How to Make Agri-finance Benefit Rural People in Emerging Markets

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The importance and value of agribusiness finance

**AGRICULTURE AND ACCESS TO FINANCE**

**IMPORTANCE OF AGRICULTURE as major source of livelihood**

- 75% of poor people in developing countries live in rural areas - 2.1 billion live on less than $2 a day; 880 million live on less than $1 a day - majority depend on agriculture economically

- Agriculture is a source of livelihood for 86% of rural people - Jobs to 1.3 billion small holders and landless workers

- 2.5 billion households of the developing world population are involved in agriculture with low access to finance

**LACK OF ACCESS TO FINANCE to adopt efficient technologies and efficient resource allocation**

- **India**: within 6000 households in 2 states 87% of marginal farmers surveyed had no access to formal credit; 71% had no access to a savings account in a formal FI

- **India**: only 49% of small farmers have access to institutional finance

- **Rural Nicaragua, Honduras and Peru**: the credit constrained population constitutes 40% of all agricultural producers

- **CEU**: nearly 50% of small holders in five countries report financial constraints as the major barrier to growth and expansion of their enterprises

- **Africa**: Less than 1% of commercial lending goes to agriculture

**FINANCE IS A NEEDED CATALYST FOR POSITIVE CHANGE IN RURAL LIVELIHOODS**

The direct and indirect benefits to the farmer are multiple

**SUMMARY OF AGRI-FINANCE BENEFITS TO THE FARMER**

| IMPROVED INCOME LEVELS | • Higher yields  
|                        | • Improved quality of products  
|                        | • Better post harvest practices and access to storage  
|                        | • Better access to markets and perhaps better prices  
|                        | • Long term assets acquisition / investments  
|                        | • Value added in agricultural production: produce higher value products |

| RISK MITIGATION / INCOME SMOOTHING | • Income diversification / off farm employment (can be at the expense of specialization)  
|                                   | • Savings  
|                                   | • Access to loans / funds  
|                                   | • Insurance (health, life, crop, weather) |

| HOW TO ACHIEVE THESE BENEFITS? | • Capacity building / technical assistance: improved access to technologies and financial skills  
|                                | • Access to finance  
|                                | • Access to insurance and participation in risk sharing facilities |

HOLISTIC APPROACH TO AGRI-FINANCE NEEDED
### Why banks do not finance agribusiness - high risk profile

**Cost to serve** - Rural financing involves higher transaction costs than in urban areas (aggregation issue), because of distances between borrowers, lower population densities, lower quality infrastructure and the impact of seasonality and risk of rural production activities. This means banks and related financial institutions tend to focus more on urban than rural clients.

**Seasonality and loan term structure** - frequently long gestation periods from planting/livestock birth to harvest/slaughter means that agricultural credit may need to be repaid in “lumpy installments”

**Heterogeneity of farming and lack of information** - range of farm and non-farm income can make the assessment of loan suitability more complex

**Production and yield risks** - uncertainty due to natural hazards such as weather, pests and disease

**Market and price risk** - fluctuations in price, particularly where markets are likely to be imperfect and information may be lacking

**Risk of loan collateral limitations** - local farmers may lack land title or land value may be low, moveable farm assets such as livestock and equipment are higher risk forms of security

Agriculture finance should cover the whole supply chain

**Generic Agriculture Supply Chain (Any Commodity)**

**Production (Inputs)**

- Farming
  - Land Preparation
  - Planting
  - Spraying
  - Fertilizers
  - Harvest

- Post-Harvest Handling
  - Sorting / cleaning
  - Grading
  - Inspection
  - Packing (depends on shelf life)

**Transport to Market**

- Depends on proximity to market
- Depends on international vs. national market requirements (e.g. clearance, customs, inspections)
- Storing

**Distribution Channels**

- Depends on farmer-corporate distribution contractual arrangement
- Logistics coordination

**Retail**

- Specifications - Quality; Traceability
- Delivery
- Product development
- Other

**Consumers**

- End product buyers
- Urban vs. rural buyers

**Technology (Improving yields, quality, efficiency, post harvest handling / storing / transportation)**

**Financial Institutions addressing financing needs for improvements along the supply chain**

- Short-term credit / working capital - for inputs, cash flow management, income smoothing
- Term credit - for fixed asset or land acquisition, leasing, inventory build-up
- Deposit and transfer services - for cash flow management, risk mitigation, investment and asset building
- Insurance products (health, life weather)

