Value Chain Financing, Warehouse Receipt Financing/Collateral Management, and Equipment Financing

Lessons from AgriFin Study Tour in India

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Introduction

AgriFin Study Tours are organized to share information on innovative practices in agriculture finance. The objective is to bring bankers from their home countries to see agricultural financing undertaken in other countries, facilitating peer-to-peer exchange between participants and the hosts of the tour. This type of south-south exchange is an opportunity for bankers to learn from each other with a view to replicating elements of these practices in their respective institutions.

In October 2015, AgriFin organized a study tour to visit HDFC Bank and Mahindra Finance in Jaipur, India. The two host organizations in India are pioneers in regards to reaching smallholders and providing finance. HDFC, India's sixth largest bank with over 3,000 branches across India with farm lending assets of around US$5 billion, have developed innovative ways of financing smallholders using value chain financing and warehouse receipt techniques. Mahindra Finance is the sister company of Mahindra Tractors, the number one seller of tractors in the world, providing financing to smallholders who wish to invest in farming equipment.

HDFC - Dairy VCF Co-operatives Model

Pictures: Leadership of the Thakur Singh Dairy Co-Operative Society (DCS); HDFC ATM installed at the DCS building; Meeting with members of the DCS.

Participants visited two Dairy Co-Operative Societies of a federation comprising of 12,600 dairy farmers, organized into 21 dairy unions to examine HDFC's value chain financing model. Participants witnessed the collection process, saw the flows of the commodity (dairy) from farmer to society to dairy processing plant and most importantly how the flow of funds between the value chain actors enable HDFC to provide financing to farmers and the cooperative unions for both working capital and investment purposes.

Technical information on HDFC's innovative model for value chain financing (VCF) in India's dairy sector can be found on the AgriFin website including a video and audio recording of a webinar.

Critical Success Factors for Financing the Dairy Value Chain

The bank can commence a VCF program by initially capturing cash flows and data so as to facilitate due diligence and improve risk management. HDFC starts by offering deposit, and money transmission services, thereby capturing customer cashflows. Over time this enables the bank to develop a very strong understanding of all the actors, and ultimately to use this data and knowledge to provide finance.

Value chain financing requires the bank to customize its lending and monitoring processes and redesign its lending products to better fit the value chain clients. Each value chain needs a product team, relationship and sales managers who control a certain number of business correspondents and manage companies, aggregators/agents/business correspondents and farmers. Within the bank the product team must work with other product groups and support functions such as IT. VCF provides significant opportunities for cross-selling across product lines.

Lending should be be facilitated through an existing value chain relationship (or set of relationships) and the entry of banks and financial institutions should further strengthen and support those value chains.

HDFC - Warehouse Receipt Financing

Participants visited R.K. Warehouse in Morija (Chomu) which stores mung beans, groundnut and black millet and has a capacity of over 3,000 metric tons. The collateral manager, along with some of the more than 500 farmers linked to the warehouse, aggregators, traders, processors and HDFC colleagues, walked the study tour participants through the end to end process flow for warehouse receipt financing including how the process of receiving, documentation, marking to market, collation and management of the storage and the release process of commodities worked. HDFC explained that by using the value of the goods in the warehouse as collateral, it is able to expand its lending significantly by providing working capital financing to collectors and aggregators.

Technical information on warehouse receipt financing and collateral management arrangements can be found on the AgriFin website through videos () and a Featured Topic.

Critical Success Factors for HDFC's Warehouse Receipt Financing

The timing and type of commodity is important. This type of warehouse storage is only appropriate for non-perishable commodities. Borrowers are able to store their commodities in the warehouse for a period of time without unecessarily tieing-up working capital.

Trust between the bank, collateral manager and borrowers is essential. Collateral Management Agreements, based on the utilization of an independent third-party collateral manager, with appropriate documentation and insurance in place, are critical. The success of such an arrangement relies on trust between all key actors and the assurance that goods are well maintained in the warehouse, and never released prematurely.

A specific and efficient operational set-up within the bank is essential, so as to ensure that all payments occur smoothly and collateral for lending is always in place. The bank should establish a dedicated product control group within the bank to facilitate all movements of the commodity (and the financing elements).


Pictures: Discussion with the Warehouse collateral manager; Discussion with the clients of HDFC and farmers and traders that use the warehouse.

Mahindra Finance - Equipment Financing

Mahindra Finance offers financing to farmers wishing to purchase Mahindra and Mahindra tractors and equipment. Mahindra Finance customers are primarily and small scale farmers (between 1 and 10 2 acres) who use their tractors for agriculture and haulage. Customers include both the "banked" and the "unbanked" (70% of the medium farmers have formal bank accounts while only 10% of small farmers have). Customers repay their loans half-yearly based on the seasonal nature of agricultural harvesting and marketing. Generally the portfolio performance is good although the smaller farmers have the highest rates of non-performance. The equipment purchased acts as the collateral against the loan (in a traditional leasing arrangement). Due diligence is innovative and based on potential income post purchase of the tractor, to account for the scaling up of their income.

Participants traveled 100-150km outside Jaipur to Kotputali, Sawai Modhopu or Tonk. Visits started at the dealerships, where tractors are bought, serviced and re-sold. Three visits were then made to farmers of varying sizes, from 1 to 75 hectares.

More information on equipment financing can be found on the AgriFin website.

Critical Success Factors to Mahindra Finance's Equipment Financing

Importance of connection with the local community. Emphasis was put on the importance of local references for confirming the ability to pay and also the need to be 'on people's doorsteps' for business and collection. This is the most important channel for their customer service and understanding. *Sutradhers*, opinion makers/leaders in communities who help with collection and new references are not only repeat customers but help with credit assessment of and repayment by other customers. Direct marketing through activity centers and cross-selling currently account for only 20% of their business volume.

Product, geographical and customer segment de-risking is required. Mahindra have undertaken this since 1995 and it has been a key contributor to success. Product-wise, they have moved from auto/tractor to other types of products up to heavy commercial vehicles in 2012. Geographically they have moved from semi-urban customers to include urban, semi urban, rural and remote rural classed customers. Income-wise they started with low and middle income customers and now lend to those with higher income.

Technology, people, processes and geography are important elements to take into consideration. Handheld devices are relied on for the field agents that are dispatched from the various dealerships allowing them access to all information on the central server in regard to the clients. Mahindra also relies on mobile technology to SMS clients when their payments are due as well as automated telephone reminders and balance confirmation when required. Mahindra invest in their people, including through senior management mentoring of junior staff and building capacity across the range of skills needed in regard to all aspects of equipment financing.

Pictures: Tractor servicing at the Mahindra Tonk Dealership; Marketing truck

Conclusions

Success is possible. Participants agreed that value chain financing is becoming an important and effective way to finance agriculture. They were glad to see that there are practical examples that show it can be done successfully, profitably and sustainably, irrespective of initial challenges. However, it was acknowledged by all and reinforced by HDFC that VCF requires patience; there can be a long gestation period before success is seen.

VCF requires ownership and commitment from all stakeholders. Participants understood the importance of a committed attitude from all stakeholders in the value chain. Whether from leadership in the bank and organizations to cooperatives, a commitment to decentralized operations, acceptance of use of payment systems etc. all play an important role in ensuring success. The quality and dynamics of relationships within the chains are important and need to be nurtured once identified.

Tailor made "solutions" taking into account local realities have made the difference. Much of what the participants registered came back to the tailor made solutions that HDFC and Mahindra have created over time for their customers. The 'doorstep' and relationship-based marketing, monitoring and repayment options displayed by Mahindra along with flexible repayment schedules are another example.