FINANCING FARM INPUTS THROUGH A RISK-SHARING CONSORTIUM

Tips from AGRA's Implementations in Ghana and Burkina Faso

Techinical Note
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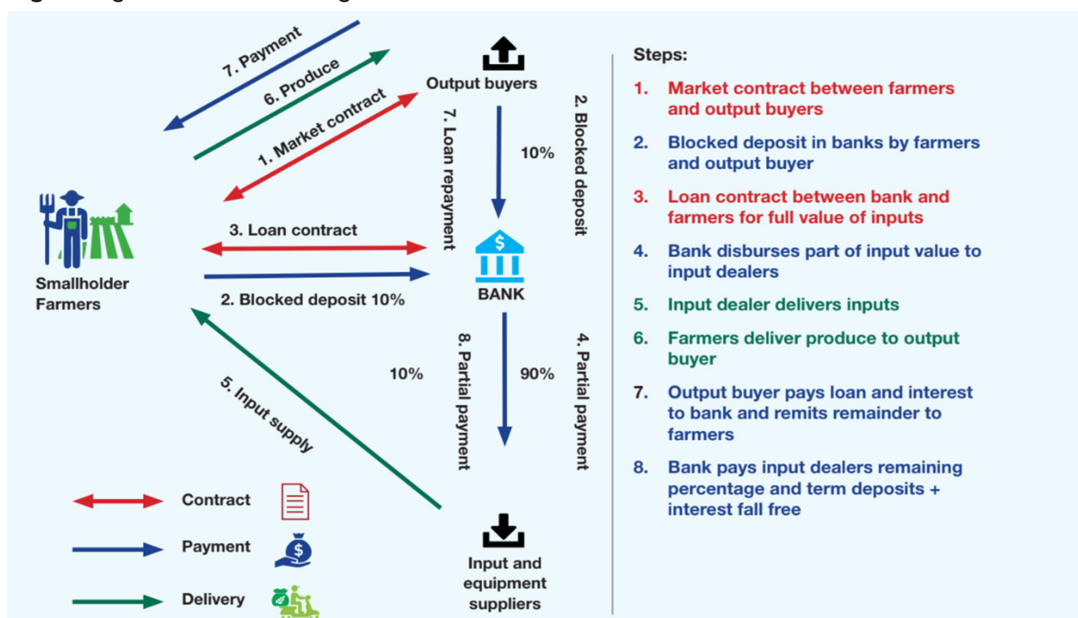
INTRODUCTION

TO AGRA'S INPUT FINANCE RISK-SHARING MECHANISM

Increased agricultural production and well-functioning agribusiness ecosystems are keys to rural economic development, food security, climate change resilience and enhancing the livelihoods and living standards of smallholder farmers. One of the most obstinate barriers to increased farm production across the global South is inadequate access to reliable and timely financing to cover the cost of farm inputs. An emerging input finance strategy builds on the recognition that improved crop production benefits many different ecosystem actors. Not only do smallholder farmers and their producer organisations stand to gain from higher quality and quantity of production, but so do input suppliers, off-taking buyers and financial service providers. Given that these actors are united by the potential benefits of increased production, it makes sense for them to collaborate in carrying a portion of the risk that goes into making stronger production possible.

Together with its agribusiness ecosystem partners in Ghana and Burkina Faso, AGRA has been experimenting with a risk-sharing input finance model, also known as a tripartite financing arrangement. This approach brings together four categories of actors to spread the risk of input financing and bolster the ecosystem in select value chains. As a general overview of the risk-sharing model: a financial service provider receives blocked deposits from producer organisations and off-taking companies working together under contract, with each deposit covering 10% of the farm inputs needed to achieve the agreed production. Then, combined with their signed off-taking contracts as collateral, the bank remits payment for 90% of the value of the required inputs to select input suppliers, who deliver all the inputs to the producers, thereby retaining 10% of the finance risk. At harvest, producer organisations deliver their product to the off-taker, who repays the bank's credit worth 70% of the input value (plus interest). The off-taker remits the remaining product cost to the producer organisations, who distribute the profits to their farmer members. Finally, the bank frees all the partners' blocked deposits. Figure 1 provides an overview of these transactions that form the basis of the risk-sharing input finance model.

