investments in agricultural processing industries, and possible investments in the mutual rural credit associations. These are briefly discussed below.*

Marketing/Processing

(xxviii) *The deficiencies in the marketing system outlined in para (iii), severely constrain the growth of a market oriented segment of small and medium sized farmers, limiting the potential market for ProCredit Bank and other potential providers of rural finance. Investments in marketing infrastructure and processing enterprises as well as the strengthening of farm-agribusiness linkages would be important to expand the effective demand for rural financial services. For example, abattoirs are in need of upgrading, since many if not most of these do not meet the EU standards which Bulgaria has already accepted for its facilities. Since the processing/grading/packaging facilities and the product lines they generate need to be fully in line with developing market demand, any external funding should involve partnerships with appropriate private sector firms.*

(xxix) *This is an area where external funding agencies such as EBRD could further investigate opportunities for investment.*

Private Mutual Rural Credit Associations (PMRCAs)

(xxx) *The network of 33 Rural Credit Cooperatives are currently the most important formal source of finance for small and medium sized farmers and their services are highly valued by their clientele. Though the performance of the individual cooperatives varies, their growth is generally constrained by the absence of an appropriate legal framework which would allow them to mobilise deposits and other funding sources. A modification of the Banking Law in this respect has been under discussion for some time and there appears to be some opposition from commercial banks wishing to avoid the entry of new competitors.*

(xxxi) *One important advantage of the Credit Coops relates to the fact that these have already established physical infrastructure in rural areas, a workable financing technology and a reliable pool of costumers. The Credit Coops can build on their learning costs and knowledge built-up over the last 7 years. Moreover, their proximity to rural clients and their current unregulated status provides scope for increased flexibility in regard to collateral requirements and well as in managing loan defaults which are caused by external factors outside the responsibility of the borrower.*

(xxxii) *EBRD could consider assessing the financial performance of the credit cooperatives on an individual basis and offer credit lines to the most promising ones, based on their past performance. Moreover, through policy dialogue with the GOB it could lobby for amendments of the Banking Law which would enhance the growth of Non Bank Financial Institutions servicing SMES both in urban and rural areas. Increased competition among different types of financial institutions and service providers fosters innovations, enhances efficiency and will thus improve the range and terms of financial services available to costumers.*

1. INTRODUCTION

1.1 This report is prepared by Investment Centre of Food and Agricultural Organization of UN ("FAO/TCIE") at the request of the European Bank for Reconstruction and Development ("EBRD") in order to provide some information and recommendations relating to credit-financed investment in the Bulgarian rural sector. While the main intention is to address the sphere of interest of Pro-Credit Bank, some more general recommendations (see Executive Summary) are made to EBRD as these may be of interest should it wish to explore ways in which it might increase its investments and lending in the Bulgarian rural sector¹.

1.2 Opportunities for investment in the run-down and under-capitalized Bulgarian agricultural sector are many. However, lending in rural areas, and in particular to farmers, entails greater risks and costs than much urban-based banking. The risks are augmented at present due to the substantial changes which have occurred in the economy in the last decade, changes which have disrupted much of the structure of the agricultural production sub-sector, and the systems which supported it. Included here are entities in the downstream food chain, namely those carrying out processing, grading/packaging and marketing.

1.3 Special conditions now apply in the Bulgarian agricultural sector. Many of these conditions are transitory; others may be more long lasting in their effects. Some are positive, but the more potent are negative. The negative factors affect on-farm investments through impacts on terms of trade for agricultural producers (through unfavourable price movements for inputs and/or outputs), and through increasing the risks and uncertainties of farming. Both positive and negative factors are listed, with brief annotations, in Chapter 2 below.

1.4 Because of these factors, there are difficulties for banks wishing to build an agricultural portfolio. On the other hand, there are also opportunities for banks prepared to take a different approach to that followed by conventional lenders. This does not mean ignoring the usual risks and costs of lending to farmers. It means rather managing these risks and costs in imaginative ways. The opportunities for credit-financed investment outlined in this report have been included only when it is considered that the risks and costs are manageable.

1.5 In addition to enterprise selection, risk management would also mean starting operations in favourable situations and expanding out from these areas only as staff gain experience and as procedures are improved.

1.6 Accordingly, the report is based on preliminary field level surveys in five important agricultural regions in the country, namely Plovdiv, Veliko Turnovo, Haskovo, Dobrich and Shouman, where farming is comparatively well developed. The results of these preliminary surveys indicated that it would be useful for the mission to visit and pay special attention to Plovdiv and Veliko Turnovo regions.

1.7 The over-riding issue at virtually all levels, from villages to government offices, is the European Union. Accession to the European Union is highly likely to offer better economic

¹ The Mission comprised: Richard Roberts, Team Leader/Agricultural Investment Specialist; Vlaho Kojakovic, Banking Specialist; Frank Hoellinger, Rural Finance Specialist; Magdalena Kaloianova, Interpreter/Local Economist. Ida Christensen, Rural Specialist, wrote Annex 5, Sustainable Livelihoods Study.

conditions for Bulgarian farmers. This issue is covered in more detail in Annex 3. With full entry likely by 2007, the interim period is very much a period of preparation, laying a foundation for greater economic activity in the future. For any bank lending in rural areas, elements of such preparation would build on basic activities such as:

- (a) Development of suitable loan products for changing conditions;
- (b) Identifying and strengthening linkages to valued clients;
- (c) Building linkages to other entities in the food chain, such as processing and marketing firms;
- (d) Improving staff capacity to handle new areas of lending.

1.8 This report seeks to provide information to support these activities.

1.9 The nature of the demand for credit-financed investment is examined in Chapter 3, focussing on: the clients and their enterprises, regions of the country, and enterprise types (sub-sectors) respectively.

1.10 Chapter 4 addresses the current supply situation for farming loans. ProCredit Bank faces competition, from the credit cooperatives (and increasingly from some commercial banks) and from the State Fund for Agriculture both directly, and through its commercial bank partners.

1.11 The full set of Conclusions and Recommendations is set out in Chapter 5. Whereas the main thrust of these recommendations is specific to ProCredit Bank, there are others which are labelled as being of relevance to the EBRD.

2. THE BULGARIAN AGRICULTURAL SECTOR

A Summary of Key Features

2.1 The term 'agricultural sector' in reality is misleading, for it implies a degree of common purpose and common approach which does not exist. Rather, the rural community exhibits a marked dichotomy.

2.2 On the one hand there is the vast bulk of so-called farmers, who have little or no market orientation, and who only sell the occasional, unplanned surplus. Essentially these people, who make up the vast bulk of the rural population, are really just home gardeners.

2.3 On the other hand there is the second category, namely the commercially-oriented farmers. These are so categorised because they deliberately set out to make all or at least a substantial part of their income from farm production. They are the most likely to seek farming loans, and they are the most likely to be able to make productive and profitable use of loan finance. A significant number in this category have professional training in agriculture or a related discipline, and/or have built up considerable experience in farm production over a number of years.

2.4 Not surprisingly, some farm enterprise types currently lend themselves more readily to production for the market than others. In terms of livestock, dairy is perhaps the enterprise which has most potential for change in the immediate future, and this change is most likely to be expressed more in consolidation of holdings, rather than an overall increase in the national herd. Both investment loans and working capital loans are likely to be needed for this type of change.

2.5 On the crop side, grapes for wine production offer most potential of all the major crops, again in the short term. Enhancement of net returns with this crop can best be made by product improvement, including planting of grape varieties which are in demand. Much scope exists for this type of development, which again will call for finance. Bulgaria offers favourable growing conditions for a wide variety of temperate fruit tree crops, provided that irrigation can be assured. Here too investment and working capital loans will be required. Long term investment credit involving developments on leased land is a problem here, and is discussed elsewhere in the report. Vegetable production requires short term finance, except where irrigation facilities need to be put into place.

2.6 The balance of this Chapter consists of two annotated lists. These deal, respectively, with the positive and the negative factors currently impacting Bulgarian agriculture.

Positive Factors for Rural Investment

Human Factors – Good Farming Skills and No Shortage of Labour

2.7 Basic farming skills are good. In terms of both crop and livestock management standards of husbandry are high. Less satisfactory is the current lack of orientation of production towards a specifically identified market. An exception to this is a small group of younger farmers who are relatively new to the industry, who have come into it on discharge from the army, or on

completion of university studies, and who are generally understood to have a keen appreciation of the need for production to be driven by market opportunities.

2.8 Many in this group are observed to be taking a more entrepreneurial approach to their production activities. They are usually young (30 – 50 yrs) farmers who have already established new enterprises, or have improved existing ones. Apart from being market-oriented, they follow the practices to convert this orientation to profit, keeping up-to-date with market prices for fresh products and generally using appropriate technical and marketing support services. They constitute a potential core of good borrowing clients.

2.9 Labour in rural areas is plentiful and cheap. Unemployment levels for those of working age are high (officially just over 20 percent¹) and a typical wage is 160 BGN (approx. Euro80) per month, 12 BGN per 8 hour day. In all, though, the rural population follows the general worldwide trend of urban drift. One estimate is that the rural population of the country will fall from the current 25% to 12 % over the next 20 to 25 years. This clearly has implications for banks lending to farmers. Labour costs will increase, but so will the demand for loans to allow consolidation of farm enterprises (see Chapter 5 below).

2.10 Variety of income sources is a feature of Bulgarian rural areas and it is likely that a core exists of potentially good borrowers for non-farm rural enterprises. Some indication of the importance of these sources can be gained from the results of a survey of rural mayors in Veliko Tarnovo, where of a total population of 13,293, the number of persons receiving income from non-farm sources (excluding pensions) was 3,316, or 25 percent. The range of non-farm enterprises found in rural areas includes: engine/vehicle workshops, small general engineering shops, bakeries, oil expressing plants, chicken processing, transport and tourism are all closely related to farming. All offer opportunities for credit-financed investment.

Research and Extension Support Services

2.11 Existing research services are adequate for most agricultural enterprises. National Agricultural Advisory Services, extension services agency under the MFA is currently going through a process of improvement with the aim of ensuring that there are adequate numbers of well-trained staff in all 28 regions. These officers are available for consultation at no charge to farmers. Soil maps are comprehensive, allowing specialized, informed advice to be given by extension staff when new crops are being considered by farmers and investors. FAO is currently implementing capacity strengthening project, where the NAAS staff is the main beneficiary, which aims at supporting the delivery of market relevant advice and assistance aiming at the integration of small and medium sized farmers into the market economy. More about extension support services is described in Annex 3.

¹ Ref. National Agriculture and Rural Development Plan under the SAPARD, May 2003, p. 13

Land Areas and Other Natural Conditions

2.12 Substantial areas of arable land exist¹, and a significant percentage of this area is currently unused. Much of this is suitable for high value cropping. Moreover tests have shown that a good proportion of the land is sufficiently 'clean' to permit certified organic farming. With EU accession, markets for organic products could provide interesting opportunities for Bulgarian producers. Typical land costs: Purchase: 200-250 BGN/dca; Rent; 6 BGN/dca/year.

2.13 Land rental opportunities abound. This lowers the barriers to entry into farming, opening up opportunities for young, ambitious and currently unemployed Bulgarians. Municipalities, churches/monasteries², educational institutions are all favoured as landlords as negotiation of long term lease agreements is easier with such 'single owners' than is the case with those tracts of land that have many individuals as owners.

European Union Accession in Preparation

2.14 EU accession is likely to increase marketing opportunities and improve the terms of trade for farmers. It will similarly increase the number of profitable investment opportunities in this sector. However, this process will not be rapid. Accession is scheduled for 2007, and it will take some time for the opportunities to develop after this date. More details are given in Annex 3.

Subsidies for Farmers

2.15 The GoB currently subsidises farm production to the extent of 74m BGN per annum. The future of these subsidies is not clear, but the practice of payments to farmers to improve their net incomes is likely to continue. Indeed, it is planned that in the future the State Fund for Agriculture will become the channel for EU subsidies to farmers. More details of the subsidy programme, current and future, are given in Annex 2.

Producers' Associations being Formed

2.16 Some externally-funded projects include initiatives to support the establishment of producers' associations for farmers operating specific enterprises. These associations will provide a means for information exchange and also practical collaboration in identifying markets and improving products to suit these markets. Eventually joint marketing may be possible. The aim of all of these moves is to increase farm gate returns.

¹ Some 3.6m ha. (AgroStatistics, No. 14, June 2001, Ministry of Agriculture)

² For example, in Veliko Turnovo the Orthodox Church owns more than 10,000 dca of arable land which is currently unused or under-utilised (Personal communication: Archbishop Grigorii, whose area of jurisdiction covers some 450 parishes and 20 monasteries, spread over the region.).

Old Cooperative Infrastructure can be Harnessed

2.17 Substantial infrastructure in the form of buildings, and crop support structures, currently lie unused¹. These were part of the old cooperative system. By harnessing the results of past investment which is no longer productive, farming entrepreneurs can start productive enterprises in which the initial costs are much lower than if the investment were to start from zero². Profitability is thereby enhanced.

Negative Factors for Rural Investment

Land Tenure Problems

2.18 The restitution of land to former owners, as a result of the political changes in 1989/90, has been done in such a manner as to bestow some of the land on persons who have no experience or interest in working it. Some of these new owners have joined cooperatives or have rented out the land. Others have left it idle. There is a widespread belief that agricultural land is currently undervalued, both as an item of sale and for rental purposes. As a result persons who might otherwise wish to sell their land (for example, land which has been the subject of restitution) are reluctant to do so; in these circumstances it is not surprising that there is no real land market as such, reducing the utility of land as collateral in the conventional sense.

Irrigation System Largely Inoperative

2.19 A number of factors have contributed to a reduction of some 90 percent in Bulgaria's irrigated area. Generally grains and oilseeds (wheat, barley, rye, spelt, sunflower) are rainfed. But orchards, vegetables and fodder crops such as maize require irrigation. The irrigation in Bulgaria has in the past depended largely on pumping stations, and water delivery through channels. With the channels now largely dry, as a result of the non-operational status of the pumping stations coupled with lack of maintenance of the channels, attention is now turning to utilising groundwater and direct pumping out of rivers and streams for arable land which is favourably situated in relation to these sources of water.

Marketing Deficiencies, both Infrastructure and Information

2.20 Only 2 of the 28 regional main centres have large wholesale markets for fruit and vegetables. These wholesale markets might also function as retail markets when smaller quantities are traded. As a result of this lack of the necessary infrastructure, many farmers are forced to rely on itinerant buyers who purchase products at the farm at fixed prices (at the low level). Under this system prices tend to be lower than would be the case if there were direct access to a properly functioning wholesale market. Furthermore, among the frequent observations of farmers is that their marketing efforts are often undermined by the ready availability of imported products (especially from Turkey), selling at prices which suggest an element of dumping. An effective market information system, with prices broadcast over the radio, morning and evening, does not

¹ In 8 villages in the region of Veliko Turnovo, covering a total population of 13,293, there are reportedly 48 cooperative stores and other structures currently unused, but which could be rehabilitated. Nationally the number is unknown, but is believed to be substantial.

² A good example was observed in Plovdiv, where an enterprising 32 year old farmer was operating a duck raising enterprise, handling some 35,000 ducks per annum, and making use of old cooperative barns, which he had modified by fitting with cages and other equipment.

exist. If it did then farmers with crops maturing would have an idea of the prices being realised in urban markets. However, farmers are marketing a percentage of their products directly to neighbours achieving in that way much higher margins.

2.21 Marketing linkages to the processing industry were poor due to the restructuring of the industry over the last 13 years. Much investment is still needed to upgrade processing infrastructure in order to meet alternative markets. However, there are signs that the bottom point has been reached, and in several of the enterprise types significant percentage increases in output have been registered in the last 2 – 3 years. Of the total number of 209 processing enterprises, 147 are newly established and some are building strong links with the agricultural producers. This is particularly case in Plovdiv region.

Cyclical Nature and Weather Vulnerability of Agriculture

2.22 Common to all areas of agricultural investment is the cyclical nature of crop yields, creating uncertainty as to returns from cropping enterprises. Coupled to this is vulnerability to adverse weather events. Insurance is available in Bulgaria both for livestock mortality and for crop losses from fire and from a range of weather conditions (but drought losses are excluded). However the insurance premium payments increase production costs. The bottom line is that in some years losses will be made on an individual production enterprise. If that enterprise is relatively important in the farm, then the whole farm may well make a loss for that year.

Price Fluctuations

2.23 Farmers always have to cope with fluctuations in farm product prices. Bulgaria is no exception. Contract farming arrangements remove this area of risk, and are also a means of fixing input costs, which can also vary, though rarely as much as product prices. Unfortunately, contract farming arrangements, in which prices are fixed at or before planting/sowing, are still little used in Bulgaria. As with production losses, price fluctuations may mean that in any given year the enterprise, or the farm as a whole, can make a loss.

2.24 Most banks now lending to farmers have unhelpful collateral requirements. The most frequent complaint of farmers regarding banks, as recorded in the surveys in the five regions of the study, is that collateral requirements are very difficult to meet. Most lenders, at least until recently, have demanded urban property as collateral for agricultural loans. This prevents many valid investments from benefiting from credit. (See Annex 2 for more on collateral).

Slow Legal System

2.25 The slowness of the legal system is a problem for banks wishing to enforce collateral arrangements. This may also be a factor restricting the more widespread use of contract farming arrangements in the country.

3. DEMAND ASSESSMENT

Introduction

3.1 Demand for farm credit is examined below from three particular angles. Firstly, the structure of farms is outlined, with a view to establishing the type of farmer who could be targeted for inclusion in a core group of potential borrowers from ProCredit Bank. Secondly, information is given on some of the more promising regions from an agricultural investment point of view. Thirdly, the more important sub-sectors (farm enterprise types) are described, with a view to identifying those which lend themselves most readily to credit financed investment.

3.2 Perhaps the most important common thread between these three angles is latent dynamism. Rural areas as a whole, and the agricultural sector in particular, currently exhibits a certain degree of stagnation. This is born of economic change, disruption of markets, loss of jobs, winding down of industries located in rural areas and other factors affecting personal circumstances, perceived prospects and attitudes to opportunities.

3.3 Yet change is on the way. The latent dynamism will become more and more overt and real. A number of factors are involved. One is the land distribution programme, now complete but yet to bear its most important fruit, which is a thriving market in rural land. Another key factor is the obvious spread, albeit rather slow, of entrepreneurial enterprise. Taken together, and they are mutually reinforcing, these two factors will undoubtedly bring a new dynamism to rural areas in the next four years of pre-EU accession period, as a movement to consolidate farming enterprises grows. In turn this will lead to a demand for ancillary services in rural areas, of input supply, of marketing, of transport, of building etc. In every case investment will be required, and in most cases a variety of credit products will be needed to finance the farm enterprise consolidation and related rural businesses.

Potential Borrowers

Dichotomy

3.4 There are two distinct segments within the rural population in Bulgaria. More than 85 percent of the rural population are really villagers rather than farmers. Their orientation is to village pursuits, one of which is keeping a garden and growing some of the food required for the family. This group has no market orientation, and only sells the occasional, unplanned surplus. Essentially these persons are really just home gardeners, not farmers, and it is a mistake to base policy formulation or business planning for the agricultural sector on data that includes these home gardeners as Bulgarian 'farmers'.

3.5 The second category is the one to target, namely the commercially-oriented farmers. These are so categorized because they deliberately set out to make all or at least a substantial part of their income from farm production. They are the most likely to seek farming loans, and they are the most likely to be able to make productive and profitable use of loan finance. A significant number in this category have professional training in agriculture or a related discipline, and/or have built up considerable experience in farm production over a number of years.

3.6 As opportunities are revealed, it is this group also which is the most likely to embark upon investments associated with farm consolidation.

The Rural Economy: Agriculture and Non-Agricultural Enterprises

3.7 Agriculture is by far the most important single economic activity in rural areas in terms of income, employment and GDP. Figures from the last census indicate that agriculture accounts for 49.4 percent of income in villages, while salaries from non-agricultural work (19 percent) and pensions (16 percent) make up the bulk of the balance.

3.8 Other non-farm income such as agro-tourism, handicrafts, small processing workshops, trade, etc. appear to be concentrated either in peri-urban areas or in regions with lower agricultural potential (e.g. mountainous regions). However, all these activities are strongly related to farming.

3.9 While acknowledging the important role of non-farm income in rural areas, this exercise focuses on agricultural livelihoods, and therefore on the structure of farms, and the associated investment options to increase production, value of output and incomes.

Farm Structures

3.10 Some 770,000 farms exist in the country, based on plots owned by 1.77 million Bulgarians. Of this number, 86.3 percent have holdings of up to 1 ha (10 dca) in size, while 0.2 percent of holdings account for 66.7 percent of the total area under private management. Cooperatives accounted for almost as much again as the total under private ownership, but this report is concerned with individual farms. The figures show clearly the highly skewed situation of private arable land ownership. Definition of farm sizes is listed in table below.

Table 1. Quantitative Indicators for Classifying Farm Sizes

	Subsistence	Small	Medium	Large
	Dca/Number	Dca/Number	Dca/Number	Dca/Number
Livestock				
Cows	2 (80%)*	up to 5 - 10	5 – 20	Over 20
Sheep		up to 20	20 - 100	Over 100
Goats		up to 20	20 - 100	Over 100
Pigs	2 - 3	up to 10	10- 30	Over 30
Poultry		up to 100	100 - 500	Over 500
Bees		up to 10	10 - 50	Over 50
Crops				
Orchards	1 - 5	5 - 20	20 – 40	Over 40
Vineyards		up to 5 ¹	5 – 200	Over 200
Vegetables	1 - 2	up to 15	15 – 50	Over 50
Grain		up to 200	200 – 1500	Over 1500
Essential oils				

3.11 Land tenure problems are being addressed, albeit slowly, and through gradual processes. This approach is one that is likely to optimize benefits in the country, and will eventually lead to an active land market. Thus most persons entitled to land restitution have already received individual ownership titles, and a unified register / cadastre system has been introduced.

3.12 However, the land purchase market is currently not active, for two principal reasons: owners don't want to sell, as they feel that land is currently under-valued (with an eye on EU accession) and potential buyers lack financial resources. In addition, in the short term there are two key problems. The first of these is land fragmentation, which is a key constraint to a competitive agricultural sector and to the emergence of medium scale farms. Specifically it affects farmers who would like to lease larger plots, and invest in machinery/livestock to exploit these areas. The second is the difficulty of arranging leases of more than five to seven years, which tends to constrain investment in long term farm enterprises, especially tree crops and vines. Future movement in the land market and in farm consolidation has already been mentioned above. It is likely to move very quickly once it starts in earnest.

3.13 In the meantime there is still much that small farms can do by way of increased investment, production and profitability, through more effective exploitation of labour intensive crops such as fruits and vegetables, and grapevines. There is a similar situation with certain livestock enterprises since small farmers already own a sizeable proportion of the cows, sheep and goats in the country. The following sections illustrate opportunities with various enterprise types and in priority regions.

¹ Sources: FAO (1998) Bulgaria: Investing in Vineyards. SFA uses a different classification: producers with less than 15 dca are classified as small, those with 15 – 80 dca as medium, and those with more 80 dca as large producers.

Priority Regions

Overview

3.14 The most promising regions for small-scale agricultural investment are Plovdiv, Haskovo and Veliko Turnovo. Each region has particular areas of high agricultural potential. All three regions have good road connections with regional centres, and well developed infrastructure. Plovdiv is most suitable for vegetables and fruit production, while Haskovo has significant potential for livestock production and orchard growing. The highest potential for investment in Veliko Turnovo is in livestock production and increasingly, crops for the production of essential oils. Dobrich region has a high potential for grain production, but the size of investments required are likely to be somewhat higher than the scale envisaged by ProCredit Bank. Accessibility to the regional centre and good road connections are not as developed in Dobrich as is the case in other regions.

3.15 Table 3.1 below compares average output per ha (in kg) for grain and vegetable crops in the three identified regions, highlighting almost double productivity of vegetables in Plovdiv region and higher productivity of grains in Dobrich region when compared to the other regions identified.

Table 3.1¹. Comparison of Average Output in 2002 for Different Regions in kg per ha

Average Output – kg per ha	Plovdiv	Veliko Turnovo	Dobrich
Wheat	2,403	2,950	3,842
Barley	2,398	3,011	3,445
Maize for seeds	3,087	1,077	3,081
Beans	526	84	538
Sunflower	523	792	1,370
Cotton	926	491	-
Tobacco	1,171	-	1,502
Sugar beet	5,490	-	-
Tomatoes	18,011	9,452	9,001
Cucumbers	17,145	9,500	8,500
Green pepper	9,488	5,880	9,619
Onion	7,662	-	7,889
Cabbage	16,182	-	11,823
Potatoes	9,629	-	8,500
Melons and watermelons	10,894	-	15,000
Apples	5,047	-	5,997
Pears	2,967	-	1,492
Plums	4,033	-	1,027
Cherries	1,569	-	805
Apricots	229	-	999
Peaches	2255	-	1,000
Vineyards:			
Wine	2,949	-	3,492
Table grapes	3,152	-	4,000
Strawberries	3,333	-	2,513

Source: Table compiled with data provided by Vitosha Research / National Agricultural Advisory Service

Plovdiv Region

3.16 Plovdiv is the region with the highest overall potential for agricultural investment. Of the total regional area of 170,000 ha, 150,000² ha is agricultural land. The vegetable output per ha is far higher than that of other regions. Land is more consolidated than in the other regions of the country, and the irrigation system infrastructure dating from the communist period is still partly in use³. For the same reason, land is more expensive than in other regions (800-2,000 BGN/dca when purchased, or 30-60 BGN/dca/month when rented). Some 80% of arable land is used for vegetables (both open field and greenhouse grown) and grain production (concentrated within cooperatives), while the remainder is used for fruit orchards and pastures. A small percentage of land consists of vineyards (see table below for figures).

¹ Data for Haskovo region not available.

² Regional Agricultural Advisory Service.

³ According to Regional Agricultural Office around 70,000ha of arable land was covered by irrigation system infrastructure of which 7,600ha are still functional.

Table 3.2. Land Usage and Total Production (tons) Plovdiv (2000 data)

Crop	Area - ha	Production – tons
Wheat	55,316	132,902
Barley	12,009	28,799
Maize for seeds	8,570	26,456
Beans	1,669	878
Sunflower	14,876	7,784
Cotton	97	90
Tobacco	2,822	3,306
Sugar beet	10	56
Tomatoes	5,592	103,545
Cucumbers	2,200	44,189
Green pepper	4,318	44,794
Onion	1,135	8,710
Cabbage	2,075	34,564
Potatoes	4,574	44,046
Melons and watermelons	3,727	40,612
Apples	6,736	33,565
Pears	54	834
Plums	1,948	10,358
Cherries	586	2,640
Apricots	23	5
Peaches	581	5,636
Vineyards		
<i>Wine</i>	10,192	29,495
<i>Desert</i>	1407	4,351
Strawberries	25	84

Source: Table compiled with data provided by Vitosha Research / National Agricultural Advisory Service

3.17 There are approximately 30,000 farms in the region of which majority are subsistence farms, and only 9,600 are registered. The main specialisation of this category of farm is the growing of fruit and vegetables, although many of the farms are mixed combine vegetable growing and animal-breeding.

3.18 Although animal breeding is not of high priority in the region, recent years have seen an increase in the number of producing animals (cows, sheep, goats), consequently increasing milk production in 2002 by 20%¹. Pig meat and poultry production saw an increase of 15% in the same period.

3.19 Market linkages between agricultural producers and traders; and producers and processors are developed to a workable standard. There is the Plovdiv Commodity Exchange where trading of foodstuff and grains on a large scale takes place. The Plovdiv Wholesale Market (expected to be opened next year) should also give additional opportunities for the marketing of agricultural products. There is also a major processing plant handling fruit and vegetables, providing a market outlet for growers of these items.

3.20 Agricultural extension services are more developed than in other regions. There are three institutions providing different consulting services to agricultural producers:

¹ Vitosha Research/NAAS.

1. Regional Advisory Agricultural Service office with five specialists;
2. Regional Agricultural Office,
3. Agricultural University of Plovdiv.

Haskovo Region

3.21 Haskovo is another region with high potential for agricultural lending, particularly in the areas of livestock breeding and production of fruit. The total arable land is approximately 200,000 ha of which 35% ha is used for animal grazing, 33% is used for grain, 10% for vegetables and 8% for orchards and vineyards¹.

3.22 Approximately 20% of the total arable land is cultivated by small agricultural producers, while the remaining land is cultivated by productive cooperatives and by large land lease holdings growing grains. The price of land is more affordable than in Plovdiv (500-1,000 BGN/dca when purchased, 15-30 BGN/dca/month when rented), which represents a lower entry barrier for a new or expanding producer. The lower price of the land is a reflection of the fact that soil is less fertile than in Plovdiv region and only a small proportion is irrigated (less than 6%)².

3.23 The principal farming system in the region is based on family-sized, subsistence farms. There are approximately 60,000 of this type of farm, with an average size of 7.6 dca. Only a small percentage of these farms are market oriented. Most of these properties involve mixed enterprises, combining vegetable production, crop production for fodder, and stock-breeding. Large numbers of farmers are involved in fruit production, particularly the production of apples and plums. The number of orchards in the region has seen a yearly increase of 10%³ over the last four years.

3.24 Animal production is of significant importance for the many small farms with a variety of activities. There are also a number of specialised animal-breeding producers. About 60% of these breed cattle, while the others breed pigs, laying hens, sheep and goats.

3.25 Specialised animal breeders have larger number of animals (up to 20 cows, or 20 breeding sows). There are also several farms that breed geese and ducks for liver (*foie gras*) production for export to France.

3.26 The majority of smaller producers are not offered contracts by traders and processors, while specialised livestock breeders have seasonal or yearly contracts with traders and slaughterhouses. Further improvements in the marketing of agricultural products in the region are expected next year when the Haskovo Wholesale Market is scheduled to open.

3.27 Non-farm rural activities include eco-tourism in the municipalities of Madjarovo, Stambolovo, Ivaylovgrad and Mineralni Bani, and hunting tourism in the municipalities of Harmanli, Haskovo and Ivaylovgrad.

3.28 Agricultural extension services are offered through the office of Regional Agricultural Advisory Service.

¹ Vitosha Research/NAAS.

² Vitosha Research/NAAS.

³ Vitosha Research/NAAS.

Veliko Turnovo Region

3.29 According to the regional office of NAAS, 270,000 ha of arable land was in use in 2001, of which 200,000 ha was for crops and vegetables. The largest share of land is sown to cereal grains, including fodder grains (for details see table 3.4 below). Increasing areas are planted in essential oil crops.

3.30 The largest and most consolidated part of the arable land is in the north of the territory, while in the rest of the region it is scattered around in small plots. The price of land varies between 10-30 BGN/dca/month if rented, and 500-800 BGN/dca if purchased. Road connections with the regional centres are good.

Table 3.4. Land Usage and Total Production (tons) Veliko Turnovo in 2002¹

Crops and Vegetables	Areas - ha	Production - tons
Wheat	117,028	165,265
Maize for grain	99,719	30,989
Sunflower	28,605	22,655
Cotton	55	27
Tobacco	-	-
Sugar beet	1,133	12,099
Tomatoes	878	8,646
Cucumbers	497	3,412
Green pepper	399	1,901
Onion	459	1,476
Cabbage	308	2,696
Potatoes	1,724	6,399
Melons and watermelons	463	617
Oil crops	28,683	-
Apples	236	321
Pears	3	3
Plums	586	657
Cherries	394	437

3.31 Livestock production has a high potential in this region. Typically animals are raised on small farms, in a combination with fodder grain production.

3.32 However, there is now an increase in the number of medium-sized farms that specialise in animal breeding. Being larger, these farmers have a better chance of having contract arrangements with processors and traders, as well as off-take contracts with dairy companies for milk produced. Many of these specialised animal breeders use ex-cooperative infrastructure purchased at a minimal price during the privatisation of large cooperatives.

¹ Some of the yield figures in this table appear to be grossly erroneous. They are included in part to illustrate something of the difficulty of obtaining reliable data at this point in time. It is anticipated that the forthcoming Agricultural Census, which is expected to be published in May 2004, will provide a much more useful basis for business planning.

3.33 There are 330 registered vegetable producers, mainly in the municipalities of Gorna Oriahovitsa, Liaskovets and Veliko Turnovo. Produce is mainly sold to traders (90%), and some of it is sold to canning companies in the region.

3.34 Along with an increasing number of agricultural producers growing crops for the production of essential oil (15 registered producers in 2002, many non-registered), there are other examples of the development of alternative agricultural production activities such as silk worm breeding, mushrooms, fish farming, as well as organic agriculture (two organic projects in the municipalities of Elena and Zlatitsa).

3.35 Marketing channels for purchase of agricultural products are traders for vegetables and crops, milk collecting points for milk, and abattoirs (and itinerant livestock buyers) for slaughter stock. There are 13 milk processing plants and 6 slaughterhouses in the region. At present there is no plan for a wholesale market.

3.36 Agricultural extension services are offered through the office of Regional Agricultural Advisory Service. Recent activities have involved the establishment of a regional association of vegetable, fruit and flower producers.

Comparison of Some Sub-Sectors

Diversity of Productive Enterprise Types

3.37 Bulgarian agriculture is very diverse. The variety of enterprise types is a tribute to the generally temperate climate, with high sunshine hours and cool winters, diversity of topography, irrigation potential and good soils. The farm production skills of the rural population match the natural conditions, and provide an excellent base on which to re-build a profitable farm production sector.

3.38 On the basis of an examination of the relative benefits to farmers and to the national economy, the Government of Bulgaria has indicated its preference for attention to be given to dairy and other livestock production, to fruit and vegetables, and to grapes, for both wine and table purposes. A brief examination is now made of the key investment opportunities in each of these groups. The approach taken is to identify the chief constraints to improved productivity and profitability, and to associate improvements, and associated investment accordingly.

Dairy Sector

3.39 Cattle breeding provides regular daily income for a farmer and a stable market with a relatively low labour input. Smaller farmers transport milk to a common cooling tank in the village provided by the processor, while milk from the larger farms is collected at the farm gate by the processors once a day. Some of the milk is sold to neighbours at much higher prices. Cooling tanks for medium/large size farmers are supplied by processors and repaid in milk. The farmer receives a premium from processors and subsidy from the state for high quality milk.

3.40 The main weaknesses and threats for farmers include fluctuation in the price of milk and fodder, decrease in price due to low quality because of lack of cooling facilities, adverse weather conditions, poor access to irrigation, lack of storage facilities, livestock diseases and marketing difficulties for farmers producing cheese and yoghurt.

3.41 Major lending opportunities are in providing seasonal working capital for buying the fodder, medicine, insemination, with longer-term investments in cooling tanks, improved milking machines, equipment for sample testing, refurbishment of buildings, financing production of grains for fodder, buying of agricultural machinery.

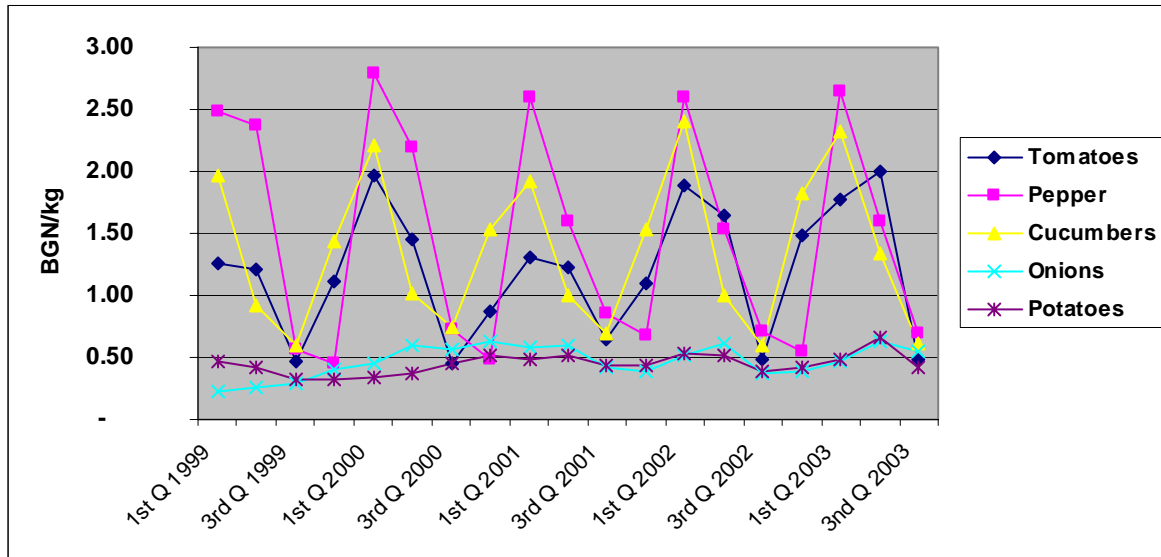
3.42 For the many smaller farmers who are interested in exploring the local market, “closing the cycle” of production (i.e. adding value) by producing yoghurt, cheese and butter for the local wholesale and retail “open” markets would be the best solution for obtaining higher profits. The share of the farmer in the retail prices of these products is much higher than that is the case with raw milk.

3.43 Additional income is received from the sale of yearlings and calves. Smaller farmers sell young animals once or twice a year, while medium-sized farms with a large number of animals tend to sell them more regularly as they are bred to a certain age. This is an important income for a farmer, as the extra money earned allows for additional direct investments and/or the repayment of loans. Prices of calves and yearlings over the last four years have been fairly stable and represent a sound regular income for the farmer, as it can be seen from the graphs in Annex 1.

Vegetable/Fruit Sector

3.44 Vegetable and fruit growing, traditional for all the observed regions, is most advanced in terms of production and marketing in Plovdiv and Haskovo. Although vegetable and fruit are predominantly produced on small farms, emerging commercially-oriented farmers running medium-sized farms, would appear to be the best potential clients for ProCredit for these sub-sectors. These farmers frequently have some training in agriculture, and are particularly interested in greenhouse farming, and in vegetable and fruit tree growing. Plovdiv is a major region for this type of horticultural product. There is a long tradition of vegetable growing here and market linkages (with agro processing industries like vegetable canning and juice production) are an added advantage.

3.45 Among the main vegetable crops produced are tomatoes, pepper, potatoes and beans, while fruit orchards produce apples, pears, peaches, plums, apricots and various berries. Price movements month to month are a real issue, especially for perishable, horticultural crops. Generally, the more perishable the crop, the greater is the fluctuation in its price. This is illustrated in Graph 3.1 below.

Graph 3.1: Historic Quarterly Prices of Vegetables for Period 1999-2003

3.46 Among the major market outlets are the processing plants producing canned vegetables and fruit juices. For small farmers the transactions are carried out mainly through the traders, while an increasing number of larger farmers have direct contractual arrangements with the factories.

3.47 Orchard growing is dominated by apples, pears, peaches and apricots, but there is an emerging trend of farmers growing strawberries and other berries. Fluctuation of prices is similar to those of vegetables. Price change is even more dramatic for berries. Higher profits are made in the months before the mass harvest for supply coming from last years' harvest of fruit which was stored in cooling facilities (apples, pears) and early produce coming from the greenhouses (different berries).

3.48 The main weaknesses and threats in the sector include seasonal fluctuations in prices, adverse weather conditions, poor access to irrigation, lack of storage facilities, diseases and marketing difficulties.

3.49 Major lending opportunities include: financing inputs (seedlings, fertilizers, herbicides, etc.) by providing short term working capital through the year and with longer-term investments in storage facilities for fruit, drip irrigation systems and greenhouses for vegetables and berries. For more advanced, larger producers grading and packaging equipment might also be worthwhile investments. It is worth noting that investments which take advantage of the peaks in seasonal price movements are likely to be of most benefit to producers and to their financiers. Such investments include storage (especially cool storage/controlled atmosphere storage) and greenhouses (for out-of-season production).

Pork Meat Sector

3.50 Pig breeding is carried out by a range of farmers, starting from subsistence farmers who have one or two breeding sows together with other agricultural activities to specialized commercial farmers producing for the market with 50 sows, or even more. Pork production accounts for 50% of total meat production. Regionally, pig breeding is widespread along the country, with a large number of medium-size farmers, with good potential market linkages, in the regions of Plovdiv and Haskovo.

3.51 Sows have litters twice yearly, on average nine pigs per litter survive and stay on the farm to be fattened to approx 110 kg. Fattened pigs are sold to traders and local slaughter-houses if raised commercially, or to neighbours in the village if raised on subsistence farms in small quantities. The highest demand for pork is in winter season, lowest in summer months. On a monthly basis, demand is higher at the end of the month when consumers receive their salaries. Prices fluctuate accordingly. Production costs are between 70% and 90%, depending on input prices. There is a well defined cycle of price fluctuation in pig breeding – known internationally as the 'Hog Cycle'.

