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Meeting the Challenges of Value Chain Development

A Learning Event

Financing Value Chains

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Rural and Agricultural Finance: An Integrated Framework Overview

Geoff Chalmers, ACDI/VOCA

A demand-side approach ...

... focuses on firm and household finance needs and uses, not products and providers

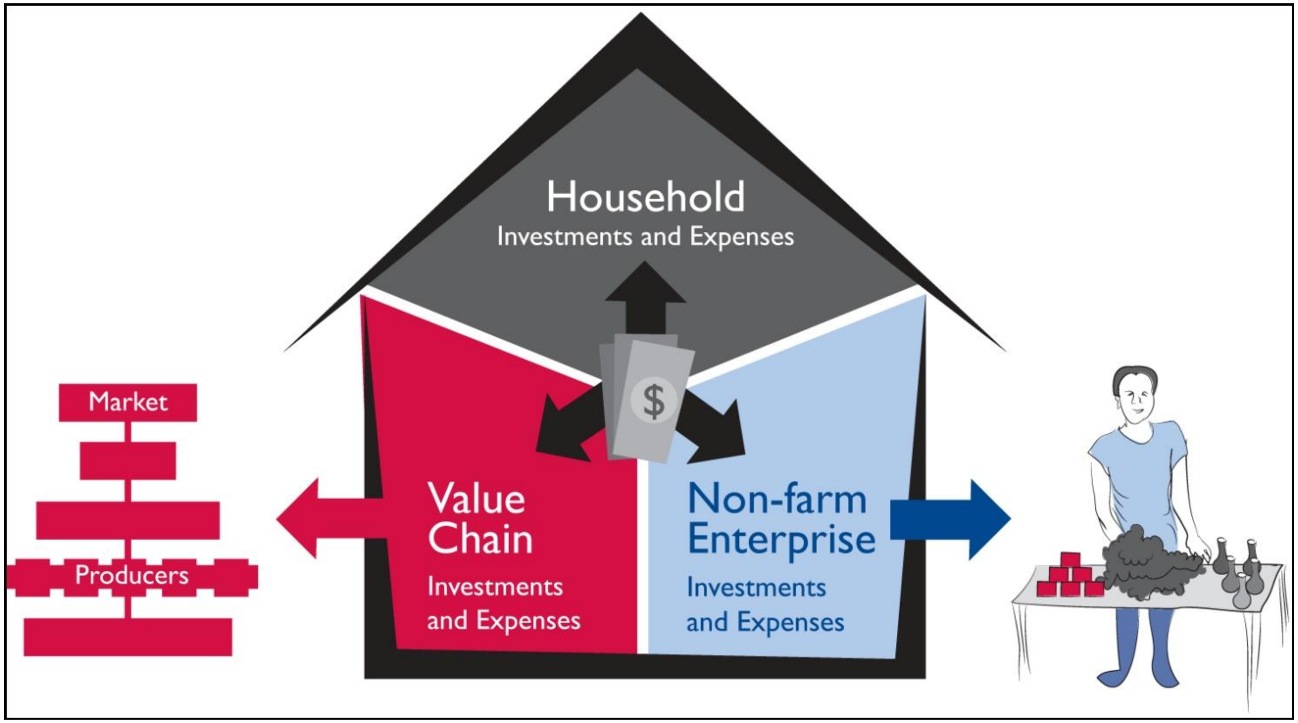
1. Agricultural Value-Chain Finance
2. ‘Non-farm’ Enterprise Finance
3. Non-enterprise Household Finance
4. Enabling environment: macro- & meso-, legislation/ regulation, hard/soft infrastructure

Source: “Rural & Agricultural Finance: Taking Stock of Five Years of Innovation” by Jason Agar, Kadale Consultants

