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FINANCING SUSTAINABLE **SUPPLY CHAINS**

How Multinational Companies Can Leverage Development Finance Institutions to Meet Corporate Sustainability and Business Goals

resonanceglobal.com
info@resonanceglobal.com

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THE SUPPLY-SIDE CHALLENGE FOR **SUSTAINABILITY TEAMS**

Levi Strauss & Co. had a dilemma. In 1991, it became the first multinational apparel company to establish a comprehensive workplace code of conduct that set standards for workers' rights, a healthy work environment, and an ethical engagement with the planet for its manufacturing suppliers in emerging markets.[1]

By 2014, the company continued its trailblazing ways by setting more ambitious corporate environmental and social goals. Levi Strauss & Co. had also created a program to assess how its suppliers met its workplace standards, identifying problem areas to improve. To realize its targets, thousands of Levi Strauss & Co.'s garment suppliers would have to upgrade their environmental, health, safety, and labor standards.

There was just one problem: the company had little to no direct control over its garment suppliers. Levi Strauss & Co. needed a way to reward and incentivize its suppliers, but how?[2]

In Côte d'Ivoire, Cargill, one of the world's largest traders and processors of cocoa, was confronted with a similar problem. The local farming cooperatives were struggling to provide a consistent and reliable supply of cocoa beans to Cargill and were incurring high costs. Why? Because the farmers supplying the cooperatives were relying on run-down trucks that were unable to handle road conditions and that frequently broke down while trying to transport the cocoa beans to the cooperatives from the farms.

Buying new vehicles was nearly impossible, too. Banks saw too much risk in the fluctuating cocoa prices and small margins, so the only available financing came in unaffordable, often unattainable, short-term, high-interest loans.[3] Cargill needed a way to shore up a sustainable supply of cocoa, but how?

Two companies. Two problems. No easy solutions. Emerging and frontier markets offer tremendous growth opportunities and cost-effective supply chains for multinational companies. However, these markets are also riddled with complex challenges that threaten a company's business and corporate sustainability goals.

Today, leaders must navigate issues like climate change, water scarcity, declining agricultural productivity, deforestation, forced and child labor practices, substandard wages, unreliable manufacturing equipment, dilapidated and failing infrastructure, inconsistent crop yields, and much more as they seek a high-quality and consistent commodity supply.

Amid a volatile, insecure world, how does a company secure, strengthen, and build sustainable supply chains in emerging and frontier markets? Fortunately for Levi Strauss & Co., Cargill, and many other companies, the answer was found by forming cross-sector partnerships with **development finance institutions (DFIs)** that unlocked new funding opportunities for private-sector projects.

AN INTRODUCTION TO DEVELOPMENT FINANCE INSTITUTIONS

DFIs are specialized development banks or subsidiaries set up to support private-sector development in developing countries.[4] These organizations are usually majority owned by national governments and source their capital from national or international development, or benefit from government guarantees. This ensures their creditworthiness, enabling them to raise large amounts of money in international capital markets and to provide financing on very competitive terms.[5]

Types of Development Finance Partners

	MULTILATERAL DEVELOPMENT BANKS	NATIONAL DEVELOPMENT FINANCE INSTITUTIONS
Notable Organizations	IFC International Finance Corporation WORLD BANK GROUP; ADB ASIAN DEVELOPMENT BANK; European Investment Bank; IDB Inter-American Development Bank	OPIC; KFW; CDC Investment works; FMO Entrepreneurial Development Bank
Common Tools	Direct Credit; Guarantee; Credit to FI; Technical Assistance; Co-Funding	Co-Funding; Credit to FI; Direct Credit; Guarantee

Each DFI has its own goals, objectives, and investment priorities that can range from seeking private-sector investment opportunities in specific geographic regions, like Sub-Saharan Africa, the Middle East, or Southeast Asia, to investing in specific markets, like energy, agriculture, telecommunications, or apparel.

