

The background of the book cover is a collage. On the left, there is a large, stylized, golden-brown graphic of a plant or tree branch. In the center, there is a photograph of two men in a rural setting. One man, wearing a turban and a grey jacket, is crouching and working with a large bowl of small, round, light-colored objects (possibly potatoes or onions). The other man, wearing a light blue shirt and dark pants, is standing and looking towards the right. In the background, there is a small, white, single-story building with a sign that reads "KARAFIN".

AGRICULTURAL VALUE CHAIN FINANCE

Tools and Lessons

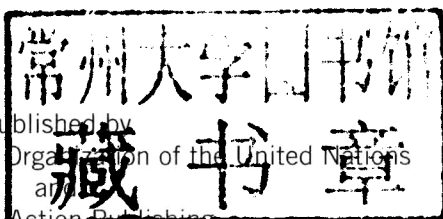
Calvin Miller
and Linda Jones

Agricultural Value Chain Finance

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Linda Jones

Published by
The Food and Agriculture Organization of the United Nations
and
Practical Action Publishing
2010



PRACTICAL ACTION
Publishing



Practical Action Publishing Ltd
Schumacher Centre for Technology and Development
Bourton on Dunsmore, Rugby,
Warwickshire, CV23 9QZ, UK
www.practicalactionpublishing.org

© FAO, 2010

ISBN 978 1 85339 702 8
FAO ISBN 978 925 106277 7

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A catalogue record for this book is available from the British Library.

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Cover photo: Potato conveyor belt © FAO/Olivier Thuillier, and authors' own photos

Cover design by Practical Action Publishing

Indexed by Andrea Palmer

Typeset by S.J.I. Services, New Delhi

Printed by Hobbs the Printers Ltd, Totton, Hampshire

Agricultural Value Chain Finance

Praise for this book...

‘This book makes a useful contribution to the rapidly expanding literature on value chains by clarifying the myriad methods, some old, some new, used to finance actors in agricultural value chains.’

Richard L. Meyer, Professor Emeritus, Ohio State University

‘I recommend the publication to be read by all stakeholders in the agriculture sector.’

*N.V. Ramana, former CEO, BASIX, India and Chairman,
Indian Society of Agribusiness Professionals, India*

‘This is a “must read” for anyone interested in value chain finance. The authors have moved forward our understanding by presenting a conceptual framework, supported by an extensive use of case studies, which makes this book indispensable for those involved in financing as well as policy makers.’

Kenneth Shwedel, Agricultural Economist

‘An insightful and complete analysis of agricultural value chain financing. An essential reference for anyone interested in improving access to agricultural credit in developing countries.’

Mark D. Wenner, Inter-American Development Bank

About the authors

Calvin Miller is an agricultural economist, with a specialization in rural finance. He is Senior Officer and leader of the Agribusiness and Finance Group in the Food and Agriculture Organization of the UN. During his career he has worked in agriculture and financial development in more than 50 countries, with 15 years of global experience in technical assistance, project management and research in rural and agricultural development finance and marketing. He gained direct field experience working for 16 years in Latin America in agricultural and rural finance, agricultural value chain development and agro-enterprise development.

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Acknowledgements

The concept of Value Chain Finance is broad, and the term is used to describe varying aspects of the approach and its supporting tools. Therefore, a nuanced understanding of value chain finance is best derived from the learning of many who are experts in one or multiple aspects of financing the value chain. This volume brings together the experience of many such experts.

This collection is built upon the expertise and contributions of a multitude of persons and their institutions and businesses. It is not always feasible to provide footnotes and references to all these people and their presentations, papers, discussions and other contributions. The presentations and papers can be accessed on the Rural Finance Learning Centre (RFLC) at www.ruralfinance.org/id/48273 and publications at www.ruralfinance.org/id/1813. The authors appreciate this valuable information and the rich insights, which can now be shared with a wider audience. The volume also draws from two articles by one of the authors published in the *Enterprise Development and Microfinance* journal, Vol. 13, Nos. 2 and 3 and Vol. 19, No. 4.