3.52 The main weaknesses and threats for farmers include fluctuation in price of meat and fodder, diseases, and marketing difficulties with traders.

3.53 Major lending opportunities are in providing seasonal working capital for buying the fodder after the harvest (when its price is lowest), purchase of animals, medicine and insemination material, while longer-term investment needs are in the building of storage facilities and mills for fodder, refurbishment and equipping of buildings with pens, and purchasing agricultural machinery.

Wine and Grapevine Sector

3.54 Bulgaria has a long history of vine cultivation and wine production. Natural conditions are good for the production quality wines for both the domestic and export markets. The total area covered by vineyards in 2003 is somewhere between 96,000 ha and 110,000 ha¹. It is estimated that commercially cultivated vineyards totalled 71,500 ha (both table and wine grapes), while the balance is cultivated for non-commercial purposes.

3.55 In the past, commercially marketed wine was produced mainly by co-operatives. However, since land restitution there are a large number of privately owned vineyards with an average area of around 0.3 ha per farmer². Some of these growers have taken the opportunity to plant new vineyards with more profitable varieties of grapevines, and the performance of these rehabilitated enterprises is generally much better than that of those co-operatives which still exist. However, there are still very large areas of suitable land which have not been improved, constituting an opportunity for profitable investment.

3.56 Market opportunities for Bulgarian wine are potentially good, but much effort needs to go into key strategies in order to unlock this potential. Individual growers can re-plant in varieties for which there is a strong demand (unlike many currently grown in Bulgaria). Then, on

¹ MAF, Wine Outlook Report, 2002.

² Investing in vineyards in Bulgaria, FAO, 1998.

a national basis, much can be done to promote quality Bulgarian varieties such as Mavrud, and to strengthen export demand for these by introducing a provenance of origin system, with associated controls and publicity. Coupled with this are the steps the Government of Bulgaria is now taking to implement a strategy for giving a stronger role to vine-growing associations. This will give more power and lobbying strength to these associations, and should result in fairer prices being paid to growers by wineries.

3.57 Currently the biggest problems faced by growers are: price fixing (at low levels) by wineries, difficulties in obtaining credit for the rehabilitation of vineyards, including planting new varieties, and the lack of a balanced approach to marketing Bulgarian wine. These difficulties are strongly inter-connected, and remedial measures need to be harmonized.

3.58 Vineyard rehabilitation is a long term investment, and banks entering this field need to be prepared to structure loans accordingly. Many grape farmers will also need access to seasonal loans to meet the costs of labour and materials, especially in spring and early summer, for pruning, fertilization, weed control, spraying and irrigation. Labour costs at harvest, in the late autumn, can also be high, and in the case of some growers these will need to be credit-financed.

4. EXISTING SUPPLY OF BANK FINANCE TO FARMERS

Farmers Do Not Have Ready Access to Bank Credit

4.1 This chapter examines briefly the current supply situation for credit for the agricultural sector. Given the primary focus of ProCredit Bank on small and medium scale operators, the supply position is examined in relation to this group. More detail on this topic is given in Annex 2.

4.2 The Bulgarian banking crisis of 1996-97, still influences the financial system and banking practices. The results are: low levels of financial intermediation, conservative lending policies by banks, and restrictive collateral requirements. Among the conservative lending practices has been a reluctance to lend sums less than BGN 20,000, and when lesser sums are lent the practice has been to demand collateral to the value of 200 percent or more of the amount lent. This has reinforced the usual difficulty farmers have had in obtaining bank credit, due to risk and cost considerations. but more on the agricultural implications, in the next section, below.

4.3 There are signs that this overall lending scenario is beginning to change. Conservative lending policies might be necessary in a transitional period after a severe financial crisis ensuring safety and security but they are low profit strategies. Some banks have already started to adopt more aggressive lending strategies in order to actively reach out to new target groups and under-served markets. The performance of ProCredit Bank is being closely monitored and might inspire other banks to engage in these large untapped markets. Some commercial banks have recently started to provide SME loans.

4.4 There are also a number of micro-finance programmes, including a network of credit unions established in 1995 under the EU PHARE programme. These have agricultural portfolios, but are small (see next section). In addition, three micro-finance programmes have been funded by USAID, but their outreach is not particularly great, and moreover is focussed primarily on urban areas.

4.5 An additional factor limiting the effective operations of non-bank financial institutions is that they are legally prevented from accepting deposits from the public. This situation may change in the fairly near future as new legislation is passed. In the meantime credit unions and other MFIs depend on external funding, especially from donors, perforce limiting their ability to build substantial loan asset portfolios.

The Supply of Agricultural Finance – The Constraints

4.6 Apart from the general factors constraining banks' attitudes towards lending, as outlined above, the key constraints for agricultural lending are the following:

- *Limited sector knowledge:* Banks are generally urban-based and urban-oriented.
- *Restrictive collateral requirements:* The perceived risk of agriculture, reinforced by limited in-house knowledge of the sector, has led banks to demand very high collateral ratios, with a strong preference for urban property.

Realisation of other forms of collateral, including rural property, is considered too difficult. (More detail on this key issue is found in Annex 2.).

- *Weak creditors' rights*: Foreclosure of collateral may take two years and more, and local courts often decide in favour of borrowers.
- *High transaction costs*: Low population density in rural areas¹ add to transaction costs related to the on-site inspection of farms, appraisal of collateral and supervision of borrowers.
- *Seasonality and long gestation periods*: Much of the loan demand from agricultural and related activities is seasonal, limiting the ability of borrowers to make frequent periodic repayments in equal instalments.

4.7 Apart from commercial banks, agricultural finance is mainly provided by specific lending programmes from the State Fund of Agriculture (SFA) and the Tobacco Fund² at subsidised interest rates. Moreover, there are several subsidy programmes provided by the European Union (SAPARD) and the national budget through SFA. These programmes are targeted at specific investment purposes and are normally disbursed to the suppliers of inputs, equipment and services.

4.8 Short and medium term loans are provided by the network of 33 Private Mutual Rural Credit Associations (PMRCAs). The UNDP supported JOBS-Programme has an equipment leasing facility for urban and rural Micro-enterprises including farmers. The main features of these programmes and institutions are described in some detail in Annex 2.

4.9 The following section summarizes the current situation in relation to the competition which ProCredit Bank faces in providing loans to the agricultural sector.

The Supply of Agricultural Finance – The Lenders

State Fund for Agriculture (SFA) and Associated Commercial Banks

4.10 The SFA was established in 1995 as a NBFIs under the Law on Support for Agricultural Producers. It offers short, medium and long term loans, subsidies and combinations of both. Its clientele is limited to registered agricultural producers and it operates through its 28 regional offices, situated in regional centres. According to an agreement with the EU, SFA has assumed the functions of the SAPARD Agency in Bulgaria and will disburse subsidies of the EU after 2007. Whether after this date it will still make loans is doubtful.

4.11 At present the SFA is used as an instrument of government policy in that short-term loans are targeted to certain crops and are restricted to the purchase of specific inputs in order to induce the adoption of specific production technologies. Accordingly the programmes of SFA change every year in response to the agricultural conditions of the previous year and the policy objectives for the coming year

¹ Some 40 persons per sq. km.

² The Tobacco Fund lends to tobacco processors for purchasing tobacco which has been grown under contract.

4.12 Details of the SFA operations, funding, loan and subsidy products and conditions for farmer clients are given in Annex 2. In summary, the following points can be noted:

- (a) Investment loans (medium and long term) for crops are focused towards vineyards, orchards, strawberries, etheric oil plants, medicinal plants and glasshouse facilities, growing out-of-season salad vegetables and other produce.
- (b) Investment programmes for livestock production targets the purchase of pedigree animals like sows, cows, sheep, goats, hens, ducks ostriches, rabbits, turkeys, bees. It also includes the purchase of equipment for animal breeding and milk collection, and the construction of warehouses, buildings, fodder plants and milk collection points.
- (c) The SFA funds the purchase of both new and used machinery and equipment.
- (d) Working capital loans, combined with subsidies, fund the purchase of fertilizer for wheat, maize and oil crops.
- (e) Much of the lending activity of the SFA is channelled through the 19 commercial banks with which the SFA has special agreements.
- (f) For seasonal loans the SFA operates a slightly more flexible approach to collateral than is the case with commercial banks, accepting the pledging of crop for up to 50 percent of the required amount. For investment loans real estate is preferred, but moveable assets, e.g. machinery, are also accepted.
- (g) Loan applicants have to make an equity contribution of 30% of the total investment costs¹. Subsidies and loans are usually not disbursed to the farmers but to the suppliers of goods and services (traders, construction companies, etc.).
- (h) SFA lends at very favourable interest rates. For direct lending, the rate is 6% (3% for young farmers). Those commercial banks having agreements with SFA pay 2.5% to SFA, with on-lending rates fixed at 9%, with the commercial bank accepting the credit risk.
- (i) The manner by which SFA operates (e.g. extensive documentation requirement), its linkage to subsidy (with the tendency for larger operators to gain most) means that larger farmers predominate in its portfolio.
- (j) As a result of the above there is limited outreach of SFA (only 107 investment loans in 2002, with an average loan size of BGN.126,000) and significant unspent resources (amount lent compared with amount budgeted).

¹ In 2002, the equity contribution varied between 20 and 30% depending on loan term and amount.

- (k) SAPARD, handled by the SFA, has reinforced the tendency to direct assistance towards larger operators, and for actual disbursement to be significantly lower than budgeted. In the implementation period 1 June 2001 to 31 December 2002 only 205 projects investing in agricultural holdings were approved. Minimum investment amounts, the requirement for projects to be pre-financed and very complicated application procedures and documentation all mitigate against small and medium sized farmers benefiting from SAPARD grants. The result has been concentration on cereal farmers (which are typically large scale) rather than on farmers in priority sectors such as dairy and vineyards.

The Private Mutual Rural Credit Associations (PMRCAs)

4.13 With details found in Annex 2, the salient features of this movement are:

- (a) It consists of 33 cooperatives, and has been heavily dependent on foreign assistance.
- (b) Cooperatives are not able to accept deposits, but use share capital as a means of supplementing the amounts received from donors. Effectively, though, the scale of lending which they are able to sustain is quite small in relation to the demand.
- (c) Loans are made only to farmers, for both farming and other purposes. Borrowing farmers do not have to be registered.
- (d) Loans are both short and medium term.
- (e) Interest rates reflect the market (5-12% above BNB base rate); collateral requirements are flexible, and may include guarantees for smaller loans.

Other Lenders/Mechanisms

4.14 The Job Opportunities through Business Support Project (JOBS) and other micro-finance initiatives have some relevance to farmers, but this is of very modest significance for the future ProCredit Bank agricultural portfolio. Leasing is possible, and is a popular lending mode for vehicles. Nevertheless there are legal difficulties which will keep this as a very minor mechanism for the financing of investment in farm machinery.

The Farmers' Perception of the Existing Sources of Finance

4.15 The general perception, which is well-founded, is that existing sources of farming loans are difficult to approach, require a voluminous and confusing amount of documentation, and require collateral which is difficult to provide. Moreover, from the point of view of small and medium sized farmers, it is very clear that the more important lenders in terms of volume favour large farmers, especially cereal producers.

5. CONCLUSIONS AND RECOMMENDATIONS

General Recommendations (for EBRD)

5.1 Although the present exercise is focused primarily on ProCredit Bank, a number of issues of potential interest to EBRD suggested themselves.

A. Enriching Banking Services

5.2 Firstly, there is the issue of building a financial infrastructure accessible to those living in rural areas. Accessibility has both the obvious geographical, and the less obvious aspects which concern product lines, operational procedures and orientation of owners, management and loans officers. Currently in Bulgaria there is a dearth of financial intermediaries which are geared to serving rural areas. Even the rural credit cooperatives have serious shortcomings in that they cannot offer deposit services, and their ability to lend is heavily constrained by lack of resources.

5.3 More than this, despite an apparent uniformity in the rural population, there are very marked differences in peoples' circumstances, aspirations and command of resources (land, labour and capital). There is a need for this variety to be matched with variety in banks serving the sector. This is a truism for most countries, but in Bulgaria there is an additional factor operating, which tends to skew attention towards just one sector of the rural population.

5.4 Commercial banks have been reluctant entrants into the business of making agricultural loans. The public sector has intervened (see Chapter 4) in order to redress the situation. But the public sector entities responsible while adhering to the laudable objective of increasing the supply of investment capital to the agricultural sector, have done so in such a way as to require conditions to be met (described in Chapter 4) which tend to favour larger operators. Their policies are also skewed towards term finance, meaning that demand for seasonal and shorter term advances (especially unspecified advances such as general working capital) is not in balance with supply. These situations mean that smaller farmers, and those requiring short term finance, are very much in need of better access to banking services.

5.5 Thus there is a clear need to enrich the supply market for financial services in rural areas, with financial intermediaries which are able to offer more variety in their terms and conditions, particularly for loans, than is the case at present. The ideal situation would be one in which an entrepreneurial farmer has a choice between two or more lenders which are in effect competing for his business.

5.6 Investment in banks and other intermediaries which are in a position to expand their rural operations is therefore warranted from a developmental point of view. One such candidate is the Private Mutual Rural Credit Associations movement, currently supported by the EU (see Chapter 4).

5.7 Such investment in intermediaries other than ProCredit Bank should not be seen as being to the detriment of the EBRD's ProCredit shareholding. Although there will undoubtedly be competition for the best borrowing clients in certain areas, the resulting improvement in rural

productivity and rural economies generally will mean that all will benefit, on the 'rising tide' principle.

B. Downstream Investments

5.8 The second area of potential for investment is in downstream entities involved in processing, grading, packaging and marketing farm produce. Indeed, deterioration in the infrastructure in these fields over the last 10 years severely compromises the productivity and profitability of on-farm investments. Only by improving the ability of farmers to sell advantageously the full potential of the sector can be realised. Indeed, unless the downstream sector benefits from new investment, then parallel investment in banks servicing farmers will be compromised to a degree which is likely to become more and more significant, as trade in food products expands in Eastern Europe¹.

5.9 Until a decade ago both the on-farm production sector and the processing/marketing sector were heavily geared to markets in the former Soviet bloc, including the domestic, Bulgarian market. Since the radical changes, structures in the country have not adjusted. If local producers ignore the domestic market, then neighbouring countries will seize the opportunity thus presented. Indeed, this has already started.

5.10 Within the EU Bulgaria enjoys similar comparative advantages as was the case within the Soviet bloc. This means that it should be able to produce fruit and vegetables requiring high sunshine hours in the ripening period, following cool winters. A large number of products, for both the fresh and the processed markets, fall into this broad category. The prognosis for export of these items is likely to be favourable. For meat and dairy products the domestic market, especially as it expands, is likely to be of principal importance.

5.11 Marketing/processing investments, especially geared in the first instance to the domestic market, will have a strong developmental effect. Abattoirs are especially in need of upgrading, since many if not most of these do not meet the EU standards which Bulgaria has already accepted for its facilities. Since the processing/grading/packaging facilities and the product lines they generate need to be fully in line with developing market demand, any external funding should involve partnerships with appropriate private sector firms. The present exercise did not address the market situation in any depth. Clearly further study would be required before viable areas and partners for investment can be identified. It is possible that such a study has already been done, but the mission has no information on this.

Recommendations for ProCredit Bank

A. Products and Operational Principles

¹ As long as per capita income levels remain below Euro2,500 per annum, the elasticity of demand for food products is likely to be greater than 0.5, indicating a strong domestic demand as incomes improve in the country as a whole. This demand will be for the higher value farm products – meat and meat products, dairy products, fresh and processed fruit and vegetables. If Bulgarian consumers and their immediate suppliers cannot obtain produce locally in the form (variety, quality, packaging, presentation), at the time and at prices which are comparatively favourable, then food imports will increase, setting back even further the Bulgarian rural economy.

5.12 **Maintain simple, low cost application procedures, with rapid loan-decisions.** Small and micro farmers are unable to afford the time, the effort, the transportation and consultant-related costs involved in heavily bureaucratic, complex and slow loan application procedures. Moreover, farmers of a basic educational level are also intimidated by this process and are unlikely to apply for a loan under such conditions, even in cases where they might have highly promising business prospects. The farmers interviewed clearly indicated the need for quick, simple, efficient and free of charge procedures for loan application and prompt payments. A surprising number of small farmers expressed a willingness to pay higher interest rates (if necessary) for the benefit of having easy access to loans. The Credit Co-operatives' procedures were highly praised both for their speed and simplicity. Most small farmers view the Credit Cooperatives as the only micro-finance institutions that can address their needs and respond to their individual requirements. However, compared with the Credit Cooperatives, ProCredit has a better access to sources of funds, can better diversify portfolio risks and has therefore a good growth potential in rural areas.

5.13 In product design it is worth noting that non-farm income is important (see Annex 2). Much of this is received monthly, and may well provide a base for a small monthly repayment to a lending bank, with the major loan repayments scheduled to coincide with the receipt of income from the credit-financed project.

5.14 **Maintain flexible attitude towards collateral and scheduling of repayments.** Collateral is a major issue for potential borrowers in rural areas, since banks have normally focused on urban property, to the exclusion of most items of value which rural people are in a position to offer. Thus collateral requirements need to be reviewed to include cows, cowsheds, agricultural equipment, cars and guarantors. The criteria for guarantors would also have to be relaxed in order to reflect the reality of the farming population. Consideration should be given to the possibility of approving two or more guarantors. In view of the current difficulties with other banks, it is not surprising that small farmers interviewed mentioned the desire for flexibility in collateral requirements. This is now offered by the credit cooperatives.

5.15 But farmers also mentioned, justifiably, the need for loan repayment schedules which more closely match their income flows. For vegetable farmers in Haskovo, for example, this would mean repayments in October, November and December. Credit co-operatives have yet to reach this level of flexibility in loan repayment scheduling. Moreover, as mentioned in Chapter 4, lack of funds and regulatory constraints limit the expansion of this cooperative network. These circumstances, which could change in the future, are currently fortunate for ProCredit Bank, as they provide a moment of opportunity to meet at least part of the currently unsatisfied demand from quality rural clients.

5.16 **In the current supply market, concentrate on short/medium term loan products.** ProCredit Bank would find it difficult to compete with the interest rates of loan products offered by the SFA both directly and through its partner commercial banks. This will seriously limit the extent to which ProCredit will be able to finance longer term investments. However, for short and medium term loans the absence of hidden costs and less bureaucratic documentation with ProCredit could constitute a balancing advantage. Examples of medium term loans which could be funded would include those to clients whose scale of operations is being extended or intensified, perhaps through establishing irrigation based on direct river drawing or on groundwater, converting existing (old cooperative) buildings to intensified livestock or indoor

crop production, improvement/upgrading of machinery or consolidation of enterprises by buying out a neighbour's operation. In each of these cases the Pro-Credit approach to collateral will convey a comparative advantage, and could be exploited.

5.17 **Types of short-term loans.** The first type of short term loan would be the usual form of working capital loan, covering costs of labour, fuel, seasonal chemical inputs etc. This form of credit helps build up the bank's knowledge of the client base before longer term lending is contemplated. Short term lending, particularly for well-defined working capital needs, is just as much a good entry-level product for farmers as it is for urban-based borrowers.

5.18 Another suitable entry level product would be the provision of short term loans which would enable the core group of borrowers to take advantage of month-to-month price differences in some key inputs, for example fodder and feed grains. These prices can fluctuate as much as 60% during the year. Since fodder makes up 60—70% and at least 70% of the costs of dairy and pig breeding operations respectively, the ability to buy feed at low (at harvest) prices is clearly one that is advantageous. Such a Agri-Bridge-Loan might also be used for financing storage of produce to be sold out of the peak season. Such loans would, however, need to be based on a thorough market and price analysis. Warehouse receipts might be used as collateral.

5.19 More advanced farmers with a proven track record as successful borrowers might be offered an overdraft facility in line with their borrowing capacity. This would enable them to cope flexibly with unexpected liquidity shortages, caused by fluctuations of input and output prices or external events affecting farm outputs such as adverse climate conditions or pests and diseases. Such a product is presently not available to most farmers in Bulgaria and might become a flagship product for ProCredit Bank for its most reliable clients.

5.20 **For the future – consider term loans.** A typical pattern emerging from the case studies is that farmers use their own funds¹ for financing start-up investments in agricultural activities and eventually seek loan finance for expansion if the investment succeeds. The main competition for investment finance comes from the State Fund for Agriculture (SFA), which offers a number of standardised loan products for different investment purposes. Examples are orchard development loans, loans for herd enlargement and loans for purchasing farm machinery. Farmers particularly appreciate the low interest rate of 6%, or 3% for young farmers, and the grace and repayment periods which are harmonised with the expected cash flow of the investment.

5.21 However, SFA funds are limited, application procedures are slow and cumbersome, and might not always be fully transparent. ProCredit might enter this market by offering a highly flexible investment loan product, which would be available quickly, reliably and with a minimum of paperwork. Loan appraisal and repayment schedules should take into account the total farm household cash-flow, including non-farm income sources and a conservative estimate of incremental income derived from the investment. Current minimum amounts of total project investment used by SFA (especially for SAPARD) are unrealistic for many farmers, so flexibility here is important.

¹ These may come from other businesses, sale of assets or of businesses, through restitutions, etc.

5.22 **Sequencing of products.** Sequencing of loan product introduction will be important, with short term lending providing an opportunity to build knowledge of the clientele, before progressing to medium term advances or overdraft facilities.

5.23 **Follow policy directions in determining sub-sectors for priority consideration.** The Government of Bulgaria has certain production priorities among the various options open to Bulgarian farmers. Thus dairy, vine, fruit and vegetable production is encouraged, together with the production of ancillary products such as fodder and livestock feedstuffs. Since policy making and delivery for the agricultural sector is likely to favour these priorities, banks lending to the sector would have a higher degree of comfort with investments in these enterprises than might otherwise be the case. There is a happy coincidence here, as it is precisely these sub-sectors which suggest themselves as being most suited to ProCredit financing.

5.24 Some typical loan types in rural areas are listed in Annex 2.

B. Target Clientele

5.25 **Age:** Those within the desired core group of borrowers are likely to be with the age range 20-50 years. Since the average age of the rural population is 61 years (1998 estimate) this appears unrealistic. However, average figures¹ mask the reality of a clear dichotomy between the much more numerous, elderly population, who are basically home gardeners, and the younger group of farmers, typically aged in the mid-forties, and who account for a substantial proportion of the marketed farm production in the country². It is those in the latter group who can be expected to make the most profitable use of loans for productive purposes. Nationally, and at present, the number within this target clientele group is not likely to be more than a few thousand individuals. Whether the number will grow depends very much on the future profitability of farming, which in turn depends on factors associated with the place of Bulgaria in the future European food production and processing industry. Access to demand driven financial services would enable small and medium sized commercial farmers to grow and exploit the possibilities brought by the accession to the Common Agricultural Policy. ProCredit might establish a long-term house-banking relationship with promising rural clients in a market with limited competition.

5.26 The marketing strategies outlined in the section below are designed to self-select a pool of potential borrowing clients who would be likely to fit the profile desired by ProCredit.

5.27 **Farm Size:** The main potential market for ProCredit Bank loan products in rural areas consists of small and medium sized farmers. They are currently underserved by the banking system, since they can often not meet the collateral and documentary requirements of commercial banks and SFA. Many of them might have a long-term growth potential and offer scope for ProCredit bank to engage in a long-term bank - client relationship.

5.28 ProCredit might consider servicing larger farmers as well, at least for an initial period. This could be done at lower risk and transaction cost, and might help ProCredit to develop skills and expertise in loan appraisal and market analysis, and establish a reputation as a rural lender of note. Naturally, for larger farmer ProCredit would be in more direct competition with

¹ PHARE-ACE supported national representative survey, quoted in National Agriculture and Rural Development Plan for 2000-2006 under the EU SAPARD, p.23.

² For example, they account for 59% of total crop sales, *op.cit* p.23.

SFA and commercial banks. Nevertheless, interviews and survey results revealed that many large farmers are unsatisfied with the current suppliers of finance and would even accept smaller loan amounts if they were accessible at convenient terms. ProCredit may not be able to compete with interest rates, but could counter this by offering quick and non-bureaucratic access to loans.

5.29 **Registered Versus Non Registered Farmers:** Although some within the desired core group of borrowers are likely to be registered, there is no advantage to a lending bank for an insistence of borrowing farmers being registered. Unregistered farmers should be a certain target for ProCredit, as they are not eligible to receive SFA subsidies (more in Annex 2),

C. Marketing Issues

Establishing a Positive Image in Rural Areas

5.30 There is a general mistrust in the banking system in Bulgaria due to the financial crisis in 1997. This is particularly the case for the small private banks. Bulgarian banks bought by foreign banks who claim and advertise themselves as powerful international institutions are regarded as stable and secure (Post bank, United Bulgarian Bank). ProCredits marketing strategy should emphasis its attributes as stable institution with strong international shareholders, experienced in lending to the small business community in urban and rural areas.

5.31 Commercial banks and SFA have a negative image in rural areas, mainly because of their slow, bureaucratic and often intransparent procedures that lead to high transaction costs and delays for loan applicants. Given the nature of supply competition in the loan market it is essential for Pro-Credit Bank to position itself as a financial partner with a difference. Elements of this difference would include: private sector image; attractive branded product range based on real needs; conditions for loans which are in line with collateral position and cash flows of borrowing clients; speed and friendliness in dealing with loan applicants. Rural areas of Bulgaria present an attractive field for a bank wishing to project an efficient, private sector image, since competition for demand driven quality financial services is thin to non-existent.

Potential Marketing Channels for Rural Loan Products

5.32 Municipal authorities and/or producers' associations could provide suitable entry points for a carefully crafted publicity campaign, once a core product range is established.

5.33 **National Agricultural Advisory Service (NAAS):** The 28 regions of the country each have a regional centre, e.g. Plovdiv and Veliko Turnovo. Each regional centre also has an agricultural office, and a branch of the national extension service (NAAS). The agricultural office attached to the region keeps a list of registered farmers. This provides a first means of identifying part of the potential clientele (though the likely core clientele of ProCredit is likely to include only a small number of registered farmers). NAAS offices already display posters and handle other publicity material for commercial companies selling inputs and farm machinery. They could similarly handle information material from ProCredit Bank.

5.34 **Regional Administration:** The regional administration is also the forum for meetings of mayors of villages within the region. These regular meetings could be harnessed for the purposes of presentation to the local village leaders. The mayors might be suitable entry points for ProCredit into the villages because they have a good knowledge on local economic conditions and

possibilities. They are often trusted and consulted by villagers in economic issues such as marketing and input supply. Compared with NAAS with its sectoral focus, the mayors offices would lend themselves to reach rural SMEs engaged in non agricultural activities. Mayors may have an interest in improving the village population's access to financial services, especially if small and medium sized farmers and non-farm entrepreneurs constitute a significant part of the voters. If an interest in attracting ProCredit can be assumed, it is likely that the mayor would try to weed out poor loan applicants, especially during the initial phase. Once ProCredit is present, direct involvement of the mayor may not be required any longer. If costumers are satisfied and there is a real demand, the "word of mouth", supported by the promotional activities described below, might be sufficient.

5.35 Before organizing the meeting with/through the mayor's office, the bank should send some information/promotion materials to mayor's office which he/she could distribute among the market oriented farmers. In its initial contact with the mayor's office, the bank could stress the importance of credit for agriculture in the light of the development of the village and the main attributes of its products and services along the lines described in the previous section.

5.36 **Branch Associations:** The Branch Associations of food processors are well organized and structured. They have offices in the regional centers and publish newsletter containing useful information regarding legislation, import, export, taxation, etc. concerning the activity of their members (meat processor, milk processors, etc.) ProCredit may contact their head offices (usually in Sofia) in order to advertise new banking products for the rural areas. Moreover, these associations organise regular meetings for their members which could be used as a hub for bank's dissemination of relevant information, or even as a forum for presentation of the bank's products to potential borrowers. A list of branch associations can be found in annex 6.

5.37 **Fairs:** There are two big agricultural fairs in Bulgaria. Plovdiv fair, which takes place in the middle of March and Dobrich fair, held in August. They are of a similar size and have a similar number of visitors. Price for exhibitors is between 130 and 170 Euro per square meter. Farmers have a tradition of visiting the fairs even though they have no intention to buy something. These fairs are a good promotion venues for ProCredit and its officials to advertise and contacts with input suppliers, as well as agricultural leasing companies. The contact details can be found in annex 6.

5.38 **Newspapers:** There are several weekly newspapers targeting the rural community. They are popular among the small and medium farmers as they provide valuable information on agronomic novelties, relative legislation and credit opportunities. The advertising fee of these newspapers are not very high. ProCredit can consider organising a competition together with the newspapers through which the bank would have a chance to market its products by providing a free assessment of potential projects to the readers.

5.39 **TV/Radio:** TV programs have by far the largest audience but, in the same time, they are the most expensive marketing channels. Bulgaria has three channels with national coverage. The state TV has the longest running agricultural program running, airing every Sunday at midday. Nova TV, private television station, has agricultural program called "Agrobusiness" on Sundays, at 13.15. Radio programs with national coverage do not have agricultural programs. However, local radio stations have agricultural programs during weekday mornings and on

Sundays. ProCredit should advertise through those stations. Contact details can be found in Annex 6.

5.40 Virtually all the potential clientele for Pro-Credit Bank will be literate. Most will have a high school education and some a university qualification. Accordingly it can be assumed that well-designed pamphlets, of the type already used by Pro-Credit, will be effective for agricultural loan product sensitization. In 1998 85 percent of households in Bulgaria had a fixed line telephone. Whereas the bulk of those without a fixed line are in rural areas, the advent of cell phone networks will have increased the ability to reach clients by telephone, reducing greatly the cost of making direct contact with a client.

5.41 Different marketing strategies might be required depending on the age of the target group. Market oriented farmers can be broadly divided into two subgroups. The first group, which is over 40 years of age, consists mostly of farmers who became unemployed during the last 10 years and therefore forced to find new way of providing income for their families. Approximately 60% of the total number of targeted farmers belong to this category. Some have been working in agriculture before (e.g. in cooperatives or state farms, others have invested resources obtained through non-agricultural activities). Most of these farmers have good practical experience in their main farming activities and a considerable number has participated in training activities. This group of farmers has a limited track record in the financial system and needs to be targeted actively by the bank. Their sources of funds are mainly informal (friends and family, traders, etc.), with obvious limitations for serving the financial needs of these farm households. The perception of the banking system is often negative, because many of these farmers think that banks are in general not interested in serving them. Banking products offered to agricultural producers would have to be marketed "at their door-steps" to demonstrate the commitment of ProCredit and rebuild confidence. Proactive, thoroughly conducted advertising policy with an intensive field presence would be needed in case of this group of customers.

5.42 The second group of farmers are relatively young, below 40 years of age. This is a new generation of farmers, in a large majority educated in post-communist era after the changes of 1989. They have a more positive attitude towards the banking system and many have already applied for and received loans from banks. This group of farmers usually has better education and more contacts with urban areas. They read newspapers (both political and agricultural), watch TV programs and use Internet on regular basis (certain percentage). Public marketing campaign through window displays in the bank branches of regional centers, adds in mayors' offices, farmers' associations, relevant papers, radio and TV stations, as well as e-mail updates and other means of Internet advertising would be effective with this group of people. However, it would be important for ProCredit to proactively identify experienced farmers with good growth potential to initiate its rural lending. Once a reliable pool of clients is established, these could help ProCredit to screen further loan applicants. This may be effective if existing borrowers are satisfied with ProCredit's services and wish to maintain long term "house banking" relationship with the bank.

5.43 Virtually all the potential clientele for Pro-Credit Bank will be literate. Most will have a high school education and some a university qualification. Accordingly it can be assumed that logical to believe that well-designed pamphlets, of the type already used by Pro-Credit, will be effective for agricultural loan product sensitization. In 1998 85 percent of households in Bulgaria had a fixed line telephone. Whereas the bulk of those without a fixed line are in rural areas, the advent of cell phone networks will have increased the ability to reach clients by telephone, reducing greatly the cost of making direct contact with a client.

Maintaining a Regional Focus

5.44 Maintaining a focus on a limited number of regions and on areas within these regions in the early stages will be advisable, as staff build up experience. In this connection the market situation for the potential borrower's produce will be vital. Plovdiv offers a factory buying point for fresh produce, as does the wholesale market in Sofia. The milk buying situation varies over the country and is changing fairly rapidly. This would need review on a region by region basis where and when loans are contemplated. Meat packing plants are in a similar situation, and given the likelihood of substantial investments in abattoirs in order to meet standards now applying, ProCredit Bank could usefully follow developments in this area in order to assist in future decision making on regions in which the bank's marketing could be focussed¹. A further reason for ProCredit to monitor these developments is that they may indicate useful entry points for borrowing farmers. Such borrowers, because of the likelihood of their being contracted, would be in a position to manage much of the marketing risk of their farming operation.

5.45 In those areas where larger farms, and seasonal crops such as cereals and sunflower predominate, for example, Dobrich, the large farmers might be suitable entry points for ProCredit. Although some farmers in this area have obtained loans to replace farm machinery and irrigation equipment, there is understood to be a significant, unsatisfied demand.

Classification of Villages

5.46 ProCredit might consider drawing up a classification of villages according to established criteria of vulnerability (distance, economic infrastructure, etc), agricultural potential, extent of eagerness and initiative on the part of the farming population to take loans, etc. A classification of villages would be more appropriate than the current SAPARD practice of classifying municipalities.

Flagship Products

5.47 Emergency loans, to farmers temporarily in financial distress due to adverse physical events or price changes, would provide good publicity for ProCredit, and could, with care, become a lead product line. Another candidate as a flagship loan product could include medium term advances for farm consolidation, as this area of business is likely to grow substantially as the land market becomes more active.

D. Staffing Issues

Recruitment

5.48 Appraisal of rural loans will need new skills on the part of Pro-Credit Bank. Serious entry into the rural loans market should be preceded by the bank taking on staff with the necessary agricultural training and background. Ideally, staff would be recruited from the target areas for ProCredit's rural loan products. This would help the bank to better understand the specific local

¹ *Inter alia* SAPARD authorities are understood to be giving attention to investments in processing and marketing in specific sub-sectors.

conditions and the idiosyncrasy of rural people. It would also strengthen the possibilities for ProCredit to establish long-term bank client relationships in rural areas.

Training

5.49 ProCredits loan officers without an agricultural background would require specific training in agricultural economics to become familiar in appraising the profitability and cash flow of agricultural enterprises. One possibility would be to participate in training courses provided within the FAO technical cooperation project currently being implemented in Veliko Turnovo, Shumen and Stara Zagora. This project provides basic training in agricultural economics and farm management to NAAS extension officers.

5.50 Agricultural loan officers would also have to be trained in evaluating the different types of collateral in rural areas. Background data on farm and non farm assets of the rural population can be obtained from sources such as the UNDP rural survey (field work completed but report not yet released) and the forthcoming World Bank survey (field work starting autumn 2003) and the Ministry of Agriculture and Forestry ("MAF") census (data collection completed, report due for release May 2004).

E. Collaboration between ProCredit and Other Actors in Rural Development

5.51 Agricultural loan staff should be actively encouraged to collaborate with firms, institutions and agencies the activities of which are important to the productivity of the sector. Included here are: processors, extension agencies (NAAS/RAAS), farm supply firms, mayors and other local municipality officials. ProCredit may be in a position to encourage group extension visits in villages where farmers have applied for or received loans.

5.52 A further possibility might be to establish tri-partite arrangements with processing enterprises which have supply contracts with farmers. For example, in the dairy sub-sector, DANONE, the largest processing plant in Bulgaria, has established supply contracts with different types of suppliers, including cooperatives, private farmers and collection points. Though DANONE prefers large suppliers (cooperatives and large individual farmers), the scarcity of supply obliges it to also purchase milk from smaller farmers, either directly or through milk collection points. The threshold to become supplier is usually a minimum of 15 cows. Currently, most suppliers have between 30 and 60 cows. DANONE has an active interest in enhancing supply of quality milk. Hence, in the past it has financed milk cooling tanks to private farmers and cooperatives. Currently, it is looking for partnerships with financial institutions willing to finance the expansion of promising milk suppliers. The existence of a purchase guarantee for the milk and the pre-selection of viable farmers through DANONE limits the credit risk for ProCredit. Further, loan repayments could be effected through deductions at source at the processing level reducing transaction costs. Similar schemes could be designed with other dairy companies or with processing companies in other sub-sectors.

BULGARIA

EXPANDING PROCREDIT'S OPERATIONS IN RURAL AREAS

ANNEX 1

**CHARACTERISTICS OF THE POTENTIAL DEMAND FOR RURAL
FINANCE**

ANNEX 1

CHARACTERISTICS OF THE POTENTIAL DEMAND FOR RURAL FINANCE

Disclaimer:

1. An analysis of the structure of demand for loans in rural areas is hampered by lack of accurate data. Even more recent studies rely on data from 1996 or refer to 1992, when the last full agricultural census has been carried out. A new survey is currently being carried out and the result will probably be available around spring of 2004. Moreover, FAO is implementing a baseline survey in 14 Municipalities of socio-economic data on the rural population on behalf of the World Bank. The statistical information presented in this section report is based on the survey on farm structures carried out by the Ministry of Agriculture and Forestry (“MAF”) at the end of the 1999/2000 agricultural season¹, the latest data source available.

1. Importance of Agriculture in the Rural Economy

2. Reliable data on share of different non-farm income sources for the rural population does not exist. Available information suggests, that agriculture combined with some related service activities (trade, small scale processing) **is by far the most important economic activity** in terms of **income, employment and GDP** (also as consequence of the widespread de-industrialisation in rural areas). According to the census from 1992, the most important income sources in the villages are agriculture (49.4%), salaries from non-agricultural work (19%) and pensions (16%) (Nikolowa, 2002).

3. According to more recent surveys by the National Statistics Institute and MAF, between 300.000 and 370.000 people declare agriculture being their main source of income. More than one million persons report agriculture as a secondary source of income. This may reflect the fact that a huge number of Bulgarians receive either pensions or salary income which is often complemented by small-scale agricultural activities.

4. Eighty-five percent (85%) of the persons who declared agriculture as their main income source work as individual farmers (physical persons). A quarter of all market oriented individual farmers (physical persons) declare having complementary non-agricultural income, with on-farm processing being the most important activity. Half of the farms specialised in annual crops provide machinery hiring services. However, only 16% of all farms are engaged in on-farm processing, most of these being specialised livestock producers. A large share of the cooperatives provides machinery hiring services.

5. Other non-farm income such as agro-tourism, handicrafts, workshops, trade, etc. appear to be concentrated either in peri-urban areas or in regions with low agricultural potential (e.g. mountainous regions). SAPARD grants might complement the diversification of rural areas into non-farm activities. Only a very small part of the 42.000 farmers interviewed during the 1999/2000 MAF survey are engaged in other non-farm activities, such as agro-tourism, aquaculture or handicrafts.

¹ Structures des Exploitations Agricoles en Bulgarie, campagne agricole 1999/2000, Ministry of Agriculture and Forestry (MAF), June 2001. This survey used secondary data and air photos complemented by 42.000 farmer interviews.

2. Farm Structures

6. According to the 1999/2000 survey of MAF, there is a total of 760,700 farmers in Bulgaria cultivating 3.6 million ha (36 million dca) of land. The survey only distinguishes between legal persons and physical persons (individual farmers). Within the legal persons, a distinction is made between cooperatives and other legal persons such as companies or registered traders. Regarding the legal structure of these farms, 99% are run by physical persons operating on 20% of the total agricultural land. The remaining 1% of farms consists of 5400 legal persons operating on 80% of the agricultural land. This dichotomy in the agricultural structure is also reflected in the average farm sizes of 0.9 ha in case of the physical persons versus 353.7 ha in case of the legal persons.

7. Within the universe of 760.000 farms, the survey encountered about 42.000 market oriented farmers consisting of 36.200 physical persons and 5.400 legal persons. The first category includes small, medium and large scale farmers, which control about 226.000 ha or 6% of the total agricultural land in Bulgaria. The average size of farms registered as physical persons is 6.2 ha. Thus, the majority of subsistence oriented farmers only operates on 14% of the total agricultural land. About 450.000 small land owners have rented out their land either to cooperatives or to individual farms.

8. However, the distinction between physical and legal persons only permits a rough approximation of the farm size structures. Among the physical persons, there are farms of different sizes. The definition of small and medium farmers as well as the delineation of small-farmers from subsistence farmers and medium from large farmers are often difficult and depend on regional characteristics. For the purpose of the study, the following indicators are used to define different farm sizes.

