Financing Agriculture Forum 2012

New World of Agriculture
and the Opportunities for Finance

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Nancy Barry, President

Enterprise Solutions to Poverty

Progressive farmers are looking for solutions—and agribusinesses and input suppliers are finding ways to work with large numbers of small farmers

A growing group of small, progressive farmers see farming as a business not subsistence.
They are seeking access to improved seed, planting materials, irrigation to increase yields.

Financial institutions need to:
•Find the progressive farmers
•Finance bundles of improved inputs
•Finance irrigation, small farm equipment

Agribusinesses—seeing that over 70% of agricultural output is produced on farms of 1 to 5 ha—are finding ways to work with small farmers.
•Companies are building value chains that provide inputs, advice, procurement, bank finance
•Input suppliers are working with agro-dealers, MFIs and agribusinesses building distribution for inputs, advice, financing, weather insurance.

- Financial institutions need to know how to build collaborations with agribusinesses that have value chains with large numbers of small farmers. Opportunities in dairy, F&V, oilseeds, coffee, sugarcane.
- FIs need to partner with input suppliers, using agro-dealers for loan origination, as BCs and as insurance agents

Urban migration and rural dynamics are propelling new income streams, enterprises and financing opportunities in rural areas

Urban migration is creating new dynamics and opportunities:

- Labor shortages in agriculture
- Consolidation of small farms to 5, 10, 20 ha, through leasing and purchase
- Urban to rural remittances increasing, 30% of rural incomes in China, Kenya

- Farmers who are expanding tend to be promising bank clients, with lower risks and transaction costs
- Progressive farmers are combining cash crops, dairy and commerce with higher, smoother incomes and lower risks
- Rural towns are dynamic
- FIs need to get good at savings, insurance, payments-for a range of enterprises including ag customers in rural areas and small towns.

Rural means more than farming

•In Africa, only about 40% of rural incomes are from agriculture with the rest in services and remittances

•A new breed of younger, more educated agro-entrepreneurs is emerging—modern farms, agro-dealers, contract services.

FIs need to look at total cash flows of households

Banks should back emerging agro-entrepreneurs and well functioning coops as aggregators

Mobile applications and large players are opening new opportunities for small farmers

Increasingly, mobile phone-based software, connectivity being used to:
•Provide information to farmers on weather, methods, price and markets
•Make complex collaborations possible—dealers, VCF, insurance
•Lower costs for payments, savings, loans, insurance transactions

Financial institutions need to:
•Encourage ag borrowers to use tools to improve methods, access
•Use mobile based technologies to facilitate multiparty collaborations
•Piggy back on deep telecom agent distribution systems

Emergence of large players
•Mega farms where large tracts available.
•Large integrating companies, e.g. ETG and Olam investing in farms, storage, cold chain, processing, pulling pieces together
•Commodity exchanges organizing markets, providing incentives for quality, shortening supply chains

Financial institutions need to know these trends and players and build collaborations that enable their clients to connect with these developments.

Some African countries are at the cutting edge of some innovations, with lessons for other emerging markets: case of Kenya

Leveraging agro-dealer networks

- Farmers receiving from agro-dealers Inputs, credit, weather information, and insurance
- 200 out of 7,000 Kenyan agro dealers do 80% of sales. Based in towns, educated agro-entrepreneurs offering inputs, advice, insurance at lower prices, beginning to act as aggregators

Companies collaborating

- Equity Bank and agribusinesses building value chain financing—about 40,000 small farmers engaged to date
- Syngenta Foundation has catalyzed partnership with input companies, weather insurance and finance with NGO, MFIs, agro-dealers, agribusinesses to offer package of solutions

Dynamic markets, small holders

- Kenya is a global leader in horticulture exports, $300 million.
- Similar demographics to India—dominance of small farmers, organic consolidation, emerging entrepreneurs