The authors are extremely grateful for the input of nearly 90 papers and/or presentations made by experts and practitioners in this field from around the world. In particular, the authors would like to acknowledge the persons who made valuable written contributions through publications or summary documents from international conferences organized by the FAO on this topic. These include: Rodolfo Quirós and Claudio Gonzalez-Vega in Latin America, Yogesh Ghore in Asia, Mumbi Kimathi and Jonathan Campaigne in Africa, Larry Digal in Southeast Asia and Michael Winn in Eastern Europe. The case studies in the text have been graciously drafted by Grace Ruto, Farm Concern; Jonathan Campaigne, DrumNet; Kalyan Chakravarthy and Raju Poosapati, YES Bank; Enrique Zamorra, LAFISE; and Emmanuelle LeCourtois and Åke Olofsson, FAO.

In addition the authors would like to note the insightful contributions made by Richard Meyer, Anita Campion and Mark Wenner in providing their expert review comments.

Finally, strong recognition is given to the FAO for its support for the international conferences on the topic and allocation of the time and resources needed for developing this volume. Special thanks also goes to the colleagues in the FAO who contributed research and review to the publication, including Doyle Baker, Prasun Das, Eva Gálvez-Nogales, Ivana Gegenbauer, Martin Hilmi, Maria Pagura, Carlos da Silva, Andrew Shepherd, and Tigist Woldetsadik.

Preface

This volume provides a global review of experiences and learning on the broad subject of value chain finance for agriculture in developing countries. Value chains in agriculture comprise a set of actors who conduct a linked sequence of value-adding activities involved in bringing a product from its raw material stage to the final consumer. Value chain finance, as described in this volume, refers to the financial flows to those actors from both within the value chain and financial flows to those actors from the outside as a result of their being linked within a value chain.

The purpose of this book is to provide an understanding of the emerging field of agricultural value chain finance. Key questions include:

- What is value chain finance, how is it applied and what can it offer to strengthen agricultural development?
- How can financial systems, governments and services be prepared for the demands of financing modern agri-food chains?
- How does agricultural value chain financing affect inclusion, especially for small producers and what can be done to make these systems more inclusive?
- What can governmental and non-governmental (NGO) agencies do to support increased and more effective agricultural financing through value chains?

These issues are addressed through examination of a wide array of experiences and illustrations of large and small organizations from around the world that are participating in or linked to agricultural value chain financing. The central concern of the volume is not to take a stand on the virtues and weaknesses of value chain finance, but rather to describe how the various types of value chains are being used to strengthen and extend financial products and services to the agricultural sector. Many of the value chain finance instruments and processes are not new; however, what is new and noteworthy is the extent to which value chain finance is being utilized by financial institutions, agribusinesses and farmers. Noteworthy are the variations across applications, the range of organizations that are facilitating value chain finance in innovative ways, the emergence of integrated value chains as a widespread global model, and the increasing diversification, intensification and combination of financial mechanisms. Quite often, tools and models of value chain finance that were first developed by larger agribusinesses are now being adapted to include small farmers and small-to-medium scale agribusinesses. Therefore, the cases and learning collected here do not have a specific small-farmer emphasis although

there is increasing application of value chain finance mechanisms for the benefit of smallholders, as illustrated in many of the examples.

The volume represents the extensive experience of many organizations, with the learning presented through case studies and descriptive analysis, followed by lessons learned and recommendations. The information is primarily drawn from a rich collection of documents, presentations and discussions that took place at international conferences on the subject that were organized by the FAO in Latin America, Africa, South Asia and Southeast Asia during 2006 and 2007, and research work in Eastern Europe and Central Asia in 2008. These conferences were organized in partnership with regional organizations on each continent. The information is augmented by learning from the research and case examples of multiple organizations who are working in this field.

