USAID
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FINANCING VALUE CHAINS

PRESENTERS:

Geoffrey Chalmers, ACDI/VOCA
Greta Greathouse, Chief of Party, Haiti Integrated Financing for Value Chains and Enterprises (HIFIVE) project
Mark Rostal, Chief of Party on USAID's Financial Inclusion for Rural Microenterprise (FIRM) program, Kenya
Robert Fries, ACDI/VOCA
Joe Dougherty, Cardno
Megan Falvey, Crimson Capital Corp.
Xavier Gine, World Bank
Kate Druschel Griffin, Grameen Foundation
Lena Heron, USAID Bureau of Food Security
Anicca Jansen, USAID Office of Microenterprise Development

Approximate number of participants/attendees: 35

Part 1: Introduction

For value chains to grow and incorporate more of the world's poor, a diverse range of financing needs must be met. From input credit and working capital, to more sophisticated instruments such as leasing and factoring, we have learned that we can lower the risk of providing these products by building on the close inter-relation of value chain actors and understanding the financing needs and cash flow of the entire household. This session provided a brief overview of a model of integrated rural and agricultural finance, and examined three recent country-specific "value chain finance" (VCF) projects (Haiti, Kenya and Honduras) that were built on such an approach. The session emphasized broad strategies for ensuring that finance contributes to overall value chain competitiveness. Participants were engaged through an innovations marketplace breakout session that highlighted five specific "value chain finance" products and services, and explored lessons learned and replication potential.

To provide background on the development of VCF as an analytical method, Anicca Jansen noted that VCF is like Dorothy's realization in the Wizard of Oz that "Everything you need you had all along," i.e. the products we talk about today such as warehouse receipts' finance and factoring have been around for decades if not centuries. We just need to pull them into the value chain framework. The official USAID Microenterprise definition of VCF formerly excluded agriculture explicitly, since agriculture was always very political – loans were forgiven at election year, heavily subsidized, etc. Under the Microenterprise Best Practices project, rural and agriculture finance was essentially ignored. In the book that summarized this project, a chapter on Credit Unions (traditionally in to RAF) had to be commissioned (David Richardson and Barry Lennon). But when AMAP was launched, there was a theme devoted to rural and agriculture finance.

Geoff Chalmers led this research along with Lena Heron in the USAID Agriculture Office. This work converged as value chain finance,[1] which, as Geoff emphasized, focuses on the demand-side approach – firm and household finance needs and uses, not products and providers, drive the demand for financial services. When we look at problems or ways we could improve the VC, many of the issues that often surface have a financial element, either in understanding them or solving them. Seeing the link to the household and enterprise levels helps to visualize the problems, and it also helps identify the most appropriate answers to these problems. Geoff noted, importantly, that there are many shared challenges in this approach at the value chain, enterprise, and household levels, but these often boil down to two issues: cash flow and risk. As the old phase of separating agriculture from finance ended, it has fed into a new phase of various agriculture and rural finance initiatives and frameworks.[2] The panel presentations and marketplace innovations in this session identified project strategies for linking VC and financial sector actors to facilitate investments. They also discussed several innovative initiatives, products, and services in the industry that aim to meet firm and household finance needs.

Part 2: The Tried and True – Panel Presentations from Kenya, Haiti, and Honduras

In the second part of the session, three panelists presented lessons learned in VCF from projects in Kenya, Haiti, and Honduras. Mark Rostal discussed the agriculture finance dilemma and opportunities in Kenya, and lessons learned from the USAID Financial Inclusion for Rural Microenterprises (FIRM) project and the Value Chain Finance Center initiative. Mark concluded that risk aversion is high in Kenya, but so is interest and appetite for advancing agricultural VCF. Financial institutions want numbers – a quantitative approach is necessary to generate interest in agriculture finance. Financial institutions do not have specific strategies in this area, so we have to structure it to make agricultural VCF work. The process often takes up to a year to develop. Further down the VC, microfinance is required and financial institutions are seeing it takes time.

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[1] *The Commercialization of Microfinance: Balancing Business and Development*; Edited by Deborah Drake and Elisabeth Rhyne; 2002

[2] "Rural & Agricultural Finance: Taking Stock of Five Years of Innovation"; Jason Agar, Kadale Consultants; 2011

In the case of Haiti, Greta Greathouse shared lessons learned in rural finance from USAID's Haiti Integrated Financing for Value Chains and Enterprises (HIFIVE) project. The project uses a very broad definition of VCF to facilitate the development of diverse products adapted to rural and agricultural needs. The project focuses on building relationships among local VC participants and financial institutions. On the financial institution side, risk mitigation is a key element that means going beyond simple guarantees to prepare financial institutions – especially small institutions – to manage diverse products. The time horizon for developing and scaling VCF solutions is also much longer than the life cycle of most USAID projects. Scaling up enhances results and encourages other institutions to participate. There is a clear need to encourage other projects to work with same producers groups. In facilitating the development and scaling up of VCF solutions, it is effective to target both large and small financial institutions in Haiti.