Table 1: Quantitative Indicators for Classifying Farm Sizes

	Subsistence	Small	Medium	Large	SFA minimum requirements
	Dka/Number	Dka/Number	Dka/Number	Dka/Number	
Livestock					
Cows	2 (80%)*	up to 5 - 10	5 - 20	Over 20	min 10
Sheep		up to 20	20 - 100	Over 100	min 50
Goats		up to 20	20 - 100	Over 100	min 50
Pigs	2 - 3	up to 10	10- 30	Over 30	min 20
Poultry		up to 100	100 - 500	Over 500	min 500 - 3000
Bees		up to 10	10 - 50	Over 50	min 20 families
Crops					
Orchards	1 - 5	5 - 20	20 - 40	Over 40	
Vineyards		up to 5 ¹	5 - 200	Over 200	100 dka
Vegetables	1 - 2	up to 15	15 - 50	Over 50	
Grain		up to 200	200 - 1500	Over 1500	
Essential oils					

¹ Sources: FAO (1998) Bulgaria: Investing in Vineyards. SFA uses a different classification: producers with less than 15 dca are classified as small, those with 15 - 80 dca as medium, and those with more 80 dca as large producers.

2.1 Micro and Subsistence Farms

9. Restitution has created a huge number of owners of small agricultural plots, many of which live in cities and have no link to farming. A large share of these farms is operated by pensioners mainly for subsistence purposes. Their growth potential is limited. However, due to the special non economic value attached to land ownership, only a limited amount of land is offered on the market. There are, however, some very small farms engaged in intensive vegetable or orchard production which might have the potential to expand by renting in or buying additional land.

2.2 Small and Medium Sized Farms (SMFs)

10. Available information suggests that the number of SMFs is limited, but growing. They can be found in all sub-sectors, but their comparative advantages are in labour and land intensive sub- sectors, with less scope for large scale mechanisation. Examples are dairy production, vegetables, pigs, orchards and wine, but also niche markets (medicinal crops, bee keeping).

11. According to the 1999/2000 MAF survey, physical persons mainly rely on family labour and employ on average two persons per farm. 90% of the total workload during the 1999/2000 season was performed by family members. Salaried workers are primarily employed in farms specialised in grain or oilseed production or in dairy. In turn, cooperatives and other legal persons mainly rely on salaried workers.

12. International comparisons show that farms operated as family businesses and mainly relying on family labour often have a high productivity because all family members share the benefits of their effort. Moreover, these farms save transaction costs related to hiring and supervising wage labour. However, due to their small size and limited collateral base, they are more disadvantaged in terms of access to financial services.

13. Medium sized farms may have the potential to invest in better production technologies and exploit economies of scale in production through mechanisation. Moreover, they have better access to markets and advice. Some of them might have the potential to grow and develop into large farms. Proper access to financial services may have a catalytic role for the growth of small and medium farms.

14. The SMFs, which were interviewed by the mission team and during the small survey carried out by Vitosha Research in the five regions, show the following characteristics:

- Many farmers have gained farming skills during the socialist period and tend to have at least an intermediate technical formation.
- Many have university degrees in agriculture or related fields and started to have their own farm operations.
- Some have had another business (shops, trading, etc.) which they sold and invested the resulting funds in agriculture.

- Some continue to have other businesses (trading, transport), most have one family member with a salary income (especially those living in proximity to cities). Some have learned about agriculture through courses.

15. All interviewed farmers consider farming as a business and have invested considerable own funds to start their farming operations. They possess good technical know-how and farming skills as well as sufficient knowledge about the markets of their main products. Another characteristic is the high degree of specialisation despite relatively limited size of operation: most farmers concentrate on one or two major farm activities. This may in part be explicable to the fact that most rural inhabitants receive either **pensions, salaries or both**. Though these are generally low they cover the basic needs and constitute a “fall back”-option in case the agricultural activity fails.

16. The main constraints of the SMFs are related to marketing, access to land, farm machinery, irrigation and to financial services.

- Access to land is constrained by the difficulties to buy or rented larger contiguous tracks of land and the problems of arranging for long-term lease contracts which might be necessary for medium and long term investments (orchards, irrigation, fencing, etc.).
- Further difficulties are related to **access to machinery**, since most farmers complain about high costs for machinery rental. However, ownership tractors, cultivators, combiners etc requires minimum-sizes to be economically viable which are often beyond the scale of SMFs. Moreover, they require lump-sum payments which are often beyond the financial means of SMFs. Access to bank loans is constrained by absence of sufficient suitable collateral.
- Irrigation: Only 10% of former areas still functional. Operations and maintenance costs often too high. Partial rehabilitation on a smaller scale might be feasible.
- Marketing:
 - Oligopolistic structures (dairy, wine)
 - Lack of sorting / grading / packaging / storage facilities, especially for perishable crops such as fruits and vegetables

2.3 Large Farms

17. Large farms often have several hundreds of hectares or heads of animals. This category is mostly composed of cooperatives, but there are also other legal entities as well as large individual farmers. Most of these farms mainly operate on rented land.

18. These farms have considerable economies of scale in production and marketing and the ones which are managed properly and are likely to be competitive after the EU-accession. They have access to commercial bank credit both using SFA credit lines and the bank's own funds, and of SAPARD grants. However, their access to loans is constrained by collateral

requirements of banks, documentary requirements. As will be shown below, large farms produce a large share of the output in cereals and oil crops, aviculture. They also have an important share in capital intensive crops like orchards and vineyards.

2.4 Participation of Different Farm Types in Different Farming Systems

19. The MAF survey from 2000 also shows the participation of physical and legal persons in different types of farming systems. Farmers are classified under a specific farming system if more than two thirds of their income is sourced by the respective crops. The following classification has been used: farming systems are defined according to the following criteria:

- **Annual crops:** Farms receiving more than two thirds of their income from annual crops such as grains and oilseeds.
- **Tree crop and horticulture farms:** Farm receiving more than two thirds of their incomes from perennial crops or vegetables.
- **Livestock producers of “herbivores”:** farmers receiving more than two thirds of their incomes from dairy production, sheep or goat raising.
- **Other livestock producers:** Farmers receiving more than two thirds of their incomes from pig raising or aviculture.
- **Mixed farms:** All farmers who do not fit into the other categories.

20. Table below illustrates a marked concentration of legal persons in the production of annual crops and, to a lesser extent, perennials and vegetable production. Physical persons participate in all sub-sectors without showing a significant concentration. However, their main importance in relation to the total production is in mixed farming and livestock production.

Table 2: Participation of Physical and Legal Persons in Different Farming Systems

	Annual Crops		Perennials and Vegetables		Livestock Herbivores		Pigs and Aviculture		Mixed Farms		Total	
	No	Area ¹	No	Area	No	Area	No	Area	No	Area	No	Area
Physical persons	5.900	156	6.100	20	10.200	18	6.300	9	7.700	23	36.200	226
Legal persons (total)	4.000	2.386	600	375	350	3	200	0,4	250	30	5.400	2.893
Legal persons (cooperatives)	2.600	1.853	460	345	15	0,5	0	0	50	20	3.150	2.218
Total	9.900	2.641	6.700	395	10.550	21	6.500	9	7.950	53	41.600	3.119

21. Legal persons produce an average of 373 ha of grain. Physical persons only account for 7% of the total grain area with an average size of 6 ha. In case of sunflower, their participation is limited to 6% of the area, with an average size of 8 ha. Maize is the most important cereal for physical persons and more than 70% is produced on plots below 2 ha.

¹ In 1000 ha.

22. Only few cooperatives are engaged in livestock production which is mainly a domain of physical persons. 93% of all physical persons have livestock. 99% of all goats, 92% of all sheep and 78% of all cows and buffaloes are raised by physical persons. However, most of these animals are raised in very small holdings using simple and often deficient production techniques. Only 9% of all cows and 7% of all sheep are raised by legal persons. Many of these, however, possess larger numbers of animals, with an average of 100-200 cows and 200 – 300 sheep, together with an average of 600 ha of land.

23. The production of orchards and vineyards is again dominated by legal persons account for 93% and whereas they only cultivate a minor share of total area under annual and perennial crops. Also, they account for 32% of the area planted with potatoes, with an average size of less than one ha.

Table 3: Participation of Physical and Legal Persons in Perennials, Vineyards, Potatoes and Tobacco

	Perennial Crops		Vineyards		Potatoes		Tobacco	
	% of farms	% of area	% of farms	% of area	% of farms	% of area	% of farms	% of area
Physical persons	83	7	92	5	97	3%	93	23
Legal persons (total)	17	93	8	95	3	6%	7	77
Legal persons (cooperatives)	13	83	6	91	1	5%	5	69
Total	100		100	100		100	100	100

2.5 Irrigation

24. According to MAF (2001), out of the 42.000 market oriented farms interviewed, 9.259 have irrigated land, totalling 151.000 ha or 34% of their total agricultural land. 90% of this land is irrigated by gravity; only 2% is under drip irrigation and 1% under micro irrigation systems. This proportion applies to both physical and legal persons.

2.6 Age Structure

25. Amongst the physical persons, only 12% of the farms are managed by persons of an age under 40; more than half are run by pensioners. Managers of cooperatives are in average 10 years younger.

Table 4: Age Structure of Different Categories of Agricultural Producers

Age group	Physical persons	All legal persons	Cooperatives
< 30 years	3%	2%	1%
30 – 39 years	9%	14%	8%
40 – 49 years	16%	27%	21%
50 – 59 years	25%	36%	41%
60 – 69 years	28%	18%	25%
Over 70 years	19%	3%	4%
Total	100%	100%	100%

2.7 Current Financing Strategies if SMFS and Access to Financial Services

26. The survey and the interviews with farmers during the mission have shed some light on the sources of funds of SMEs, their perception of these funding sources and the effective potential demand.

- Most farmers used own funds to start their business. Restitution provided some initial assets which were complemented by sales of existing businesses (e.g. shops).
- Working capital is mostly provided by the farm household itself, in some cases complemented by non-farm income sources. Seasonal requirements are met through borrowing from two major informal sources: 1) Family and friends and 2) traders / processors.
- Most of the interviewed farmers managed to get access to loans for expansion of their activity, in most cases from the State Fund for Agriculture (SFA).¹ Some farmers are member of the Credit Cooperatives.

27. The interviewed farmers showed a strong demand for loans with longer terms and grace periods to finance productivity enhancing investments or enlarge their scale of operations. Obviously, high interest rates were a common complaint, but also the excessive documentary and collateral requirements. Actually, some farmers felt that commercial banks were not really interested in lending to them using excessive documentary requirements to discourage them from filing loan applications.

3. Main Implications for ProCredit Bank

3.1 Main Target Markets

28. The main potential market for ProCredit Bank in rural areas are SMFs. They are currently underserved by the banking system, since they can often not meet the collateral and documentary requirements of commercial banks and SFA. Many of them might have a long-term growth potential and there is scope for ProCredit bank to engage in a long-term bank client relation. However, this would require ProCredit to acquire specific expertise in appraising investments opportunities in specific agricultural sub-sectors as well as understanding the respective markets. Regarding the latter, it is important to distinguish long-term trends in prices, costs and profitability from cyclical and seasonal fluctuations.

29. On the one hand, the relatively high degree of specialisation increases the risk profile of these potential clientele because their repayment capacity depends to a large degree on outside factors and systemic risks such as prices for products and major inputs. On the other hand, idiosyncratic risks related to production and marketing may be lower because specialised farmers

¹ It has to be acknowledged that the sample of interviewed farmers has been biased by the fact that the farmers were selected by the regional offices of NAAS. One of the main activities of NAAS is to assist farmers in the loan applications for SAPARD and SFA. It is difficult to assess the outreach of SFA amongst SMEs, because no data has been provided by SFA.

have better technical and management skills as well as identified marketing channels. Medium sized farmers may have the necessary scale of operation to adopt up-to date production and post-production technologies reducing risks and enhancing profitability.

30. Provided there will be no drastic changes in the agricultural policy of the EU, it can be expected that the accession to the EU and resulting application of the Common Agricultural Policy will diminish the vulnerability of producers to market and price related risks. Moreover, direct income transfer payments to farmers de-link farm income from price and demand fluctuations and provide an additional source for loan repayment.

31. ProCredit might consider to service larger farmers as well, at least for an initial period. This could be done at lower risks and transaction costs and might help ProCredit to develop skills and expertise in loan appraisal and market analysis and establish a pool of core clients. However, for larger farmer ProCredit would be in more direct competition with SFA and commercial banks. Interviews and survey results revealed that many large farmers are unsatisfied with the supply of finance and would even accept smaller loan amount if they were accessible at convenient terms. ProCredit would not be able to compete with the interest rates, but by offering quick and unbureaucratic access to loans.

Moreover, larger farmers might be suitable entry points for ProCredit in regions where seasonal crops such as grain and oilseeds prevail (e.g. Dobrich). There is a huge demand for replacement of farm machinery and irrigation equipment, buildings.

3.2 Potential Entry Points for ProCredit Bank into Rural Lending

32. First focus on peri-urban areas, because of:

- Proximity to ProCredit branches and to markets
- Farmers have often other income sources (salary income, trading, etc)

33. As a second stage, consider opening branches or lending outlets in rural areas. Transaction costs are a major impediment for loan access in rural areas. Recruit loan officers from rural areas, who know the idiosyncrasy of the rural population.

34. Offer short terms loans to small farmers, small and medium term loans to medium and larger farmers

35. Use inverse pricing: Short term loans might carry higher interest rates than medium term loans (interest rate elasticity of loan demand increases with longer terms / larger amounts)

36. The future of SFA is unclear. If SFA is converted into a guarantee fund, the scope for ProCredit will increase considerably, especially for medium term loans.

37. ProCredit can learn a lot from the Credit Coops:

- Proximity to clients is important.
- Some initial losses are likely: Institutional learning costs and establishment of a viable client base.
- Long-term relationship with clients can to a certain degree substitute conventional loan collateral.

38. Consider pre-financing of SAPARD grants for medium size farmers. Might be a good entry point for establishing a long-term relationship with high potential clients.

Marketing strategy:

- Emphasise the high hidden costs borrowers normally face when applying to banks loans, due to excessive documentary requirements.
- Develop a loan appraisal method which requires a minimum of formal documentation (on-farm appraisal by trained loan officers)
- Offer multi-purpose short term loans secured with guarantors, or through pledging of moveable assets (as a contrast to directed loan from SFA, disbursed to input suppliers)
- Offer non targeted multi-purpose medium term loans (2-3 years). Loan appraisal should focus on existing repayment capacity and collateral (machinery, insured quality animals, land (in peri-urban areas)). No specific investment appraisal and loan supervision is needed.
- At a second stage, offer medium term loans for specific investment purposes such as irrigation equipment, purchase of livestock, rehabilitation of farm buildings, land purchase, etc.). Loan appraisal should also assess the incremental cash flow resulting from the investment.
- Advertise lower pricing of medium term loans (contrary to other F.I.s in Bulgaria)
- Offer interest rate rebates (or less restrictive collateral requirements) and access to larger amounts with longer repayment terms for repeated borrowers
- Target non-registered farmers who cannot access SFA loans

39. Tax: Income from agricultural production, as well as from rental or lease income are not taxed under the income tax. Transfer of ownership or lease of agricultural land are exempted from the VAT. Agricultural land and forest land and farm buildings used for production purposes are also exempted from municipal real estate taxes. Tax on land sales amounts to 2% of the tax valuation of the land.

40. Following below is the analysis of the promising sectors.

3.3 Potential Sub-Sectors for ProCredit Bank into Rural Lending

3.3.1 Dairy Sector

Summary

41. **Cattle breeding** is popular with small, family-size farmers in combination with other agricultural activities, but there is an increasing number of medium-sized farmers that specialise in animal breeding. This is particularly the case in the regions of Veliko Turnovo and Haskovo.

42. Cattle breeding provides regular daily income for a farmer and a stable market with a relatively low labour input. Smaller farmers transport milk to a common cooling tank in the village provided by the processor, while milk from the larger farms is collected at the farm gate by the processors once a day. Cooling tanks for medium/large size farmers are supplied by processors and repaid in milk. The farmer receives a premium from processors and subsidy from the state for high quality milk.

43. Animals graze on common village pastures which decreases the cost of food in summer months, while in winter they mainly feed on fodder and industrial concentrate.

44. The main weaknesses and threats for farmers include fluctuation in the price of milk and fodder, decrease in price due to low quality because of lack of cooling facilities, adverse weather conditions, poor access to irrigation, lack of storage facilities, livestock diseases and marketing difficulties for farmers producing cheese and yogurt.

45. Major lending opportunities are in providing seasonal working capital for buying the fodder, medicine, insemination and longer-term investments in cooling tanks, equipment for sample testing, refurbishment of buildings, financing production of grains for fodder, buying of agricultural machinery.

Overview of the Sector

46. After the break up of the large co-operative state farms at the beginning of the 1990s and the consequent redistribution of co-operatives' assets, the majority (over 80%) of the milk production (total of 370,000 cows in 2002¹.) has moved to small private farms with herds of less than 10 animals². Cattle breeding is equally spread around the southern region of Bulgaria, but the most promising regions where more commercially-oriented farmers are emerging are the regions of Veliko Turnovo, Haskovo and Plovdiv.

47. Small farms are run as family enterprises without a special focus on commercialisation and growth. Milk is used either for auto-consumption and/or marketed locally in the village. Surpluses are sold at low price to the local processing plant.

48. Farms are characterised by an inferior production processes, technologically primitive breeding methods and a lack of mechanization. During the summer months animals graze on common village pastures, which in most villages is available for use without charge, while during

¹ Agrostistics Department, MoAF.

² Agrostistics Department, MoAF.

the winter months they are fed fodder and industrial concentrates. Animals spend the night inside the buildings. Cows are milked individually twice a day (in the morning and evening) and their milk is then delivered to a common cooling tank, or milk collection point, usually based in one of the producer's house in the village. The tank is emptied once a day by the processor. At the collection point, the average quality is also very poor and the production of one "bad" supplier is enough to contaminate the milk of all other suppliers.

49. All such farms visited suffered from a lack of hygiene standards, and this was recognised as the most urgent need for investment. Furthermore, none of the small farms had any modern equipment or adequate storage facility for the milk.

50. Medium size farms (10-30 cows) account for an increasing proportion of milk production. The number of these specialised farmers has increased over the last five years, particularly in the in regions of Veliko Turnovo and Haskovo. Farmers are usually young families, in some cases former workers of large state-owned co-operatives, with strong technical backgrounds and some agricultural education. In many cases these farmers rent or purchase buildings and machinery from the dismantled cooperatives at a very low price, which provides them with a good start for their future business

51. Medium size farms have the biggest potential for the future as they have a capacity to produce a higher quality of milk providing them with the premium price and subsidies from the state. Some of them also succeeded in moving one step further and "closing" the circle by producing cheese, yogurt and butter which they then market directly, thus allowing them to increase their profits and production.

52. All such farms visited were in much better condition than the small-scale farms and two of them had cooling tanks supplied by the milk processing plant that was being repaid in milk through an off-take agreement. As it can be seen from the financial model which accompanies this annex described below, a typical farm with 20 cows "in milk", is able to earn a substantial cash-flow and repay a cooling tank in one year.

Financial Characteristics

53. Financial returns for the farmers are derived from the following main factors: price of milk, price of fodder, price of meat, productivity, quality and length of off-take contracts with the dairies.

The Price of Milk

54. The average price of milk in the first three quarters of 2003 was 0.28 BGN per litre¹, while the production costs per litre varied, in the regions we visited, throughout the year. During and outside of the active production period, it fetched around 0.22 BGN. High quality milk, increasingly in demand by larger processing plants, obviously carries a higher price. The

¹ Data provided by SAPI.

production of quality milk is further supported by the MoA through a special subsidy scheme¹ providing additional premium for the farmer.

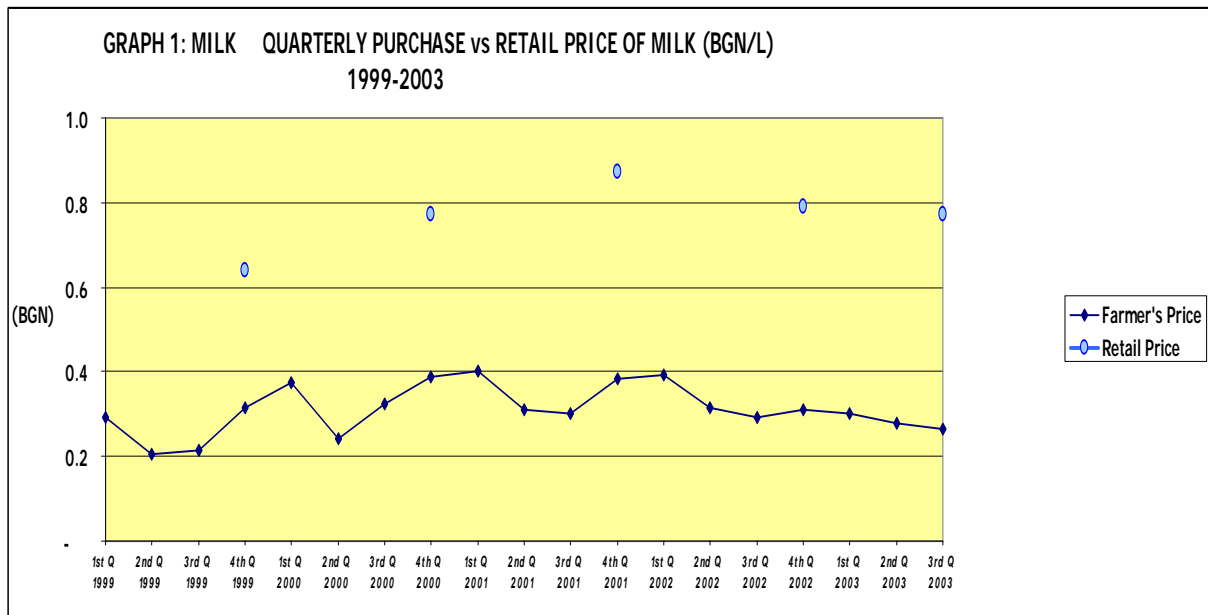
55. The farmer's profits are increased by the direct marketing of some of the milk and derived products locally. In that way the farmer obtains retail price for the goods.

56. Graph 1 below illustrates quarterly fluctuations in the purchase and retail price of milk over the last four years. Purchase price was characterised with an increase in first quarter of the year and sharp fall in second quarter. This trend reflects seasonal production characteristics explained by the highest supply and cheaper production in second and third quarters of the year. During this period (outdoor grazing period), the feeding of animals is much cheaper and production and supply of raw milk are at their highest. During the winter season, animals are fodder-fed which is more expensive, and kept inside, resulting in the lower supply and higher prices of raw milk.

57. At the same time, the retail price has developed a relative upward trend over the last three years climbing from 0.6 BGN in 2000 to 0.8 BGN in 2003. The reason for the increase most probably lies in the fact that the largest players in the processing market offer a variety of products to the final consumer, charging the higher margin. The effect is not transferred at the producers' level.

¹ In order to avoid the drastic drop of raw milk purchase prices during the second and third quarters of the year, when the seasonal productivity and supply of raw milk is at its highest, the Ministry of Agriculture and Forestry provides a premium for produced high-quality cow milk. They provided subsidy amounted to 10% of the basic raw cow milk purchase, paid to any registered milk producer, who has executed a contract for purchasing his milk by a milk-collection center or a milk-processing plant. A compulsory condition for providing the subsidy is for the handed-over milk to be of high quality (extra and first quality) and to comply with the provisions of Regulation No. 30 of the Ministry of Agriculture and Forestry dated 20.11.2000 concerning the veterinary, sanitary, and hygiene requirements on raw milk production, the establishment and operations of milk-processing plants, production and sales of thermally-treated milk and dairy products.

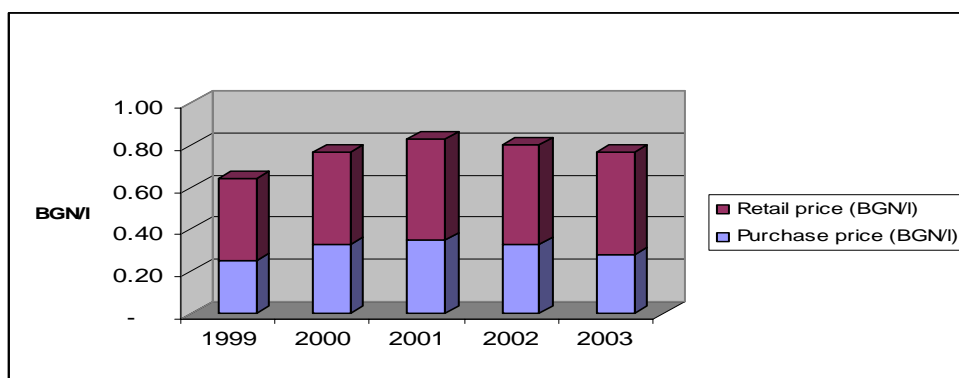
The subsidy is to be provided for the 01.04. – 31.09. period of the respective year, with its total value capped for each year (for 2002 subsidy was amounting to 2.3 million BGN). The subsidy is to be provided to any and all real persons, including individually owned private companies, and legal entities, who have been registered as agricultural producers at the regional departments of the MAF, who do not have any liabilities to the State Fund Agriculture, and who have executed a contract with a milk-processing company. The farmers are expected to supply the produced at their farm milk only to milk-collection centers, which are licensed by the State Veterinary and Sanitary Control Department, and from which they are supposed to receive an original invoice and two copies (or two paid cash orders), certified by an original stamp and a document (protocol, issued by a laboratory of the State Veterinary and Sanitary Control Department) to certify the quality of the milk. In order to apply for the subsidy, the farmers are not required to be members of any branch association.



PREPARED WITH DATA FROM: SAPI, MoA, FAO

58. Further evidence of the unfavourable position of the primary producer dependant on sale of milk at the set prices is in Table 1 and Graph 2 below, where the off-take price paid to the farmer is illustrated as a percentage of retail prices. The average share has been decreasing in the last few years and currently stands at around 40%. However, with the improvement of milk quality, especially by medium seized farmers and EU accession, this share will most probably increase. In the other EU countries this share varies within the range of 55% to 60%¹.

Graph 2: Relative Share of Farmer's Price in the Retail Price of Milk



¹ MoAF, Situation and outlook report of milk, 2002.

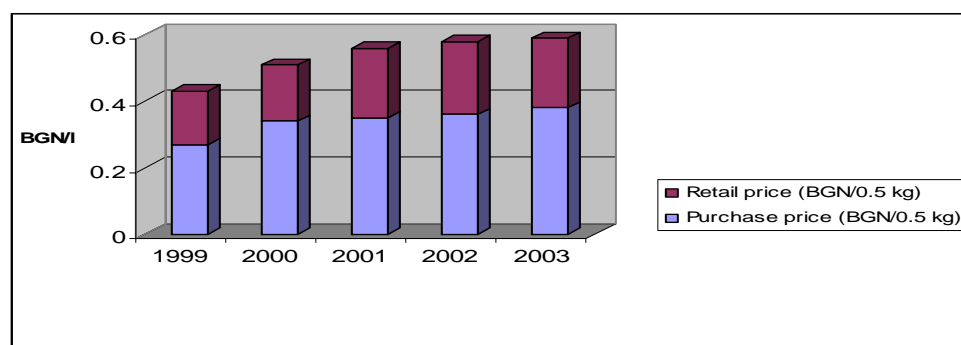
Table 1: Relative Share of Farmer's Price in Retail Price of Milk and Yogurt, Cheese and Butter

	1999	2000	2001	2002	2003
MILK					
Purchase price (BGN/l)	0.26	0.33	0.35	0.33	0.28
Retail price (BGN/l)	0.64	0.77	0.83	0.8	0.8
Farmer's Share (%)	40%	43%	42%	41%	37%
YOGURT					
Purchase price (BGN/0.5 kg)	0.27	0.34	0.35	0.36	0.4
Retail price (BGN/0.5 kg)	0.43	0.51	0.56	0.58	0.6
Farmer's Share (%)	63%	67%	63%	62%	64%
WHITE CHEESE					
Purchase price (BGN/kg)	1.81	2.30	2.27	2.31	2.41
Retail price (BGN/kg)	3.23	3.66	3.57	3.61	3.7
Farmer's Share (%)	56%	63%	64%	64%	65%
BUTTER					
Purchase price (BGN/kg)	-	-	-	-	-
Retail price (BGN/kg)	5.26	6.4	6.52	4.67	4.7
Farmer's Share (%)	51%	53%	54%	54%	54%

Source: SAPI, MoA

59. For the smaller farmers who are interested in exploring the local market, “closing the cycle” of production by producing yogurt, cheese and butter for the local wholesale and retail “open” markets would be the best solution for obtaining higher profits. The share of the farmer in the retail prices of these products is much higher than that is the case with raw milk (graph below).

Graph 3: Relative Share of Farmer's Price in the Retail Price of Yogurt



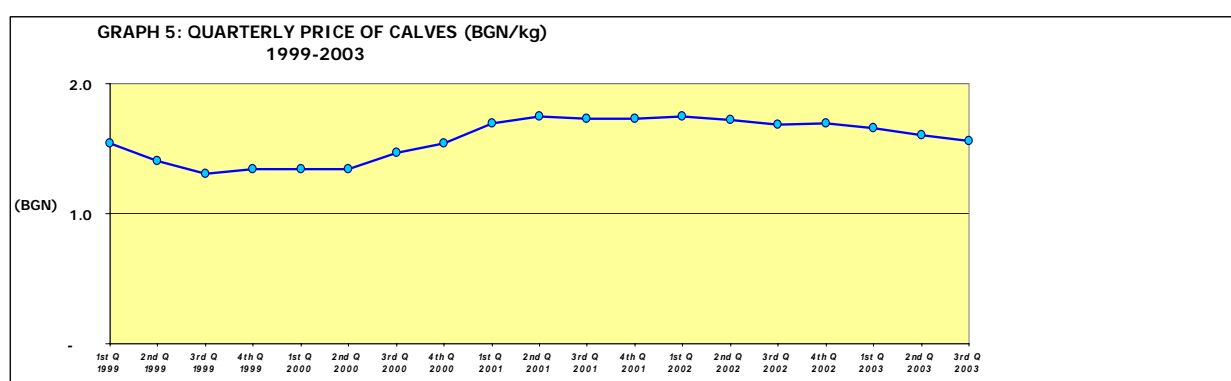
Source: Sapi, MoA.

The Price of Meat

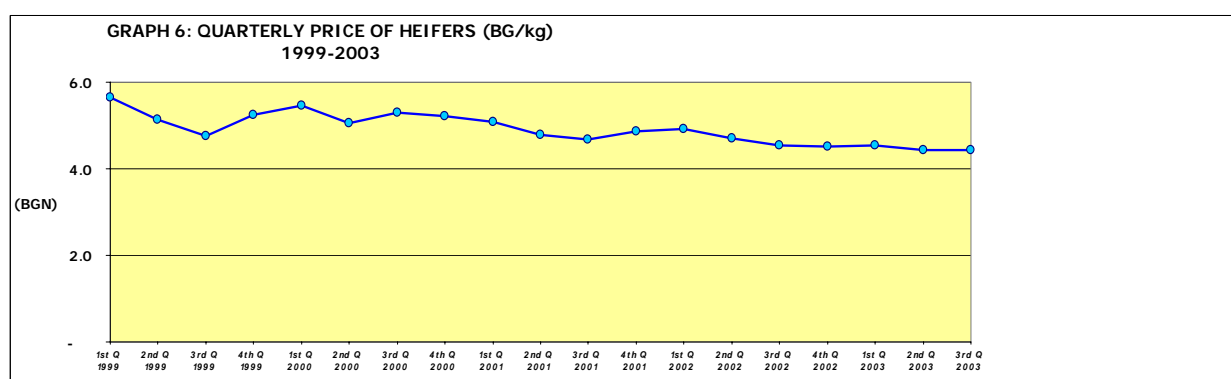
60. Further income received by the farmer is from sale of heifers and calves. Smaller farmers sell young animals once or twice a year, while medium-sized farms with a large number

of animals sell them more regularly as they are bred to a certain age. This is an important income for a farmer, as the extra money earned allows for extraordinary investments in the repayment of loans.

61. Prices of calves and heifers over the last four years are fairly stable and represent a sound regular income for the farmer, as it can be seen from the graphs below.



PREPARED WITH DATA FROM: SAPI, MoA, FAO.



PREPARED WITH DATA FROM: SAPI, MoA, FAO.

Fodder

62. Main expenditure for the farmer is fodder grain used for animal feed in the winter months. Approximately 60% to 70% of the costs for feed comprise of the production costs of raw milk. The other expenditures include veterinary costs, insemination costs, transport and larger periodical expenses like construction and refurbishment of sheds for animals, cooling facilities for milk, machinery for own production and fodder feed.

Recommendations for Financing

63. As mentioned in the financing section above, in the case of those dairy farms visited during the assignment, investments should focus on increasing the productivity and quality of milk produced. This would allow for further improvements in cash flows and longer term off-take contracts with major dairies at premium prices. In order to reach this productivity level,

investments in upgrading of the building infrastructure (air conditioning, heating), replacement of outdated milking equipment and milk cooling facilities and the purchase of animals are the longer term investments. Working capital is needed for regular purchase of fodder, medicine and transport.

64. Smaller farmers would see the most potential and increase in profits in closing the production circle by diversifying to cheese, yogurt and butter and developing direct linkages with the market. As analyzed above, these products bear higher margin than raw milk which is more sensitive to price fluctuations and exposed to speculation by small dairies operating in the market. Investment could include cooling facilities and other necessary equipment, as well as working capital for the expenses mentioned previously.

Financial Model of a Dairy Farm

65. The financial model accompanying this section is attached in electronic form to the report. The model looks at a one-year production cycle of a farm/orchard. The following assumptions are made: The farm is an on-going entity, rather than as a start-up; Input prices used are prices supplied by SAPI agency for the period Sep 2002 – Aug 2003; Sensitivity analysis can be performed by changing input data (number of animals, prices of milk and fodder).

66. In the case presented (20 cows “in milk”, 20 heifers and 10 calves), it is possible to see that there is substantial free cash available for potential repayment of a commercial bank loan. For example, it is possible to repay a cooling tank in one year. In the case that the number of animals is half the number than the one presented in the model, time for the repayment of cooling tank increases to 2 years. The seasonality of monthly cash flow generation (due to the fluctuations of milk production) could be addressed through semi-annual instalments.

3.3.2 Vegetable Sector

Summary

67. Vegetable and fruit growing is traditional for most of the regions, but most advanced in terms of production and marketing are Plovdiv and Haskovo. Although vegetable and fruit is predominantly produced on small farms, emerging commercially oriented farmers running medium-sized farms would offer the best potential clients for ProCredit. Especially considering that this new breed of farmers are usually the new generation – well educated and forward looking.

68. The main weaknesses and threats in the sector include seasonal fluctuation in price, adverse weather conditions, poor access to irrigation, lack of storage facilities, diseases and marketing difficulties.

69. Major lending opportunities are with financing the inputs (seedlings, fertilisers, herbicides, etc) by providing short term working capital through the year and with longer-term investments in investment storage facilities for fruit, dripping irrigation systems and greenhouses

for vegetables and berries. For more advanced, larger producers freezing facilities and packaging equipment might also be a recommended option.

Overview

70. Vegetable and fruit is mainly grown on small, family-sized farms (around 70%¹), although there is an emerging number of larger, commercially-oriented farmers with some training in agriculture, particularly interested in greenhouse vegetable and orchard growing. This is particularly evident in Plovdiv region, where the tradition in vegetable growing is developed and market linkages (with agro processing industry like vegetable canning and juice producers) are an added advantage.

71. Among the main crops produced are tomatoes, pepper, potatoes and beans, while main fruit orchards produce apples, pears, peaches, plums, apricots and different berries.

Prices

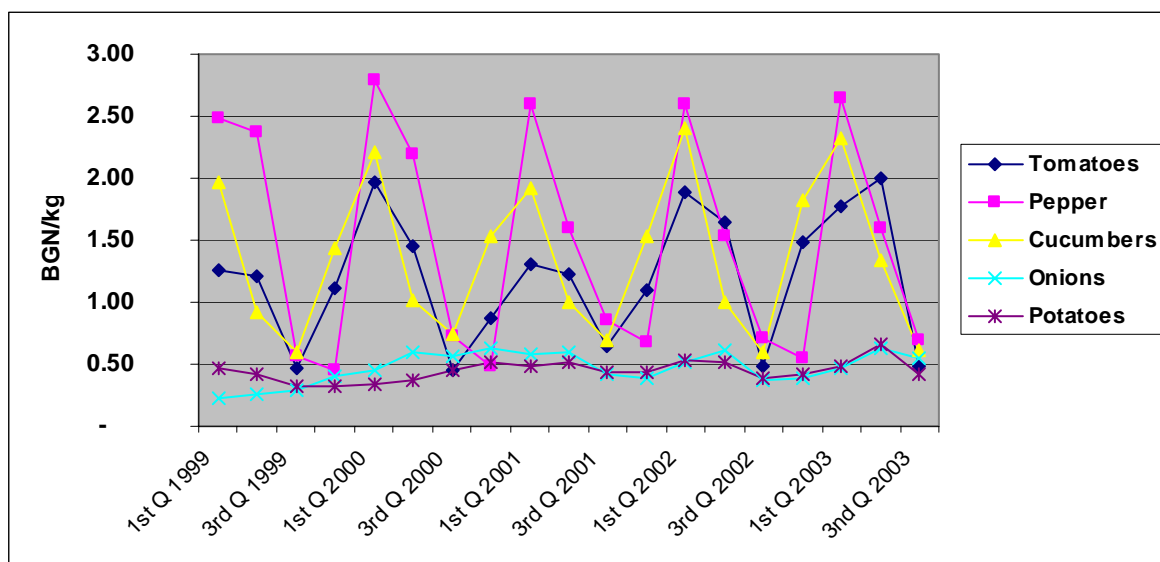
72. The main obstacle facing vegetable producers are the fluctuating market prices of most common perishable vegetables. Prices are at their lowest level in the third quarter of the year, but increase up to five times in the first two quarters of the year. The main reason for this fluctuation is oversupply in the harvest time and non-existence of adequate storage facilities for producers. Produce which does not require special conditions for storage, like onions and potatoes, have much more stable prices year-round.

73. The only possibility for mitigating these fluctuations and earning higher profits in the first half of year is for the producers who are using greenhouses and have adequate storage facilities. These producers are able to have income from as early as May and store some of the harvest after the harvest period, that is September / first half of October. As mentioned in the opening paragraph, there are a large number of new producers emerging in this field in Plovdiv and Haskovo region.

74. The table and graph below illustrate these fluctuations and highlight the recent history of prices of the most traded vegetables.

¹ National Agricultural Advisory Service.

Graph 1: Historic Quarterly Prices of Vegetables for Period 1999-2003



Source: Graph constructed on the basis of data provided by SAPI

Table 1: Historic Quarterly Prices for Main Vegetables

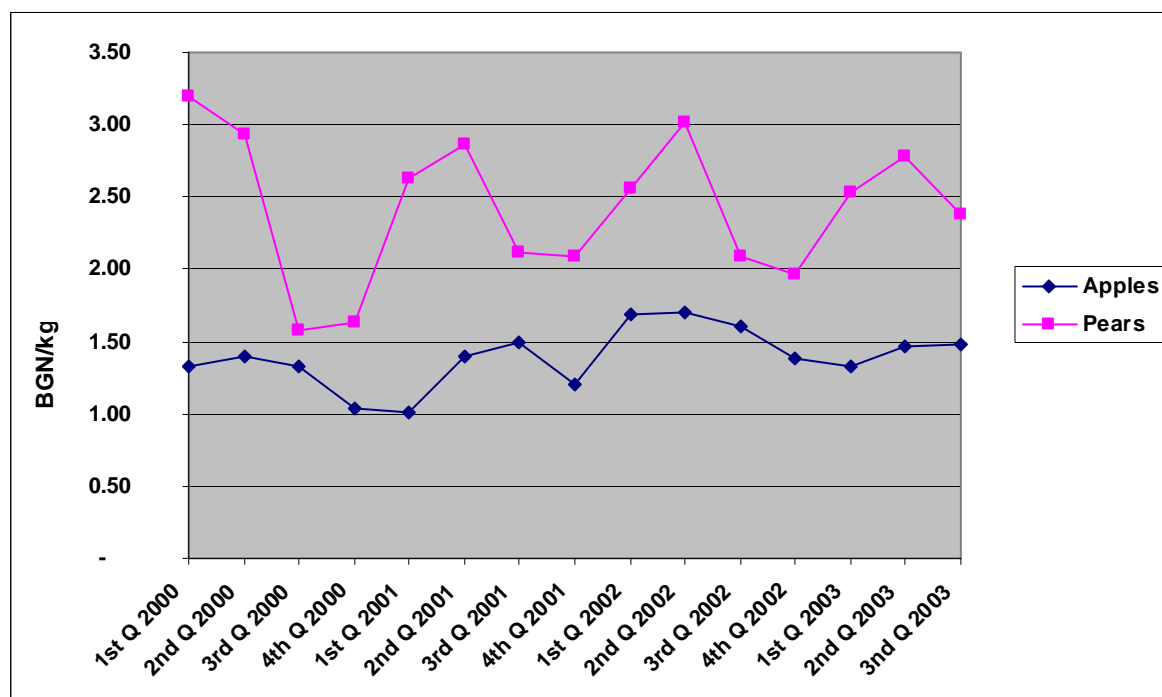
VEGETABLES	2002				2003		
	1st Q	2nd Q	3rd Q	4th Q	1st Q	2nd Q	3rd Q
Tomatoes	1.88	1.64	0.48	1.48	1.78	1.99	0.49
Pepper	2.60	1.54	0.71	0.55	2.65	N/A	N/A
Cucumbers	2.40	1.00	0.59	1.82	2.33	1.34	0.62
Onions	0.51	0.61	0.37	0.38	0.47	0.63	0.55
Potatoes	0.54	0.51	0.38	0.42	0.48	0.65	0.43

Source: SAPI

75. Orchard growing is dominated by apples, pears, peaches and apricots, but there is an emerging trend of farmers growing strawberries and other berries.