Many shared challenges at value chain, enterprise & household levels

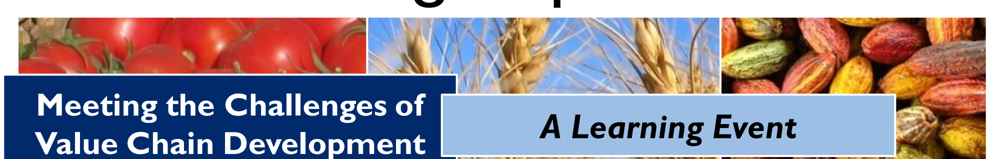
- Rural enterprises and households face common challenges – remote, dispersed population, poor infrastructure
- Seasonality a significant factor, especially where agriculture is rainfed
- FI perception of rural risk is high and generalized
- Products, services evolved from urban
- Unequal access based on size and level of connectedness
- But it’s changing… commercial <u>motivation,</u> technological means, increased <u>collaboration</u>

Integrated model of rural/ag finance



VC Finance: Challenges from a demand-side perspective

1. Side-selling a disruption for agricultural value chains
2. Enterprises & households face production, price & market risks
3. Fixed asset finance hard to obtain
4. Farmers lose value through forced early sale
5. Poorer farmers continue to be excluded
6. Power relationship between producers and buyers can be exploitative
7. Working capital and cashflow very weak

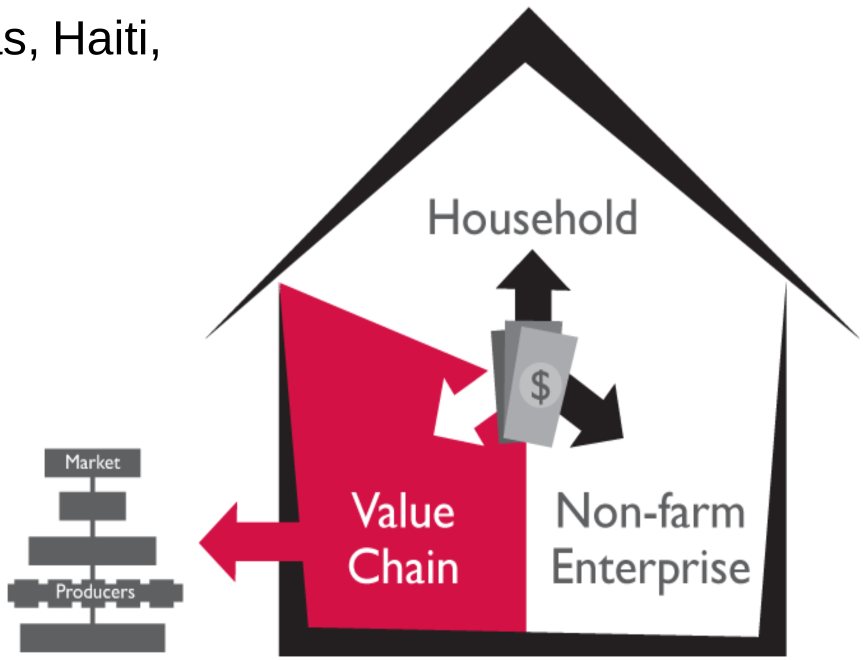


Our agenda: Long-term strategies and lessons, illustrative innovations

Part 1: Project strategies for linking VC, financial sector actors to facilitate investments. Lessons from Honduras, Haiti, Kenya

Part 2: Marketplace of innovative initiatives, products, services:

- Leasing and micro-leasing
- Ag commitment savings
- Purchase order financing
- Index based insurance
- Sequencing of savings interventions for vulnerable poor



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Agriculture Value Chain Finance in Kenya: Trends and New Approaches

Mark Rostal, DAI

Introduction

1. The Agriculture Finance Dilemma
2. The Agriculture Finance Opportunity
3. USAID FIRM: Focus & Approach
4. Value Chain Finance Overview
5. Dairy Example
6. The Value Chain Finance Center
7. Lessons Learned
8. Feed the Future's Future

The Agriculture Finance Dilemma

- Troubling realities
  - Unsustainable population growth
  - Tremendous resource pressure
  - Rapid urbanization
  - High rates of inflation
- Agriculture uncertainty
  - Political interference
  - High interest rates and debt service capacity
- Result: flight to perceived "safety"
  - Pouring into local treasuries
  - Buying and developing real estate

The Agriculture Finance Opportunity

- FI profitability and liquidity
- Pressure for FIs to diversify risk
- Political realities and national priorities
- Demystify and de-risk agriculture finance

USAID FIRM: Focus & Approach

- FIRM (January 1, 2011 – 2015), $18 million
- Six thematic FS areas: agriculture, ICT, clean renewable energy, gender/youth, DCA loan guarantees and policy
- Centered upon partnership and facilitation
- Opportunistic and transaction driven (numbers)

Value Chain Finance Overview

Demystify agriculture finance by augmenting traditional value chain analysis with a quantitative, numerical, understanding of individuals/businesses in the chain and their relationships.

