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## THE PROSPECTS AND CHALLENGES OF MANAGING CREDIT FACILITIES GRANTED TO COTTON FARMERS (OUTGROWERS) OF THE GHANA COTTON COMPANY

By

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A DISSERTATION SUBMITTED TO THE DEPARTMENT OF PLANNING AND MANAGEMENT, IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF MASTER OF SCIENCE DEGREE IN DEVELOPMENT MANAGEMENT

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# DECLARATION

I, A. John Akansiaba declare that this thesis: "Managing *Credit Facilities Granted to Cotton Farmers: Prospects and Challenges Facing Companies Engaged in Cotton production in Ghana. The Case of Ghana Cotton Company"* is my own work and that all sources of materials used have been duly acknowledged. This thesis has been submitted by me in partial fulfillment of the requirement for a Master of Science Degree in Development Management at the University for Development Studies. To the best of my knowledge this thesis is not submitted to any other institution anywhere for the award of any academic degree. I accept responsibilities for any inaccuracies and errors in this work.

John A. Akansiaba ..... 26/6/2012.....

(Candidate) Date

Prof. David Millar ..... 04/09/12.....

(Supervisor) Date

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## DEDICATION

To Maureen, Amanda and their mother Joana Anyawie, who assumed the responsibility of their proper upbringing in their formative years; the time they most needed my fatherly love and spiritual guidance while I was pursuing this programme. I must thank these three people in my life for the sacrifices and deprivations that my absence from home might have caused them.

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## ABSTRACT

*This study analyzes the problem of managing agricultural credit facilities (input loans) offered to* cotton out-growers at North Western Division (NWD) of the Ghana Cotton Company Limited (GCCL), a company engaged in the production of seed cotton using the out-grower system, and their effect on the development of cotton production in Ghana. It is based on a practical management problem identified by the researcher during the study.

Data were based on the analysis of cotton out-growers performances over the last ten (10) years gathered from the Monitoring and Evaluation Unit, the Accounts department, Credit and Supplies Unit, Production department, and the Internal Audit Unit. The results were also based on questionnaire administered to the management, Cotton Production Assistants, and cotton out-growers to obtain primary data. The data was analyzed and synthesized from both the primary and secondary sources. Suggested strategies, the implementation of which would ensure the effective management of inputs loans and improve liquidity, profitability and the reduction in bad debts management are made at the end of the study.

The production of cotton in Ghana is operated using the out grower's system where farmers are pre-financed with inputs mainly fertilizers, insecticides and land preparation. The farmers supply land and labour and beyond this, bear no other economic risk or responsibility. The farmers are required to produce seed cotton for sale to the cotton companies in order to pay off the credit granted. The performances of the farmers over the past ten (10) years have become very poor leading to many farmers' inability to pay back the loans.

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The management of the credit scheme has been the concern of management of the various players in the cotton industry. Theoretical and conceptual considerations have been reviewed on existing literature by seasoned academicians and professionals in the field of loan management. The basic understanding of the concepts and findings were vital for grasping the problem at hand and suggesting ways to solve the problem. Results from the management revealed that 100% of them are of the view that the company cannot operate without pre-financing the out-growers. This reveals how important the input loan scheme is to the entire operations of the company.

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Continuous financing of defaulting farmers is the fact that GCCL does not have a data-base of all the farmers in the out-grower scheme. Developing of a data base of out-growers will enable the company to assess the performance of each farmer on the scheme in terms of production and repayment track records. GCCL need to transfer the of Risk of Cotton Production to Out-Growers by adopting the group farming system and also facilitate the granting of loans to farmer groups from banks with the groups taking full responsibility for repayment of the loan and the company acting only as guarantors or witnesses. GCCL also need to set production target for out-growers, and out-growers who are able to meet such targets should be publicly rewarded. Cotton Production Assistants (CPAs) must be given performance targets and those whose farmers are able to produce enough to pay back their input loans should be handsomely rewarded financially or through promotion. GCCL should create a credit department headed by a Credit Officer and also develop the Capacity of CPAs on credit supervision.

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# LIST OF ACRONYMS

| | | |
|---|---|---|
| ADB | - | Agriculture Development Bank |
| AFC | - | Agriculture Finance Cooperation |
| CEO | - | Chief Executive Officer |
| CDB | - | Cotton Development Board |
| CPA | - | Cotton Production Assistants |
| 'AO | - | Food and Agriculture Organisation |
| GCCL | - | Ghana Cotton Company Limited |
| WTC | - | International Women's Tribute Centre |
| NCD | - | North Central Division |
| NED | - | North Eastern Division |
| NPL | - | Nulux Plantations Limited |
| NWD | - | North Western Division |
| PDL | - | Plantations Development Limited |
| SARI | - | Savannah Agriculture Research Institute |
| SPSS | - | Statistical Package for Social Scientist |
| UNDP | - | United Nations Development Programme |

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# INTRODUCTION

## 1.1 Background

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When a firm sells goods or renders services, it can demand payment on or before the delivery date or it can extend credit to customers and allow some delay in payment. Why would firms grant credit? Among several reasons, offering credit is a way of stimulating sales. According to Bhalla (1999), a credit facility is created when a firm sells goods or renders services and does not receive payment immediately. Thus, trade credit creates receivables or book debts which the firm is expected to collect in the near future. The values of these book debts are carried on the balance sheet under various titles such as accounts receivable, trade debtors, trade receivables, customer receivables or debtors. These receivables include credit to other firms, called trade credit, and credit granted to customers, called consumer credit and they represent a major investment of financial resources by businesses. Furthermore, a credit facility is a very important source of financing for corporations. No matter how one may look at it, receivables and receivables management are very important aspects of a firm's short-term financial policy.

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Farmers' loans or accounts receivables in any commercial concern such as Ghana Cotton Company Limited (GCCL) constitute a substantial portion of the current assets of the firm. This therefore calls for the effective management of credit facilities granted to cotton farmers since they impact directly on the liquidity, profitability and the risk of bad debts of the Company. Loans granted to cotton farmers also directly impact on the working capital of the Company as they constitute a significant investment of the

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# CHAPTER ONE

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Company's assets and thus need effective monitoring and control. How this asset is managed has an effect on the shareholder value.

The primary goal of credit facilities granted to cotton farmers is the Company's deliberate policy to achieve a certain performance target to maximize the profits of the Firm by striking a balance among liquidity, profitability and risk. The Company's credit policy and collection policies together, determine the level of investment in its farmer loans. Furthermore, the total amount of farmer loans outstanding at any given time is determined by the volume of credit granted and the average length of time between credit and collections. The effectiveness of a company's credit policies can also have a significant impact on its total performance and profitability.

Akinsami (2000) and the International Women's Tribute Centre (IWTC) (1985) are of the view that credit facility/transaction refers to an arrangement to receive goods or services now from a person or institution and pay later. Owusu-Acheampong (1986) on the other hand defined a credit facility/transaction as a temporary transfer of capital resource from an individual or institution to another person or institution for a specific period of time, and at an agreed interest charge. To Yakubu (2008), credit is a transaction during which a person or group of people receive money, goods or services from another person or group of people with a promise to pay back at a later time. He states that this is the basic understanding of credit in the traditional setting. However, the researcher refers to credit as an advancement of services to farmers in the form of finance and inputs (ploughing

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services, seeds, fertilizers etc) while waiting for later re-payments from the sales of the seed cotton.

From the perspective of the GCCL, a credit facility is made up of farm inputs in the form of fertilizers, insecticide and land preparation to cotton out-growers. The cotton out-growers therefore are expected to pay for the cost of inputs through the seed cotton they in turn offer to the Company during the purchasing season. The farmers ability to pay back the loans (inputs) therefore depends to a large extent on the volume of seed cotton they produce for sale to the sponsor cotton company. The gross value of the seed cotton purchased is determined at a marketing centre, the total cost of credit is deducted and the net amount (if any), is paid to the farmer. Where the gross value of the seed cotton purchased from the farmer is inadequate to cover the cost of inputs supplied, the farmer invariably is deemed to have failed to pay their loan.

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The operations of the GCCL in seed cotton production involve huge investment of funds, especially in the pre-financing of out-growers. Input loan management therefore revolves around an attempt to balance profitability and liquidity. Many business organizations that extend credit facilities to their customers liberalize their credit terms to generate more sales, towards possible profit. The longer the credit term, the greater will be the amount of debt and the greater the possible strain on the firm's liquidity.

Credit management begins with the decision as to whether or not to grant credit and is important because of its significance on the liquidity and working capital of a company.

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Working capital is "the value of assets used (consumed) in the main trading activities of the company, example cash, raw materials, work in progress and credit given to customers". It is that part of the total capital which is employed in short-term operations such as raw materials, semi-processed products, sundry debtors and short-term investments (Cinnanmon and Helweg-Larsen *et al*, 2006).

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In the context of this study, poor credit management refers to inadequate financial controls. It indicates the range of weaknesses which are contributing to either businesses under performing or eventually going into liquidation. Liquidity on the other hand refers to the degree to which an asset can easily be converted to cash. That is, a company's ability to meet current obligations with cash or other assets that can be quickly converted to cash. Also, profitability in the context of this study, refers to a financial benefit that is realized when the amount of revenue gained from a business activity exceeds the expenses, costs and taxes needed to sustain the activity. Any profit that is gained goes to the business's owners, who may or may not decide to spend it on the business. Performance on the other hand refers to an efficient functioning of a company.

The level of credit facility affects the amount of working capital, requiring the firm to rely on borrowed funds at high interest to finance business operations of which GCCL is not an exemption. The significance of credit facility on working capital is that high levels of accounts receivable affect the liquidity and profitability position of the firm.

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These events constitute the operating cycle of a business. If all these events could happen simultaneously, there would not arise any need for working capital. However, since cash inflows and cash outflows do not match, an organization needs necessary cash or liquidity to be able to meet its short term or immediate obligations. Thus, adequate working capital is essential for the smooth operations of the business. Large levels of accounts receivable means that the cash flow of the firm is impaired, resulting in weak liquidity and profitability.

In practice, companies may grant credit for several other reasons, among which are ways of stimulating sales, the company's market and financial position, the customer's status and requirement, dealer relationship, industrial practice and competition within the industry. The cost associated with granting credit is not trivial. First, there is the chance that the customer will not pay. Second, the firm has to bear the costs of carrying receivables. The credit policy decision thus involves a trade-off between the benefits of increase sales versus the cost of granting credit (Ross et. al., 1998).

These costs must be considered against the background that the granting of credit enhances sales. The Finance Officer must match these cost with the incremental benefits emanating from increased sales due to the extension of credit facilities and then reach a decision whether to grant credit or not. Thus, the rational decision about the credit policy of a firm lies in matching incremental profits arising from increased credit sales with incremental costs associated with receivables. The problems associated with account receivables are:

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- Late payments (overdue loans) which constitute financial cost to the company because account receivables must be financed and
- Nonpayment, resulting in bad debts, which are direct expenses that must be written off.

## 1.2 The Cotton Industry and Ghana Cotton Company Limited

As a form of employment, farmers mostly in the three Northern Regions engage in the production of the crop to increase their incomes. Large scale cotton production by the then Cotton Development Board of the Ministry of Agriculture started in 1968, long after many other countries in West Africa (Mali, Burkina Faso, Benin, Togo and La Cote d'Ivoire) had done so. Successes achieved in these countries in terms of production continue to serve as benchmarks for Ghana. For instance, while Ghana only managed to produce 36,000 metric tons of seed Cotton in 2006/7, Burkina Faso produced a colossal 700,000 metric tons.

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The fortunes of Ghana Cotton Company Limited (GCCL) have drastically declined over the years due to both internal and external factors. Some of these include little attention paid by government to the sector; the absence of subsidies to cotton farmers; high interest rates on loans for agriculture; poor loan recovery from farmers; mismanagement and above all, a bearish world market price for the commodity.

The effect is that the booming textile industry in the past is now a pale shadow of itself. The few firms still in operation now have to depend heavily on raw material imports.

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Cheap imported textile products price out those of local firms on the market. If Ghana were to reverse the situation, then Ghana Cotton Company Limited has to be supported to deliver. As it stands now, the Company is able to attract only a few out-growers. Inadequate support to these farmers coupled with untimely delivery negatively affect yields.

The Company's broken down fleet of tractors and haulage trucks compounds the problem. In spite of the fact that Company plans to cultivate 30,000 hectares of cotton come 2011, this may not succeed if support does not come by way of a re-engineering of the Company.

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### 1.3 The Systems of Cotton Production in Ghana

Operations of the cotton industry in Ghana involve two parties engaged in quasi-contracting, namely, farmers and cotton processing companies. The cotton companies supply and pre-finance all production inputs including land preparation, cotton seed, fertilizer and insecticides and bear all the associated economic risks. The farmers supply land, labour, and tools and beyond this, appear to bear no other economic risk. The farmers are required to produce seed cotton for sale to the cotton companies in order to pay off the credit granted them. The cotton companies therefore bear a great deal of risk in the growing of seed cotton. To compensate for this risk, cotton producer prices are set at very low economic levels. The above system has been in operation since cotton growing started in Ghana and has created an expectation on the part of producers that all their inputs should be supplied on credit, however, producer prices should be higher

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(GCCL, 1996). Farmers have the impression that the only way to service their credit is through the production and sale of seed cotton to GCCL. Where a farmer's produce is inadequate to pay back the credit, they do not see the need to settle the difference through other means like cash payment

The current seed cotton production system has been identified by all independent experts (German International Cooperation and Cotton Development Project) who have undertaken detailed studies of it to be the fundamental cause of the low and stagnant cotton production levels in Ghana in comparison to that of its neighboring countries.

This cotton production system as noted by the Consultants has a number of major weaknesses including:

1. Low farmer interest in cotton growing because of the low producer prices.
2. The temptation in producers to divert fertilizer and insecticides since they do not pay directly for these inputs which are very much sought after.
3. The opportunity for producers to sell their seed cotton to companies that did not sponsor them especially when the values of their yields are not expected to cover their input cost.
4. Resultant low yields due to farmers' non-adherence to optimum cotton growing practices.
5. The apparent diminished exposure of farmers to any economic risk.

A firm, in whatever activity it is engaged should be managed effectively and efficiently. This implies that the firm should be able to achieve its objectives by maximizing the use of resources. The managing of the resources implies co-ordination and control of the

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efforts of the firm for achieving the organizational objectives (Pandey, 1996). The process of managing is facilitated when management charts its future course of action in advance, and takes decisions in a professional manner, utilizing the individual and group efforts in a coordinated and rational manner. One systematic approach for attaining effective management performance is financial planning and budgeting (Kock, 1998). But the question one needs to ask is: **Do cotton companies pay much attention to the management of loans granted to cotton farmers?** Table 1.1 presents the percentage loan recovery from 2001 – 2009. From Table 1.1, loan recovery has not seen any improvement since the last 10years, from a high of 70.1% in 2002 to 49.2% in 2009. There is evidence on record as presented in Table 1.1, of increasing unpaid loans which have directly affected seed cotton production over the years in the GCCL.

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**Table 1.1: Percentage Loan Recovery from 2001 - 2009**

| Year | NCD | NED | NWD | GCCL |
|---|---|---|---|---|
| 2001 | 60.8 | 59.6 | 77.0 | 67.4 |
| 2002 | 73.1 | 76.5 | 77.4 | 70.1 |
| 2003 | 59.8 | 72.6 | 70.1 | 67.0 |
| 2004 | 57.9 | 71.5 | 68.6 | 66.0 |
| 2005 | 55.5 | 65.9 | 63.7 | 61.7 |
| 2006 | 50.2 | 61.4 | 59.7 | 57.2 |
| 2007 | 52.6 | 58.5 | 57.3 | 56.1 |
| 2008 | 45.3 | 51.7 | 50.1 | 48.0 |
| 2009 | 44.7 | 48.9 | 54.0 | 49.2 |

Source: GCCL Monitoring and Evaluation Unit Annual Report, 2008/2009, page 12

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NCD: North Central Division

NED: North Eastern Division

NWD: North Western Division

The operations of cotton companies in seed cotton production involve a huge investment of funds, especially in the pre-financing of out-growers. The development of an effective credit policy is to enable the firm achieve a sound and optimal financial decisions that will help improve the firm's liquidity.