Mobile for everything

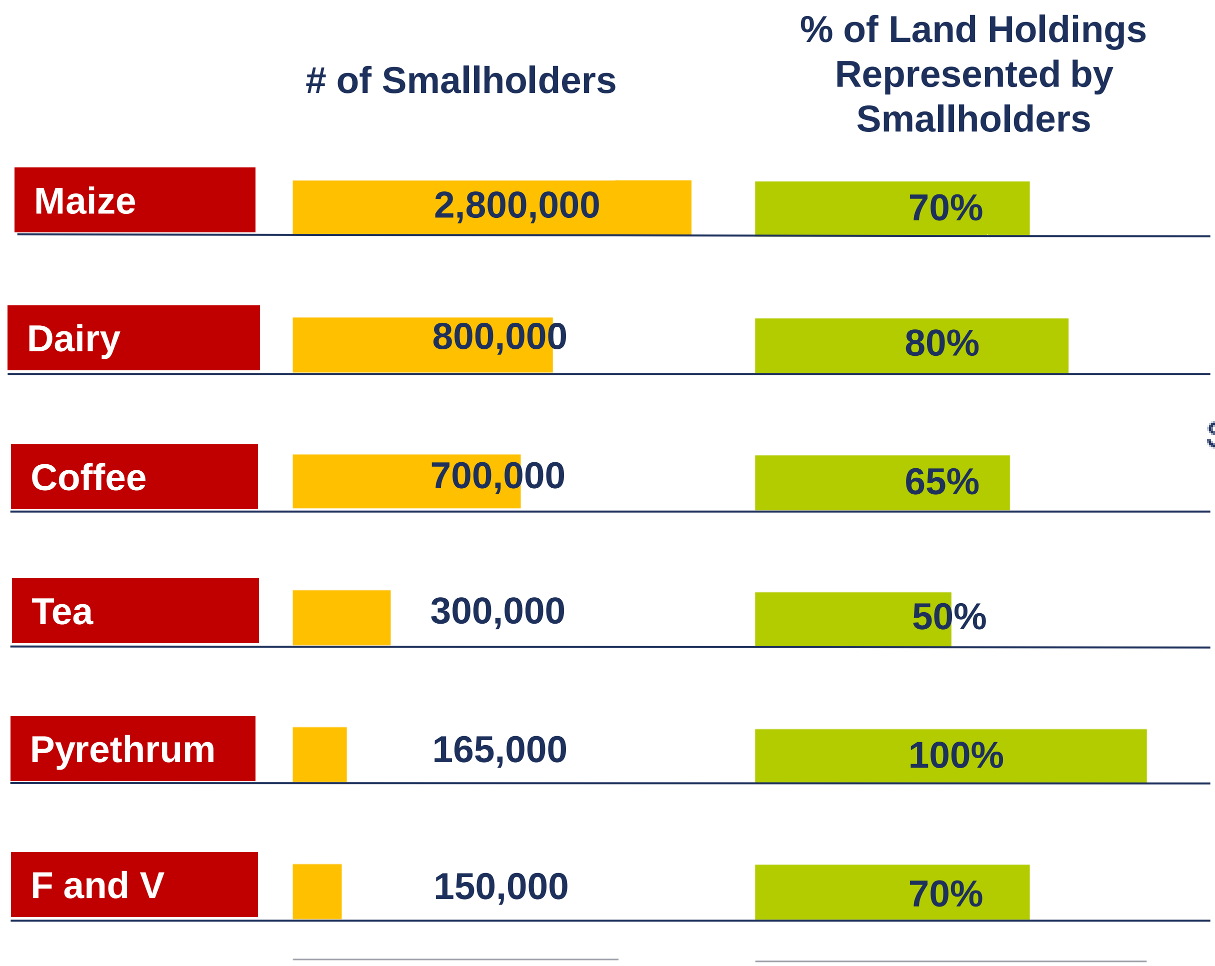
- Safaricom MPESA is the global leader in BOP mobile services, providing money transfer, payments, savings, insurance through 25,000 agents reaching 15 million subscribers. Now being used for agro-solutions