76. Fluctuation of prices is similar to those of vegetables (Graph 2 below). Price change is even more dramatic for berries. Higher profits are made in the months before the mass harvest for supply coming from last years' harvest of fruit which was stored in cooling facilities (apples, pears) and early produce coming from the greenhouses (different berries).

Graph 2: Historic Quarterly Prices of Apples and Pears for Period 2000-2003



Source: Graph constructed on the basis of data provided by SAPI

Financing Needs of Farmers

77. The financial needs of producers are spread throughout the year. Financing is required for land preparation and fertilisation in October and for seeds in February. From March to May there is intense work involving the production of seedlings, the application of fertilisers and insecticides. Spraying of fruit is a large expense from March to September. High labour costs are related to the harvesting period in September and the first half of October.

78. Irrigation is one the major obstacles, especially for spring and summer months. Although almost one third of total agricultural land in Bulgaria was supplied by an irrigation system in 1998 (table 2 below), only a small percentage is still in use today¹. Plovdiv has the highest percentage of land under irrigation systems, of which around 10% still functions. This is one more reason why the price of agricultural land in that region is much higher than in other regions.

79. At the places where irrigation infrastructure is in place and functioning, the amount of water used for each hectare of irrigated land is around 2,000 cubic metres/year². This is a high expense for the farmers.

80. The majority of family-size farms rely on gravity irrigation or use ground water (wells) or river water. In times of drought they face a rise in water costs which they are ill

¹ Oko Inc Report on Agricultural Water Management Policies in CEE.

² Oko Inc Report on Agricultural Water Management Policies in CEE.

equipped to bear, even with the help of state water subsidies (50%). Concerns were aired among farmers visited about the Government's decision to abolish such subsidies from 2004 onwards; a decision that will force them to decrease the area of irrigated crops they have under cultivation.

81. Among the larger, specialised farmers, drip irrigation is popular and in increasing demand, although it requires high investment and maintenance costs.

Table 2: Specific Indices Relating to Irrigation, 1995-1998 ('000 ha)

Designation	1995	1996	1997	1998
Area equipped for irrigation	673	636	636	582
Share of total agricultural area (%)	70	71.1	71	65
Actually irrigated land	42	103	43	42
Share of total agricultural area (%)	4.4	11.5	4.8	4.7
Total agricultural area	961	894	894	889

Source: Oko Inc Report on Agricultural Water Management Policies in CEE

Marketing

82. Linkages with the processing plants producing canned vegetables and fruit juices is for the smaller farmers mainly through the traders, while an increasing number of larger farmers have contractual arrangements. More independence and possibility to obtain higher profits for smaller farmers is to be found in marketing their products through the informal wholesale and retail trading places.

EU Accession

83. In light of the EU accession, legislation related to quality control and food standards of fresh fruit and vegetables is being harmonised with the EU legislation. An administrative structure was installed in April 2001 to carry out compliance checks, quality control on fresh fruit and vegetables and oversee harmonisation with EU legislation. Since July 2001, an ordinance has been in place governing recognition of producer organisations and individual producers.

Investment Opportunities

84. The major investment opportunities for ProCredit are specifically related to financing of storage facilities for fruit, dripping irrigation systems and greenhouses for vegetables and berries. For advanced larger producers, freezing facilities and packaging equipment might be a profitable investment.

85. Working capital is needed throughout the year – starting from February with investments in seeds and seedlings, from March to May expenses for rented machinery, fertilisers and herbicides and spraying. In summer months for irrigation and in harvest season for labour. Last expense is land preparation for the next season at the end of harvest in October.

Financial Model of an Apple Orchard

86. The financial model is aimed at a one-year production cycle of an apple orchard. It is assumed that the orchard is yielding and provides regular income for a farmer. Costs and prices of apples for the last 12 months are average prices supplied by SAPI.

87. The model shows that the main income for the farmer is in summer/harvest months, so repayment of loans should be geared towards that period.

3.3.3 Pork Meat Sector

Summary

88. Pork breeding is carried out by a range of farmers, starting from subsistence farmers who have one or two pig mothers together with other agricultural activities to specialised commercial farmers producing for the market with up to 50 pig mothers. Pork production provides for 50% of total meat production. Regionally, pig breeding is widespread along the country, with a large number of medium-size farmers with a potential market linkages in regions of Plovdiv and Haskovo.

89. Mother pigs have litters twice yearly, on average nine pigs per litter survive and stay on the farm to be fattened to approx 110 kg. Fattened pigs are sold to traders and local slaughterhouses if raised commercially, or to neighbours in the village if raised on subsistence farms in small quantities. The highest demand for pork is in winter season, lowest in summer months. On a monthly basis, demand is higher at the end of the month when consumers receive their salaries. Prices fluctuate accordingly. Production costs are between 70% and 90%, depending on input prices. According to the Hog cycle, prices are expected to increase in the next period.

90. The main weaknesses and threats for farmers include fluctuation in price of meat and fodder, diseases, and marketing difficulties with traders.

91. Major lending opportunities are in providing seasonal working capital for buying the fodder after the harvest, purchase of animals, medicine and insemination material, while longer-term investment needs are in the building of storage facilities and mills for fodder, refurbishment of buildings and purchasing agricultural machinery.

Overview of the Sector

92. Pork production is of high importance for the meat sector. It accounts for over 50%¹ of the total meat production in the country. Although most commercially produced pork comes from large farms, there is an increasing number of medium-size farms who are marketing their products successfully and managing growth of their small businesses in a sustainable way. Trend towards the commercialisation of smaller and medium-sized farms has been developing over the last two years. A large number of these farms are in Plovdiv and Haskovo regions.

¹ USDA GAIN Report on Grain and Feed, May 2003.

93. Medium-size producers have 10 to 20 mother pigs and run their farm as family businesses. Most farms use only family labour and one or two workers which are not employed on a permanent basis. Fattened pigs are sold at the weight of 110 kg.

94. Some of the farmers have self-sustainable fodder production, while others face the cyclicity of fodder prices which makes them more exposed to market uncertainties.

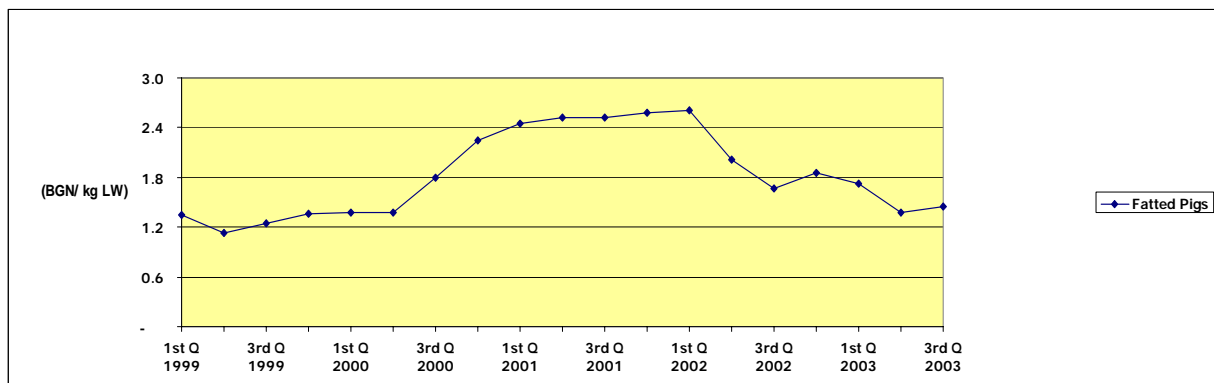
Financial Characteristics

95. Financial returns are derived from the price of meat at the market, price of fodder, weather conditions and off-take contacts with traders and slaughterhouses.

Price of Meat

96. In general, the highest demand for pork is in winter season, lowest in summer. On a monthly basis, consumption/demand for pork is highest at the end of the month when consumers receive their salaries, and fades away towards the middle of the month. On a yearly basis, as the graph shows, prices have a cyclical nature. This cyclicity can be explained by the 'Hog cycle' theory¹. Every four years the hog price cycle and the seasonal price pattern both bottom in the late fall. Hog prices were low in 1998/99, peaked in 2001 and, again, cyclically and seasonally bottomed in 2002. Changes in the cycle are additionally caused by fluctuations in fodder prices, as discussed below.

Graph 1: Quarterly Prices of Fattened Pigs (BGN/kg LW) 1999-2003



Source: Price data provided by SAPI.

97. As the graph shows, in the 2nd Q of 2001, when the cycle peaked, prices were on average 40% higher than the same period in 2000 and 60% higher than in 1999. The average price for 2001 was between 2.44 BGN/ kg LW to 2.52 BGN/ kg LW. Farm purchased price in that

¹ Hog prices and production continue to follow the distinct cyclical and seasonal patterns that have been characteristic of the industry for many years. The four-year hog price cycle results from prices increasing for two years and then decreasing for two years. Pork production cycles are opposite of price cycles and decline for two years and then increase for two years. Seasonal price and production patterns are also opposite to each other move in opposite directions?. Production is high and prices low in the spring, production is low and prices seasonally high in mid-summer, and production is again high in the late fall with usually the lowest prices of the year occurring at the same time.

period was on average 30% higher than production cost¹. Production costs varies between 70% and 90%, depending on input prices and regions.² According to the Hog cycle, prices are expected to increase in the next period.

Price of Fodder

98. About 70% of pork production cost is for feed expenses. Fodder grain prices follow a characteristic seasonal development trend, being lower at the time of crop collection (the second half of the year) and higher during the months preceding the new crops (the first half of the year). The table below presents the prices of three main fodder crops for 2001 and 2002, and their relation to the price of meat (in kgs). The average feed conversation rate is 3.20- 3.70 kilos of feed for a kilo of growth³.

Table 1: Prices of Three Main Fodder Crops in Relation to Price of Fattened Pig

	2001				2002			
	I	II	III	IV	I	II	III	IV
BARELY								
Fattened pigs (BGN/kg LW)	2.45	2.53	2.53	2.59	2.61	2.01	1.67	1.85
Barley (BGN/kg)	0.21	0.21	0.16	0.17	0.17	0.16	0.12	0.13
RELATION	12	12	16	16	16	12	14	14
MAIZE								
Fattened pigs (BGN/kg LW)	2.45	2.53	2.53	2.59	2.61	2.01	1.67	1.85
Maize (BGN/kg)	0.25	0.26	0.23	0.21	0.20	0.20	0.20	0.17
RELATION	10	10	11	12	13	10	8	11
WHEAT								
Fattened pigs (BGN/kg LW)	2.45	2.53	2.53	2.59	2.61	2.01	1.67	1.85
Wheat (BGN/kg)	0.24	0.24	0.18	0.18	0.18	0.17	0.13	0.15
RELATION	10	10	14	14	15	12	12	12

Source: Data provided by SAPI

99. Price of fodder is strongly influenced by weather changes and droughts in 2001 and 2002 which caused the prices to be higher than expected. This was a particular problem for smaller producers in non-grain growing regions.

Other Costs of Production

100. The other elements in production formula include labour costs (accounts from 12-15% on average), veterinary services (up to 5%) and electricity, water and transportation (up to 15%). In cases when pork farms have their own grain and feed mill production, profitability can reach 35 percent.

101. Most medium size farmers sell the fattened pigs through the traders, but some have direct contract with the processing industry.

¹ USDA GAIN Report on Livestock and Products, 2002.

² Information on production costs obtained from different sources had a discrepancy of up to 25% for the same period.

³ MoAF, Situation and Outlook Report of Meat, October 2002.

Recommendations for Financing

102. Working capital for supply of fodder when the price of fodder is low after the harvest, purchasing of mother pigs, medicine and covering expenses of insemination, Longer term needs are in purchasing small mills and production of own fodder, refurbishment of buildings and purchasing of agricultural machinery.

Financial Model of a Pig Farm

103. The model accompanying this section looks at one year production cycle of a pig farm. The following assumptions were made: The farm has been an on-going entity for at least two years, rather than as a start-up; In the base case scenario there are 20 mother pigs and approximately 90 pigs for fattening, of which every month 30 fattened pigs are sold at 100 kg (taken into consideration yearly cycle); Input prices used for the period Sep 2002 – Aug 2003 (price of pigs, fodder) were supplied by SAPI (MoA) and NAAS; Building premises are rented (usual agreement for the livestock building is 10 years), as was the most often observed case in farms visited;; Other costs (veterinary, electricity, water costs) are estimated on the basis of interviews with farmers and background information received from NAAS and MoA.

104. In the base case scenario, there is substantial free cash available for the potential repayment of a commercial bank loan on a monthly basis. Available CF is higher in the second half of the year with a peak in December, when a demand for meat is higher and prices of fodder lower. The first two quarters of the year show lower profits/free cash due to the suppressed demand and higher prices of grain. CF is lowest in summer because of a low demand.

105. Sensitivity analysis can be conducted by changing the price of fodder, number of animals and prices of meat.

3.3.4 Wine and Vine Sector

Summary

106. From the regions visited, vine growing is present in areas around Haskovo and Assenovgrad. In the past, wine was produced by the co-operatives, but these vineyards are now dying out. There is an increasing number of individual farmers who emerged after the land restitution in the last ten years. They planted new vineyards with more profitable sorts of vines and their performances are much better than those of still existing co-operatives. Market opportunities for them are available due to high demand from the wine industry and the fact that more than 70% of existing vineyards are aged 20 years or more.

107. Vine growing is a long-term investment, with the first harvest arriving only seven years after vine seedlings have been planted. Initial investments involve costs of land purchase, cultivation and planting of seedlings. Once the vineyard starts to yield, main expenses for the grower include intensive labour cost during spring time when trimming, fertilisation and land cultivation takes place. There are sprayings and water irrigating expenses in early summer and extensive labour use during the harvest time.

108. The greatest threat for the farmer is the risk of diseases that often causes a drastic reduction in the harvest. Another threat is price fixing by the wine producers. As grapes cannot be stored without being processed and have to be sold in a very short period of time, this threat is not resolvable at an individual level. There are no functioning working associations of grape growers in these regions to protect their interests and mitigate this threat.

109. Major financial need is for working capital to cover spraying, watering and labour costs during the yielding period and term lending with a substantial grace period during the first seven years when there is no income received.

Overview of the Sector

110. Bulgaria has a long history of vine cultivation and wine production. Among the Eastern European countries, it has had strong reputation of producing and exporting quality wines to the western European markets.

111. The total area covered by vineyards in 2003 is somewhere between 96,000 ha and 110,000 ha¹. It is estimated that commercially cultivated vineyards totalled 71,500 ha (both table and wine grapes), while the balance is cultivated for non-commercial purposes.

112. During the privatisation in 1990s wine making and grape production was separated which resulted in fragmented holdings and loss of important vineyards. Land restitution which followed, divided large plots of vineyards among numerous farmers, resulting in privately owned vineyards with an average surface area of around 0.3 ha per farmer².

113. However, a small number of the new-comers in the sector have planted new vineyards with more profitable sorts of vines and their performance assures them increasing percentage in the production market. These individual farmers represent a new driving force with a greatest potential among the wine growers. Provided that they have consolidated enough land, their crop performance is very competitive and market linkages well developed.

114. In the last two years there is also a trend towards reorganisation of redistributed land and the formation of new farming structures revolving around these groups of individual farmers. This implies that the land can be sold, leased and consolidated into viable units.

Financial Characteristics

115. Financial returns for the farmers are dependent on price of grapes, prevalence of diseases, weather conditions, availability of water for irrigation and productivity. Initial costs for the establishment of a vineyard are the highest, involving land purchase, cultivation, purchase and planting of seedlings and close supervision in the first period of growing.

Price of Grapes

116. The price of grapes is fixed by the major wine producers. As grapes cannot be stored without being processed and have to be sold in a very short period of time, grape growers are fully

¹ MoAF, Wine Outlook Report, 2002.

² Investing in vineyards in Bulgaria, FAO, 1998.

dependent on prices dictated by the processors. Although demand is higher than supply, lack of functioning working associations of grape growers protecting their interests is leaving winegrowers exposed.

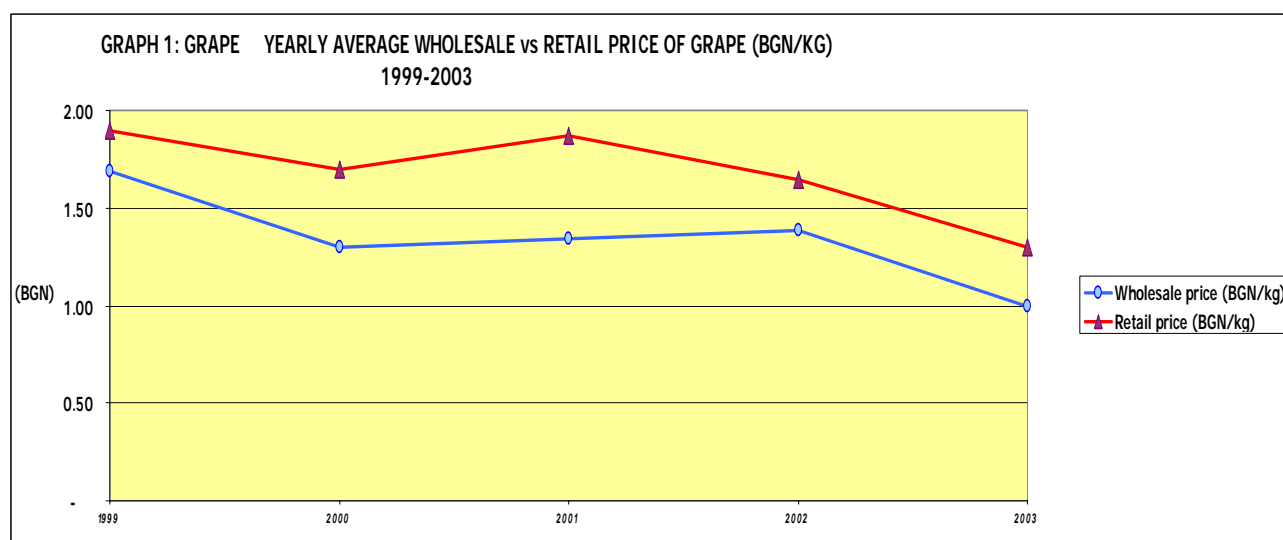
117. Prices of grapes fluctuated between 1.20 and 1.40 BGN/kg in the last three years¹. The highest prices achieved were for varieties which were destined for export wine - red varieties - Merlot and Cabernet Sauvignon; and white varieties - Chardonnay and Sauvignon Blanc, while the remaining varieties maintained lower prices.

Table 1: Average Prices of Grapes 1999-2003

GRAPES (average price)	1999	2000	2001	2002	2003*
Wholesale price (BGN/kg)	1.69	1.30	1.34	1.38	1.20
Retail price (BGN/kg)	1.90	1.7	1.87	1.65	1.5

*estimate

Source: SAPI



Graph prepared on the basis of data provided by SAPI.

118. Average yields in 2001 varied between 2.7 and 4.2 tons per ha. Since 1992 average yields have been fluctuating between 2 and 5 tons per ha², depending on the area, age of vines and technology of winegrowers and annual climatic conditions. Higher yields are achieved by the smaller individual winegrowers mentioned above. For a comparison, average yields in Italy and France are between 8 and 9 tons per ha. 403,000 tons of grapes collected were used for the production of wines and other products, and 30,500 tons were destined for direct consumption³.

¹ SAPI.

² MoAF, Wine Outlook Report, 2002.

³ MoAF, Wine Outlook Report, 2002.

Other Costs of Production

119. Other major costs include labour costs for land cultivation, trimming, fertilisation and harvest during the yielding years. During the year of vineyard establishment, major expenses are related to the planting of seedlings, land cultivation and fertilisation. Constant costs are also spraying material, water and transportation.

120. Support to the industry is coming from the government, which listed vine-growing and wine producing among the priority for the agribusiness sector in light of the EU accession. In that light several new laws have been adopted in 1999 and 2000, as well as a national strategy for the development of vine growing and wine producing which supports the stronger role of wine-growing associations. This will give more power and lobbying strength to these associations in breaking wine-producer's price fixing.

Recommendations for Financing

121. Major financial need is for working capital to cover spraying, watering and labour costs during the yielding period and term lending with a substantial grace period during the first seven years when there is no income received.

Other References:

Nikolova, Kalinka, (2002)
Finding Farmers, Country Survey: Bulgaria
Centre for Central and Eastern European Studies, University of Liverpool, Working Paper No. 54

Ministry of Agriculture and Forestry (MAF), June 2001:
Structures des Exploitations Agricoles en Bulgarie, campagne agricole 1999/2000 (available only in French and in Bulgarian)

BULGARIA

EXPANDING PROCREDIT'S OPERATIONS IN RURAL AREAS

ANNEX 2

THE SUPPLY MARKET FOR AGRICULTURAL CREDIT

ANNEX 2

THE SUPPLY MARKET FOR AGRICULTURAL CREDIT

TABLE OF CONTENTS

1.1 Key Features of the Bulgarian Financial System.....	1
1.2. Formal Suppliers of Financial Services	2
1.3. Recent Improvements of the Supply Market for Loans.....	4
2. The Suppliers of Agricultural Finance.....	5
2.1. State Fund for Agriculture.....	6
2.1.1 SFA Loan Programmes and Subsidies for 2003	7
2.1.2 Lending Terms and Conditions	8
2.1.3 Outreach of SFA in 2000/2001	9
2.1.4 Implications for ProCredit Bank	10
2.2 SAPARD	10
2.2.1 The Implementation of SAPARD's until end of 2002.....	11
2.2.2 Relevance for ProCredit Bank	13
2.3 The Private Mutual Rural Credit Associations (PMRCAs).....	14
2.4 Job Opportunities through Business Support Project (JOBS).....	15
3. Cross-Cutting Issues: The Use of Rural Assets as Collateral	15
Leasing.....	17
The farmers' Perception of the Existing Sources of Finance	18

APPENDICES:

Appendix 1:	SFA investment credit lines for 2003
Appendix 2:	Funded investment projects under SFA schemes for 2000 and 2001
Appendix 3:	General documents required for applications for SFA loans
Appendix 4:	Specific documentary requirements for SFA loans
Appendix 5:	Collateral requirements for SFA
Appendix 6:	SFA: Approved and completed projects in 2002
Appendix 7:	SFA: Measure "Improving the processing and marketing of agricultural and fishery products"
Appendix 8:	SFA: Measure "Development and diversification of economic activities"

ANNEX 2

THE SUPPLY MARKET FOR AGRICULTURAL CREDIT

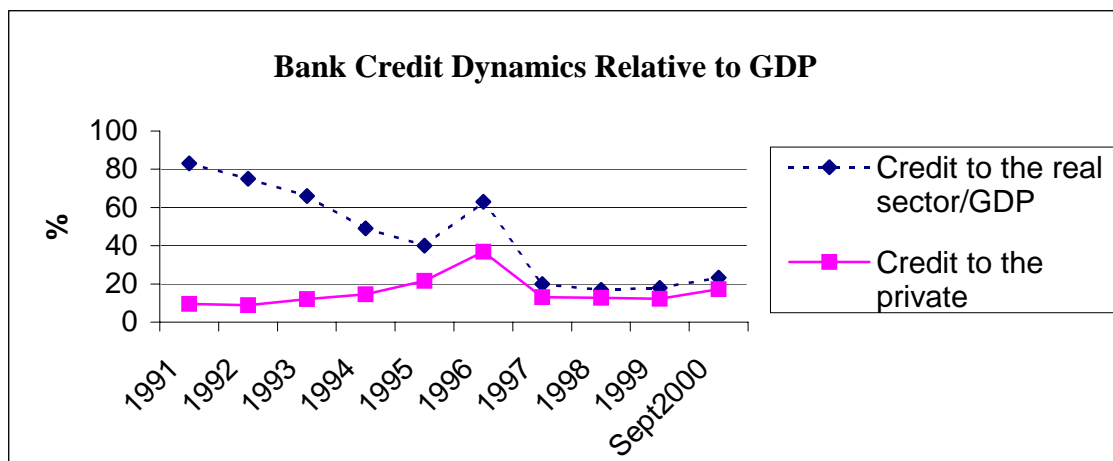
1.1 Key Features of the Bulgarian Financial System

1. In 1996-97, Bulgaria experienced a severe banking crisis accompanied by high inflation rates and a strong devaluation of the Bulgarian Leva (“BGN”). The crisis induced important policy and legal reforms aimed at ensuring a sound macro-economic environment and re-establishing confidence in the financial system. A currency board was introduced pegging the BGN to the German mark. Sound macro-economic management has brought down inflation and interest rates (Table 2 below) and improved the business environment in general.

2. Financial sector reforms were a necessary pre-condition to restore confidence in the banking system and enable deepening of financial intermediation. Many banks were closed and most state owned banks were privatised. A new banking law was enacted which foresees tighter prudential regulation¹ in order to ensure security and solvency of the banking system. Moreover, on-site and off-site supervision has been enhanced since 1997 contributing to improved compliance with prudential regulations.

3. Despite these positive features, the legacies of the banking crisis still influence the current status of Bulgaria’s financial system. This is mirrored in low degrees of financial intermediation, conservative lending policies of banks and restrictive collateral requirements. The total Domestic Credit to GDP Ratio dropped from 67% in 1995 to 18% at the end of 2000 (see Table 1). Though credit to the private sector has been increasing in absolute and relative terms reaching 14,5% at the end of 2000, it is still lagging behind private sector growth.

Table 1: Credit to the Real Sector and to Private Enterprises in Relation to GDP



Source: Yonkova, IME, based on BNB data

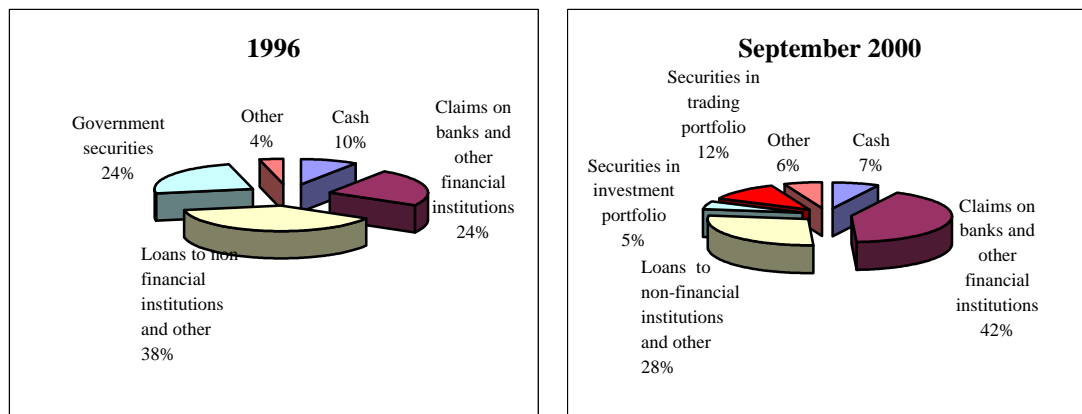
¹ Tight prudential regulations were introduced amongst others for risk weighted capital adequacy and minimum reserve requirements, large loan exposures and aggregate exposures to a single party.

4. Deposit to GDP ratio remains around 21%, indicating that the confidence of depositors in the banking system has not yet been fully restored. However, deposits constitute the major funding source for commercial banks, accounting for 80% of total bank liabilities in 2000. However, most deposits are short term limiting the ability of banks to provide medium- and long-term loans. In fact, most commercial banks only offer short to medium term loans with maturities from 1 -3 years. Under the currency board arrangement, the role of BNB as lender of last resort has been limited to exceptional situations so that central bank re-financing is usually not available to banks¹. The inter-banking market has become an important source of funds. Recently, interbank interest rates have become a nominal anchor in defining interest rate levels for the majority of banks. The stricter banking supervision and the minimum reserve requirements under the currency board have increased the confidence amongst commercial banks.

1.2. Formal Suppliers of Financial Services

5. In 2000, there were 35 licensed commercial banks in Bulgaria. After an aggressive privatisation programme in 1999/2000, most commercial banks are now owned by foreign shareholders who control about 80% of all banking assets. Bank managers adopted a risk adverse strategy focussing on maintaining good operations with a minimum of losses first, in order to avoid being replaced by the foreign owners. This is reflected by the limited loan portfolio and the high investments in low risk interest bearing assets such as deposits in foreign currency or government bonds instead of lending. At the end of 2000, bank loans only represent 31% of banks assets, whereas 50% of bank's assets are invested in securities and deposits (Roussenova, 2001, see graph 1). At the end of 2001, Bulgarian banks had a secondary liquidity ratio including cash, cash equivalents, and government securities, of nearly 60% (USAID, 2002).

Graph 1: Structure of Banking Sector Assets



Source: Yonkova, IME, based on BNB data

¹ Regulation 6 of BNB establishes the terms of extending collateralized BGN loans to banks in cases of liquidity risks affecting the stability of the banking system. The total amount of the highly liquid assets pledged as collateral should cover at least 125% of the loan amount approved by the BNB. The loan should be repaid within three months.

6. The main factors for such conservative behavior are:
- Comparatively higher risks in the real sector, coupled with insufficient expertise of most banks regarding project assessment;
 - Short track record of most private companies;
 - Restrictive banking regulations concerning commercial lending such as loan loss provisions and collateral requirements¹;
 - Weak creditors' rights coupled with slow procedures for foreclosure and sale of seized collateral, both due to legal constraints and underdeveloped markets for repossessed assets;
 - Limited number of viable investment projects which are profitable enough to support the current market interest rates;
 - Limited access to funding sources, notably due to the absence of central bank re-financing and the poor development of capital markets
7. Lack of competition might be a further factor underpinning the cautious behaviour of banks as reflected in high interest spreads (see table 2). The concentration in the banking sector is considerable. Three banks (two already foreign owned- Bulbank and United Bulgarian Bank and one still state-owned- DSK Bank) hold about 50 % of total banking system assets. On the other hand, 19 out of 35 banks have market shares below one per cent (see graph 2). Of them only one bank (Bulgarian American Credit Bank) is specialized on one particular segment of the market – mortgage lending. All other are rather universal banks though many are focusing on specific segments of the market. Generally, most commercial banks focus on larger corporate clients and avoid SMEs, both agricultural and non-agricultural. Loans below US\$ 20.000 are rarely provided and demand over 200% loan collateral.

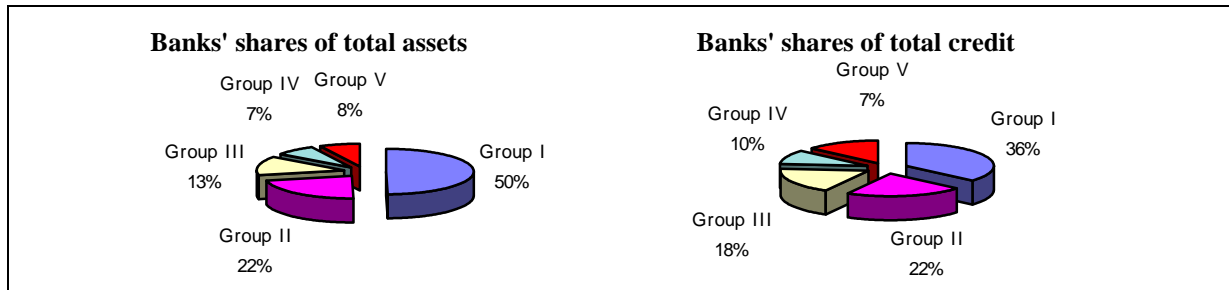
Table 2: Interest Rates (annual, %)

	Dec-1995	Dec-1996	Dec-1997	Dec-1998	Dec-99	Dec-2000*
Basic interest rate	38.5	435.03	6.95	5.17	4.49	4.73
Interbank rate (average)	44.01	442.14	1.58	2.86	2.53	2.03
Short-term credits	51.43	481.11	13.85	13.52	13.33	14.17
Time deposits	25.29	211.87	3.04	3.30	3.27	3.12**

Source: Yonkova, IME, based on BNB data

¹ For example, banks are restricted from extending “big” loans, exceeding 25% of the bank’s own capital. This barrier is especially valid for smaller banks with low capital levels.

Graph 2: Shares of Banking Market, December 2000¹.



Source: Yonkova, IME based on BNB data

1.3. Recent Improvements of the Supply Market for Loans

8. However, there are signs that this picture is beginning the change. Conservative lending policies might be necessary in a transitional period after a severe financial crisis ensuring safety and security but they are low profit strategies. Some banks have already started to adopt more aggressive lending strategies in order to actively reach out to new target groups and underserved markets. For example, Bulgarian American Credit Bank has introduced several commercial and mortgage loan products, primarily in the major urban centres, and is rapidly expanding its portfolio. In 2001, it introduced the first mortgage backed bonds in the capital market. Mortgage loans range from US\$ 10.000-25.000 for SMEs until US\$ 4 million for large commercial projects. The performance of ProCredit Bank is being closely monitored and might inspire other banks to engage into these large untapped markets. Some commercial banks have recently started to provide SME loans.

9. Some micro-finance programmes have also contributed to broaden the range of financial services, especially for micro-enterprises and SMEs. For example, under the EU PHARE programme, a network of credit unions has been established in 1995. The network gained momentum in 1998 after having received the permission to start lending. USAID has been funding three Micro-finance programmes: USTOI (supported by Catholic Relief Service), Nachala (supported by Opportunity International) and KAAS (supported by World Council of Credit Unions). The three micro-finance programmes had a total outstanding portfolio of US\$ 4 million distributed over 6000 active borrowers at the end of 2001 and projected a growth rate of 200% for the period 2002 -06 (USAID 2002).

10. However, the outreach of these MFIs is still low: Their presence is limited to certain regions their focus is on urban areas. Moreover, the range of loan products offered is narrow: Most MFIs focus on short-term loans to be repaid in less than one year; few offer medium term loans up to three years. Most loans are below BGN 10.000, average loan size is US\$ 950. Only the Credit Unions established under EU-PHARE and JOBS programme have some outreach in rural areas and will be described in the next section.

¹ To ensure precise monitoring of changes and dynamics within the system, in 1999 BNB classified commercial banks into five groups according to balance sheet size: Group I-over BGN 500 million (3 banks); Group II-BGN 300-500 million (5 banks); Group III-BGN 100-300 million (6 banks); Group IV-BGN up to BGN 100 million (13 banks) and Group V- 8 foreign banks branches.

11. The development of Non Bank Financial Institutions (“NBFI”) is constrained by the banking law which restricts lending and savings mobilisation to commercial banks. Most micro-finance institutions are registered under the cooperative law and operate under a Memorandum of Understanding between the GOB and supporting donors. Growth is constrained by and depends on continuation of donor funding. However, most donors would like to see a stable legal and regulatory framework for NBFIs which guarantee at least their legal status and possibly introduces some sort of prudential regulation and supervision. This places ProCredit Bank in a strong position vis-à-vis the other MFIs.

2. The Suppliers of Agricultural Finance

12. The conservative attitude of banks has a particularly averse effect on the credit supply to the agricultural sector: At the end of 2000, bank lending to agriculture, including SFA, only accounted for 1% of the GDP, whereas the share of agriculture amounted to 13,9% of GDP. Micro-finance programmes also concentrate on urban and peri-urban customers, and their loans products do not suit agricultural producers.

13. Apart from the general factors constraining banks' attitude towards lending, the key constraints for agricultural lending are the following:

- **Limited sector knowledge:** Due to their unfamiliarity with production and marketing patterns in agriculture, banks are not able to identify profitable investment opportunities and tend to overstate the risks related to agricultural lending.
- **Restrictive collateral requirements:** Due to tight prudential regulations and lack of sector knowledge banks often demand collateral values of 250% and beyond of the loan amount. Moreover, only first class collateral (deposits, urban real estate) are accepted and most rural assets is excluded. The use of other rural assets such as rural houses, agricultural land, buildings and is restricted by difficulties to sell seized assets.
- **Weak creditors' rights:** Foreclosure of collateral may take 2 years and more and local courts often decide in favour of borrowers.
- **High transaction costs:** Low population density in rural areas add to transaction costs related to the on-site inspection of farms, appraisal of collateral and supervision of borrowers.
- **Seasonality and long gestation periods:** Much of the loan demand from agricultural and related activities is seasonal, limiting the abilities of borrowers to make frequent periodic repayments in equal instalment.

14. Apart from commercial banks, agricultural finance is mainly provided by specific lending programmes from the State Fund of Agriculture (SFA) and the Tobacco Fund¹ at

¹ The Tobacco Fund lends to tobacco processors for purchasing tobacco which has been grown under contract.

subsidised interest rates. Moreover, there are several subsidy programmes provided by the European Union (“SAPARD”) and the national budget through SFA. These programmes are targeted at specific investment purposes and are normally disbursed to the suppliers of inputs, equipment and services.

15. Short and medium term loans are provided by the network of 33 Private Mutual Rural Credit Associations (“PMRCAs”). The UNDP supported JOBS-Programme has an equipment leasing facility for urban and rural Micro-enterprises including farmers. The main features of these programmes and institutions are described below.

2.1. State Fund for Agriculture

16. State Fund for Agriculture (“SFA”) has been established in 1995 as a NBFi under the Law on Support for Agricultural Producers. It is responsible for disbursing subsidies as well as subsidised loans to registered agricultural producers through its 28 regional offices. According to an agreement with the EU, SFA has assumed the functions of the SAPARD Agency in Bulgaria and will disburse subsidies of the EU after 2007. The Regional Directorates of SFA are supposed to screen grant applications as well as make on-site inspections of applicants. Only registered farmers can apply for SFA grants and loans (see box 1).

Box 1: Registration of farmers

Any farmer (irrespective of the size of its farm enterprise and land ownership) can be registered as a farmer. Registration is free of charge but any registered farmer must be unemployed. The farmer has to declare the size of his holding, the main production activities and some other basic data. This information has to be certified by the mayor, the veterinary service (livestock) and the Land Commission (crop production). Data are assembled in a central registry and should be used for planning and policy by the government. Only some institutions (including the SFA) have access to the database; information in it is generally treated confidentially.

17. SFA offers credit lines, subsidies and combinations of both. Subsidised and directed credit has been a major instrument of the agrarian policy of the post transition governments. The amounts have been considerable, between 2-4% of the agricultural GDP (World Bank, 2000). SFA has traditionally offered short-term loans for working capital purposes and medium and long-term loans for investment purposes. Short-term loans are targeted to certain crops and restricted to the purchase of specific inputs in order to induce the adoption of specific production technologies. Some of the programmes combine loans with grants.

18. Though credit lines can hardly be seen as a major cause of commercial banks' conservative attitude towards agricultural lending, they might limit the possibility of progressive banks to enter the market on non-subsidised terms. The Fund's short term loans have therefore come under severe criticism from international financial institutions. GOB is increasingly recognising this problem and intends to gradually phase out short term credit lines. Investment loans are available for different purposes and the repayment terms and conditions vary according to the specific investment purpose.