Fig 1: Diagram of Risk-Sharing Mechanism



Source: AGRA Finance Team and IFAD's Leveraging South-South and Triangular Cooperation (SSTC). Risk-sharing as a Driver for Smallholders Farmer Finance: Value Chain Financing Model - Value chain financing model offers a risk-sharing solution for SMEs and farmers.

IDENTIFYING APPROPRIATE CONTEXTS AND VALUE CHAINS

Evidence to date indicates that this risk-sharing model for financing farm inputs is more likely to function in contexts and value chains that meet certain criteria. Whether you are an investor, technical assistance provider, off-taking company, input supplier, producer organisation, or other stakeholder considering this approach, it is helpful to consider AGRA's lessons learned when investigating whether and how this risk-sharing model responds to your landscape and needs.

Does your **target value chain** have at least one buyer with a strong and ongoing demand for product that is not in adequate local supply, and are they willing to buy on contract?

Tighter, more formal, structured value chains work better with this model because the incentives of each actor depend on reliable off-taking contracts and an ecosystem of motivated actors who can work together toward their converging goals.

Is there a critical mass of producers of that crop or a related crop in a manageable geographic area and who are organised in groups or can be assembled in **collaborative groups of producers?**

The model requires a sufficient number of producers to make participation of all parties worthwhile as well as efficient. Since reaching out to individual farmers is time-consuming and counter-productive in the long term, we recommend favouring producers who are already working in producer organisations or cooperatives, or who would be well disposed to doing so.

Do the producers have trouble accessing inputs due to **lack of financing options?**

If it's not broken, don't fix it! If the relationships between farmers and input suppliers and/or off-takers are such that farmers are accessing the inputs they need to produce at or near their capacity, it may be better to reinforce that existing consortium than to introduce new partners.

Do the producers have access to a certain type of inputs but **lack knowledge, demand or appetite to invest in inputs** that would substantially increase their yield/quality/profits?

On the other hand, if there are reasons beyond a gap in input finance per se, this risk-sharing model has the potential to facilitate the testing and adoption of new crops, improved inputs or recommended practices that producers would not otherwise consider trying.

Are there **input suppliers in the value chain who are interested** in such a risk-sharing arrangement and willing to try it?

In some contexts, it is difficult to find reliable suppliers with the capacity to produce quality inputs at the scale needed, and in certain cases (like in Ghana with cashew saplings), input suppliers may not perceive an advantage to participating in such a risk-sharing consortium. Make sure that the inputs will be feasible to obtain on time and that the suppliers are genuinely motivated.

Are there **FSPs in the region(s) that have a genuine motivation to participate** and willingness to devote time and attention in collaboration with other consortium partners to launch and maintain the risk-sharing mechanism?

Similar to the input suppliers, the financial partner also needs to be sincerely motivated to participate actively in the consortium. The model requires that each partner come prepared to invest time and energy to build a collaborative relationship with the other partners, adjust internal risk management and operational processes, and troubleshoot together when unforeseen obstacles arise.

If your answers to these questions are all positive, the next step is to assemble the right partners. If you answered 'no' to some of these questions, consider looking further for a viable market segment, or seeking a different approach to input finance.

ASSEMBLING A RISK-SHARING CONSORTIUM

Once an appropriate context and value chain have been identified, it is critical to identify consortium partners who have the commitment and capacity to fulfil their roles. The risk-sharing input finance mechanism works because the motivations and incentives of each partner category converge around increased quantity and quality of production. Figure 2 summarizes each partner's typical motivations to participate as a member of the risk-sharing consortium.