Many business organizations that extend credit facilities to their customers liberalize their credit terms to generate more sales, towards making more profit. The longer the loan cycle, the greater would be the stress on the firm's liquidity. The need to confront the current credit policy of the GCCL is imperative and one approach is to find a way of delivering credit to farmers in a manner that would enhance their performance, improve their repayment record and reduce the credit risk of the Company (GCCL, 2009).

The main focus of GCCL's operations over the last 10 years (2001- 2010) has been the revival of the cotton industry in Ghana. It was essentially a joint venture between government and private firms with an interest in cotton production. The Ghana cotton industry has changed dramatically since its revival. In 1997 Government took the decision to sell its 30% shareholding in the Company to private investors, consisting mainly of textile companies, input suppliers and the Agricultural Development Bank (ADB). In 2008 the Government of Ghana acquired 340,650 of ADB's Shareholding in

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GCCL, representing 74.28% of the company's total shares and became the majority shareholder in the area.

The cotton industry in Ghana has been completely deregulated and GCCL no longer enjoys a monopoly position. All government subsidies have been withdrawn and all companies operating in the industry must do so on commercial basis. The industry is now characterized by fierce competition. While GCCL remains the market leader, its market share has shrunk considerably since deregulation from eighty nine (89%) in 1986/87 to sixty percent (60%) in 1996 (GCCL, 1996). The current market share is still estimated to be about sixty five percent (65%) however; this is under severe threat from competitors in the industry. At present, there are about five cotton companies that compete with GCCL in the northern savanna belt of Ghana (GCCL,2009). However, of these only two pose a serious threat to GCCL, namely Plantations Development Limited (PDL) and Nulux Plantations Limited (NPL) (GCCL, 2001).

The implications of poor management of credit facilities on the liquidity, profitability and on the overall performance of the company are of prime concern. Therefore this study seeks to highlight on new strategies that would assist management to identify the challenges that are causing the GCCL to make losses and recommend ways that would bring it back to profitability.

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### 1.4 Problem Statement

The Ghana Cotton Company Limited after incorporation, achieved national reputation as one of the most efficient and profitable companies in Ghana. Company profits have been in excess of one million Ghana cedis per annum since 1993. It achieved high growth and profitability because of the high quality of its products and service delivery (GCCL, 2009). However, the collapse of world market prices of cotton in 1998 ever since has impacted adversely on the Company making it suffer losses from 1999 to date. To add to that, a lot of loans to farmers have become delinquent in recent times leading to declining cash in-flows and increasing bad debts which are consequently leading to trade losses. The liquidity position of the Company has further been seriously impaired as a result of the prevailing harsh economic conditions in Ghana as it is now difficult to obtain low cost capital to run Company operations. Management was thus compelled to take a closer look at the operations of the Company, which revealed that loans to farmers had increased by 55% over the period 1999 to 2008 (GCCL, 2009). It was thus found imperative by management to devise measures to improve the Company's credit management.

GCCL's operations encompass all elements of the cotton production and processing chain. The Company's credit is made up of a standard unit which consists of pre-financing all direct costs of growing cotton. This consists of the preparation of land and the supply of seeds and fertilizers (GCCL, 2001). With the withdrawal of Government subsidies coupled with the high cost of borrowing in Ghana, the cost of farm inputs supplied to farmers on credit keeps on rising. This has led to increasing unpaid loans,

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which have directly affected seed cotton production over the years in the industry. Cotton companies are experiencing an extremely serious situation caused by the great difficulties they encountered during the last ten (10) years to recover their inputs credit from cotton producers. The recovery rates for some companies have been as low as 60% (Ghana Cotton Development Project, 1999). Most of these companies are very indebted to banks, mainly the Agricultural Development Bank, and the decline of lint cotton prices worsening the situation. The situation is serious as in the very short run it could mean the discontinuation of inputs credit and subsequently the collapse of cotton production. The biggest task confronting the management of GCCL and for that matter the cotton sector, is how to manage the credit facilities offered to cotton farmers to ensure that they are able to pay off their loans at the end of each cotton season.

Available records from the Company indicate that a total of GH¢ 720,904.25 of bad debts of farmers for the period 1st June 2004 to 31st May 2008, has been written off (GCCL, 2009). The policy of providing credit to out-growers appears likely to continue as long as the cotton companies envisage expansion drives. The situation shows that the liquidity position of the Company is adversely affected, thus prompting the need for management to take a second look at the management of credit facilities offered to farmers.

Farmers whose loans become delinquent usually abandon cotton production to avoid paying their loans (GCCL, 2001). As a private cotton company in a fierce competitive economic environment, the management of credit to farmers should be prudently handled

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in order to sustain the industry. *This therefore calls for an empirical investigation into the poor management of GCCL in providing credit facilities to cotton farmers in Ghana.*

### 1.5 Research Questions

The main research question to be addressed by the study is as follows:

What are the prospects and challenges facing GCCL in providing credit facilities to cotton farmers in Ghana?

The specific questions whose answers will all contribute in responding to the main questions are as follows:

1. What are the common reasons for cotton farmers' failure to produce and sell enough volume of seed cotton to pay back their loans?
2. What other mechanisms exist to transfer the risk of growing cotton to the cotton out-growers?
3. What are the bottlenecks that hinder the current input loan scheme offered to the out-growers?
4. What other possibilities exist to ensure that cotton companies produce seed cotton without pre-financing cotton out-growers?

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### 1.6 Research Objectives

The main objective of the study is to assess the prospects and challenges of credit facilities managed by GCCL to cotton farmers.

The specific objectives of the study are as follows:

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1. To identify reasons why some cotton farmers continuously fail to produce and sell adequate seed cotton to pay back input loans.

2. To examine other mechanisms by which the risk of growing cotton could be transferred to the out-growers.

3. To identify the bottlenecks in the current input loan scheme offered to the out-growers.

4. To explore other possibilities that exist to ensure that cotton companies produce seed cotton without pre-financing cotton out-growers.

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### 1.7 Significance of the Study

Ghana Cotton Company's dependence on loans as the main source of finance with its attendant high interest charges to pre-finance cotton growers who in turn fail to pay back the loans is putting a serious strain on the financial resources of the company for the past ten years. The production of cotton in Ghana is operated using the out grower's system where farmers are pre-financed with inputs mainly fertilizers, insecticides and land preparation.

Farmers' inability to pay back credits offered to them by way of producing enough cotton to offset the inputs loan, and their subsequent inability to pay any difference by way of cash, has invariably affected the company's liquidity position thus leading to a decline in cash flows. The system used whereby producers only re-pay their debts if their yield exceed the costs of inputs supplied may be a contributive factor to the ever-increasing value of un-retrieved loans. GCCL solely bears the costs of any default by producers. Financing charges are currently one of the largest single costs incurred by GCCL. The

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granting of credit to out-growers must be viewed as an undertaking based on profit motives and not necessarily a means of producing raw seed cotton.

Farmers' produce, which is the main source of repayment, has been declining per yield over the years resulting in their inability to break even, and thus their failure to pay for the credit facilities enjoyed. GCCL does not get the required volume of seed cotton for processing from the out-growers, and this invariably affects the company's turnover. Records show that the unpaid loans have never been settled over the years (GCCL Appraisals of Operations, 2001).

The inability of the out-growers to settle the cost of inputs means a fall in yield per unit. The rising cost of inputs supplied to the farmer has continuously affected his yield, thus putting a lot of pressure on them to increase their yield, which for sometime now is not attainable. Therefore, this research seeks to highlight on new strategies that will assist management to identify ways by which inputs loans can be administered properly in order to sustain the heavy investments in pre-financing the out-grower. One possible way of doing this is to unearth the challenges and prospects of the input credit granted to cotton farmers and how it can be improved for the benefits of GCCL hence the study. The result of the research could also serve as a basis for further research on credit management in the cotton industry in the three Northern Regions of Ghana.

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### 1.8 Conceptual Framework

Mugenda and Mugenda (2003) say a conceptual framework is a graphical or diagrammatic representation of the relationship between variables in a study. It helps the

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researcher see the proposed relationship between the variables easily and quickly. In this study, the conceptual framework is based on five (5) independent variables that are presumed to influence the management of credit in the cotton industry in Ghana.

These factors are:

i. Credit disbursement

ii. Legal and regulatory framework

iii. Management problems

iv. Knowledge about credit

v. Recovery rate

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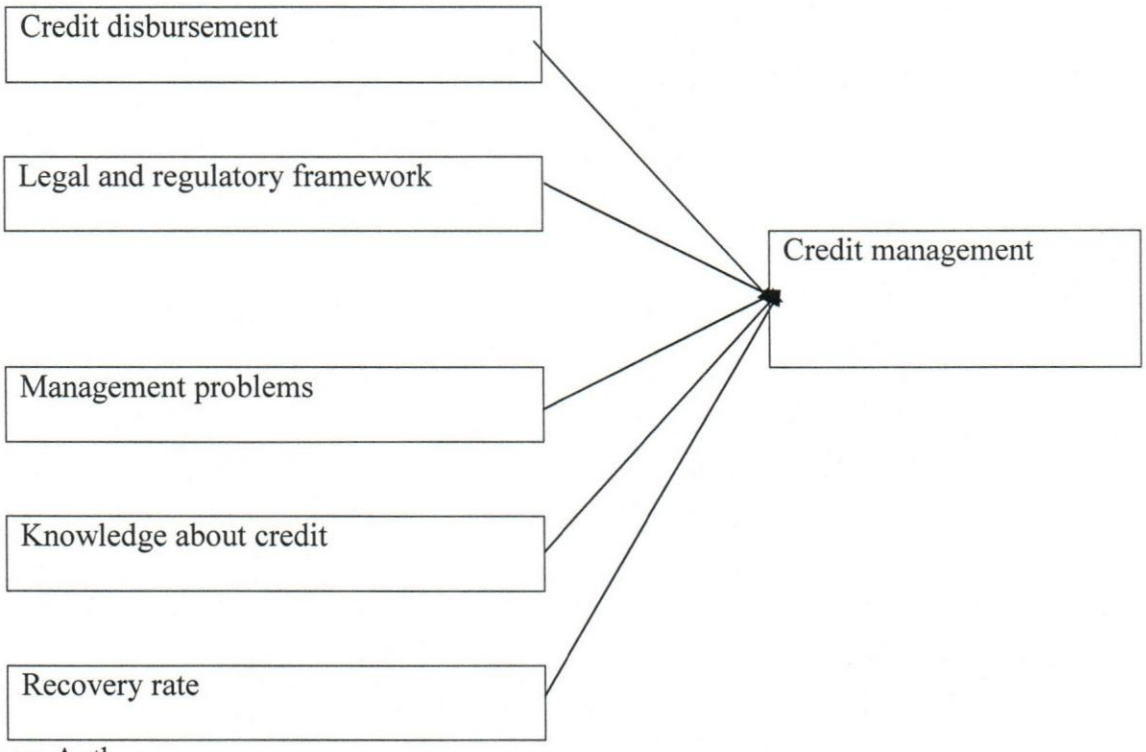
**Figure 1.1: Factors Influencing the Management of Credit**




Source: Author

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Cotton production requires expensive inputs and farmers need to be provided with quality inputs on favorable credit terms which, in turn, requires efficient credit recovery by management. An efficient knowledge about credit, its disbursement, knowledge of legal regulatory frameworks of the sustainability of the scheme will significantly influence the overall success and recovery rate of disbursed input credit. Poor management and low entrepreneurial skill base significantly influence the prudent management of inputs credit.

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# CHAPTER TWO

## LITERATURE REVIEW

### 2.1 Introduction

This chapter is tailored to the review of past works with much emphasis on the objectives of the study. Published and unpublished literatures are reviewed. The literature review generally focused on issues relevant to the study.

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### 2.2 A Historical Perspective of Cotton and its Importance

Cotton is the world's oldest commercial crop and is one of the most important fiber crops in the global textile industry (Baffes, 2004). The economies of some of the world's poorest countries for example Benin, Burkina Faso, Chad and Mali are highly dependent upon cotton and its export earnings are a significant contributor to their Gross Domestic Product (GDP). Cotton also has macroeconomic significance in several countries as it accounts for approximately 40% of total merchandise export earnings in Benin and Burkina Faso, and 30% in Chad and Mali. Its contribution to GDP in these countries and other developing countries ranges from 5 percent in 2009 to more than 8 percent in 2010. Cotton has proven to be an economically viable crop that has had a significant and positive impact on exports, economic growth, and rural development. In the Francophone zone for instance, half a million metric tons of cotton was exported in 2004/2005 (Goreux, 2004).

Many Francophone West African Countries, particularly Burkina Faso depend on cotton as a main export commodity that provides employment and foreign exchange earnings. It

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also has bi-products that are used as raw materials for the production of feed for livestock and poultry. Sixty percent (60%) of the export earnings of Burkina Faso in 2009 came from cotton. According to Baffes (2004), Burkina Faso depends on its 600,000 metric tons of cotton production a year to fight or alleviate poverty through the creation of jobs and improving living standards by improving infrastructure, health, income, and education. Cotton ginning, input supply, transport, and marketing constitute cotton related activities that account for a large share of rural employment, generating revenue for the people of the communities and tax to government. This has a tendency of helping to attain the United Nations Millennium Development Goal (MDGs) number one; that is, eradication of extreme poverty and hunger.

At the micro level, cotton remains an important crop to the people of the three Northern Regions of Ghana both from social and economic view points. It provides employment and a source of raw materials in the production of edible oils, soap, textiles, seed cake for feeding livestock among others. Cotton is grown in rotation with other crops especially maize for higher yields and to control striga which is a problematic weed in the area. As a land opening crop, it promotes food production by improving soil fertility in subsequent crops, by leaving well prepared land for cereals such as millet, sorghum, groundnuts and cowpea. Consumption patterns of smallholder cash crop producers mean that much of their additional income is spent on locally produced goods and services generating multiplier effects that benefit other households.

### 2.2.1 Cotton Production in Developing Countries (Sub-Saharan Africa)

Cotton is an important cash crop to a number of developing countries. Especially in Africa, cotton is typically a smallholder crop, and the main cash crop grown on rain fed land where the use of purchased inputs such as chemicals and fertilizer is minimal (Baffes, 2004). Cotton has a strong poverty reduction impact, because it is cultivated in small family farms in areas where opportunity for growing other crops are very limited and per capita income very low (Goreux, 2004).

