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The Concept of Agricultural Value Chain Finance and Types of Value Chain Business Models

Calvin Miller

Senior Officer and Group Leader Agribusiness and Finance

Executive Summary

Changes in the food industry and agricultural production and marketing systems are well noted across the developed and developing world. The increase in food prices caused concern by many governments and increased interest of investors in agriculture. The dynamics of population growth, urbanization and increased incomes have increased the demand for food towards more processed foods and high-value agricultural products such as meats, edible oils, fruits and vegetables, while shifting away from traditional products such as staple grains. To meet these demands and remain competitive, producers must move beyond their traditional markets and be linked into coordinated agricultural value chains that can meet consumer demands and industry requirements.

The linkages and coordination arrangements taking place among all value chain actors open new opportunities to improve their access to financing. This has given rise to the concept of **agricultural value chain finance (AgVCF)**. It is defined as those arrangements governing financial flows into and within the agricultural value chain. Conventional agricultural finance centers on the capacity, reputation and collateral of the borrower and their business activity. In AgVCF, the risk assessment goes beyond the client to the strength and competitiveness of the whole value chain focusing on the product flow transactions and financial arrangements taking place within business operations of the various actors involved. Hence, even small farmers and clients without adequate collateral for conventional financing can be financed in cash or in kind because of their relationships with buyers and other VC actors and also because the cost and risk of financing are much less when disbursements and/or payments can often be made at point of sale. For bankers, a value chain approach to finance also means they take a holistic approach to assess the financing risks and costs and then structure the financing to fit the nature and specific needs of the value chain partners.

A value chain can be organized in various **business models** defined largely by the key driver of a value chain. These are classically defined as: a) producer driven, b) buyer driven and c) integrated value chains. However, in undeveloped regions with many small producers and agro-enterprises, a fourth model arises: d) facilitated model. Here a public or private development agency serves as an enabler to bridge linkages and build capacity in order to make it possible for these target actors to participate in competitive value

chains. The fast-growing adaptation of mobile technologies and information and communication technology (ICT) can also favor this inclusion.

Coordinated value chains have also opportunities for innovation and adaption of many new **financial instruments** that were previously not common in agriculture and agribusiness. These include new products of trade related finance like receivable finance and factoring, adaptation of forward contracts and futures. Alternative collateral arrangements such as crop receipts and warehouse receipts and greater use of insurance, guarantees also become more important. In addition, interest in joint venture financing often through investment funds, among other arrangements has grown significantly due to value chain coordination. .

For **donor agencies** and **governments**, the terms agricultural value chain and AgVCF have become more familiar but are not well understood. It is important to note that AgVCF is a comprehensive approach to lending that is structured to fit the needs of those in the VC and builds from the knowledge of the markets, the transactions, the capacity and the relationships of those involved. For many small producers and agro-enterprises not linked into competitive VCs, capacity development is needed before they can take full advantage of the opportunities. Also, work is needed to adapt the regulatory frameworks for the new financial instruments and for ensuring compliance of buyer and seller contracts.

For more information please contact: Calvin Miller at FAO calvin.miller@fao.org