MAKING THE BUSINESS CASE

REDUCING COSTS AND RISKS

Value chain financing unlocks the viability of an enormous potential market in smallholder farmers by offering a way for banks to share risks, costs, and essential information with a lead firm partner within the chain.

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INTRODUCTION

This step examines the main advantages to the bank of adopting a value chain financing approach, including reducing information gaps, lowering transaction costs and increasing opportunities for cross selling. Bank teams should

consider these factors when making the business case to their senior management and Board of Directors.

INFORMATION GAPS REDUCED

Information gaps are substantially reduced because the bank – through partnerships or contracts with value chain participants such as aggregators and processors – is able to utilize information that otherwise would have been unavailable or expensive to obtain. This information encompasses:

- Agronomic (including technical and engineering) knowledge of the crop(s) or livestock involved in the value chain, including yields, best practices, input demands, and timing of input delivery. The bank does not need to have in-house expertise to collect this information, merely enough to interact with the relevant value chain participant who has the expertise and well-established business relationships (usually upstream with producers).
- Profiles of participants/customers engaged in the value chain, such as primary producers, small-scale traders and collectors, mid-level and wholesale aggregators, processors, and exporters.
- Region-specific and cultural factors, e.g., dominant local language, and customary trade relationships.
- Market intelligence, including price behavior, market shares of different buyers, and input suppliers.

LOWER COSTS

Banks can see substantially lower transaction costs in delivering and servicing multiple financial products by relying upon the existing networks or transaction platforms of value chain partners. In some cases, financial institutions have created payments platforms around those existing relationships, allowing them to operate as if they had an extensive branch network but without the fixed costs of building one.

Connecting the bank with the lead buyer or trader in an already-established commercial relationship is a preferable starting point. Once established, this relationship allows the bank to design and introduce financing vehicles priced to reflect the cost- and risk-sharing arrangements between it and its value chain business partners.

It is also important to be able to deliver services up and down the chain in a cost-effective manner. While production financing can be achieved through the buyer, other services require a different delivery method. The choice of delivery mechanism becomes a decision between direct provision through bank branches, or the use of agent networks. The latter not only allows better servicing of the value chain participants, it also makes the services available to others outside the value chain who live or work within reach of the agents.

CROSS SELLING

The benefits of an agent-based delivery network become more apparent when considering that farmers who have been able to receive financing through a value chain arrangement tend to lose financial access once their produce is delivered, the loan is repaid, and the surplus revenue to the producer is paid out. Smallholder farmers are more likely to benefit from financial inclusion – and remain active consumers of financial consumers products – if they have

additional options such as savings accounts, particularly if they can choose from among a few types of accounts that meet their needs and preferences (e.g., term deposits). In this way, farmers develop the ability to pay providers as needed or transfer funds to relatives through the financial institution. At the same time, those additional non-lending services, and other new products such as insurance, bring additional revenue to the bank.

BUSINESS CASE SCENARIOS

Broadly speaking, there are two principal business case scenarios in support of a bank adopting a VCF approach to broadening its agriculture lending base:

1. Expanding the coverage of a value chain in which the bank already maintains some established business relationships (e.g., with an aggregator or processor) yet only limited outreach upstream to producers and input suppliers.

2. Establishing a presence in a value chain new to the bank's portfolio, using market intelligence and research (such as that carried out by AgriFin and its

selected partner banks). This could be initiated on a pilot basis within the bank's existing standards (e.g., loan caps).

Regardlessof the selected business case imperative, successful adoption of VCF hinges upon a clear understanding the target segment (based upon market intelligence and value chain mapping) and the identification of appropriate entry points and products.

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