

## Financial Performance of Agriculture

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**Abstract:** The paper aims at studying the efficiency of agricultural financing at the current stage. The paper concerns the nature and principles of financing of agriculture, its main source. The features of agricultural production and their impact on the organization of financing the agricultural sector are defined. The proposals to provide agrobusinesses with financial resources are developed. To ensure the proper management of financial relations in the agricultural sector it is important to identify and take into account the peculiarities of agricultural production, among which the most important are: a diversified nature of agricultural activity, the seasonal nature of agricultural activity and the duration of the production cycle, the influence of natural factors, the use of land as the main means of production, the high capital ratio and a significant depreciation of fixed assets, low profitability and unprofitability. As an additional source of funding for current and investment activities of the agricultural sector enterprises one can use a bank factoring.

**Key words:** Agriculture • Financing • Financial resources • Credit • Leasing • Factoring • Insurance • government support

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### INTRODUCTION

In the Message of the President of the Republic of Kazakhstan "Strategy "Kazakhstan-2050": a New Policy of the Established State" it is indicated that a large-scale modernization of agriculture must be implemented, especially in the face of growing global demand for agricultural products. To do this, state thinking of a new type should be provided [1]. As a result, a program for the development of agricultural complex in the Republic of Kazakhstan for 2013-2020 is developed, the financial recovery of agriculture being one of its tasks, which is possible by increasing the efficiency of funding [2]. In such circumstances, it becomes necessary to study the efficiency of agricultural financing at the present stage and the development of proposals to improve it.

Methodological problems of financing efficiency of agriculture were dealt with in the works of N. Ermasova [3], S. Ermasova [3], B. Aymurzina [4], M. Kovalenko [5], Y. Agirbova [5], M. Serov [5], N. Kazakov [6], K. Pankov [6], I. Maslenkov [6], B. Ziyabekov [7], G. Utibaev [8], E. Ogloblin [9], Y. Lopatinskii [10] and many other researchers. However, many aspects of this problem need further investigation. The issues of attracting investment in the sector are poorly researched. The issues of

improving the financial management of agricultural enterprises require further development. The foregoing caused the choice of the research issue, tasks and objectives of the study and necessitated a comprehensive study of the problems of financing agriculture in the implementation of industrial-innovative development of Kazakhstan till 2050.

The paper aims at studying the efficiency of agricultural financing at the current stage. To accomplish the goals it's necessary to determine the essence and principles of agricultural financing, its main sources, specifics of agricultural production and, given their impact on the organization of financing in the agricultural sector, to develop proposals to provide agribusiness with financial resources.

**The Main Results of the Study:** The concept of "financing" is among those that are widely used in various fields of knowledge and business turn to characterize the processes associated with the movement of financial resources [11]. However, so far there is no single scientific point of view regarding the content of this concept, its place in the system of financial activity of the economic entity and the scope of use in practice. As a result, financing is treated diverse, although in fact

Table 1: Principles of Organization of Agriculture Financing \*

Name of the principle	Characteristics of the principle
Principle of adequacy	To ensure the planned activities sufficient resources should be provided that
Principle of timeliness	Ensuring timely receipt of funds to finance the costs.
Principle of availability	Availability for all business entities of various forms and sources of funding.
Principle of priority funding	Financial resources are directed to the development of industries and activities that are of strategic importance to the agricultural economy, since they determine the scientific and technical progress in the field - an elite seed production, breeding, preservation of soil fertility, investment, support for agricultural science, social sphere.
Principle of multiplicity of sources and channels of funding	Funding comes from different sources and are distributed in different directions. An important role in the realization of this principle is the choice of effective distribution channels of financial resources.

\*Composed by the author based upon [3]

the authors consider the same process from different positions, resulting in differences in the defining the object and the subject of financing and the nature of the processes.

Excluding from the field of research the processes of movement of financial resources going beyond the turnovers of the particular market participant, it was concluded that the financing is the activity of economic units to form financial resources they need for future use from different sources. Understanding that the formation of financial resources is conditioned by their further use, allowed to consider financing as one of the parties of the financial activity of a market economy unit, the subject of which is the sources of financing (as a set of potentially available funds in the market) and the result - financial resources, which formation supposes the implementation of collaborative processes of choice of financing sources, attracting of funds and converting them into a form suitable for use.

Effective management of the agriculture financing is provided by implementation of a number of principles, the most important of which are shown in Table 1.

An effective system of financial management, organized by taking into account the principles cited, form the basis of high rates of increasing the resource potential of agricultural enterprises, providing them with the necessary financial stability in the development process and constant performance growth.