Segmenting agricultural clients—what to avoid, what to seek in agri-finance

Does the farmer	What to avoid in agri-finance	Promising but risky in agri-finance	What to seek in agri-finance
Have a reasonably steady, growing flow of cash?	Subsistence farmer producing staples with little or no cash income	Farmer producing cash crops equaling >50% production	Mix staple, cash crop and dairy, with commercial produce growing, > 70%
Demonstrate that ready, willing and able to adopt new methods, forge new linkages?	Traditional farmer—no interest in change 30% in India, 40% in Kenya	Wait and see farmer—will follow if see big benefit 30% in India, 30% in Kenya	Progressive farmer- quick to adopt modern methods—40% in India, 30% in Kenya
Have enough land and water to make a decent living from agriculture?	Under 1 ha with no irrigation, under .5 ha with	One ha with irrigation, 2 ha with	2 to 20 hectares—ideally with irrigation
Have strong market linkages to sell products at reasonably stable, good prices?	No market links, no prospects for sale at stable, reasonably remunerative price	Loose market links either through decent relationships with traders, wholesalers	Tight or stable loose value chain relationships with agribusinesses, buyers
Have access to the inputs and advice needed to increase productivity, earnings?	No access to technology improvements, or loose government extension	NGO type TA	Technical services built into input supply or value chain relationship
Have the track record as a good borrower and money manager?	High indebtedness to money-lender	Decent cash flow but no history of borrowing	Strong repayment history with input suppliers, FIs, agribusiness

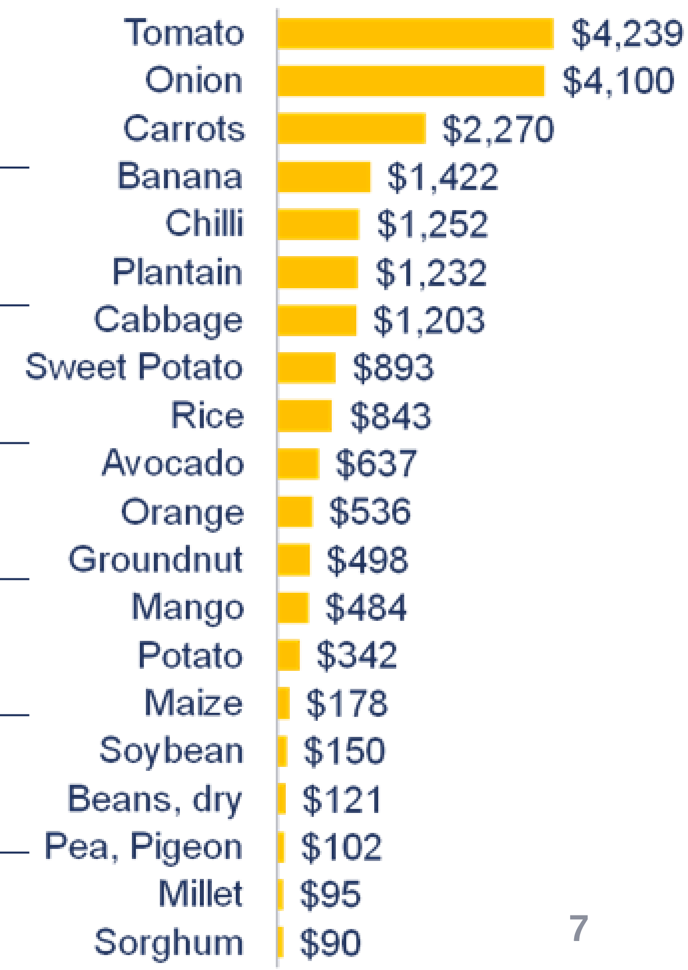
Banks need to select and understand key commodities if they are to develop commodity-specific solutions with agribusinesses and agro-input dealers

In Kenya, most small farmers are in six commodity groups



Sources: AfDP, World Bank, Coffee Board of Kenya

In Kenya, earnings per acre vary significantly by crop



Selecting commodity groups for focus: filtering for for revenue potential, scalability, nutrition value and competitiveness.
In Kenya, horticulture, dairy and maize emerge as the most promising commodity groups for focus.

