**ValueLinks Module 8**

**Value chain finance**

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**ValueLinks 2.0**

1. Setting boundaries
2. Chain analysis and strategy
3. Value chain strategies
4. Programs and projects
5. VC upgrading solutions
6. Business models
7. Business linkages
8. Services
9. VC Financing
10. Quality and standards
11. Managing data & monitoring

Solutions for improving the value chain
Value Chain Financing Solutions

Contents

1. Financing needs of value chains and VCD
2. Financing solutions
3. Risk management

VC development and financing issues

- Value chain analysis
- VC development strategy
- Improved business models
- Financing solutions

1. Do financing gaps exist now?
2. Current financing problems of operators
3. Public financing needs of VCD
4. New financing needs of operators
5. Additional long & short-term capital needs
6. Conditions under which investing is profitable
7. Financial instruments & arrangements
Reasons for financing gaps along the VC

Current financing problems along the value chain

Financing needs of value chain development

Classifying the financing needs arising in VC development
Calculating capital needs

...derived from the analysis of improved business models

Key activities:
- New production technology
- Intensification / more inputs
- New sales channels

Key resources:
- Equipment
- Buildings
- Other long-term assets

Cost structure:
- Greater working capital to pay for raw material and inputs
- Ability to repay long-term credit

Financial Needs of VC Actors

Typical financing needs of operator business models

Primary producers → Processors Industry → Traders → Market

Short term working capital
2-6 months
- Bridging the period between
- purchase of inputs and sale of harvest
- delivery of buyers

Long term Fixed assets
2-5 years
- Investment into
- tree plantation
- greenhouse
- storage space
- equipment, machinery

- Bridging the period between
- purchase of intermediate products and sale of product
- delivery of products and payment of buyers

- Bridging the period between
- purchase (in bulk) and retail (store value)
- Export of product and payment of overseas buyers
- Investment into
- buildings
- vehicles
### Value Chain Financing Solutions

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#### Financing solutions

##### Overview of financial instruments / arrangements

<table>
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<tr>
<th>Period</th>
<th>Value chain finance</th>
<th>VC-external finance using VC linkages as hard / soft collateral</th>
<th>Individual lending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term (up to 12 months)</td>
<td>Based on contracts</td>
<td>Based on hard collateral (assets):</td>
<td>Based on hard collateral / cash flow</td>
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<tr>
<td></td>
<td>Supplier credit</td>
<td>Warehouse receipt finance</td>
<td>Bank overdraft</td>
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<td></td>
<td>Buyer credit</td>
<td>Trade finance, such as factoring, purchase-order finance, repo finance</td>
<td>Individual short-term credit</td>
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<tr>
<td></td>
<td>Finance interlinked with production contracts</td>
<td>Export trade finance (export receivables financing), especially letter of credit, bill of lading financing</td>
<td>Microfinance loans</td>
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<td></td>
<td></td>
<td>Triangular arrangements with buyers, based on soft collateral:</td>
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<tr>
<td></td>
<td></td>
<td>Short-term bank loans based on guarantees or contracts + on-lending</td>
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<tr>
<td></td>
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<td>Credit based on production contracts</td>
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<tr>
<td>Medium and long-term (1-7 years and longer)</td>
<td>Based on hard collateral: Equity capital of buyers / lead firms</td>
<td>Triangular integrated arrangements based on hard and soft collateral: Medium-term bank loans based on contracts of buyers and on long-term support by NGOs and/or producer associations – using a combination of different financial instruments</td>
<td>Based on hard collateral and/or balance sheet: Financial Leasing, Operating Leasing, Individual term loans, Equity venture capital</td>
</tr>
</tbody>
</table>

Source: own compilation based on Coon et al., 2010; KIT and IRR, 2010; Meyer, 2007; USAID, 2008
**VC-Internal Financing Arrangements**

*Internal / external value chain financing*

- **Supplier credit**
- **Deferred payment**
- **Deferred payment**
- **Advance payment on order contract**
- **Trader credit**

**Financial Institutions**

**Warehouse receipt finance**

- **Production**
- **Storage**
- **Trade**

- **Farmers**
- **Traders**

**Warehouse operators**

**Agricultural Bank**

- Receives produce
- Issues receipt
- Keeps stocks

= guarantee
Tripartite Finance

Furniture Production → Furniture Manufacturers → Wholesaler Retailers

Orders

Pembuat mebel
Home industry

ASMINDO
Verifies orders and reports to Swamitra

Swamitra
Microfinance wing of Bukopin

Bank Bukopin

Ministry of Cooperatives and SME

Value Chain Financing Solutions

Contents

1. Financing needs of value chains and VCD
2. Financing solutions
3. Risk management
Risks And Costs of Financing...

...individual enterprises  ...commercial transactions & export business  ...value chain upgrading

Increasing risk / coordination needs / information needs

- Technical / weather risk
- Performance risk (failure to realize biz model and generate cash flow)
- Market risk (price, cost demand volume)

PLUS:
- Contract default risk (due to informality)
- High transaction cost for small loan size and heterogeneity of lenders

PLUS:
- Coordination cost
- Contract risk / moral hazard

PLUS:
- Uncertainty & intransparency of VC
- Supply chain risk
- (= high information and monitoring cost along the VC)
- Contract risk

...companies with sufficient equity

3

...(informal) SME lacking equity

Risk Management Instruments

- **Technology development and adoption** (R&D, postharvest technology, software development, IT, education programs)

- **Enterprise management practices** (e.g. farm diversification, certification, Just-in-time management, inventory control, food safety practices, logistics planning, early warning systems)

- **Financial instruments** (e.g. credit, insurance, warehouse financing)

- **Investment in infrastructure** (e.g. transport / communication, energy, informatics and knowledge transfer, storage and handling, processing facilities, weather stations)

- **Policy and public programs** (regulatory measures, agricultural policies, property rights, labor laws, disaster management, safety nets)

- **Private collective action** (action by cooperatives, industry associations)
Summary: Main lessons to remember

- Value chain development requires that operators invest into fixed assets and use greater amounts of working capital. Often, VCD also implies that governments have to invest into physical infrastructure and public service capacity.

- Mobilizing the necessary funds is a challenge. Financing gaps have to do with the size and amount of collaterals of enterprises, financial literacy, the attractiveness of business models and with constraints in the financial system.

- Financing solutions include complementing existing business linkages by advance or deferred payments, and/or using business linkages and contracts as a means to secure external loans. VC finance integrates financing solutions and the improvement of business models, linkages and services to address the constraints that prevent financial institutions from lending.

- Important accompanying solutions include risk management and instruments to enhance financial literacy and make the financial aspects of VCD more transparent.