The main objective of financing is the mobilization of financial resources by selecting sources of financing, attracting funds and their using [12]. Financial resources, formed from a variety of sources, enable the company to repay its obligations in time, to invest in new production, to ensure the expansion and modernization if necessary, to fund research, development and their implementation, etc [13]. Features of turnover of funds in the organization

of financing the agricultural enterprises, being an aggregate of relations on the formation, distribution and use of funds of cash assets (financial resources) led to search the major sources of funding in the agricultural sector (Figure 1).

Unlike other activities, peculiarities of agriculture funding are determined by the specifics of agricultural production. In our opinion, the most determining and problematic factors influencing the arrangement of financing in the agricultural sector of the economy today is the use by the agricultural enterprises of the land as the basic means of production, significant depreciation of fixed assets, low profitability and unprofitability of agricultural enterprises, as well as other factors (Figure 2).

An important factor influencing the organization of financial relations in the agricultural sector of the economy is a diversified nature of agricultural activity. As is known, the basic prerequisite to get the loan is the profitability of the enterprise. Banks must be sure that the borrower is able to pay the loan. Unfortunately, the low yield or even unprofitability of agricultural enterprises calls in question the possibility of obtaining credit. However, if the company is engaged in the two activities, in determining the creditworthiness of the borrower it should be taken into account the profitability of production not in general but for certain types of agricultural products. If the agricultural commodity producer is seeking a loan to expand production of profitable products, the bank may be interested in a loan given to the client, as it is likely that the use of credit in this case will enable paying the loan and getting more revenue at using it [6, p. 38].

This approach will enable breaking the cycle of problems, where, on the one hand, agricultural enterprises are unprofitable because they cannot get credit, but on the other hand, they do not get credit because they are unprofitable.

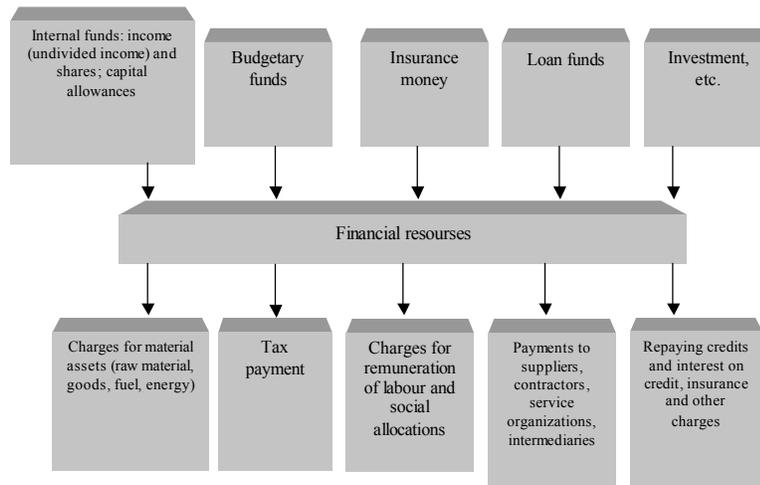


Fig. 1: Movement of Financial Resources of Agricultural Enterprises\*

\* Composed by the author based upon [4]

