



## 2<sup>nd</sup> African Continental Briefing

### Promoting inclusive finance models for farmers in Africa

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Organized by the Pan African Farmer's Organisations (PAFO), the ACP-EU Technical Centre for Agricultural and Rural Cooperation (CTA), and the African Union Commission (AUC)

This Briefing is linked to the Brussels Briefings organized by the CTA, EC/DGDEVCO, ACP Group and Concord every two months on key issues related to agriculture in ACP countries <http://brusselsbriefings.net>

### Background Note

#### 1. Context: Addressing the rural finance gap through agricultural value chain finance

After many years of declining investment, there is a renewed interest in agricultural financing. The agro-food sector has undergone changes that have influenced new models of production and marketing involving: a focus on demand rather than on producer-defined agricultural goods; fragmented marketplaces; food safety and traceability requirements; and higher quality standards. This evolution requires a better understanding of the whole set of transactions within each value chain and that of the agricultural sector within which it operates.<sup>1</sup>

Financial services providers often see high risks because they lack an understanding of the agricultural sector and food markets, and have no way to evaluate the risks in agricultural value chains.<sup>2</sup> To most financial institutions, the cost of directly lending to small-scale farmers in remote rural areas is prohibitive and they are reluctant to finance rural entrepreneurs, citing high transaction costs and risks related to agriculture such as crop failure, diseases and market fluctuations as a justification.<sup>3</sup> The result is a serious and long-lasting rural finance gap that keeps the economic potential of agriculture unrealised.

Increases in finance and investment are needed at all levels of the food chain, especially to increase the access to finance by smallholders.<sup>4</sup> To be successful, the value chain finance approach requires a solid financial entity with appropriate institutional infrastructure, a clear commitment to rural finance, a supportive enabling environment, and a viable market of value chain activities that are suitable for this type of financial product.

Value chain financing is an approach that identifies where the financing needs are, where there are financing gaps, who can provide the financing, and what the ways are to improve access to financing, in addition to ensuring the agricultural produce or product is well defined and has a market value. **Value chain finance is an approach that takes a systemic viewpoint, looking at the collective set of actors, processes and markets of the product, as opposed to an individual lender-borrower within the system.** Decisions about financing are based on the health of the entire system, including market demand, and not just on the individual borrower. While much of the emphasis in a value chain finance

<sup>1</sup> Calvin Miller and Linda Jones. Agriculture value chain finance. Tools and Lessons. FAO and Practical Action Publishing. 2010

<sup>2</sup> Jennifer Bernhardt, Stephanie Grell Azar, Janette Klaehn, Technical Guide. *Integrated Financing for Value Chains- Credit unions fill the agricultural lending gap and create market linkages.* WOCCU, 2009.

<sup>3</sup> KIT and IIRR. 2010. *Value chain finance: Beyond microfinance for rural entrepreneurs.* Royal Tropical Institute, Amsterdam; and International Institute of Rural Reconstruction, Nairobi.

<sup>4</sup> Calvin Miller and Linda Jones. Agriculture value chain finance. Tools and Lessons. FAO and Practical Action Publishing. 2010

approach is on the health of the chain and its value-adding transactions and linkages, a well-rounded assessment of all borrowers is still critical.

Numerous **financial instruments** have been adapted or developed to use in financing value chains: (a) those based on the commodity itself; (b) those based on accounts receivable; (c) finance based on fixed assets where the commodity itself serves as guarantee; (d) different products that help reduce risk; and (e) other products that improve the credit supply. These include various trade finance instruments, warehouse receipts, factoring, etc. and risk mitigation products related to the product such as forward contracts and guarantees. Another tool to reduce risk is insurance – indexed insurance, farm insurance, livestock insurance, health insurance, which all help to improve the credit supply. The same occurs with futures contracts, which are very important and useful in AVC finance systems.

The small-scale businesses of asset-poor farmers at the beginning of the chain are intimately connected with the larger businesses of traders, food processors and supermarket chains at the end of the chain. Thus, it is crucial to address the financial gap that hampers growth, limits agricultural development, and results in a loss to the financial sector, which in turn neglects millions of potential rural clients.

## **2. Value chain finance and innovative ways of delivering financial services**

The development and business communities involved in the African agriculture and agribusiness sectors have recently experienced a tremendous resurgence of interest in the promotion of value chains as a way to add value, diversify rural economies, and contribute to increasing rural household incomes in most developing countries. Value chains are increasingly recognized as a means to reduce the rural poverty prevalent in the region. However, and from a development perspective, governments and support agencies must ensure that the financial systems in their countries are able to meet the demands arising from the growth of modern agro-food value chains.<sup>5</sup> The renewed focus on agriculture and agribusiness, as priority sectors for spurring economic growth in Africa, calls for developing value chains that integrate producers and markets to make the agricultural sector more responsive to consumer demand.

Agricultural value chain management offers an opportunity to reduce the cost and risk in financing and increase access to smallholder farmers, expand the financing opportunities for agriculture, improve efficiency and repayments in financing, and consolidate value chain linkages among participants in the chain. The specific opportunities that financing can create within a chain are driven by the context, business model and the relative roles of each participant in the chain.

For financial institutions, value chain finance creates the impetus to look beyond the direct recipient of finance, so as to better understand the competitiveness and risks in the sector as a whole, and to craft products that best fit the needs of the businesses in the chain. Value chain finance can help the chains become more inclusive, by making resources available for smallholders to integrate into higher value markets.<sup>6</sup>

There are additional benefits to bringing in formal financial entities to finance value chains. By providing poor and low-income communities with access to formal finance, a financial service provider can reduce the liquidity and production constraints that weaken the negotiating power of smaller producers. As a third party, the institution can also: facilitate consensus building and align the incentives of different value chain actors, increase value chain competitiveness, and improve end products. The financial institution can also assist the smaller producers or Farmer Organisations in assessing the risk associated with some of the value chain actors.