The objective of the conferences was to learn more about practical experiences and approaches to value chain finance across countries. The conferences enabled a diverse set of participants to share and obtain information on best practices with the goal of increasing the supply and efficiency of financial services for rural producers, marketers and processors. Businesses active in the agricultural sector (including producers, processors, marketers and exporters) met together with leaders from financial institutions, technical assistance providers and policymakers to discuss this subject. Each region and country brought forth specific issues related to agricultural value chain finance, and these are noted in this volume. Overall, however, the concept and application of agricultural value chain finance has been shown to be consistent across regions.

An important part of each of the conference discussions was to analyse relevant policy issues: policy constraints, ways to improve policies, how to best perform in environments which lack desired policies for financing in the sector, and so on. These policy issues were reviewed from the distinctive perspectives of the many and varied types of stakeholders within a value chain, including those who provide the financing, investment and regulation.

We hope that this volume will serve as a practical primer on value chain finance for business and financial leaders, policymakers and practitioners, extension agents, universities and training institutes. We have strived to offer a rich learning opportunity by collecting, consolidating and presenting an array of relevant experiences from around the world.

Contents

Boxes	vii
Figures	ix
Tables	x
About the authors	xi
Acknowledgments	xiii
Preface	xv
1. Introduction	1
Defining value chain finance	2
Why is there interest in value chain finance in agriculture?	3
Overview of content	3
2. Understanding agricultural value chain finance	5
Context	5
The concept of agricultural value chain finance	8
Agricultural value chain finance as an approach	14
Enabling environment	17
<i>Standards and certification</i>	19
<i>Regulation and enforcement</i>	20
<i>Macro-economic and social context</i>	21
Value chains and diversified livelihoods	23
3. Value chain business models	27
Producer-driven value chain models	29
Buyer-driven value chain models	30
Facilitated value chain models	36
Integrated value chain models	40
Case Study 1. Farm Concern International: commercial village approach	45
4. Agricultural value chain finance instruments	55
Product overview	55
Product financing	55
<i>Trader credit</i>	58
<i>Input supplier credit</i>	60
<i>Marketing company credit</i>	62
<i>Lead firm financing</i>	64
Receivables financing	67
<i>Trade receivables finance</i>	67
<i>Factoring and forfaiting</i>	69

Physical asset collateralization	72
<i>Warehouse receipts</i>	72
<i>Repurchase agreements (repos)</i>	82
<i>Financial lease</i>	83
Risk mitigation products	84
<i>Crop/weather insurance</i>	84
<i>Forward contracting</i>	85
<i>Futures</i>	87
Financial enhancements	89
<i>Securitization</i>	89
<i>Loan guarantees</i>	90
<i>Joint ventures</i>	93
Bringing it together	95
Case Study 2. Producer-driven financing of farm inputs: Niger	
informal inventory credit	100
Case Study 3. LAFISE Group: integrated financial instruments	
and value chain services	108
5. Innovations	115
Value chain innovations	115
Financial innovations	117
Technological innovations	120
<i>Management systems</i>	120
<i>Networks and exchanges</i>	121
<i>Mobile phones and mobile banking</i>	122
Infrastructural innovations	123
Policy and public sector innovations	124
Case Study 4. DrumNet and technological innovations	126
Case Study 5. Integrated agro food parks: avenues for	
sustainable agricultural development in India	137
6. Lessons learned and summary recommendations	147
Lessons learned	147
Summary of recommendations	153
<i>Recommendations regarding financial institutions</i>	154
<i>Recommendations regarding value chain stakeholders</i>	155
<i>Recommendations regarding policymakers</i>	157
List of conferences	159
References	161
Index	167