**Risk for the FI generally decreases as supply chain moves forward**
## Supply chain finance differs from traditional agriculture lending

<table>
<thead>
<tr>
<th>Area</th>
<th>Traditional Lending</th>
<th>Supply Chain Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lending</strong></td>
<td>• Asset based</td>
<td>• Cash flow based</td>
</tr>
<tr>
<td></td>
<td>• Contracts</td>
<td></td>
</tr>
<tr>
<td><strong>KYC</strong></td>
<td>• Relationship banking</td>
<td>• Supply chain</td>
</tr>
<tr>
<td><strong>Credit risk</strong></td>
<td>• Traditional assessment: needs sufficient client info</td>
<td>• Improved systems for risk assessment / automation / parametric</td>
</tr>
<tr>
<td></td>
<td>• Information through existing relations in supply chain</td>
<td></td>
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<tr>
<td><strong>Risk mitigation</strong></td>
<td>• Careful client selection</td>
<td>• Loan portfolio diversification</td>
</tr>
<tr>
<td></td>
<td>• Insurance / hedging</td>
<td>• Risk sharing / first loss</td>
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<tr>
<td></td>
<td></td>
<td>• Insurance / hedging</td>
</tr>
<tr>
<td><strong>Client type</strong></td>
<td>• Larger commercial farmers</td>
<td>• Smaller commercial farmers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Organizations / associations of small farmers</td>
</tr>
<tr>
<td><strong>Capacity building</strong></td>
<td>• Clients are knowledgeable</td>
<td>• Need financial education and awareness raising to become better clients for FIs</td>
</tr>
</tbody>
</table>
What could banks need in terms of technical assistance?

- Develop better understanding of specific supply chains and their economics---identify key agribusinesses and their clients/suppliers and mapping opportunities for lending
- Understanding, quantifying and managing risks around specific commodities and supply chains
- Separating systemic (e.g. weather, yield, price) from idiosyncratic risks (e.g. client performance)
- Ways to vet new clients for credit approval
- Use of technologies to reach new clients and reduce the cost of serving them (e.g. mobile banking, POS, mobile phones, etc.)
- Development of loan products to better meet client needs and the particularities of commodities and supply chains
- Promotion, awareness raising, and training of potential clients: SME agribusinesses and farmers
What could banks need in terms of investments?

- **Lines of credit**
  - Short term funding
  - Longer term funding

- **Risk sharing**
  - Reduce credit risk on the specific agriculture loan portfolio
  - Increase capacity to originate new loans
  - Improve key balance sheet ratios, risk management and operational efficiency
  - Potentially increase risk-adjusted return on capital

- **Loan securitization**
  - Enables banks to tap the bond markets for alternative funding
  - Investors for mezzanine and senior tranches
Agriculture supply chain finance integrates multiple actors

SUPPLY CHAIN FINANCING INCLUDES MULTIPLE OPTIONS FOR FINANCING AND CONTRACTUAL RELATIONSHIPS

- BUYER / CORPORATE
- INPUT SUPPLIER
- FINANCIAL INSTITUTION
- FARMER

- Financial Intermediation
  - Often becomes the catalyst for bundled services

- Technical Assistance
  - Technical assistance can be delivered by the FI, the buyer or supplier

- Delivery of goods
- Payment for goods (+TA)
- Disbursement to supplier (=> loan to farmer)
- Inputs provided to farmer, based on loan from FI (+ TA)

Spurred by contractual relationships with other participants in the chain, farmers are more likely to invest, improve their technology and know-how or seek out new buyers ➔ leap forward in productivity
Value chain financing to small farmers should leverage the corporate-bank relationship in an optimal way.

### The Value Chain Financing Spectrum

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Level 1 (TIGHT)</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Level 4 (LOOSE)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Product</td>
<td>Long-term asset financing</td>
<td>Asset / Input / Working Capital</td>
<td>Input / working capital</td>
<td>Short to very short-term working capital</td>
</tr>
<tr>
<td>Financial Institution</td>
<td>Assumes all risk</td>
<td>Assumes all risk, loan process</td>
<td>Assumes all risk, loan process, collection</td>
<td>Assumes all risk, loan process, collection</td>
</tr>
<tr>
<td>Corporate / Buyer</td>
<td>All process</td>
<td>Guarantee purchase</td>
<td>Non-exclusive purchase</td>
<td>Referral, opportunistic purchase</td>
</tr>
<tr>
<td>Repayment</td>
<td>Buy back deductions</td>
<td>Buy back deductions</td>
<td>Bank collection</td>
<td>Bank collection</td>
</tr>
</tbody>
</table>

