Credit Guarantee models for Fertilizer Financing in Africa

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In 2018, the Governing Council of the Africa Fertilizer Financing Mechanism (AFFM), realigned the strategic orientation of the AFFM. As a result, the tenure of AFFM was extended to 2032 and the Council reaffirmed the Mechanism’s aim to create an enabling environment for mobilizing investments needed to achieve a target of 50kg of nutrients per hectare of fertilizer use as agreed in the 2006 Abuja Declaration. In this regard, AFFM through a study, identified credit guarantees as a financial instrument which can contribute to boosting access to fertilizers in Africa.
The study revealed that the agricultural/fertilizer sector faces three main challenges:

- **Perception of agriculture as highly risky:** Financial institutions deem the agricultural value chain as high risk and are thus reluctant to fund the sector. Alternatively, they demand a risk premium of 10%-15%.

- **Limited understanding of financial processes:** Potential borrowers have limited understanding of the financing processes and the preparation of business plans required by financial institutions to successfully complete loan application processes.

- **Lack of sufficient collateral:** Potential borrowers lack sufficient collateral to secure financing from financial institutions.

In acknowledgement of these challenges, AFFM is focusing on the provision of credit guarantees and other financial solutions along the fertilizer value chain that will promote the provision of reliable and adequate access to fertilizer by farmers.
Credit guarantee instruments were selected by AFFM for several reasons:

**Do more with less**
- Scarce risk capital can be leveraged to avail more funds to projects.
- In comparison to loans, guarantees tie up resources for a shorter period of time and improve commitment capacity.

**Crowding in**
- Crowding in can be used to attract private investment into Africa’s fertilizer value chain.
- Crowding in can provide greater amounts of capital that enable governments to share risks/financing with the private sector.

**Risk sharing**
- Because of perceived risks in Africa, there is an additional 10-15% risk premium on projects compared to other regions of the world. Guarantees would enable this risk to be shared.
The Africa Fertilizer Financing Mechanism proposes the following guiding principles to ensure the effectiveness of the credit guarantee scheme for long-term sustainability:

- Leverage the credit guarantee scheme on existing African Development Bank templates for efficiency and alignment purposes.
- Collaboration with local implementing partners to identify target beneficiaries and develop their capacities.
- Provision of unfunded partial credit guarantees to financial institutions for risk sharing purposes.
- Development and monitoring of the credit guarantee scheme pricing mechanism, with the aim of evolving towards a high degree of long-term financial sustainability.
- Focus communication to target beneficiaries with support for business development and loan applications.
- Build a strong and reliable fertilizer distribution network.
AFFM intends to increase the availability and affordability of high quality fertilizer to smallholder farmers. Towards this, AFFM seeks to target beneficiaries with potential to reach smallholder farmers. By so doing, the impact on smallholder farmers can be twofold:

1) increasing the availability of fertilizer; and
2) increasing financial institutions’ confidence with providing financing to the agricultural sector in general.

The direct beneficiaries would be:

- **Private importers, blenders or suppliers:** these require investment capital related to fixed assets such as blending facilities, warehouses, and vehicles for transport. On average, only dozens of such companies exist per country that would require an investment size in the range of USD 1 - 2 million.

- **Wholesalers, distributors, agro-dealers and retailers:** they require funding of inventories and debtors. This could be made available in the form of working capital finance, including supplier finance or lines of credit.
The credit guarantee implementation process will focus on operations that make use of partner organizations in the market where the credit guarantee scheme will operate. With their local knowledge and outreach, these organizations can connect with the target beneficiaries.

AFFM categorizes partner organizations into two groups:

- **Financial Institutions:** AFFM seeks to partner with credible financial institutions that have a demonstrated ambition to help finance fertilizer value chains. These financial institutions provide financing to eligible beneficiaries with experience working in rural areas.

- **Implementing partners:** AFFM relies on credible implementing partners that have the capability and willingness to reach out to target beneficiaries. They have a sound knowledge of the fertilizer market and value chain and are familiar with local financial institutions. In addition, they have experience in developing pipelines and fertilizer value chain development.
This credit guarantee product targets private importer, blender, wholesaler and distributor companies in need of investment capital. AFFM, through its local implementing partner, decides whether to provide a commitment agreement for a guarantee to the target beneficiary. The target beneficiary can directly apply for a guarantee with the local implementing partner. If the local implementing partner, operating on behalf of AFFM, approves, then the target beneficiary will receive a commitment agreement. The commitment agreement offers a confirmation by AFFM that a portion of a potential loan can be guaranteed. With such an agreement, the target beneficiary can then shop for a competitive rate at various financial institutions for financing subject to the agreed conditions in the commitment agreement. Here, the AFFM provides a partial guarantee to cover up to 50% when the financing is secured.

Credit guarantee schemes

AFFM works with three types of credit guarantee instruments that will target beneficiaries’ main financing needs. These are:

- the portable credit guarantee for investment loans;
- the portfolio credit guarantee for working capital; and
- the trade credit guarantee.

The trade credit guarantee is also ideal for working capital.

