

**UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT**

**UNCTAD Series on Innovative Financing in the Commodity Sector and  
Dynamic Industries**

***LEVERAGING OFFSHORE FINANCING TO EXPAND  
AFRICAN NON-TRADITIONAL EXPORTS: THE  
CASE OF THE HORTICULTURAL SECTOR  
(new case studies)***

Prepared by the UNCTAD secretariat



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## FOREWORD

Access to finance is considered to be a critical catalyst of trade expansion and economic development, particularly in developing countries. Many participants in the commodity sector and in such dynamic industries as fisheries, renewable energy and electronics depend on credit to upgrade their operations and achieve sustainable livelihoods. Where credit is constrained or very dear, producers and other actors in the value chain are unable to meet market demand and integrate effectively into local, regional and international supply chains. This means missed opportunities for growth and chronic incapacity to increase participation in global trade.

Where, however, sustainable sources of financing are made available at reasonable cost, participants can move up the value chain into higher value-added production processes. They can also diversify their activities and explore opportunities offered by new, high-growth dynamic industries. This virtuous circle of higher investment and higher return further stimulates economic development and poverty reduction.

Drawing on knowledge acquired from its technical assistance activities and research on cutting-edge pro-development financing techniques, UNCTAD is publishing a new research series, entitled **Innovative Financing in the Commodity Sector and Dynamic Industries**.

With contributions from international experts and practitioners, the series promotes best practices in this area of financing based on concrete case studies. Such practices include encouraging financiers such as local banks to adopt innovative approaches as they strive to expand their outreach to producers, providers of auxiliary services and exporters in developing countries. The series should thus prove useful to producers, enterprises and market support institutions engaged in the commodity and dynamic sectors.



Supachai Panitchpakdi  
Secretary-General of UNCTAD

January 2007



## INTRODUCTION

One of the consequences of globalization, and to some extent the civil strife and economic difficulties that Africa suffered especially in the 1980s to the 1990s was a large outflow of migrants from Africa to Europe, the Americas and, to a limited extent, some parts of Asia. Globalization had also meant freer flow of information and goods across borders than hitherto. As a result, there has been a steady increase in demand for ethnic foods as well as tropical fruits and vegetables globally. Available data show that on an annual basis, Africa's exports of fruits and vegetables declined by 12.5% in 1985, but in 1995 and 2004 the exported tonnage rose respectively by 16% and 26.6%. Africa's flower exports have also seen increases, with a more diversified range of flower types and varieties in the continent's export basket. More countries have become horticultural exporters. Whereas prior to the mid-1990s, horticultural exports were significant in only a handful of countries, such as South Africa, Zimbabwe and Kenya, today the list has expanded to include Ghana, Côte d'Ivoire, Uganda, Ethiopia, Egypt, Zambia and a few others.

Demand for African horticultural produce has also been driven by the low cost of production that has shifted the comparative cost of production for certain types of flowers and vegetables in favour of Africa as compared to traditional producers in Europe and elsewhere; improved air links between Africa and the key European markets; distance advantages enjoyed by Africa as compared to other competing producers of tropical fruits and vegetables; a deliberate policy of many African Governments to diversify their exports away from soft commodities, with their highly volatile prices, to value-added exports; rising entrepreneurship following the freeing of the export sector from State monopolies, etc. Recent applications of innovative financing structures in support of the trade have also contributed to the rising importance of horticultural exports in Africa. As horticultural exports are perishables that are traded on consignment and not in commodity exchanges where agricultural commodities are usually traded, structuring financing for such exports has not been easy. In such deals, banks usually find it difficult to mitigate the unfamiliar risks, ranging from performance, weather, quality, perishability/ rejection to pricing. Lessening these risks in a market with new and untested entrants is a daunting task. In recent years, however, skill and experience have been brought to bear on this constraint, and interesting deals are being made with low risk. Receivable financing whereby flower exporters are granted evergreen overdraft facilities tied to borrowing base certificates hinged on the value of receivables is growing in importance. Owing to the rise of supermarkets as direct markets of some exports, factoring and forfaiting have also become key financing instruments for horticultural exports. In an innovative deal, migrant remittances were used to mitigate risks in a pre-export financing deal in favour of an African agricultural bank that needed hard currency funding to pre-finance horticultural and other agricultural exporters. Experience shows that there is no limit to what imaginative bankers can do to profitably support the growth of the booming African horticultural export business.

This document was first published in 2000 and has now been revised to capture recent developments in this important sector. Chapter I of this report describes the risks and constraints in financing horticultural trade in Africa, while Chapter II explains the role of various parties, ranging from Governments, banks, producers, exporters, buyers, auction floors, and insurance companies in ensuring successful horticultural export financing structures.

In Chapter III, some of the successful deals in support of the sector are presented. Deal structures cover pre-shipment financing, receivables financing, forfaiting, post-shipment financing and infrastructure financing. The examples do not by any means exhaust the full range of possibilities; rather, they provide important success factors in horticultural export financing deal structuring that mitigate the performance, payment and country risks inherent in such deals.

The first two annexes touch on related important issues: the former examines the development impact of horticultural exports from the point of view of value creation in the supply chain, while the latter

presents the specialized facilities of Afreximbank in support of Africa's horticultural exports. The third annex gives a brief description of how the main elements of a facility structure are outlined in a term sheet. The last annex explains in greater detail the marketing and risk analysis of the last successful case study on infrastructure finance in Zambia using short-term receivables.<sup>1</sup>

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<sup>1</sup> This introduction was provided by Okay Oramah, Director, Planning and Development at the African Export-Import Bank (Afreximbank) in Cairo, Egypt.

## **Chapter I**

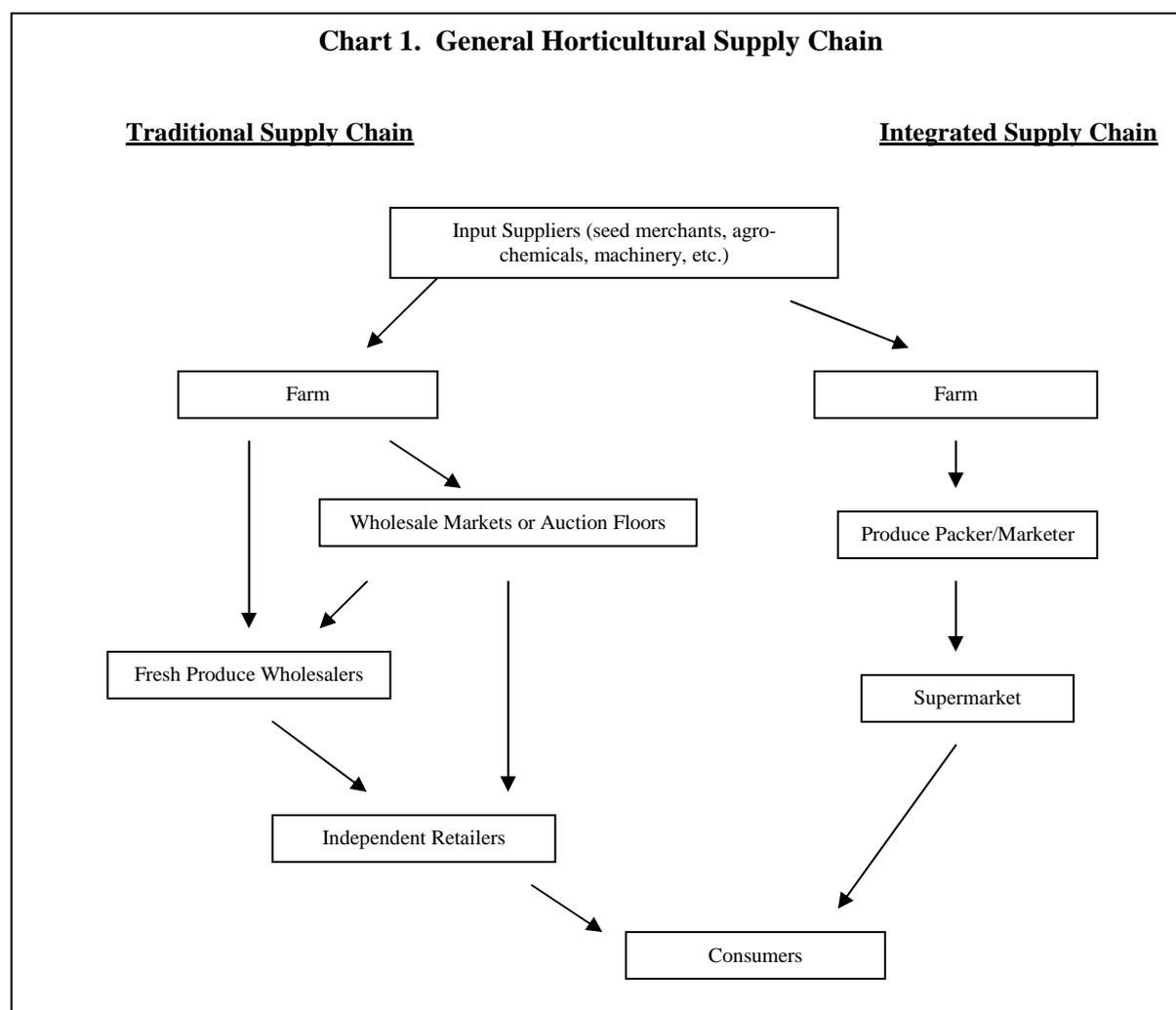
### **RISKS AND CONSTRAINTS IN FINANCING AFRICA'S HORTICULTURAL TRADE**

The financing needs of African operators in the horticulture industry are significant, as their private capital is limited and the expenses and requirements involved in developing their business are multiple. Financing leverage is required for virtually all aspects of horticultural operations – planting, transportation, packaging, preservation and export. The elementary factors of production are land, labour, capital and entrepreneurship. In many African societies, land is universally available, at least for the planting of varieties of flowers and vegetables (which are intensive crops). There is an abundance of labour and some level of skill in horticultural management.

The main element lacking is capital. There is a need for financing to fund acquisition of the necessary equipment and inputs for the planting, harvesting, packaging and preservation of produce prior to export. Even the movement of produce from farm gates to the port of export requires the use of specialized trucks, which are expensive. The necessary capital is not readily available to growers and exporters. Horticulture exporters in Africa must usually wait for an average of 45 to 60 days before they receive payment for their goods from their major buyers in OECD countries. During this waiting period, they have to borrow locally to pay their creditors as well as for working capital purposes so that they can remain in operation and produce for new export orders. In many cases, overdraft facilities are used for such purposes. Most often, however, their financing needs are not fully met by these facilities, and not always on time. This makes it difficult for them to plan efficiently for orders and manage costs effectively. Thus, the situation drastically affects their abilities to meet orders and manage costs effectively. Moreover, when it comes to managing the concentration of risks, banks are sometimes not willing to support this sector notwithstanding the growth potentials.