Source: Adapted from “IFC Agricredit Report: Final Report to IFC on India Agri-credit Project”, NBA Enterprise Solutions to Poverty, July 31, 2010
If possible, tight value chain arrangements could be beneficial to all actors

CHARACTERISTICS

PHYSICAL CHARACTERISTICS
- Perishability (e.g. fruits and vegetables)
- Centralized processing (e.g. sugar, cotton)

SPECIALIZED PRODUCTS / BUYERS
- Special, requested product qualities (e.g. white onion)

PRICE PREMIUMS or other benefits
- E.g. organic, fair trade commissioned products

BENEFITS

FOR THE BANK / FI
- Lower administrative and transaction costs (corporation does most in client generation, disbursements, collections)
- Corporation has a permanent purchasing arrangement with farmers financed (more assured repayments through buy back deductions)
- Corporation provides inputs and advice to farmers - increasing output, earnings, and repayment capacity
- Bank takes full credit risk
- Access to financing – at lower rates
- Justification to make the needed expenditures and investments (knowing that product will be purchased)
- Moving out of traditional, often exploitative relationships with traders / money lenders
- BUT, the risk might be creating a heavy dependency of farmers on a single purchaser

FOR THE AGROBUSINESS
- Steady, relatively certain supply of higher quality produce, justifying its investment in the organization and inputs in building the value chain with small producers
- Bank takes full credit risk

FOR THE SMALL FARMER
- Access to financing - at lower rates
- Justification to make the needed expenditures and investments (knowing that product will be purchased)
- Moving out of traditional, often exploitative relationships with traders / money lenders
- BUT, the risk might be creating a heavy dependency of farmers on a single purchaser
PRE-HARVEST LOAN TO GROWERS - REACHING FARMERS THROUGH FINANCIAL INSTITUTION / BANK
Leveraging synergies across investment and advisory services

IFC Advisory to Bank:
- Risk management
- Lending products
- Policies / procedures

IFC Advisory to Agribusiness and Farmers:
- Productivity
- Standards
- Business practices

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Input Supplier

Agribusiness / Buyer

IFC
Credit line to a bank

BANK
Pre-harvest loan

Farmers
Loan repayment

INPUTS

Funds

Inputs

Loans repayment

Crop

Payment

Addressing Opportunities in Agri-Finance - Business Model (1)
Addressing Opportunities in Agri-Finance - Business Model (2)

**REACHING FARMERS THROUGH AN AGRIBUSINESS COMPANY**

- **IFC**
  - Loan
  - Line of credit
  - Advisory
  - Risk-sharing

- **Company A**
  - Loan finances

- **8,000+ Farmers**
  - Repayment - via buyer

- **IFC Advisory**
  - Technical Assistance
    - Sustainable Practices (Water, Pests, Harvesting)
    - Increased Yields
    - Business Management Training
    - Access to Markets

- **Industry Advisory**
## Addressing Opportunities in Agri-Finance: IFC Selected Examples

<table>
<thead>
<tr>
<th>Opportunity</th>
<th>IFC Value Proposition</th>
<th>How it Worked For…</th>
</tr>
</thead>
</table>
| **Agriculture Finance** | 1) Working with Financial Institutions  
*Support FIs to serve agribusiness needs profitably*  
- Global practices in agri-finance  
- Capacity building to banks | Who: **NSB and FMB Bank (Malawi).**  
IFC Role: Support IFC investment by capacity building in FIs to support warehouse financing and outgrower schemes for agriculture ($1.9M project)  
Key Results: Ongoing project (TBD) |
|                      | 2) Working across the Agri-Supply Chain  
*Create linkages across the supply chain in order to increase profitability through increased productivity or new market access*  
- Delivery models to farmers  
- Scaling up pilot projects  
- Supporting sustainability | Who: **ECOM Coffee (HQ- Nicaragua, covers LAC, South East Asia, East Africa).**  
Client Need: Access to market, linkages, financing for increased productivity  
IFC Role: USD $25M in debt commitments and IFC + Nestle technical assistance for training and productivity improvements  
Key Results: (1) Increased productivity >40%  
(2) Estimated $4.5M over 3 years  
(3) Established channels for training |