25+ commodity value chains examined

8 staples, 11 horticulture commodities, 5 livestock categories

Filter 1: Income potential	Value chains with high revenues per hectare
Filter 2: Scalability	Value chains with high numbers of smallholders
Filter 3: Competitiveness	Value chains with strong demand and competitiveness

1. Income potential from horticulture is 2 to 7 times more than from staples; additional benefits for women, poor, and youth
2. Dairy has strong growth linkages; significant nutritional value
3. Tea and coffee have strong growth potential and good prospects for increasing productivity levels
4. Maize contributes 12% to Kenya's agriculture GDP; 98% of farmers grow maize; most important food security crop

Source: Adapted from *Strategic Review*, Feed the Future, USAID Kenya, 2010

In each targeted value chain, it is important to identify which organizations will be the most effective drivers and change agents--providing inputs, improved technology, aggregating output and providing market links

Need to analyze capabilities of producer organizations, input suppliers, agro-entrepreneurs, buyers sand retailers to provide needed services to farmers in Kenya.

- Strong capability
- Potential or limited capability
- Minimal to no capability

Potential Change Agents

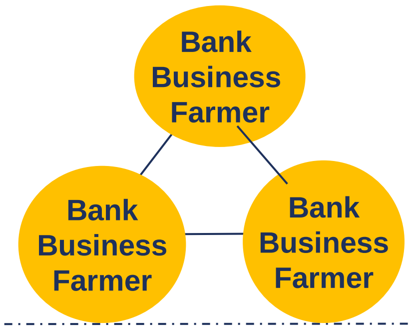
Constraint	Producer Organization	Input Suppliers	Agro-entrepreneurs/ Aggregators	Agribusinesses, Buyers	Retailers, Super-markets
Production and productivity Poor crop selection, poor access to inputs and extension, poor access to water, credit, breeding stock.	Potential or limited capability	Strong capability	Potential or limited capability	Potential or limited capability	Minimal to no capability
Aggregation of output Poor harvest handling, inadequate warehousing, crop theft, poor access to processors and slaughterhouses.	Potential or limited capability	Potential or limited capability	Strong capability	Strong capability	Minimal to no capability
Link to markets Poor market facilities, poor marketing services, no quality incentives, lack of standards .	Potential or limited capability	Potential or limited capability	Strong capability	Strong capability	Strong capability

Source: Strategic Review, Feed the Future, USAID Kenya, 2010

Determining which of three main agri-finance arrangements to use in financing small farmers

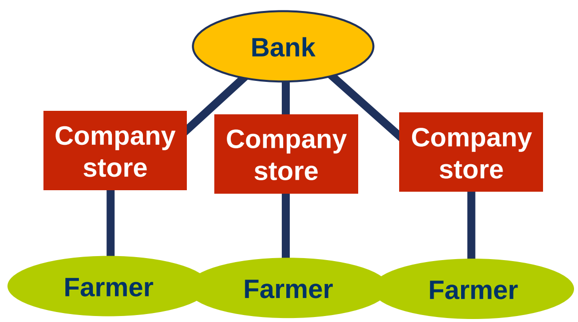
Capacity | Model | Existing and emerging examples

Finance small farmers in value chains



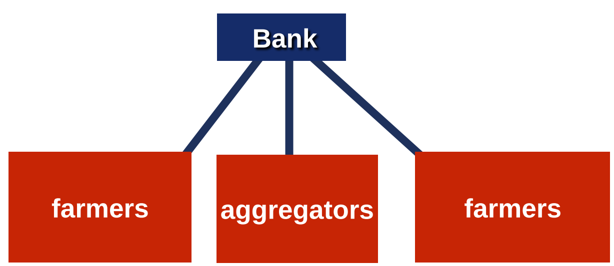
- India: Jain Irrigation, KRBL, EID Perry, Hatsun Agro, Amul
- China: New Hope, COFCO-Mengniu, Wumart
- Kenya: Brookside, Frigoken, BIDCO, coffee farmers

Utilize distribution system of the business to finance small farmers and merchants



- India: TKS-HDFC Bank, ITC eChoupals
- Mexico: Bimbo to and through retailers
- Colombia: Servientrega
- China: China Mobile

Finance farmers directly and through aggregators



- India: Kisan Credit Cards, Mahindra Finance, Jain SAFL
- China: Rural Credit Coops
- Kenya: Equity Bank

Determining the functions of the financial institution and company under tight and loose value chain financing relationships