For example, IDB Invest, the private-sector arm of the Inter-American Development Bank, seeks to invest in projects that "benefit poor, vulnerable or excluded populations, strengthen women's economic opportunities, tackle climate change, provide financing to smaller businesses or improve products and services to better meet people's needs."[6] Many of the projects it seeks to finance advance clean energy, modernize agriculture, strengthen transportation systems, and expand access to financing.[7]

CDC Group is the UK Government backed DFI. Its mission is "to support the building of businesses throughout Africa and South Asia, to create jobs, and to make a lasting difference to people's lives in some of the world's poorest places."[8] Its "dual objective is to support growth and jobs that lift people out of poverty and to make a financial return which is reinvested into more businesses."[9]

FMO, the Dutch entrepreneurial development bank, aims to "contribute to a world in which, in 2050, more than nine billion people live well and within the means of the planet's resources."[10] It focuses on investing in underserved markets with challenging business environments and in countries that often have a fragile private sector, little job security, and high poverty rates.[11]

In addition to the economic development focus that DFIs have, many also have policies that require clients to comply with social and environmental standards, along with accountability and compliance obligations that must be met to receive financing.

THE PLAYERS

DFI-invested projects often involve multiple players who can play different roles depending on the financing deal. Some of the players can include:

- Supply chain actors
- Technology service providers
- Financial service providers
- International development partners

THE VALUE OF PARTNERING **WITH DFIs**

Often DFIs and companies can create mutually beneficial partnerships. DFIs have money to invest in promising projects that not only meet their goals but also will strengthen and stabilize a company's supply chain. For example, as OPIC merges into the DFC*, its investment capability will go from a $20 billion spending cap to $60 billion.[12] And, according to the Center for Strategic and International Studies, "Since 2000, DFIs have grown from almost $12 billion in annual investments to $87 billion in 2017."[13]

Along with the need to secure a stable supply chain, many companies have also set ambitious sustainability targets aligned to the United Nations (UN) Sustainable Development Goals. The UN estimates that, to achieve its goals, it will take between US $5 to $7 trillion per year, with an investment gap in developing countries of about $2.5 trillion annually.[14] The UN forecasts that much of this spending will come from domestic and international development finance institutions.[15]

As an investment partner to a company, a DFI can bring:
- More patient capital, including longer-term loans.
- A higher risk tolerance than other investors, since they're designed to go into countries or markets that other private investors won't.
- Little to no impact on the company's balance sheet.

When a DFI invests in a project, it can help a company in multiple ways, such as:
- Building brand loyalty between suppliers and multinationals.
- Improving the product quality.
- Ensuring a sustainable product quantity.
- Ability to incentivize sustainable practices to meet a company's ambitious sustainability targets.
- Achieving important company business objectives, like increased revenue, decreased costs, improved consumer brand identity, and reduced risk to the supply chain.

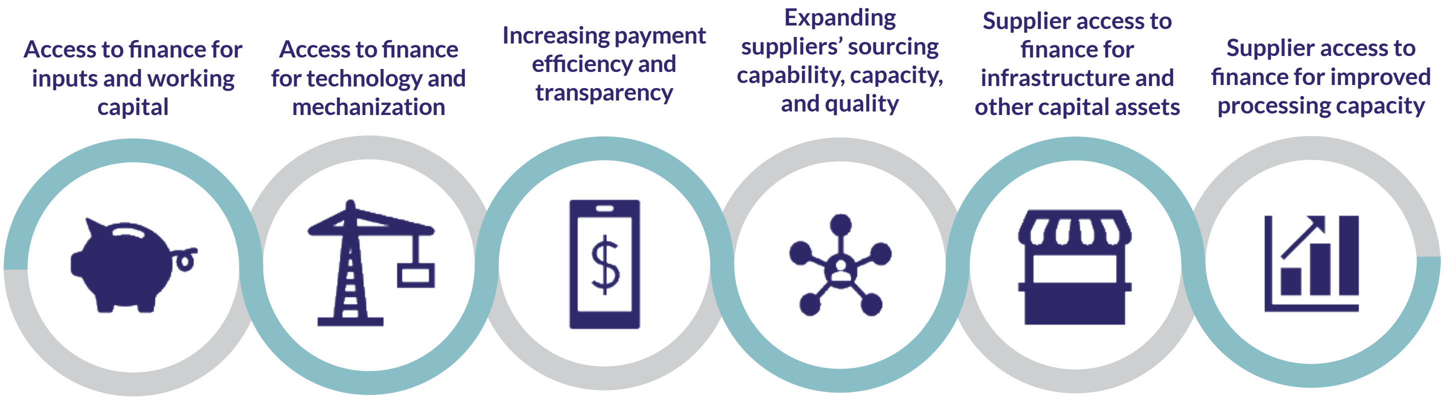
** The Overseas Private Investment Corporation (OPIC) is the United States government's development finance institution. On October 5, 2018, President Trump signed into law the Better Utilization of Investments Leading to Development Act of 2018 (The BUILD Act), which consolidates, modernizes, and reforms both OPIC and USAID's Development Credit Authority to become the U. S. International Development Finance Corporation. The DFC launch is expected in October 2019.*