On the other hand, buyers in OECD countries are generally mindful of their own cash flows, which could be affected by making upfront payments or pre-payments, which are obligatory before goods are shipped or by opening letters of credit. By paying upfront for goods, which are deliverable usually only after 30 to 90 days, buyers expose themselves to increased working capital costs by borrowing upfront to finance the importation or using their existing credit lines. This is why foreign buyers in the horticultural sector (supermarket chains, auction floors and traders) prefer to operate on open account and deferred payment terms.

This situation has left horticultural exporters in Africa with no choice but to source for funds to generate exports and thereafter expect payments by the buyers. Unfortunately, in the horticulture market, the buyer calls the shots. In effect, the exporters seek funding at "all costs" to meet their export orders.



In this chapter, some of the limiting factors that prevent financiers from providing financing for horticultural activities in Africa are examined.<sup>2</sup> Horticulture players generally suffer from the problems described below.

**a) Undercapitalization**

Many growers and operators in the horticulture sector in Africa are small family enterprises. They make no attempt (or do not have the capacity) to inject equity funds into the business, waiting for the banks to provide even set-up funds. Their only contribution is generally ancestral land. However, banks do not view this as an indication of serious commitment to the ventures by their promoters and are therefore reluctant to provide funds. Some bank credit policies stipulate a certain level of financial commitment by the promoter to a business for it to qualify for advances.

**b) Low collateral**

In the absence of any significant equity capital, these operators are unable to acquire the necessary equipment for their activities. In essence, what they make available as collateral is only land, for

<sup>2</sup> The information in this chapter and the following one is mainly drawn from discussions at two regional meetings (Mali/Bamako in February 2001 and Kenya/Nairobi in May 2001) that UNCTAD organized on "Diversification and development of the horticultural sector in Africa" (website: <http://www.unctad.org/infocomm/Diversification/workshops.htm>), as well as from responses from a number of banks to a questionnaire submitted to them by UNCTAD on that issue. From the replies, there appears to be some measure of uniformity in the nature of problems they encounter.

which at times they have no adequate title documents. Lenders are not always comfortable with this arrangement as it means that the borrower has no stake to protect in the operation, a fact which could have a direct bearing on his commitment to its success.

**Box 1. The marketing and supply chain in  
African horticulture**

Fruit and vegetable distribution is primarily handled through three different channels, with the latter two being most common:

1. A “short” channel of direct sales and local markets;
2. A “traditional” distribution involving the physical presence of the products on a wholesale market (e.g. Rungis or Brussels);
3. An “integrated” channel whereby supermarkets manage the supply chain from beginning to end.

In the traditional channel, there are multiple firms providing marketing, operational and distribution services along the supply chain from growers to an array of end-users such as retail outlets, small shops, and restaurants. However, the nature of this chain has increasingly been replaced with the emergence of supermarkets\* since the mid-1990s with an integrated approach to supply management, resulting in fewer actors along the supply chain. From the growers’ perspective, however, the sector is still very sensitive to consumer and marketing trends, where traders mainly capture information and pass it back to growers via new orders to supply. Hence, it is common to see major supermarket retailers and multinational trading firms with a large working capital base playing a key role in coordinating the production, processing and marketing of commodities from certain countries. For instance, four major traders – Dole, Fresh Del Monte, Chiquita and Fyffes – handle more than 35 per cent of world trade in fruits and vegetables.

\*For a detailed analysis of supermarkets’ impact on the supply chain, see Annex 1.

**c) Poor expertise**

Some of the main constraints on horticultural development in Africa are the limited technical and managerial capabilities of African operators to acquire and apply appropriate, up-to-date production and post-harvest handling technology on the one hand, and to run a horticultural farm as a profitable business on the other. It is hard to find professionals in botany or related agricultural studies willing to venture into the growing of horticulture and floricultural plants on a commercial scale. However, the increasing popularity of contract farming used by large exporters has alleviated some of the problems faced by small growers. By contracting independent farmers to grow certain products, large exporters agree to provide the technical expertise needed to produce horticulture that will meet the high phytosanitary standards of importing countries and consumer demands in a competitive market. Cultivation of horti/ floricultural plants is much more than mere tree planting – it is the creation of an end product that will hopefully be profitable and marketable to a diverse body of consumers. Banks will obviously prefer to deal with professionals who have not only good knowledge of plant behaviour but also good managerial and business skills.

**d) High operational costs**

The perishable nature of the products entails very high operating costs. Such costs stem from expensive and, at times, inadequately supplied inputs like high fuel costs, specialized means of transport, and the urgency of having to prepare perishable products for export that includes crating to loading. All this not only means high insurance costs (most growers and exporters usually take out insurance on crop and delivery from the time the product is on the farm up to the time it arrives at the airport and ready to be shipped), but also constitutes one of the biggest risks in horticulture trade finance, because unless the produce is delivered to the market in time, its quality may deteriorate; if that happens, it will be rejected or command a much lower price.

Furthermore, insufficient governmental measures supporting the building and maintenance of adequate key infrastructures (roads, railways, energy and telecommunications networks, irrigation

systems), leave small as well as large farmers with inadequate tools for their agricultural production and cause inefficiencies that in turn create additional costs along the whole agricultural supply chain, i.e. from production, processing and transportation to export. As a result of these costly elements, profit margins are severely eroded, leading to fears by banks that cash flows from such activities may not be sufficient to service loans.

**e) Inadequate carriers**

Bankers are also concerned that growers and exporters may not find ready freighters to transport the cut plants or fruit/vegetable produce to the market as and when desired. A few years ago, Zimbabwe used to have seven daily flights ferrying products to Europe. But as inward cargo dried up, the number was reduced to only two flights daily. This became the only option since freighters cannot charge exporters for losses on the cargo-free inward trip, which in any case would make their products far more expensive than market realities.

**f) Pests and adverse weather conditions**

In most African countries, meteorological services are very inadequate, a factor that leads to inaccurate prediction of weather behaviour. In effect, farmers simply practise blind cropping, resigning themselves to fate. Moreover, in the absence of standard pest control measures, agricultural activities become extremely risky and unattractive to lenders.

**g) Product seasonality**

The seasonal nature of activities in the sector affords lenders little room to make medium- and long-term facilities available to either the growers or the exporters. Short-term advances are naturally more expensive and do not provide any reasonable opportunity for flexibility. There is a fear that if, for any reason, the farmer failed to plant at the appropriate time, there would be a shortfall that would affect the servicing of loans.

**Box 2. Cut flower production in Africa\***

Most African countries grow flowers mainly to meet European consumer demand. The African countries make use of certain market opportunities, such as supplementing the European market during the winter and cultivating species which are hard to grow in Europe or which require too much energy because of their long growing times. These countries benefit from a developing infrastructure, knowledge, transport facilities and entry to the European market in particular, owing to trade agreements with the EU. Nevertheless, although the African growers have basic advantages in terms of production costs (adequate supply of cheap land, water and labour) and favourable climate, countries are faced with obstacles such as a lack of proper infrastructure, a lack of proper technologies, transport and logistics problems, and welfare and ecological issues.

The first cut flower nurseries were established in 1969 in Kenya, originally a coffee-producing country. Nowadays, there are over 1,000 flower farms in the country (although 75 per cent of total exports are supplied by just two dozen large or medium-sized enterprises). Family farms growing cut flowers are rare in Africa. The major large-scale nurseries are owned by foreign investors, banks, wealthy individuals, cut flower growers from Western Europe and local governments. At the major nurseries, the number of employees varies from a hundred to even thousands of people. The managers of these farms are often recruited from the United Kingdom, the Netherlands, Germany or Israel. On the other hand, local people have also set up small farms in recent years.

In Europe, flowers are sold mainly through the Dutch auctions or directly to wholesalers. Nowadays, the tendency is to bypass the Dutch auctions in favour of direct selling to supermarket chains and wholesale markets (as is the case with the UK market). For instance, between 1990 and 2000, sales of flowers from Kenya, Zimbabwe and Zambia directly to the British market increased tenfold. The main reason for this is that many companies (mainly Dutch and German firms) have established themselves in these countries, investing heavily to organize the horticultural sector. Moreover, local farmers have organized themselves into cooperatives to form holdings of 50 hectares and more, sometimes with the support of associations such as the

Export Flower Growers Association of Zimbabwe and the Zambian Export Growers Association. In Zambia, a central purchasing agency known as Agriflora buys directly from producers and bypasses the auction halls by selling directly to the supermarkets in Europe and North America.

Rather than buying in an auction from unknown suppliers, supermarkets want to buy large quantities through long-term contracts, directly from known producers. Buying directly is the shortest route from grower to shop (which in a way ensures a certain quality) and is also important because supermarkets want to be certain about the conditions under which the produce that they sell is being produced. It gives them greater control over their suppliers and more information on the latter's working conditions. In addition, it lowers costs and reduces delay. In parallel to these changes, information technology and the Internet have also taken on an important role in the distribution channels of the floriculture industry.

African producers, particularly those who operate on a large scale, have been the main beneficiaries of the change in supply patterns. Supermarkets are interested in African flowers because they are inexpensive and because growers are willing to accept a set price. For the growers, the arrangement is attractive because supermarkets buy large quantities at pre-arranged prices. But in order to live up to their side of the bargain, African growers must invest in optimal production methods. Often this includes infrastructure investments in greenhouses and artificial ventilation/heating facilities in order to allow greater attention to quality. While growth is also highly dependent on the availability of cheap airfreight facilities, further production growth hinges on the ability to attain capital at affordable rates.

\* For further information on the cut flower industry, please refer to <http://www.floracultureintl.com>.

#### **h) Market/price risks**

These risks are very important, particularly when the market has an oversupply of perishable products. Prices of horticultural produce could drop drastically during the term of the transaction, making it difficult for producers/exporters to service their loans. At the same time, it may often be difficult to secure a fixed price contract. This situation would result in a higher safety margin for the financiers and less credit to the growers.

When growers deal directly with supermarkets, the price risk may seem lower because the sale is often at a pre-set price; on the other hand, however, the market risk is higher as the quality standards requested by the buyers are very rigid and could lead to rejection of the produce (unlike auctions, where there is an open market which means that a seller is relatively sure that the product will be sold, but at a price determined by its quality and market demand).

#### **i) Storage risk**

A critical measure of quality for horticultural and floricultural products is freshness. In most of the countries where such products are produced, storage facilities are inadequate and road networks are dilapidated. Where storage facilities are available, constant power outages can cause spoilages and deterioration in quality. Of course, in such circumstances, loans could go bad.