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**Table 2.1 Cotton Area, Yield, Production and Exports in Selected African Countries*2004/05**

| Country | Area (,000ha) | Yield Kg/ha | Production (,000 tone) | Exports (,000 tone) | Est. Exp value in millions$ ** | Cotton Dependence *** |
|---|---|---|---|---|---|---|
| Benin | 325 | 441 | 143 | 105 | 199 | 1 |
| Burkina Faso | 450 | 533 | 240 | 189 | 190 | 1 |
| Cameron | 217 | 507 | 110 | 77 | 97 | 5 |
| Central African Rep. | 10 | 250 | 3 | 5 | 7 | 3 |
| Chad | 310 | 274 | 85 | 56 | 79 | 1 |
| Cote D' Ivoire | 300 | 467 | 140 | 88 | 102 | 5 |
| Ethiopia | 113 | 177 | 20 | 7 | 6 | 0 |
| Ghana | 20 | 275 | 6 | 0 | 4 | 0 |
| Guinea | 14 | 222 | 3 | 3 | 15 | 0 |
| Kenya | 50 | 97 | 5 | 0 | 0 | 0 |
| Mali | 540 | 435 | 240 | 211 | 205 | 1 |
| Mozambique | 230 | 115 | 26 | 22 | 20 | 4 |
| Niger | 5 | 423 | 2 | 1 | 0 | 0 |
| Nigeria | 790 | 127 | 100 | 0 | 18 | 4 |
| Senegal | 50 | 420 | 21 | 17 | 19 | 3 |
| South Africa | 40 | 510 | 20 | 0 | 0 | 0 |
| Tanzania | 420 | 250 | 105 | 98 | 51 | 2 |
| Togo | 202 | 347 | 70 | 58 | 103 | 3 |
| Uganda | 120 | 308 | 37 | 27 | 24 | 2 |
| Congo D. R | 11 | 265 | 3 | 0 | 0 | 0 |
| Zambia | 180 | 273 | 49 | 34 | 23 | 0 |
| Zimbabwe | 360 | 327 | 118 | 84 | 44 | 3 |

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Sneyd (2006) indicated that over the past fifty years, production of cotton in sub-Saharan Africa rose by a factor of 8.5 from 200,000 tons per year to over 1,700,000 in 2004/05.



earnings relative to other agricultural products. For Tanzania and Uganda, cotton is the second largest export commodity. For Central African Republic, Senegal, Togo and Zimbabwe the crop is the third largest export commodity. In the same way, for Mozambique, and Nigeria cotton stands as fourth export commodity. For Cameron and Cote D'Ivoire, it is the fifth export commodity. One can conclude that given high price fluctuation in cotton market, high dependence of these countries on cotton for their

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foreign exchange earnings can affect the economy of these nations, particularly when decline in world price of the crop occurred in the 2001/ 2002 production year.

### 2.3 Background of Ghana Cotton Company Limited

The government of Ghana realizing the importance of cotton production established the Cotton Development Board (CDB) in 1968 to help encourage farmers to grow cotton to feed the local textile industries. The project was undertaken in conjunction with the help of the Food and Agricultural Organization (FAO) of the United Nations and the United Nations Development Programme (UNDP) which began with a modest achievement of fifteen (15) metric tones in its first year of operation. Seed cotton production under the Board realized its peak at 10,184 metric tons in 1976 and dropped to 1,500 metric tons in 1985 (GCCL, 2003).

The fall in production was blamed on inadequate inputs, problems of marketing the produce due to low prices and labour unrest stemming from poor remuneration. Obsolete machines further aggravated the problems of processing quality lint to compete favorably with those from other countries. As a result of the decreasing output, the Cotton Development Board could not meet the government of Ghana's expectation. The cotton industry was revived through the liberalization of the industry in 1986, which resulted in the Ghana Cotton Company Limited evolving from the Cotton Development Board.

With the establishment of the GCCL, seed cotton production shot up from 1,500 metric tons in 1985 to 6,500 metric tons in 1986 and continued to surge up to 21,000 metric tons

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of seed cotton in 1993. Thereafter, production declined to as low as 11,000 metric tons in 1995. It picked up again and rose to 24,000 metric tones in 1998 and declined once more to 12,680 metric tons in 2010 (GCCL, 2010 annual report). A situation that may be a worry to many stakeholders since the share-value will also depreciate. GCCL (2009) statistics showed that since then efforts to raise seed cotton production has been futile. Factors believed to have contributed to this menace include;

- Ineffective monitoring of farmers activities to ensure high yields for loan recovery.
- The failure of the company to ensure repayment of input loans granted to farmers. Farmers who failed to pay back their loans moved from company to company year after year.
- Diversion of Inputs by farmers.
- High farmer loan evasion rate.
- Rivalry between cotton companies leading to:
    i. Price wars
    ii. Diversion of cotton from sponsors to non-sponsors

The privatization of the Cotton Development Board and the subsequent liberalization of the cotton industry in 1986 were attempts by government to introduce entrepreneurship and private capital into the industry to achieve rapid expansion in the production of seed cotton with its attendant benefits, such as reduction in poverty, creation of jobs and contribution to improving standards of the rural farmers.

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## 2.4 The Structure of Cotton Sector in Ghana

After Ghana cotton was privatized in 1985, the cotton sector became fully a private sector led production activity comprising of the following stakeholders:

- **The producers,** most of them being smallholders. Their farm equipment is almost everywhere limited to hand hoes, with few of them possessing draught-oxen and some ploughs or ridgers. They lack financial means and depend mainly on their food crops (cereals and legumes) to feed their family members and to secure some cash to pay children school fees and cloths, medical or housing essential expenditures. Farmers are not organised into cohesive Farmer Based Organisations (FBOs).
- **The tractor-ploughing contractors,** who could be farmers themselves. They plough the fields against a fee of about Ghc 30/half hectare. Quality of ploughing could be very poor resulting in destruction of the soil and heavy erosion.
- **Cotton companies of which the number is not well known,** but could be estimated to be as many as five. Among them, three major companies own operational ginning mills whose total capacity expressed in seed cotton reaches as much as 80,000 tons. Most companies enter production contracts with farmers, in which they commit themselves to supply them on time and on credit basis with the input necessary for cotton growing. In turn, the same farmers are supposed to sell all their seed cotton to the company according to contract agreement. At the beginning of the season, companies meet to fix the seed cotton price, to avoid the devastating effects for the whole sector of an out bidding system.

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- **Savannah Agriculture Research Institute (SARI)** conducts experiments on cotton growing, breeding and protection against pests and diseases. The links between SARI and the cotton companies look rather loose.
- **The Government of Ghana** does not interfere in the cotton production business since it is fully privatised. However, the government may decide to levy some taxes on lint imports to render local production price more attractive to local textile industries.

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### 2.5 The Role of the Peasant Out-grower

Agriculture is Ghana's most important economic sector, employing more than half the population on a formal and informal basis and accounting for almost half of GDP and export earnings. The country still depends largely on peasant agriculture for both food and cash crops. Ghana is undoubtedly blessed with abundant arable and fertile land for cultivation. This is to say that there is no area in Ghana which is barren. From Greater Accra Region to Ashanti Region, Central Region to Eastern Region, Northern Region to Upper West Region, anywhere you go you will find one agric product or the other. And these produce (both food and cash crops) can be grown in large and commercial quantities However, improvement in the productivity of this sector is hampered by many characteristic problems and deficiencies associated with this type of agriculture. According to the Food and Agriculture Organization (FAO, 1986) to the United Nations, the restrictions imposed by so-called traditional techniques on the household labour force are among the main cause for the persistence of subsistence economies in tropical and sub-tropical African and also in a large part of Mediterranean Africa.

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In sub-Saharan Africa four-fifths of agricultural energy is provided by human labour. It is estimated that the same proportion of arable land is worked with primitive hand tools. With such tools the average household can only cultivate between 1.5 to 2 hectares. A number of policies have been implemented over the past twenty years to increase farm labour productivity through a better use of energy (FAO, 1986). These policies have set out to improve hand tools, to introduce animal drawn equipment and also to promote more widespread use of tractors.

The most systematic strategies have been those implemented in West Africa where animal traction has been encouraged to boost cotton production and groundnut output and, in some cases, rice production (FAO, 1986). According to the FAO report, in Mali 78% of the cotton crop is now based on animal traction, 60% in Burkina Faso and Senegal, and 38% in Chad.

Peasant agriculture production is generally undertaken in extreme weather conditions with erratic rainfall distribution. The soil, which is cultivated usually, has varying degrees of fertility and this leads to land productivity differential even between farms not far apart. Unsatisfactory arrangements for marketing the farm produce complicate the extent to which the peasant sector can be assimilated into the exchange-monetized economy.

Agriculture production in Ghana is still mostly undertaken by smallholder farmers on relatively small plots of land and is very labour intensive. Shifting cultivation in both the forest and savanna zones is practiced; a new parcel of land is opened up each year for

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cereal production, followed usually by roots crops and plantains in the forest zone, or groundnuts or cotton in the savanna zone.

**2.6 Loans to groups of borrowers**

Granting of credit or Lending to groups has been a feature of many micro-finance enterprises and Non Governmental organizations programmes. The success of micro-finance development in the third world rests mostly on the innovative use of joint-liability groups to grant loans to people without traditional collateral (Morduch, 1999). Each group member is liable for the debts of the others; if one does not repay, the others must pay, or else all will lose access to future loans.

In seasonal agriculture, all have to borrow at the same time, and all face similar patterns or risk, so that in a bad year, producer group liability may actually encourage group default. To avoid this, monitoring of borrowers' production activities by the lender is required and repayments may need to be rescheduled where factors outside farmers' control genuinely undermine their ability to repay.

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Microenterprise programmes often prefer group loans to individual loans because they value social capital, because they aim for community-level outcomes, and because, as inexperienced lenders, groups shift many tasks to borrowers. Furthermore, group loans can reach poorer borrowers than individual loans (Conning, 1998). For example, in 1999 the average individual loan in the United States was $10,630, but the average group loan (per member) was $1,802 (Langer *et al,* 1999).

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Commercial micro-finance schemes inspired by the Grameen Bank, typically also work on the principle of group liability. However, many rely on regular repayments as a substitute for monitoring of loan use which has limited their relevance to seasonal agricultural production.

Meanwhile, some contract farming schemes have collapsed as a result of opportunistic traders offering to buy farmers' production at higher output prices than those available within the scheme. Stringfellow et al (1996) report some success in using group liability mechanisms to strengthen repayment in interlocked contracts for high value crops within relatively concentrated output marketing systems. As contract farming schemes often include an advisory component, this provides an opportunity for the lender to monitor the production activities of borrowers. The process of group formation, however, requires care, particularly when the instigation comes from the lender rather than group members themselves.

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Joint liability also means that honest borrowers must sometimes pay the debts of defaulters. This can spark a domino effect in which borrowers who would have paid their own debts choose instead to stop payment, both their own debts and those of defaulters (Besley and Coate, 1995). Groups also break down because the fortunes of members diverge through time. Some members have more luck, skill, or effort and so want bigger loans, but poorer members cannot afford to be saddled with big debts should their less-poor partners default, so the group breaks up. Joint-liability groups are the main

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innovation in microenterprise development in the third world. Success may therefore depend on the presence of commercially-oriented micro-finance enterprises and Non Governmental organizations able and willing to provide the necessary group "animation".

## 2.7 Managing Loan for Business Sustainability

Management is the skill of coordinating human and material resources to achieve specific objectives (Mahmoud, 1996). In the performance of his task, the manager relies on other people he works with and through them to achieve the overall objectives of the organization. For the purpose of this study, management is defined as the co-ordination of all the resources of an organization through the process of planning, organizing, directing and controlling in order to attain organization objectives. Management also involves communicating and diligently monitoring tasks and goals, then fairly rewarding the people who achieve them, and who have made a commitment to them on the basis of corporate good and personal interest.

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The management of a company's credit policy is a strategic issue requiring the attention and involvement of top management for the fact that as a result of vested interest among functional managers (finance, production and monitoring). Uncoordinated efforts would have significant financial implication which might adversely affect the maintenance of optimal levels of working capital of which farmers loans or accounts receivables is a significant component. Consistent with the overall company's liquidity and profitability

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requirement, there is the need for all the divisions to be involved in the formulation and implementation of the credit policy of the company.

The formulation of credit policy is of direct interest to the monitoring and evaluation manager because credit affects the volume of the firm's activities; the financial manager because farmers loan represents investment of the firms' funds and the rate of payment of accounts receivable and the production manager whose production schedule and level of inventory is affected by the pushing effect of the credit policy affecting the rate at which products are purchased.

Generally, the loan management process is not conducted in vain. It is done in consultation with the directors, the CEO and the other members of management team. Credit management revolves around an attempt to balance profitability and liquidity. This implies that many business organizations that extend credit facilities to their customers liberalize their credit terms to generate more sales, towards possible profit. The longer the credit term the greater will be the amount of debtors and the greater the possible strain on the firm's liquidity. Any type of credit policy has a pattern of cost and profitability associated with it. Notwithstanding the tremendous effect of extension of credit facilities, the development of an effective credit policy is to enable the firm achieve sound and optimal financial decisions that will help improve the firm's liquidity.

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The quality of loan management is an important element in a profitable and soundly run financial or commercial institution. According to Linder (1995) capable loan management possesses the following:

- Industry expertise to assist the Chief Executive Officer in planning.
- The technical expertise to design and administer the necessary systems and controls to carry out the board's policies and require compliance with applicable laws and regulations.
- The ability to manage day-to-day operations to achieve the institution's performance goals.

The loan manager in every organization or institution engaged in lending plays many different roles, which should be delineated in the job description. Linder (1995), quoting Edgar M. Morsman Jnr (Effective loan management, Philadelphia: Robert Morris Associates) outlines these roles to include:

- Leader – An effective leader attempts to realize his or her full potential and inspires subordinates to strive for their potential.
- Spokesman – Since the subordinates expect their manager to represent them inside and outside the firm, these duties cannot be ignored.
- Adjudicator – The loan manager spends considerable time reacting to exceptions and resolving conflicts. Negotiations skills and conflict management are key elements of the job.
- Nerve Center – The loan manager acts as a central processing unit by gathering, evaluating, and disseminating information and acting as a liaison with other areas

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of the organization. The pivotal role is characterized by problem – solving and decision – making.

- Thermostat – Constantly evaluating the environment, the loan manager adapts the lending unit to changing conditions such as new competitive threats or regulatory opportunities (managing change).
- Control Tower- The loan manager allocates the time, talent, and other resources of the lending unit to maximize results; this role includes delegation, coaching, and counseling.

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**Sustainability** is the ability to continue a defined behaviour indefinitely. For more practical detail, the behaviour you wish to continue indefinitely must be defined. For example, **environmental sustainability** is the ability of the environment to support a defined level of environmental quality and natural resource extraction rates indefinitely. Then there is **economic sustainability,** which is the ability of an economy to support a defined level of economic production indefinitely. And we must not forget **social sustainability,** which is the ability of a social system, such as a country, to function at a defined level of social well being and harmony indefinitely. According to Beets (1990), Sustainability can be defined as the ability of a system to maintain productivity in spite of large disturbances such as repeated stress or a major perturbation.

Financial sustainability is often defined as managing the triple bottom line - a process by which firms manage their financial, social and environmental risks, obligations and opportunities. These three impacts are sometimes referred to as profits, people and planet.

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However, this approach relies on an accounting based perspective and does not fully capture the time element that is inherent within business sustainability. A more robust definition is that business sustainability represents resilience over time – businesses that can survive shocks because they are intimately connected to healthy economic, social and environmental systems. These businesses create economic value and contribute to healthy ecosystems and strong communities.

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Business or Financial sustainability requires firms to adhere to the principles of sustainable development. According to the World Council for Economic Development (WCED), sustainable development is development that "meets the needs of the present without compromising the ability of future generations to meet their own needs." So, for industrial development to be sustainable, it must address important issues at the macro level, such as: economic efficiency (innovation, prosperity, and productivity), social equity (poverty, community, health and wellness, human rights) and environmental accountability (climate change, land use, biodiversity).

There are a number of best practices that foster business sustainability, and help organisations move along the path from laggards to leaders. These practices include:

- Stakeholder engagement: Organisations can learn from customers, employees and their surrounding community. Engagement is not only about pushing out messages, but understanding opposition, finding common ground and involving stakeholders in joint decision-making;

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- Environmental management systems: These systems provide the structures and processes that help embed environmental efficiency into a firm's culture and mitigate risks. The most widely recognized standard worldwide is ISO 14001, but numerous other industry-specific and country-specific standards exist;
- Reporting and disclosure: Measurement and control are at the heart of instituting sustainable practices. Not only can organisations collect and collate the information, they can also be entirely transparent with outsiders. The Global Reporting Initiative is one of many examples of well-recognised reporting standards;
- Life cycle analysis: Those organisations wanting to take a large leap forward should systematically analyse the environmental and social impact of the products they use and produce through life cycle analysis, which measure more accurately impacts.