RISK-SHARING PARTNER MOTIVATIONS AND INCENTIVES

Fig. 2

Keeping in mind the likely incentives of each partner in the model can help to identify appropriate actors, test assumptions, and support all partners in building and managing the consortium.

ACTOR	INCENTIVES TO PARTICIPATE IN RISK-SHARING INPUT FINANCE SCHEME
Financial Institution	▪ Expand outreach to new segment of clients ▪ Diversify product offerings ▪ Build agricultural portfolio, enhance competitive market position ▪ Contribute to social mission by reaching lower income and smaller agribusinesses ▪ Reach rural and agricultural clients more efficiently and at lower risk ▪ Build skills in consortium approaches and negotiations
Off-Taker	▪ Source of raw materials ▪ Quality standards ▪ Reduced procurement costs ▪ Lower financial risk (covering just 10% of the input risk)
Producer	▪ Access to buyer contracts ▪ Reduced risk – finding buyer, accepting low price ▪ Ability to access inputs with only 10% deposit ▪ Increased exposure and access to access to improved inputs ▪ Agricultural extension and other technical support
Input supplier	▪ Substantial risk reduction ▪ Free up working capital ▪ Build local demand for specialised inputs ▪ Increase efficiency ▪ Reduce risk of anticipatory investment in inputs being lost ▪ Reduce risk of inputs not being properly used / under-performing

Each partner category is like one leg of a chair: all four must work individually and collectively to achieve their shared objectives (Figure 3).

Based on the experiences of AGRA's partner, Advans Savings and Loan Ltd, and other partners in Ghana and Burkina Faso, several criteria have been identified for selecting promising partners. Figure 4 provides a summary overview of these criteria, which bear further testing and documentation by AGRA and its partners and other global stakeholders. These criteria and their rationale are described in detail in the AMEA case study entitled Financing Farm Inputs through a Risk-Sharing Consortium: Lessons from AGRA's Input Finance Model in Ghana and Burkina Faso.