#### **j) Loan diversion**

Bankers have expressed their concern about the tendency of beneficiaries of loans to divert them to other types of crop production or, in some cases, to other domestic needs. Where this happens, the ability to repay loans is jeopardized. Generally, there appears to be a tendency among farmers to want to switch to other crops at the slightest hint of improvement in their prices or to choose to sell to higher bidders, thus not executing their initial sales agreement. In such circumstances, appropriate market feasibility studies and suitable monitoring may be necessary in order to avoid serious potential for failure.

### **k) Non-existent local market**

The virtual non-existence of markets for horticultural products in Africa poses a grave threat to growers. This is because, when international buyers refuse goods (owing to quality issues) or exporters are unable to ship the goods (due to *force majeure* events, such as the airline strike or the truck drivers' road blockade in Europe a few years ago), there would be little or no chance of marketing these products in the local market to recover basic operational costs. The question here is how long the products could last if the strikes were to continue. This scenario is obviously an issue of concern to lenders.

### **l) Quality risks**

Quality is a highly important issue in horticultural trade, and is expected to be a dominant barrier to future entry into European markets as quality standards continue to rise throughout the first decades of 2000. Producing horticultural crops for export is a much more difficult undertaking than producing for local markets. There are several reasons for this. First, the EU continues to impose stiff food safety and phytosanitary standards on horticultural imports from developing countries. Secondly, NGOs and civic organizations continue to lobby for horticulture production that is environmentally friendly and lives up to international labour standards. Thirdly, the growing dominance of supermarkets in the governance of an integrated supply chain has meant more quality and due diligence standards created within the supply management of each supermarket chain and within the industry of food retailers as a whole.<sup>3</sup>

Market players have been adapting logistics and services to meet consumer demands, and are actively promoting the image of quality. Minimum standards of quality, grading and labelling must be established and adhered to in order to satisfy the needs of the market and be able to export to developed countries.<sup>4</sup> Therefore, as African producers are confronted with standards covering more aspects of production and a higher threshold of import approval, financing becomes increasingly crucial in acquiring the latest production technology, facilities and skills to keep abreast of quality trends.

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<sup>3</sup> In the early 2000s, major food retail associations in the UK began implementing sectoral codes to establish a benchmark of quality for the entire food retail industry. For more information, see Annex I.

<sup>4</sup> Quality elements that are important in export marketing include grade of produce, defects, ingredients in processed products, mode of preparation of raw materials for processing, preparation and density of liquid medium, additives, drained weight, cleanliness, strength of container and packaging material.

## Chapter II

### HOW CAN VARIOUS PARTIES PLAY A ROLE IN STRUCTURED FINANCE FOR HORTICULTURE TRADE IN AFRICA?

The widespread constraints described in the previous chapter explain the generalized reluctance of financiers to make credit available on reasonable terms to the horticultural sector in Africa. In addition, with the disappearance of many agricultural banks, development banks and other specialized banks in most African countries, the general inclination of formal financial institutions has been to neglect this sector and concentrate on a few major clients in major cities. Local funds are generally not available, but where they are provided, lending rates are prohibitive and terms and conditions are incompatible with industry requirements.<sup>5</sup> As a matter of fact, exporters and growers are forced to finance their long-term investment needs with expensive short-term loans since local banks are unwilling to grant them medium-term loans. Even then, most exporters and growers may not have suitable collateral instruments required by the banks to qualify for loans.

High interest rates, together with stringent loan requirements, have systematically prevented small to medium-sized farmers from accessing credit on reasonable terms and caused many operators to disappear. An example is the cut flowers industry in Uganda, which has faced serious problems since the late 1990s. Cut flowers are a major industry in Uganda, employing more than 6,000 and generating annual export revenue of US\$ 32 million (2004 figures). One reason for the crisis in the industry was the way in which financing was structured. First, only short-term financing was available, and that was not adequate for the developing cut flowers industry. Moreover, loans were contracted in dollars and sales were initiated mostly in the auction halls of the Netherlands in Dutch guilders (the euro has since replaced the guilder), a currency that at times depreciated in relation to the dollar. In consequence, the delays in reimbursement, combined with high interest rates, made some firms in the industry insolvent, causing them to cease operations.

Access to offshore financing is also restricted because of a perceived high performance and country risk on the part of international banks as well as stringent regulatory constraints in the case of financing exceeding 360 days.<sup>6</sup> Therefore, it is necessary for appropriate financing structures to

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<sup>5</sup> Local interest rates have experienced periods of great volatility due to changes in performance risks. Local banks would charge on average a minimum interest rate of 30 per cent per annum for short-term loans, i.e. loans with a maximum tenor of 24 months. The all-in financing cost is then substantially increased by additional costs related to exchange rate fluctuations, liquidating charges of foreign currencies into local currency or administrative costs such as telegraphic transfers and management fees. Source: Moyo, Edwin Masimba, "Horticulture Trade Finance: Zimbabwe Examples", at the African Regional Workshop on the Horticultural Sector in Nairobi, Kenya in May 2001.

<sup>6</sup> According to the so-called Basel Accords (currently Basel I which will be replaced by Basel II in June 2007), issued by the Basel Committee on Banking Supervision of the Bank of International Settlements (BIS), international banks shall align their capital adequacy requirements to the underlying risks that they face to protect themselves against unexpected losses. The current minimum capital requirement for banks is 8 per cent of risk-weighted asset value. This means that if a bank has a loan exposure with a risk weight of 100 per cent (as the case of unrated corporates or banks in Africa), the full value of the exposure is taken into account in calculating the capital requirement, which in this case translates into a capital requirement of 8 per cent. On the contrary, if the risk weight of an exposure is 20 per cent, then the minimum capital requirement is only 1.6 per cent, i.e. 8 per cent of 20 per cent. The introduction of Basel II regulations in 2007 and the trend towards the use of risk-adjusted return on capital (RAROC), will have an impact on the lending strategies of international banks. The requirement for adequate capital to cover risks will be directly related to the amount of risk the bank runs on a specific transaction and will therefore depend on the creditworthiness of the client and the structure of the transaction. This will entail more stringent credit allocation for lower-rated companies and the use of more structured deals. Smaller clients may become less attractive for international banks. For an extensive overview, see UNCTAD, *Potential Applications of Structured Commodity Financing Techniques for Banks in Developing Countries*, UNCTAD/DITC/COM/31, 2001.

respond to the needs and requirements of the industry, while finding ways to circumvent obstacles so that all relevant parties in this sector can perform their duties efficiently and access funds at fairer rates.

**Table 1. Institutions providing horticultural credit<sup>7</sup>**

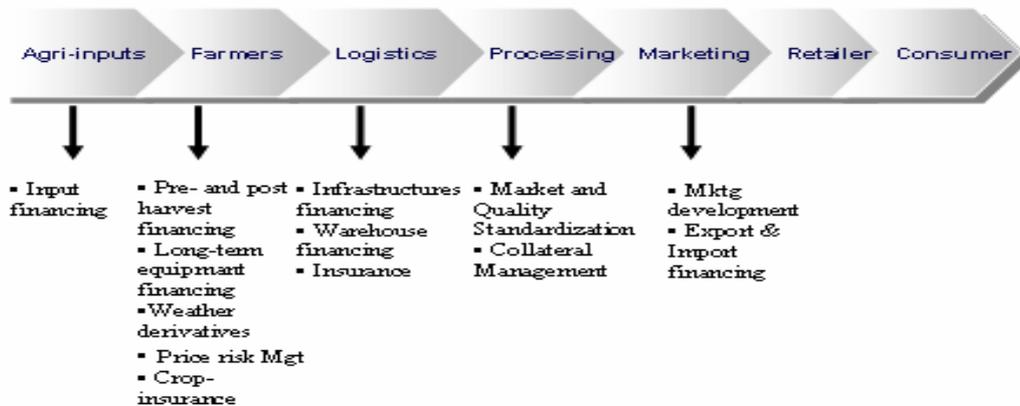
<b>Institution</b>	<b>Types of credit and services offered to farmers, exporters, etc.</b>	<b>Constraints</b>
1. Parastatal organizations	Training and advisory services	Lack of funds
2. Agriculture cooperatives	Seed, supply and agricultural implementation	Lack of funds
3. Cooperative banks	Long-term loans	Not enough liquidity to cover the market
4. Development banks	Long-term loans	Require high collateral which smaller-scale farmers and exporters cannot afford
5. Commercial banks	Short-, medium- and long-term financing	Interest rates extremely high
6. International banks	Offshore financing	Not easily accessible due to high country risks. Some African countries are rated by credit agency as below investment-grade level.
7. Financing alternatives	Use of insurance coverage and structured export financing based on export receivables to mitigate risks	Need innovative structuring of multiple transactions among many parties tied into an overall scheme to mitigate risks

Financiers can reduce their risks by providing finance along the supply chain, rather than just at one point in the chain. They can provide members of the supply chain (farmers, processors, service providers), including infrastructure providers, with credit not on the basis of the borrower's credit risk but on the basis of their place in the supply chain (see Chart 2). Therefore, in addition to providing finance to farmers, they may also consider financing the following:

- *Provision of inputs (pesticides, herbicides, fungicides)*: It may for example be worthwhile to include the financing of the import of these inputs as part of financing in order to ensure that production does not fail because of the non-availability of critical inputs;
- *Transport*: If there are no good means of transport available, the financier may consider financing not only the farmer but also a transport company, so that the latter can invest in a refrigerated truck. The bank can use the transport contract between the farmer and the transport company as collateral for the loan;
- *Storage*: If storage facilities are not satisfactory, the bank may consider investing in financing a storage facility, using future revenue from the expected export flows as a guarantee for repayment.

<sup>7</sup> Source: Moyo, Edwin Masimba, "Horticulture Trade Finance: Zimbabwe Examples", May 2001 at the African Regional Workshop on the Horticultural Sector in Nairobi, Kenya.

**Chart 2: Agriculture Supply Chain Financing**



When financing along the supply chain, banks would take collateral over goods as these move through the supply chain rather than at just one point or as the goods move from one stage to the next. For example, the bank can start financing the goods once they enter an upcountry warehouse and continue financing as the goods are transported and processed and then enter an export warehouse, or are exported and transferred to a vessel, transported to the importing country and then stored again. In doing so, banks normally work through specialized collateral managers and agents who take responsibility for controlling the commodity stocks and flows.