Firms that are sustainable have been shown to attract and retain employees more easily and experience less financial and reputation risk. These firms are also more innovative and adaptive to their environment.

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The granting of credit creates debtors and results in the tiding –up of the company's funds .The interval between the date of credit extended and the date of payment or recovery has to be financed out of working capital. The effective and prudent management of accounts receivable would therefore, improve the profitability and liquidity of the business and reduces the possibility of bad debts. Farmer's loan or accounts receivable need to be effectively monitored and controlled because uncontrolled

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farmer's loans have the greatest potential of resulting into bad debts. Thus the prime goal of accounts receivable management is to maximize the value of the company by striking a balance among liquidity, risk and profitability (Pandy, 1996). Accounts receivable needs careful analysis and proper management as substantial amounts of the company's fund are invested or tired up as a result of extending credit to customers.

For a commercial concern like the Ghana Cotton Company limited, the perennial decline in seed cotton production coupled with heavy deficits on unpaid loans is a big challenge to the management of the company. Thus, such companies become cash-strapped as a result of accumulated accounts receivable and a declining economic growth such as is the current economic situation in Ghana.

The design and implementation of more appropriate credit policies and the strict implementation of these policies are the best ways of ensuring that loans build up are controlled through appropriate policy on extending credit facilities.

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**2.8 Nature and Goals of Credit Policy**

A firm's credit policy deals with the stipulation of the length of time that credit is given and the cash discount offered for early payment if any. A credit policy according to Pandy (1996) refers to those decision variables that influence the amount of trade business organizations extends to their customers. The credit policy also states the selection of customers who are given credit and how outstanding amounts from customers are collected. Once credit policies have been established or initiated, proper

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credit management considerations of policy changes will each influence the amount of funds tied up in accounts receivables. The objectives of the formulation of credit policy are to maximize sales and profit, to have controls over receivable and to have control over the cost of credit and collection (Srinivasan, 1999). Granting credit is investing in a customer, an investment tied to the sale of a product or service. A firm credit policy deals with the establishment of procedures for extending credit and collecting amounts due from customers for credit sales.

The starting point in formulating a credit policy is the characteristic credit terms of the industry. A firm must meet the terms provided by other firms in the industry. However, when the customer has a poor credit background, the terms would be altered in a downward direction to protect the firm extending trade credit.

A firm's credit policy will in particular deal with the following components: The terms of sale deals with whether sales are on credit or on cash basis and would spell out such conditions as the credit period, the cash discount and discount period and the type of credit instrument. Credit analysis deals with the process of distinguishing between customers who would pay and those who would not. Collection policy deals with the procedures that will be followed in collecting loans granted.

In principle, every business wants to be paid for the goods or services as soon as possible. Once a sale has been made, the profit making cycle is completed but the resources employed in the process cannot be set working on another cycle until they are released by

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payment. The convention of trade is a very powerful factor in determining how long it takes for a customer to pay. In many cases, a firm will be virtually tied to a particular terms of credit because they are conventionally offered by its competitors (Brockinton, 1990).

However, the seemingly oblivious reasons why firms extent credit to their customers is to remain competitive in their industry. If a firm's competitors sell on credit and offer cash discounts, the firm must do likewise or suffer lost of sales. Thus constrained to offer credit, firms must devise credit policies that ensure the level of accounts receivable does not increase to excessive level. The four elements necessary for the establishment of a sound credit policy are;

1. The payment-terms offered to the customers,
2. The credit standards used to evaluate credit request,
3. The analysis of the creditworthiness of the customer and,
4. The monitoring and collection policies for outstanding receivables.

Payment-terms decisions are concerned with whether to sell for cash or credit, whether to offer early payment cash discounts and what type of credit terms to offer. Credit-standards decisions involve determining what level of default risk to accept before refusing credit sale. Credit analysis is the evaluation of the default risk associated with individual accounts. Collection management is concerned with the eventual payment of credit sales. One other option opened to a firm in its attempt at reducing the level of receivables is to lower product prices rather than offer credit terms, but the element of the risk of not being paid on time cannot be eliminated.

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Usually, credit is used as a sales promotion tool and also for customer retention. Sometimes, it is also useful for maintaining sales levels during off-season, or to encounter trade recession. Credit enables customers to build-up stock levels or items, thereby helping the firm to achieve capacity utilization (Srinivasan, 1999). Granting credit has the effect of diverting financial resources which necessitates supplementary financial assistance from banks or other sources to sustain credit sales.

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Deciding on the amount to be invested in receivables as well as deciding on credit limits to individual's clients, setting terms of credit and payments are the constituents of the credit policy formulation of a company. Broadly, the objectives of credit policy are :(a) to maximize sales and profit, (b) to have control over receivables and (c) to have control over cost of credit and collection.

Indiscriminate credit sales or overtrading, especially in case of low quality products will not enhance profitability. Refraining from credit can save the incidence of bad debts, but the profits foregone on the potential additional volume of sales may be even more. The objective then is for the firm to design effective credit policies that will keep bad debt losses to the minimum commensurate with a maximum sales volume.

Collection or Recovery management begins with developing an information system for monitoring outstanding receivables. A common system is a receivable aging schedule, the objective of which is to detect changes in the length of time it takes to collect or recover outstanding loans or receivables.

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Studies conducted on measures of reducing the level of a firm's receivables have recommended factoring of accounts receivables as one measure. Brockington (1995) for instance states that, "firms can reduce their investment in receivables by factoring without restricting the amount of credit offered to customers". That is, by factoring the firm does away with credit control department and all aspects of its receivable administration are handled by the factor.

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According to Ross *et al* (1998), firms may find the arrangement of a factor managing its receivables cheaper than running a credit department. It should however be appreciated that in the African business setting, factoring a firm's receivables is frowned upon. A customer would not be comfortable having to settle his indebtedness to a firm through third party because of the loss of confidentiality. There is some element of social stigma associated with the use of factors in the administration of receivables in the African business setting. The use of the factor also carries a bad image for the firm because, it suggest that the firm is in some financial difficulties. The commission and administrative fees of the factor, which range between 0.02-5% of the invoice value of the debt, can also be prohibitive.

According to Ross *et al* (1998), there are no magical formulas for assessing the probability that a customer will not pay. In very general terms, the classic five Cs of credit are the basic factors to be evaluated. To evaluate the credit risk, the credit manager must consider these five Cs" of credit: character, capacity, capital, collateral, and conditions. Ross *et al* (1998) further explains the "Cs" as follows:

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- Character

This refers to the customer's willingness to meet credit obligations. This factor is of considerable importance because every credit transaction implies a promise to pay. There is thus a moral hazard of whether the promise will be fulfilled.

- Capacity; the customer's ability to meet credit obligations out of operating cash flow.
- Capital; the customer's financial reserves.
- Collateral; assets pledged by the customer for security in case of default.
- Conditions; this refers to the general economic conditions in the customer's line of business.

The credit policy of the firm would have an effect both on the general level of investment in accounts receivable and on the firm's competitive position. Management must however try to strike a balance between the general levels of investment in accounts receivable and the competitive position of the business.

The credit policy of a firm also affects its working capital by influencing the level of the book debts. The credit terms to grant to customers may depend upon norms of the industry to which the firm belongs. But a firm has the flexibility of shaping its credit policy within the constraint of industry norms and practices. According to Pandey (1996), the firm should be discretionary in granting credit terms to its customers. Depending upon the individual case, different terms may be given to different customers. A liberal credit policy, without rating the credit – worthiness of customers, will be detrimental to the firm and will create a problem of collecting funds later on.

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The decision to grant credit to customers has a number of effects on the company. Granting credit is in effect the granting of a loan to a customer, who may pay a future date or default in payment all together. It is therefore important to assess the profitability of either delayed payment or complete failure to pay. Thus before granting credit, the firm must evaluate the customer in order to determine credit risk.

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Studies have repeatedly pointed to the need for a greater supply of institutional credit especially where hire labour and modern inputs are needed to raise productivity. Thus, though the institutional mobilisation of rural savings is essential, it may be counterproductive to abolish or undermine rural credit.

Uma lele (1992) points out that this is because costs of purchased inputs increase when currencies are devalued, and internal transport costs are increased as a result of the general inflation caused by devaluations but there is relatively little further scope to raise prices. The promotion of cash purchases even as inputs prices increase is likely to reduce input use, especially among low-income producers.

Financial Business organizations hardly do without granting some credits. Many organizations extend credits to their trusted customers with ulterior motives of increasing their sales turnover, in order to improve the profit margin. In view of these motives, trade creditors rely on several sources of information to assess the customer's credit worthiness. The feedback received shall be analyzed, the outcomes of which will be part of final decision either to grant the creditor or not.

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Some micro-financing programmes have worked successfully. The rate of recovery in some cases is about 97% (Harper 1998). The basic reason could be that the beneficiaries are more conscious of their obligation to repay their loans. In some instances timing of credit delivery is the best. However, certain unfavorable micro-economic environment has not assisted beneficiaries of various credit schemes. Beneficiaries of credits must develop a credit culture in which borrowers understand they need to repay and creditors have trust that this obligation will be honoured.

Inadequate credit, either from the government or commercial banks, is a clear factor that deters production of agricultural products. The policy prevails that peasants must have substantial collateral in order to borrow. Programmes of credit for marginal farmers, who need it most, are non-existent or minimal. In Zimbabwe, for example, only ten (10%) of the peasants receive loans compared to 95% of the large-scale commercial farmers (Thompson, 1991).

According to Thompson, (1991) "in some of the least endowed communal lands, the percentage of peasants receiving loans is as low as two or three percent (2 or 3%). This is consistent with the policy of the Agricultural Finance Corporation (AFC) to avoid loans to 'high risk' producers; yet it defeats the 'growth with equity' goal of the government, producing the same discrepancies in incomes as in production". Credit for peasant production has the same negative bias in virtually all the sub- Saharan African countries, and solutions are not easy to find. Most credit schemes in these countries will continue to

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support the 'master farmers,' rather than assist the marginal farmers over the threshold to lucrative production.

In some national cotton production chains, inputs can be provided to farmers beneath the real cost by correlatively reducing the seed cotton purchase price as compensation. In Ghana, in principle, only the seeds are free of charge and the other inputs are sold at cost price. The attained bank credit levels forced the Company to buy, recently, inputs under supplier's credit, a more costly operation whose financial cost is given in the input cost price and not in financial charges. (Ghana Cotton Company Limited, Business Plan 1996)

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**2.9 The Credit Period**

Ross *et al* (1998) defines credit period as "the basic length of time that credit is granted to customers". The credit period varies widely from industry to industry, but it is almost always between 30 and 120 days. If cash discount is offered, then the credit period has two components: the net credit period and the cash discounts period. The net credit period is the length of time the customer has to pay. The cash discount period, as the name suggest, is time during which the discount is available. It is generally stated in terms of a net date. For example, if the firm's credit terms are 'net 35', it is expected that customers will repay credit obligation not later than 35 days. According to Pandey (1996) a firm's credit period may be governed by the industry norms. But depending on its objective, the firm can lengthen the credit period. On the other hand, the firm may tighten its credit period if customers are defaulting too frequently and bad-debt losses are building up.

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The credit period available to cotton out-growers is normally the whole cotton-growing season, that is, from May to March the following year. Within this period, the company commences the credit procedure by providing land preparation and inputs distribution lasting approximately six months (May to October). Because of the system used, producers are indebted to the company until their seed cotton is marketed. The marketing of the seed cotton usually covers a period of three to four months (November to March the following year).

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**2.10 Loan Management and Shareholder Value**

Loan Management refers to the decisions a business makes with regard to its overall credit and collection policies, and the evaluation of individual credit applicants. Accounts receivables management is both an asset and a problem for a business and thus requires proper and effective management. Loans or receivables are an asset because of the promise of a future cash flow and a problem because;

- there is the need to obtain finance elsewhere at cost to finance loans or receivables while waiting for payment from credit granted
- there is the possibility of some credit customers failing to pay, resulting in write-off of the debt which is a direct expense.
- administrative costs involved in collections and
- lost investment opportunities in the amount invested in receivables which could have been invested elsewhere.

Accounts receivables management is important because the cash flows from credit granted cannot be invested until the account is collected. About one quarter of most

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commercial concern's like Ghana Cotton Company assets are usually made up of accounts receivable.

The efficient management and control of farmer's loans therefore takes an added importance as a result of the fact that recovery determines both profitability and liquidity of the business. The financial manager can add value to the company's shareholders value in the proper management of loans by effectively influencing three areas in account receivable management. These areas are:

- influencing the company's aggregate investment in receivables
- Influencing the company's credit terms and
- Influencing the credit standards.

These decisions come under what is known as the credit policy of the company. It should however be appreciated that the formulation and implementation of the company's credit policy is not in the exclusive domain of the financial manager, but is determined by the company's credit strategy and the operational objectives. Credit policy formulation is thus a collective responsibility of top management with inputs from the various line and functional managers whose activities have a bearing on credit management.

Too much investment in receivables or loans can be very costly because most customers may pay very late and requires financing from short-term borrowing at high interest rates and also some customers may never pay. Setting stringent credit standards can erode shareholder value because of lost customers and setting too lenient credit standards can

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also erode shareholder value because of uncollectible sales. Loan management therefore requires careful and efficient management in order to obtain an optimum investment to increase shareholder value.

### 2.11 Rationale for Rural Finance to Farm households

Credit is essential for agricultural development. Circumstantial evidence shows that where agriculture had grown rapidly, institutional credit has expanded more quickly. Although farmers as producers greatly prefer to hold their savings in physical productive assets on their own farms, they must also rely on external credit at various points in time, generally because the realization of income and the act of expenditure do not occur at the same time. To cite a few illustrations: A field-crop farmer harvests his crop once or twice a year, whereas his consumption is continuous. For a dairy farmer, the interval between the realization of income and the act of expenditure is shorter and his income is more or less continuous , provided he has two milk animals and ready access to marketing facilities. For a tree-crop farmer, there is a vast gap between the times when expenditure is incurred and when income is generated.

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There is also a problem of indivisibility of fixed capital – for example, construction of wells; purchase of pumpsets, farm implement, bullocks, and tractors; and improvement of soil and moisture availability all require large expenditure that cannot be divided into smaller payments unless credit is available.

However, far more important than these reasons are the stochastic surges in capital needs and savings that accompany technological innovation in agriculture. In order to shift

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production functions upward, farmers must be able to purchase modern inputs such as high-yielding varieties of seeds, fertilizer and irrigation (Desai 1989; Mellor 1966). Thus, institutional finance for agriculture development should promote both credit and deposit services: credit to tide farmers over the deficit period and to enable them to take advantage of the new technological opportunities, and deposit services for savings during the period of surplus.

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**2.12 Sources of Loans for the Peasants farmers**

In developing countries as is the case of Ghana, small-scale farmers dominate the agricultural economy. Over 80 percent of the farming populations in Ghana are small holders residing mostly in rural areas. Anaman (1988) disclosed that small farms are mainly responsible for self-sufficiency of food in Africa and cultivation of export crops. They are also very significant in world development with 50% of world's population depending on them. In a survey carried out in 1973/74 by the Federal Office of statistics as reported by Olayide (1980), the small-scale farms were classified to range between 0.1ha and 5.99ha and they constitute about 80.78% of all farm holdings, the medium scale farms range from 6.0 to 9.99ha and constituted about 13.59 % of all farm holdings while large farms range from 10.0ha and above and constituted about 5.63% of all farm holdings. The need for agricultural loan among the small scale farmers can not be over emphasized as it enables them to establish and expand their farms. According to Ojo (1998), one of the problems confronting small-scale enterprises including farmers in Nigeria is inadequate capital despite the fact that small-scale famers produce the bulk of

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the food consumed locally and some export crops which generate foreign exchange for the country.

