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Value Chain Financing

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Executive Summary

Agri financing in developing markets is hampered by many obstacles. Besides regulatory and infrastructural deficiencies, the fragmentation of agriculture and the lack of value chain integration makes financing of agriculture sometimes a risky venture. In general, the more upstream in the chain the riskier it becomes. That is, small farmers are price takers generally handicapped by lack of market information and lacking bargaining power towards traders and processors. While in the West cooperatives have been instrumental in organizing farmers in the value chain, in developing markets, cooperatives are plagued by mismanagement, lack of capitalization and governance issues. While in the West smallholders have gradually moved out of agriculture finding employment in other industrial sectors, in developing markets the lack of alternative employment has kept smallholders in agriculture hampering consolidation and economies of scale. The lack of transparency of landownership systems further complicates much needed consolidation but also farmer financing (in a country as Uganda 50% of legal cases relate to land issues).

Notwithstanding the aforementioned issues, agriculture in developing markets can be financed in a sustainable way. However, this needs strong commitment by banks to invest in knowledge and dedicated agri experts. It requires the development of rural branch networks, dedicated agri products and a robust risk management system. Only few banks have taken the effort to invest in this since in many cases banks see quicker and more lucrative alternatives to allocate their capital (e.g. Treasury Bills).

Rabobank, through its subsidiary Rabo Development, has invested in several rural banks in Sub-Sahara Africa to stimulate rural and agricultural banking. It does so by combining capital investments with management support and technical assistance. Strong emphasis is put on developing a value chain approach where partnerships are forged between the different stakeholders in sectors to improve bankability. Supported by Rabo Development's advisory unit (RIAS) the banks have been implementing outgrower schemes, Warehouse Receipts Financing, Saving based loan schemes, value chain analysis and other agri related financing tools & schemes to boost the agri lending volumes. Correspondingly, technical assistance is provided to promising cooperatives often in partnership with the agri processors.

This has particularly been successful in countries that already have a minimum agri infrastructure such as Zambia where extension officers of the Zambia National Farmer Union (ZNFU) work closely together with Zanaco, the Rabo partner bank. Also in Tanzania, NMB has been successful in developing value chain financing from scratch in only a few years reaching 125,000 smallholder via primary cooperative societies under various outgrower schemes. The forward linkages with the agri processors have proven critical in the financing success.

However, it is not enough to develop value chain finance schemes. Although they can be instrumental in starting the financing carousel, one thing they don't do is to help develop farmers into emerging commercial farmers. Although certainly not all smallholders can and want to develop into commercial farmers it is key that banks have the capacity to identify the promising growth oriented farmers for an individual financing approach. Whereas value chain financing typically stops short of working capital financing, emerging farmers need medium and sometimes long term financing to invest in irrigation, plantations and equipment. Although the value chain approach is still relevant to this segment of farmers traditional outgrower schemes tend to be less suitable.

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For an example of a value chain financing case (Palabana dairy cooperative in Zambia), please refer to Youtube, **"Milking the market Zambia style"**