Instead of obtaining better security by controlling goods, banks can structure their financing around payments from offtakers, such as processors, traders and end-users, especially industrial users and supermarkets, and/or around the supply of agricultural inputs and equipments. This works when there are regular contacts between the beneficiary and the offtakers and/or the farmers' suppliers. The stronger the contacts, the easier the finance.

The risks that the financier runs are basically limited to crop risks, i.e. the risk that the farmer will not produce enough or will not produce the required quality – shortcomings that can be offset by the banks' use of new risk management tools.

This chapter describes the main potential roles in finance of the relevant parties involved in international horticulture trade. It also identifies the bottlenecks that need to be overcome along the financing continuum in order to enable various actors in each promising product chain to capture and sustain market opportunities. Along with the description of the activities of the parties, it becomes pertinent to look at ways of harmonizing the roles of each party, with the goal of ensuring better access to export funding on fairer terms.

**A. The role of Governments**

Governments play a crucial role in enhancing and promoting exports. Success may be achieved by introducing appropriate legal and regulatory reforms that are needed in order to improve the industry's access to finance. These reforms include enforcing proper rules and regulations (for instance, regulations related to phytosanitary issues), assisting in the gathering of market information and in other marketing efforts, and providing suitable infrastructure. In many African countries, however, the Government has mostly failed to provide a supportive environment.

One of the problems giving lenders concern about exposure to Africa is the risk of adverse governmental policies capable of affecting the performance of a facility. A situation where exporters are required to repatriate all export proceeds without regard to offshore financial obligations (or a

situation where there is no possibility of a security mechanism for export proceeds repatriation) poses a grave risk to international lenders. Furthermore, there are numerous infrastructural and regulatory provisions such as airplane landing rights, costly registration of collateral charges, and many other rules which exporters consider inappropriate, cumbersome and costly.

In addition, the provision of amenities such as irrigation projects and all-weather roads will go a long way to reducing the costs of doing business and therefore encourage exporters to develop efficient trade. African Governments should facilitate the development of such basic infrastructure, including post-harvest handling facilities, decentralized cold storage (at airports for example), energy supply, transportation networks, telecommunication networks and research-related activities to develop better quality, new varieties and enhanced growing techniques.

In addition, one of Government's main roles in stimulating horticultural exports should be in the streamlining of the legal and regulatory framework to facilitate the smooth operation of loans and also to provide incentives, whether fiscal (such as export tax exoneration or reduction of import taxes on certain main inputs) or financial (such as partial financing or Government guarantees on credits to small-scale enterprises), in order to enhance export finance and facilitate external trade.

In this respect, over the past decade the Government of Tunisia has, for example, put in place several incentives to increase production and exports in the agricultural<sup>8</sup> and fishing sectors<sup>9</sup>. These measures were made effective by the Agency for the Promotion of Agricultural Investment (APIA), the governmental body established in 1982 to encourage the development of private investments in the horticulture and fishing sectors. In 1993, APIA promulgated the Code for the Promotion of Investment in Agriculture and Fishing<sup>10</sup> that created a major programme for exports development through the facilitation of external trade. Moreover, other financial measures, such as the National Guarantee Fund or Centre for the Promotion of Exports (CEPEX), were established to guarantee reimbursement of pre-export credits advanced by local banks to local producers or to provide export subsidies, respectively.<sup>11</sup> All these measures were taken to address the concerns of exporters, namely, the need to finance an activity at the lowest cost, to find the necessary credit to invest, produce, sell and insure exports' operations against the risk of non-payment, and to promote their export marketing and trade strategies.

**Box 3. The horticulture and fishing sectors in Tunisia: Export incentives, financing instruments and marketing support structures\***

**I. Code for the Promotion of Investment in Agriculture and Fishing**

The incentive code covering the horticulture and fishing sectors provides fiscal and financial incentives. Fiscal incentives can come in two forms:

A. Local partially exporting enterprises can benefit from:

- Exemption from value-added taxes and consumption duties on goods, products, and services;
  - Complete deduction of export revenues from the tax base related to personal income for the first 10 years;
  - Reimbursement of customs' duties and taxes on imported capital goods which have not been manufactured locally.
- ./...

<sup>8</sup> Agriculture has always played a prominent role in Tunisia. Today, agriculture accounts for 14 per cent of GNP, 10 per cent of total exports of goods and 22 per cent of employment. The main products exported (2004 figures, 1 Tunisian dinar = US\$ 0.730) are olive oil (708.0 million Tunisian dinar [MTD] = 516.8 million US\$ [MUSD]), dates ( 105.1 MTD = 76.7 MUSD), ornamental plants (12.0 MTD = 8.7 MUSD), citrus fruit (14.0 MTD = 10.2 MUSD), flower growing (1 MTD = 0.730 MUSD) and wine.

<sup>9</sup> Box 3 lists Government measures that apply to the horticulture and fishing industries in Tunisia. However, for a detailed case study of Government assistance in financing the fishing sector, see "Fisheries Finance: New Products by the Bank Sector" published by UNCTAD in 2006.

<sup>10</sup> See Box 3 for a detailed description.

<sup>11</sup> Ibid.

B. Local totally exporting enterprises (meaning that they export at least 70 per cent of their produce with the possibility of selling the remainder on the local market) enjoy similar tax exemption and/or reduction as above. Moreover, they are required to pay the following taxes, duties, levies, and contributions:

- Taxes and duties relating to private vehicles;
- A one-off countervailing tax for road transport;
- Taxes and duties for services rendered;
- Social security contributions and payments;
- Personal income tax and a business tax after deducting 10 per cent of exporting revenue from the core tax base for the first 10 years;
- Freedom to recruit four managerial and supervisory agents of foreign nationality by simple notification to APIA.

The incentive code also provides for partial financing of investment costs that can be granted according to the three types of loan classifications:

Category A: Investment equal or lower than 40,000 Tunisian dinar (TD), and with the promoter providing 10 per cent of the financing.

Category B: Investment ranging from over 40,000 TD to a maximum of 150,000 TD, and with the promoter providing 10 per cent of the financing.

Category C: Investment valued over 150,000 TD, and with the promoter providing at least 30,000 TD.

Moreover, the Government provides financial incentives in the following forms:

- Investment award: Granted to investors at a level of 25 per cent, 20 per cent, and 7 per cent of the total project cost for the above-mentioned categories A, B, and C, respectively;
- Study award: Granted for investments under categories B and C, with a cap of 1,500 TD and 5,000 TD, respectively;
- Favourable interest rates for land loans;
- Special benefits for new promoters such as an investment award of 6 per cent of total project costs;
- An undertaking by the Government to pay the employer's social security contributions for the salaries of Tunisian employees for the first five years of business operation at full capacity;
- A reimbursable grant not exceeding 70 per cent of the amount self-financed with a ceiling of 100,000 TD, an interest rate of 3 per cent, and the length of reimbursement period of 12 years with a five-year grace period.

## **II. Financial instruments to enhance support of production and export**

In order to enhance the production of local products and promote their export, the Government established the National Guarantee Fund and the Centre for the Promotion of Exports (CEPEX).

### **National Guarantee Fund (NGF)**

The NGF was created by the Government in 2000 to support small and medium-sized farmers and fishermen in accessing short-, medium- and long-term loans from local banks.

As a matter of fact, in addition to investment credits to finance agricultural projects, farmers need short-term operational credits (seasonal crop credit, seasonal credit and advance credit on merchandise) and export credit finance from banks. However, given the reluctance of banks to grant pre-export credit either because they do not know the exporting company sufficiently or because the company does not supply the customary guarantees, the NGF will provide banks with the following guarantees against the risks of non-payment:

Refinancing of outstanding payments, i.e. unpaid loan amounts (principal and interest);

Reimbursement of eligible credits advanced by local banks by paying interest on unpaid amounts on loan principal declared to the Fund, in a proportion ranging from 50 per cent to 90 per cent of unrecoverable loans.

### **Centre for the Promotion of Exports (CEPEX)**

CEPEX was created in 1973 to support Tunisian exporters and foreign operators in their marketing efforts by providing them with a range of customized services. CEPEX has two funds at its disposal to promote and improve strategies and the export environment: /...

A. FOPRODEX (Fund for Promoting Exports): FOPRODEX provides several subsidies for exporters in their activities to launch and promote their operations. While the requesting enterprise provides 20 per cent of the budget for the projected activity, FOPRODEX will assist up to 80 per cent in part as a subsidy and in part as a loan. The maximum amount to be subsidized is 30 per cent and the maximum loan is 50 per cent. The interest rate is the current market rate. Promotional activities that are subsidized are mainly the following:

- Creation of advertising materials such as catalogues, CD-ROMs, websites, and documentary films;
- Creation of the label and design of a registered trademark;
- For the clothing industry, staging of fashion shows and other collections;
- Participation in international tenders;
- Market research and implementation;
- Participation in trade fairs abroad;
- Internal development of an export department within the company;
- Promotional and marketing days.

B. FAMEX (Access Fund for Foreign Markets): This Fund was created in 2000 to complement the facilities provided by FOPRODEX. FAMEX provides subsidies of up to 70 per cent, with a ceiling set at 10,000 dinars, intended to finance the cost of drawing up an "Export Marketing Plan" for companies and service providers.

Moreover, CEPEX has created Tasdir Net Data, an Internet database of marketing information providing two types of information:

- a) Market profiles, a database of up-to-date information on 1,800 Tunisian exporting companies;
- b) External trade statistics, a database collection of annual and monthly statistics relating to external trade, trade issues specifically related to Tunisia, etc.

\*This is an updated version of the paper "Horticulture in Tunisia: Export incentives, financing instruments marketing and support structures", by Fethi Gritli, Director in charge of management of international relations, Tunisia Bank Company, Tunis. The paper was presented at the UNCTAD Regional Workshop for Horticultural Economies in Africa held in Nairobi, Kenya, 29-31 May 2001. <http://www.unctad.org/infocomm/Diversification/nairobi/gritli.pdf>

## **B. The role of producers, exporters and associations**

Producers and exporters are the key players in the horticulture chain. The more organized producers and exporters are, the more bargaining power they have. Producers, exporters and organizations, if set up properly, can (a) enhance performance; (b) decrease dependence on middlemen; (c) increase the share of final export price that goes directly to the small-scale farmer by reducing the monopsony power of exporting firms and importing firms (whether the product is sold through the auction, agents or directly to the supermarket chains); (d) provide marketing strategies; and (e) enhance access to finance through group collaboration and the pooling of resources to meet financiers' requirements.

