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FROM PILOT TO LAUNCH

CASE STUDIES HIGHLIGHT DIFFERENT APPROACHES

Banks seeking to enter an agriculture value chain or expand their presence likely will seek to use a pilot project to test their approach before scaling up. Internal planning that wins the support of senior management is essential, and two examples are showcased here.

LAUNCHING THE VCF PROJECT

The launch of a new VCF or the expansion of a piloted operation typically begins with an internal bank proposal to management. Such proposals differ among individual banks but there are several common characteristics. The examples of India's HDFC Bank and Yapi Kredi of Turkey are illustrative of cases that have successfully established value chain finance operations in their existing markets and are actively seeking new opportunities. Additionally,

management will need a number of internal tools for tracking the progress of value chain financing pilot initiatives, such as a value chain profit and loss template, to gauge progress before scaling up the new activities. Often a bank will undertake 2-3 loan cycles to examine the profitability of the model before scaling it up. Based on HDFC's case in the dairy value chain, it can take 4-5 years before the project becomes 'business as usual' within the bank.

CASE STUDY 1: INDIA’S HDFC

At India’s HDFC Bank, a “Product Program” is put together for internal approval that includes eight components:

1. Objective; e.g., to provide credit and payment services to smallholder farmers working with an aggregator.
2. Purpose of the loan; e.g., working capital, or micro-irrigation investment.
3. Arrangements in place between aggregator and farmers, the implications for agreement between aggregator and the bank, the existence of guarantees, and aggregator assessment.
4. Facility details: terms, maturity, pricing, collateral, geography, documentation, and service-level agreements, if any.
5. Product caps and triggers, including total lending under the program, delinquency triggers, and remedial actions.
6. Reporting and management information systems.
7. Risk analysis including first, second, and third ‘ways out’.
8. Business plans, and 3-year projections.

The product program is created for each aggregator or set of aggregators and their respective groups of farmers. HDFC formulates a companion document outlining the profit and loss account associated with the program, including estimates of revenue from cross-selling products such as insurance and other retail products. Once a program is approved and successfully implemented, a new program with different caps and triggers could be formulated, possibly requiring board approval if caps exceed existing policies.

CASE STUDY 2: TURKEY’S YAPI KREDI

In Turkey, Yapi Kredi's approach involves formulating an action plan for the value chain operation. This plan includes the assignment of responsibilities within the bank for the different components of the plan .

1. After validation by a director, the marketing department arranges meetings with related parties to discuss requirements for an action plan. A steering committee is established if the value chain project requires major development.
2. If the project does not require changes to existing procedures, the marketing department will meet with the "Agri-sales Department" to consider an acquisition strategy and action plan.
3. Execution of the action plan falls to the sales department. An action plan consists of:
4. Estimated sales volume and revenues from the value chain project
5. Products/services to be presented for the value chain
6. Terms and conditions for the products (pricing, maturity, collateral)
7. A specific campaign structure for the value chain, if necessary
8. Required visits to processors and other parties of the value chain
9. Agreements and protocols if required

The sales department prepares a timetable and to-do list for the action plan and begins to implement the plan with regional supervisors and branches.

CONCLUSION – WHAT WORKS? WHAT HAMPERS SUCCESS?

When a bank has the systems in place and experience with farmers and supply chains, agricultural lending can be an effective path for banks to increase business and diversify portfolios. There is no single formula to create a successful agricultural value chain operation; solutions are context-specific, not only in terms of the particular agricultural activity involved and the value chain structure but also in regards to the legal and business environments in which the dealings between the bank and other value chain participants take place.

Successful value chains create value for all participants involved. As a general principle, the value chain finance relationship must make economic sense for all participants, and not just for the bank. In practice, this principle translates into properly aligning incentives for all participants: producers, aggregators, processors, and financial institutions.

Value chains must be a viable business proposition. Value chains must be market-driven, sustained by demand, and supported by suitable preexisting infrastructure. During the identification stage, it should be determined whether the value chain is likely to become dependent upon financing for its viability or whether it is capable of growing through financial support.

There is no single financial product or group of products that is guaranteed to unlock the potential inherent in lending to farmers. Banks and financial institutions must invest in understanding the activities that take place throughout the value chain. They also should recognize the variations in demand for products and the potential for managing risks through existing value chain relationships. With better research comes better products. With better products, clients are more likely to succeed and repay loans. Read more.

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'Yapi Kredi’s Approach'

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'Bank Proposal to Management'