DEVELOPMENT FINANCE OFFERINGS

DFIs typically use six major financing tools, and sometimes a combination, to support projects, including: 1) direct credit; 2) credit to financial institutions; 3) guarantee and credit enhancement; 4) impact equity and debt; 5) co-funding and matching grants; and 6) technical assistance.

TYPE	BENEFITS
Direct credit Lending directly to project or business	• Enables higher risk appetite • Concessionary terms given risk profile • Crowding in other investment
Credit to financial institutions Lending to bank or non-bank financial institution to enable on-lending	• Targeted credit expansion • Can reduce cost of capital to end beneficiaries
Guarantee and credit enhancement Reducing risk to other investors	• Reduces borrower collateral requirement • Reduces cost of capital • Enhances “bankability” of project
Impact equity and debt Investing through a managed impact fund	• Patient capital • Coupled with technical assistance • Crowding in other investment
Co-funding and matching grants Providing seed or grant funding alongside private capital	• Reduces overall cost and risk profile • Crowding in other investment
Technical assistance Offering transaction support and/or best practice guidance	• Reduces project development costs • Improves performance and sustainability

What Supply Chain Challenges Should You Target for DFI Investment?



THE DEAL-MAKING PROCESS

The process for pitching and closing a deal varies. There is no prescriptive step-by-step guide, but there are critical considerations that a sustainability team needs to consider when pursuing partnership opportunities with a DFI. For instance, most discussions between a company and a DFI begin with a specific project that needs financing.

"Typically, companies come to us. We do not have the capacity to create a project like USAID, which can bid out, fund, and implement," says Alex Hadden, Director, Structured Finance at OPIC. "Usually, when we meet with a company, they've worked on a project for years. They'll have a business plan, a commitment to equity, but will have struggled to fill out the debt financing piece of their capital plan."

"CDC enters into risk sharing agreements by partnering with local African and South Asian or international banks. This allows us to effectively scale our support for trade and supply chain finance across these markets," says Freddie Tucker, Investment Executive, Trade & Supply Chain Finance, at CDC Group. "These banks have access to local markets as well as the expertise to implement operational capabilities and manage supply chain finance programs with the potential to support thousands of local businesses."

How Long Does It Take to Close a Transaction?

How long it takes to close a deal varies. At OPIC, for instance, Hadden doesn't like to work on a transaction unless he can see a path to close in six months. But he admitted it often takes about a year from the pitch to the first disbursement.