For example, producers'/exporters' organizations may explore ways of building their financial sustainability by establishing bulk imports of inputs at a locally competitive price. Moreover, as a way of boosting competition, exporters of horticultural products must deliver items of prime quality that meet international standards. This needs to be achieved through the use of adequate handling and storage facilities that enable the products to retain freshness up to delivery point. In view of the huge costs associated with the installation of these facilities, it may be beneficial for the exporters to join together and pool resources and financing in order to acquire adequate machinery for servicing group members and others in the industry who may so desire and who are willing to pay the required charges.<sup>12</sup>

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<sup>12</sup> For example, flower production in Columbia only took off after the exporters had created an association with sufficient clout to negotiate with airport authorities and airlines. This allowed exporters to invest in cold storage

There is also the issue of technical and managerial competence. Many financiers have expressed deep reservations about the technical and managerial competence of horticultural producers and exporters. This could be addressed by the organization through the provision of consultancy, technical information and support, as well through employment of agricultural specialists to provide assistance to growers on compulsory issues. The organization could also license exporters and withdraw licences on repeated reports of quality problems, increasing banks' faith in the skills of "licensed exporters".

In view of the above, growers and exporters are also encouraged to form local handling agencies. A handling agent may be incorporated as a limited liability company with the growers and exporters as equity holders. The role of the agent can be multiple. For example, the agent could be the intermediary through whom a loan is accredited. With this, the agent could also provide all transportation and storage infrastructure necessary for effective handling of products. Such infrastructure would include refrigerated vehicles and storage cabins both on-site and at the airports of shipment. Additionally, the agent could coordinate activities with the offshore marketing agents to ensure that exporters receive real value and timely settlement for their exports. The agent may be profit-driven and would charge the growers for services provided by simply facilitating the activities of these operators for fee considerations. Exporters, however, would still be paid according to the prevailing prices on the auction floors in Europe or to the prices agreed with their buyers, such as for example in the case of direct sales to supermarket chains.

Furthermore, exporters and growers can explore the possibilities of marketing their products directly to supermarket chains. Where this is done, there is a need to appoint an agent (who can also be appointed by the buyers) to liaise with the buyers and coordinate with the carriers to ensure that deliveries are cleared promptly and supplied to the supermarkets in good time. Furthermore, the agent oversees the grading of the products to determine their real value. Upon completion of the deal, the agent also carries out other follow-up activities to ensure that payment is made.

### **C. The role of local banks**

There are a number of cooperative institutions providing both finance and financial services to growers, but none of them seems to have an answer for the exporting industries. They run at low capacity, largely due to a lack of financial resources. The only sources of capital come from the development banks and commercial banks. With few exceptions, African banks have "burnt their fingers" previously in financing agricultural exports and have been moving away from agricultural finance to concentrate more on supposedly less risky (or good-risk) commodities such as oil or gold, and to finance exporters (rather than growers) of coffee, cocoa, tea and so forth. Now, only large horticultural farms, which provide the requisite collateral, can expect to be financed by the commercial banks.

One reason why domestic banks have not been effective in developing financing mechanisms is that they have approached this market with the same financial products as are provided in OECD countries. Yet developing country markets have different requirements with different and greater risks, which require structuring finance transactions that would leverage those risks and still allow good returns.

In the current situation, horticulture exporters in Africa usually wait for an average of one to four months before receiving payment for their goods sold primarily to international buyers. During this waiting period, they have to borrow locally to pay their creditors as well as for working capital purposes so that they can remain in operation and produce for new export orders. In most cases, loans and overdraft facilities are used for such purposes. On most occasions, however, their financing

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facilities at the airport and gain sufficient volume to charter aeroplanes to take their products to the United States of America.

needs are not fully met by these facilities, and not always on time. As such, this situation drastically affects their ability to meet orders and manage costs effectively. Therefore, domestic banks may respond to the requirements of the market by playing a more significant role and by developing new innovative financial instruments from harvest up to the time of consumption of the goods. This would require banks to look for international lines of credit that are available through international financial institutions.<sup>13</sup> It would also necessitate a thorough analysis of the industry and proper due diligence in respect of the various flows of transactions in order to mitigate risks and ensure repayment.<sup>14</sup>

Similarly, local banks could serve as planks to leverage offshore financing for export activities in Africa. This can be done particularly through cooperation with their foreign parents, where appropriate, or their correspondent banks acting as financing intermediaries. Local banks may furnish international banks with needed credit information on exporters and monitor credit disbursement and repayment.

A crucial factor in this arrangement, however, is the usual insistence by international banks that the local banks become the primary obligors, in which case they bear primary responsibility for repayment of loans granted to exporters. This stance is most often resisted by the local banks, which prefer only to assume facility agent roles for commission considerations. On the other hand, this apathy towards assuming primary responsibility for such funds rather discourages international banks, which see no grounds for confidence in local exporters when the local banks are reluctant to trust their performance and hence repayment capabilities. Local banks therefore need to evaluate their clients with a view to determining those with efficient performance records and therefore access financing for on-lending to them.

#### **Box 4. Sources of credit**

**Contracting exporter:** Exporters or buyers of smallholders' crops may provide credit in kind in the form of inputs in return for crops grown under contract. Often this service is supplemented with general advice on crop management and specific technical guidance on the use of purchased inputs. In some cases, a contract serves to assure a private lender of the smallholder's creditworthiness, thus facilitating access to private credit.

**Savings and credit schemes:** Smallholders deposit up to 25 per cent of the value of the loan in a savings account, and the remainder is provided on credit.

**Group schemes:** Specialized micro-finance institutions may support groups of smallholders to set up "group liability" schemes where the responsibility is assumed collectively to cover each member's liability to repay.

**Agricultural suppliers:** Exporters, traders or buyers supply inputs on credit to appointed suppliers in the growing area, who then take responsibility for supplying the inputs to smallholders.

#### **D. The role of international banks**

From the international banks' point of view, horticulture is a difficult commodity to finance. In general, first, it is perishable; second, the value of the collateral may not always be determined beforehand; and third, the product may be handed over to consumers (and even consumed) before the final payments are made, while this horticulture produce is supposed to function as collateral for the loans to the exporter. Moreover, international banks' negative perception of country risks in Africa limits the incentive to finance the sector.

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<sup>13</sup> In this respect, the role of multilateral financial institutions in financing horticulture with special emphasis on facilities from and deals structured by Afreximbank is explained in Annex II.

<sup>14</sup> The role of local banks in structured commodity finance has been extensively discussed by UNCTAD. One of the recent studies is "Potential applications of structured commodity financing techniques for banks in developing countries", UNCTAD/ITCD/COM/31. Other studies and papers related to commodity structured finance can be found on the online database of documents from the UNCTAD Commodities Branch, <http://r0.unctad.org/commodities/docs.htm>.

There is, however, a need for international banks to participate in the finance and development of the horticultural sector in Africa and to appreciate the significance of the reforms being undertaken by many African countries, and on that basis to reappraise their perceptions of African risks. As a prelude, OECD central banks (and with them, the Basel Committee) may consider removing the blanket condition that all African exposure by their banks be regarded as doubtful debt and be fully provisioned as such in the balance sheet. When this is done, not only will financing flows to Africa increase but funding costs will also be reduced considerably.

Furthermore, international banks, especially those with African subsidiaries, should work hand in hand with them and together identify producers and exporters with sufficient clout to warrant financing support. At the moment, medium- to long-term funds are almost not available to the sector, seriously limiting its capacity for growth.

Some horticultural exporters enjoy pre-financing at the discretion of the buyers, while others even obtain loans in advance from international banks before shipping their produce. However, the predominant mode of financing is post-shipment (mainly bill discounting using forfaiting or some other structure). This only refinances the growers for expenditures already incurred through borrowing from local banks at exorbitant rates. In view of the low profit margins, the growers may continue to move in circles with no potential for growth beyond present capacities. Currently, most exporters sell their products through offshore marketing agents representing their interests on the auction floors. In some cases, however, direct sales are also being made to the supermarket chains. Payment from the auctions/agents arrangement is not prompt, which can lead to the adoption of the forfaiting scheme whereby the exporter is paid a discounted value for his exports.

The role of international banks can be very valuable (particularly for exporters) in the horticultural sector as they have the capacity and experience to structure trade finance mechanisms that can bridge performance and country risks inherent in African deals, respond to the requirements of the market, and offer good terms. Box 6 gives an example of how an international bank, with its knowledge of the market and partnership with local banks, assisted in the expansion of an exporting firm in the fruit market.

Basel II will have a major impact on both short- and medium-term commodity finance to "risky" countries. Except for banks that can demonstrate, through their track records (three years of records are required), that they have designed relatively safe structured finance mechanisms, capital adequacy requirements for risk to emerging countries will increase sharply.

#### **E. The role of offshore buyers and auction floors**

Horticultural products are very delicate and, as such, require a market that is willing, cooperative and ready. In this market, it is the buyer who calls the shots. Generally speaking, foreign buyers in the horticultural sector are not keen to open letters of credit to their sellers – in this case, African exporters – but prefer to operate on open account, which is a simple method of paying cash on delivery of goods. This situation leaves horticultural exporters in Africa with no choice but to source for funds to generate exports and thereafter expect payments by the buyers. For these reasons, the relationship between exporters and buyers needs to be very trustful, so as to avoid rejection of products for flimsy reasons or unfair pricing strategies that discourage investments for further production.

**Box 5. How can affordable credit be best provided?**

Credit is a critical service for smallholders. With access to credit, they can buy the services and inputs that enable them to grow crops suitable for export. There are several sources of credit, each of which has its own advantages and disadvantages.

The need to overcome the potential for default, due either to an inability or refusal to repay loans, requires careful screening and selection of borrowers, monitoring of the use of the loan, and the introduction of procedures to minimize the risk of default. Processing, trading and marketing companies often provide credit to smallholders in return for a commitment to market their crops through the same company. Loans are recovered by deducting the cost of the loan from the price paid to the smallholder for the crops grown.

It is essential to establish – and adhere to – an effective credit monitoring system that can be audited. Close monitoring of smallholders (e.g. to minimize default) and their suppliers (e.g. to minimize late payment) is required to ensure that maximum benefit is derived from the credit. More generally, good communications help foster good company/smallholder relations and a sense of trust, which has the positive effect of reducing payment default.

**Issues in the selection of borrowers**

From the credit provider's perspective, there are several issues that must be faced when assessing whether or not to approve a loan. It is necessary to screen out farmers who may prove to be unreliable or lazy. Farmers must have the necessary skills and resources to put the credit to productive use, must be creditworthy, must be committed to the enterprise for which they are borrowing, and must prove that they are able to repay their loans. With all types of lending, there is a need to overcome the potential for default due to an inability to repay through crop failure, or "strategic" default when the farmer "chooses" not to repay.

