**EXERCISE 11. CALCULATING THE COST OF A LOAN**

|  |
| --- |
| *OBJECTIVE***After this exercise the participants will be able to:*** Work out the cost of a loan.
* Decide whether it is a good idea for them to apply a loan
 |
| *EQUIPMENT NEEDED** Flip chart, marker pens
 | *EXPECTED OUTPUTS** Calculation of the cost of loans with different conditions
 |
| *TIME** 2 hours
 | *PREPARATION** Complete Exercise 10A and 10B.
* If possible, find out from local banks or microfinance institutions their terms and conditions for seasonal loans for working capital. If this is not possible, estimate the interest rates, loan periods, repayment rates, and other conditions for the loan to make the exercise as realistic as possible.
 |

*This exercise uses the information generated in Exercise 10a and Exercise 10b to calculate the costs of a loan. It enables farmers to see whether it is a good idea to apply for a loan.*

*You can do this exercise in two ways – either for individual farmers to work out their own credit needs, or for all the participants to work out the credit needs of the group.*

*SUGGESTED PROCEDURE:*

1. Ask the farmers where they normally go if they need to borrow money. How much money can they borrow? When do they have to pay it back? What is the interest rate? Is borrowing a good idea?
2. Ask the farmers to name some situations when they borrow money. Ask them to describe how they decide whether to borrow money and how much to borrow.
3. Discuss the different possible sources of capital: own savings, borrowing from family members, group savings and loans, or loans from money- lenders, input suppliers, buyers, or financial institutions. Ask the farmers to discuss the advantages and disadvantages of each. Get them to write the interest rates, loan periods, and other terms and conditions on a big sheet of paper (like Table 44).
4. Explain to the farmers that they will be working out the costs of various loans from a microfinance institution or a bank. (Make sure they understand if the terms and conditions are real or imaginary.)
5. Ask the farmers to select a product they would like to produce, and say what it would cost to produce and market it (see Exercise 10B and Exercise 10B for details). Use your data from previous gross margin analyses with the farmers.
6. Ask them how much money they have available to pay for these costs.
7. Get them to calculate the shortfall:

**Amount of money needed = Total costs – Amount of money available**

1. Ask them how much they would like to borrow. This may be the same as the shortfall, more, or less.
2. Ask them what they will spend the money on in terms of technologies and the expected gains from using these technologies.
3. Get the farmers to work out the cost of loans from each of the sources of capital they have named (Table 45). (Not all the sources of capital will be useful, so the farmers should decide which ones to consider.)

**Cost of loan= Amount of Loan X Interest rate per month X Number of months**

**Amount to be repaid = Amount of loan + Cost of loan**

1. Invite the farmers to compare the various sources of capital. Which one would they choose? Might a combination (e.g., borrowing from a family member and from a bank) be an option?

TABLE 44. EXAMPLES OF LOAN CONDITIONS FROM DIFFERENT LENDERS

In this example, we have used dollars, but consider using your local currency with farmers.

|  |
| --- |
| **LENDER MAXIMUM REPAYMENT OTHER CONDITIONS INTEREST RATE LOAN ($)** |
| Family member | 10 | Repay in 1 month |  | None |
| Moneylender | 50 | Up to 6 months |  | 6% per month |
| Trader | 20 | Repay at harvest | Must sell produce to trader at 10% lower price | 4% per month |
| Postal Bank | 50 | Up to 6 months | Must have business plan Deposit of $20 | 7% interest over 6 months |

TABLE 45. COMPARISON OF LOANS FROM DIFFERENT LENDERS

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **LENDER** | **LOAN AMOUNT** | **INTEREST RATE PER MONTH** | **NUMBER OF MONTHS** | **COST OF****LOAN** | **AMOUNT TO BE REPAID** |
|  | **$**A | **%**B | C | **$**D = A × B × C | **$**A + D |
| Family member |  |  |  |  |  |
| Moneylender |  |  |  |  |  |
| Trader |  |  |  |  |  |
| Postal Bank |  |  |  |  |  |