2.1.1 SFA Loan Programmes and Subsidies for 2003

19. The programmes of SFA change every year in response to the agricultural conditions of the previous year and the policy objectives for the coming year. The programme for each year has to be endorsed by the Ministry of Agriculture and the Council of Ministers before the bill for the state budget is accepted by the National Assembly. SFA's budget comes from different sources including: transfers from the national budget, half of the income accruing from rental and sales of state land, export taxes from agricultural exports and 4% of the income of insurance of agricultural production, stockbreeding, machinery, buildings, equipment and other property of agricultural producers. The following budget has been allocated for SFA in 2003:

- Investment loans: BGN 100 million
- Investment subsidies: BGN 7 million
- Subsidies for quality produce: BGN 40 million

20. In 2003, SFA offers the following loan products:

- (a) *Investment programme crop production*¹. The different credit lines under this programme are targeted at the establishment of vineyards, orchards, strawberries, etheric oil plants, and medicinal plants. Loan terms vary between 2-7 years, depending on the type of crop. Finance is also available for the construction of new or the purchase of existing glasshouses (only through commercial banks). The repayment period is 5 years, with 2 years of grace period for repayment of the loan principal. The total allocated budget for 2003 is BGN 450.000.
- (b) *Investment programmes for livestock production*. This programme targets the purchase of pedigree animals like sows, cows, sheep, goats, hens, ducks ostriches rabbits turkey, bees. It also includes the purchase of equipment for animal breeding and milk collection. Moreover, the construction of warehouses, buildings, fodder plants and milk collection points is funded, though funding is only available through commercial banks, irrespective of the amounts. The total allocated budget for 2003 is BGN 11.000.000.
- (c) *Investment loans for agricultural equipment*. This programme consists of two sub-programmes. The first sub-programme is disbursed through commercial banks and finances only new equipment. Repayments period is 4 years, with 6 months of grace period. A down-payment of 30% is required. The second sub-programmes is directly disbursed by SFA and finances new as well as second hand equipment. Repayment periods are 4 years for new equipment and 2 years for second hand equipment, including a 6 months grace period. The equipment serves as main collateral. Most major importers and suppliers of farm machinery and equipment have signed contracts with SFA.

¹ Further details on the loan programmes are provided in appendixes.

- (d) *Working capital loans plus subsidies.* These loans are combined with direct subsidies for the purchase of fertiliser for wheat, maize, soya, sunflower and peanuts. Wheat producers can receive 2,7 BGN /dca as subsidy and another BGN 2,7/dca as loan, up to a maximum of 5.000 dca. There is also a ceiling of the total amount of BGN 100.000 for physical and legal persons and BGN 140.000 for Cooperatives. For the other crops, the BGN 1,5 per dca are available as subsidy and BGN 4,5 as loans. The same loan ceilings apply.

21. Moreover a number of direct subsidies have been provided to farmers (see box 2).

Box 2: Direct subsidies for agriculture in 2003, provided through SFA

- Grain production: Grants per ha of seeded quality grain production and for the production of quality seeds
- Quality milk (cows, buffaloes, sheep and goat) sold to processors
- Animal breeding: subsidised based on number of animals, subject to standards of animal welfare, hygiene and sanitary requirements, minimum number of animals required
- Planting of perennial crops: subsidy per tree during immaturity period
- Production of vegetables
- Export subsidies for processed and unprocessed agricultural products (paid to exporters)

2.1.2 Lending Terms and Conditions

22. Loan applicants have to make an equity contribution of 30% of the total investment costs¹. Subsidies and loans are usually not disbursed to the farmers but to the suppliers of goods and services (traders, construction companies, etc.).

23. SFA is more flexible than commercial banks regarding collateral requirements. For seasonal loans, farmers have to provide 105 – 150% of the loan amount, either as immovable property (real estate, house, apartment), or as moveable property (machinery and equipment). Alternatively, 50% of the loan amount can be secured through pledging of the next harvest, while the remaining 50% have to be secured through either real estate or moveable assets. Maximum loan amount for seasonal loans is BGN 70.000 per year, or BGN 50.000 if future harvest is used to secure the loan. Pledged crop must be insured against hail, fire and flood (in case of potatoes). Property which is pledged has also to be insured against conventional risks.

24. In case of investment loans, SFA accepts pledging of moveable assets but prefers real estate mortgages, usually houses in the villages or urban apartments. The collateral should cover 105 -150% of the loan amount, depending on the type of collateral provided. For loans up to BGN 20.000, the collateral value is derived from the tax value of the property. For loans between BGN 20.000 – 50.000, the collateral value has to be assessed by a licensed company. In case of financing through commercial bank, the latter are free to establish their own collateral requirements.

¹ In 2002, the equity contribution varied between 20 and 30% depending on loan term and amount.

25. In case of default, the farmer has to pay penalty interest rates and is also required to repay any subsidy received. The same applies if the loan is used for non-intended purposes.

26. In 2002/03, 14 commercial banks which have an agreement with SFA, can access funds at 2.5%; on-lending rates are fixed at 9%. In principle, a long-term re-finance facility might be necessary to encourage commercial banks to provide medium and long-term loans, in view of the short term deposit base of most banks. However, in practice, a spread of 6.5%, banks might not be sufficient for banks to carry the full credit risk and transaction costs of loan appraisal and supervision. This leads in practice to a limited number of loans mainly targeted at large farms which are able to satisfy the banks restrictive collateral requirements. Moreover, Table 3 shows, that the budget of SFA has only partly been spent.

27. Since October 2002, SFA provides loans below BGN 50.000 directly through its 28 regional offices. Interest rates are fixed at 6%; loans for young farmers below the age of 40 are available at 3% annual interest. The role of SFA as direct lender is being questioned by the World Bank and proposals exist to convert SFA into a guarantee fund.

28. Though SFA has low nominal interest rates, loan applicants have to fulfil extensive documentary requirements which result in high transaction costs and – consequently – higher effective interest rates. Examples for documentary requirements are given in appendix 4

2.1.3 Outreach of SFA in 2000/2001

29. Table 3 shows that the limited outreach of SFA loans and the large average loan size, even for the loans provided directly by SFA. A second feature is the large amount of unspent resources reflecting the difficulties of farmers to accessing SFA's funds.

**Table 3: Funded Investment Projects under National SFA Schemes
(for the period 01/01/2002 – 31/12/2002)**

Investment Programme	Finances/Re-financed Projects			Programme Funding for 2002
	Number	Amount	Average loan size	
1. Programme "Livestock husbandry" via commercial bank refinancing	25	1,496,380	59,855	5,000,000
2. Programme "Livestock husbandry" direct SFA project funding	19	486,595	25,610	
3. Programme "Crop cultivation" via commercial bank refinancing	17	3,416,324	200,960	10,000,000
4. Programme "Crop cultivation" direct SFA project funding	20	4,595,959	229,798	
5. Equipment via commercial bank refinancing	23	3,098,820	134,731	10,000,000
6. Equipment direct SFA project funding	3	368,760	122,920	
Total:	107	13,462,838	125,821	25,000,000

30. The outreach of the subsidies for quality milk production is low. In 2001, only 3.6% of the overall milk production received subsidies. Premiums were only paid for one product and for a limited time period.

2.1.4 Implications for ProCredit Bank

31. ProCredit might compete with SFA in the following:
- Be more flexible and customer friendly regarding documentary requirements.
 - Allowing the purchase of single animals (now minimum requirements).
 - Financing farmers which are not registered as agricultural producers (but for example as traders).
 - Offer flexible short term loans disbursed to the farmers in cash.

2.2 SAPARD

32. SAPARD is the main instrument of the EU to support applicant countries in preparing their agricultural sectors for the EU accession and the adoption of the Common Agricultural Policy. During 2000 – 2006, an annual transfer of EUR 53m is available to co-finance eligible investment projects in agriculture and related sectors in Bulgaria. As a precondition, GOB has prepared a National Agricultural and Rural Development Plan (NARDP) for this period, in line with the National Economic Development Plan.

33. Four priority areas for Bulgarian agriculture were defined:
- (i) Improvement of the conditions for production, processing and marketing of agriculture, forestry and fishery products in accordance with EU-standards; development of environmentally friendly agriculture, as well as improvement of the activities for environmental protection in agriculture and forestry.
 - (ii) Integrated rural development aiming at preservation and consolidation of their economies and communities in order to slow down the depopulation of rural areas.
 - (iii) Investments in human resources: qualification and training of the workforce employed in the production and processing of agriculture, forestry and fishery products.
 - (iv) Technical assistance.

34. These priority areas are supported through 11 measures under which the investment grants are focussed. For example, priority area 1) includes six measures, of which the most important for the purpose of this report is measure 1.1 *Investments In Agricultural Farms*.

35. Due to some initial delays, the programme started in June 2001. During the period of June 1st 2001 and December 31st 2002, only three measures have been financed:

- Measure 1.1: Investments in agricultural holdings;
- Measure 1.2: Improving the marketing and processing of agricultural and fishery products, and
- Measure 2.1: Development and diversification of economic activities, promotion of multiple activities and alternative income.

2.2.1 The Implementation of SAPARD's until end of 2002

36. During the period of June 1st 2001 and December 31st 2002, 205 projects have been approved in measure 1.1 *Investments in agricultural holdings*. Within this measure, most investments were related to cereal production (mainly purchase of specialised farm machinery), followed by meat and fruit and wine (see table 4 below). Only four projects in the dairy sub-sector have been approved. 65 projects were approved under measure 1.2 *Improving the Marketing and Processing of Agriculture and Fishery Products*. The number of projects approved under measure 2.1 *Development and Diversification of Rural Activities* totalled 28. The respective total amounts reimbursed were BGN 18 million (measure 1.1), BGN 9,3 million (measure 1.2) and total of BGN 335.117 (measure 2.1). In the latter category, rural tourism was the main sub-sector receiving finance.

Table 4: Investments in agricultural holdings - number and value of the approved and reimbursed projects per measure sector for the period 01/06/01 - 31/12/02¹.

Sector	Number of projects		Approved Investment costs	Reimbursed projects		Average per project (approximate)		
	Appr	Reimbursed		Eligible investment costs	Subsidy	Approved	Eligible investment cost	Reimbursed subsidy
Milk	4	4	2,108,892	199,600	99,800	527,223	199,600	99,800
Meat	16	16	13,702,320	3,724,724	1,862,362	856,395	931,181	465,591
Fruit and vegetables	37	37	11,404,551	1,576,700	788,350	308,231	315,340	157,670
Cereals, essential oils, perennials, medicinal perennials, tobacco and cotton	148	148	60,448,107	31,829,296	15,914,648	408,433	402,902	201,451
Total	205	205	87,663,870	37,330,320	18,665,160	428,000	419,000	210,000

Source: Annual Report on SAPARD implementation in Bulgaria, 2002

¹ **Note:** All costs are in BGN.

The breakdown of the projects by sectors is conditional as some of them have applied for support under more than one sector at one and the same time.

37. Regional distribution of projects shows a concentration in the following districts:

- Measure 1.1 in the districts of Plovdiv (14, 8%) of total approved investments), Bourgas (9,9%) and Stara Zagora (9,8%).
- Measure 1.2 (in value terms): Plovdiv (23% of total approved investment costs), Bourgas (14,7%) and Stara Zagora (10,8%).
- Measure 2.1 (in value terms): Bourgas (16,8%, Lovech (10,8%) and Sofia region (10%). However, measure 2.1 was distributed more evenly over the country: 230 out of a total of 263 municipalities) defined as rural areas in NARDP.

38. In April 2002, the Committee on Agricultural Structures and Rural Development of the European Commission approved a package of amendments in NARDP, on the basis of which the SAPARD Agency began the accreditation preparations or the implementation of the following measures:

- Sub-measure 1.2.1: Wholesale markets
- Measure 1.4: Forestry, afforestation of agricultural areas, investments in forest holdings, processing and marketing of forestry products
- Measure 1.5: Setting up of producer groups
- Measure 2.2: Renovation and development of villages, protection and conservation of the rural heritage and cultural traditions
- Measure 3.1: Development and improvement of the rural infrastructure
- Measure 4.1: Technical assistance

39. These figures show that the outreach of SAPARD is still limited. The utilisation rates of the approved budget of 49% (measure 1.1), 37% (measure 1.2) and 10,9% (measure 2.1) point to initial disbursement problems, despite an intensive publicity campaign. However, the outreach of the programme is likely to increase significantly to the extent to which administrative procedures can be streamlined and additional measures are implemented.

40. A second feature is the large size of the individual grants limiting the outreach of the programme for small and medium farmers and rural entrepreneurs. Applications from primary production came from cereal farmers, rather than from farmers in the priority sectors, dairy and wine. Though, in principle, any registered farmer can apply for SAPARD grants, there are several conditions which constrain the access of small and medium sized farmers to SAPARD grants:

- **Minimum investment sizes:** In order to be eligible, the proposed investments projects related to sub-sectors 1 and 2 must have a minimum size of EUR 15.000; investments in sub-sectors 3 and 4 must be of at least EUR 10.000.
- **Pre-financing of total investment costs:** SAPARD grants can refund up to 50% of the investment costs after SFA staff have verified the completion of the investments. Therefore the investor must pre-finance the entire amount up-front. Lack of equity and restrictive collateral requirements pose major hurdles to farmers even if they present viable projects which would create considerable

additional cash flow. Collateral requirements of commercial banks usually range between 150 – 250% of the loan amount, depending on the type and quality of collateral. If this collateral is also applied to the part of the loan which pre-finances the grant, collateral requirements exceed several times the loan amount.

- ***Complicated application procedures:*** Applicants have to provide a business plan and a huge number of documents and certificates to be eligible. This is also mirrored by the high rate of rejection of applications due to incomplete documentation. In practice, farmers need professional advice from specialised consultancy companies in order to prepare successful applications. Costs of feasibility studies can be included up to maximum of 5% of the total investment costs. Advisory companies prefer larger applications which are more lucrative for them. Their fees are high despite the fact that they cannot guarantee successful applications.

41. If these constraints can not be tackled effectively, SAPARD might have a regressive impact on the farm structure in Bulgaria which is already skewed towards large scale producers. There are indications that in 2003 the size of projects has decreased and number increased. This reflects a stronger participation of medium sized individual farmers in SAPARD (data to be added in appendix, as available).

42. A recent FAO evaluation of the first 6 months of SAPARD implementation suggests that links between agro-processors and producers should be strengthened in order to enhance access of primary producers to grants and the necessary bank pre-financing. Processors are in a much better position to access both bank finance and subsidies. Amendments in the SAPARD implementation arrangements could create special incentives to processors in order to either pre-finance the SAPARD grant or provide a guarantee to a bank doing the pre-finance. The major risk of not getting the SAPARD grant is failure of the applicant to carry out the investment as programmed¹. Processing enterprises would be in a prominent position to monitor project implementation. Stronger farm agri-business linkages could also trigger more bank financing for the part of the investment costs which are not covered by the grant.

2.2.2 Relevance for ProCredit Bank

43. Though most SAPARD grants are currently provided to larger farmers (beyond the target clientele of ProCredit Bank), the programme should be monitored for the following reasons:

- It is focussed on strategic sub-sectors, based on the Rural Development Plan of GOB. These sub-sectors will receive special attention of GOB in order to enhance their competitiveness in view of the EU accession in 2007. The targeting of investments in processing and marketing in specific sub-sectors is likely to address key bottlenecks for primary producers. This may provide guidance for selecting sub-sectors as entry points for ProCredit's expansion into rural lending.

¹ However causes of the discrepancies between approved investments amounts and the amounts which have been reimbursed would merit further investigation.

- There are discussions to lower the minimum investment sizes eligible for SAPARD grants, increasing their availability to small and medium sized farmers.
- Pre-financing of SAPARD grants might be a relatively low risk business opportunity and could be the basis for a long-term relationship with promising clients.

2.3 The Private Mutual Rural Credit Associations (PMRCAs)

44. The PMRCAs were established under the Agricultural Credit Fund Scheme, which has been financed by PHARE and GOB. The PMCRAs are authorised under paragraph 17 of the Transitional and Final Provisions to the Law on Banks to undertake lending activities without being licensed as banks. The PMCRAs have received an initial capitalisation of ECU 7 million from the EU and BGN 3 million from GOB. The latter has provided an additional BGN 4 million through SFA in 1998. For each BGN of share capital mobilised the PMCRAs could access BGN 10 of matching funds. The network has received continuing international technical assistance. In February 2000, the Federation of the PMCRAs has entered into a partnership with the German Cooperative and Raiffeisen union (DGRV).

45. The network consists of 33 credit cooperatives, distributed throughout the country. Members have to pay in a minimum share of EUR 52 to become eligible for loans. The loan amount is limited to 15 times the amount of share capital paid in. Membership is open to rural farm and non farm SMEs, but loans can only be provided to farmers. However, loans are not confined to registered farmers but to any person receiving the major part of his/her income from farming. Moreover, the PMCRAs are free to provide loans for non-agricultural purposes from their share capital or additional outside resources mobilised.

46. PMCRAs are required to have a professional manager and at least one loan officer. The size of the Coops varies between 100 and 800 members, the total network has more than 10.000 members. The individual Credit Cooperatives are free to set the interest rates on shares (to attract capital) and loans. In general, 5-12% is added to the BNB base rate.

47. The PMCRAs provide mainly short term loans of 1-2 years. Around 75% of the loans have maturities up to 9 months for working capital purposes, the remainder finances investments in farm machinery, equipment, land, greenhouses, livestock, etc. Maximum loan amount can not exceed EUR 20.000. Collateral requirements are flexible: Loans up to BGN 3.000 can be secured through a co-guarantor; larger loans require the pledging of moveable assets or mortgaging of immoveable property. Farm machinery, rural houses and – in some cases - cows are accepted as collateral¹.

48. During their establishment period, some of the PRMCAs experienced “moral hazard”-type problems with some of their members, since the prospect of “free donor funds” attracted some farmers with dubious intentions. Most of the problem loans result from the initial period. In recent years, the Coops have gained good knowledge on their members and on-time repayment rates are reported to be 93% on average. Most of the defaulting loans occur due to

¹ Normally this is confined to high quality breeding cows which have to be properly insured.

external factors which periodically affect agricultural activities and can be recovered later. Strong social control and a sense of joint liability in the villages are effective means to control wilful default. However, in cases when problem loans had to be enforced, the PCMRA's suffered under the slow legal and administrative procedures in foreclosing collateral and selling the foreclosed assets, as reported by other financial institutions (see next section).

49. The performance of the individual Credit Coops depends to a significant extent on the quality of the management. The most dynamic ones managed to grow and increase their capital base by attracting new members, and are understood to be negotiating international re-finance from OikoCredit. In general terms, however, the growth of the network is severely constrained by their provisional legal status which prevents them from mobilising deposits and attracting other national and international funding sources. Improvement of the legal status of NBFIs would not only benefit the PRMCAs but also other micro-finance institutions as mentioned above.

2.4 Job Opportunities through Business Support Project (JOBS)

50. The Job Opportunities through Business Support Project (JOBS) has started in 2000 and is being implemented by the Ministry of Labour and Social Policy with the support of UNDP. The project aims at employment creation through promotion of entrepreneurship by supporting Micro-enterprises, SMES and agricultural producers. With a total budget of US\$ 7 million, JOBS has created 24 Business Centres, including 11 Business Incubators and three Business Information Centres. An equipment leasing facility of US\$ 2 million is available and is operated through the Centres. Until early 2002, 38 equipment leases were financed with a total value of over US\$ 300.000 and further applications valued at US\$ 400.000 were in the pipeline (US AID 2002). Maximum lease amount is US\$ 10.000, the lease rate is the BNB base rate plus 10-15%. The lessee must make a down-payment of 20% of the purchase price and purchase the equipment after 2 years.

3. Cross-Cutting Issues: The Use of Rural Assets as Collateral

51. Absence of suitable collateral is a key problem in rural areas. Many rural assets have a low collateral value and are difficult to monitor, foreclose and liquidate. The banking legislation encouraged banks in their conservative attitude towards collateral. The situation is further aggravated by the fact that most banks are not very familiar with the agricultural sector and moreover have a limited presence in rural areas. Therefore, they lack the necessary skills to assess opportunities and risks appropriately, which could allow them to have a more flexible stance regarding collateral.

52. A **Mortgage Bond Law** has been passed in September 2000 to enhance the range of financial instruments and increase the access of banks to long-term funding sources¹. However, only urban real estate can be used to secure bonds. The first mortgage of a property must be at least 125% of the loan amount. According to Regulation 8 on the Capital Adequacy of Banks, loans secured by first mortgages have a risk weight of 50% and are included in the risk

¹ The Law gives every licensed bank the right to issue mortgage bonds backed by its portfolio of loans secured by first ranking mortgages over real property. The potential buyers of these mortgage bonds are pension funds, life insurance companies and investment companies and individual investors.

component of the balance sheet in amount equal to half of their nominal value. Loan secured with other physical assets carry a risk weight of 100%.

53. Normally, banks charge a one-time fee for loan appraisal (including the collateral). Collateral is normally insured against risks which could bring about the destruction or depreciation of its market value. However, the mortgage law excludes agricultural land.

54. The government has recently introduced a number of legal and institutional reforms aiming at enhancing the use of rural assets as collateral and streamlining the perfection and foreclosure of claims. For example, the foreclosure provisions of the Code of Civil Procedure have been amended in order to reduce delays in enforcement of valid claims. Following amendments to the Law on Registered Pledges, a central registry has been created where pledges can be registered at low cost and with few administrative hurdles. Since 2000 there is a registry in which the contracts for lease or rental, signed for a period of at least 2 years, are listed.

55. The land restitution process is completed and most agricultural land is now privately owned¹. Immoveable assets are registered in the Real Estate Property Registers. Establishment or transfers of property right to real estate are performed by the regional notaries. Inquiries can be done relatively easily in one of the computerised registers, either by the owner's name or by land title.

56. Despite these improvements, agricultural land is normally not accepted as collateral, mainly because of the low levels of sales transactions in rural land markets and low prices for agricultural land. On the other hand, most farmers do not possess urban real estate or sizeable financial assets which could be used to secure loans. Moreover, they are reluctant to mortgage their houses, often the only eligible collateral they possess. The government tries to stimulate land markets by establishing a market information system.

57. *Moveable assets* are accepted by some financial institutions be used as collateral, but are valued very conservatively. Problems for using moveable assets relate to the lengthy legal procedures during which the value of the asset may deteriorate considerably. Moreover, markets for moveable assets such as farm machinery are thin, also due to lack of access to credit facilities which would enable farmers to finance these lumpy investments.

58. Due to the large number of cows and other animals in small and medium sized farms, many farmers might be in position to offer these as loan collateral. However, only registered herd book animals have significant collateral value (e.g. dairy cows BGN 1.200 – 2.000). Moreover, prices for animals fluctuate considerably and repossession might be difficult. Livestock insurance is available, but premiums are high, about 8-9% of the value of the animal. Therefore, livestock appears only to be a suitable form of collateral for smaller loans and should be limited to farmers who have already established a sound track record with the lender.

59. The *system of warehouse receipts*, pursuant to the Grain Storage and Trade Act, provides an alternative in short-term lending to grain producers and processors through using grain as collateral. The warehouse receipts, issued by the licensed public warehouses, constitute a simple mechanism enabling stored grain to be collateral for short-term loans. Thus, grain

¹ In 2000, 98% of the land has returned to its legal owners who have received legal documents of ownership (Nikolova 2001).

producers and processors enjoy greater flexibility in using their grain as collateral, while waiting for a favourable moment to sell it. Using warehouse receipts makes the sales transactions much easier and faster, as there is no necessity to transfer the grain physically. Financial institutions accepting warehouse receipts as collateral have the advantage of high security ensured by both the excellent management of the licensed public warehouses and the ongoing control on part of the supervising agency.

60. In 1999, there were 5 licensed warehouses with total storage capacity of 98 100 tons. By the end of 2000, their number had grown to 23 with total storage capacity of 254 255 tons. In 1999, the licensed public warehouses (LPW) issued merely 5 warehouse receipts for deposited 5 000 tons of maize, used as collateral for bank loans amounting to BGN 500 000. In 2000, the number of warehouse receipts totalled 391 for deposited quantities of wheat, barley, maize and sunflower. The commercial banks involved (S.G. Express Bank AD and Union Bank AD) extended loans to the total value of BGN 7 000 000. By August 31, 2001, the number of licensed public warehouses had grown to 35 with total storage capacity of 367 835 tons. As of the same date, the number of licensed grain-storage facilities totalled 110 with storage capacity of 810 875 tons. Therefore, overall licensed storage capacity, both in licensed public warehouses and licensed grain-storage facilities, amounted to 1 178 000 tons.

61. Regarding harvest 2001, some 1 000 new warehouse receipts has been released. So far 171 warehouse receipts have been issued for deposited 70 000 tons of grain, part of which already used as collateral. As regards the commercial banks involved, besides S.G. Express Bank AD and Union Bank AD, the system has attracted also Biohim Bank, the Central Cooperative Bank, United Bulgarian Bank and so forth. In 2000, SFA extended BGN 1 000 000 worth of subsidy toward storage costs for grain deposited by agricultural producers in licensed warehouses. The increase in number of these facilities is attributed to the fact that storage costs have been almost fully subsidized.

Leasing

62. According to the Bulgarian law, there are two types of leasing: operating and financial. Every company may act as leasing company (lessor). There are no licensing requirements. According to the Law on Banks, such a company should be registered in the BNB as a non-bank financial institution. In 2001, 25 leasing companies were registered. But there are companies operating as leasing companies, which are not registered in BNB. Their number is hard to be estimated. Currently, there is no legal base for control over the leasing companies' activities.

63. The main advantage of leasing is the less complicated appraisal procedures: the time for evaluation of application and signing the contract takes on average half as long as the completion and approval of loan applications. Usually, the lessee must make a down-payment of 30%, but no additional collateral is required. Leased assets are usually insured against the most common risks.

64. Banks are avoiding leasing as a form of financing. This is partly due to the unfavourable tax treatment since leasing is VAT taxable. Moreover, important impediments for repossession of the leased item exist in Bulgaria. In case of default, the lessor cannot foreclose on the asset if the lessee does not agree. Repossession in case of default requires action by the local police backed by a court order. Local courts do not always fully understand the principles of

leasing which puts speedy repossession at risk. This reduces the incentives for financial institutions to offer leasing. Moreover, supply chain and support structures (repair shops, spare parts, etc.) are not always readily available. This increases the risk of default due to breakdown of leased equipment and of accelerated depreciation due to lack of proper maintenance. Finally, as mentioned above, markets for used machinery are thin.

The farmers' Perception of the Existing Sources of Finance

65. The general perception is that existing sources of farming loans are difficult to approach, require a voluminous and confusing amount of documentation, require collateral which is difficult to provide and favour larger customers.

66. Implications for ProCredit:

- Local 'presence' is important, to counter the perception of remoteness of commercial banks.
- Speed of service and minimal documentation is especially important for seasonal loans.
- Transparent, streamlined procedures are important in case of term loans in order to minimise delays and borrowers' transaction costs (such as repeated travels, etc.).
- Imaginative attitude to collateral will definitely be appreciated by the potential clientele.
- Repayment phasing is important, as cash flow from farming is lumpy and irregular.

SAPARD annual report has good tables and figures on recent macro- and sector indicators.

Note: Population density is low

References

Yonkova, A., Financial Sector Competitiveness: On a Crossroad between Legacies of the Past and New Development, Institute for Market Economics, <http://www.ime-bg.org/en/index.html>

FAO (??): Bulgaria: Implementation of SAPARD - initial assessment, Rome

APPENDIX 1

SFA INVESTMENT CREDIT LINES FOR 2003

Programme	Animals/Plants/Machinery Type	Minimum Quantity	Term (months)	Grace Period (months)	
Animals	Heifers, pregnant cows and cows with up to 2 calves	10	48	18	
	Pregnant buffaloes and buffaloes with up to 1 calf	10	48	18	
	Pig-mothers and breeding pigs over 4 months	20	24	12	
	Sheep mothers, pregnant sheep, sheep with up to 2 lambs	50	30	12	
	Goat mothers and goats for breeding	50	30	12	
	Horse – mothers and female breeding horses up to 3 years	5 - 3 respectively	48	18	
	Laying hens for stock produce	1 500	24	6	
	One day chickens for broiler production	3 000	12	3	
	One day chickens for egg production	2 000	24	6	
	Turkeys, ducks and geese for stock production	500	32	8	
	One day geese, ducks and turkeys for stock production	1 000	24	6	
	Ostriches up to 6 months	10	32	8	
	Purchase of rabbits for stock production	100	12	3	
	Creation of apiaries	20 families	48	18	
	Restoration of apiaries	20 families	36	12	
	Purchase of equipment (machinery, inventory)		36	9	
	Hatching, and determining the quality of chickens				
	Growing animals and poultry				
	Milk collection points				
	Plants	Vineyards		84	48
Orchards			84	48	
Raspberries			36	12	
Strawberries			24	12	
Blackberries, blueberries			36	12	
Aronia, kiwi, blackcurrant, redcurrant, gooseberries			48	24	
Rose for oil production			60	24	
Lavender			60	24	
Fennel			36	12	
Others			60	24	
Common balm			36	12	
Mint			36	12	
Sage			36	12	
St John's wort			36	12	
Other medicinal			36	12	
Asparagus			60	24	
Lucerne			24	12	
Planting material /vineyards и orchards/					
Building of plastic greenhouses for vegetables, fruits and mushrooms			60	24	
Building of greenhouses with plastic cover for vegetables, fruit and mushrooms			36	12	
Purchase of greenhouses for vegetables, fruit and mushrooms			36	12	
Equipment (Direct financing)		Purchase of new agricultural equipment		48	6
		Purchase of recycled equipment		24	6
Equipment (Re-financing)	Purchase of new equipment		48	6	

APPENDIX 2

FUNDED INVESTMENT PROJECTS UNDER NATIONAL SFA SCHEMES FOR THE PERIOD 01/01/2000 – 31/12/2001

N.	Programme/Line	2000			2001		
		Number of Projects	Amount	Average per Project	Number of Projects	Amount	Average per Project
I	Investment programme						
1	“Agricultural start” incl.:	254	2,519,626	9,920	97	1,043,758	10,760
	-equipment	35	331,629	9,475	15	145,456	9,697
	-livestock	91	925,699	10,173	28	302,510	10,804
	-beekeeping	43	421,574	9,804	18	208,391	11,577
	-greenhouses	-	-	-	1	10,800	10,800
	-land	19	182,409	9,600	11	129,236	11,749
	-establishment of perennial plantations	43	412,225	9,587	12	135,145	11,262
	-restoration of perennial plantations	-	-	-	3	34,000	11,333
	-other	23	246,090	10,700	9	78,220	8,691
2	“Bulgarian farm”, incl.:	168	4,723,989	28,119	45	1,479,615	32,880
	-equipment	50	1,292,556	25,851	7	358,250	51,179
	-livestock	30	771,100	25,703	8	249,258	31,157
	-beekeeping	10	207,305	20,731	2	49,000	24,500
	-greenhouses	1	15,000	15,000	1	25,000	25,000
	-land	29	913,640	31,505	6	142,702	23,784
	-establishment of perennial plantations	28	1,050,258	37,509	13	245,456	18,881
	-other	20	474,085	23,704	8	409,949	51,244
3	“Development”, incl.:	42	7,039,096	167,598	11	4,610,092	419,099
	-equipment	17	2,730,500	160,618	4	1,094,840	273,710
	-livestock	8	1,060,400	132,550	2	1,434,800	717,400
	-greenhouses	-	-	-	2	1,560,000	780,000
	-establishment of perennial plantations	9	1,717,036	190,782	2	368,452	184,226
	-other	8	1,531,160	191,395	1	152,000	152,000
4	“Organic farming”	1	8,000	8,000	-	-	-
5	“Mountain farming”, incl.:	27	346,040	12,816	18	247,120	13,729
	-equipment	2	15,000	7,500	3	42,650	14,217
	-livestock	12	162,810	13,568	5	71,400	14,280
	-beekeeping	5	51,380	10,276	2	15,300	7,650
	-land	-	-	-	1	25,000	25,000
	-establishment of perennial plantations	7	96,850	13,836	4	57,470	14,368
	-other	1	20,000	20,000	3	35,300	11,767
6	“Young farmer”, incl.:	30	326,925	10,898	5	51,350	10,270
	-equipment	8	84,665	10,583	-	-	-
	-livestock	8	97,600	12,200	1	10,050	10,050
	-beekeeping	5	54,100	10,820	1	4,300	4,300
	-land	4	55,890	13,973	-	-	-
	-establishment of perennial plantations	2	14,000	7,000	3	37,000	12,333
	-other	3	20,670	6,890	-	-	-
7	“Greenhouses”	12	4,162,605	346,884	1	1,475,000	1,475,000
8	“Basic machinery overhaul”	1	12,000	12,000	-	-	-
	<i>Total under section I:</i>	<i>535</i>	<i>19,138,281</i>	<i>35,772</i>	<i>177</i>	<i>8,906,935</i>	<i>50,322</i>
II	“Establishment of perennial plantations”	10	7,923,645	792,365	26	24,755,013	952,116
III	“Agricultural machinery”	18	381,877	21,215	26	603,971	23,230
	<i>Total I + II + III</i>	<i>563</i>	<i>27,443,803</i>	<i>48,746</i>	<i>229</i>	<i>34,265,920</i>	<i>149,633</i>
IV	Programme funding:	-	26,000,000		-	36,000,000	

APPENDIX 3

GENERAL DOCUMENTS REQUIRED FOR APPLICATIONS FOR SFA LOAN PROGRAMMES

1. Application form for request of credit /Form/;
 - 1.1. Declaration of related/involved persons /Form/;
 - 1.2. Declaration stating civil state and property /Form/;
 - 1.3. Declaration stating availability of open bank accounts, credits used by SFA and other banks, and other obligations /Form/
2. Certificate for paid/outstanding tax obligations;
3. Certificate for paid/outstanding social security payments.
4. Documents certifying legal status
 - 4.1. Court registration /copy of court decision/;
 - 4.2. Certificate for actual legal status, issued not earlier than 3 months before the date of application for credit.
 - 4.3. Constituent association contract/statute;
 - 4.4. BULSTAT registration certificate
 - 4.5. Tax registration certificate
 - 4.6. VAT registration certificate
 - 4.7. Certificate for absence of outstanding legal proceedings;
 - 4.8. Certificate for absence of bankruptcy proceedings;
 - 4.9. Certificate for absence of obligations over the assets offered as a collateral.
 - 4.10. Permissions/licenses for practicing the activity (if legally required)
 - 4.11. Permission of a competent body to use the credit and offer the collateral;
5. Registration card as an agricultural producer.
6. Documents for certification of financial status (not required in cases of 100% finance):
 - 6.1. Yearly tax declarations for two preceding fiscal years
 - 6.2. Accounting sheets, income and expense statements, cash flow reports and DMA statements for two preceding fiscal years /certified by an expert-accountant with enclosed report, if legally required/;
 - 6.3. Accounting balance, income and expense statements, and cash flow reports for the last accounting period /3, 6 or 9 months/;
 - 6.4. Bank references for credits used
 - 6.5. Bank statement extracts for all accounts (not required for purchase of equipment)
7. Investment project /for credits over 50 000 lv./
8. Documents for ownership of the assets used as a collateral.

General documents for animal and plant programmes only:

9. Tax value and/or expert evaluation of the assets used for collateral as well as insurance, if the above are insured /not required for credits through CB/.
10. Contracts for delivery of assets, subject of the required preferential credit, with indicated price per unit, quantity, cost, term and way of delivery and payment with attached "proform" receipts.
11. contracts for realisation of produce.
12. Written agreement for the servicing of the credit by a CB with which the fund has a refinancing agreement.

General documents for purchase of equipment programmes only:

8. Contract for delivery of equipment subject to requested preferential credit with indicated: type, model, Number of engine, price per unit, term and way of delivery and servicing during the period of the guarantee with "proform" receipt attached.
9. Protocol from Centre for Testing Agricultural Forest Equipment and spare parts - Plovdiv or Russe - and statement form the centre for the correspondence of the tested machinery to the safety requirements and a certificate for approval of the type, and certificate for correspondence to the approved type and statement of the centre for the trueness of the certificates and satisfaction of the safety regulations of the country. /Required only when new equipment is purchased and are given to the producer by the supplier/. In case at the moment of application the equipment is not on the territory of the country, the supply of the documents in para. 9 will be a condition for the conclusion of the credit agreement. (Only for direct SFA financing)
10. Contracts for realisation of the produce.

APPENDIX 4

SPECIFIC DOCUMENTARY REQUIREMENTS FOR SFA – PROGRAMME FOR ANIMAL BREEDING

<i>Art. 1 Livestock</i>	<i>Art. 2 Poultry</i>	<i>Art. 3 Rabbits</i>	<i>Art. 4 Apiaries</i>
Permission from National Veterinary Service for import of the animals and a certificate of origin /when imported/.			Copy of the license of the bee-mothers' producer when bee mothers are purchased.
Certificate /Form/ from Regional Directory for Selection and Reproduction of Animals, that the animals which will be purchased are herd animals /when purchased in the country.	.		Certificate of registration of the families from the seller with registered regional number of the apiary, issued by the municipality mayor/office.
Agreement /Form/ with Regional Direction for Selection and Reproduction of Animals for future breeding activity /given after conclusion of credit agreement with CB, hence SFA, and is a necessary condition for the refinancing of the CB in order to use the credit form SFA.	.		Certificate from veterinary service that the families that will be purchased are in good health.
Documents for ownership or rental agreement for the buildings /for min the term of the credit, certified by a notary and registered/ where the birds will be bred. Certificate for (inscribed circumstances??) regarding the property.			
Certificate /Form/ from Regional Veterinary Service, that the buildings, where the animals will be bred comply with hygienic regulations.			
Contracts for delivery of fodder, necessary for the feeding of the animals. In case the producer produces own fodder, documents for ownership or rental arrangements /for cooperatives/ of agricultural land, for minimum the term of the credit and prepared according to legal requirements.			

<i>Art. 5 Equipment</i>	<i>Art. 6. Buildings - building</i>	<i>Art. 8 Buildings - restoration</i>	<i>Art. 7 Building - purchase</i>
Documents for ownership of the equipment by the seller /required when purchased from a physical person/.	Documents for ownership or given right of building on the area, where the building and construction work will be done. Building permission issued by the municipality.	Documents for ownership of the buildings by the agricultural producer, applying for the credit.	Documents for ownership of the buildings by the seller.
	Contract for the building and construction work, with indicated, value, term and way of buildings and payment arrangements. As an inseparable part of the contract, attach a detailed account of the building and construction work by type, quantity and price per unit. In case the building and construction work are done by own labour, please attach only a detailed account of the building and construction work by type, quantity and price per unit.		
			Certificate /Form/ from regional veterinary service, that the buildings, where the animals/bird will be grown, comply with hygienic regulations.
			Evaluation by a licensed expert of the buildings, subject of the credit.
	Note: it is required in this art. of the programme that the producers own animals at the moment of application, and intend to expand their activity, or to apply simultaneously for the purchase of animals or birds.		

The producers who apply for credit according to the investment programmes have to give the full dossier of general and specific documents required in the regional offices of SFA in the place where the activity of the project will be performed, and register in a register.

The officers of the regional office perform the check on the place where the activity will take place, of the conditions for realisation of the project and the collateral offered, prepare a protocol and statement on the project, including an analysis of the sources for repayment of the credit, regardless of its size, and send the originals of the dossiers in the Central office of SFA.

The term of study of the applications for financial help, preparation of statements and their presentation to the competent offices which can take a decision is 30 working days.

APPENDIX 5

COLLATERAL REQUIREMENTS FOR SFA

By agreement between SFA and the person receiving the credit, the credit can be guaranteed by the following:

Mortgage on immovable properties and rights of belonging over immovable property, owned by, as follows:.....

Special pledges on:

a. Moveable belongings, property of the person receiving the credit, which remain in accountable keeping of the persons receiving the credit:.....

Moveable belongings, property of third persons,, which remain in accountable keeping with the third person.....

Pledge on money in BGN and convertible currency on account №..... in CB

Pledge on government bonds

Pledge on commercial enterprise of

Point out the main material assets of the enterprise

Pledge on future harvest from the current or following year;

Pledge on young animals and animals for fattening and their production;

The pledges in art “e” and “ж” are accepted only with combination with other collateral in this section

Guarantee bywith a domicile and office address in city., municipality, street.№.....BULSTAT №....., tax №, presented by, identity card №, issued on by, personal number, called in the present agreement “guarantor”.

Bank Guarantee, issued by

Registration of an order/warrant , issued by

Other collateral, which are not in a contradiction with art. 26 of agricultural producer protection law and are accepted by Bulgarian law.

Agreements have to be signed for the institution of the collaterals, according to the acting law, which are an inseparable part of this contract.

The person receiving the credit can dispose of the object of the pledge only after a prior agreement of the Fund, and the incomes from the realisation relate to the repayment of the credit or the persons receiving the credit exchanges the realised part of the pledge with other valuables.

The person receiving the credit can process the pledged short term assets, and in this case the pledge expands to cover the produce and art. 17.8 applies.