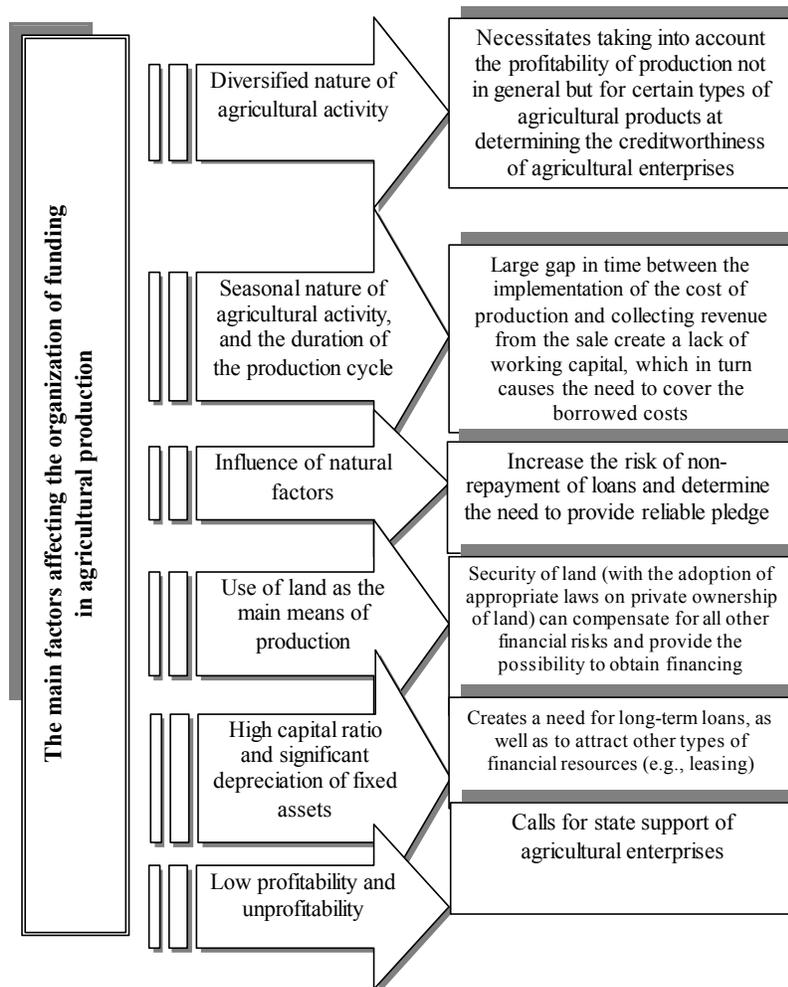


Fig. 2: Features of Agricultural Production and Their Impact on the Organization of Financing\*

\* Composed by the author based upon [5]

One of the important features of the lending of agricultural producers is the seasonal nature of agricultural activity and the duration of the production cycle. This leads to a large gap in time between the implementing the cost of production and collecting revenue from the sale, creating a shortage of working capital, causing, in its turn, the need to cover it with the borrowed costs.

Another feature is the increased risk of non-repayment of funds received as a result of the negative impact of natural factors, notably: adverse weather conditions, disease, parasites, etc., that can reduce crop yields and animal productivity, resulting in its turn in a loss of the planned financial performance. In addition, there is the risk of loss or damage to property resulting from natural disasters, not only reducing the profitability of production, but also destroying the pledge.

It is important to note that one of the factors affecting the funding is ecological risk. After all, environmental pollution may decrease the productivity and quality of crops and livestock [14]. At the same time, the application of various sanctions on air pollution to the enterprise will lead to lower yields. Thus, the increased risk of non-repayment of funds received, conditioned by the influence of natural factors, requires additional measures of agricultural enterprises, for example, property insurance, providing reliable pledge, etc [15].

Throughout the civilized world under a land is the pledge to long-term low-interest loans for the agricultural sector. However, in our conditions this form of lending has not yet received extensive development as it supposes developed agricultural land market. To date, the implementation of lending on security of land is constrained mainly by the fact that the land as a factor of production, earning profit, has an extremely low liquidity. Funds of reallocation consisting of fully fertile land, do not reduce now and even grow. This is confirmed by the fact that, following the recovery of the relevant banking activity the slump set in: banks are reluctant to take the land to secure long-term loans.

At the period of the land market establishing and for the development of mortgage lending the following scheme is proposed, which excludes the possibility of abuse and partially compensates for lack of legal basis and the adverse macroeconomic background.

The fund of concessional lending determines the proportion of funds for long-term loans, including those ones secured on land. A competition among commercial banks for the right to participate in mortgage lending takes place. The selected commercial banks obtain credit secured on their property (signing the relevant credit

agreement); they place this credit themselves among agricultural producers on the security of land. In the case of loan default and foreclosure on the land, commercial banks do not become owners of the land and therefore put up the land for a special auction according to the general rules for mortgage of the property. Agricultural producers whose land is adjacent to the mortgage sites are allowed to participate in the auction. In the absence of demand the second round of the auction is announced over time, being open to all agricultural producers or potential producers (living in this district nationals or citizens giving a written commitment to move to the area and having proof of the ability to work in agriculture). If the second round produces no result, then the state buys the land. The land bought out by the state are available for agricultural producers to lease with option to purchase. To avoid illegal transactions through dummies the rule must be established saying that such deals are broken without the return of funds paid by buyers. It is obvious that at the first stage the volumes of mortgage operations will be small and mostly in areas with high liquidity lands. In the long term the loans secured on land must get extensive development with the creation of a network of mortgage banks authorized by the state and with the increase of profitability of agricultural production [7].

As an additional source of funding for current and investment activities of the agricultural sector enterprises one can use a bank factoring. Factoring as a form of commission operations, coupled with lending the working capital of producers, allows transferring the unpaid debt claims (invoices, bills, receipts of grain, etc.) by a factoring company (in our case by the bank). Working according to the scheme of factoring, the supplier of goods gets most of the money for goods shipped almost immediately, while the recipient is entitled to a deferred payment up to several months. The basic principle of factoring is that the factor company (factor-bank) buys from its customers their requirements to other clients, during the first 2-3 days it pays an advance from 70% to 90% of the required amount and the remaining amount of payment is received by the customer-supplier after factor-company gets the bill from the client-buyer [16].

