FINDING AN ENTRY POINT

PARTNERING WITH THE RIGHT LEAD FIRM, UNDERSTANDING FINANCIAL NEEDS

The point at which a bank chooses to enter a value chain is determined by the organizational structure of the chain, the financial flows, and strong potential partners.

Quick jump for topics

INTRODUCTION

In this step, guidance is provided on how to choose an entry point for financing. Financial institutions evaluating entry points into a value chain need to consider: 1) the organizational structure of the value chain; 2) financial flows

with the associated risks; and 3) key players, lead firms. When looking at an entry point, there are important considerations beyond financial performance when determining the key actors with whom to work.

ENTRY POINT OPTIONS

The most viable entry point for a bank seeking to gain business within an agriculture value chain will depend largely on the organizational structure of the target chain itself. Agricultural value chains usually fall into one of four organizational categories based on:

- **Leading firm/anchor firm:** Value chains where there is one firm or only few companies downstream that constitute the ultimate buyer. Typical examples of these are found in industrial crops such as sugar cane, cotton, palm oil, and breweries. Lead/anchor companies tend to be retailers, large processors, and export-oriented food businesses.
    a. Strength, organizational and financial, of lead firm
    b. Strength, reliability of upstream contracts (with aggregators/with producers, if applicable)
    c. Solvency and reliability of aggregators involved
- **Aggregators:** Buyers of agricultural products, including local or international traders, processors, wholesalers, and some retailers;
    a. Information aggregators hold about producers
    b. Ability of aggregators to share in lending administration costs
    c. Solvency and reliability of aggregators
- **Producer organizations:** Cooperatives or associations that gather and market member produce, and;
    a. Information that farmer-based organizations retain and manage about their producers
    b. Ability of farmer-based organizations to share the cost of loan administration
    c. Solvency and reliability of farmer-based organizations
    d. Governance and management of farmer-based organizations
- **Facilitator organizations:** Groups, such as NGOs or government bodies, outside the value chain seeking to deliver social or development gains, such as higher farm incomes or financial inclusion.
    a. Ability of facilitator to provide credit guarantees
    b. Exit strategy of facilitator

FINANCIAL FLOWS

The path of financial flows within the value chain will also point to the appropriate entry point for a bank, as it will want to ally itself with a partner with a sound record of financial management, deep knowledge of borrowers within the chain, and the scale to match the bank's business goals.

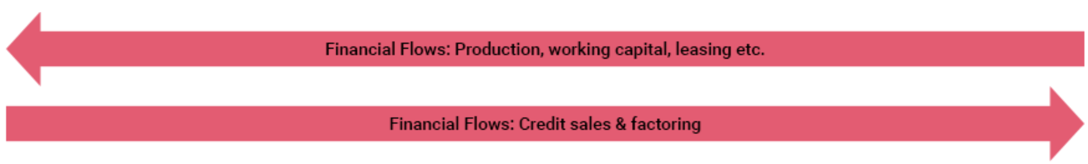
In contrast to product flows, which move from upstream (primary producers) to downstream (processors and consumers), financing flows within the value chain move in both directions. The magnitude and direction of these flows are important factors in determining a suitable entry point for a financial institution.

For example, banks might consider bonded warehouse financing or factoring products depending upon which value chain member they work with and that participant's place upstream or downstream in the chain.

A common entry point for a bank is its relationship with an aggregator, which can sometimes act as a commercial or bank agent. In this role, the aggregator identifies those producers that are acceptable credit risks. While the aggregator identifies the creditworthy farmers, the final lending decision is made by the financial institution.

Here is what financial and produce flows look like in a value chain.

Financial flows within the value chain



	Input Supply	Agricultural Production	Trading & Logistics	Processing	Distribution & Retailing
Financial Products	Working Capital	Production & Consumption Loans	Working Capital Warehouse Finance	Working Capital Equipment Finance & Leasing Factoring	Factoring Warehouse Financing Equipment Leasing
Risk	Medium	High	Medium	Low	Low
Need	Medium	High	High	Medium	Medium
Type	Formal	Informal	Informal	*Formal / Contract*	*Formal / Contract*

Source: Agrifin VCF Bootcamp, 2014.

ANCHOR FIRMS

- **A common strategy for financial institutions is to enter a value chain business through a key player or anchor company in the value chain. Three criteria are commonly used by financial institutions to select the leading player:**
- **Strong financial performance.** Staying power and financial responsibility provide an element of confidence, indicating that the leading player understands and successfully manages its role in the market and meets its financial commitments. Sound financial performance also suggests that the leading player is adept at managing risks within the value chain.
- **Leading role in the value chain.** The food and agricultural markets are dynamic. New technologies, policy adjustments, consolidation and changing consumer preferences, among others, drive their evolution. Leading players are able to recognize changes, adjust their business model, and transmit these changes to other participants in the value chain.
- **Close to producers.** Demand for credit is generally strongest at the producer level. Working with a leading player close to producers is an advantage for financial institutions and makes the greatest use of available information. Being close to producers suggests more than merely performing as an aggregator; it implies deep understanding of the production process and strong relationships based on trust with producers.

ASSESSING A HYPOTHETICAL VALUE CHAIN ANCHOR FIRM

	Anchor company to be evaluated for the following
Process Management (Good)	- Company has a manager for each route - Vintage of the aggregator is 2nd / 3rd generation - Define frequency for farmer engagement for each officer
Data Quality (Average)	- Farmer data is above average; company is working with the bank on data dependability
Balance in the Chain (Average)	- Dependence on aggregator is still very high, preventing company from delivering its mandate
Payments (Good)	- Company is working with the bank to convert payments to bank accounts
Crop Failures / disease (Good)	- Company support by way of veterinary services, feed & vaccine is well accepted, keeping farmers loyal for generations
Contracts (Unrated)	- Contracts with the aggregators well documented - No farm-level contracts

EXPERIENCE FROM BANKS

Let's see some examples of how commercial banks chose their entry point:

Bankaool, Mexico
HBL, Pakistan

HDFC, India

Click to know about

'Lessons from a Banking Partnership in Honduras'