In the case of Honduras, Bob Fries discussed lessons on sustainability learned from the Millennium Challenge Corporation-funded Farmer Access to Credit, or Acceso a Crédito para Agricultores (ACA), project. The project objective was to facilitate lending to 5,000 farmers and SMEs engaged in the horticulture value chain. While ACA anticipated most of the finance would come from banks, in reality it was the microfinance institutions (MFIs) that had the majority of borrowers. The most successful partners had a strategic interest, flexibility, and the capacity to manage risk. If it was not important for the success of the financial entity to expand into the agriculture sector, then it would not get very involved. From a sustainability and demand perspective, "build it and they will come" did not happen. Small farmers were entering this financing territory for the first time and wanted to see it worked before taking on debt. They sought debt financing from elsewhere first. In terms of funding, the loan fund mechanism of the project was getting paid to move money out of the trust fund, while ACA was getting paid to increase the number of loans to producers. This delayed an exit strategy.

After the panel, the Q&A session touched on common themes across the three cases. On the role of strategic alliances, Bob noted that where the FIs have a specific market and a specific VC in mind, it can work to facilitate strategic relationships. One of the key questions that emerged was where we are in terms of getting the banks to pay to benefit from an opportunity. In Mark's experience, if banks want the opportunity and see it as profitable, they will pay for it, but they are not there yet with smallholders in Kenya. In Haiti, Greta noted some banks are paying for opportunities, but certainly not unless there a partial guarantee exists from an investor or donor like USAID. Bob emphasized the opportunity costs also matter here – the cost of not going after other opportunities. If the bank would give up more to pursue lending to smallholders, it is not likely to happen.

The panelists also tied their presentations back to a question raised in the keynote address, namely the tradeoff between seeking the highest potential (entrepreneurial) institutions or the highest impact (number of clients) institutions in our VCF approach. Bob noted that these two ends of the spectrum are not necessarily mutually exclusive. In Honduras, Del Campo issued $100 credit cards that were specific to one store. People went for it because it was a novel thing, and they used it at the store and paid it off faster because it was credit. In Haiti, Greta said the high potential entrepreneurial financial opportunity and institutions are not there yet, so the focus is on the smallholder lending impact side. In Kenya, the Ministry of Agriculture emphasizes the need to get lower interest rates and that farmers cannot afford high rates. Mark felt that from his experience they can, you just have to do the analysis.

Part 3: Innovations Marketplace – Breakout Sessions

For the third part of the session there were five presenters at five separate tables. Each presenter provided a brief overview of an innovative financial service and engaged the group in a roundtable discussion or a "marketplace" format. Participants had the opportunity to choose their group, and this was divided into two, half-hour sessions. The five topics were as follows:

1. Index Insurance – Lena Heron, USAID/BFS
2. Leasing – Joe Dougherty, Cardno
3. Purchase Order Financing – Megan Falvey, Crimson Capital
4. Agricultural Commitment Savings – Xavier Gine, World Bank
5. Pathways out of Poverty Approaches to Bringing in the Vulnerable Poor: Kate Druschel Griffin, Grameen Foundation

Several key points emerged from the discussions. Risk is a huge challenge to financial institutions getting into financing agriculture, and farmers also tend to be risk averse. Index-based insurance is one promising solution to this challenge. If you can get a data set that is highly correlated to the crop you're insuring, you can benchmark levels (rainfall, etc) at which insurance indemnities are automatic, which means there are much lower administrative costs and less moral hazard than conventional crop insurance. It's not a sliver bullet, but can be integrated into a wider risk management framework. It can facilitate household risk reduction, supplement household risk reserves (i.e. savings), strengthen informal coping mechanisms, be built into working capital loans, and ease pressure on public recovery mechanisms. Challenges to index-based insurance include data availability and reliability; weak capacity of local institutions to design these complicated contracts; and the need for adequate outreach and education so that people understand the insurance contracts—managing expectations.

With the innovation of leasing, the Zambia PROFIT project piloted leasing of tractors to farmers from Dunavant in Zambia, and helped Dunavant create a packaged portfolio of leases to auction to banks. The leasing innovation worked because the project identified problem first, sought other solutions in the VC, and finance came in as part of the solution. PROFIT did not provide subgrants or other funds to make the innovation work, rather they figured out who had the incentive to provide leasing and facilitated the product development to bring to market.

Purchase Order Financing (POF) is a transaction-based (rather than collateral driven) form of working capital that provides finance to the SME at the production phase, enabling it to fill larger, more frequent orders. POF is accessible because it does not require that the SME borrower pledge real estate collateral or provide audited financial statements (which most SMEs do not have). POF can and has been successfully applied in a wide variety of jurisdictions/environments (does not require a sophisticated legal-regulatory framework) and at different levels of economic development. It is market-based and sustainable with the proper accompanying technical assistance at the design/set up stage. POF also uses existing relationships in the value chain and provides benefits to all actors in the value chain.

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