Understand the relationships of buyers and sellers:

- How each actor maximizes profit
- How a financial institution locks in credit recovery
- How a financial institution minimizes risk
- How finance increases productivity, efficiency and growth
- How value chain financing improves development

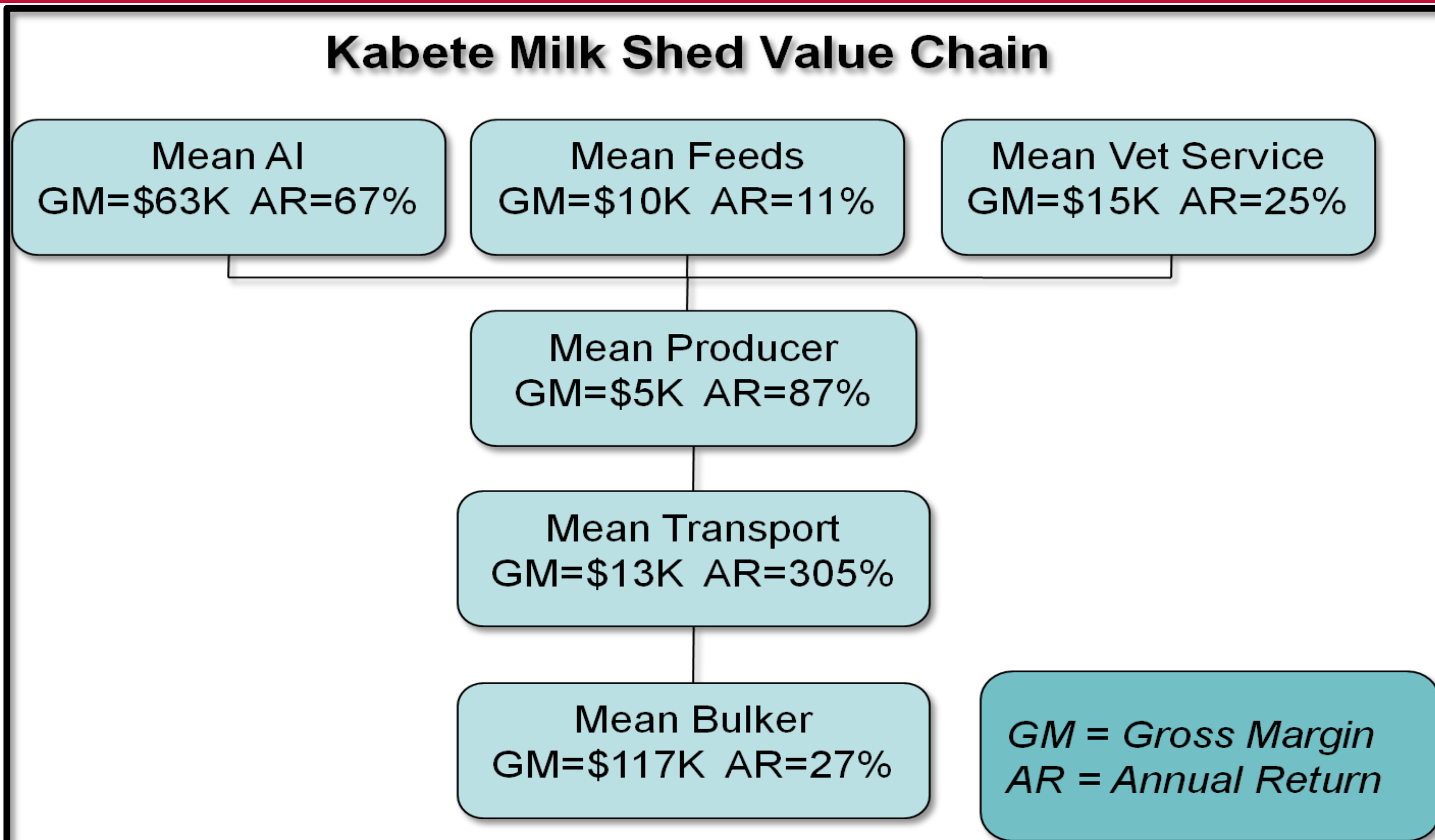
Approach:

- Quantify revenue and costs; determine value add; measure timing of financial flows
- Identify risks; create customized financial solutions; partner with financial institutions and others

Dairy Example

Location→ Category↓	Kabete	Nyeri	Nakuru	Eldoret	Totals
AI Providers	16	18	14	11	59
Vet Services	22	22	26	4	74
Feed Supply	15	14	20	5	54
Producers	48	52	77	45	222
Bulkers	16	19	21	6	84
Transporters	16	17	20	8	61
Totals	133	142	178	79	532

Dairy Example



Dairy Example

- Many producers are highly profitable and capable of demanding and paying for services (financial services included).
- Milk transporters – from small bicycle traders to large truck operators – compete minimally and range from adequately profitable to extremely profitable. Small and large transporters are capable of supporting financial services.
- Veterinarians and AI service providers are, in general, not adequately profitable to support financing. However, many of these businesses cross-sell both services and, by doing so, are adequately profitable to support financial services.
- Feed dealers receive stock through supplier credit. Dealers, however, earn low margins on dairy feed and are not incentivized to increase feed supply versus working with other high-turnover, high-margin products (poultry meal, pesticides, etc.).
- Bulking operations range from loss-making ventures (predominately cooperative and self-help structured businesses) to moderately profitable ventures (primarily small private businesses) to a few extremely profitable larger private businesses (vertically integrated from milk production to processing and marketing). Only the last category is adequately profitable to effectively support financing.
- All dairy value chain actors suffer from poor access to cash and limited rural outreach of savings and credit services. There are also very few financial product offerings customized to meet the needs of their businesses.

Dairy Example

Product↓ Milk Shed→	Kabete	Nyeri	Nakuru	Eldoret
Savings-cum-Credit for Herd Improvement	Immediately Relevant	Immediately Relevant	Immediately Relevant	Immediately Relevant
Structured Savings for Income Smoothing	Immediately Relevant	Immediately Relevant	Immediately Relevant	Immediately Relevant
Structured Inputs Savings	Immediately Relevant	Not Relevant	Immediately Relevant	Relevant with Development Partner Assistance
Vehicle Leasing	Immediately Relevant for Transporters and Veterinarians	Immediately Relevant for Transporters and Veterinarians	Not Relevant	Not Relevant
Micro Leasing	Immediately Relevant for Bulkers	Immediately Relevant for Bulkers	Relevant After Bulker Technical Improvement	Relevant After Bulker Technical Improvement
Inventory Credit for Feed Supply	Relevant with Development Partner Assistance	Relevant with Development Partner Assistance	Relevant with Development Partner Assistance	Relevant with Development Partner Assistance
Traditional Micro Finance Lending	Immediately Relevant for AI and Milk Traders	Immediately Relevant for AI and Milk Traders	Immediately Relevant for AI and Milk Traders	Immediately Relevant for AI and Milk Traders
Structured Trade Lending	Immediately Relevant	Immediately Relevant	Immediately Relevant	Immediately Relevant
Cash Transfer Services	Not Relevant	Immediately Relevant	Immediately Relevant	Immediately Relevant

The Value Chain Finance Center

- Joint venture with FSD Kenya
- Their contribution: $5 million
- USAID contribution: TA and consulting
- Produce and disseminate high-quality VC research leading to improved financial inclusion and increased access

Lessons Learned

- Risk aversion is high but so is interest and appetite
  - Old school legacy vs. new school
  - Relationships and trust in Africa
- FIs only want the quantitative, numerical approach
  - The traditional subsector, BDS reports/analysis don’t work, don’t generate excitement
- Most, if not all, FIs are not structured to win in agriculture finance
  - Lacking strategy, structure, systems & skills
  - Partnerships are unproductive without that first, and are full of unwelcome surprises
  - Their money first or OPM first?