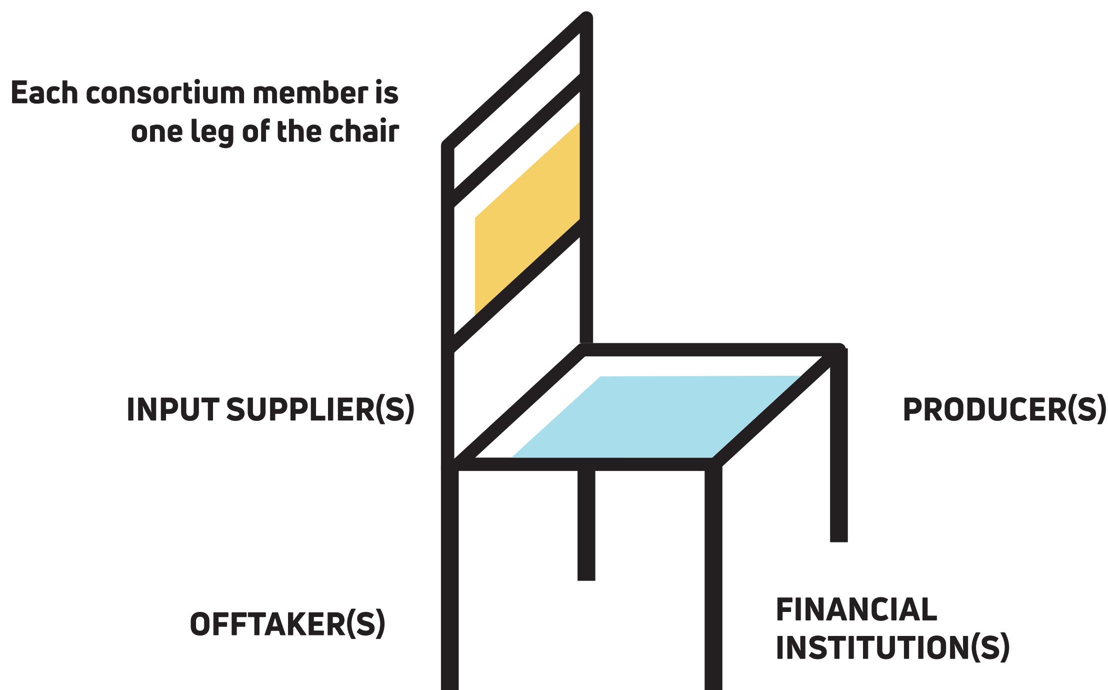


Fig 3: Consortium Partners Share the Burden of Both Risk and Responsibility

SUMMARY OF PARTNER SELECTION CRITERIA

Fig. 4

Financial Institution

- Business-driven interest, leadership-level commitment
- Time, staff, operational budget
- Basic understanding of agriculture (risks, seasonality, prices, timing, market)
- Institutional flexibility and intention
- Digital component - transparency, efficiency
- Open search vs. existing relationships
- Individual or pool of FIs

Off-Taker

- 2-3 years in target VC
- Existing relationships with the farmers
- Has financed own farmers
- Training, capacity building for farmers
- Tracks and monitors crops

Producer

- Organised in groups, governance
- Minimum 2 years with off-taker
- Minimum farm size (by VC)
- Can meet internal bank and regulatory requirements (age, ID card, citizenship)
- Ideally: funding and technical assistance for capacity building

Input Supplier

- Offers inputs meeting off-taker and producer criteria
- Acceptable pricing
- Motivated to engage with other consortium partners
- Training, demo plots, coaching, etc.

LAYING A SOLID FOUNDATION FOR SUCCESS

With all four categories of key actors on board, the consortium's next step is preparing the terrain for a successful implementation. The gearing-up process should begin 12 months prior to the target date for the first round of input loans—being sure to allow sufficient margin before the expected date of planting. The following points should be built into the implementation and maintained (ideally with some neutral, third-party support that purposefully engages all partners) for at least three crop cycles.

1

CONSORTIUM PARTNER CAPACITY BUILDING

It is critical that each partner has the understanding and institutional capacity to fulfil their roles and responsibilities in the mechanism. In order to collaborate effectively, the partners need to understand not only the goals and operational details of the mechanism, but also the motivations and pain points of their fellow partners. AMEA endorses using an Agribusiness Cluster Approach[1] and has prepared a Toolbox containing peer-reviewed strategies, including iCRA's Agribusiness Cluster Coaching Curriculum.

2

CONTRACTS

It may seem obvious, but experience shows that detailed and well understood contracts are essential to reinforce trust and guard against the inevitability of unforeseen events. Contracts need to be clear and explicit about issues such as pricing, storage and transportation of inputs and harvest, and steps to take in case of market fluctuations or other disruptive circumstances.

3

COMMUNICATION AND STEERING COMMITTEE

A successful risk-sharing mechanism relies on an ongoing shared understanding, trust and buy-in of the offtaker(s), financial service provider(s), producers and input suppliers. The dynamic contexts in which these actors operate are such that any weaknesses or breakdown in understanding, trust and buy-in are quite apt to result in a collapse of the consortium as a whole. Hence mechanisms to facilitate regular communication among all of the partners—and not just when challenges arise—are key to a successful consortium over the long term.

4

KNOWLEDGE MANAGEMENT AND KNOWLEDGE SHARING

Further experimentation and documentation are needed in areas such as expanding financial service provider partners to include MFIs, exploring off-taker and input supplier-led implementations, and proactive strengthening of each consortium partner's capacity and understanding–with special attention paid to producer organisations. By sharing this case study, AMEA hopes to inform and inspire its members and the rural development sector to consider this promising tool, leverage the learning of peers, and continue honing strategies to advance the state of the practice in accelerating the development of professional farmer organisations.

This Technical Note is based on the AMEA case study Financing Farm Inputs through a Risk-Sharing Consortium: Lessons from AGRA's Input Finance Model in Ghana and Burkina Faso.

1. AMEA Annual Learning Report 2021

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