If because of a fall in price of the collateral or as a consequence of natural disasters, damages, accidents etc, the value of the above decreases or are destroyed and the Fund find the collateral to be insufficient, the persons receiving the credit is obliged to present immediately additional collateral or to decrease the size of the credit to a value determined by the Fund.

APPENDIX 6

BREAKDOWN OF APPROVED AND COMPLETED PROJECTS BY MAIN OBJECTIVE OF INVESTMENTS

Improving Processing and Marketing of Agricultural and Fishery Products In the Period 01/06/2002 – 31/12/2002

Objective	Number of Projects	
	Approved	Completed
Adapt establishments to EU standards of Hygiene and food quality	10	5
Improve or rationalise processing procedures	24	4
Improve storage capacity	4	1
Improve the presentation and preparation of products	7	0
Encourage the better use or elimination of by-products or waste	2	0
Adoption of technologies for new products and up-to-date packaging	18	3
Total	65	13

Note: the breakdown of the projects by objectives is conditional as some of the projects have more than one objective.

APPENDIX 7

MEASURE "IMPROVING THE PROCESSING AND MARKETING OF AGRICULTURAL AND FISHERY PRODUCTS"

Numer and Value of Approved and Reimbursed Projects per Sector

Sector	Number of Projects		Approved Investment Costs	Reimbursed Projects		Average Project Size		
	Approved	Reimbursed		Approved	Approved	Approved	Eligible Investment Cost	Reimbursed Subsidy
Wine	10	3	18,699,403	6,779,431	3,389,716	1,869,940	2,259,810	1,129,905
Fruit and vegetables	19	4	30,275,604	3,542,384	1,771,192	1,593,453	885,596	442,798
Milk and dairy products	7	1	12,154,736	1,459,381	729,690	1,736,391	1,459,381	729,690
Meat	24	5	45,495,829	6,933,966	3,466,983	1,895,660	1,386,793	693,397
Fish and fishery products	5	0	9,414,107	0	0	1,882,821	-	-
Total	65	13	116,039,679	18,715,162	9,357,581	1,785,000	1,440,000	720,000

APPENDIX 8

MEASURE “DEVELOPMENT AND DIVERSIFICATION OF ECONOMIC ACTIVITIES, PROVISION FOR MULTIPLE ACTIVITIES AND ALTERNATIVE INCOME”

Sector	Number of Projects		Approved Inv. Costs	Reimbursed Projects		Average per Project (approximate)		
	Apprvd	Reimbursed		Apprvd	Subsidy	Apprvd	Eligible Inv. Cost	Reimbursed Subsidy
Rural tourism	12	1	3,329,696	318,260	159,130	277,475	318,260	159,130
Local craftsmanship and agroindustry	1	0	35,751	0	0	35,751	-	-
Timber sawing, carpentry and bio-fuels	5	1	1,549,934	199,131	99,565	309,987	199,131	99,565
Silkworm breeding	0	0	0	0	0	-	-	-
Bee keeping	3	1	650,754	2,583	1,291	216,918	-	-
Horse breeding	0	0	0	0	0	-	-	-
Aquaculture	3	0	960,536	0	0	320,179	-	-
Mushroom production	2	1	434,496	150,260	75,130	217,248	150,260	75,130
Processing of essential oil plants, herbs and mushrooms	2	0	347,506	0	0	173,753	-	-
Total	28	4	7,308,673	670,234	335,117	261,000	168,000	84,000

BULGARIA

EXPANDING PROCREDIT'S OPERATIONS IN RURAL AREAS

ANNEX 3

**SPECIAL FEATURES OF BULGARIAN AGRICULTURE
(in summary)**

ANNEX 3

SPECIAL FEATURES OF BULGARIAN AGRICULTURE (in summary)

Agricultural Advisory Services

1. Providing quality advisory services to the small farmers is at least as important as supporting them with financial services. An important area of advice relates to the general management of the farm and marketing of the farm products. Because many small farmers have no previous agricultural experience, they often lack the experience of agriculture and management needed to make key technical, economic and marketing decisions. To date, most farmers do not keep any accounting records and do not know how to develop marketing linkages which leaves them very vulnerable. Introducing basic management tools would help them to make their choices in a more rational way. Furthermore, while most farmers are, for the moment, reluctant to receive any form of technical assistance from the State, once they see the economic benefit of technical recommendations the demand for extension advice will doubtless increase.

2. So far, few sources of reliable advice are accessible to the farmers in Bulgaria. The only free advisory service available to farmers is the National Agricultural Advisory Service (“NAAS”). NAAS was founded by the Government in 1995 with a technical and financial assistance from the EU-Phare Programme. The agency is funded and supervised by the MAF. It has 28 regional centres (i.e. one in each administrative region, working in close collaboration with the regional offices of the MAF and the SFA) and a central direction in Sofia. Each regional centre is staffed with three to five extensionists, including one agronomist, one livestock technician, one mechanisation specialist, one economist, and one specialist in a field related to the region's main agricultural production. The agency has 166 staff in total.

3. Until today, NAAS was primarily involved with the preparation of SAPARD/credit applications, and very little time and resources were spent on giving technical advice to small and medium-sized farmers. However, FAO has recently approved a technical cooperation project entitled “Capacity Building for Sustainable Delivery of Agribusiness Advice to Market-oriented Farmers”. The project has as an objective strengthening the capacity of NAAS staff, and supporting the delivery of market relevant advice and assistance aiming at the integration of small and medium sized farmers into the market economy. The project’s chief training components are in the areas of farm management, marketing, farm data and market information analysis. It aims at developing training support materials which will cover all the issues and topics needed for the NAAS to properly respond to the needs of small and medium-sized farmers and private-sector agricultural product buyers (e.g. costs calculations, gross margin analyses, investment analysis, collection and dissemination of market information).

4. During the pilot phase of project implementation a knowledge transfer process will be exercised through a series of field training events. The training courses will be held in conjunction with farmer groups and private-sector buyers in selected farmer communities of Veliko Turnovo, Schumen and Stara Zagora. These pilot areas were partly chosen to coincide with the planned ProCredit lending activities and ProCredit will be invited to participate in the workshops and thus promote its products to the farming community.

Agricultural Statistics

5. Statistics of interest to banks making agricultural loans are collected, analysed and presented mainly by the Statistics Section of the Ministry of Agriculture and Forests (MAF). Other statistics, peripheral to the agricultural sector, are the responsibility of the National Statistics Office. The latter office is currently (September 2003) analysing the results of a census the data for which were collected earlier in 2003. Publication of the results is expected by May, 2004.

6. MAF also undertakes sample surveys in order to obtain information for policy making purposes in the Ministry. Some of this information can be obtained from the Ministry, by interested parties.

Agro-Processing, Crops, Dairy, Meat (see also Annex 5 for more detail)

7. Agro-processing capacity, particularly for crop products, has sharply reduced since 1990. The principal cause is the loss of the reliable markets of the former Eastern bloc. An ancillary factor is that privatization has been difficult, as the processing machinery and equipment of the old factories was not well suited to producing the type of quality demanded by alternative markets, and indeed being offered by Bulgaria's competitors in the domestic market. This means that even the domestic market cannot be regarded as secure, and prompts a quality and promotion challenge.

8. Ideally the future should be very positive for the Bulgarian processed food industry. Natural conditions for growing many of the raw materials are excellent. As noted elsewhere in this report, crop and livestock husbandry levels are high, and the farming population increasingly includes those who take a very commercial and market oriented attitude to farm production.

9. ProCredit Bank will no doubt note the growth of opportunities to fund production enterprises geared to raw material supply to processing plants. For this reason agricultural loans officers should follow carefully the developments in processing infrastructure. EBRD may well look at the possibilities of re-building Bulgaria's processing capacity.

EU Accession

10. Bulgaria is scheduled to join the EU in 2007. In the pre-accession period, agriculture was identified as a key sector for the Government. The assumption is that by 2007 Bulgaria will fully adopt EU legislation and adjust its sector policies. In order to achieve this objective, the Government adopted the National Agricultural and Rural Development Plan in 1999. The Plan has as its objective "*development of efficient and sustainable agricultural production and competitive food processing sector through improved market and technological infrastructure and strategic investment policies*¹". The paper aims at providing the best strategy for the sector, although recommended policies might have to become a "moving target" closer to time due to current pressure for EU Common Agricultural Policy to change.

¹ National Agricultural and Rural Development Plan 2000-2006.

11. Five sectors have been selected by the Government as a priority in the National Agricultural and Rural Development Plan on the basis of their competitive advantages in the future EU market. The same sectors are recommended for receiving financing from the EU structured funds (SAPARD, PHARE) and private banks.

Primary Sector Priorities	Processing Sector Priorities
Priority Sub-Sectors	Priority Sub-Sectors
Vineyards	Wine production
Fruit and Vegetables	F&V processing
Milk production	Dairy production
Meat production	Meat processing
Forestry	Forestry product processing

12. Monitoring of the progress is done by the EU Commission and reported on a yearly basis in October every year. The last report highlighted steady progress in alignment with legislation and institution building, but slower progress in the enforcement of legislation.

13. The main area of legislative progress was noted in:

- the creation of the national cadastre and property register following the finalization of the land and forest restitution process;
- progress in the identification and registration of animals as an effort towards creation of Integrated Administration and Control System;
- establishment of sectoral associations (such as vine and wine chambers established in all regions).

14. It is expected that the accession will have an overall positive impact on the agricultural sector if main directions of the EU CAP stay unchanged. The first positive impacts of pre-accession benefits are already being felt by processors' increase in exports in the last two years, while the main impact for the primary producers is expected to follow after 2007.

15. New market opportunities for the processors are emerging and will increase in the short and medium pre-accession period. Following "double-zero" agreement with EU signed in 2001, exports to the EU increased by 15% to EURO 247 million in one year (trade balance in favour of Bulgaria increased by 8%). This trend is expected to continue over the next three years.

16. However, once the food prices adjust to EU prices, main benefactors will most probably become farmers who will see their income increasing (for the products for which the CAP provides direct price support) while the processors will most probably be the ones to absorb higher prices for raw materials (with consumers paying higher prices for food). However, they will still benefit from the inexpensive labour which will keep them competitive on the EU market.

17. The impact of EU pre-accession arrangements on processing standards, with the associated substantial requirement for investment capital, is covered elsewhere in this report.

Irrigation

18. In 1990 the land area irrigated was 570,000 ha. By 1997 this had fallen to 50,000 ha. Today more than 80 percent of the internal canal system is practically unusable (ref. National Agriculture and Rural Development Plan under the SAPARD, May 2003, p. 35). Moreover the most of the pumping stations which formerly provided the water for the canal system are no longer operational, due to a combination of lack of maintenance and theft of components. It is believed by governmental planners that large scale re-investment to rehabilitate the old system is not warranted at this stage. This is because of the fall in market demand for the produce of irrigated crops. In turn this is due to a reduced agro-processing capacity in the country. Nevertheless, many of the farming enterprises for which the soil, sunshine hours and local experience give Bulgaria a comparative advantage in Europe require access to moisture greater than that provided by normal precipitation. This fact points at the need for some rehabilitation of the old system, or a switch to reliance on groundwater, or both. In the short and even the medium term the focus will more appropriately be on groundwater exploitation.

Machinery and Equipment on the Farm

19. In 1990 the horsepower per arable hectare in Bulgaria was 70. A comparative figure for Germany at that time was 450 horsepower per ha. Since then the effective horsepower per hectare in Bulgaria has been reduced too much less than half the 1990 figure. Machines have not been replaced as needed, so the percentage of old, non-functioning tractors and combines has risen sharply. Apart from reliability considerations, many of the older combines were of such a design that they did not produce a clean 'sample' of grain. In turn this reduces the return from millers. This is one factor indicating a significant potential demand for agricultural machinery.

20. Elsewhere in this report a future is outlined in which consolidation of farm enterprises is the centre piece. An important component of this consolidation will be increasing mechanization, as the need to improve labour productivity becomes a key element in the greater profitability of farming.

21. Some figures are relevant here. In 2000 the total market for agricultural machinery and equipment was Euro 65 million. Whereas some of the expected increase from this point will be provided by special programmes (e.g. SAPARD) which tend to favour larger farmers, there will still be an important segment of the progressive farming population which requires loans on a more modest scale. A significant level of investment will be required, especially in tractors in the 70 – 80 horsepower range, together with associated implements.

Marketing of Farm Products

22. The changes in structure of the agricultural sector since 1990 have been accompanied and indeed largely driven by the loss of former secure markets for farm products, especially for those items for which Bulgaria has a comparative advantage, namely fresh fruit and vegetables¹.

¹ High sunshine hours, warm summers and cool winters favour the cultivation of many fruits and vegetables.

In the days of the Soviet trading bloc there were three main outlets for local products. Firstly there was the fresh trade, which involved rail transport of fruit and vegetables (especially salad items) to Moscow and other large population centres. Second, the processing industry absorbed large quantities of product. Third, there was the local market.

23. Of these, only the local market survives to any great extent. Opening up trading opportunities has seen a number of other countries, e.g. Hungary, seize the chance to export fresh products, while the markets for processed items have been similarly challenged by industries better able to package and market for increasingly discerning consumers, both in Bulgaria and elsewhere in Europe.

24. The local market, though, is full of promise, and may well provide the springboard for future export growth. Bulgaria's GDP is still at a level where the elasticity of demand for food is high – probably over 0.5¹. Thus as domestic incomes improve; the local market will grow for farm products, providing a useful base on which to build an export push.

Organic Agriculture

25. According to the strategy of the Ministry of Agriculture, production of organic products is seen as one of the most important niches for Bulgarian agriculture within the EU market.

26. According to Research Institute for Organic Agriculture, Bulgaria today has approximately 600 ha of organic areas, with 150 small and medium farms being converted to organic production.

27. An increasing number of small farmers in Bulgaria are converting to organic farming in the hope of gaining a strong foothold in once Bulgaria joins the EU market in 2007. Comparative advantages include vast farmland free from chemical-synthetic fertilizers and pesticides, making the land ready to use for organic production, and low labour cost, which is of more importance in organic when comparing to traditional agriculture.

28. In January 2001, MoA and several NGOs, presented to the Government draft legislation for organic agriculture which was subsequently approved and accepted by the Council of Ministers in August 2001. Legislation was presented in two ordinances related to organic production of plants, plant products and foodstuffs of plant origin and organic production of livestock, livestock products and foodstuffs of animal origin.

29. There are four large and several small associations active in different regions of the country. These associations are mainly involved in certification of organic produce, providing advisory services to their members, but also some of them (like Bioselena) offer financing to farmers involved in organic agriculture.

¹ Meaning that for every increase in income of 1 unit of currency, 0.5 of that unit will be spent on food. In the current Bulgarian situation the additional demand is likely to be for firstly for livestock products, then for fresh fruit and vegetables.

30. Four biggest agencies include the following:

1. Agency for Agricultural Information and Innovation
2. Agrolink Association
3. Bioselena Foundation for Organic Agriculture
4. Foundation for Organic Agriculture

31. Agency for Agricultural Information and Innovation is based in Veliko Turnovo where it has around 20 active members, mainly farmers involved in organic agricultural production and processing producing vegetables, plants for essential oil processing and organic seeds. The Agency provides advisory services related to production, processing and trade of organic produce, as well as standards certification. It is also actively involved with R&D, training and education.

32. Bioselena is most active in the region of the Central Balkan (Stara Planina region), where it works with approx. 80 farmers. The Association has strong links with the Swiss Agency for Development and Co-operation and the Research Institute for Organic Agriculture in Frick, Switzerland. Activities include advisory services, certification of organic produce, marketing in the country and abroad. Bioselena is the first specialised association in organic agriculture that provides credit to its members/farmers involved in organic production in the region. Credit is offered under the following conditions:

- maximum sum: up to 25,000 BGN;
- able to finance 70% of total cost of the project;
- repayment period: up to 5 years with 1 year of grace.

33. Bioselena is actively involved in advocacy work where it receives a lot of support from its international partners.

34. Agrolink association is active since 1999 in the region of Vitosha mountain, Rila mountain and Strandja mountain. It has 30 member farmers with a total surface area of 80 ha of farms in the regions. Association also has as its members several agronomists, botanists and scientists involved in advisory activities to the farmers in those regions. Agrolink supports organic livestock breeding, as well as production of strawberries, raspberries, vegetables, medical plants and grain. However, it does not have a licence to certify the products, for which it relies on agencies such as Bioselena.

35. There are a number of smaller associations of farmers involved in organic agriculture in different parts of the country, such as Bio-Bulgaria. This association relies heavily on the four agencies listed above, and benefits from the regular technical advice and training services which they provide.

Available Financing for Organic Farming

36. Except for sector associations like Bio-Selena and two small NGOs supported by USAID that offer financing (along with technical advice) to small organic farmers, there are no special programmes available from the commercial banks. ProCredit Bank, together with Bio-

Selena and Swiss Agency for Development, is currently involved in pilot project of financing several organic farmers.

37. In September 2002, there were plans announced by the Minister of Agriculture to promote organic farming with money from the SAPARD programme. Budget planned was in a range of EURO 350m. However, no information on the implementation of these plans is available.

38. The EU European Organic Farming project, announced in August 2003, has included Bulgaria as one of the beneficiaries. The project will identify how the complementary development of Organic Farming in both existing EU states and in Central and Eastern European (CEE) accession states can be fostered through policy design and innovation.

Implications for ProCredit Bank

39. At the time of writing organic production is no more than a tiny niche in the overall agricultural sector. Market demand is likely to grow, following a worldwide trend. However, a caveat is in order. Organic producers expect to receive a price premium over produce which is not certified as organic. This price premium in turn depends on correct positioning in the market, which necessitates appropriate infrastructure and certification in the production area, and promotion closer to the consumer. Experience elsewhere has demonstrated that these required structures and mechanisms are readily started, with waves of enthusiasm, but they are difficult to maintain through time. ProCredit should certainly continue to look at loan requests from both producers and marketers of organic produce, but should examine very carefully the durability of the certification/marketing system on which the expected price premium depends.

BULGARIA
EXPANDING PROCREDIT'S OPERATIONS IN RURAL AREAS

ANNEX 4
AGRO-PROCESSING

ANNEX 4

AGRO-PROCESSING

Introduction

1. Bulgaria has a strong tradition in food processing. In the last 13 years, the industry has undergone a process of privatization and restructuring, following a very substantial downturn in activity and throughput with the loss of much of the former Soviet bloc market, coupled with a downturn in demand in the domestic market due to lower *per capita* incomes. There are signs however that the bottom point has been reached, and in several of the enterprise types mentioned below significant percentage increases in output have been registered in the last 2 – 3 years, albeit from production levels well below those of the pre-reform period.

2. According to Ministry of Agriculture and Forestry (“MAF”), currently 85 percent of the industry is now in private hands. There are 209 large processing plants of which 147 are newly established, with more than 1,000 small processors active in the sector. Major products include flour and other grain products, sunflower and other vegetable oils, dairy products, wine, tobacco, processed fruits and vegetables, essential oils, fresh and dried mushrooms and herbs. Inexpensive labour, inexpensive raw material and know-how are the major factors behind recent dynamic developments in the food industry. Major exported products are grains, sunflower, vegetable oils, dairy products, wine, tobacco, processed fruits and vegetables, essential oils and herbs. It is estimated that the local food processing industry sources (on average) 30 percent of its raw materials from imports.

3. Over the last two years, most food companies reported stabilization of their financial status and market presence. Investment in new technologies and modern quality control systems have improved food safety standards. These food manufacturers have embarked on more active marketing, expansion of product range and brands promotions. Although some progress has been made, there is still a long way to go to regain the production volumes achieved ten years ago.

4. In 2002, local food sales amounted to US\$2.1 billion (estimate) with an annual growth of 7% over the last three years. Due to Bulgaria’s future accession to the EU, there is an active trend toward modernization, upgrading and adaptation of local facilities to EU requirements. The major challenges to the food industry are adopting sanitary, hygiene, food safety standards and quality management systems (GMP, ISO, HACCP) in order to be competitive within the EU market.

Market Developments

5. There are about 1,000 registered food production/processing enterprises operating in 2003. Unregistered companies operating outside state regulations account for 25% of the market throughput. This percent varies among various sub-sectors. The highest number is in the beverage industry, and the lowest in the dairy industry.

6. Meat processing industry is the fastest growing industry, growing at the pace of 10% per year in the period 1999-2002. Second largest growing sub-sector is cereal food production with 20% increase in the same period. Growth was also registered through industry consolidation and new investment.

7. Officially registered food sales in 2001 were about US\$1.5 billion in value. It is estimated that the actual figure is close to US\$2.0 billion (including taxes) due to unreported sales. Initial estimates for 2002 are in the area of US\$2.1 billion.

Sector Overview

8. Food industry consists of 13 sub-sectors: meat and meat products; canned fruits and vegetables; fish/seafood; animal fats and vegetable oils; milk and dairy products; grains and cereal products; pet foods; bread milling, confectionery and other cereal products; sugar, chocolate and cocoa products; food additives; diet foods; alcohol: wine; beer and malt manufacturing; mineral water and soft drinks.

9. Parallel to the formal processing industry, a large number of home prepared foods are sold to consumers, especially in rural areas. Over the last 3 years, the consumption of home-made food has declined due to a decrease in price and increase in supply of industrially processed food.

10. Most important sub-sectors in terms of linkages with the primary producers are dairy, meat, fruit & vegetable and wine sub-sectors. Some of these are also the most dynamic, experiencing a lot of investment in the last three years (like dairy and meat processing). All three sub-sectors are heavily under pressure to undergo changes needed for joining the EU market.

Dairy Sub-Sector

11. EU hygiene and sanitary norms in the dairy industry should be fully embraced by 2010 according to agreements between the Government and EU. Dairies that will not meet EU requirements by 2007 will not be able to export their produce into EU, and 2010 they will have to face closure.

12. The industry consists of two types of processors: small processing plants called 'mandras' with a low cost policy producing only a few varieties of long-lasting cheese (such as feta) and large, modern, processing plants (mainly with partial foreign ownership) which have the capacity to compete internally and in the wider EU market.

13. Earlier this year, mass veterinary inspections resulted in closure of 25% of above mentioned small dairies as not meeting the standards that are being harmonised with the EU standards. The main reasons for closure were lack of cooling equipment, excess water content in fresh milk, poor hygiene conditions and shorter than required aging period for processed dairy products. It is expected that most of these will close in the next five years.

14. There is a lack of access of small/medium sized companies to credit and investment and subsidy programs promoted by the Government

15. Currently, there are 10 dairies approved to export their product to the EU, mainly cheeses. These exporters face difficulties related to the protection of their trade marks and brands. For example, Bulgarian exporters are not able to export under the label "Feta" for "Bulgarian white cheese" since these two appellations are already patented by Greek and Turkish parties. The top three dairy companies in Bulgaria are:

- Danone Serdica (2001 sales of US\$21.0 million);
- Delta Bulgaria (2001 sales of US\$11.0 million);
- Vitalact (2001 sales of US\$5.0 million).

Meat Sub-Sector

16. Over the past two-three years, a large number of new companies have emerged in this sub-sector, where the growth in the last three years is the highest of all the food processing sub-sectors. The reason for this development is the increased consumption of ready and semi-ready convenience foods, and increase in purchasing power.

17. Companies face frequent fluctuations in prices of raw meat, as well as lack of a constant and reliable meat supply. Raw meat supply to the processing industry is closely related to price and quality of raw meat sold in the retail market. Usually, when local meat has a high price, processors prefer to use imported meat.

18. New EU's sanitary and hygiene standards should be implemented and adopted by the end of 2003. After this period, the National Veterinary Service will close down meat processors which fail to meet these EU criteria. Top processing companies are:

- Mesokombinat Lovetch (a part of Boni Oborot Holding, sales of US\$20 million in 2001);
- Boni Commerce (2001 sales of US\$8.0 million);
- Interfoods (2001 sales of US\$5.0 million).

Fruits and Vegetables Sub-Sector

19. The situation in this sub-sector is the worst of the three being discussed here, and there is a steady trend toward reduction in exports of fruit and vegetable products. This is related to low efficiency of local producers. They are small, fragmented, lack necessary capital, equipment and know-how; and rely on expensive energy sources and inputs. At the same time dumped imported produce from Greece and Turkey is a main source of raw material for the processors. For example, the largest fruit and vegetable wholesale market in Sofia shows imports account for 60% of total turnover in the second and third quarter and for 80% in the first half of the year.

20. Locally produced frozen, dried fruits and vegetables as well as juices are more competitive than fresh produce.

21. The most competitive are varieties of wild forest fruits and small fruits - strawberries, blackberries, blueberries, raspberries, and sour cherries. The most exported vegetables are red peppers in various forms. The top three processors are:

- Nash Dom Bulgarian Holding (2001 sales of US\$12.0 million) - compotes, pickles and cans;
- Litex Juice (2001 sales of US\$7.0 million) - fruit and vegetable juices;
- Storko (2001 sales of US\$6.0 million) - cans and pickles.

Wine and Grape Sector

22. There are around 270 wineries in Bulgaria owned by 96 enterprises of which 11 are large concerns that dominate the sector. The privatization of wineries started in 1993 and, in September 2003, all the wineries had been privatized. There is an increasing number of private, medium-sized cellars (around 50 at the moment) with new type of owners that are mostly Bulgarian entrepreneurs, not necessarily originating from the wine sector, but interested in investing in sector with good prospects of returns. It is estimated that, in 2002¹, most wineries made profits.

23. The sector is more than 80% export-oriented, and accounts for 30% of the export revenues of trade between Bulgarian food exporters and the EU².

Table 1: Value of Wine Export

		1998	1999	2000
Total export	EURO (millions)	4,000	3,850	4,500
Value of wine export	EURO (millions)	118	70	55
Wine share in export	%	2.8%	2%	1.2%
Volume of wine export	Litters (millions)	169	101	76

24. The first major foreign private investment in the sector took place in 1998 when Agribusiness Team of EBRD signed EURO 2million equity investment and EURO 26million long-term loan investment in Domaine Boyar, the biggest and most successful exported of Bulgarian wine. The investment was aimed at the enhancement of skills and technology and the strengthening of the competitive position of Domaine Boyar in export markets.

25. The main weakness and threat facing the industry are old and depleted vineyards (more than 70% are older than 25 years³). However, above mentioned emerging medium-size private producers are in the process of establishing long term contracts with vineyard owners and encouraging new plantations of vine. They also provide extension services on vineyard management, cultivation practices, mechanization and advise on more profitable sorts of grapes. This process provides an investment gap for the ProCredit Bank who can explore financing of the grape producers through risk-sharing mechanism with the processors.

¹ Vertumne, Etude de marche, Bulgarian Wine and Vine industry overview, 2002

² Bulgarian Wine Industry, J.E. Austin Associates, 2001

³ Vertumne, Etude de marche, Bulgarian Wine and Vine industry overview, 2002

Investment Opportunities in Agro-Processing¹

26. The re-structuring of the processing industry provides a basis for substantial investment in order to improve quality of output and in general to enable the production of the sector to be marketed effectively. Naturally the starting point would be the market itself.

27. Scale is clearly an issue. Larger enterprises have already attracted foreign investment (e.g. Danone in dairy processing/marketing). This is likely to continue, and to also involve investment in consolidation of enterprises.

28. Smaller enterprises are still a potentially viable segment of the industry. Many of these enterprises need to borrow for working capital purposes, including for the purchase of raw material. Particular medium and longer term investment items would include the following, sub-sector by sub-sector:

Meat Processing

- Renovation of facilities and equipment in abattoirs to meet EU standards.
- Measures, including construction and machinery, to deal with pollution at abattoirs and processing plants.
- Promotion and market development for specialty meat products.

Dairy Processing

- Investments in cooling equipment on-farm and improvement of equipment in collection centres.
- Upgrading of facilities and equipment in small-scale cheese-making and yoghurt plants.

Canning/Pickling/Freezing Vegetables and Fruits

- Market and product development, including packaging and label design.
- Renewal/upgrading of equipment for market-led product lines.

Wine

- Financing of grape producers through risk-sharing mechanism with the processors
- Upgrading of primary processing equipment.

¹ This section draws on a number of sources, especially the National Agriculture and Rural Development Plan, 2000-2006, GoB (version 27 May 2003).

BULGARIA

EXPANDING PROCREDIT'S OPERATIONS IN RURAL AREAS

ANNEX 5

**SUSTAINABLE LIVELIHOODS STUDY OF HASKOVO AND DOBRICH
REGIONS**

ANNEX 5

SUSTAINABLE LIVELIHOODS STUDY OF HASKOVO AND DOBRICH REGIONS

TABLE OF CONTENTS

1. Introduction	1
2. Approach and Methodology	2
3. Description of Study Area	7
Haskovo	7
Dobruja.....	7
4. Vulnerability Context and Livelihood Assets in Rural Bulgaria	8
4.1 Access to Livelihood Sources at Village Level	8
4.2 Livelihood Assets at Household Level	9
4.3 Vulnerability of Ethnic Minorities.....	12
5. Livelihood Strategies	12
5.1 Multiple Sources of Livelihood.....	12
5.2 Income, Expenditure and Saving Patterns.....	12
5.3 Agricultural Production Cycle (shocks and seasonality)	13
Irrigation	14
5.4 Experiences with Agricultural Credit	15
5.5 Support Networks, Trust and “Group Culture”	16
5.6 Coping Strategies and Informal Lending Sources.....	17
6. Exclusionary Processes	18
6.1 Policies and Procedures of Micro-Finance Institutions	18
SAPARD	18
ProCredit Bank.....	18
State Fund for Agriculture (“SFA”)	19
The Private Mutual Rural Credit Associations (“PMRCAs”)	20
The Credit Cooperatives in Haskovo and Dobruja	20
6.2 Registration of Family Farms.....	21
6.3 Contracts with Traders or Processors	22
6.4 Access to State Subsidies.....	22
6.5 Access to Collateral	22
6.6 Access to Extension Support.....	23

7. Aspirations for the Future	24
7.1 Perceived Strengths	24
7.2 Perceived Needs and Priorities for Improving Rural Livelihoods.....	24
7.3 Needs and Priorities for Financing	25
Micro-Finance Products.....	25
Loan Procedures	28
Collateral Requirements and Conditions for Loan Repayment.....	28
8. Proposed Options for ProCredit Lending Strategy	28
8.1 Sectors for Financing	28
8.2 Fast and Simple Application and Approval Procedures.....	29
8.3 Varied and Innovative Micro-Finance Products	29
8.4 Flexible Collateral Requirements	29
8.5 Realistic Conditions for Loan Repayment	29
8.6 Increased Outreach of Micro Finance Services	29
8.7 Lessons from Experiences with Group Lending.....	30
An Example of Group Guarantee Mechanism	31
8.8 Typology of Potential Small Farmer Clients.....	31
8.9 Collaboration Between ProCredit and Other Actors in Rural Development	33
Farmers' Credit Cooperatives.....	33
Regional Agricultural Advisory Services	33

APPENDICES:

- 1. Guiding Questions for Household Interview**
- 2. Guiding Questions for Village Group Discussions**
- 3. Comparison of Typologies of Potential Small Farmer Clients: Dobrich – Silistra**

ANNEX 5

SUSTAINABLE LIVELIHOODS STUDY OF HASKOVO AND DOBRICH REGIONS

1. Introduction

1. The present Sustainable Livelihoods Study¹ (SLA) is part of a wider FAO Investment Centre (TCIE) effort to provide technical assistance to EBRD in supporting ProCredit Bank's expansion of operations into rural areas in Bulgaria. The Study was funded by the FAO Livelihoods Support Programme (LSP) in response to a request made by TCIE to add a sustainable livelihoods dimension to this EBRD initiative.

2. The Sustainable Livelihoods Study seeks to gain insights into poor farmers' livelihood systems, their vulnerabilities, social exclusion and strategies for overcoming constraints. It examines the role that targeted microfinance services can play in improving small and micro farmers' livelihood strategies and raising rural household incomes. The Study is expected to contribute to ProCredit Bank's understanding of the specific needs and priorities of a considerable number of potential clients who are now not considered "bankable". The study results and recommendations aim to assist ProCredit in developing appropriate microfinance products and lending strategies that respond to small farmers' real needs and capacities, as defined by them selves.

3. In the initial stages of its expansion, ProCredit Bank is not intending to target services to the poor sections of the rural population. Hence, the poorest and most vulnerable families were not included in the sample of the Rural Household Survey and the case studies carried out by TCIE². Nevertheless, the poor³ and the very poor⁴ farmers ("small" and "micro" farms) constitute a large part of ProCredit's potential client base in rural Bulgaria - mainly borrowers of small credit.

4. The Sustainable Livelihoods Study adds a poverty dimension to the above mentioned survey by focusing on the potential strengths, capacities, needs and priorities of poor farmers in relation to rural finance services⁵. It is believed that, by improving lending policies to include these potential clients during later stages of its rural expansion process, EBRD/ProCredit will contribute more directly to rural poverty alleviation in Bulgaria.

5. The specific objectives of the Sustainable Livelihoods Study are to:

- (a) assess the vulnerability context, the livelihood assets and the strategies of the poorer sections of rural households in disadvantaged rural areas of Haskovo, Dobrich and Silistra regions;

¹ Carried out by Ms Ida Christensen, Rural Sociologist, FAO - TCIL.

² Undertaken in August-September 2003 by Vitosha Research and NAAS with the supervision of TCIE.

³ Defined as having access to about 5-10 cows or up to 20 sheep/goats for the livestock sector; 1.5 ha of land for the horticultural and market-gardening sectors; 1 ha for the wine sector; and up to 20 hectares for the grain sector.

⁴ Defined as having access to less than the above mentioned assets.

⁵ For more background on the objectives and justification for LSP's involvement, see relevant TORs in Appendix 1.

- (b) examine the perceptions of a sample of poor rural people in relation to their strengths and constraints in pursuing their livelihood strategies through access to existing rural financial services;
- (c) identify this target group's special needs and priorities relating to loan access procedures and desired rural finance products; and
- (d) examine and present a set of options for ProCredit Bank's rural lending strategy that would target the micro-farms in an effective and sustainable manner.

6. In line with LSP's objectives, the SL study results are expected to benefit FAO's institutional learning through: a) providing an example of how poverty oriented SL approaches can be applied to an initiative that does not have a poverty focus; b) learning lessons on SLA application in the context of a transitional economy of Eastern Europe (so far most lessons are from Africa, Asia, Latin America); and c) facilitating the sharing of knowledge across FAO divisions, in support of mainstreaming sustainable livelihoods approaches in FAO's work.

7. LSP's involvement in Bulgaria would also contribute to: a) the overall programme objective of having "FAO and partner agencies apply enhanced sustainable livelihood approaches"; and b) the LSP Sub-Programme (3.5) goal of "harnessing investment projects in support of poverty reduction and sustainable livelihoods for the poor".

2. Approach and Methodology

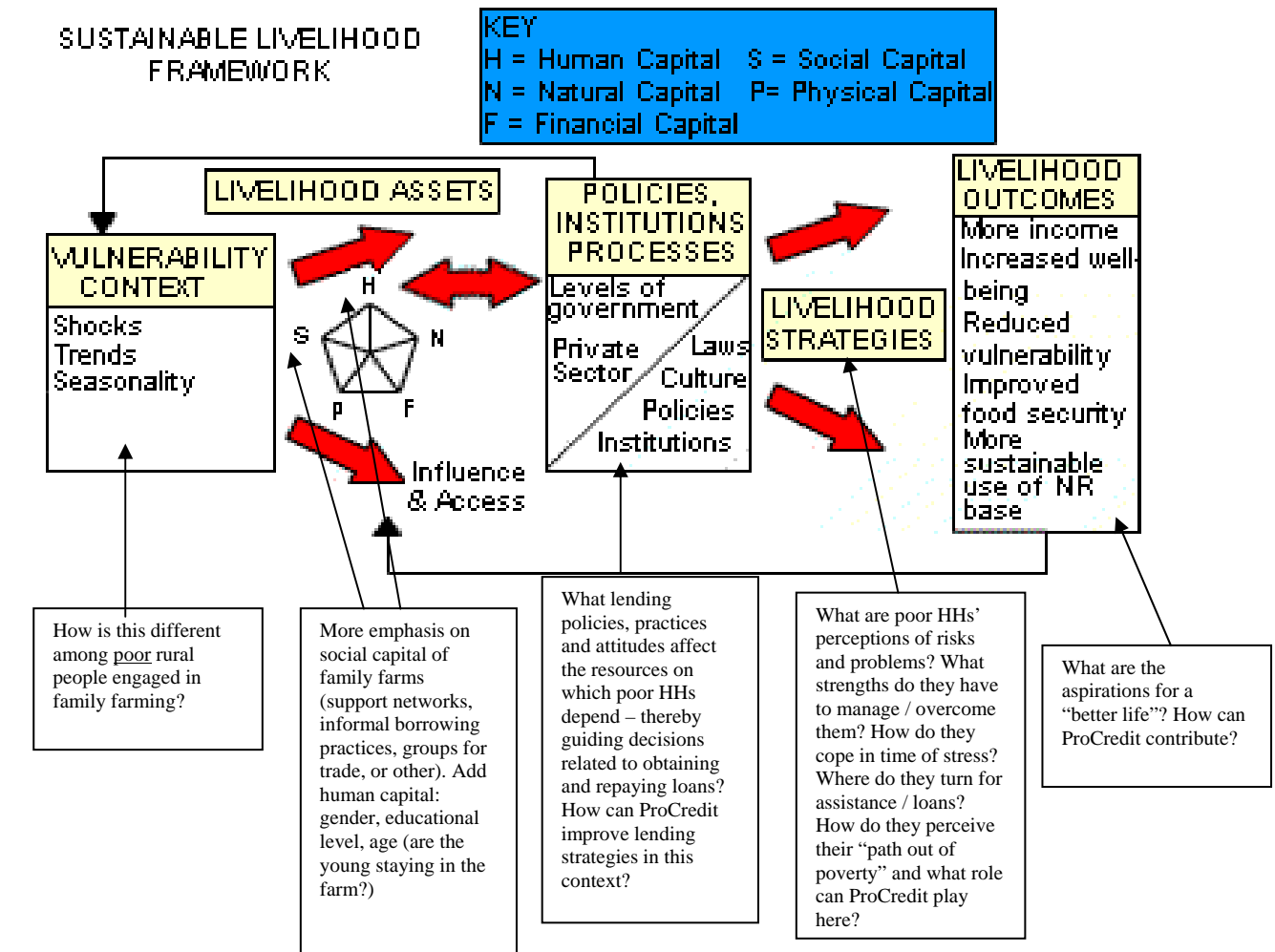
8. This study adopts a people-centred sustainable livelihoods approach to poverty reduction. It is an approach that makes a shift from a material to a social perspective, which focuses on the enhancement of people's capacities to secure their own livelihoods. It focuses more on opportunities and priorities than on problems, acknowledging the multiple strategies people employ to improve their livelihoods in an environment with multiple actors (such as private sector banks, government schemes, NGOS and international bodies). It is an approach that looks not only at the production of food but also at the ability of individuals to procure the additional items essential to their wellbeing.

9. The value added by this study to EBRD's work is a focus on people's vulnerability and livelihood assets, how these relate to poverty and how rural lending could play a part in enhancing people's livelihood strategies.

10. In support of this study, an in-house task group for Bulgaria was formed between various FAO departments to backstop and provide inputs into the study at various stages as well as to facilitate the exchange of lessons emerging from the experience. As a first step, the draft questionnaire of the ProCredit household survey – designed by TCIE - was reviewed and changes were made to reflect the information needs under the sustainable livelihoods framework. As a second step, the household survey results were reviewed, and information gaps were identified. The lacking qualitative data needs (livelihoods focused questions) were added in order to achieve a more holistic view of small potential clients' vulnerability context and livelihood strategies.

11. Within the framework of the Sustainable Livelihoods Approach, a set of key questions were raised. These appear in Figure 1 below:

Figure 1: Sustainable Livelihoods Framework



12. The study involved two missions to Bulgaria: the first (12-21 September 2003) covered the south-eastern region of Haskovo and the second (6-14 November 2003) covered the north-eastern regions of Dobrich and Silistra, in the geographical area of Dobruja. All field work was carried out in rural areas within these regions. The choice of the regions was based on four main criteria:

- they were covered by ProCredit services;
- they were among the regions included in the EBRD household survey;
- they were not visited by preceding TCIE missions;
- they were served by credit cooperatives that were active in small rural lending and could assist in field visits.

13. The study was based on quantitative data from secondary sources, mainly from the regional statistical offices in the country, as well as on qualitative information obtained through primary data collection methods during field work. The methods used in the field included:

- Village focus group discussions with a selection of small farmers living in rural areas.
- Semi structured interviews with a selection of rural households who depend on small family farms as their main source of livelihood.
- Key informant interviews involving representatives of village authorities (mayors), ProCredit Bank staff, credit cooperative leaders, production cooperative representatives, etc.