Lessons Learned

- At the lower end of the value chain, a MF approach is required and convincing large FIs takes time
  - Bankers wearing suits on motorcycles?
- Demonstration and spillover is important
  - Where Kenya Commercial Bank goes, others follow
- Requests for DCA loan guarantees are growing in demand
  - USAID Kenya has three current facilities in agriculture with KCB, Fina Bank & Lesiolo Grain Handlers and the queue for this year and beyond is long and growing
  - We are limited by subsidy or the ‘insurance premium’ although the government of Kenya has a vision

Feed the Future's Future

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Finance for Haiti's Rural Population and Value Chains

Greta K. Greathouse, USAID HIFIVE

Haiti and HIFIVE

Haitian context

- Haitian agriculture has been in decline for 25 years
  - Increased impoverishment in rural zones and food insecurity
  - Import dependency
  - Agricultural sector = 24% of GDP; 60% of employment
- Agricultural lending: less than 1% of commercial bank lending; 5% of MFI lending

HIFIVE

- Objectives target improved availability of financial products and services that serve the needs of Haiti’s rural populations and value chain participants
- HIFIVE’s grant fund, Haitian Catalyst Fund, is main tool for achieving objectives

Strategy

Create enough solutions to have an impact

1. Local solutions to support expanded local production
2. Increase chances of success via risk mitigation for FIs
3. Enlist enough committed FIs to reach a critical mass
4. Use a very broad definition of value chain finance
5. Development of diverse products adapted to rural and agricultural needs: both basic and more sophisticated

HIFIVE Methodology

Local solutions

- Contributes to strategic buy-in
- Local FIs know their market best: the value chains they would be most comfortable with/ types of risk they are most willing to take
- Recognize local product niches
- Use of local consultants
- Building relationships with local VC participants

HIFIVE Methodology

Risk mitigation

- Better prepared FIs with improved technical capacity
- Products adapted to key VC needs
- DCA guarantees for some MFIs
- Credit programs on ag lending
- Targeted BDS services to key VC actors to improve bankability

HIFIVE Methodology

Reaching critical mass

- Target both large and small institutions
- Seek strategic buy-in to expanding broadly defined agricultural/value chain finance
- Use successful pilot programs to generate more success:
  - They will become models for replication by other FIs
  - FI may add additional products/additional value chains
  - Give them additional support for scaling up

- Identify FI's needs
  - Liquidity
  - Technical; product design
  - Risk mitigation

HIFIVE Methodology

A broad definition of value chain finance

- Positive impact on risk mitigation
- Start in FI's comfort zone and let success expand it
- Both simple and complex solutions are needed
- Overlaps between people's farm and non-farm activities, financial needs

HIFIVE Methodology

FI collaboration with local VC participants/ groups

- FI provides financial literacy training to producer groups
- Producer group provides training for credit recipients
- Producer group participation in recommending participants for pilot program (subject to FI approval)
- Input into credit product design
- Producer groups as credit recipients

FECANNO Triples Exports

FECCANO: Federation of 6 cocoa growers associations, 1800 members, formed to help growers export directly to Europe.

KOFIP: Financial institution focusing on rural poor

SEFADES: Technical assistance partner

- Seasonal loans to growers association members
- Working capital loans to women members to support marketing and transformation activities

CODECRAM: Mangos Lead to Beans

CODECREM: Small caisse with interest in ag lending to help poor rural producers

- Production cycle credit for mangos, 2010
- Production cycle credit for beans, 2011

Both VC solutions feature

- Collaboration with producers' associations
- Training for associations' members

2 other caisses with mango programs

Lessons Learned

It's do-able.

- More lessons learned
  - Takes longer than the life cycle of many USAID projects
  - Strategic buy-in of FIs is critical to success
  - Scaling up of successful pilots will enhance results
  - More work to improve quality of growers' associations/producers' cooperatives is needed

Lessons Learned

- More Lessons Learned
  - Highly variable levels of organization, capacity and structure among value chains will impact results
  - Training for credit recipients greatly increases impact: financial literacy training, ag technical capacity; BDS
  - ICT capacity of FI's must be up to challenge of adding new products and tracking loan performance
  - Every success helps to reduce risk perception strategy
  - Targeting both large and small institutions is successful

Visit Haiti!