A study by Afolabi (2002) revealed that 66.99% of the sampled small scale farmers in Oyo State, Nigeria used their loans on farm operations such as payment for hired labour, purchase of implements, fertilizers, seeds and other farm inputs while 31.07% of them utilized their loan for household purpose which include paying for children education and medical treatment. Only 1.94% of them spent their loan proceeds on meeting the expenses of feeding and clothing the family. According to Afolabi and Fagbenro (1998), informal source of credit is more popular among the small scale farmers which may be due to the relative ease of obtaining credit devoid of administrative delays, non-insistence on security or collateral and flexibility built into repayment programme which was against what is obtained in the formal sources.

In spite of the importance of loan in agricultural production, its acquisition and repayment are fraught with a number of problems especially in the small holder farming (Awoke, 2004). Hunter (1996) said that the spate of defaults in commercial banks lending to agriculture is pervasive and present in both developed and developing credit markets. Balogun and Alimi (1988) identified the major causes of loan default as loan shortages, delay in time of loan delivery, poor supervision, non profitability of farm enterprises and undue government intervention. According to Von Pischke (1980), some of the impacts generally associated with default include the inability to recycle funds to other borrowers, detriment of other financial intermediaries from serving the needs of farmers and the

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creation of distrust. Although, a number of reasons have been attributed to loan default by many commentators, little is known about the effect of socio-economic factors affecting loan repayment capacity of the small scale farmers.

There are, or have been, in most countries, special schemes through which poor people, particularly in rural areas, can access loans. These loans are usually at very low rates of interest, and are thus potential loss makers for the banks. Loans under these schemes are also often tied to particular activities or inputs, which have not been chosen by the borrowers and may not be suitable for them. According to Harper (1998) "this only exacerbates the problem of non-payment, which is itself often abetted by political interests, and the result is that few people benefit, and whatever credit culture that may have existed is destroyed and the banks are forced into massive losses. Bankers come to regard banking for the poor as political chicanery, as charity, or as a necessary but loss-making government-mandated necessity".

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In micro financing, as in many fields, the institution that does the job may be more important than the details of the job itself. There are certainly many examples of well-designed programmes which have failed because the implementing institutions were unable to manage them properly, as well as successes which clearly owed more to the competence of the institution than to the virtues of the programme itself.

Mismanagement may be the fault of incompetent managers rather than the institution as a whole, but the wrong institution, even with the best managers, is unlikely to be able to

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make a success of a micro finance programme, however well it has been designed. (Harper, 1998).

Weston and Brigham (1996) on their part indicate that, "a firm's success and even survival, is it's ability and willingness to maintain production and to invest in fixed or working capital are to a very considerable extent determined by its financial policies, both past and present".

Financial goals of a firm are the quantitative expressions of the firm's mission and strategy, and are set by its long-term planning system as a trade-off among conflicting and competing interests. For most people in commercial banking, lending represents the heart of the industry. Loans therefore dominate assets holdings and generate the largest share of operating income. As with any investment, extending loans to businesses and individuals involves taking risks to earn high returns. Returns come in the form of loan interest, fee income, and investment income from deposits. The profitability of agricultural loans follows cyclical trends in the farm economy (Kock, 1998).

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Kock (1998) contends that "agricultural loans are similar to commercial loans and industrial loans in that short-term credit finances seasonal operating expenses, in this case, those associated with planting and harvesting crops. Much like working capital loans, the proceeds are used to purchase inventory in the form of seed, fertilizers, and pesticides and to pay other production costs. Farm operators expect to repay the debt

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when the crops are harvested and sold. The fundamental source of repayment is cash flow from the sale of harvested crops in excess of operation expenses".

Agriculture loans however differ from other loans because agriculture is perceived by most governments to be a vital national industry. Most governments therefore lend considerable sums to farmers through farm credit systems. Banks often work with some agencies to keep farmers operating, even when it appears that they will sustain large near-term losses. Loan losses are a natural by-product of extending credit. Banks and other institutions lending credits cannot forecast with perfect accuracy which loans would be paid in a timely manner. Otherwise, no bad loans will be made without some form of fraud. Still management can pursue policies that limit problem loans (Kock, (1998).

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Problem loans and loan losses are caused by a variety of factors, some controllable and some uncontrollable. According to Kock (1998) "controllable factors are those that reflect overall bank policy as well as inadequate credit analysis, loans structuring, and loan documentation. Uncontrollable factors typically reflect adverse economic conditions, adverse changes in regulations, environmental changes surrounding the business operations, and catastrophic events. While there is little to be done to prevent uncontrollable problems, effective credit-granting procedures can significantly reduce other sources of losses".

The Food and Agriculture Organization (FAO) indicates that, "a number of credit institutions are just not experienced enough to handle small farmer credit so other

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approaches must be envisaged. Amongst these, of interest is an already existing system, which could still answer certain needs. Credit is distributed through an industrial or export crop marketing body. Guarantee of loan recovery at the time of marketing has, in fact, enabled these credit systems to function fairly well whenever the marketing bodies have been run along relatively competitive lines. These systems have also proved to have initiative, as shown by the introduction of group credit or barter systems which by-pass the financial institutions. The inputs, which are provided in advance, are paid for, in kind, after the harvest. Though these systems are limited by their specific nature they are nevertheless justified in well defined circumstances"

The issue of loan delinquency has been pronounced in many public lectures as one of the reasons why commercial banks have not shown much interest in small holder loan scheme financing. Loan default can be defined as the inability of a borrower to fulfil his or her loan obligation as at when due (Balogun and Alimi, 1990). High default rates in smallholder producers lending should be of major concern to policy makers in developing countries, because of its unintended negative impacts on small holder loan scheme financing. As noted by Baku and Smith (1998), the costs of loan delinquencies would be felt by both the lenders and the borrowers. The lender has costs in delinquency situations, including lost interest, opportunity cost of principal, legal fees and related costs. For the borrower, the decision to default is a trade-off between the penalties in lost reputation from default versus the opportunity cost of forgoing investments due to working out the current loan.

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Many factors have been identified as major determinants of loan defaults. Okorie (1986) shows that the nature, time of disbursement, supervision and profitability of enterprises which benefited from small holder loan scheme in Ondo State, contributed to the repayment ability and consequently high default rates. Other critical factors associated with loan delinquencies are: type of the loan; term of the loan; interest rate on the loan; poor credit history; borrowers' income and transaction cost of the loans. Desai and Bhupat. (1993), identify a host of reasons for delinquency in repayment of agricultural loans in some selected countries in Table 2.2. Some of the countries and reasons as presented in Table 2.2 include the following:

**Table 2.2 Reasons for Delinquency in Repayment of Agricultural Loans in Some Selected Countries**

| **Region/Country** | **Reason** |
|---|---|
| High delinquency Sub-Saharan Africa Low-income countries Ethiopia, Chilalo | Loan programme expended rapidly; failure to take first defaulters to court on account of lack of full support and cooperation of local institutions, requirement of down payment for loans; profitability of cereals lower than expected due to declining prices; lack of consumption credit. |
| Ethiopia,Minimum Package Programme of (MPP) | Requirement of down payment for loans; lower than expected profitability on cereals due to declining prices; lack of consumption credit. |
| Upper Volta | Delay in loan sanction; low crop yield; adverse weather; delay in Getting animal traction package. |
| **Region/Country** | **Reason** |
| Middle-income countries Kenya, the Vihiga | Improper identification of farmers who did not really need credit; lower than expected profitability of the maize enterprise because of inadequate credit for hiring labor for land preparation and more |

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| | than adequate credit for fertilizers. |
| Asia Low-income countries Bangladesh | Unsound lending; inadequate supervision; natural calamities; Diversion of loans; unwillingness to repay. |
| India | Failure to tie up lending with development programmes and with productive investment; ineffective, unrealistic, and faulty loan recovery policies; lack of market tie-ups including that for inputs; lack of supervision; delayed loan disbursement; over-financing or under-financing; apathy and indifference of bank management; lack of discipline and responsibility among borrowers. |
| Indonesia | Vagaries of weather; price fluctuations; speculative borrowing; crop damage; lack of incentives to repay; ineffective collection efforts. |
| Nepal | Lack of irrigation and support services; dependence on weather; deliberate non-repayment because no action may be taken by the bank (ADB's findings). |
| Pakistan | Improper assessment of loan requirement; natural calamities; lack of supervision; poor collection efforts; improper farm technology; socio-economic factors. |
| Sri Lanka | Seasonal factors (income variation due to seasonal factors); defects in credit delivery system; crop failure; misallocation of borrowed funds. |
| Middle-income countries China, People's Republic of- Korea, | Poor materials benefits on the loan. Poor land supervision; sociopolitical power; natural calamities. |
| **Region/Country** | **Reason** |
| Republic of Malaysia | Limited follow-up |
| Philippines | Calamities; poor market prices; ineffective collection efforts; lack of capacity to pay. |

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| | |
|---|---|
| Taiwan | Lack of attention in recovery; inappropriate handling of loan duration; lack of working experience; interference of the "ultraletftists"; natural calamities. |
| Thailand | Emergency; legal action/confiscation of property; crop damage; too much outside debt; intentional defaults (in that order of importance)' inability to repay loans. |
| Latin America and the Caribbean Middle-income countries Brazil | Concept of loan repayment being unfamiliar (particularly for government loans); collateral not required; low subsidized interest rate; poor asset quality, which arises from related lending to firms within a conglomerate. |
| Chile | Same as above. |
| Near East and Medierra-nean Basin Middle-income countries Yemen, Republic of | Shortage of rainfall; depletion of watertable in wells; inappro-priate repayment schedule; insufficiency of loan given; failure to implement the project on account of non-availability of supplies at the market; lack of production facilities (poultry); borrower delays |
| Jordan | Drought; poor administration and technical efficiency; poor supporting services like extension and marketing. |
| Low delinquency Sub-Saharan Africa Low-income country Ethiopia, Wolamo Agri-cultural Development Unit (WADU) | Non requirement for down payment for loans; extension of consumption credit at low interest rate; profitable investment, especially in coffee, which brought higher prices than cereals; higher willingness of borrowers to repay loans in time; this desire was reinforced by WADU's policy, followed from the outset, of excluding all farmers from a given area from future credit programmes if repayment for the area fell below 95 percent. |
| **Region/Country** | **Reason** |
| Near East and Mideterra-nean Basin Middle-income countries . Egypt | Creation of banks closer to farmers; credit in kind; increased administrative efficiency through training programme; availability of irrigation/water throughout the year; smooth availability of marketing facilities for both farm inputs and products. |
| Jordan | Institutional laws do not approve of any interest or capital |

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| | |
|---|---|
| | Exemptions; borrowers are notified almost two months in advance; borrowers have option to repay their maturing debts by authorizing Jordan company for marketing and manufacturing agricultural products to repay. |
| Syria | Farmers are interested in keeping their credit rating; effective Loan appraisal and supervision; effective loan recovery apparatus; high coordination among cooperatives, marketing institutions, and banks; loan recovery through produce marketing by public-sector marketing institutions through the bank; fear of foreclosure; fees and prohibition from attaining further loans; incentives to loan collectors; participation of farmers' union and administrative authorities in promoting high loan recoveries; stringent measures are applied in supervising the implementation of the agricultural productivity plan. |
| North America High-income country United States | Diversity of lenders; suitable lending terms and techniques; very favorable past loan repayment records. |
| **Region/Country** | **Reason** |
| Latin America and the Caribbean, all countries in general | Large proportion of loans are collateralized; large proportion of Loans are refinanced, rephased, and rescheduled; large proportion of loans are given to larger farmers; small coverage of farmers both in absolute and relative terms; regular loan repayers are guaranteed continuation of credit line even if others do not repay; low interest rate on agricultural loans compared to nonagricultural; more professional lending decisions and decentralized with the involvement of the local farmers; deprivation of loans for new crops as well as new borrowers; diversion of institutional credit to other uses from which loans are repaid. |
| Asia | Differences in loan delinquencies |
| All countries in general | Degree of progressiveness of farmers; geographical conditions affecting agricultural productivity; tenurial arrangements; socio- |

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|---|---|
| | cultural realities; and degree of efficiency of the lending institutions |

Sources: Asian Development Bank 1985; Asian Productivity Organization 1984; FAO 1973.

As Hallberg (2000) observes, government assistance strategies in both developed and developing countries often try to achieve a combination of equity objectives (alleviating poverty and addressing social, ethnic and gender inequalities) and efficiency objectives (raising the productivity and profitability of firms). However, as Ojo (2003) argues, all these small holder loan scheme assistance programmes have failed to promote the development of rural folk. Oftentimes, the finance provided have been misdirected, gone to wrong persons or found to be inadequate to impact on the expected development of the assisted target groups. This was echoed by Tumkella (2003) who observes that all these programmes could not achieve their expected desires due largely to abuses, poor project evaluation and monitoring as well as moral hazards involved in using public funds for the purpose of promoting private sector enterprises.

Roberts (1985) focused on those small farm holders who can generate sufficient production and income to have a surplus above their subsistence and immediate family requirements, which they can use to repay a loan. He identified four general categories of small farmers and rural poor as follows:

- The small holders who have enough land and labour to produce subsistence living and also surplus, but fail to do so because of lack of management and required inputs;
- the farmers who may have the same amount of land as the previous category, but have a tenant status;

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- the farmers who do not have sufficient land to feed themselves under any known system that they can develop at present;
- the landless labourers who depend on agriculture for their living.

The overarching objective of the study is to point the way to maintaining production that will keep farmers afloat and the industry alive in the face of falling lint prices and high inputs costs.

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According to Roberts (1985), "Many agricultural financial institutions sponsored by Governments have attempted to advance loans to the first three categories above without any sound method of distinguishing between those recipients who could, and would, repay except under very adverse circumstances and those who either could not or would not repay. The result has been failure to establish a continuing sound financial system for those small farmers who are motivated and would develop if they received the proper training in technical skills and sound farm management plus the necessary capital inputs."

The main factors which seem to have influenced agricultural production in most African countries, according to Chole (1990), include input policy; guaranteed producer prices; "reliable" market facilities; research and extension policy; and provision of infrastructure and roads. Added to this is the role of the political party machinery and farmers' clubs and other local institutions in mobilizing rural population to engage in agricultural activity".

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Lending to smallholder farmers engaged in food production has been a feature of many donor and NGO programmes. Most of the information available in the literature review is therefore, based on management of inputs supplied to food crop and other agriculture activities farmers. Nevertheless, the information gathered therein is appropriate in finding answers to problems of managing the input loan scheme run by the cotton industry in Ghana as well. The management of input loans to cotton out-growers requires a new holistic approach. The operations of cotton companies in seed cotton production involve a huge investment of funds, especially in the pre-financing of out-growers. The need to confront the current credit policy of the GCCL is imperative and one approach is to find a way of delivering credit to farmers in a manner that would enhance their performance, improve their repayment record and reduce the credit risk of the Company (GCCL, 2009). The overarching objective of the study is to point the way to maintaining production that will keep farmers afloat and the industry alive in the face of falling lint prices in the world market and the high input costs.

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# CHAPTER THREE

# RESEARCH METHODOLOGY

## 3.1 INTRODUCTION

This section provides the framework upon which the research goals and objectives were realized. Saunders et al (1997) draws attention to the importance of research by stating that people undertake research in order to find things out in a systematic way, thereby increasing their knowledge. People also conduct social research for many reasons. Some want to answer practical questions. (e.g. Will a reduction in average class size from 55 to 45 increase students writing skills). Others want to make informed decisions (e.g. should the University of Cape Coast engage the services of a Private security firm to improve the security system of the campus). Still others want to change society (e.g. what can be done to improve standard of living through cotton production). For this research, it is to answer the question: What are the prospects and challenges in providing credit facilities to cotton farmers in Ghana?