Boxes

2.1	Value chain definitions	11
2.2	Flower chain financing, Mexico	14
2.3	Five C's of lending applied to value chain financing	17
2.4	Financial flows within the rice industry	23
3.1	Cacao producer association, Peru	29
3.2	Buyer relationship credit-worthiness, Costa Rica	31
3.3	Formal contract agriculture, Philippines	34
3.4	Failure of contract farming in tomato production in Brazil	35
3.5	Success factors for contract farming	36
3.6	Facilitating chain development in Malawi and Tanzania	38
3.7	Facilitating artichoke chain development and finance in Peru	40
3.8	BRAC integrated services model for agriculture, Bangladesh	42
3.9	National Agricultural Cooperative Federation, Korea	44
4.1	Small-scale farmer capacity and competitiveness, Kenya	58
4.2	Trader finance in Latin America	59
4.3	Input supply credit, Myanmar	61
4.4	Input supplier credit, Bangladesh	62
4.5	Processor finance for agave farmers, Mexico	63
4.6	Marketing company finance, Costa Rica	64
4.7	Lead firm finance and assistance in Central America	65
4.8	Factoring in Serbia	70
4.9	Formal agri-fishery warehouse receipts, Philippines	75
4.10	Informal warehouse receipts, Tanzania	76
4.11	Field warehousing, India	77
4.12	Publicly controlled warehouses, Philippines	78
4.13	Agricultural warehouse receipts in the wider system, India	78
4.14	ACE and global risk mitigation	80

4.15	Warehouse receipt challenges and solutions, India	82
4.16	Warehousing livestock, Mexico	82
4.17	Using futures in price risk management, MCX, India	88
4.18	Livestock securitization, BNA, Colombia	90
4.19	Public-private contract farming, Thailand	93
5.1	Kisan credit cards, India	120
5.2	Integrated information management, BASIX, India	121
5.3	Electronic network for fruit and vegetable trade, India	121
5.4	E-choupal information centres, India	122
5.5	Transportation innovation in the Philippines	123
5.6	Value chain approach to agricultural services, Costa Rica	124
5.7	Agri-export zones in India	125
5.8	Warehousing of nomadic farmers' honey in northern India	140

Figures

2.1	Product and financial flows within the value chain	10
2.2	Interlinked cereal lending	12
2.3	BASIX livelihood services model	24
3.1	Different ways to coordinate and structure the value chain	27
3.2	Artichoke value chain	41
3.3	Rabobank integrated agriculture finance structure	43
3.4	Commercial village approach for African traditional vegetables	47
3.5	Market access financial service flowchart	50
4.1	Pre-export receivables finance basic scheme	68
4.2	Pre-export receivables finance scheme	69
4.3	HDFC Bank warehouse system	73
4.4	SACCO Cooperative warehouse storage	76
4.5	Brazil rural finance note finance	86
4.6	Para-finance guarantees in Mexico	91
4.7	Financing with future receivables	92
4.8	Value chain financing: shrimp industry model	94
4.9	Capturing the agri-food value chain	95
4.10	Poverty production cycle	101
4.11	Inventory credit flow chart	106
4.12	Traditional cost structure in Nicaragua	109
4.13	LAFISE Group partner model of intervention	110
4.14	LAFISE Group integrated service model	111
5.1	A stylized value chain	116
5.2	Inter-connected value chains in a subsector	116
5.3	The DrumNet actors	129
5.4	Process flow	132
5.5	A holistic perspective: agricultural value chain approach	140

5.6	Integrated agricultural food park model and activities	142
5.7	Customized financial products for edible oil processing value chain stakeholders	143
5.8	Non-financial services favouring credit recovery	143
5.9	Integrated dairy at IAFP: information, product and financial flow	144
6.1	Farmer-centric ecosystem services	149

Tables

2.1	Kenyan Government Interlinked Cereal programme	13
3.1	Typical organizational models of smallholder production	28
3.2	Hortifruti financing models	32
3.3	Sales in target sites (March–August 2008)	51
4.1	Description of agricultural value chain finance instruments	56
4.2	Benefits and limitations of product financing	66
4.3	Benefits and disadvantages of receivables financing	72
4.4	Benefits and challenges of inventory finance and warehouse receipts	81
4.5	Financial lease considerations	83
4.6	Summary analysis of agricultural value chain finance products	96
4.7	Price increase gained from inventory credit	103
5.1	Performance indicators	135

CHAPTER 1

Introduction

'Agriculture continues to be a fundamental instrument for sustainable development and poverty reduction' (World Bank, 2008: 1–2); yet, 'financial constraints in agriculture remain pervasive, and they are costly and inequitably distributed, severely limiting smallholders' ability to compete' (ibid.: 13). Sudden and dramatic changes in food prices have exposed the vulnerability of agricultural production in meeting global demand and call for increased investment in agriculture at all levels. The question is how the right amount of investment can be acquired, particularly in a challenging milieu where financial uncertainty causes a reduction in available resources along with increased fear and scrutiny of risk. An answer to addressing these constraints goes beyond conventional measures since agriculture has always been difficult to finance through formal financial institutions and approaches.