Portable credit guarantees

This credit guarantee product targets private importer, blender, wholesaler and distributor companies in need of investment capital. AFFM, through its local implementing partner, decides whether to provide a commitment agreement for a guarantee to the target beneficiary. The target beneficiary can directly apply for a guarantee with the local implementing partner. If the local implementing partner, operating on behalf of AFFM, approves, then the target beneficiary will receive a commitment agreement. The commitment agreement offers a confirmation by AFFM that a portion of a potential loan can be guaranteed. With such an agreement, the target beneficiary can then shop for a competitive rate at various financial institutions for financing subject to the agreed conditions in the commitment agreement. Here, the AFFM provides a partial guarantee to cover up to 50% when the financing is secured.
Portable Credit Guarantee Process Flow:

1) AFFM contracts implementing partners in each country where the Credit Guarantee Scheme is to operate and where the AFFM has no direct local reach;

2) The implementing partners analyze and contract financial institutions that are willing to participate in the modalities of the scheme, with the final approval to be given by the AFFM;

3) The implementing partners analyze applicants (target beneficiaries) and issue commitment agreements to the applicants;

4) The applicants shop at participating financial institutions to negotiate the most attractive terms;

5) Upon agreement of a loan between the applicant and the financial institution, AFFM issues an individual guarantee to the financial institution;

6) Implementing partners monitor the progress of the loan guarantees at the financial institutions on behalf of AFFM.
The portfolio credit guarantee targets wholesalers, distributors, agro-dealers and retailers. This scheme does not look at the credentials of each and every applicant. Instead, it gives participating financial institutions permission to attach a partial credit guarantee to any beneficiary meeting the eligibility criteria and for which the partner financial institution has decided to provide a working capital loan or credit facility. The financial institution reports quarterly to AFFM on the loans that are guaranteed under the portfolio credit guarantee scheme. The credit guarantee will cover 50% of the unpaid part of the loan principal, plus interest payable when the guarantee is called by the financial institution.

Figure 2: AFFM portfolio credit guarantee mapping
Portfolio Credit Guarantee Process Flow:

1) AFFM contracts implementing partners in each country where the Credit Guarantee Scheme is to operate and where AFFM has no direct local reach;

2) The implementing partners analyze and contract financial institutions that are willing to participate in the scheme and/or with which AFFM has an existing working relationship, with the final approval to be given by AFFM;

3) AFFM signs a contract with participating financial institutions on the guarantee scheme modalities and limits of portfolio of guarantees to be issued;

4) Individual applicants (target beneficiaries), possibly with support from the implementing partners, reach out to participating financial institutions and apply for a loan (the financial institutions likewise can reach out to the applicants);

5) Financial institutions conduct the credit analysis of the applicant and issue a guaranteed loan;

6) Implementing partners monitor the progress of the portfolio of loan guarantees at the financial institutions on behalf of AFFM.
The trade credit guarantee model operates at two levels:

1) upstream suppliers to hub agro-dealers.
2) hub agro-dealers to retail agro-dealers.

In both cases, the hub agro-dealers are the pivotal channel for the upstream players as well as the source of product and credit for the downstream players. Under the trade credit model, a fertilizer importer, manufacturer, blender or supplier will avail fertilizer to hub agro-dealers on credit and AFFM will share the credit risk involved in the transaction with the supplier at an agreed pari-passu percentage. The hub agro-dealer will then give the product on credit to distributors and the chain will continue until the fertilizer reaches the smallholder farmers. The model can also be applicable to farmer cooperatives.

Figure 3: Trade credit guarantee mapping

1 The Latin term « pari-passu » means at an equal rate or pace. In a pari-passu agreement, all the parties are treated the same.
Trade Credit Guarantee Process Flow:

1) AFFM contracts implementing partners in each country where the Credit Guarantee Scheme is being implemented;

2) Implementing partners identify, analyze and contract the manufacturer, importer or supplier willing to participate in the scheme, on modalities and limits of guarantees to be issued, with the final approval to be given by AFFM;

3) Implementing partners identify and introduce hub agro-dealers and SMEs to the manufacturer, importer or supplier;

4) Implementing partners build effective linkages intended to build trust and confidence needed to facilitate the provision of fertilizer on credit;

5) Implementing partners provide tailored business management and technical assistance so hub agro-dealers can operate as successful businesses;

6) Support the hub agro-dealers in obtaining other required resources such as warehousing and equipment, where possible;

7) Implementing partners facilitate the process flow of fertilizer down to farmers, provide required technical assistance and monitor the progress.
AFFM seeks to partner with credible financial institutions that have a demonstrated the ambition to help finance fertilizer value chains. As such, the main conditions for participating in the credit guarantee scheme are:

- Demonstrated commitment and willingness to provide financing to beneficiaries that meet predetermined eligibility criteria and/or have a significant current loan book of fertilizer-clients;
- Up-to-date fulfillment of regulatory requirements (registration, licensing, audited financial statements);
- Demonstrated financial stability and performance using CAMELS\(^2\) and regulator rating (management, risk rating, profitability, liquidity, leverage, portfolio quality, growth);
- Demonstrated adequate procedures, internal controls and systems for target beneficiary appraisal, credit approval, default recovery, reporting, monitoring and risk management;
- Preferably have a network in rural areas (branch offices);
- Preferably have experience working with other credit guarantee schemes.

\(^2\) CAMELS is a recognized international rating system that bank supervisory authorities use to rate financial institutions by six factors: Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity.
Implementing partners

AFFM wishes to work with credible implementing partners that have the capacity, capability and willingness to engage target beneficiaries. Selection of implementing partners will include, but are not limited to, the following:

- Sound knowledge of the fertilizer market and value chain;
- Familiarity with target beneficiaries in the local market setting;
- Familiarity with local financial institutions and a demonstrated ability to initiate contact, conduct negotiations and conduct monitoring & evaluation activities;
- Ability to develop local market intelligence;
- Ability to develop a pipeline of eligible beneficiaries;
- Ability to support further fertilizer value chain development;
- Capacity to perform credit assessments and high-quality reporting to AFFM.
Boosting access to fertilizers through innovative financing solutions