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The researcher reviewed existing literature and an attempt was made to review the various methodologies used by such researchers to arrive at their conclusions. Brown (1996) states that research methodology is an essential component of any study and provides the framework upon which the whole process is suspended. It is therefore very important to adopt a good methodology and conduct the research efficiently in order to obtain accurate and precise data. The following were covered: study area, case studies, sample size, research design, methods of data collection and methods of data analysis.

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## 3.2 PROFILE OF THE STUDY AREA

### 3.2.1 Study Area

The North Western Division -Tumu is located in the Sissala East and Sissala West Districts situated in the North – Western part of Ghana in the Upper West Region. The Districts take 39% of the area of the Upper West Region (Tumu district assembly profile 2006). The division which was formally known as Tumu Area was formed in 1999 as a result of the restructuring of the entire GCCL. The production of cotton in the Sissala district was coordinated by the Wa Area before the creation of the Tumu area in 1991. However, cotton cultivation had been going on since the establishment of CDB in 1968. For sometime now, the liquidity position of the Tumu division has been declining in cash flows for reasons of inability of farmers to payback credit offered to them through the production of enough seed cotton hence the necessity to conduct this study in the area. The division is made up of three departments namely; Production, Ginnery, Accounts and Administration that are headed by managers directly responsible to the General Manager. There is also security unit that is under the office of the General Manager.

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### 3.3 Sampling Size

Punch (2004) established that selecting a sample that adequately reflects the variation in a given population is quite challenging and calls for appropriate approach. Miller (1991) also indicated that, a researcher needs to select only few items from the universe for the study purpose. He further stated that, an ideal sample is often preferable to larger sample or interviewing a larger number of people saying the same thing. The size of a sample should neither be excessively large, nor too small. It should be optimal (Karma, 1999).

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The process of sampling involves any procedure that uses a small number of items or parts of a whole population to make conclusions regarding the whole population. Based on the literature above, a survey was conducted to an approximate number of 60 cotton out-growers, approximately 10 top management staff from the company was selected and interviewed and an approximate number of 10 respondents who are field staff in the cotton company engaged in the supervision of the farmer's cotton fields were also interviewed.

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### 3.4 Research Design

The researcher after considering the nature of the research study - exploring the financial impact of farmers' inability to produce enough seed cotton to pay off their input loans and description of the reasons of cotton out-growers failure to meet their obligations decided to adopt the descriptive and exploratory research techniques. The descriptive research technique seeks to determine the answers to who, what, when, where, and how questions that may arise from the study in dealing with the objectives of the research. Descriptive research may provide important information in many situations that are needed to solve business problems. Descriptive research techniques also provide accurate information, although errors cannot be completely left out. This type of research attempted to determine the extent of differences in the needs, perceptions, attitudes, and characteristics of sub-groups.

Exploratory on the other hand is the type of research, which is conducted to clarify or define the nature of a problem. It does not give conclusive evidence in itself. Rather, it

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opens up for more research work to be done. Exploratory research is therefore conducted with the expectation that subsequent research will be required to provide conclusive evidence.

Saunders et al. (1997) indicate that, "exploratory studies are a valuable means of finding out 'what is happening; seeking new insight; asking questions and to assess phenomenon in a new light". It is conducted during the early stages of decision-making when the researcher is very uncertain about the nature of the problem. It therefore helps to crystallize the problem by identifying information needs for future research.

The advantage in employing exploratory research is that, it is flexible and adaptable to change. If you are conducting exploratory research you must be willing to change your direction as a result of new data which appear and new insights which occur to you (Saunders et al, 1997).

### 3.5 Selection of Basic Research Design

The following research designs were therefore adopted.

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#### 3.5.1 Exploratory Design

The Exploratory Design was adopted to explore the financial impact of farmers' inability to produce enough seed cotton to pay off their input loans. The exploratory design also assisted the researcher to explore mechanisms to transfer the risk of producing cotton to the out-growers.

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### 3.5.2 Descriptive Design

On the other hand, the descriptive design was adopted to describe why some cotton out-growers fail to meet their obligations. Also, the descriptive design assisted in describing some of the lapses that have bedeviled the management of the input loan scheme.

## 3.6 DATA COLLECTION APPROACH

According to Miller (1991), there are two major approaches used in social research to gather data. These are the primary and secondary data sources. However in selection of a method for data collection, the socio-economic demographic characteristics of the study population play an important role. The researcher used surveys as a method to generate primary data. Surveys are a research technique in which information is gathered from a sample of people by the use of questionnaires. The research study relied on both primary and secondary data for the information required for the research study.

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### 3.6.1 Primary Data

The researcher conducted surveys with the GCCL sponsored farmers, in both Sissala East and West Districts. This tool was used to elicit information regarding their performance for the past six years. Self-administered questionnaires were sent out to the management of North Western Division (Tumu).

The task of writing a questionnaire, determining the list of questions, and designing the exact format of the questionnaire is an essential aspect of the development of research

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design. The researcher therefore adopted the use of questionnaires and in-depth personal interviews to elicit information from management and farmers respectively.

### *3.6.1.1 Self-administered Questionnaire*

Respondents in this category included management staff of GCCL at the North Western Division in Tumu, and other field staffs who provide technical advice to the farmers. The researcher therefore decided to use the self-administered questionnaire because of the under-listed advantages:

- Geographical flexibility
- Relative low cost
- Respondent convenience
- Standardized questions.

SPSS was used to sort-out data for interpretation. The data was presented in the descriptive manner i.e. reporting on mean, maximum, minimum, pie chart, bar chart and use of statistical tables where appropriate.

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### *3.6.1.2 Personal Interviews*

These are direct communications where interviewers, in face –to –face situations, ask respondents questions. Interviews are classified into unstructured, semi-structured and structured. According to Osuala (2005), the structured and semi-structured are based on pre-arranged set of questions, though semi-structured interviews have the tendency of allowing some space for both open-ended and close ended questions.

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The semi-structured was used in the study. The researcher spent between 30 to 50 minutes in interviewing cotton farmers in the Sissala East and West Sub Divisions of the North Western Division of the GCCL in Tumu, who are predominantly illiterate. The reason for the choice of this method includes:

- Opportunity for a feedback,
- Opportunity to ask probing questions,
- Length of interview is ideal and flexible,
- Expects high participation.

The qualitative information from the interviews was subjected to analysis during the data collection process and after the data has been collected. The information was sorted to allow for an accuracy and consistency of data and for easy analysis.

### 3.6.2 Secondary Data

This survey made use of the secondary sources, to avoid duplication of outcomes and to pave the way for a useful primary data to be generated. Secondary data were collected from the accounts, internal audit, monitoring and evaluation, and production departments of the company.

## 3.7 METHOD OF DATA ANALYSIS

The researcher employed tabulation and graphs in the analysis of secondary data. This is an orderly arrangement of data in a table or other summary format. The approach was

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useful for indicating percentages and cumulative percentages as well as frequency distributions. Data were sorted-out by the application of SPSS computer software programme. Thus, the key factors that are identifiable with the study topic were grouped accordingly. Qualitative data were cleaned with the aim of checking accuracy and consistency of information on each questionnaire in relation to the set objectives. A manual for the coding was designed after knowing the nature of responses. Coding was done for open and closed-ended questions.

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# CHAPTER FOUR

# FINDINGS AND DISCUSSIONS

## 4.1 INTRODUCTION

This chapter seeks to analyze the responses of all the stakeholders in the cotton production industry namely the Management of the GCCL, the Cotton Production Assistants (CPAs) and the Out-grower farmers to the research questions. Both the primary and secondary data collected were analysed. Data compiled from the Monitoring and Evaluation unit and Production Department of the NWD, Tumu by the researcher revealed a significant deterioration of inputs loans repayments over the years. The loan recovery rate has slumped indicating that production levels of seed cotton have also dropped leading to heavy financial losses to the once vibrant company. Management over the years has adopted business minded policies that seek to ensure that farmers pay back their loans through the production and sale of seed cotton to the GCCL. However, out-growers performance in respect of seed cotton production, loan recovery and other related issues have not been encouraging over the pass ten years.

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## 4.2 Profile of Respondents (Management)

The following presents the profile of the respondents in the study area.

### 4.2.1 Staff Structure of Management

There is a well laid out management structure of the GCCL, NWD, headed by a General Manager – who is responsible for the day-to-day running of the Company. The General Manager is assisted by other management members including the Accounts Manager who

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heads the Accounts Department, assisted by an Accounting Assistant, and an Accounts Clerk and two store keepers. Other Management members include the Field Operations Manager who co-ordinates the farming operations and is responsible also for submitting timely and accurate technical reports on operations to the General Manager. There is also a Monitoring and Evaluation Officer who monitors the activities of the Cotton Production Assistants (CPAs) and also prepares annual reports on Loan Recoveries for the attention of management. There are also positions including a Public Relations Officer, Ginnery Operations Manager, a Secretary and a Security Officer.

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### 4.2.2 Age Distribution of Management

Management has a relatively younger age population with 10%, 40% and 30% of the members belonging to active working age bracket of 20 – 29, 30 – 39 and 40 – 49 respectively. Only 30% of the management members belong to the age bracket of between 50 – 59 and none was above 60. Table 4.1 shows the age distribution of management members.

**Table 4.1: Management Staff Distribution by Age Categories**

| AGE GROUP | NUMBER | PERCENTAGE (%) |
|---|---|---|
| 20 – 29 | 1 | 10.0 |
| 30 – 39 | 4 | 40.0 |
| 40 – 49 | 3 | 30.0 |
| 50 – 59 | 2 | 20.0 |
| **TOTAL** | **10** | **100.0** |

***Source: Field Survey, July 2011***

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## 4.3 PROFILE CHARACTERISTICS OF FARMERS

This section presents the profile of the characteristics of farmer respondents

### 4.3.1 Distribution by age categories

Approximately 60 cotton out-growers across the study area were sampled. It was revealed that 88.3% of the farmers were aged between 20 and 49 which constitute the economically active age group. The researcher deemed this as good since cotton production is a labour intensive activity. The remaining 11.7% of farmers were between the ages of 50 – 59. This is shown in Table 4.2 below.

**Table 4.2: Distribution of Farmers by Age**

| AGE GROUP | NUMBER | PERCENTAGE (%) |
|---|---|---|
| 20 – 29 | 3 | 5.0 |
| 30 – 39 | 15 | 25.0 |
| 40 – 49 | 35 | 58.3 |
| 50 – 59 | 7 | 11.7 |
| **TOTAL** | **60** | **100.0** |

***Source: Field Survey, July 2011***

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### 4.3.2 Dependants of Farmers

Farmers are engaged in cotton production with the view to raising income to support their families and improve their quality of lives. All the out-growers sampled had dependants ranging from 1 to 5 and above. Statically, 38.3% and 25% of the respondents had dependants ranging from 3 – 4 and 4 - 5 respectively, whiles 16.6% of the respondents

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had 5 or more dependants. The number of dependants signifies the availability of labour to work in the cotton fields. This is shown in Table 4.3 below.

**Table 4.3: Number of Dependants of Farmers**

| NO. OF DEPENDANTS | NUMBER | PERCENTAGE (%) |
|---|---|---|
| 1 – 3 | 12 | 20.0 |
| 3 – 4 | 23 | 38.3 |
| 4 – 5 | 15 | 25.0 |
| Over 5 | 10 | 16.7 |
| **TOTAL** | **60** | **100.0** |

***Source: Field Survey, July 2011***

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### 4.4 Profile of Cotton Production Assistants (CPAs)

The Cotton Production Assistant Officers were engaged and trained by the GCCL to act as field staff supervising the cotton fields of the out-growers on regular basis and also supplying them with inputs and extension information. The survey conducted revealed that 10%, 70% and 20% of CPA's were between the ages of 20 – 29, 30 – 39 and 40 - 49 respectively, and none was above the ages of 50. This is shown in Table 4.4 below.

**Table 4.4: Age Distribution of CPAs**

| AGE GROUP | NUMBER | PERCENTAGE (% |
|---|---|---|
| 20 – 29 | 1 | 10.0 |
| 30 – 39 | 7 | 70.0 |
| 40 – 49 | 2 | 20.0 |
| **TOTAL** | **10** | **100.0** |

***Source: Field Survey, July 2011***

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### 4.5 Defaults in Loan Re-payments

"Loan" as used in this research refers to the cost of inputs and tractor services advanced to the out-growers while waiting for re-payments through the volume and cost of seed cotton the out-growers offer to the Company in the purchasing season. Defaults in payments arise where the value of the seed cotton is not sufficient to cover the cost of services and inputs supplied. Unfortunately, over the years, there has been a consistent decline in loan repayments by out-growers putting the company in a rather precarious financial situation. This is particularly so because out-growers are not made to pay back such loans. On a question to management members as to why farmers fail to pay back loans granted them, 80% of them stated that the problem stems from poor yields, whilst 20% of them posited that some farmers have the intention to cheat the Company.

### 4.6 Mechanisms Put in Place to Transfer Risk of Production to Out-growers

To say that the Ghana Cotton Company Limited of the NWD is exposed to a lot of risk in the cotton production process is an understatement. This largely stems from the methodology of pre-financing all the production activities from land preparation to inputs supply and to the purchase of the seed cotton. This is particularly so because the farmers are only expected to supply land and labour and bear no further cost beyond this.

This is further compounded by the nagging question of who actually owns the cotton farms. During this research, a question of who owns the cotton farms was put to management, 8 out of 10, representing 80% of respondents said the farms were owned by the Ghana Cotton Company Limited, whilst the remaining 20% contended that the farms

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were owned by both the company and the farmer. This field survey indicated that an overwhelming 85% the respondents were of the view that the farms belong to them, whilst the remaining 15% said the farms belong to the Cotton Companies. There is therefore a worrying situation where majority of management members are of the view that the farms belong to the cotton companies and farmers hold a contrary view. If management believes that the farms belong to the company because of the pre-financing arrangement, and make farmers buy into that idea, then naturally the farmers will expect the company to bear any post-production losses that may occur. Similarly, if cotton farmers hold the view that the farms belong to them and they are only being assisted by the company to produce seed cotton for them, and per the arrangement, farmers are not made aware of any liability in case of default, then they think it is fair deal when they default.

What is needed therefore is a clearly written Loan Agreement where a farmers' liability clause is factored in. The agreement must state clearly the ownership status of the farms and details of a cost-sharing arrangement where causes of defaults in payment can not be squarely put on the door steps of the farmer, and better still, a full-cost-recovery arrangement where the companies can establish a clear case of misapplication or diversion of inputs against a farmer. The Loan Agreement must seek to criminalize diversion of inputs and the penalty therein must be clearly stated. In the view of the researcher, this should be easy to do because a follow up question established that all the out-growers considered inputs as loans.

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What is lacking therefore are the mechanisms put in place to transfer the risk of production to the out-growers. In a question posed to management in this regard, there were varying opinions on ways to act. As shown in table 4.5 below, 50% of management posited that out-growers should be made to secure loans from banks whilst the remaining 50% were split between bearing the cost of land preparation and seeds, and formation of farmer grouping.

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**Table 4.5: Mechanisms Put in Place to Transfer the Risk of Production to Out-growers**

| MECHANISM | NUMBER | PERCENTATGE |
|---|---|---|
| Farmers preparing land for themselves and paying for seed | 3 | 30 |
| Grouping of farmers | 2 | 20 |
| Making farmers to secure loans from banks | 5 | 50 |
| **TOTAL** | **10** | **100** |

***Source: Field Survey, July 2011***

From the table above it is clear that management's preferred option would be for out-growers to secure loans from the banks. However, in the view of the researcher, this is Problematic because majority of the farmers the cotton companies deal with are peasant farmers and their capacity to raise loans from financial institutions is suspect, because they may not have the required collateral. In other words seed cotton production will suffer in the absence of pre-financing. The solution therefore is an arrangement that will ensure continuous pre-financing but which at the same time ensures that farmers are held accountable for losses, thus a loan agreement.