The environment for agricultural finance is further influenced by the growing concentration of control in the agricultural sector. Driven by gains from economies of scale and globalization of the food chain along with access to resources, multinational and other interconnected agribusinesses have a greater impact in a sector that is characterized by increasing vertical and horizontal integration. The consequences of tightening integration are profound, especially for smallholders and others who are outside of the interlinked chains. In short, agriculture is evolving towards a modern, extremely competitive system driven by consumer demand for higher value, more processed products, and consistent quality and safety standards. Hence, enhancing smallholders' productivity, competitiveness and their participation in these global value chains have been noted as priorities of the agriculture-for-development agenda (World Bank, 2008).

Agricultural value chain finance offers an opportunity to reduce cost and risk in financing, and reach out to smallholder farmers. For financial institutions, value chain finance creates the impetus to look beyond the direct recipient of finance to better understand the competitiveness and risks in the sector as a whole and to craft products that best fit the needs of the businesses in the chain. Naturally, this more comprehensive approach to agricultural financing is not unique to value chain finance; some leading financial organizations in the sector employ such a focus in their loan assessment processes but this is more often not the case. In fact, much of the finance available to value chains is not from financial institutions but rather from others within the chain. At the same time, value chain finance can help the chains become more inclusive, by making resources available for smallholders to integrate into higher value markets. Finance that is linked with value chains is not

new and some types of trader finance, for example, have been around for millennia; what is new is the way it is being applied more systematically to agriculture, using innovative or adapted approaches, tools and technologies. Examples of their application and innovation from around the world are shared and discussed in the following chapters.

Defining value chain finance

In our fast-paced development context, value chain finance is an evolving term that has taken on a range of meanings and connotations. The flows of funds to and among the various links within a value chain comprise what is known as *value chain finance*. Stated another way, it is any or all of the financial services, products and support services flowing *to and/or through* a value chain to address the needs and constraints of those involved in that chain, be it a need to access finance, secure sales, procure products, reduce risk and/or improve efficiency within the chain. The comprehensive nature of value chain finance, therefore, makes it essential to analyse and fully understand the value chain in all aspects. The authors use the term here in reference to both internal and external forms of finance that are developing along with the agricultural value chains that they serve:

1. Internal value chain finance is that which takes place within the value chain such as when an input supplier provides credit to a farmer, or when a lead firm advances funds to a market intermediary.
2. External value chain finance is that which is made possible by value chain relationships and mechanisms: for example, a bank issues a loan to farmers based on a contract with a trusted buyer or a warehouse receipt from a recognized storage facility.

This discussion of value chain finance does not include conventional agricultural financing from financial institutions, such as banks and credit unions, unless there is a direct correlation to the value chain as noted above. Inevitably, there will be some grey areas in any such definition, and we recognize that financing approaches are often continuums through which an arbitrary line must be drawn for practical reasons of analysis and discussion.

An example of internal value chain finance is the case of input supplier credit in Myanmar where agro-input retailers offer deferred payment sales to smallholder farmers (Myint, 2007). A typical case of external value chain finance is exemplified in Kenya where small fruit and vegetable growers are able to access bank finance for agro-chemicals thanks to their export contract. The exporter pays the farmers through the bank, which deducts the scheduled loan payments before releasing the net proceeds to the farmer group (Marangu, 2007).

Value chain finance in agriculture must be seen in the light of the larger context, not only of the value chains proper but also the business environment of each country as this impacts value chains and the financial systems.