Key Lending Functions

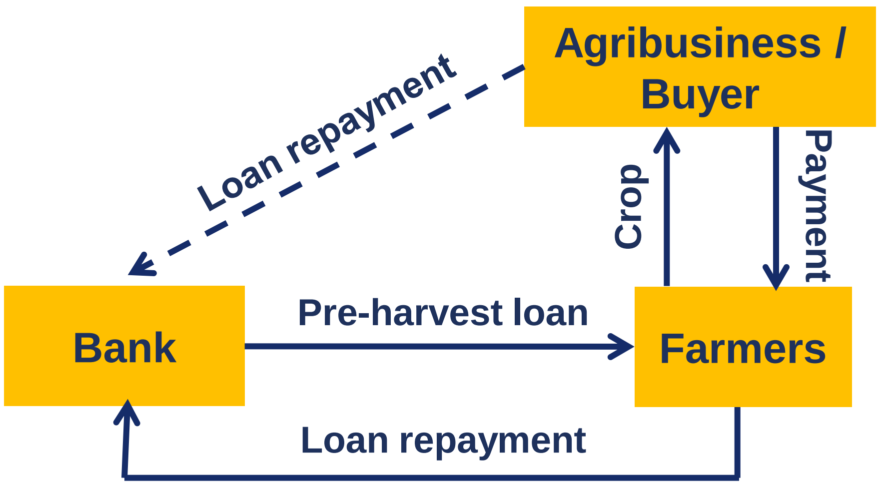
L = Loose Value Chain Financing T = Tight Value Chain Financing	Bank	Company Intermediary
Origination, documentation		T, L
Data bases on procurement history		T
Screening, recommendation	L	T
Appraisal, approval	L, T	
Risk assumption	T, L	
Disbursements	L	T
Collections of repayments	L	T
Processing of repeat loans	L	T

Moving from loose to tight value chain financing reduces risks and costs to the bank:

Stable, established corporate-farmer relationship due to:

- Natural monopoly e.g. sugar cane, milk due to weight, perishability
- Differentiated products, with price differential e.g. Jain onions, KRBL basmati rice
- Strong win-win with farmers due to price differential and immediate payment on procurement, financing arrangements and tech services e.g. Wumart and F&V coops

Financing arrangements for tight value chain financing



Conditions for model to work:

•Agribusiness has tight, stable relationships with a substantial number of farmers eg over 1,000 ideally over 10,000

•Agribusiness has developed strong, differentiated value proposition based on services, price and procurement arrangements—if not contracts—to protect against side selling.

Roles of agribusiness and bank:

- Agribusiness provides data bases on procurement, screens borrowers, and collects repayments when procures
- Agribusiness provides services to build productivity, quality of farmer output.
- Bank assumes credit risks, does loan appraisal and disburses usually directly.

Risk of participating farmers side-selling, fail to provide needed quantity, quality

•Risk mitigating instruments: focus on high value commodities and agribusinesses that provide differentiated price fro quality, TA, quick payment