In some instances such as in the UK's Department for International Development\*, the usage of a questionnaire sheet provides decision makers with an easy and updated point of reference on issues relating to the provision of support for smallholders. Overall, credit providers must deal with two main issues:

- a) How do I screen and select appropriate smallholders for loans?
- b) How do I ensure repayment of the loan in full?

\* For further information please refer to <http://www.dfid.gov.uk>.

Source: Khalil, Fahid and Bruno M. Parigi, "Screening, Monitoring and Consumer Credit", Working Paper, 16 October 2001.

Furthermore, the role of offshore buyers in structured finance transactions is very significant, as they become lenders' preferred risk hub. Since buyers are the source of payment in the trade transaction, their cooperation in structuring a trade finance transaction can add some measure of comfort to financiers. For example, in a forfaiting transaction, the lender is more willing to advance funds to an exporter on the strength of promissory notes issued by a buyer and endorsed by his bank, rather than simply discounting export receivables that are not secured by any guarantee. In the former case, the financiers have in fact in their hands a negotiable instrument which, as it is abstract and independent from the underlying commercial contract, is an unconditional commitment to pay at maturity and is also marketable in the secondary market. Therefore, in these circumstances, if a buyer is adamant about issuing his promissory notes at the contract stage, the exporter will not be able to obtain the necessary financing to bridge the cash flow gap required for his export products. Overall, this would stunt the growth of the sector. In the present situation, both supermarket chains and auction floors are less prepared, in comparison with traders and agents, to seek further guarantees or endorsements for their debt instruments to the exporters due to the fact that traders and agents, who have better contacts with exporters, have a more accurate perception of performance risk. It is, however, expected that once the offshore buyer-producer relationship is deepened, auctions and supermarket chains will begin to support this financing scheme as well since it is beneficial for both parties: the

exporter is able to grant his buyer a deferred payment, while the exporter obtains without recourse financing as soon as the goods are shipped or even during the manufacturing period.

In another scenario, where a good relationship exists between a grower/exporter and the buyer, the buyer can also enter into a contract with the exporter, enabling goods to be supplied to him in due course. Under this arrangement, the buyer can advance funds to the exporter, and such advances are deducted from the value of the products delivered in due course. The advances need not necessarily be in cash but may also be in the form of inputs such as chemicals and pesticides valued at a price agreed with the grower/exporter. This is a form of buyer credit that has immense potential for stimulating export growth in the horticultural sector. These loans depend largely on the relationship between the exporter and the buyer. Many buyers are still sceptical about advancing loans owing to a lack of loyalty on the part of exporters, who could be shopping around for better prices in the market. In such circumstances, any advances provided to them may not be recovered. However, once due diligence has been properly established, buyers' strong fears that exporters might side-market their produce to those offering higher prices would be assuaged and buyers would benefit from the advantages offered in these financing schemes.

Auction floors play a role in horticulture trading, mainly in the flower industry and less so in the vegetable and fruit sector with the increasing influence of supermarket chains. Growers who ship their crops through the auction usually pay a sales commission (of 12 to 16 per cent) but often have reduced marketing and promotional costs. A major benefit of selling through the auction is that growers are more or less sure that their produce will be sold (but without any guaranteed price), that the agent/cooperative will pay growers directly, and that payments will go directly into growers' bank accounts. It eliminates the need to grant credit to customers for several weeks and – more importantly – reduces the risk of bad debts.<sup>15</sup> Moreover, auction floors can further contribute to export expansion by providing an endorsement on their payments to enable growers to discount their receivables.

Another possibility would be for the growers to obtain offshore finance structured around their sales to the Dutch flower auctions (or even supermarket or international buyer). These auctions (buyers) accept assignments of payments – in other words, they agree to pay to a financier the money paid for exporters if this exporter has assigned these payments as reimbursement for a loan. Thus, reliance on this financing mechanism, which has been used for some African exporters, would enable international financiers to eliminate the country risk and convert it into a performance risk. If this financing model is difficult to use, it probably indicates that African exporters do not have an acceptable track record.

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<sup>15</sup> Auction sales are done via two reverse style Dutch clocks. Prices start above the expected selling price and fall as the clock runs, until the first buyer stops the clock using an electronic keypad. Unlike in the case of traditional auctions, it is the first buyer who gets the product. It is a fast, efficient selling method, with over 1,500 sales transactions per hour. Prices vary daily depending upon supply and demand. Selling the product is a daily gamble since there are no guaranteed prices.

**Box 6. A tropical export finance facility of US\$ 20 million**

**Arranger:** MeesPierson Bank (now part of Fortis)  
**Borrower:** One of the largest exporters of fruit from South Africa

**The deal:** In 1999, MeesPierson saw a great deal of potential in the liberalizing South African fruit market. With the demise of the monopoly of Unifruco and Outspan on fruit export a few years previously, many new parties have entered this market. Some of them successfully built a customer base all over the world. MeesPierson's client developed from a local distributor of fruit into a world player of substance within the space of two years. This change implied an increase in credit requirements as well. MeesPierson, involved with the customer since the beginning of its export activities, assisted the company with structuring a new, enlarged facility of US\$ 20 million.

The facility was available partly for advance payments to the farmers and partly for goods during transport and for receivables finance in destination countries, mostly Europe. The facility was provided by MeesPierson, its joint venture partner FBC Fidelity Bank, and Rand Merchant Bank.

The client was able to face stiff competition from the bigger world players in the fruit market by obtaining a finance structure that responded to his needs and market requirements.

**Security:** The facility included a **collateral pool** where all the available collateral (stocks, receivables, shipping documents) were combined for the three banks. This pool was managed by MeesPierson.

The fruit trade has some specific characteristics that have to be taken into account. Farmers deliver their fruit to the exporter without knowing whether the end-buyers will accept the fruit. Only upon arrival in the port of destination in Europe will the end-buyers accept or reject the goods and will a final price be determined. For instance, if the demand for citrus collapses during shipment, the final price can be lower than expected. Therefore, the exporter arranges the logistics flow in an optimal way so that the fruit arrives in perfect condition. The exporter was also responsible for selecting the end-buyers on performance.

**Remarks:** One of the important elements in the accomplishment of the transaction was the experience, knowledge and contacts that MeesPierson had built up in the fruit market in Europe before offering its first export facility, in a collateral pool, to a South African client.

Moreover, knowledge of the markets in the origin countries as well as in the destination countries enabled MeesPierson to meet the needs of its customers and to handle the risks involved in an optimal way.

Another important element was the local representation of MeesPierson in South Africa and its partnership with the local bank, FBC Fidelity Bank. This enabled the financing transaction to be managed properly and smoothly while at the same time reducing performance and quality risks.

*Source: Trade and Forfeiting Review, Volume 2, Issue 7, April 1999.*

## **F. The role of supermarkets**

Since the mid-1990s, African horticulture has experienced the greatest change brought on by the increasing dominance of supermarkets in the supply chain. While trade in fresh fruits and vegetables has intensified between Europe and Africa on the international front, supermarkets have expanded into rural areas of sub-Saharan Africa, spurring greater intra-regional trade.<sup>16</sup> This trend has caused what is already a buyer-driven industry to become more so as supermarkets have vertically integrated the management of production, processing, marketing, and retailing to come under their control.

Because fresh produce has been labelled a “destination” category in which it is one out of three categories<sup>17</sup> to have considerable influence on consumers’ choice of supermarket patronage,

<sup>16</sup> Weatherspoon, Dave D. and et al. “Battle of Supermarket Supply Chains in sub-Saharan Africa: Challenges and Opportunities for Agrifood Suppliers”, December 16, 2004, UNCTAD/DITC/COM/MISC/2003/5.

<sup>17</sup> The other two categories are meat and wine selection.

supermarkets have and will continue to change the way the horticultural supply chain is operated. Thus, supermarkets are expected to be a source of structured financing as they become the major offshore buyers of African horticulture, gradually replacing previous actors such as traders, agents and auction houses. It is possible for horticultural producers to structure financing around their contract sales to supermarkets. Rather than relying on reimbursement from the producer, the financier relies on the supermarket that will pay the financier as long as the producer has indeed performed. Because major supermarkets generally have long-term competitive contracts with producers and tend to be perceived as more creditworthy, financiers are more likely to lend funds to producers through supermarkets acting as the hub of the financing scheme.

The consolidation of actors along the supply chain means that there will be losers and winners in accessing affordable credit. For African growers who operate on commercial farms or are organized on a massive scale with the capacity to cope with the stringent food safety and quality standards established by the supermarket chains, they are integrated into the supply chain under which there is an alignment of interests among all intermediaries to provide the best products for the supermarkets. Thus, upstream actors such as growers and exporters will have an easier task accessing affordable credit through reputable supermarket retailers based in Europe, who have an interest in ensuring that the working capital of upstream actors is financially low so that final profit margins are high after additional costs have trickled down along the supply chain.

For small, independent farmers in Africa, the emergence of an integrated supply chain has meant a greater need to access affordable credit in order to invest in the technology, expertise and facilities to compete on an equal footing with large growers. Because these farmers often operate on small, family-owned plots of land that are spread throughout the African countryside, corporate entities with access to leveraging offshore have very little incentive to invest in them. As actors not folded into an integrated supply chain under the auspices of a major supermarket or produce retailer, small farmers must find alternative methods to access international funding.<sup>18</sup>

## **G. The role of insurance**

The role of insurance in strengthening credit and performance risk-mitigating structures cannot be overemphasized. Modern insurance coverage has also become available to further reduce the risks of financing to Africa. Prominent among such insurance policies is political and commercial risk insurance.

Traditional political risk coverage includes:

- *Pre-shipment contract frustration*: Covers the exporter's costs and expenses incurred in the manufacturing of goods, construction or loss of resale prior to payments coming due;
- *Post-shipment (or payment/credit risk)*: Provides coverage for amounts due under a contract;
- *Contract frustration (non-delivery)*: Covers the failure of a supplier to deliver goods which have been pre-financed or for which barter goods have been delivered in advance. The insurable loss is the value of such pre-finance or barter goods;
- *Unfair calling of bonds*: Covers the unfair calling of on-demand stand-by letters of credit or as performance bonds. Calling such bonds following a political event such as trade embargo or license cancellation is also insurable;
- *Confiscatory acts of Government*: Covers the confiscatory acts of Government for mobile assets such as consignment stock or fixed assets or investments in the foreign country. This includes such Government interference in project business as cancellation of concessions;
- *Political violence*: Covers the physical loss or damage to mobile or fixed assets due to such events as war, terrorism and civil commotion.

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<sup>18</sup> For a detailed analysis, see Annex I entitled “The impact of supermarkets in the supply chain on small growers in Africa: Financing challenges and options”.