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<sup>5</sup> KIT and IIRR. 2010. *Value chain finance: Beyond microfinance for rural entrepreneurs*. Royal Tropical Institute, Amsterdam; and International Institute of Rural Reconstruction, Nairobi.

<sup>6</sup> Calvin Miller and Linda Jones. *Agriculture value chain finance. Tools and Lessons*. FAO and Practical Action Publishing. 2010

### 3. ICT uses for inclusive agricultural value chains

It is essential to improve access to reliable and timely information critical for taking advantage of market opportunities. Cheaper forms of ICTs, such as mobile phones and the networks needed to connect them, have facilitated access to critical information for farmers, small traders, business people in production systems management, market access services, and have led to financial inclusion.<sup>7</sup> ICTs are among the most effective drivers of inclusive agricultural value chains and agricultural growth and transformation in ACP countries.

Market access ICT services comprise of any service that provides beneficiaries, especially farmers, with access to information on the pricing of agricultural products (inputs and outputs), and on finding and connecting to suppliers, buyers or logistics providers, such as storage facilities and transport companies. Such services include simple pricing services, virtual trading floors (matching services or full commodity exchanges) and holistic trading services. Market access services also cover ICT solutions that help the typically larger upstream and downstream firms, such as processors or exporters, to improve the management of their operations and the quality of their produce – here called downstream administration.

Some ICT innovations include SMS messages via mobile phones to provide farmers with weather forecasts, government contacts, and information on pests and recommended chemicals. There are also radio services and phone help desks in remote areas with access to the agricultural information in local languages. National Farmers' Information Service (NAFIS) in Kenya converts text into audio in English or Swahili. Farmers use landlines or mobile phones to place requests for voice-based information. The Talking Book in Ghana is a hand-held audio computer that records locally produced agricultural and literacy information for Ghanaian farmers to play back in their own language on livestock, fish farming and health. Network and Knowledge System (LINKS) in Kenya and Ethiopia collates data on livestock sales and prices for dissemination through SMS messages. M-Farm, also in Kenya, is a non-subscription mobile phone service that gives farmers information about market prices across the country through text messages. The Livestock Identification Trace-back System (LITS) in Botswana uses radio-frequency identification (RFID) technology to capture data on individual cattle, and transmits this information directly, and error-free, to a central database.

### 4. The way forward

The situation for banks involved in agricultural finance is no different from that of other businesses. Getting the business model right is key to long-term survival. Understanding and using collateral management, structured finance and credit support techniques should be part of a banker's arsenal.<sup>8</sup> Five key conclusions can be drawn from successful AVC finance: (i) Continuous market-based information on the chains is important for all those involved; (ii) Partnerships based on mutual interests with interrelated systems reduce risk; (iii) Reduced transaction costs; (iv) Finance within or toward the chain is an essential element to strengthen the AVC; (v) Structuring of financial products appropriate to the chain and its stakeholders is fundamental.<sup>9</sup> The renewed focus on agriculture and agribusiness, as priority sectors for spurring economic growth in Africa, calls for developing value chains that integrate producers and markets to make the agricultural sector more responsive to consumer demand.

The best innovations in AVC finance depend on the chain, the capacity of the different stakeholders in the chain, the interests of the stakeholders and the socio-economic and political context. Agricultural value chain finance offers an opportunity to: reduce costs and risks in financing; reach out to smallholder farmers; expand the financing opportunities for agriculture; improve efficiency and repayments in financing; and to consolidate value chain linkages among participants in the chain. The specific opportunities that financing can create within a chain are driven by the context, business model and relative roles of each participant in the chain.

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<sup>7</sup> Calvin Miller, V.N. Saroja and Chris Linder. ICT uses for inclusive agricultural value chains. FAO. 2013

<sup>8</sup> Lamon Rutten. *De-constructing agricultural finance: how re-thinking the model can improve the method. Models of agricultural value chain financing. Perspective of chain members.* Proceedings of the conference "Agricultural Value Chain Finance". Edited by Rodolfo Quirós. 2011.

<sup>9</sup> Ibid.

## 5. Objectives of the Briefing

Building upon earlier CTA work for the international conferences on *Making the Connection: Value Chains for Transforming Smallholder Agriculture*<sup>10</sup>, the Brussels Briefing on VC Finance and 'ict4ag'<sup>11</sup>, this Briefing will place a particular emphasis on value chains, advocacy and policy development. It will furthermore discuss the new context of value chain finance in Africa, the different value chain business models and the innovative applications of ICTs from a farmer's perspective.

The Briefing aims to: (i) highlight the key opportunities in value chain finance for farmer's organisations; (ii) provide space for sharing experiences and innovations on VCF; and (iii) facilitate networking among development partners.

This Briefing will feed into the CTA/AFRACA conference on *Revolutionising finance for agri-value chains* to be held in Nairobi on 15-17 July 2014.

### Target group

The representatives of the regional African farmer's organizations (PROPAC, SACAU, EAFF, ROPPA, UMAGRI) and the national farmer's organisations, policy-makers, civil society groups, research networks, development practitioners, and international organisations.

### Available material

Input and comments before, during and after the meetings will be included in the Briefings blog: <http://brusselsbriefings.net>. A Reader and Highlights in printed and electronic format will be produced shortly after the meeting.

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<sup>10</sup> CTA International Conference 2012. <http://makingtheconnection.cta.int/>

<sup>11</sup> CTA International Conference 2013. <http://ict4ag.org/en/>