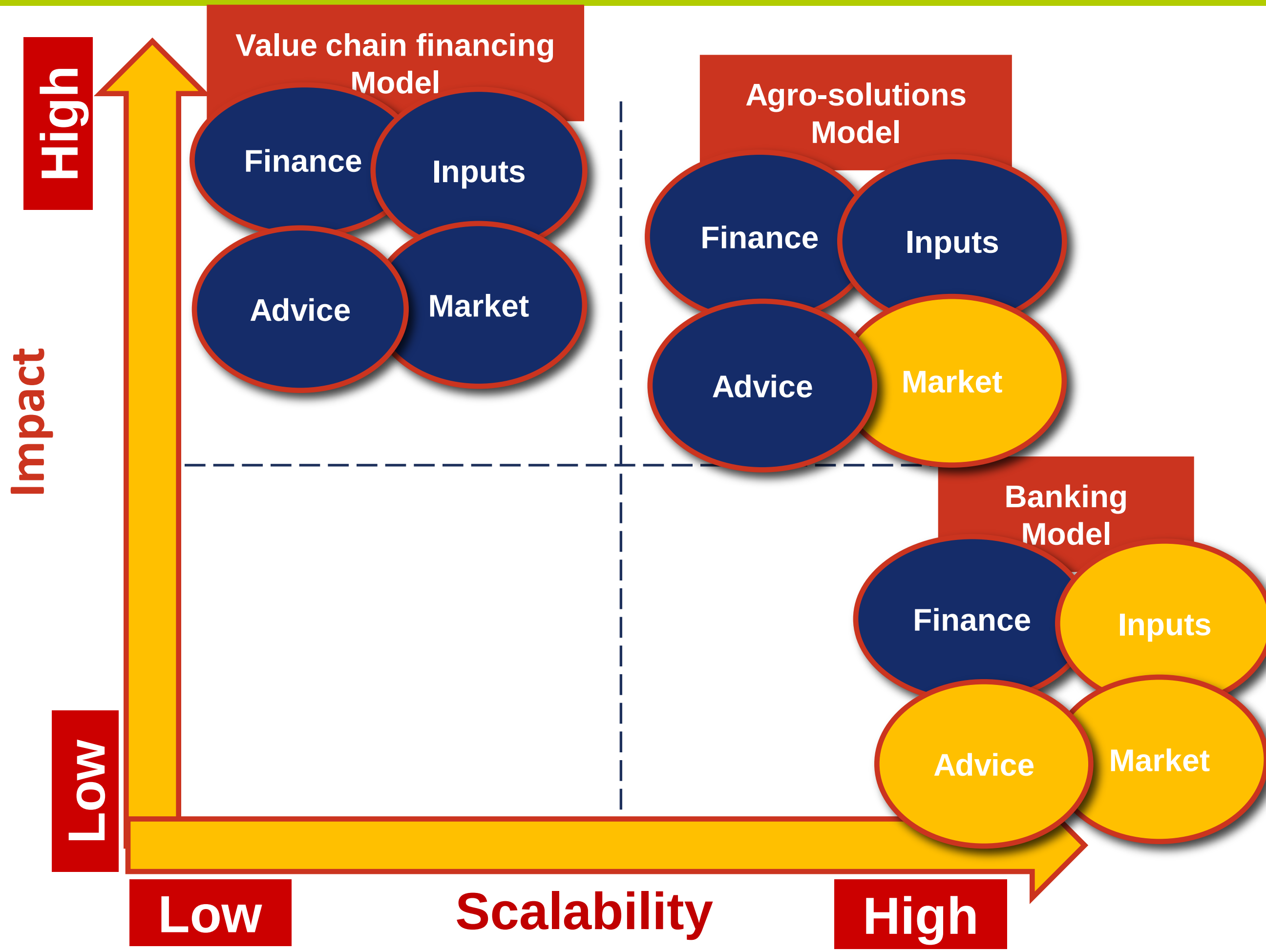
•Lend to farmers with at least two years supplying to the agribus/buyer, representing at least 70% of farmer's cash crop sales

Determining whether to promote tight or loose value chain financing: case of BIDCO in Kenya

	Bidco builds tight value chain relationship with farmers and begins with loose value chain relationship with Equity	Bidco builds loose value chain relationship with the farmers and tight value chain financing relationship with Equity
Risk of side selling by farmers undermining sustainable supply to Bidco	Low risk since farmers would have no incentive to sell to others	High risk, due to avoiding loan repayments in procurement process
Reliable targeted technical and procurement services	Strong, with Bidco field staff devoted to technical and procurement services	Weak, with Ministry of Agriculture staff good at contacts but weak on delivering technical services
Direct cost to Bidco of building value chain with small farmers	Relatively high, with Bidco devoting staff or agents to this work	Relatively low, due to reliance on Ministry of Agriculture
Risk of non repayment on Equity Bank loans	Low, with solid win-win relationships established with farmers	High, due to farmers avoiding loan repayments bundled with Bidco procurement
Potential to grow to scale	High, with Bidco assigning staff or agent to every 30 villages in procurement area	Low, due to weak organizational an technical arrangements and risk of side selling