As for performance risk in a pre-export horticulture finance transaction, there is also a grave risk that the exporter may not be able to meet contract requirements due to unforeseen incidents. Inability to export could be caused by, for example, plant diseases and pests, adverse weather conditions and drought, power cuts, strikes and workers' sabotage, poor service providers and sabotage. These could lead to a failure to meet export schedules and hence loan repayment obligations.

Some insurance companies have introduced what is now known as “horticulturists’ policy” to insure against hazards affecting price and quality, such as deterioration of product in transit, machinery breakdown (cold room and pre-cooler machinery), fire and allied perils. Although these insurance products are making receivables-based financing easier, they do not cover market risk. Low prices in the market, caused by an oversupply situation or adverse international trends, are not insurable.

Moreover, some banks are working with insurance companies to enable growers to benefit from insurance policies that cover the risk of deterioration of product quality from farm to product in transit.

## **H. The role of rating agencies**

A credit rating agency (CRA)<sup>19</sup> is a company that assigns short-term and long-term credit ratings for issuers of certain types of debt obligations. In most cases, these issuers are companies, cities, non-profit organizations or national governments issuing debt-like securities that can be traded on a secondary market.

A credit rating measures creditworthiness, the ability to pay back a loan, and affects the interest rate applied to loans. A rating provides an indication as to the value and risk level inherent in an entity or asset. Where an asset is provided as collateral to secure a transaction, a rating is aimed at evaluating the asset to determine whether it meets the agency’s standard for inclusion in the transaction. Assets are eligible collateral if they can be analysed as having either a reliable stream of income or a secondary market liquidation value. It is important to fully understand the potential credit risks inherent in the asset and how the asset can be used to ensure value for the financiers. Lenders rely to a large extent on the rating of companies or specific transactions (especially in the case of securitization) when deciding whether or not to join a financing syndicate.

There are two types of ratings: international and local ratings. The international rating of a company indicates the likelihood that it will reimburse a hard currency loan. In virtually all cases, this likelihood is deemed to be no better than the likelihood that the Government of the country in which the company is headquartered will reimburse its hard currency loans – in other words, the company’s rating will be constrained by the rating of its country. Only a handful of countries in Africa (e.g. Egypt, Mauritius, Morocco and South Africa) are rated, while the remainder are considered sub-investment grade. This ensures that all these countries will also receive a low rating, too low to receive international funds on the basis of rating alone.

The local rating expresses the risk that the company will be able to reimburse a local currency loan. This rating can be, say, AA (very good), even if the country’s rating is BB (sub-investment grade)<sup>20</sup>. Normally, local currency loans are expensive, but it is at times possible to structure loans in such a way that a “pass-through” to the international finance market is made, and the producer or exporter

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<sup>19</sup> The three main rating agencies are the US-based Standard & Poor’s, Moody’s and Fitch Ratings.

<sup>20</sup> This is according to S&P’s long-term credit rating system, which rates companies on a scale from AAA to D. Investment grade level goes from AAA till BBB, while non-investment grade starts from BB. Intermediate ratings are offered at each level between AA and B (i.e., BBB+, BBB and BBB-). Fitch’s long-term credit ratings are also set up along a scale from ‘AAA’ to ‘D’, first introduced in 1924 and later adopted by S&P. Moody’s also uses a similar scale, but names the categories differently, i.e. investment grade level goes from Aaa till Baa3 while speculative grade goes from Ba1 till C.

obtains a loan at international market conditions but reimbursable in the local currency. If such a structure is feasible, it can give a company that has a local currency rating of, say, AA, credit at, say, A- terms. Unfortunately, local rating services are absent from virtually all African countries, and most companies, in particular in the horticultural sector, are thus simply unrated.

International rating agencies may consider expanding their services and rate more African entities, perhaps in cooperation with local banks and other interested parties. Given the peculiarities of most African economies, application of universal rating standards will obviously not give the African entities sufficient room to meet and hence they will continue to record low ratings. Therefore, other favourable environmental factors, such as economic and financial sector reforms, and lower operating costs, should be taken into consideration in the rating of African deals and entities. Certainly, the level of equity capital required to operate in Europe, for example, is not the same as in Africa, given the relatively low wages and other costs.



## Chapter III

### SUCCESSFUL FINANCING TRANSACTIONS

The aim of this chapter is to explore opportunities and ways to finance horticultural trade sector in the African region through learning from existing success structures and case studies. This section therefore analyses successful international structured trade finance transactions by evaluating their background, structure, risk mitigation tools and the essential elements that led to their successful applications. A brief description of the main terms and conditions of each transaction will be given; however, for a more detailed description of a standard term sheet document, please refer to Annex III.

#### **A. Case study I: Pre-shipment financing in Zimbabwe (1997)<sup>21</sup>**

This case study refers to a pre-shipment finance transaction conducted in Zimbabwe in 1997, i.e. at a time when the international community and international markets still had confidence in Zimbabwe.

It is quite important to point out that at the time, some horticultural exporters in Zimbabwe used to enjoy pre-financing at the discretion of buyers while others even obtained pre-shipment loans from banks since international credit lines were available. This system has since been discontinued because of Zimbabwe's political instability and low credit rating on the international market which, as we will see in the next case study, have made difficult for Zimbabwean exporters to structure similar transactions and access credit at favourable terms and conditions.

##### *a) Introduction*

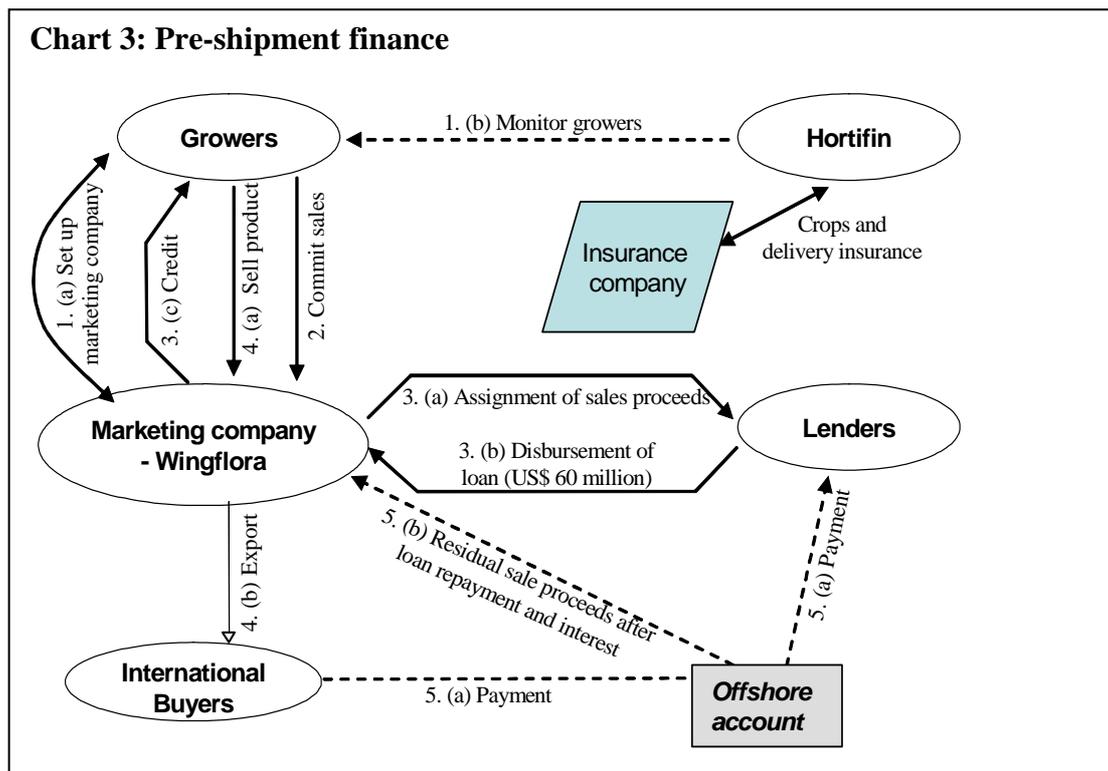
As a result of competition in the world market, Zimbabwean farmers, who have been involved in growing and exporting flowers since the early 1980s and had built up a worldwide reputation for the production of high-quality flowers, had to update their production techniques in order to employ high-yield, low-cost production methods. However, the country's macroeconomic policies had not been particularly helpful in encouraging investment by farmers. High interest rates and inflation were impeding effective and significant growth of the floriculture industry. The liberalization of the economy, on the other hand, had resulted in various offshore lines being made available for reinvestment in Zimbabwe without the need for Reserve Bank approval.

A company called Hortifin (Pvt) Ltd. identified investment potential in the floriculture industry in Zimbabwe and sought to raise a trade finance facility of US\$ 60 million, through the London-based merchant bank Singer and Friedlander Ltd., to help flower growers acquire modern facilities, in particular a new high-tech greenhouse concept that would control climate and spread of diseases, leading to improved production yield per hectare per annum.

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<sup>21</sup> The following three case studies on Zimbabwe were presented by Edwin Maismba Moyo in his two papers "Horticulture trade finance: Zimbabwe examples" and "Horticultural trade finance: Tying Western counterparties into the deal" at the African Regional Workshop on Horticultural Sector Diversification, which was held by UNCTAD in Nairobi, Kenya in May 2001. Mr. Moyo is CEO of Trans Zambezi Industries Ltd, a horticulture exporting company with production and processing operations based in Harare, Zimbabwe and Lusaka, Zambia. For further information, please refer to their website [www.wezim.co.zw/tzi](http://www.wezim.co.zw/tzi).

b) Flow of the transaction



1. A group of selected Zimbabwean flower growers export their products to offshore buyers through a local marketing company, Wingflora Pvt Ltd., which in turn decides to create Hortifin Pvt Ltd., to act as agent for the sole purpose of monitoring growers, the quality of their production and making sure that they are not side-marketing.
2. The flower growers commit all their sales to the marketing company.
3. The proceeds of all sales are assigned to the lender and payable onto an offshore special purpose account pledged to the lender. Thereafter, the lender makes funds available to Wingflora for onward disbursement to the growers.
4. The growers sell their products to Wingflora, which exports them to international buyers.
5. International buyers pay through the offshore account, charged to and controlled by the lender, from which loan repayments and all associated charges and interest are deducted before the residual sum is remitted to the growers through Wingflora.