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Farmer Access to Credit
Honduras

Bob Fries, ACDI/VOCA

Basic Facts

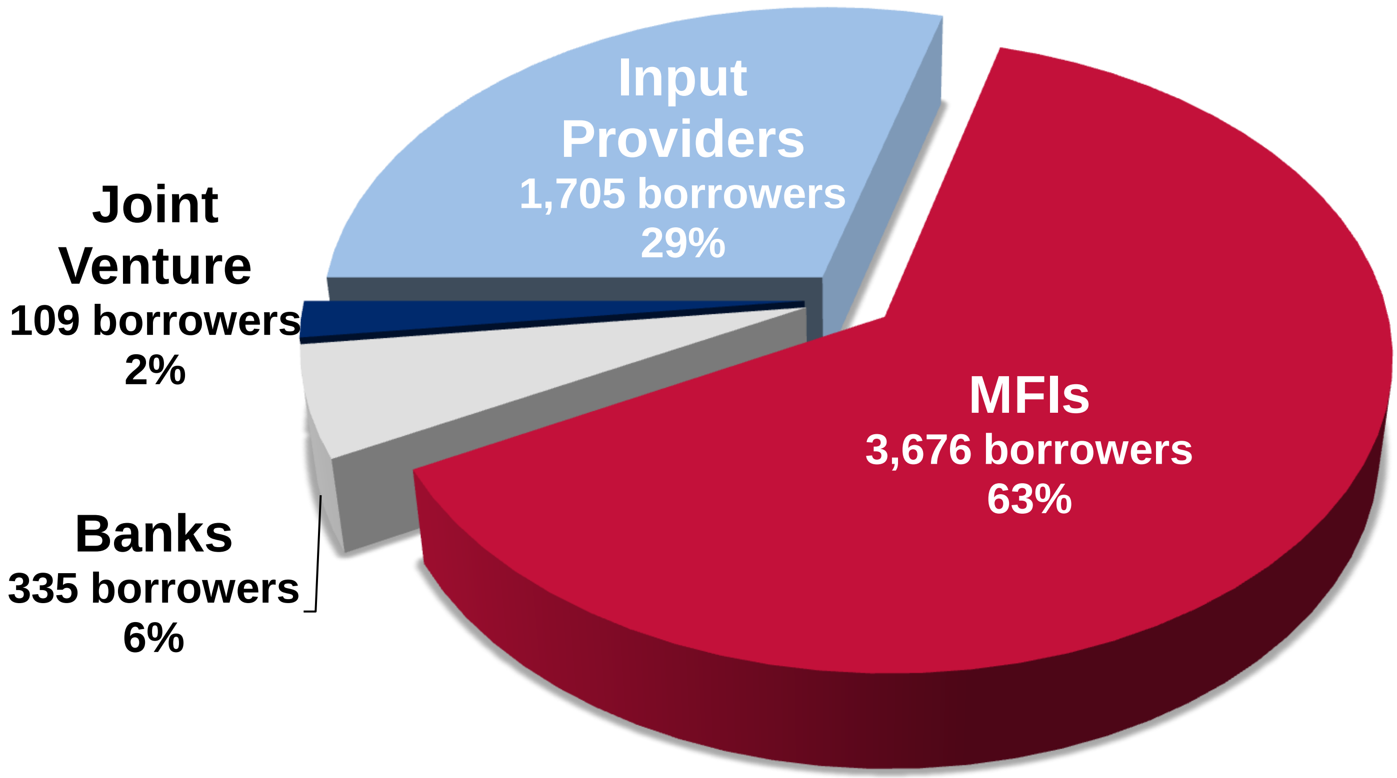
Funder: MCA - HONDURAS
REDUCING POVERTY THROUGH GROWTH
MILLENNIUM CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Timing: May 2007 to August 2010

Objective: Facilitate lending to 5,000 farmers and SMEs engaged in the horticulture value chain