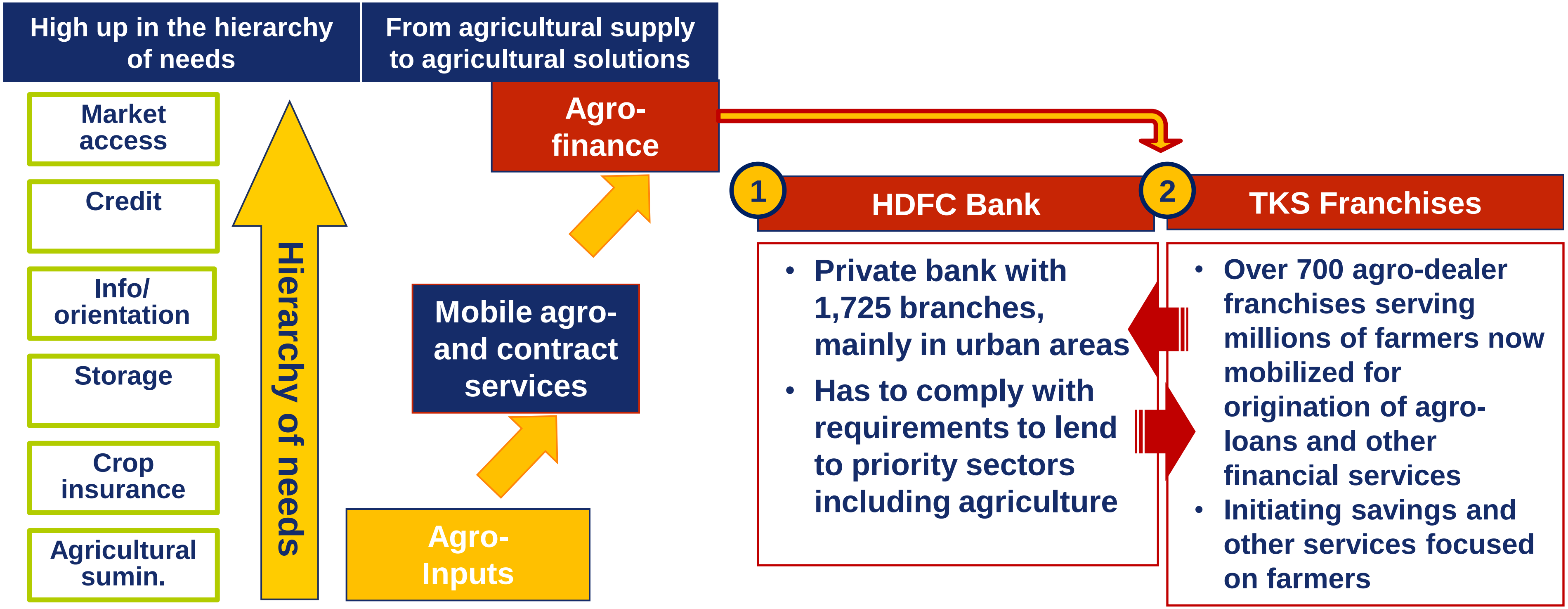
Positive
Medium
Risky

The agro-solutions model, which leverages distribution systems of input suppliers, irrigation and equipment supply companies, may be the optimum model in increasing productivity and earnings of large numbers of small farmers by providing inputs, advice and finance.



While value chain financing often will have the highest impact on farmers, as it links small farmers to secure markets, tight value chains are difficult to implement and often have a relatively small number of farmers engaged. Agri-finance alone often is not sufficient to build small farmers' incomes and create the capacity to repay loans

In India, Tata is converting the TKS franchises into an agro-solutions network—offering inputs, information, contracting, and financial services with HDFC Bank



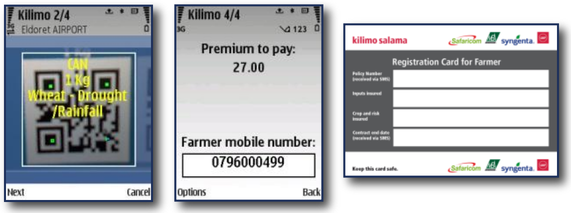
	1 HDFC Bank	2 TKS Franchise
Provide	▪ Financing farmers ▪ Assumes 100% of risks	▪ Distribution system ▪ Understanding, relations with farmers ▪ Inputs, services and advice-higher productivity
Obtain	▪ Low-cost access to reliable borrowers ▪ Solid screening of known farmers by TKS franchises	▪ Capacity to offer better financial services ▪ Margin for service ▪ Capacity to finance inputs