WHAT DFIs LOOK FOR IN COMPANY PARTNERS

- **Goal alignment.** Each DFI has its own priorities and mandates that will drive its investment decisions. When evaluating a potential deal, a DFI will want to see how a project aligns with its goals. The DFI also wants to know why it is needed in the market, rather than the institutional or private sector players already in the area. “Multinationals and local corporates operating across Africa and South Asia recognize the multitude of commercial and social benefits that establishing a supplier finance program brings,” says Tucker, CDC. “As a DFI, we focus extensively on development impact. We assess the impact our support and capital have on the wider market, in particular the impact and contribution this brings small and mid-size enterprise suppliers and smaller local distributors.”
- **Understand DFI requirements.** DFIs will have standards that the multinational and recipient of its support must meet. The IFC Global Trade Supplier Finance Program, for example, requires multinationals to be near or at investment grade and to have a social and environmental management system that is in line with IFC’s Performance Standards.
- **Credible country or sector partners.** “The agency can’t give a financing commitment until they’ve lined up their partners. This is as much a character risk issue as a credit one. Finance should be the last thing pulled together,” says Hadden, OPIC. DFIs want companies to have confirmed the interest of potential partners and to know these stakeholders are credible and trustworthy. Most DFIs will want to see a sales agreement or a memorandum of understanding from the company confirming it will be purchasing from the supplier.
- **Impact assessment.** The DFI will look for a complete assessment on the estimated economic, environmental, and social impact a project will have on a country or in a particular market.

“Most people don’t realize that the hardest challenge we (DFIs) have to overcome is finding good deals.”

— Alex Hadden, Director, Structured Finance for OPIC

Many financing institutions today recognize that partnering with companies provides an opportunity to identify prospective investment projects. “Our opportunities are not often with multinationals but with local projects or company partners,” says Hadden. “However, the multinational can make that project bankable. A farmer growing macadamia nuts or mangoes or sugar, those businesses would be risky for us to invest in from a credit perspective. But doing it for Coca-Cola or PepsiCo becomes a whole different story. We know there’s demand.”

HOW TO STRUCTURE
A SUCCESSFUL PARTNERSHIP

- **Identify projects.** Companies need to understand the major challenges in their supply chains so they can develop the right project. Is there an issue with a processing facility? Could it use more efficient equipment? Is the facility facing electricity shortages that disrupt production? Are farmers struggling to deliver a consistent or quality product? If so, why? Are farmers facing draught conditions or irrigation issues? Do they lack reliable transportation? Many companies may not have direct connection to the farmers or suppliers, so it may mean working with a cooperative or aggregate to better understand the challenges on the ground.
- **Select the right local partners.** Finding the right project paired with the right partners is key. "The greatest prospects for success are driven by the quality of your partners," says Hadden. "On a basic level, will they defraud you? Do they have qualifications and skills and capital and management expertise and local context to successfully implement the project? We are more like a partnership institution than a bank, so we're trying to find people to work with overseas that are credible and good, which can be hard to find. The best partners in commercial financings have three to five years of operating history, their businesses are well underway, and they're looking for growth capital. The best greenfield financings have strong underlying contracts."
- **Check internally at the company for current DFI projects or existing partnerships.** Sustainability teams often lead supply chain projects connected to DFIs. But sometimes other departments, like treasury, finance, or procurement and sourcing may already be working with a DFI on a supply chain project.
- **Tell the supply chain about DFI opportunities.** Many suppliers have no idea that investment opportunities exist to expand their operations or to improve efficiencies, the environment, or the labor market. A company can go a long way in jump-starting projects by sending an email, making an announcement, or simply connecting directly with their suppliers to let them know they may qualify for investment assistance.
- **Explore an introductory conversation with a DFI.** Although it is common for a DFI to come in when financing is needed, most will gladly talk with a company at any phase. "We're happy to have introductory conversations with multinationals at any stage in their thinking around implementing a sustainable supply chain finance solution," says Jessica Camilli Bluestein, Associate Operations Officer at IFC.

"For companies considering a supply-chain finance program, our team can be part of the conversation early on. We are able to share our experience in creating successful supply-chain finance programs from both social and financial perspectives so that all participants in the supply chain benefit from this approach."

— Freddie Tucker, Investment Executive, Trade & Supply Chain Finance, at CDC Group

MULTINATIONAL AND DFI
PARTNERSHIP SUCCESS STORIES

SUCCESS STORY: LEVI STRAUSS & CO. AND IFC'S GLOBAL TRADE SUPPLIER FINANCE PROGRAM

CHALLENGE

For Levi Strauss & Co. to meet its sustainability targets, it needed to rely on its suppliers to implement more sustainable business practices. However, the company struggled to incentivize its suppliers to move toward more sustainable sourcing and processing practices.