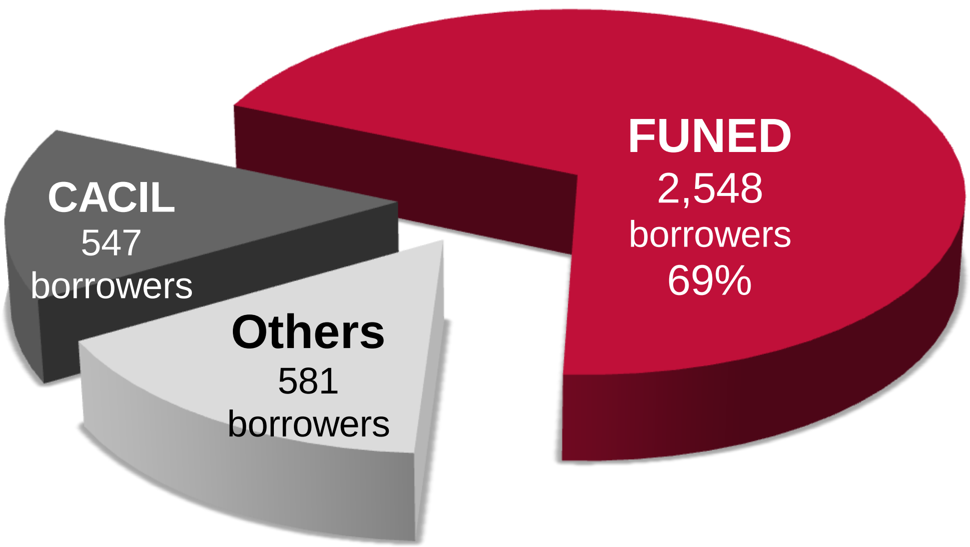
Anticipated lenders: Banks, MFIs, Buyers, Input providers, in descending order

How well did we predict?

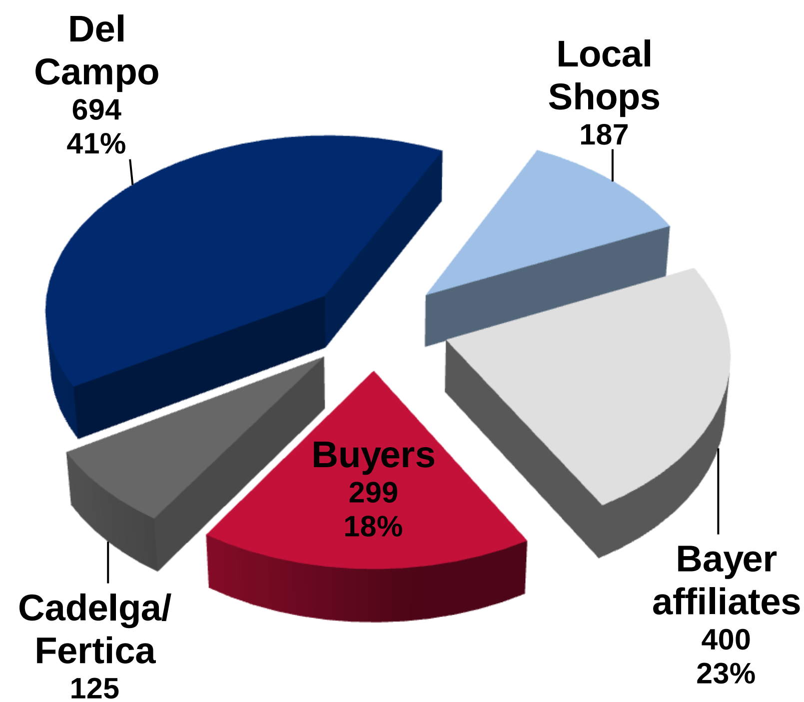


Leaders Drove the Numbers

MFIs



Agribusiness

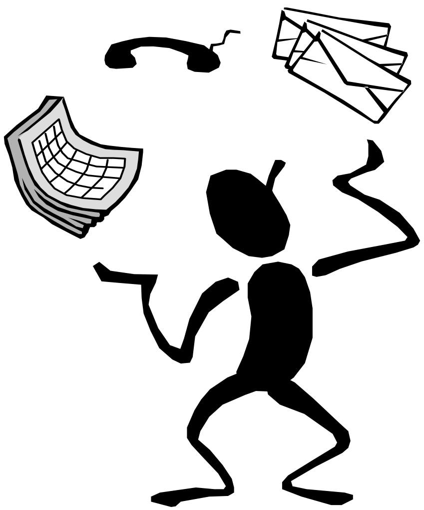


Leaders' Prerequisites

- **Strategic interest**
  - In expanding finance to small farmers
  - Fundamentally important to their business