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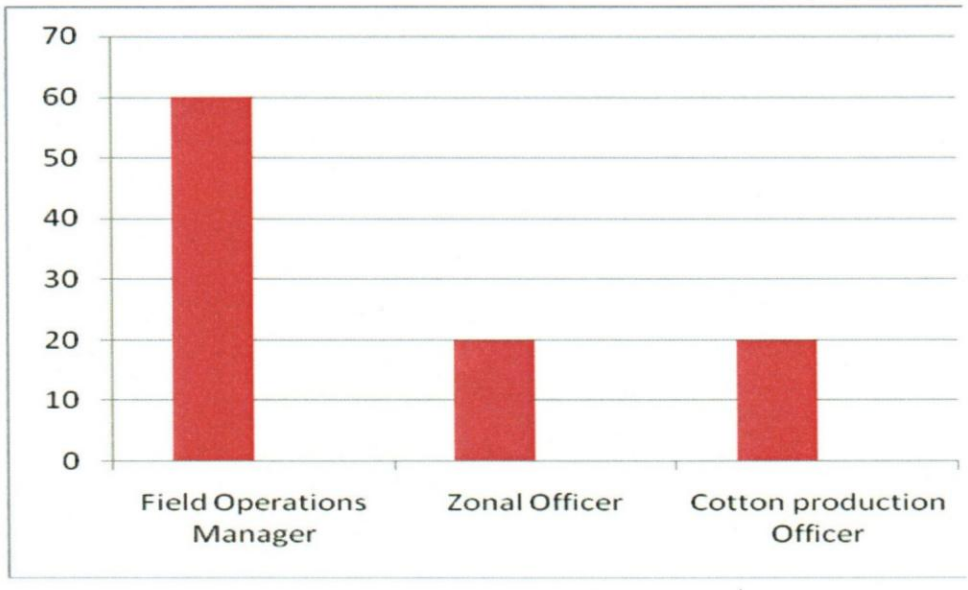
### 4.7 Lapses in the Current Loan Scheme Advanced to Out-growers

Management of the current input loans scheme is far from impressive. Considering the litany of failures the scheme has recorded in loan recovery as demonstrates earlier in the introductory pages, over the past years, there has been a consistent decline in input loan recovery putting a strain on the finances and liquidity position of the company. The lapses can be examined from many angles, from management perspective; the most crippling issue is the clear lack of an identified authority entrusted with the responsibility of granting input loans and monitoring its servicing. In an answer to a question posed by the researcher on the responsibility for granting and monitoring of credit to farmers, management gave conflicting responses. From Figure 4.1 below 60% of respondents mentioned the Field Operations Manager, 20% each said it was the Zonal Officer and the Cotton Production Assistants.

**Figure 4.1: Perceived responsibility of Granting and Monitoring of Credits to Farmers**




***Source: Field Survey, July 2011***

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Linder (1995) is of the view that a loan managers in every organisation or institution engaged in lending plays many different roles, which should be delineated in the job description. He added that capable loan manager should have the expertise to assist the Chief Executive Officer in planning and be able to design and administer the necessary systems and controls to carry out the boards policies and require compliance with capable law and regulations

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### 4.8 Continuous Pre-financing Defaulting Farmers

When Management staff were asked to describe the percentage rate of credit repayment, 80% of them responded "very bad" and only 10% said it was "good". Ironically, when the same management members were asked whether it made economic sense of continue pre-financing defaulters, all the management staff answered in the affirmative and indicated the need to be discretional in granting credit. This same assertion is held by Pandey (1995) that a firm should be discretional in granting credit terms to its customers.

However, management staffs were still in the business of providing loans to defaulting farmers because they wanted to maintain the Company's "enviable" reputation of being market leader for the past 10 years. This is to prevent a further shrinking of its market share which is currently hovering around 65% as a result of the intense competition from new entrants in the business. The company also believes that its level of production can only go up if they are able to recruit and maintain more out-growers. Particularly disturbing is the revelation by management that 40% of farmers recruited were based on

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"good will" (confidence and trust) and 20% on "access to land" as shown in table 4.6 below:

**Table 4.6: Bases of Recruitment of Farmers**

| Recruitment Criteria | Number | PERCENTATGE |
|---|---|---|
| Good will | 4 | 40.0 |
| Experience in cotton production | 4 | 40.0 |
| Access to Land | 2 | 20.0 |
| **TOTAL** | **10** | **100.0** |

***Source: Field Survey, July 2011***

From the Table 4.7 above it is clear that source of information for evaluating out-growers is largely based on "good will" and "access to land" rather than experience in cotton production. Management also believes that continuous pre-financing of defaulting farmers will enable them settle their previous indebtedness to the company and also settle their current indebtedness. Responses of management as to the reasons for continuous financing of cotton farmers continuous to distance farmers from being responsible for taking responsibility for their inability to honour their indebtedness to the company as shown in the Table 4.7 below:

**Table 4.7: Reasons for Continuous Pre-financing of Cotton Farmers**

| RESPONSE | NUMBER | PERCENTATGE |
|---|---|---|
| Good farmers default because of bad weather | 8 | 80.0 |
| To ensure re-payment of the past loans | 2 | 20.0 |
| **TOTAL** | **10** | **100.0** |

***Source: Field Survey, July 2011***



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If 80% of management believe that farmers default because there has been a consistent bad weather over the past years, resulting in poor yields, hence the inability of farmers to settle their indebtedness to the company. This brings to question the preparedness of management to adopt practical and innovative measures aimed at transferring the risks of production to farmers, since management can not hold farmers responsible for poor weather. Based on the above reasons, when the researcher put a question to management as to whether it is possible for the company to operate without pre-financing farmers, their answer was an emphatic "NO". When asked to explain further on their responses, 90% of them contended that the farmers can not afford the cost of production, as indicated in the table 4.8 below:

**Table 4.8: Possibility of Company Operating Without Pre-financing Farmers**

| RESPONSE | NUMBER | PERCENTATGE |
|---|---|---|
| Farmers cannot afford the cost | 9 | 90 |
| Government owns the company | 1 | 10 |
| **TOTAL** | **10** | **100** |

***Source: Field Survey, July 2011***

What this means is that if out-growers are unable to bear the cost of production, then naturally production will decline since the company's production is directly linked to the number of cotton out-growers. When a similar question was put to out-growers as to whether they will grow cotton without pre-financing, 66.7% of them said "No" and 33.3% of them answered "Yes". The study found that only a paltry 33.3% of out-growers will venture into the business of cotton production without pre-financing. The practice of

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continuous pre-financing of defaulting farmers must stop as it constitutes a major lapse of the current loan scheme.

### 4.9 Absence of a Legally Binding Agreement

Currently, out-growers are not made to sign any legally binding agreement that mandates out-growers to pay to the company any difference that may arise when the value of their seed cotton is not enough to pay back their loans: They just walk away freely and some even accuse the company of cheating them. The absence of a legal regime has led to a situation where farmers divert inputs to food crop farms, or sell cotton inputs to other farmers and some even dare to sell their seed cotton to other cotton companies. This constitutes a major lapse and should be checked by putting together a legally binding document and interpreted in the language that these outgrowers understand, and duely signed.

### 4.10 Loose Monitoring and Poor Record Keeping

Loose monitoring is one of the major lapses faced by the current loan scheme. When the CPAs were asked the number of times they visited farmers, 60% of them said they visited them twice a week. This is illustrated in Figure 4.2

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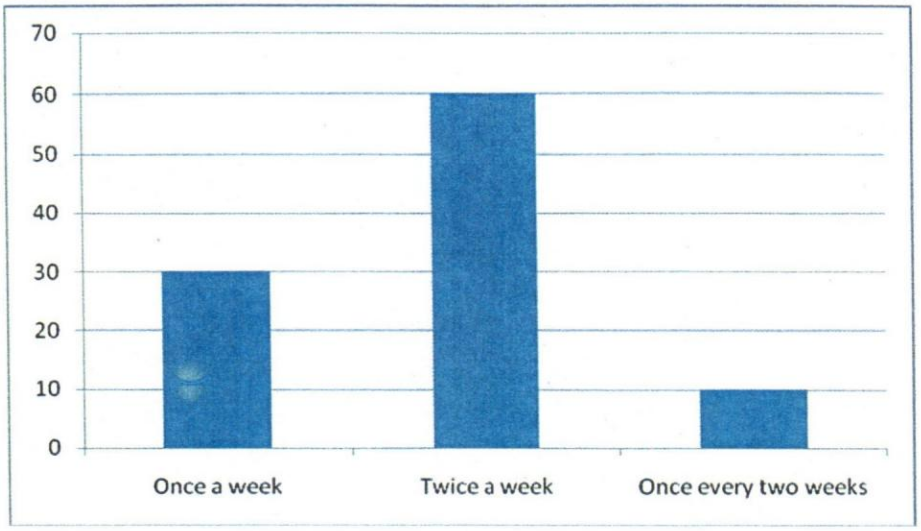
**Figure 4.2: Number of Times Visits are Made to Farmers**




***Source: Field Survey, July 2011***

From figure 4.2 above, 10% and 30% of CPAs visit their farmers once in every two week and once in a week respectively. The fact that they could not provide a definate answer as to the number of times they were required by management or by the terms of their engagement to visit farmers indicate that the CPAs themselves were not closely monitored or that management has not prioritized monitoring by supplying the CPAs the required resources to engage in regular monitoring. This state of affairs must be reversed and CPAs must be made to submit regular, accurate and timely field reports to management capturing at least their bi-weekly visits.

### 4.11 Poor Yield of Cotton

In an attempt to breakeven, the company has set low producer prices in order that they can meet the high cost of inputs. This has affected the ability of farmers to pay off their loans and still have some income. The continuous increase in input prices without a corresponding increase in producer prices has led to a diminished interest among farmers

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to continue to engage in cotton production. Most of cotton farms are exhausted because of continuous farming over the years and this has led to poor yields which also accounts for the inability of farmers to pay back their loans.

When the researcher put a question to farmers regarding reasons for poor yield of cotton, other reasons were advanced. As indicated in Table 4.9 below, 46.7% of respondents attributed the poor yield of cotton to poor weather, whilst 5% of respondents attributed it to late land preparation. Whereas 25% of respondents identified late input distribution, 23.3% of the respondents contended that the issue of poor yield was attributable to diversion of inputs for other crops. This is not in agreement with the publications of the 'GCCL Appraisal of Operations report (2000), which indicated that farmers do not get the required volume of seed cotton due to failure of rains and fertility of the soil.

**Table 4.9: Factors Resulting in Poor Yield of Cotton**

| FACTORS | NUMBER | PERCENTATGE |
|---|---|---|
| Weather | 28 | 46.5 |
| Late land preparation | 3 | 5.0 |
| Late input distribution | 15 | 25.0 |
| Diversion of inputs for other crops | 14 | 23.3 |
| **TOTAL** | **60** | **100.0** |

***Source: Field Survey***

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### 4.12 Possible Means of Seed Cotton Production without Pre-financing

To say that the current loans scheme lends itself to a lot of abuse is not an understatement. This is illustrated by the year-to-year decline in recovery rates. These under-recoveries threaten the sustainability of the scheme, hence the need to brain storm on other possible ways of transferring the risk of production to out-growers. However, as demonstrated earlier, both management and out-growers have indicated that it is practically impossible to continue seed cotton production without pre-financing. Any other suggested means of financing seed cotton production such as relying on bank loans and from micro-finance institutions remains theoretical. In the view of this researcher, what is needed is to fine-tune the current loans scheme and hold out-growers more accountable even if it means discontinuing pre-financing persistent defaulting farmers.

In a question to management as to the mechanisms put in place to retrieve previous loans, 10% of respondents suggested the introduction of Group Loan System, 70% of respondents recommended the institution of legal action, and 20% of the respondents did not suggest any mechanism. This is shown in Table 4.10

**Table 4.10: Mechanisms Put in Place to Retrieve Previous Loans**

| MECHANISM | NUMBER | PERCENTATGE |
|---|---|---|
| Group loan System | 1 | 10.0 |
| Legal action | 7 | 70.0 |
| No mechanism | 2 | 20.0 |
| **TOTAL** | **10** | **100.0** |

***Source: Field Survey, July 2011***

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### 4.13 Policy Implications

The overall effect of the weaknesses in the credit policy implementation of the company is the excessive build up of loans to farmers (receivables) and the increase in loans conversion period, an indication of debtors taking too long in paying their accounts , thus denying the company cash inflow to finance business operations. The company thus has to resort to supplementary finance from the bank for short term borrowing at high interest rates for its working capital requirements and to finance farmers. The sum effect is an increase debt finance, poor liquidity and erosion of profitability as a result of high interest and bad debts.

It is pertinent therefore for management to take a radical step of developing an effective monitoring and retrieval system in the management of the company's farmer's loans to improve liquidity, profitability and the working capital position of the company. Specific measures to be taken by management to improve on the management of accounts receivables (farmer's loans) and to collect payments on past-due accounts among others are:

- Gathering and analyzing relevant information obtained on credit applicants (cotton farmer) to determine the applicants' creditworthiness
- Deciding whether to extend credit to the farmer applicant and if so determining the amount of credit to give
- Issuing invoices or letters informing farmers of past-due status of the account and requesting payment.

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- Telephoning and /or visiting the farmers in an effort to obtain payment employing a collection agency.
- Taking legal action against the farmers as a last resort, because this has a tendency of damaging business relation and is also very expensive.
- Refusing/ declining to make any new supplies to the farmers with over-due account until the past account is settled.

The company's credit policy should be reviewed periodically, and policy changes necessary to ensure effective management of credit to farmers (receivables) adopted. However, before any policy change is adopted, the policy change should be analyzed by management to determine if it is indeed preferable to the existing policy.

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# CHAPTER FIVE

# CONCULSION AND RECOMMENDATION

## 5.1 INTRODUCTION

This chapter provides a conclusion and recommendation based on the analysis of the findings in the previous chapter. Credit provides a back bone to the growth of every business enterprise and cotton production is not an exception. Through credit, the farmers are able to purchase implements, meet the cost of labour, tractor services and inputs.

As important as credit is to all agricultural activities and cotton production in particular, access to agro-inputs has been the bane of farmers. This is explained by the fact that majority of farmers engaged in cotton production are small scale farmers who are unable to raise the required capital for cotton production purposes either through their own savings, micro-finance institutions or bank loans because they are unable to meet the collateral requirement of these institutions.

Designing a pre-financing scheme to meet the creeping deficit of "credit" to assist farmers to produce the white gold can only be a welcome development. Unfortunately, the management of the pre-financing scheme as demonstrated earlier leaves much to be desired. Continuous under-recoveries of loans advanced to famers has plunged the company into a financial quagmire threatening the company's liquidity position.

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There are virtually no measures put in place to ensure that farmers settle their indebtedness to the company and yet, defaulting farmers continue to enjoy the facility. Monitoring is loose, yet CPA's are recruited to perform such an important duty. This had led to input diversion and sale of seed cotton to the company's competitors in the business. Consequently, the company looses huge sums of money annually and so it is unable to settle its indebtedness to the Agricultural Development Bank and other creditors. Before any recommendations are made, it is important to examine the future of the loan scheme and the prospects of cotton production in Ghana.

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### 5.1.2 The Future of the input loan Scheme

As established in the previous chapter, the operation of input loan scheme as a means of boosting cotton production in Ghana can not be done away with. In deed all the major stakeholders in this enterprise, as demonstrated earlier, hold the same opinion, largely because it is considered a major motivating factor to farmers to continue to engage in seed cotton production. What is worrying however, is the seemingly care – free attitude adopted by management towards the implementation of the scheme. The absence of an appointed Credited Officer to take charge of granting and recovering of loans, only points to a scheme which is facing an eminent collapse.