SOLUTION

Levi Strauss & Co worked with IFC's Global Trade Supplier Finance Program to offer short-term financing to garment suppliers that meet Levi Strauss & Co's sustainability standards. As suppliers improve against the standards, they can access more competitive interest rates. Since many suppliers face gaps in working capital, this model gave them a strong financial incentive to invest in their operations and improve operations.

VALUE

This model allowed Levi Strauss & Co. to help broker access to finance for relatively small companies in its supply chain that have, historically, struggled to access affordable working capital financing. Simultaneously, Levi Strauss & Co. could incentivize these companies to apply and improve sustainable practices.

SUCCESS STORY: NETAFIM, RABOBANK, AND USAID DEVELOPMENT CREDIT AUTHORITY

CHALLENGE

Netafim is a manufacturer of irrigation equipment, which is a proven way to increase a farm's quality, productivity, and water use efficiency, thereby leading to improved economic and environmental conditions. However, in India, small and medium farming enterprises are not able to access competitive financing to cover the high upfront costs, even with the proven benefit stream.

SOLUTION

Netafim's financial unit, Netafim Agricultural Financing Agency (NAFA), worked with USAID Development Credit Authority (DCA) and Rabobank India to offer competitive financing for farmers to lease irrigation equipment from Netafim. The DCA offered a 50 percent first loss guarantee to Rabobank, which enabled them to offer vendor financing through NAFA, which in turn on-lends to farmers. This guarantee means that, in the event of borrower default, USAID would step in and pay back Rabobank up to 50 percent of its investment, which allows Rabobank to lend to a portfolio with higher perceived risk.

VALUE

The guarantee adjusts the risk-return calculations for the other actors involved so that the commercial bank is willing to offer financing at a competitive interest rate for the farmers. This allows more farmers to utilize irrigation equipment, which increases their yields and incomes while reducing water usage.

Companies have the potential to work with development finance institutions and/or local banks to play some form of guarantor role for equipment manufacturers, like Netafim, in order to increase uptake of technologies that can help their suppliers hit increased yield and sustainability goals. Further, when a company has a strong reputation as a reliable anchor buyer, it increases the attractiveness of DFIs to offer guarantees, even without a company's direct financial participation.

SUCCESS STORY: LIVELIHOODS FUND FOR FAMILY FARMING: DANONE, MARS, INTER-AMERICAN DEVELOPMENT BANK, AND AGENCE FRANCAISE DE DEVELOPPEMENT

CHALLENGE

Seventy percent of the world's food is produced by smallholder farmers whose livelihoods are jeopardized by degraded resources and limited market access. Companies like Danone and Mars face increased supply chain risk in terms of quality and quantity—particularly in raw materials that are greatly impacted by environmental, social, and supply issues, such as palm oil, sugar, milk, mint, vanilla, and water. Without dependable farmers with sufficient livelihoods in emerging markets, companies won't have a reliable supply base, acceptable quality produce, farmers able to improve production (as per the companies' growth targets), or licenses to operate.

SOLUTION

Danone and Mars spearheaded the development of the Livelihoods Fund for Family Farming (L3F), a €120 million evergreen fund designed to take a systems approach to supply chain challenges. It invests in large-scale projects that enable farmers to generate higher yields of greater quality through sustainable practices that strengthen the connections between family farmers and business supply chains. The corporate buyers in the fund have committed to purchasing commodities originating from the projects over 10 years.

VALUE

The fund allows its corporate investors (i.e., Danone and Mars) to test and implement large-scale sustainable sourcing projects connected to their own supply chains and to participate as investors and/or off-takers. From the farmers' perspective, they get access to free trainings, support, and equipment to implement sustainable practices and to boost their yields and income.

ENDNOTES

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At Resonance, we believe market-based solutions that address economic, social, and environmental needs are the ones that last. We help companies unlock opportunities in frontier and emerging markets by designing action-based strategies, forging strategic partnerships, and executing across sector boundaries. Since 2005, we have built over 300 partnerships and delivered solutions that enable businesses to achieve their growth objectives while also meeting sustainability goals related to climate change, food security, fair labor practices, and more. Learn more at: www.resonanceglobal.com