14. Group discussions were held with farmers from ten villages in the municipalities of Haskovo, Stambulovo, Dimitrograd (Haskovo region), Dobrich, Shabla (Dobrich region) and Kainardja (Silistra region). The discussion groups included a total of 55 people, mainly men, aged between 20 and 45 years, with basic to intermediate education and an average livelihood asset base corresponding to the criteria mentioned in paragraph 16 below.

15. Household interviews covered a total of 42 respondents, 21 in Haskovo region and 21 in Dobruja (7 in Silistra and 14 in Dobrich). The total area covered by the SLA Study included 28 villages in eleven of the 26 municipalities in the above mentioned three regions (42% of all municipalities covered). Table 1 illustrates the study's geographical coverage.

Table 1: Study Coverage

Region	Municipality	Village
HASKOVO	Haskovo	Haskovo Town
		Stoikovo
	Stambulovo	Garvanovo
		Stambolovo
		Uzonjovo
		Jalti Briak
		Goliamo Botevo
	Harmanli	Malak Izvor
		Slavianovo
		Elena
		Boliarka
		Varbovo
	Dimitrograd	Gorski Izvor
		Zetiovo
Tzenovo		
Yabalkovo		
Mineralni Bani	Susam	
SILISTRA	Tervel	Kolartsi
	Kainarja	Svetoslav
		Kainarja
		Golesh
DOBRICH	Shabla	Shabla
	Dobric	Stojer
		Stefanovo
		Donchevo
		Stojer
		Stefan Karaja

16. The key condition for participation in the SLA household interviews and the focus group discussions was that farmers should belong to the poor / low-income sections of the rural population according to the following criteria, or that they should have belonged to that group immediately prior to taking a recent loan. The criteria for classification in the “poor / low income” group included access to the following livelihood assets:

- 5-10 cows or up to 20 sheep/goats for the livestock sector;
- up to 15 decares¹ of land for the horticultural and market-gardening sectors;
- up to 10 decares for the wine sector; and
- up to 200 decares for the grain sector.

17. All participants in the SLA study sample marketed their produce and considered farming to be an important business. More specifically they included:

¹ 10 decares (dca) = 1 hectare.

- households whose livelihoods depended primarily on agriculture (more than 50% of total household income);
- farmers who had taken agricultural loans from a formal lending institution;
- farmers who had not taken loans but who had either tried - without success - or would like to do so in the future; and
- farmers who had not taken loans because they – for various reasons - felt excluded.

18. As far as possible, attention was paid to achieve appropriate representation of gender, educational level, ethnic origin, main agricultural activity and age group. Regarding the latter, weight was given to the economically active group of below 60 years of age. Table 2 illustrates the characteristics of the household interview respondents.

Table 2: Description of HH Interview Respondents

Respondent Profile	Number	% of respondent HH
women	14	33%
men	28	67%
Ethnic Minorities	11	26%
Female Headed Households	2	5%
Age		
<40	15	36%
40-60	21	50%
>60	6	14%
Educational level:		
Basic	15	36%
Technical	13	31%
Higher	14	33%
Main Agricultural Activity		
vegetables	11	26%
livestock	10	24%
grain	8	19%
tobacco	4	10%
grapes	3	7%
poultry	3	7%
orchards	1	2%
other (fishing, apiculture)	2	5%

3. Description of Study Area¹

Haskovo

19. The overall area of Haskovo region is 5 543 000 dca, of which 2 650 848dca (48%) is agricultural land. The region is situated in the south-eastern part of Bulgaria and has 11 municipalities, of which three border with Turkey. The remaining municipalities border with the regions of East Burgas, Sliven, Stara Zagora, Plovdiv and Kardjali. The climate is highly influenced by the vicinity to the Mediterranean Sea, allowing two harvests in one year. The south is mountainous, whereas the North is flat with fertile humus soil. The largest Bulgarian river Maritza crosses the region, providing a good source for irrigation of early vegetables and fruits. The region has a relatively well developed industry for textiles, shoe-making, wood-processing, machine-construction and electrical appliances. Agriculture is one of the most important economic activity in Haskovo.

20. Grain crops encompass 64% of the arable land, vegetables 8%, sunflower and tobacco 20%, and vines and orchards 7%. Wheat is the most important grain crop, followed by barley and maize. Tobacco is a traditional cash crop produced in the region. The area under vegetable and vine cultivation is on the increase. All livestock (100%) in the region are raised by family farms. The municipalities of Ivailovgrad, Madjarovo, Topolovgrad, and a part of Stambulovo are the least populated in the region due to mountainous terrain and lack of access to alternative income sources, such as tourism or small industry.

Dobruja

21. The Bulgarian part of the wider geographic area of Dobruja² comprises the regions of Dobrich and Silistra. The two regions have similar geo-political characteristics, climatic conditions, agro-ecological zones and they share a common history. Dobruja claims 22% of Bulgaria's total wheat production, making it the largest single wheat producer in the country. In addition, about 40% of the country's maize production and 35% of the sunflower originate from Dobruja.

22. **Silistra** is situated in the North East part of Bulgaria, bordering the river Danube and Romania to the north, Russe and Razgrad regions to the west and Dobrich region to the south. The climate is continental, the landscape flat and the soil is of the humus type. Of a total land area of 1 942 013 dca, 1 707 935 (88%) is agricultural land. Agriculture is a key industry for the region's economy providing 38% of the overall GDP. About 61% of the land is under grain crops consisting of wheat (40%), maize (20%), sunflower (15%) and barley (5%). The second most important agricultural activity in the regions is animal husbandry. Here too, 100% of the cows, sheep, poultry and bees are bred by family farms. Perennials are grown on 63 963 dca of land, of which 24 781 dca. (34%) is under vines. The most important fruit production is apricots, followed by some cherries, plums, and apples. An additional 14 000 dca are under melons and water melons. An estimated 10 000 tons of vegetables are produced per year in Silistra, since the year 2000. Tobacco is grown on 22 000 dca of land. About 50% of agricultural land in the region is

¹ This section draws on data from the "Statistical reference book", National Statistical Institute, Sofia 2003.

² Southern Dobruja is in Bulgaria and northern Dobruja is in southern Romania.

cultivated by family farms, 32% by 32 productive cooperatives and 18% by large land leasing farmers. The registered agricultural producers for the year 2002 were 2 455. As per 2002, Silistra had 13 active milk processing factories, 6 abattoirs, 275 milk collecting units, one meat processing factory and one winery.

23. Alternative sources of income include small industries for textile, machine building, electrical and electronic appliances and transport. All of Silistra's 7 municipalities are disadvantaged in terms of distance to potential wholesale markets. The region is located considerably far from important tourist and other consumer centres (towns or resorts that consume large quantities of foodstuffs).

24. **Dobrich¹** is one of the largest regions in Bulgaria (4 723 199 dca) and has the largest area of land under cultivation in the country (3 799 907 dca or 80%). The natural characteristics of the region are the same as in Silistra, no mountains and humus soil. Dobrich borders with Silistra region and Romania to the north, the Black Sea to the east, Varna region to the south, and Razgrad region to the west. The neighbouring black sea coast hosts the country's largest summer resorts, including Albena, Golden Sands, Riviera, Sunny Bay and Saint Ilias. Dobrich - alongside with Varna region - is the main supplier of foodstuffs and working force to these resorts. Infrastructure is good in the towns, municipal centres and tourist resorts, but very inadequate in the rural areas: poorly maintained third class roads and bad sewage systems.

25. Agriculture is the region's main economic activity with grain crops grown on 73% of the arable land, sunflower on 22%, vegetables on 2%, fodder on 1%, and tobacco on 2%. Traditionally, Dobrich grain producers enjoy the highest yields per dca. in the country. During the last few years, some new crops have been introduced to the regions, including rape (oil producing plant), coriander and herbs. The lack of irrigation facilities and the harsh continental climate (hot summers and very cold winters with north-eastern wind coming from Russia) do not favour the early production of vegetables and fruit. The region has a total of 66 productive cooperatives which cultivate 49% of the arable land and a number of large land leasing farmers that cultivate 26% of the arable land.

26. Economic activities other than agriculture and tourism include textile, machine building, shoe-making industry, spare parts for automotive industry, and transport services from Balchik port, the country's largest terminal for grain processing.

4. Vulnerability Context and Livelihood Assets in Rural Bulgaria

4.1 Access to Livelihood Sources at Village Level

27. In the regions visited, there are considerable differences in poverty levels between villages within the same municipality, depending on location and access to economic infrastructure. A number of villages are particularly disadvantaged in terms of livelihood options, due to: rugged terrain and low quality agricultural land; poor rural infrastructure (few roads and/or in bad condition); poor access to processing plants / small industries; and large distances to

¹ "Development of the land lease model of agriculture on the basis of Dobrich region" Published by Stopanstvo, 2003, Authors: Kanchev, Doichinova, Angelov, Miteva.

commercial, trade and urban centres resulting in higher transport costs to reach markets, difficulty in selling products at a decent price and buying agricultural inputs (fertilizers, seeds, etc.). The livelihood sources in these villages include: own farm activity, hired farm labour, off-farm labour, clerical work in the local administration, occasional migration to towns for construction labour, pensions and some remittances from emigrant relatives.

28. Disadvantaged villages are populated mainly by old people (above the ages of 60 years). The young who are trained in a non-agricultural sector would often prefer to live on unemployment benefits and occasional off-farm labour than to work in agriculture which is risky, labour intensive and looked down upon. Promising young people tend to leave the villages in search for work in towns or abroad. It is not uncommon that every other house in such villages is abandoned.

29. Villages situated close to main roads - or even better, near regional centres – are served by satisfactory outlets for products (milk, meat, fruit or vegetable processing plants) and have an obvious advantage in terms livelihood options. The official unemployment rate is around 13% for the region of Haskovo, 13.8% for Dobrich and 15.2% for Silistra¹. It should be noted that this percentage only includes people who are registered with the Regional Unemployment Bureaux and receive some form of benefits. A large number of rural unemployed are not registered as such, while a number of officially unemployed engage in undeclared seasonal work. Thus, unemployment in rural regions can only be based on estimates ranging from about 30-40% in more advantageous areas to as much as 70 – 90% in disadvantaged areas.

30. The SAPARD programme for diversification of economic activities (under measure 2.1)² is using a geographic classification of municipalities into advantaged and disadvantaged; the latter enjoying a lower threshold for applying for loans³. However, during village group discussions some farmers expressed the opinion that this classification inaccurate and at times unfair, given the large differences between villages within municipalities.

4.2 Livelihood Assets at Household Level

31. The livelihoods of households within one village however are not very diverse. As a rule, the few households in a village that derive a large part of their income from non-agricultural sources (teachers, post office employees, village administration personnel, etc.) are considered better off, particularly due to the fact that they enjoy economic stability.

32. In **Haskovo**⁴ region there are 58 071 family farms, that cultivate a total of 439 936 dca of land; representing about 17% of the region's overall agricultural land. The remaining land is cultivated by productive cooperatives and by large land lease holdings growing mainly wheat, barley, sunflower, maize and cotton; crops that require the use of large mechanised equipment. The average size of the family farms in Haskovo is estimated at 7.6 dca. The number of family farms which breed animals is 38 561. About 60% of these breed cattle, 1% buffalo, 17% pigs,

¹ Regional Statistics of August 2003.

² More details are to be found in Annex 2.

³ These municipalities are mainly located in North West part of Bulgaria and the Rodopi mountain (South-East part). More details in: www.mzgar.government.bg

⁴ Source of data on all regions: "Census of family farms", published by the National Statistical Institute, Sofia, 2003, contains data for 2001.

27% sheep, 37% goats, and 87% - poultry. It is most common that one farm breeds more than one type of animal. The average number of animals per family farm is about 2 cows, 1.8 pigs, 2.9 goats, 9.7 poultry. Only an estimated 2.8% of family farms own mechanised agricultural equipment¹.

33. In **Dobrich** region there are 44 248 family farms, that cultivate 390 644 dca of land, representing 16% of the region's overall agricultural land. The remaining portion is cultivated by large land leasing farms and by productive cooperatives growing mainly wheat, barley, maize and sunflower. The average size of family farms in Dobrich is estimated at 8.6 dca, split in 8,2 dca for corn crops and 0.4 dca for perennials. In Dobrich, a total of 28 128 family farms raise livestock (61.6% of all farm households). Of these, 21.3% breed cows, 18.5 % pigs, 47.4% sheep, 36.8% goats and 87.2% poultry. The average number of animals per family farms is about 2.1 cows, 2,8 pigs, 5.5 – sheep, 2.8 – goats. The family farms with own agricultural equipment total 10.6% of all family farms in the region.

34. In **Silistra** there are 33 590 family farms that cultivate 375 338 dca. The main crops grown in these farms are maize, barley, wheat, sunflower, grapes, apricots, tobacco. The rest of the land is cultivated by large land leasing farmers and by productive cooperative active mainly in crop production. The average size of the family farms is 11.2 dca, split into 10.4 dca crops and 0.8 dca of perennials. About 23 341 family farms engage in livestock production; 28.4% breed cows, 2% buffalos, 25.5% pigs, 49.4% goats, and 89% poultry. The average number of animals per family farm is about 1.5 cows, 2.3 pigs, 4.8 sheep, and 2.6 goats. About 9.5% of the households have their own agricultural equipment.

35. It is difficult to assess the proportion of “poor” farm households compared to the total farm population, as the dividing line between the categories of “small farmers” (average/poor) and “micro farmers” (poor) is blurred. In the present conditions, a farmer can abruptly fall from “small” to “micro” - due to adverse weather or a sudden fall in market output prices - or graduate from “micro” to “small” through taking a loan and investing it successfully under favourable conditions. As revealed through discussions with farmers, income from non-agricultural sources (casual labour) can often put the farm in a higher group for a period of time.

36. The SLA household interviews showed that the farmers who were primarily involved in vineyard and vegetable growing had access to an average of 13 dca. of land (ranging from 5 to 54 dca). Only 50% were using their own land. The tobacco growers also had access to an average of 13 dca of all rented land. About 56% of all households interviewed had land titles in their own names (38% in Haskovo and 70% in Dobruja). Market oriented grain producers interviewed in Dobruja had access to an average of 145 dca of land. In Haskovo region, the few farmers interviewed who were growing grain for fodder did not market their output, but used it for their own cattle farm. They had access to an average of only 90 dca.

37. Landlessness is not an indicator of vulnerability in Bulgaria. Accessibility to land at a reasonable monthly rent is easy. A number of farmers interviewed reported to own a large parcel of land (up to 100 dca received after land restitution) that they were unable to rent out at a decent price, or use for production activity, due to lack of investment capital. This was especially the case for vegetable and grape growers in Haskovo region. A number of poor rural landowners interviewed were renting out their land to cooperatives, but failed to obtain a rent that could make

¹ Based on most recent data obtained from National Statistical Institute, Haskovo Region, September 2003.

a meaningful contribution to their household income. Some received an in-kind payment (sacks of grain) for rental of land. In cases where cooperatives had been liquidated, rent on the land had not been paid at all. Annual rental fees for agricultural land range - depending on the quality - between: a) 10-30% of the average yield plus 5-25 BGL/dca in Dobrich, b) 10-15% plus 4-18 BGL/dca in Silistra; and c) 10-35% of the average yield plus 6-75 BGL/dca in Haskovo¹. The market price of agricultural land ranges between 40-200 BGL/dca in Silistra, 70-180 BGL/dca in Dobrich and BGL 80-250/dca in Haskovo². Land is not accepted by financial institutions as viable collateral for loans.

38. Farm families who derived more than 80% of their agricultural income from livestock breeding had taken investment loans to increase their stock and owned an average of 12 cows or 35 pigs, and/or 15 sheep or goats. Farmers who kept livestock as a side activity owned an average of 3 cows, and/or 4 goats/sheep, and/or 2 pigs and a few chickens for household consumption. Almost all livestock farmers complained about the poor and unhygienic conditions of animal sheds that they had insufficient funds to upgrade.

39. In terms of equipment, all but two farm families owned a private car and 12% owned a truck. Among the truck owners, almost two thirds were grain farmers. About 19% of all households owned a tractor (24% in Haskovo and 14% in Dobruja). Of these, less than half owned other agricultural equipment such as a trailer plough, a weeder or a harrower. Almost all owners of agricultural equipment were involved in grain production. Of the farm families who derived more than 80% of their agricultural income from sale of grain, 60% owned mechanised equipment. Less than half of the cattle farmers interviewed owned mechanised milking equipment. All complained that their equipment was old, of low value and very costly to maintain.

40. All participants in household interviews and group discussions claimed to own a house, although the title was often in the name of a father or a mother, especially among people under 40 years of age. About 12% owned one village house as well as one flat in a town (19% in Haskovo and 5% in Dobruja). In terms of human capital, 36% of the interview respondents had basic education, 31% had been trained in a technical field (often unrelated to farming) and 33% were educated at university level. Among the people aged 50+, a large portion had held government positions in urban centres before deciding to move to the village. Some of the cattle farmers were former veterinarians with long experience in large state cooperatives. Others had learned farming skills from their parents while the youngest respondents had resorted to reading, common sense or friendly advice from neighbours to get started in farming. Only one of the respondents made use of the internet for information.

¹ Source: "Conditions and trends for development of land market in Bulgaria", published by SAPI Ltd, Sofia, 2001.

² The high prices often quoted for land in Haskovo (up to 700 BGL) refer to land for construction, located in border municipalities and areas with access to the international highway leading to Turkey.

4.3 Vulnerability of Ethnic Minorities

41. In Haskovo region, about 11,4% of the population are ethnic Turks and another 6,2% are of Roma ethnic origin¹. The share for Dobrich region is 15.6% and 6.4% and for Silistra 36.3% and 2.7% respectively².

42. Farmers of ethnic minorities tend to be particularly disadvantaged due to a number of reasons: overall, they have a lower educational level; they live in more remote areas; they own smaller plots of lower quality land, often in difficult mountainous areas (Haskovo); and have larger families that depend on their modest household income. Among Turks, the average household size is 4-5, and among the Roma population it can be as large as 6-7, compared to the Bulgarian average of 3-4. In addition, the vast majority of Roma are landless. A considerable number of Turks are also de facto landless, due to the practice of abandoning their own low-value land and migrating to new areas where they rent better quality farmland that offers opportunities, especially in the tobacco sector (in Haskovo). Both minority groups have a stronger sense of community cohesion and more developed mutual support networks.

5. Livelihood Strategies

5.1 Multiple Sources of Livelihood

43. Rural households appear to employ a variety of livelihood strategies drawing on multiple income sources. The farmers interviewed in this study derived an average of 68% of their household income from farm activities. About three quarters of the households had diversified sources of farm income, typically a mix of crop sales (vegetables, tobacco, grapes, grain) and sales of livestock products, mainly cow milk and/or meat. A number of farmers reported to have experimented with several types of farm activities before settling with their present production base. Most households interviewed also kept a few chickens, pigs or goats/sheep for subsistence. Vine growers tended to be less diversified, probably due to the stable market for their product, especially for high value varieties, such as Merlot.

44. An average of 32% of household income among the farmers interviewed came from non-agricultural sources including: pensions, spouses' salaries, some remittances from emigrant family members, casual labour mostly in towns (for men), seasonal agricultural labour in nearby rural areas or abroad (mostly in Haskovo), and seasonal work in the nearby tourist resorts (in Dobrich).

5.2 Income, Expenditure and Saving Patterns

45. Of the interviewed households, more than 70% said their farm income was barely enough to allow the household to live what they considered to be a "good life"; defined as being able to satisfy more than the absolute basic needs of food, clothing and schooling. None of these households reported to be able to make savings. Most (if not all) of their profit was reported to be re-invested in inputs for the next year's farm activity. Of those who declared to be content with

¹ Another estimated 10% are ethnic Pomaks, although they are not registered as a distinct ethnic minority group in the country's statistics.

² Source: National Statistical Institute, 2003. www.nsi.bg

their income, less than a fourth said they were able to save cash. Only in one case was this cash deposited in a bank account (the case of a very young farmer). The vast majority of participants in group discussions and household interviews (including those who considered their income to be sufficient) said they were indebted to friends, neighbours or relatives for at least one or two months per a year.

46. An average of 58% of the households' overall income went into household expenses such as food, children's schooling, house repairs and utility bills. A remaining average of 42% was reinvested into agriculture. Of the households interviewed, 45% had only one household member contributing to farm work and another 45% had two. In the case of tobacco, vegetable and vine production, both types of households depended on hired seasonal labour, some also on full-time labour. Grain producers employed little paid labour, aside from hiring mechanised agricultural services. About 10% of the household interview respondents (all ethnic Turks and Roma) were self sufficient in terms of farm labour input, having more than 3 household members engaged in full-time farm work (household size 5+).

5.3 Agricultural Production Cycle (shocks and seasonality)

47. Small **vine growers** plant the vine seedlings in autumn and wait for seven years for the first harvest. February - March is the season for cutting the vines and transporting the sticks away from the farm; a labour intensive process that implies costs for hired labour and transport. Spring is the time for planting and sprinkling while summer requires much watering (gravity irrigation), sprinkling/spraying against diseases and labour for harvest. Farmers engaged in this activity felt the benefits of a secure market, (high demand) but struggled with the risks of diseases that often cause a drastic reduction in the harvest. Another factor that appeared to make farmers vulnerable was the lack of well functioning associations of grape growers to protect their interests against the monopolistic price offered by the wine-producers. Grapes cannot be stored without being processed and have to be sold in a very short period of time.

48. **Vegetable** growers need cash for land preparation and fertiliser in October, and for seeds in February. From March to May their work involves production of seedlings and application of fertilisers and insecticides. Farmers who produce early vegetables can receive an income already from July, the mass harvest starting in September or early October. The strengths of interviewed vegetable farmers were felt to be the relatively stable market for vegetables (processing and export) and the access to informal wholesale trading places that offer greater autonomy and possibility to obtain high profits. The major constraints were related to intense labour from March to September; high cost of irrigation water; lack of storage facilities; and high cost of freezing, resulting in a very short period of sale.

49. **Grain farming: Wheat** growers need cash to plough in September, to apply fertilizers and to buy seeds sown in October. Spring is the time to sprinkle against diseases. Harvest is in August, during which there is a high need for cash for mechanized services and fuel. The main constraints experienced after harvest include lack of storage, and high transportation and storage costs. **Maize and Sunflower** producers follow almost the same agricultural cycle. Preparation of the soil and application of fertilizers take place in October. The need for cash during that period is less acute than for the wheat growers, as sowing starts in March. Maize and Sunflower growers need more cash in spring for 3-4 cultivations. Harvest is in august –

September, involving similar problems of high transportation and storage costs as those faced by wheat farmers.

50. **Orchard** farmers face the problem of having to wait for a few years before the first harvest can take place. Trees are planted either in spring or autumn, during which time cash is needed for fertilizers, 2-3 cultivations, and 2-3 sprinkling campaigns against diseases. Labour costs can also be significant around spring, where there is a need to cut the trees, as well as in fall when the fruit is harvested. High yields are possible only if farm is irrigated.

51. **Tobacco** growers were among the few farmers (from household interviews and group discussions) who had signed contracts, received state subsidies and had a guaranteed minimum price for their product. They received a cash input for seeds, had a secure market and could make use of lower quality land. From March to May they prepare the land and apply fertilizers, insecticides and pesticides. Harvest takes place in September. All activities in the tobacco production cycle are highly labour intensive. The majority of ethnic Turks in Haskovo region engage in this type of farming, using primarily family labour. The marketing of tobacco is easy but regulated by two or three large buyers who jointly fix prices on a yearly basis.

52. **Cattle breeding** offers farmers the opportunity for a regular daily income and a stable market with a relatively low labour input. Milk is often collected at the farm gate by processors. Cattle farmers can use pastures in the spring and summer to decrease the need of costly concentrated fodder. Small state subsidies are available although, for reasons mentioned in Section 5.4, poor farmers are excluded from accessing them. The main constraints faced by cattle farmers include the requirement of regular cash inputs for fodder and occasionally for medicines. Livestock diseases are an important risk while the low price of milk gives little profit. Small cattle farmers have no access to refrigerating tanks for preservation and are not organised in associations to share the costs of such.

53. **Pig and poultry breeding** also need regular cash inputs for concentrated fodder, premixes, vitamins, and occasional veterinarian care. Pigs have two production cycles per year poultry cycles are more depending on the type of bird (chickens have 45-50 day cycles).

Irrigation

54. Poor farmers in Haskovo rely on gravity irrigation for vegetables and vine production, using ground water (wells) or river water. In times of drought farmers face a rise in water costs that they are ill equipped to bear, even with the help of state subsidies for water (50%). Concerns were aired among vegetable producers about the government's decision to abolish such subsidies starting from 2004; a decision that would force them to decrease their area under cultivation of irrigated crops. Drip irrigation is desired by small farmers but has high investment and maintenance costs which they are unable to receive credit for.

55. In Dobruja, there is virtually no irrigation due to absence of rivers and ground water being at a depth of more than 80 meters. Only one farm in Dobruja (located by the seaside) made use of gravity irrigation. Water prices in that region are the highest in the country.

5.4 Experiences with Agricultural Credit

56. Of the 42 households interviewed, 30 had experiences with taking credit for agricultural investment or for working capital in the last five years. In addition, of the 55 participants in village group discussions, 22 had taken loans from the credit cooperatives.

Table 3: Experience with Credit Among Interviewed Households

Source of Loan	Number	% of Respondent HHs
Credit cooperatives	25	60%
Kainarja Credit Cooperative (Silistra)	6	14%
Doverie Credit Cooperative (Dobrich)	11	26%
Stopanin Credit Cooperative (Haskovo)	5	12%
Trakia Credit Cooperative (Haskovo)	3	7%
Other Sources	5	12%
No credit taken	12	28%
	Total	<u>42</u>
		<u>100%</u>
Regular informal borrowers of small loans from friends, family or money lenders	40	95%

57. About half of the borrowers had only taken one loan. The collateral used included: a family flat in a town (23%, all but one case were in Haskovo), one or two guarantors (70%) or a village house (7%). For the latter two types of collateral, the source of loan was one of the Credit Co-operatives. Some 60% of all borrowers, mainly from Credit cooperatives, (38% in Haskovo and 82% in Dobruja) had problems repaying their loans. A considerable number had extended their repayment period by up to three years.

58. About 83% of the borrowers had taken loans from the credit cooperatives. Of these, none reported any problems with obtaining the loans. The average loan size was BGL 3,000 extending over one year. The Credit cooperatives were by far the most preferred source of rural lending (actual and potential) among farmers interviewed. In contrast, those who used other finance sources¹ reported major problems related to complex bureaucratic procedures, and major delays in assessment/approval processes and making the loans available. A number of respondents complained that, due to delay in payment of a loan, they had wasted their grace period which coincided with the planting season. As a result, they were unable to repay the loan.

59. Among the households that had not taken loans, more than half reported to have tried through private banks but had given up, as they found the application procedures too complex and time consuming. A number of non-borrowers said they were obliged to hire a notary at a high cost to assist them in this process. Others mentioned the lack of access to collateral as the main factor deterring them from seeking loans, or as the main reason why their applications were rejected². It is worth noting that, even in cases where households did own viable property for collateral, they were reluctant to mortgage it, out of fear of losing their only stable asset. Most of the non-borrowers were discouraged from seeking further information on credit as they did not believe they had a chance even if they applied. "Bank loans are for the rich" was a shared perception

¹ Including SFA, United Bulgarian Bank and "King's Credit" from Ministry of Social Affairs.

² Two participants of village group discussions reported that they had approached ProCredit Bank's Haskovo branch for loans in the last 3 months, but were refused due to lack of collateral.

among those who never took a loan. Nevertheless, many such farmers expressed the wish (and the need) to take a loan, but only on the terms offered by the Credit cooperatives. The reason why they had not done so, was that they were aware of the Cooperatives' lack of funds.

60. Due to lack of credit or insufficient loan amounts received, a large proportion of farmers participating in the SLA study had invested considerable own funds - often borrowed from friends and relatives - to start their operations.

5.5 Support Networks, Trust and “Group Culture”

61. About 20 out of 42 households interviewed (48%) had entered into informal associations with other farmers for the purpose of producing larger bulks of output and for sharing transportation costs, equipment and animal sheds. All were proactive, risk-taking resource-poor farmers who had decided to group with relatives or with two or three neighbouring families, out of a realisation that working together could increase their profits and make a meaningful impact on improving their livelihoods. More than half were of ethnic minority origin. It is interesting to note that all the interviewed households that were of ethnic minority origin had entered such informal agreements.

62. As for membership in formalised production groups, about 60% of the farmers interviewed were members of the credit cooperatives. Four farmers also reported to have been members of the local producers association; three of the vine-growers association and one of the milk producers association. All four expressed dissatisfaction with the low efficiency level of these associations and claimed that they did not benefit from any initiatives that would protect producers' interests. Moreover, poor management and corruption had lead them to lose interest in carrying out activities jointly with the associations.

63. Group discussions revealed some suspicion of the ability of fellow farmers to manage group funds in a fair and transparent way. Such suspicion was also shared by the Turkish and Roma ethnic groups, although in to a lesser extent, since they tend to have stronger support networks based on trust and mutual help. A few farmers participating in group discussions mentioned to have made attempts to form producer associations in order to meet client requirements for large bulks of products for direct export. These however had failed due to the difficulty in encouraging farmers to unite.

64. During group discussions and household interviews it also became apparent that farmers had considerable distrust in the banking system. The devastating collapse of the country's banking system in 1995-1996 lead to a total loss of confidence in depositing savings in banks. People's perceptions are gradually changing with bank campaigns promoting a different, “foreign” approach. Nevertheless, among the small farmers the most common perceptions of banks were as follows: a) their staff are rude to ordinary people, they do not listen and therefore do not understand small farmers' needs; b) they lack flexibility and have a heavy bureaucracy; c) they impose unreasonably high service charges and commissions which are visibly spent on “new flashy offices” that benefit no other than the bankers themselves.

65. Virtually all farmers interviewed reported to invest their earnings in productive activity or in assets rather than saving in a bank account. The only exception was a young

vegetable farmer (in his very early twenties) who was clearly too young to experience the psychological consequences of the collapse of the banking system.

5.6 Coping Strategies and Informal Lending Sources

66. All participants in group discussions and household interviews felt vulnerable to external threats. The risks implied in each of the farm activities are described in Section 5.3 and in Table 4. Overall, market price instability and the sudden fall in output prices were mentioned as the major sources of risk for farmers. Livestock diseases were also experienced bringing about a sudden rise in expenditures for medicines and an urgent need for cash. Adverse weather conditions, mainly hail or drought¹, were reported to have caused considerable damage to vegetable and grain crops leading to inability to repay loans taken from the credit cooperatives. Of the participants in household interviews and group discussions, only one had his farm activity covered by insurance². This was a case where the farmer had entered a contract agreement with an entrepreneur who provided him with commodity capital and insurance for chicken farming.

67. As discussed in the Section 5.3, most small farmers are in need of urgent financial support at certain periods in the production cycle. Coping strategies were mentioned to include selling off production at a low price, selling small ruminants, engaging in a variety of off-farm casual work and borrowing money through informal arrangements made between farmers and traders, shop owners, or people in power. The main coping strategy for the Roma (especially amongst women) is seasonal labour in agriculture. In Haskovo region this often involves cross border seasonal migration into Greece or Turkey. Construction labour in neighbouring towns is a common coping strategy for men regardless of ethnicity. Ethnic Turks in Haskovo tend to occasionally cross the border into Turkey in search of casual work. In the regions of Dobrich and Silistra both men and women (especially the young of Bulgarian origin) migrate to seaside resorts such as Varna and Albena in search of seasonal work in the growing tourist industry.

68. Turning to friends and relatives for small loans is very common. Shop or café owners often give small loans in cash and in kind (buy now, pay later). Farmers who rent land are often in debt to their landowners and pay the rent at the time of harvest. Small commodity loans are also common, where farmers benefit from receiving inputs at the time needed, on the condition that they repay in kind with an agreed percentage of the production at time of harvest. A number of farmers however also mentioned falling prey to informal moneylenders at times of great need. The interest rates charged for such loans were reported to go up to 10% per month. About 95% of the household interviewees and virtually all participants of group discussions mentioned that they were taking informal loans (in cash or kind) regularly.

¹ In Dobruja, the drought of 2001 led to total loss of wheat and 80% loss of maize. In 2002 another drought caused further devastation to farmers who are uninsured and received no compensation.

² Note that no insurance available in Bulgaria covers against drought.

6. Exclusionary Processes

6.1 Policies and Procedures of Micro-Finance Institutions¹

69. The policies and procedures of most micro-finance institutions that presently engage in agricultural lending exclude small and micro farmers from their client base. The Private Mutual Rural Credit Associations are an exception in that they have adopted a flexible and responsive approach to small farmers' needs and priorities (see section on credit cooperatives below).

SAPARD

70. SAPARD is the main instrument of the EU to support applicant countries in preparing their agricultural sectors for the EU accession and the adoption of the Common Agricultural Policy. The minimum investment size is €10 000 (approx. BGL 20 000) and there are requirements that the borrower must pre-finance the entire amount and receive a grant refund for up to 50% of the investment costs. Lack of equity and restrictive collateral requirements pose major constraints even to medium-size farmers, although they might present a viable project with good prospects of generating profit. Collateral requirements of commercial banks usually range between 150 – 250% of the loan amount, depending on the type and quality of collateral.

71. The loan application procedures are complex. Applicants must provide a business plan and a large number of documents and certificates to be eligible. In practice, farmers need professional advice from specialised consultancy companies in order to prepare successful applications. The price for a feasibility study can reach up to 5% of the total investment cost, although there is no guarantee for the success of the application. Advisory companies prefer larger applications which are more lucrative, hence small farmer clients are excluded.

ProCredit Bank

72. ProCredit Bank's Haskovo branch had (at the time of the mission) about 1000 active credit clients under its ongoing SME lending programme. About 20 of these were engaged in agricultural production and took loans in the last year. The loan size ranged from BGL 600 to BGL 2 000 for working capital or small investments, e.g. for purchase of one or two cows. The interest rate was 19.8% per year for first-time borrowers. ProCredit Bank has had a credit office in Dobrich since October 2002. The office (to be upgraded to branch in January 2004) processes loan application documents for loans that are paid out of the branch in Varna. Currently, it has 400 active loans in an area of a 35 km radius around Dobrich town². Of these, 20 are supporting agricultural activities under the bank's new "Sprint" programme (introduced October 2003).

73. "Sprint" loans range from BGL 400 to 5 000 for a maximum term of 36 months, with one month's grace period, and an interest rate of 17.8% per year. Repayment methods are decided jointly with the client and include seasonal repayments to accommodate farmers or tourist businesses. Collateral requirements are restricted to a guarantor who must be receiving a monthly salary of a magnitude that depends on the loan size applied for. No registration is required. The

¹ This section draws heavily on Annex 2. For background on formal suppliers of financial services and more details on loan programmes and lending terms/conditions, read Annex 2.

² Silistra is served by the branch in Russe.

smallest agricultural loan given under this programme in Dobrich was of BGL 800 to support a cow breeding activity¹.

74. ProCredit Bank also introduced an agricultural credit scheme in September 2003 with loans offered at an interest rate of 12-14%, depending on the purpose. Investment loans have a ceiling of BGL 80,000 and 6 month's grace period while working capital loans of up to BGL 15,000 are offered with zero grace period. Registration of the farm is a pre-requisite for obtaining such loans. Agricultural equipment, village houses and agricultural land are accepted as collateral under this scheme. At the time of the mission, the promotion campaign for these loans had not yet started and very few farmers in Haskovo (none in Dobrich) had applied for such a loan. The Bank's new programme for organic farming – financed under Swiss development funds – has little chance to attract small farmers, due to eligibility requirements that include age restrictions (max. 50 years) and access to farmland that has not been under artificial fertilisers for at least 5 years.

75. ProCredit Bank officials interviewed expressed their interest in applying flexible lending rules to small clients and were open to discussing possibilities of expanding lending activities in rural areas. They felt confident that they could attract small farmers due to their free application procedures and the sole financial requirement of depositing BGL 5 in an account with the bank. This, they believed, was an advantage compared to the credit cooperatives' requirement of larger amounts of shared capital to qualify for loans. Collateral or guarantor requirements however were still difficult for prospective borrowers to meet. Another constraint faced by ProCredit Bank is the inadequate knowledge of its staff regarding the farming communities and the particular challenges implied in financing agricultural production.

State Fund for Agriculture (“SFA”)

76. SFA is more flexible than commercial banks regarding collateral requirements. For seasonal loans, farmers must provide 105–150% of the loan amount, either as immovable property (real estate, house, apartment), or as moveable property (machinery and equipment). Alternatively, 50% of the loan amount can be secured through pledging of the next harvest, while the remaining 50% must be secured through real estate or moveable assets. Maximum loan amount for seasonal loans is BGL 70.000 per year, or BGL 50.000 if future harvest is used to secure the loan. Pledged crop must be insured against hail, fire and flood. Pledged property must also be insured against conventional risks.

77. In case of investment loans, SFA accepts pledging of moveable assets but prefers real estate mortgages, usually houses in the villages or flats in urban areas. The collateral should cover 105 -150% of the loan amount, depending on the type of collateral provided. For loans up to BGL 20.000, the collateral value is derived from the tax value of the property. For loans between BGL 20.000 – 50.000, the collateral value must be assessed by a licensed company. In cases where financing is managed through a commercial bank, the latter is free to establish its own collateral requirements.

¹ The beneficiary owned only 3 cows, invested the loan in more animals and qualified for a second loan of BGL 1 600.

78. Loan applicants must make an equity contribution of 30% of the total investment costs¹. Subsidies and loans are usually not disbursed to the farmers but to the suppliers of goods and services (traders, construction companies, etc.). Since October 2002, SFA has been providing loans below BGL 50.000 directly through its 28 regional offices. Interest rates are fixed at an annual rate of 6%, except for loans targeting farmers below the age of 40 which are available at 3%.

The Private Mutual Rural Credit Associations (“PMRCAs”)

79. The network of Private Mutual Rural Credit Associations consists of 33 credit cooperatives, distributed throughout the country. Members pay a minimum share of EUR 52 to become eligible for loans. The loan amount is limited to 15 times the amount of share capital paid. Membership is open to rural farm and non farm SMEs, but loans can only be provided to farmers. Loans are not confined to registered farmers, but target any person who receives the main part of his/her income from farming. The size of the Cooperatives varies between 100 and 800 members; the total network having more than 10.000 members.

80. The PMRCAs provide mainly short-term loans of 1-2 years. Around 75% of the loans for working capital have maturities of up to 9 months. The remaining loans are for investments in farm machinery, equipment, land, greenhouses, livestock, etc. Maximum loan amount can not exceed EUR 20.000. Collateral requirements are flexible. Loans of up to BGL 3.000 can be secured through a co-guarantor; larger loans require the pledging of moveable assets or mortgaging of immovable property. Farm machinery, rural houses and, in some cases, cows are accepted as collateral².

The Credit Cooperatives in Haskovo and Dobruja

81. **Haskovo** region is served by two credit cooperatives, named “Stopanin” and “Trakia”, with a total repayment rate to date of 98% and 60 % respectively. They have a total membership of 380, (135 women) and 248 active loans (about 35% to women). The average amount of credit is 3 000 BGL with a grace period of 12 months and loan term of 24 months. In the year 2003³, they have had to reject about 130 applications for loans due to unavailability of funds.

82. **Dobruja** is served by a total of five credit cooperatives, two in Silistra and three in Dobrich. The two cooperatives in **Silistra**⁴ have average repayment rate to date 93%. They have a total membership of 460 and 330 active loans (about 30% to women). The average amount of credit is 2- 3 000 BGL with a grace period of 12 months and loan term of 1 to 2 years depending on the activity. The cooperatives in **Dobrich**⁵ have about 900 members and an average repayment rate of 96%. Of about 440 active loans per year, 25% are taken by women. The average amount of credit is 2- 3 000 BGL with a grace period of 12 months and loan term of 1 to 2 years depending

¹ In 2002, the equity contribution varied between 20 and 30% depending on loan term and amount.

² Normally this is confined to high quality breeding cows which must be properly insured.

³ Until the time of the SLA field work in September 2003.

⁴ Kainardja and Nova Cherna.

⁵ General Toshevo, DSK Dobrich and Doverie.

on the activity. One of the credit cooperatives in Dobrich, named “Doverie”, received funds from a Dutch Church Fund and began to offer loans against 15% interest rate per year. About 60% of all loans given through the Dobruja-based credit cooperatives are funding crop production and 40% are for livestock.