In Kenya and Rwanda, Syngenta Foundation has built collaborations and technology to provide inputs, advice, finance and weather insurance

Mobile phones facilitate applications and payouts

1. Agrodealers given phone with Kilimo Salama application
2. Agrodealers register farmers with mobile phones
3. Insurance policy automatically created on server and farmer receives SMS confirmation
4. Automated decisions on payouts. Payouts to all farmers in radius of same weather station

kilimo salama



Currently serving 50,000 farmers

Weather Index Insurance

UAP Better. Simple. Life.

Input Supply

Farmer Financing

One Acre Fund

Cooperatives, SACCOs

Agro-dealers

Agribusinesses

Financial Institutions

1 million farmers by 2015

Key differences in agri and rural finance

	Agri-finance	Rural Finance
Target clients	Progressive small farmers	Wide range of customers in rural areas
Products and services	Loans Weather insurance Links to inputs, info, markets	Payments Savings Insurance
Platform for Profitability	Costs and quality of loan portfolio	Getting good at payments Customer segmentation for multi-products
Distribution Channels	Rural outreach Agro-dealers Agribusiness value chains Strong ag coops	Rural outreach Own channels: mini-branches, ATMs BC channels: stores, franchises, mobile agents.
Key collaborations	Input suppliers Agro-dealers Agribusinesses Ag coops	Companies with rural distribution systems BC integrator companies
Key challenges	Get farmers finance, inputs, info and markets—while FI focuses on finance Higher risks in ag lending High-cost small transactions	Profitable, responsive mix of financial products Lower costs of many small transactions
Need to know	Agriculture, commodities, risk assessment, collaborations	Operating efficiency, strategic channels, multi-products

Combining the best of agri-finance and inclusive rural finance

Target clients

- Farmers who are part of stable, profitable value chains
- Rural households with ag and non-ag incomes
- Range of poor and non-poor customers

Multi-products as Platform for Profitability

- Broad-based savings, insurance and payment products
- Loans to progressive farmers with strong market links
- Loans and payments to/through agribus, dealers, coops

Distribution Channels and Key Collaborations

- Strategic, limited use of bank branches, leveraging
- Leverage strategic collaborations with agribusinesses, agro-dealers, companies with strong rural distribution networks

Need to know how to

- Deliver cost effective, responsive credit, savings, insurance, payment products
- Do cash flow appraisal of rural households
- Build high yield collaborations and distribution channels

Building and riding the arc of agriculture, agribusiness and agri-finance

	Difficult Conditions	Promising Conditions
	• Low end domestic markets-subsistence, staples, traders driving • One or two basic export commodities • Fragmented, uncoordinated value chains • Low yields-with limited access to inputs, information and advice • Unfavorable policies	• Dynamic domestic market growth • Several competitive export chains—adding value • Strong agribusiness value chains • High productivity by small farmers • Solid agro-inputs, dealers, franchises • Favorable policies
Lending	Careful lending to progressive small farmers with market links, diverse income sources	Robust lending to rural households with agriculture, livestock, and other income sources
Work with input suppliers	Find leading agro-dealers, use as BCs, get input suppliers to provide tech services, focus on promising commodities	Banks collaborate with input suppliers, strong agro-dealers—to provide farmers inputs, advice, finance
Build value chains	Select and cultivate value chain collaborations in high value commodities-may work with NGOs but banks should build direct agribusiness-farmer links, efficient coops and agro-entrepreneurs	Banks do value chain financing of farmers-agribusiness provide inputs, advice, procurement, originate and collect loans.
Work with aggregators	Find and back efficient farmer associations and agro-entrepreneurs—as integrators of inputs, advice, and market links	Find and back efficient farmer coops and agro-entrepreneurs—as integrators of inputs, advice, and market links