The largest amount of factoring transactions for agricultural units could be implemented through a system of specialized agricultural bank created with the assistance of the state. Such institutions are functioning successfully in many countries around the world, being among the largest banks in terms of capital amount and the volume of transactions [8, p. 314].

From the standpoint of the market economy, according to most economists, it would be preferable to establish a private bank, that is, when private capital fills itself the agricultural niche without the intervention of the state. However, given the current financial situation and the high risk of the agricultural sector the domestic private capital is unlikely to tend to focus exclusively on the agricultural area. By the same token the state cannot make in the form of an order private business to create agricultural banks nationwide, moreover, in the current environment the private capital needs certain government guarantees. Therefore, it is possible to create Joint-stock Agricultural Bank with 100% share of the state at the early stages and as it is establishing - on the share basis with the attraction of private capital while maintaining a state controlling interest. Creating such a bank the main purpose of the state is not to realize a profit, but to provide long-term financial and credit resources of agricultural producers at preferential interest rates or at no interest at all. But, in terms of attracting private shareholders, interest shall be accrued at the average rate not to the borrower but conditionally as a "profit" of the bank, which is then distributed like dividends among private shareholders.

One of the important factors affecting the financial provision of agricultural enterprises is a significant depreciation of fixed assets. Today the agro-industrial complex of Kazakhstan is provided with the equipment only by 45-65% of the demand; the majority of this equipment in terms of performance typically do not meet modern requirements. This necessitates modernizing agricultural machinery, introducing new technologies, which is impossible without attracting the long-term loans. Although the dynamics of long-term bank lending to agricultural production had a positive trend in recent years, the achieved volume of lending does not meet the needs of the industry.

From this aspect the application of the lease becomes important. Leasing is a profitable tool of the investment policy tool of a special economic nature, combining elements of credit and investment operations [17]. An important advantage of leasing is its multiplicative intersectoral effect, which is explained by the fact that buying the necessary machinery and equipment through leasing, agricultural producers contribute to the increase in production and market expansion of domestic agricultural machinery organizations [9, p. 13].

Low profitability of agricultural enterprises necessitates government regulation and public financial support for farmers. In the area of credit it's financial support of agricultural enterprises through the mechanism

of reduction in cost of commercial bank loans allowing enhancing the flow of funds into the agricultural sector. The above-mentioned state financial support, of course, will enhance the flow of funds into the agricultural sector, but some researchers believe this mechanism to be not enough effective, describing it as support of not farmers in the first place but commercial banks.

In the face of major agricultural risks the state support of insurance becomes important; it is provided by the Fund of Agricultural Insurance Subsidies by granting insurance subsidy of 50% of the cost of insurance premiums (contributions), insurance deductible for complex and index insurance of agricultural products, as well as the insurance of capital assets [10, p. 241].

An important task of improving the financial provision of agricultural producers is to ensure the fairness of government support, because as is known, not all producers have an access to a particular programs: small businesses, individual producers are usually limited in this funding [10, p. 344].

Peculiarity of modern agricultural sector of Kazakhstan consists also in that the vast majority of agricultural products is not produced by large enterprises but by small-scale ones. However, the operation of small-scale farms cannot be successful without adequate financial support. And if the lending for farms is difficult because of the lack of liquid assets for pledge, established investment instruments, etc., then for small-scale enterprises it is almost impossible. In these conditions it is necessary to create and develop the rural co-operatives and large farms.

The cited features of agricultural production should be taken into account when developing and implementing organizational and economic mechanism of financing the agricultural sector, which is a system of institutional, economic, legal, administrative and regulatory actions, methods and processes, shaping and influencing the effectiveness of financial relations. Organizational and economic mechanism of financing in a market economy must take into account the interests of all parties.

## **CONCLUSIONS**

Modern conditions of the financial relations in the agricultural sector do not meet objective requirements of the industry in the implementation of its financial services. That is why the development and implementation of an effective mechanism for financing agricultural enterprises is an important and necessary condition for economic stimulation of agricultural development, including the search for new forms, methods and sources of attracting

financial resources. To ensure the proper management of financial relations in the agricultural sector it is important to identify and take into account the peculiarities of agricultural production, among which the most important are: a diversified nature of agricultural activity, the seasonal nature of agricultural activity and the duration of the production cycle, the influence of natural factors, the use of land as the main means of production, the high capital ratio and a significant depreciation of fixed assets, low profitability and unprofitability. These characteristics determine the creation of specific financing terms of agricultural production.

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