83. The average annual interest rate of all credit cooperatives visited was 12% and the required share capital ranged between BGL 400 and 500. The cooperatives operate with one chairman, one accountant, one loan officer and one or two computers. Since 2000, they had been meeting their running costs mainly from the interest of the active loans. All have been flexible with the timing of clients' loan repayments. A number of credit recipients interviewed had extended their repayment period by more than 3 years.

84. Some of the credit cooperatives interviewed had made several attempts to move beyond the role of pure lending, to provide services such as establishing market links for their clients. Linking production to processing and marketing has proven to be a very challenging task. So far, only the “Trakia” Cooperative in Haskovo had made a loan to a processor (BGL 20,000 to a flower mill family business). Credit cooperatives were hoping to proceed with such an approach in the future. As discussed in Section 5.4, the credit cooperatives were by far the most preferred source of rural lending among the farmers interviewed in the field.

6.2 Registration of Family Farms

85. Farmers who are registered under the Trade Law receive a certificate that allows them to sell their products directly in the market (no reliance on traders). They also enjoy the right to apply for subsidies and benefits under SFA, SAPARD and the Tobacco Fund programmes. The process of registration is cheap and fast. Nevertheless, despite these potential benefits, many poor farmers do not register their farms nor are they included in the Register for Agricultural Producers. This is because they prefer to declare to be unemployed or to have a household income below 50 BGL per month; conditions that allow them access to important state benefits¹. In addition, poor farmers are often unable to bear the indirect costs of registration that includes obligatory payments of social and health insurance totalling 42.5% of the income.

86. The condition of many banks (including ProCredit) that a farmer should be registered in order to qualify for credit excludes the vast majority of small farmers from obtaining loans. Of the households interviewed, only 31% (57% in Haskovo and only 5% in Dobruja) had registered their farms with the relevant authorities. It is worth noting that very few of these family farms enjoyed the benefits offered to registered farmers. In Haskovo, the unregistered farmers belonged to the poorest households interviewed, with access to the smallest plots of land. They had few physical assets, had not taken loans but were depending by more than 75% on income from selling farm products. In the case of Dobruja, all except one of the interviewed households had not registered their farm. This was regardless of size of holding or access to resources.

¹ Including a state benefit of about BGL 56/month for the 4-5 winter months as a contribution to their costs for heating; an important alleviation of household living expenses during the cold season.

6.3 Contracts with Traders or Processors

87. The condition of some banks that a farmer should have a signed contract with a client in order to qualify for credit also excludes many small farmers from obtaining loans. As a rule, small family farms are not offered contracts by traders or processors. This is partly because some traders and processors cannot trust producers to deliver the required amount of agricultural products at a fixed quality and time. It is also due to the fact that they are unwilling or unable to bear the responsibilities of paying the producers on time. A number of small farmers mentioned incidences where processors had failed to pay them.

88. In theory, a signed contract offers the farmer a number of rights and opportunities (aside from credit and subsidies), including a secure market, predictability, the ability to do longer-term planning, and the legal right to sue a processor that has failed to pay for products delivered. In the given conditions however, small farmers see more benefits in avoiding such contracts. Being free of a contract means greater opportunities to diversify clients and greater flexibility in responding to market price fluctuations. The right to sue a client is not one that small farmers can feasibly exercise due to the long time and high costs involved in pursuing a legal case (up to 3 years, at a cost of about 4% of the amount claimed).

89. Among the households interviewed, only 16% had signed contracts with their clients. It is important to point out however that 71% of those were tobacco growers. Of the non-tobacco growers interviewed, only two (5%) had a contract with an entrepreneur: a chicken farmer in Haskovo and a milk producer in Dobruja.

6.4 Access to State Subsidies

90. The right to state subsidies also depends heavily on the existence of a signed contract with a client. State invoices for payments made by clients are a condition for obtaining SFA subsidies. Such invoices however are hardly ever received by small farmers. The cost involved in meeting the standards that qualify for subsidies also acts as a disincentive for small farmers. For example, a milk producer is required to provide a number of milk samples twice a month to a specialised laboratory for examination and quality certification. High costs are implied in examining each sample (17 BGL per sample), in using a refrigerating tank for storage and in transporting the samples to a dairy plant that offers laboratory services. These are often located at a long distance from the village. A number of respondents mentioned repeated incidences of deceit by milk processors who evaluate their products at a lower standard-level in order to pay them less and deprive them of subsidies.

91. Among the households interviewed, 17% received subsidies (all in Haskovo region), 70% of whom were tobacco growers. Of the non-tobacco growers interviewed, only two cattle farmers received subsidies which they complained were extremely low.

6.5 Access to Collateral

92. Ownership of flats or houses in selected towns is important for securing loans. All participants in household interviews and group discussions claimed to own a house, although the title was often in the name of a father or a mother, especially among people under 40 years of age. About 12% owned two properties, one village house and one flat in a town (19% in Haskovo and

5% in Dobruja). It is worth noting that, even in cases where households do own viable property for collateral, they are reluctant to mortgage it, out of fear of losing their only stable asset.

93. In terms of movable assets, all but two farm families owned a private car, 12% owned a truck and 19% owned a tractor. Less than half of the tractor owners possessed other agricultural equipment such as a trailer plough, a weeder or a harrower. Almost all owners of agricultural equipment were involved in grain production. Less than half of the cattle farmers interviewed owned mechanised milking equipment. All complained that their equipment was old and of low value. (see also Section 4.2).

94. Only a minority of small farmers are able to provide collateral that satisfies the present requirements of commercial banks. Hence the frequent comment that “bank loans are for the rich”. The Credit cooperatives have been unique in adopting flexible approaches to collateral requirements. Farmers noted that even the requirements for guarantors are often impossible to meet, since a very small proportion (if any) of village populations enjoy stable incomes. The only assets most farmers could provide for collateral would be those bought with an investment loan, including animals, crops, new cowsheds, storage facilities, or equipment.

6.6 Access to Extension Support

95. The poorest farm families tend to be more at the risk of exclusion from receiving agricultural extension services. This is a change from socialist times where such services were readily available and free of charge at the village level. Today, the National Agricultural Extension Service is suffering from major MAF financial constraints which are primarily manifested in staff and fuel shortages affecting mobility. Staff of the Agricultural Extension Service offices are based in regional towns and are unable to cover the requirements of the village population. Field visits are carried out on a selective basis, prioritising according to scale of needed assistance. Technical advice is also provided through the various Research Centres¹ and during the Agricultural Fairs held twice a year in Plovdiv and Dobrich.² The fairs are usually attended by middle to large farmers and by a good number of village Mayors.

96. Small farmers were generally unaware of the existence and role of technical advisory services. If they were aware, they tended to shy away from approaching them (by telephone or by travelling to the service centre), due to a variety of constraints including: long distances and time spent away from important farm work and lack of education and/or self confidence leading to intimidation (afraid to be “told off”). Young / new farmers had often turned to neighbours, friends or the village Mayor for agricultural advice. Older farmers seemed confident of their knowledge and saw no need in seeking technical assistance. Small farmers were also uncertain about the implications that Bulgaria's accession to the EU (scheduled for 2007) might have on their future. Most people participating in the SLA study were unaware of the current EU hygiene requirements, animal welfare and food safety standards.

¹ Close to Haskovo: a) Stara Zagora (Trakian University), specialising in turkey breeding, animal feeding, vet, etc, b) Kardjali for tobacco, c) Chirpan for cotton, d) Parvomoi for vegetables and e) Plovdiv for fruit & veg growing and canning industry. In Dobruja: a) General Toskevo specialising in wheat and barley research, b) Shumen for pig breeding.

² Plovdiv in March and Dobrich in October each year.

7. Aspirations for the Future

7.1 Perceived Strengths

97. When asked about their strengths, many farmers aged 40+ mentioned their knowledge and experience in farming and their “passion” for the particular farming activity. They felt confident of their ability to expand and draw considerable benefits from their activity if they were given easier access to investment or working capital loans. They believed they were producing a “good product” which, despite some competition, had good chances for sustainability. These farmers also had aspirations of involving their children in the family business, so that they could take over and expand it in the future.

98. Younger as well as poorer farmers saw their strength lying in their flexibility and readiness to take risks. A number of people in that category (including resource poor farmers from ethnic groups) had experimented with a variety of farm activities and were ready to move into new types of production – such as rabbits, or sheep - if given the opportunity. Flexibility also applied to finding ways of marketing products through entering agreements with diversified buyers. Another strength perceived by a large number of farmers was their hard working nature and their commitment to achieving a better life in their own land, rather than leaving and searching for opportunities elsewhere.

99. Other strengths mentioned included: a) the ability to raise a stable daily income and to easily liquidate (for livestock farmers); and b) good market links and good partnerships in farming (for those who had entered informal associations).

7.2 Perceived Needs and Priorities for Improving Rural Livelihoods

100. There was a wide perception among village group participants and household interviewees that the improvement of their livelihood is closely linked to notions of stability and “peace of mind”. Stability (including economic as well as psychological aspects of well being) was mentioned as the most desirable missing element in rural people’s realities, regardless of age or gender. What rural people seem to covet is the ability to make plans for the immediate or distant future based on some confidence in secure market prices affecting the sale of products and their overall cost of living. Another perceived improvement in livelihoods was autonomy: from buyers who dictate output prices; from friends, relatives or money-lenders to whom they are indebted; from contracted farm service providers on whom they depend for mechanised equipment; or from traders who offer second-class prices for first-class products.

101. Thus, the main areas for improving rural livelihoods as a whole were felt to be: stabilisation of market prices; accessibility to financial sources that can give the desired capital needed to make a meaningful change in household incomes (buy inputs, animals, storage facilities or equipment); links with processors who can sign a reliable contract offering insurance and job security; and access to state subsidies. Desired improvements in livelihoods included the ability to upgrade housing standards, pay for children’s education and go on a holiday once in a year or two.

7.3 Needs and Priorities for Financing

Micro-Finance Products

102. During household interviews, farmers were asked what changes they would make to their livelihood strategies if they took a loan / or a second loan. The list below includes the most frequent responses received in the field:

Investment in equipment:

- buy new van to take beehives out in good mountain areas
- buy a tractor to cut costs on hired labour
- buy small truck for transport of vegetables
- build/ renovate animal shed
- buy milking equipment
- establish small milk processing plant (shared with 3 other households) using own milk production
- purchase grain grinding equipment

Investment to expand present activity:

- buy own land to save on rent (primarily among grain farmers in Dobruja)
- expand the land under cultivation of existing crop
- expand activity of beekeeping, sheep or pigs
- expand from 4 to 10 cows
- increase melon production
- expand from one to two vegetable greenhouses and offer unemployed father a job
- improve grape variety

Investment in new productive activity:

- expand existing crop and simultaneously experiment with new production (e.g. melon)
- buy 10 sheep to complement household income from vegetable farm
- buy rabbits and start rabbit production business
- get into tobacco farming (from having moved to vegetables)
- rent 200-300 dca of land to grow grain for fodder (to cut costs of buying fodder)
- expand to herb and mushroom production
- buy a plot of land to establish eco-tourism activity (pick-nick area) – in Dobrich

Working capital:

- get smaller shorter loans to fund ongoing activities started with larger loan
- have regular access to cash inputs for chicken farm
- have flexible access to varying amounts of cash inputs for vegetable farm
- get advance payment of working capital for vine inputs
- gain access to cash in order to pay for permission to use communal ponds for inland fishing activity (to improve current practices and increase production)

103. Depending on the agricultural sector, the financial needs of farmers interviewed varied, including: small seasonal loans, working capital loans, larger investment loans or a regular access to cash for working capital. Table 4 illustrates the main financial needs expressed by interviewed farmers according to the production cycle of each agricultural activity. The shocks experienced in each type of production are included in the table in order to exemplify the types of risks that ProCredit Bank should consider when designing loan products/packages.

Table 4: Financial Needs for Main Production Activities

Production	Shocks	Seasonality	Financial Needs
Grapes for wine	<ul style="list-style-type: none"> - diseases - adverse weather - loss of production due to lack of storage facilities - abrupt fall in market prices - rise in input prices (irrigation water) 	<ul style="list-style-type: none"> - Autumn: - Feb-March: - Summer: 	<ul style="list-style-type: none"> - investment capital - working capital: labour - working capital: spraying, watering <p>* repay loans after harvest between Sept - October</p>
Vegetable	<ul style="list-style-type: none"> - same as vineyards (above) 	<ul style="list-style-type: none"> - October: - February: - March-May: - March – Sept: 	<ul style="list-style-type: none"> - working capital: land preparation - investment capital: seeds - investment capital: seedlings, fertiliser, insecticides - working capital: irrigation water, labour, transport <p>* repay loans after harvest between August – October</p>
Grain crops	<ul style="list-style-type: none"> Adverse weather Drought, Hail Rise in input prices Lack of storage facilities 	<ul style="list-style-type: none"> -September/ October -March/April -August/ September 	<ul style="list-style-type: none"> -high need of investment capital (the production is highly mechanized) - working capital: fertilizers, seeds - working capital: experienced workforce <p>* repay loans after harvest between Sept - October</p>
Orchards	<ul style="list-style-type: none"> Adverse weather Long periods prior to first harvest Fall in market prices Rise in input prices (irrigation water, fertiliser) 	<ul style="list-style-type: none"> -Autumn - Spring - Summer or Autumn 	<ul style="list-style-type: none"> - working capital: land preparation - investment capital; siblings, fertilizers, insecticides, storages - working capital: irrigation water, transport of production <p>* repay loans after the first harvest between July – December</p>
Tobacco	<ul style="list-style-type: none"> - diseases - adverse weather 	<ul style="list-style-type: none"> - March-May: - Throughout the year: 	<ul style="list-style-type: none"> - investment capital: land preparation, fertilizers, insecticides, pesticides - working capital: labour costs. <p>* repay loans after harvest in Sept - October</p>
Milk (cattle)	<ul style="list-style-type: none"> - livestock diseases - abrupt fall in market price for milk - loss of production due to lack of fridge - rising price for fodder coinciding with adverse weather for grazing 	<ul style="list-style-type: none"> - all year activity with daily income 	<ul style="list-style-type: none"> - investment capital: animals, machinery, construction of sheds, inputs for fodder production on own or rented land, tractor - working capital: regular cash inputs for fodder, medicines, transport, refrigerator use, sample-testing to qualify for subsidies commodity credit: fodder <p>* can repay loans monthly once animals have started producing milk</p>
Pig breeding	<ul style="list-style-type: none"> - diseases - abrupt fall in market prices for pig meat and large import of subsidised EU pork meat - rising price of concentrated fodder 	<ul style="list-style-type: none"> - all year activity with income depending on the herd structure (twice a year of almost every month) 	<ul style="list-style-type: none"> - investment capital: animals. Equipment, construction of sheds - working capital: regular cash inputs for concentrated fodder, medicine, for slaughtering and testing, transport <p>* can repay loans bi-monthly or twice a year depending on the herd structure</p>
Poultry (chickens)	<ul style="list-style-type: none"> - diseases and death of birds - rising price for fortified fodder 	<ul style="list-style-type: none"> - all year activity with income on 45-day intervals when birds are sold. 	<ul style="list-style-type: none"> - investment capital: birds, machinery, construction of sheds (also as commodity credit- no need for cash) - working capital in form of regular inputs of small amounts of cash for fodder, at 15-day intervals: fodder, medicines, transport, rental of shed (if not owned), heating - commodity credit: fodder <p>* can repay loans bi-monthly</p>

Loan Procedures

104. Small and micro farmers are unable to afford the time, the effort, the transportation and consultant-related costs involved in heavily bureaucratic, complex and slow loan application procedures. Moreover, farmers of a basic educational level are also intimidated by this process and are unlikely to apply for a loan under such conditions, even in cases where they might have highly promising business prospects.

105. The farmers interviewed indicated the need for quick, simple, efficient and free of charge procedures for loan application and prompt payments. A surprising number of small farmers expressed willingness to pay higher interest rates (if necessary) for the benefit of having easy access to loans. The Credit cooperatives' procedures were praised both for their speed and simplicity. Most small farmers view the credit cooperatives as the only micro-finance institutions that can address their needs and respond to their individual requirements.

Collateral Requirements and Conditions for Loan Repayment

106. Small farmers mentioned the desire for flexibility in collateral requirements. Most said that the only assets they could provide for collateral would be those bought with an investment loan, e.g. livestock, crops, cowsheds, equipment. They also favoured the use of guarantors, provided that the eligibility requirements could be made more realistic. Small farmers' preference for credit cooperatives as sources of lending is also explained by the cooperatives' wide acceptance of guarantors that are members and therefore considered trustworthy. Men and women expressed similar needs and priorities in relation to loan procedures and requirements, although women were generally more uncomfortable with the decision of mortgaging their family house.

107. Small farmers called for greater flexibility also in the timing of loan repayments. They wanted the option of repaying their loans in two or three instalments (rather than monthly), according to the type of production they are engaged in. For vegetable farmers for example, this would be in October, November and December. Credit cooperatives have yet to reach that level of flexibility. The last column of Table 4 includes the capacities and preferences, as expressed by the farmers, in relation to seasonality for loan repayment.

8. Proposed Options for ProCredit Lending Strategy

8.1 Sectors for Financing

108. For small and micro family farms the most promising and appropriate sectors for financing seem to be the intensive sectors of vegetable growing, vineyards and livestock; the latter assuring a daily income. Haskovo has an insignificant orchard and grain production; hence these sectors were not covered by the study. However these might be promising in other geographical areas of Bulgaria. The cultivation of herbs and spices was mentioned by some small farmers as profitable, although these are grown primarily in Kazanlak and Karlovo in the north-eastern part of the country.

8.2 Fast and Simple Application and Approval Procedures

109. ProCredit should make efforts to maintain its current fast procedures - even when dealing with small farmers in remote areas – because speed, efficiency and free-of-charge application procedures are major prerequisites for reaching small rural borrowers.

8.3 Varied and Innovative Micro-Finance Products

110. Currently, ProCredit offers two micro-finance products to SMEs: investment loans and working capital loans. A third product for working capital purposes could be an approved credit line that can be given out in tranches according to the farmer's request. The number of tranches and the timing of their release could be established with the farmer, taking into consideration the particular needs of his/her production cycle. The minimum loan amount needed could be as low as BGL 100.

111. A type of group-lending mechanism could be tested, following examples from Ustoi (section 8.7 below) where clients are requested to form a group and act as guarantors for each other. The current criteria for guarantors would need to be reviewed.

8.4 Flexible Collateral Requirements

112. Collateral requirements need to be reviewed to include cows, cowsheds, agricultural equipment, cars and guarantors. The criteria for guarantors would also have to be relaxed in order to reflect the reality of the farming population. Consideration should be given to possibilities of selecting two or more guarantors or introducing some sort of group guarantee mechanisms, like the method used by Ustoi (described below). The maximum limit of investment loans offered with the requirement of a guarantor should be lifted from the existing BGL 2 000 to at least BGL 5 000.

8.5 Realistic Conditions for Loan Repayment

113. Farmers should be given the option of repaying their loans in instalments that correspond to their production cycle. This could for example entail two or three instalments in autumn for vegetable and vine growers, but monthly repayments for milk producers. See Table 4 for details on best time for repayments, as expressed by farmers engaged in different productive activities.

8.6 Increased Outreach of Micro Finance Services

114. Given the constraints of small farmers residing in remote areas, ProCredit should consider innovative ways of reaching clients in their localities. One way of achieving this would be to have loan officers visit villages to publicise loan products in village meetings, pre-arranged with the help of mayors. Farmers who express interest could have the viability of their farms and property assessed, and receive assistance with completing and signing the documents in-situ, without needing to make the trip into town.

115. ProCredit might consider drawing up a classification of villages according to established criteria of vulnerability (distance, economic infrastructure, etc), agricultural potential, extent of eagerness and initiative on the part of the farming community to take loans, etc. This would facilitate the formulation of appropriate lending strategies and criteria (different thresholds) responding to the needs of different village-based clients. A classification of villages, rather than of municipalities - as practised by SAPARD - would be more appropriate.

116. Turning to the regions visited, Dobruja is sparsely populated with difficult access, inadequate rural road infrastructure and remote disadvantaged areas. ProCredit would need to build capacity to reach rural clients in this region. Haskovo on the other hand is overall more densely populated, has good rural infrastructure and easier access to towns and markets.

8.7 Lessons from Experiences with Group Lending

117. During field work, farmers were prompted to discuss the idea of forming mutual assistance groups with the aim of taking credit, using a group guarantee method to secure the loans. The participants of household interviews and group discussions generally agreed that better-off farmers with good access to assets would show little if any interest in such an arrangement, because they are in a better position to meet the standard collateral requirements and obtain loans easier. The poorest category of farmers (listed in table 5 under the "subsistence" column) were deemed to have no potential to carry through such a scheme, because they would not be able to repay.

118. However, the SLA study participants were overall quite positive about the prospects of group guarantee mechanisms if applied to loans targeting the middle category – the micro farmers. In Dobruja, of the 21 household interviewees, 10 were positive/enthusiastic about the idea of group guarantee, 6 were somewhat sceptical but thought it might work for small groups of close friends or relatives and 5 were negative because they believed that a group of people would never achieve the required level of trust. As mentioned earlier, a number of micro-farmers interviewed had formed groups with friends or relatives and some had already acted as guarantors for each others' loans, obtained from the credit cooperatives. They stressed that the necessary ingredient for the success of such a scheme would be trust, not only in each other's ability to deliver, but also in market prices that they are unable to control. Most people believed that relatives and friends/neighbours would have no problem guaranteeing for each other. There was also agreement about the most important conditions for the success of such a scheme: a) the loans should be individual for each group member (not for the whole group); b) all group members should be engaged in similar agricultural activities; and c) all should receive the same size of loan.

119. For micro farmers, group guarantee can be the only feasible way to secure loans. Although there are no examples in Bulgaria of such lending mechanisms in the rural context, some lessons can be learned from experiences with lending to small businesses in urban areas. The experience of Ustoi is presented here:

An Example of Group Guarantee Mechanism

120. The Catholic Relief Services support small-business development through the NGO Ustoi. They offer financial services targeted to the smallest, economically viable micro-entrepreneurs who reside in areas of high unemployment. The programme has introduced a group guarantee mechanism, instead of requiring collateral and formal guarantors. Entrepreneurs who want to take a loan must form solidarity groups of three to five members. Subsequently, several solidarity groups join together to form a "mutual assistance union." In order to continue receiving loans, all members of a mutual assistance union must repay their loans. If one member is unable to repay, the group must make up for the difference. This creates social pressure for repayment, which has proven to be effective.

121. The formal requirements for loans are: a) active business, b) maximum 3 employees, c) maximum 10,000 BGL in fixed assets, and d) agreement to the group guarantee principle. There is no requirement to submit a business plan, have registered business and provide collateral. The maximum initial loan size is 600-900 BGL (gradually moving to large-size loans), the loan term is 4, 6 or 8 months depending on the loan size. The average size of loans extended is 1,000 BGL and there is no grace period. Repayment rates are almost 100% which testifies to the success of the group lending methodology used. Ustoi has more than 3,500 active clients at present¹, of whom 70% are female entrepreneurs and 6% reside in rural areas. Ustoi is currently developing a strategy to target micro farm businesses.

122. ProCredit Bank should consider testing a similar group credit methodology in one or two pilot villages. If the methodology is proven successful it could be replicated in other areas and eventually expanded to cover more disadvantaged areas.

8.8 Typology of Potential Small Farmer Clients

123. In the regions visited, a number of wealth ranking exercises were carried out during group discussions with villagers and mayors. Participants were encouraged to describe the wellbeing of households in their villages in terms of indicators that would be interesting to a lending institution. They were then asked to define a typology of farm households and estimate the relative share of each in the village. Significant differences were noted between the villages. For example, Golesh village in Silistra had a much poorer population than the village of .. in Dobrich (see appendix III for details on these two extreme examples). Nevertheless, it was possible to estimate an average typology for all regions visited, which appears in table 5 below.

124. The table also gives an indication of the extent to which each type of farm family would be a good client risk for ProCredit Bank. The shades of grey on the table indicate the degree of "bankability" of each group (dark grey denoting more potential than light grey). Note, however, that the dividing line between the categories of "small farmers" (average/poor) and "micro farmers" (poor) is blurred. As discussed in Section 4.2, in the present conditions, a farmer can very abruptly fall from "small" to "micro" (e.g. adverse weather, sudden fall in market output prices), or graduate from "micro" to "small" through taking a loan and investing it successfully under favourable conditions.

¹ About 200 active loans are in Haskovo region where Ustoi has an office. No activities yet in Dobruja.

Table 5: Typology of Potential Small Farmer Clients

Potential	1: Subsistence	2: Micro	3: Small
Main assets	max. 2 cows or 2-3 pigs for the livestock sector; 1-2 dca for the market-gardening sectors. Produce for home consumption. No marketing products. Often landless	max. 5-6 cows or up to 10 sheep/goats; less than 100 birds for poultry; max. 10 dca of land for the horticultural and market-gardening sectors. Up to 100 dca (for grain)	about 5-10 cows or up to 20 sheep/goats, 10 pigs for the livestock sector; about 100 birds for poultry; about 15 dca of land for the horticultural and market-gardening sectors; about 10 dca for the wine sector; and up to 200 dca for the grain sector.
Income sources	social benefits, casual - seasonal labour (in farms or construction), backyard, chickens and small ruminants for subsistence.	Animal breeders (mainly cows) for the market, sell milk. Tobacco, vegetables. Less involved in vineyards or grain for the market. Pensions, social benefits, some traders.	Grain, vegetables, livestock, some shop owners. Sell maize, wheat, milk, vegetables to the market via middlemen.
Age	All ages up to 60. No pensioners	25 to 60+ (pensioners)	Typically 30-60
Ethnic origin	typically Roma – some landless Turks	Bulgarian / Turkish	Mostly Bulgarian
Family size	3 to 6	2 to 4	2-3
Access to immovable collateral	none housing of poor condition	very limited: cow sheds; simple village house	limited: house in village, house/flat in town, cow sheds. Few have flat in town.
Access to movable collateral	none horse, donkey carriage	animals, old car, some old machinery, crops	animals, car, crops, some equipment
Access to guarantors (under present bank eligibility requirements)¹	none	very limited	limited possibly village mayor, shopkeepers, few administration employees
Registration of farms	none	very low	low
Frequency of contracts with clients	none	very low	very low
Agricultural knowledge	limited to traditional subsistence methods - due to lower educational levels	some knowledge of agriculture, livestock and mechanics but limited access to extension support for updated techniques.	average generally better educated (many form university) in agriculture and livestock breeding. Limited access to extension.
Minimum loan size	principally not interested in loans – might need small cash for emergencies (max. BGL 300)	BGL 1 000-2 000 investment and working capital	BGL 2 000-5 000 investment and working capital
Potential for group-guarantee loans	Very Low due to lack of interest to borrow and low capacity to repay	High due to lack of alternative collateral and widespread practice of forming mutual help groups between friends and relatives	Low/Medium due to lack of trust in those who have less. Potential exists only if close friends or relatives of same economic standing could guarantee for each other.
% population in this category.	30%	55%	15%

¹ Guarantor must have a regular monthly income of a size that depends on the loan size.

125. As shown in Table 5, the most vulnerable type of farm families are not catering for the market and have little interest in taking loans. If they were to take a loan they would be ill equipped to repay. Many in this category are unemployed, of low educational level and belong to ethnic minorities (mostly Roma). Wealthier people have little confidence in their ability to deliver and repay, therefore they are not prepared to guarantee for loans given to them. Overall, subsistence farmers are risk averse and shy away from the idea of approaching a lending institution to request a loan.

126. A good client risk for ProCredit would be the middle category of “micro” farmers and the “small” farmers, as both are keen to take loans and have good potential to replay. The micro category is very positive to the idea of a group guarantee method that would allow them to secure loans. Many people in this category have taken small loans from credit cooperatives using guarantors as collateral. In fact, most borrowers of credit cooperatives belong to the category of “micro” farmers. “Small” farmers have better access to resources and agricultural knowledge compared to the “micro” farmers, and their credit needs are higher. Nevertheless, their capacity to meet present collateral requirements is equally limited.

8.9 Collaboration Between ProCredit and Other Actors in Rural Development

Farmers' Credit Cooperatives

127. Credit cooperatives are the lending institutions in the country that best know the conditions of the farming population. They are also the most preferred and the only accessible sources of credit for disadvantaged small farmers. The knowledge about rural clients and the trust Cooperatives enjoy from them are important strengths that ProCredit should draw on through some form of close collaboration. This could be through consultation, but also through an agreement that ProCredit Bank - or EBRD directly - channels a portion of its credit funds through the cooperatives.

Regional Agricultural Advisory Services

128. To meet new challenges and achieve sustainable agricultural investment among the small farm population, ProCredit would have to encourage technical advisory services at village level. Given the present constraints and the lack of MAF promotion campaign for its services, ProCredit could encourage group extension visits in villages where farmers have applied or received loans. The village Mayors could play a key role in facilitating the dissemination of technical knowledge to villagers, regarding new varieties, improved technologies, etc.

129. The exact shape of such “encouragement” and the form of collaboration between the bank and the advisory service providers would have to be discussed between the concerned parties. One option could be to make group extension visits a condition for giving loans to clients from specifically disadvantaged villages or for supporting particularly risky agricultural activities.

Appendix 1

Guiding Questions for Household Interview

The following is a set of guiding questions to be covered during household interviews. Note that this is not a questionnaire, i.e. the questions need not be phrased as such or in this order. Some detail might have to be omitted if respondents are uncomfortable with revealing information he/she might consider sensitive. Responses on income, expenditure, net profit and savings should be sought in approximation and in terms of proportion of total.

Basic Information

1. Village:
2. Municipality:
3. Respondent's Name:
4. registered farmer? (Yes/No)
5. Respondent's Sex (M/F):
6. Respondent's Age: (1: >40, 2: 40-60, 3: <60)
7. Head of HH? (M/F)
8. Educational level of HH: 1: higher, 2: technical, 3: basic

Section 1: Livelihood Assets

1.1 Human Capital

1. HH size (people living off HH income):
2. Of whom work in farm: (who?)
3. No. people contribute to off-farm HH income:
4. No. of full time employees
5. No. of seasonal employees

1.2 Natural Capital

1. Access to land (decares):
 - Of which rented
 - Of which communal
 - Of which owned
 - Of which irrigated
2. % land NOT under cultivation (why?)
3. Title deed? Yes/No

1.3 Physical Capital

1.3.1 Livestock (number)

1. cows/oxen/bulls/heifers/bullocks
2. horses/donkeys
3. goats/sheep
4. pigs
5. chickens
6. other

1.3.2. Orchards / trees (number

1. type
2. area (decares)

1.3.3. Assets/equipment

1. house
2. car
3. truck
4. Shed
5. tractor
6. trailer plough
7. weeder
8. harrower
9. other

1.4 Financial Capital

1. Savings in Leva (in account or other)
2. Liquidity to cope with unforeseen situations?
3. Insurance on your business/property/equipment? Y/N
4. Liabilities Y/N

1.5 Social Capital

1. Formal membership of formalised groups (1: coops, 2: associations, 3. Other, N: none)
2. Informal relationships of trust and reciprocity (village)
3. Benefits from market arrangements, exchange deals (labour/equipment, etc)

Section 2: Livelihoods Strategies

2.1. Patterns of HH income flow and expenditures

1. Agricultural income /yr, as % of tot. income
 - of which Crop sales
 - of which tree product sales
 - of which Livestock product sales
 - of which Rental of land, equipment
 - of which Vineyard
 - Other
2. Main Agricultural production:
3. Other income/yr (Family, Gov/ment, etc.) (as % of tot. income)
4. Expenditures/yr (as % of tot. expenditures)
 - of which for business
 - of which for food + other HH needs
5. Net yearly profit (an estimate or indication of satisfaction)

2.2. Perceptions of strengths (prioritise: 1-2-3)

2.3 Perceptions of constraints (prioritise 1-2-3)

2.4. Risks and Coping Strategies

1. Major perceived risks over a year:
2. Where do you turn for assistance?
3. Regular mechanisms to deal with income shortages:

2.5. Loan conditions and repayment capacity

1. Taken loan? (if not why?) Last loan from where?
2. First loan? (Yes/No)
3. Have you/do you borrow money from other sources? Which ones?
4. Loan amount:
5. Purpose of loan?
6. Actual loan utilisation?
7. When was the loan taken?
8. Interest rate:
9. Loan time (months):
10. Repayments in installments / year:
11. Grace period (months):
12. Collateral as Guarantee
13. Problems in obtaining credit? (prioritise: 1-2-3) Y/N
14. Difficulties in repaying the loan?
15. What is the primary source of loan repayment?

Section 3: Input/Output Market Linkages

1. Who is the target group of your product?
2. Where are your products sold? Is the demand nearby/ far?
3. Is the demand for the product constant (also in the future)?
4. How do you reach the market/s with your products?
5. Competitors? If so, is your product competitive, in price, quality, access? Sustainable?
6. Do you have any specific operational/production problems?
7. Contract with client? (Y/N)

Section 4: Vision for the Future - Desired Livelihood Outcomes

1. Which of your income sources would you prefer to invest more in? 1. Main / 2. Other
2. Any new ones you want to explore?
3. Would you consider taking another loan in the future?
4. Would you be interested in a group guarantee mechanism for securing loans? How would you suggest that such a system could work best?
5. How would you change your livelihood strategies if you took a loan? / or with the next loan?
6. What additional financial services would you need? Purpose?
7. How can your living conditions improve? (prioritise: 1-2-3)

Appendix 2

Guiding Questions for Village Group Discussions

Region:

Municipality:

Village:

Number of participants (M/F):

Age of participants (>40, 40-60, <60):

SECTION A: SOCIO-ECONOMIC ACTIVITIES

1. CROPS

- plants do you grow in your village?
- What crop products do you produce in the village?
- Which are the main problems with growing crop plants and producing crop products?
- **In your opinion**, what should be done to improve growing of crop plants and producing crop products? How? By whom?

2. LIVESTOCK

- stock do you breed in your village?
- What livestock products do you produce in the village?
- Which are the main problems with breeding livestock and producing livestock products?
- **In your opinion**, what should be done to improve breeding livestock and producing livestock products? How? By whom?

3. SOCIAL CAPITAL

- Are any cooperatives in the VILLAGE? If “yes”, what type of cooperatives?
- Specify which are the main activities of the cooperatives in the village?
- Which are the main problems that the cooperatives face?
- **In your opinion**, what should be done to improve these activities? How? By whom?

4. INDUSTRY AND PROCESSING

- Please, specify which are the main processing or industrial activities in the village?
- Which are the main problems that these activities face?
- **According to you**, what should be done to improve their activities? How? By whom?

5. OTHER ACTIVITIES

- Please, specify which other activities do you have in the village?
- Which are the main problems that these activities face?
- **According to you** what should be done to improve their activities? How? By whom?

SECTION B – MAIN CONSTRAINTS AND NEEDS

- Which are the main constraints and needs you face as inhabitants of your village? Which are the main needs in agricultural production. **How could they be solved? By whom?**

SECTION C - TYPES OF HOUSEHOLDS

- a. Could you describe the different types of families in the villages? According to their occupation, source of income and living standards, or any of the criteria you find relevant.
- b. Could you estimate which **percentage of the total households** in each type?
- c. What are their experiences with / potential for credit? What would be their special micro-finance needs?

SECTION D - MICRO-FINANCE EXPERIENCES

- a. What are the 3 main problems faced in the village related to accessing micro-finance services? **How could they be solved? By whom?**
- b. Which type of household (as described before) is the most potential borrower?
- c. Are poorer households interested in credit? How could they be targeted?
- d. Would you be interested in a group guarantee mechanism for securing loans? How would you suggest that such a system could work best?
- e. (Add any ideas discussed with ProCredit about loan products and procedures)

Appendix 3

Comparison of Typologies of Potential Small Farmer Clients: Dobrich – Silistra

<u>Golesh Village Kainarja Municipality - Silistra Region- DOBRUJA</u>			
Inhabitants: 1500 (500 households: (10% Bulgarian, 90% Turkish)			
CRITERIA	SUBSISTANCE	MICRO	SMALL
Immovable collateral	house, no running water or electricity, bad living conditions (50%)	house	house
Movable collateral	few horse, donkey carriage	cows, pigs, horse, donkey carriage	tractors, cars
Access to guarantors	no	few	high
Potential for group guarantee loans	no	some	high
Registration	no	no	some
Contracts	no	only tobacco	5% have contracts for milk
Extension/knowledge	low education no access to extension	some education - no access	more access
Min loan size	150 to 300	1000 - 2000	3000 for investment
Land	landless - cannot rent - only backyard	10 to 20 dca (for grain)	100 dca for grain
Activity	social benefits, casual - seasonal labour (in farms or construction), chickens for subsistence	social benefits and milk from cows	maize, weat, tobacco, milk
Age	70% are less than 40, 30% are 60+	to 40	up to 40
Damilly size	2 to 6	2 to 6	2 to 4
% of population	40%	57%	3%

Stefanovo Village Dobrich Municipality - Dobrich Region- DOBRUJA			
Inhabitants: 1200 (450 households: (60% Bulgarian, 30% Turkish, 10% Roma)			
CRITERIA	SUBSISTANCE	MICRO	SMALL
Immovable collateral	no	20-30% have some	50% flats in town
Movable collateral	horse, donkey carriage	40% have cars	cars, equipment
Access to guarantors	few will guarantee	50% have	more access
Potential for group guarantee loans	no potential	potential is higher - might work well	NO
Registration	no	no	all are registered agric manufacturers, small companies
Contracts	no	no	no
Extension/knowledge	lower education (only 5% have agric. Education) less access to extension	some livestock and mechanic knowledge	higher education and knowledge
Min loan size	1,000	1000 - 2000	3000 to 20000
Land	10% has up to 10dca of land. Rest are landless. Small gardens for HH consumption	1-2 dca. Backyard garden. cows, sheep, poultry	animals, old mechanical equipment, 50-300dca
Activity	social benefits, casual labour (in farms or construction)	pensioners, breed animals for the market	grain, vegetables, livestock, shop owners
Age	20-60 (no pensioners)	25-70	30-65
Family size	2 to 6	3	3 to 4
%	60% (all Roma and some Turks are in this category)	30%	10%

BULGARIA

EXPANDING PROCREDIT'S OPERATIONS IN RURAL AREAS

ANNEX 6

CONTACT DETAILS OF POTENTIAL PARTNERS IN BULGARIA

ANNEX 6

CONTACT DETAILS OF POTENTIAL PARTNERS IN BULGARIA

Branch organisations/associations:

Association of meat processors
Sofia, Shipchenski prohod Blvd.
Tel: 359 2 971 26 71 fax: 359 2 973 30 69
E-mail: amb@einet.bg
Mr Kiril Vatev – Chairman

Bulgarian Farmers Association
1606 Sofia, 29 Vladaiska Str.
Tel/fax: 359 2 521 702
Dr Stefan Stefanov – Chairman

Union of agricultural cooperatives
1000 Sofia, 108 Rakovski Str.
Tel: 359 2 876 513
Prof Atanas Ganev - Chairman

Association of pig-breeders
9700 Shumen, Bulgaria
tel: 359 54 65 268
[www. bgagro.com/organiz/svinevadi.htm](http://www.bgagro.com/organiz/svinevadi.htm)

Union of milk producers
1000 Sofia, 9 Saborna Str.
Tel: 359 2 882 494

Danone Bulgaria
Mr Nebojsa Radakovic
Balkan Purchasing Director
Tel Sofia: +359 2 93 00 460
Tel Bucharest: + 402 1 204 62 04
Mob: +359 887 83 26 61

Fairs:

Plovdiv fair

4003 Plovdiv, Bulgaria
37 Tzar Boris III – Obedinitel Blvd.
Tel: 359 32 902 000 fax: 359 32 902 432
E-mail: mailbox@fair-plovdiv.com
www.fair-plovdiv.com

Dobrich fair

9300 Dobrich, Bulgaria
5 Svoboda sq.
tel: 359 58 46 283 fax: 359 58 30 152

Newspapers:

Agrosviat (bi-weekly edition)

Sofia 1000, 1 Macedonia Sq.
Tel: 359 2 9170 610
e-mail: agrosviat@yahoo.com, vilist@internet-bg.net
Director: Mrs Voileta Stoyanova

Bulgarian Farmer (weekly)

1000 Sofia, 16 Bacho Kiro Str.
Tel/fax: 359 2 818 757
Mr Vasil Asparuhov – Editor-in-chief

Farmer (New Farmer) (weekly)

1606 Sofia
29 Vladaiska Str.
Tel/fax: 359 2 52 17 02
Mr Vladimir Rupov – Editor-in-Chief

Stopanin (weekly)

1303 Sofia, 11-A Pozitano Str.
Tel: 359 2 895 417 fax: 359 2 657 170
Mr Emil Ivanov – Editor-in-Chief