### 5.1.3 Future of Cotton Production in Ghana

The availability of land, labour and capital defines the success or other wise of every agricultural activity and cotton production not an exception. What appears to pose a major threat to cotton production in Ghana is credit and Credit Management.

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Indeed, it is even safe to assume that with the coming on stream of many cotton production companies and adopting similar production strategies of rolling out input loan schemes, the issue of lack of capital is becoming a thing of the past. What is significant is therefore the management of the input loan schemes. Since credit is key to the success of the cotton industry in Ghana, its management must be done with some finesse based on sound managerial principles.

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## 5.2 Conclusion

Credit is the kingpin for development of any industry and it is rather so in the case of the cotton industry in Ghana, which is not considered to be a highly remunerative field. Credit is essentially required by farmers who cannot afford to meet certain requirements out of their own resources. The mere provision of credit for one or two items is not adequate enough for a cotton input loan scheme to yield the desired results.

All the problems of mounting overdue and bad debts facing the GCCL as a result of out-growers' poor yield would not miraculously stop. The causes of such problems are many and more complex. They can only be handled adequately by a multi-frontal attacked at both the managerial as well as farmers level.

The company is currently operating under very difficult business conditions requiring the maintenance of an adequate working capital. Increased levels of unpaid credits result in cash shortages and erosion of profitability. Adequate control measures are therefore

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recommended to ensure that the out-growers honour their obligations to produce enough seed cotton to pay off the loans.

So while Ghana Cotton Company will be trying very hard to extend their inputs loans scheme to cover many cotton out-growers in their bid to expand, there are a number of other things, which they should keep in mind in order to minimize undue burden to inputs loan beneficiaries and to facilitate the repayment process of the cotton farmer. Defects in the agrarian structure, that is, the technical aspects of farming which make it difficult for even a willing cotton farmer to repay the loan in times of poor yield must be addressed. In reality, cotton farmers interest in the crop has dropped and those who still engage in its production are devising numerous ways to avoid paying of their contracted loans through the diversion of seed cotton and in most cases the inputs.

The provision of credit must be accompanied by technical advice from the GCCL's trained field staff both prior to and during growing seasons. Regular farm visits, out-growers meetings and field days can ensure that farmers receive the information essential to help them manage their crops efficiently and profitably.

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## 5.3 RECOMMENDATIONS

### 5.3.1 Development of a Legal Regime to Hold Farmers Accountable for Defaults in Payment

The practice where farmers who are unable to service their loans are made to walk away without any form of liability must discontinue. Instead, farmers must be made to sign legally binding documents that states clearly that incase of default, they will be held liable. This will motivate them to sit up and produce enough to pay for their loans.

### 5.3.2 Provision of a Data Base for Out-growers

One of the reasons for the continuous financing of defaulting farmers is the fact that the GCCL does not have a data-base of all the farmers in the out-grower scheme. Consequently, the company continues to recruit farmers who have a history of defaulting. Development of a data base of out-growers will enable the company to assess the performance of each farmer on the scheme in terms of production and repayment track records. It will also prevent a situation where some farmers divert inputs to other farms or sell their seed cotton to other cotton companies. Proper record keeping is useful in assessing the performance of the company on yearly basis in terms of production and loan recoveries and enables the company to forecast future production.

### 5.3.3 Transfer of Risk of Cotton Production to Out-Growers

The current scheme as it operates does not make room for the sharing of the risks associated with production between the company and the farmers. The GCCL bears all the costs of production and in cases of defaults in payments of loans by farmers, the

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company records those as their losses and the farmer is left off the hook. Such practice contributes significantly to the dwindling fortunes of the company.

To reverse this trend, the company should adopt a group farming system, where the company registers farmers in groups as opposed to dealing with individual farmers. Dealing with identified groups makes it easier for monitoring and in cases of losses; the group can be held collectively responsible for such losses.

With this system, the group can collectively make a requisition to the management of GCCL regarding inputs which would be supplied before the on-set of the faming season. This will ensure timely distribution of inputs and its application resulting in better yields which will maximize profits and reduce losses and consequently, improve the dwindling fortunes of the company.

The company can also facilitate the granting of loans to farmer groups from banks with the groups taking full responsibility for repayment of the loan and the company acting only as guarantors or witnesses. This way, the risks associated with defaults will be jointly shared by both the groups and the company as opposed to the current situation.

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### 5.3.4 Setting Production Target for Farmers and Loan Recovery Target for CPAs

The GCCL should endeavour to set production targets for out-growers and those who are able to meet such targets should be publicly rewarded. This will motivate other farmers to endeavour to reach such heights, thus creating competitive spirits amongst farmers.

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Similarly, CAs must be given performance targets and those whose farmers are able to produce enough to pay back their input loans should be handsomely rewarded financially and through promotion.

### 5.3.5 Appointment of Credit Officer

The GCCL should create a credit a department headed by a Credit Officer. The credit Officer should be assigned the responsibility of controlling the amount of input loans granted to farmers and also ensure that such loans are recovered within a stipulated time. Such an officer should be strict and disciplined with a background in security and/or financial administration.

### 5.3.6 Building the Capacity of CPAs

CPAs who are directly engaged with the out-growers need to be given periodic training and re-training on credit supervision especially with the recommended shift of emphasis from individual farmer loan scheme to farmer groups' loans scheme. Supervision must be intensified with bi-weekly reports submitted on the activities of each farmer groups. CPAs must also be trained regularly on effective mans of giving extension information to farmers.

### 5.3.7 Employ the Services of Animal Traction

During the research, one of the concerns raised by farmers as reason for poor yield, resulting in their inability to pay back input loans was the issue of late land preparation and late input delivery. This they attributed to few tractor services available in the

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operational areas. Late input delivery was also partly attributed to poor feeder road network.

On land preparation, it is recommended that the GCCL should take advantage of animal traction services available in the various communities. It is cheaper, preserves the fertility of the soil and ensures minimum disturbance of the top soil. Inputs should also be supplied in the dry season to the various farmer groups, rather than in the raining season when the feeder roads are virtually inaccessible.

### 5.3.8 Continuous Engagement with Farmer Communities

The GCCL should be seen to be interested in the social development of the communities in their operational areas. In this wise, the company should design social intervention programmes that will respond to the growing social needs of the farming communities including building of schools, health posts and market sheds for the communities in their catchment areas. Scholarships should be awarded to children of hard working farmers. This constructive engagement with the communities will motivate the youth of these communities to engage themselves in the business of cotton production with the company

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**Appendix 1**

**SURVEY QUESTIONNAIRE**

Dear Respondent,

I am a graduate student pursuing a Masters Degree Program (DM) in the Faculty of Planning and Land Management at the University for Development Studies (UDS), Ghana. I am conducting a research as part of my course assignment on the topic:

**"Managing Credit Facilities granted to cotton farmers: Prospects and challenges facing Companies engaged in cotton production in Ghana".**

**(The case of Ghana Cotton Company)**

Could you kindly spend some of your valuable time in answering the following questions below? Your response will be treated with all the confidence it deserves.

Please tick the appropriate boxes where necessary.

**(Questionnaire for Management of Ghana Cotton Company)**

1. Division:.....
   Date.....
2. Position held:.....
3. What major business activity does your company engaged?

   (i) Pre-financing the production of seed cotton ☐

   (ii) Marketing and processing of seed cotton ☐

   (iii) Sale of farm inputs to farmers ☐
4. What business strategies do you employ to attract farmers to grow cotton?

   (i) .....

   (ii) .....

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(iii) .....

(iv) .....

5. What is the market share of the company's operation? (i) 100%-80%) (ii) ☐ 80%-60% ☐ (iii) 60%-40%) ☐ (iv) 40% and below ☐

6. Which companies or organizations are in completion with you?

.....

.....

7. What type of credit facilities do you offer to your farmers to produce cotton?

(i) Cash ☐ (ii) Farm Inputs ☐ (iii) Both cash and inputs ☐

8. Does Ghana cotton company Ltd. cultivate its own farms?

(i) Yes ☐ (ii) No ☐

9. From the farmers' point of view, who owns the cotton farms?

(I) Cotton companies ☐

(II) The farmers ☐

(III) The government ☐

(IV) Both the company and the farmer ☐

10. Show in percentages terms, the quantum of credits granted to the under-mentioned category of farmers? (i) Individuals ☐ (ii) Groups ☐

11. What is company's policy towards pre-financing cotton farmers?

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.....

.....

.....

12. Which measures do you use in monitoring recoveries or payments?

a. Good average yield of seed cotton

b. Aging schedule of the outstanding loans

c. Good farm practice by farmers

d. Others if any. .....

13. Is there any written contract between the Company and the individual farmer?

(i) Yes ☐ (ii) No ☐

14. What credit period do you offer to the farmer?

(i) 90days ☐

(ii) 120days ☐

(iii) 150days ☐

(iv) No specific period ☐

15. What percentages of the farmers are able to pay their indebtedness within the credit period? .....

16. Does the company charge interest on the credit facilities to farmers? (i) Yes ☐

(ii) No ☐ (iii) No idea ☐

17. How will you describe the distribution of farm inputs to the out-growers?

(i) Very efficient ☐

(ii) Efficient ☐

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(iii) Inefficient ☐

(iv) Very inefficient ☐

18. How often is the company's credit policy of pre-financing cotton farmers changed?

.....

.....

19. Who determines the credit or pre-financing policy of the company?

.....

.....

.....

20. In your estimation, is the policy effective? (i) Yes ☐ (ii) No ☐

21. Are the farmers abiding by the credit terms and conditions?

22. What major problems does the company experience in the enforcement of the credit policy?

.....

.....

23. If No, what improvements do you think is needed to make the credit policies more effective?

.....

.....

.....

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24. Which of the following is responsible for granting and monitoring of credits to farmers in the company? ☐

(i) The General Manager ☐

(ii) The Field Operations Manager ☐

(iii) The Zonal Officer ☐

(iv) The Cotton Production Officer ☐

25. What is the most acceptable mode of re-payment of credits by farmers?

(i) Seed cotton ☐ (ii) Cash ☐ (iii) Any other method ☐

26. Who determines the seed cotton price?

(i) The cotton companies ☐

(ii) The farmer ☐

(iii) Government ☐

(iv) Cotton farmers and companies ☐

27. What suggestions do you have to ensure that farmers pay within the credit period?

.....

.....

28. In your estimation is the seed cotton price attractive to the farmer?

(i) Yes ☐ (ii) No ☐

29. How will you describe the percentage rate of credit repayment over the past three years?

☐ ☐



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(i) Very good ☐ (ii) Good ☐ (iii) Bad (iv) Very Bad

30. In your opinion, should the company continue to pre-finance defaulting cotton farmers?

(i) Yes ☐ (ii) No ☐

31. If your answer to Q.24 above is (I), why should it be so?

.....

.....

.....

.....

32. What strategy is put in place to retrieve outstanding loans from defaulting farmers?

.....

.....

.....

33. Has the strategy been effective? (i) Yes ☐ (ii) No ☐

34. Is it possible for the company to operate in the cotton industry without pre-financing the cotton farmers? (i) Yes ☐ (ii) No ☐

35. Explain further your response in Q. 28.

.....

.....

.....

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36. What are the main parameters used in evaluating the cotton farmers before credits are offered

(i) .....

(ii) .....

(iii) .....

(iv) .....

(v) .....

37. What mechanism can be put in place to transfer the risk of producing cotton to the out-growers?

(i) .....

(ii) .....

(iii) .....

(iv) .....

(v) .....

38. What do you think are the lapses in the current system of pre-financing cotton farmers?

(i) .....

(ii) .....

(iii) .....

(iv) .....

39. What are the common reasons for farmers failure to pay loans or credit granted to them?

(i) They want to cheat. ☐



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(ii) Low average yields of seed cotton. ☐

(iii) They are not properly educated ☐

(iv) Farmer are not prosecuted for defaulting loans granted them ☐

## QUESTIONNAIRES FOR FARMERS

1. Division …… Zone…….. Station ……

2. Age …… Gender …… Date ……

3. Number of dependants ……

4. How long have you been engaged in cotton production? (i) 0-2yrs

(ii) 4-8 yrs ☐ (iii) 8-10 yrs ☐ (iv) 10 yrs and above ☐

5.

6. What is your farming standing status with Ghana cotton company Ltd.?

7. What inspires you to engage in cotton production?

…… ……

8. Are you in to cotton production this year (2010)?

(i) Yes ☐ (ii) No ☐

9. Do you have any credit arrangement with Ghana cotton company Ltd. (2010)?

(i) Yes (ii) No

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10. If yes, what are the terms of your credit arrangement?

(i) 90days ☐

(ii) 120days ☐

(iii)150days ☐

(iv) No specific period

11. Do you settle your accounts or loans within the credit period? (i)Yes (ii)No

12. If No, what problems account for your inability to pay the loan within the credit period?

.....

.....

13. From which other company do you obtain your supplies?

.....

.....

14. Why do you go in for inputs from other cotton companies?

.....

.....

15. Are you engaged in the production of other cash crops? (i)Yes (ii)No

16. If your answer in 7 above is (I), how are the other cash crops financed?

(i) Personal sources ☐

(ii) Banks ☐

(iii) Micro-financing institutions ☐



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17. Do you have any problems with the way your farm activities are handled by Gccl?

(i) Yes (ii) No

18. If yes, what specific problems are these?

.....

19. Would you grow cotton if you were not pre- financed by the Ghana cotton company?

(i) Yes ☐ (ii) No ☐

20. Do you consider the supply of inputs to you as a loan?

(i) Yes ☐ (ii) No ☐

21. If you are not able to produce enough seed cotton to pay off your credit, how do you intend to pay for the outstanding loan?

(i) Cash ☐

(ii) Seed cotton for next year ☐

(iii) Do not intend paying ☐

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22. What suggestions do you think Ghana Cotton Company and for that matter the cotton industry should adopt to improve its services to you to ensure that you produce enough cotton to pay off your loan?

(i) .....

.....

(ii) .....

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23. In your estimation who owns the cotton farms?

(I) Farmers ☐ (ii) Cotton companies ☐

24. Who set seed cotton prices?

(i) The Companies ☐

(ii) Farmers ☐

(iii)Negotiations ☐

25. What reasons account for farmers' poor yield per unit over the years?

(i) Weather ☐

(ii) Late land preparation ☐

(iii) Late inputs distribution ☐

(iv) Diversion of inputs to other crops ☐

(v) Diversion of seed cotton produced to other companies ☐

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**QUESTIONNAIRES FOR COTTON PRODUCTION ASSISTANTS**

1. Division …… Zone…….. Station ……

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2. Age ..... Gender ..... Date .....

3. Number of dependants .....

4. For how long have you been engaged in cotton production?

(i) 0-2yrs ☐ (ii) 2-5 yrs ☐ (iii) 5-10 yrs ☐

(iv) 10 yrs and above ☐

5. What is the highest average per unit you ever achieved? a) 0 – 300 ☐

b) 301 – 350 ☐ c) 351 – 400 ☐ d) 401 – 450 ☐

e) 451 – 500 ☐ f) Above ☐

6. What is the least average you ever achieved? a) Under 50 ☐

b) 150 – 200 ☐ c) 201 -250 ☐ d) 251 – 300 ☐

e) 351 – 400 ☐ f) Above 400 ☐

7. State, in your view, what can be done by you to increase production?.....

8. State in your view, what can be done by the company to help you increase

Production.....

.....

9. Do you often encourage problems with your farmers?

a) Yes ☐ b) ☐

10. How many times do you normally visit your farmers?

a) Once a week ☐

b) Twice a week ☐

c) Once every two weeks ☐

d) Once a month ☐

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e) At least once during the season

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