- **Tactical flexibility**
  - Sustained willingness to change the way they do business

- **Capacity**
  - Manage risk
  - Administer a profitable loan portfolio
  - Maintain a sustainable service



Tools for Managing Risk

Understand and analyze

Market realities, opportunities, and sensitivities

TA to producers

Strategic Alliances

Be careful

Loan product design

Improving Portfolio Management

- Product prototypes and market-based rollout
- Effective structures and staff capacity
- Bookkeeping basics
  - Policies, practices, software
    - – Local input providers face special administrative challenges and incentives

Lessons on Sustainability

- Demand
  - Build it and they might not come
- Funding
  - Trust fund design and impact
- Demonstration Effects
  - FUNED vs. Del Campo experience
- Input Supply System
  - Strengths and limits

Lessons on Sustainability

Demand: Build it and they might not come

- Conceptual fit between hort, small farmers and credit
  - High cost, high return, small plots
  - But….
- Very small farmers borrow later
  - Test with other sources of funds
  - Collateral mismatch for those with titles
  - Importance of cash flow, plans for multiple funding and revenue sources, and access to small amounts of credit

Lessons on Sustainability

Funding – Lessons from the Trust Fund

- **Design Elements**
  - Short terms
  - Ambiguous windup of fund
  - Incentives tied
    to loan volumes

- **Impact on**
  - Reaching small farmers
  - Delaying exit strategies

Lessons on Sustainability

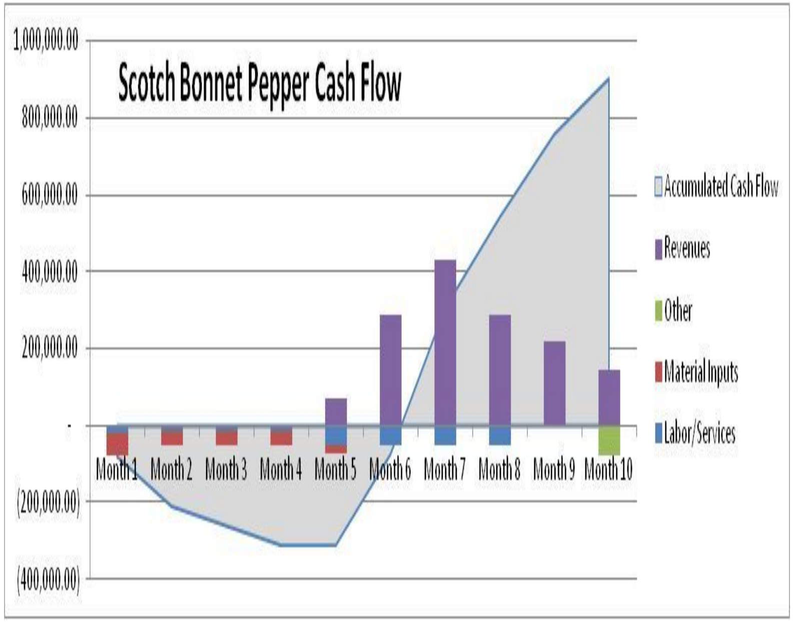
- Within an MFI

Goal: Diversify Market

\+ New financial products

<u>+ Cash Flow Analysis tool</u>

Significant growth in agricultural lending



Lessons on Sustainability

- For Input Supplier

  Goal: Expand Market and Sales

  \+ New financial products

  \+ New management elements

  - Increased and improved portfolio
  - New market position
  - New relationships between distributors and retailers
  - Replication by competitors

DelCampo
Soluciones Agrícolas

- Strength and Limit of an Input Supply Credit System:
  – The local knowledge held by the local dealer

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www.microlinks.kdid.org/vcwiki