This method, however, depends on the confidence that international donors have in the country, since they provide much of Zimbabwe’s hard currency inflow. Once donors lose confidence in a country, insurance companies such as ECGD, Hermes, NCM and COFACE, which normally cover country risks, will be very sceptical about providing such cover, as the risk of Government intervention in the flow of hard currency earnings increases sharply. This makes pre-shipment financing difficult and expensive. Post-shipment finance can still be possible as country risks are moved offshore.

c) Main terms and conditions of financing

<b>Borrower:</b>	A group of "selected" individual Zimbabwean flower growers. These growers formed a special entity, Hortifin Pvt Ltd., to facilitate monitoring of the facility by the lender.
<b>Lender:</b>	Singer & Friedlander Ltd., United Kingdom
<b>Facility Amount:</b>	US\$ 60 million
<b>Facility Purpose:</b>	Upgrading equipment used in the growing and dispatch of flowers
<b>Drawings:</b>	Various drawings, within a 12-month availability period, covering purchases of equipment and working capital in support of borrower's horticulture production
<b>Interest rate:</b>	% p.a. over six-month Libor fixed two business days prior to each interest period and payable six monthly in arrears. The interest rate is calculated on an actual 360-day year.
<b>Management fee:</b>	% flat calculated on the total amount and payable upon signature of the offer letter. The management fee is non-refundable.
<b>Commitment fee:</b>	% p.a. calculated on the total amount of the loan and an actual 360-day year. The commitment fee is payable three monthly in arrears. This is a fee paid per annum in order for the finance institution to commit the funds.
<b>Tenor:</b>	Five years from signature of the facility agreement
<b>Repayment:</b>	10 equal semi-annual repayments commencing six months after the date of signature of the facility agreement
<b>Call option:</b>	At the end of each 12-month period, if in the sole opinion of the lender there has been a change in the political or financial situation pertaining to the borrower likely to affect the security under the loan, the lender may call for immediate repayment.
<b>Security:</b>	<ul style="list-style-type: none"> <li>• Flower growers commit all sales through Wingflora;</li> <li>• Proceeds of all flower sales to be assigned to the lender and payable to an offshore special purpose account pledged to the lender;</li> <li>• Percentage of monthly sale proceeds (at the lender's sole discretion) to be retained in offshore special purpose account to meet future payments of principal and interest</li> </ul>

d) Risk mitigation

To ensure that reputable growers were selected, Hortifin had identified Wingflora (Pvt) Ltd, an established flower marketing agency (and freight forwarding company located at Harare International Airport), as the main vehicle for the deal. Wingflora, which had grown considerably in line with the growth of the floriculture industry in Zimbabwe, represented many reputable growers and therefore the activities of the growers could easily be monitored to ensure that they were in line with the overall objectives. Another advantage was that Wingflora had concentrated its activities on high-quality/high-price flowers and had, as a result, realized selling prices above the average market price. Wingflora's main roles were:

- (a) To provide clients' track records;
- (b) To ensure that products went to the international market;
- (c) To ensure that all receivables (which were to be assigned) passed through it in order to repay the loan.

Hortifin became the agent of the growers eligible for financing. It was created for the sole purpose of monitoring the growers, and to make sure that the money was used for the production of high-quality flowers and that they were not marketing their flowers on the side. Thus, the agent was present among farmers and had a direct link with Wingflora. Hortifin's main role was to process all applications for financing and to see to it that the flowers arrived at the airport with Wingflora representatives. Hortifin was structured in such a way as to mitigate performance and delivery risks. Therefore, it also requested the collateral of land and other assets from the growers as additional security on behalf of Wingflora.

In order to minimize the credit risk and to guarantee payment of the sums advanced, loan repayments were drawn directly from sale revenues earned on exported flowers which were assigned to the lenders. This means that funds were disbursed to the flower growers via the marketing company and repayments were deducted directly from the sale proceeds. An offshore special purpose account pledged to the lender was set up for this purpose.

Borrowers were also required to carry insurance cover against "loss of profits" risk, and against any potential natural or inadvertent catastrophic damage to crops (such as weed killers).

### **B. Case study II: Post-shipment financing in Zimbabwe (1999)**

This case refers to a post-shipment structured finance transaction for the horticultural industry carried out in Zimbabwe in 1999, at a time when the country's international confidence was at its lowest ebb and it was no longer possible to structure financing transactions in the borrower's country like the one previously described in case study I.

This example is designed to show how to structure a post-shipment finance transaction based on export sales flows in a situation of no confidence by international markets, by moving payment risk out of the borrower's country.

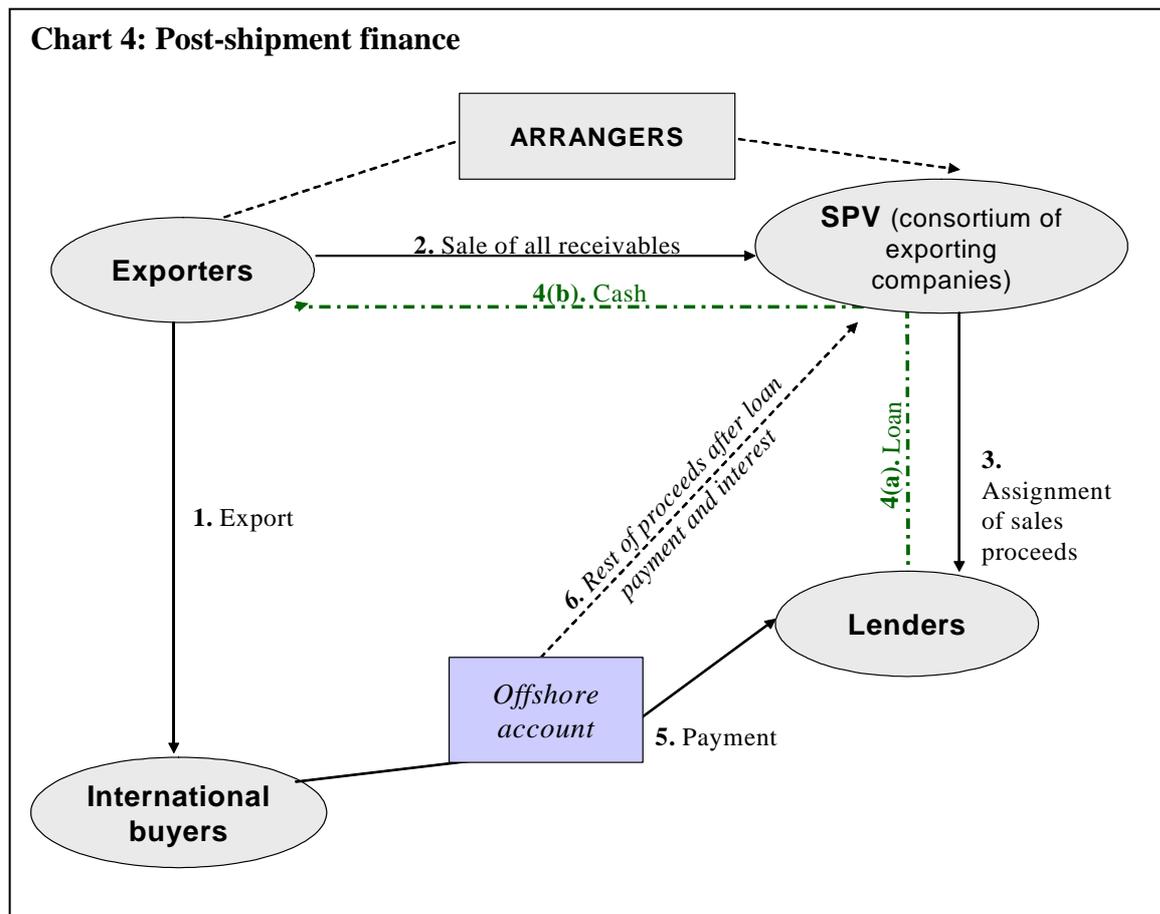
#### *(a) Introduction*

At the beginning of 1999, Zimbabwe's image abroad took a tumble when the International Monetary Fund refused to release funding to support the balance of payments. As the year progressed, a number of events ranging from land acquisition to pre-election violence undermined the country's confidence, causing its credit rating to plummet. Banks overseas had become wary of Zimbabwe's credit situation, mostly because of its economic mismanagement, which was causing payment problems (and a rapid fall of the local currency on the black market). Therefore, most foreign commercial banks had ceased granting or extending credit facilities to Zimbabwe. The limited credit coming into the country was short-term, expensive and/or heavily collateralized.

International donors were no longer willing to fund programmes in Zimbabwe. All this meant that financing based on export sales flows had to be structured differently, by moving payment risk out of Zimbabwe.

This situation, although particularly severe in Zimbabwe, can also be found in other sub-Saharan African countries.

(b) Flow of the transaction



A Special Purpose Vehicle (SPV)<sup>22</sup> was established by a consortium of Zimbabwean horticultural exporters, in order to raise funds in international markets at a time where no international banks were willing to take risks in Zimbabwe. The SPV was domiciled offshore to mitigate country risk and – in case of bankruptcy of the borrowers – to protect the assets.

1. The producers export their products to international buyers.
2. The exporters transfer the export receivables arising from the sale of horticulture products to international buyers to the SPV, which in turn uses these receivables as collateral for the loan.
3. The proceeds of all sales are assigned to the lender by the SPV and payable to an offshore special purpose account pledged to the lender. Thereafter, the lender makes funds available to the SPV for onward payment to the exporters.
4. International buyers pay through the offshore account, charged to and controlled by the lender, from which loan repayments and all associated charges and interest are deducted before the residual sum is remitted to the SPV.

<sup>22</sup> The SPV is the focal element in any asset-backed transaction. It is created after an agreement between a producer/exporter and financiers. An SPV is a special entity to which ownership of the commodities or other assets that serve as collateral is assigned. The SPV structure provides financiers with protection in case the beneficiary of the finance (i.e. the producer) goes bankrupt, and makes it easier to classify the transfer of assets as a sale. The SPV is managed and controlled by a non-related bank, which ensures that the financial flows resulting from the assets held as collateral are properly distributed.

*(c) Main terms and conditions of the financing*

<b>Borrower:</b>	Special Purpose Vehicle representing a consortium of horticulture exporting companies in Zimbabwe
<b>Arrangers:</b>	Global Financial Services USA, Inc. and SARA Consulting Ltd, London
<b>Lenders:</b>	A syndicate of international banks led by a prime international bank
<b>Facility Amount:</b>	US\$ 50-100 million
<b>Facility Purpose:</b>	Finance of export receivables
<b>Tenor:</b>	1 year but renewable annually at the option of the lenders
<b>Interest rate:</b>	% p.a. over six-month US\$ Libor fixed two business days prior to each six-month interest period and calculated on an actual 360-day year. Interest to be payable at the end of each interest period
<b>Management fee:</b>	% flat payable to the lenders on signing of the loan documentation. In the event of annual renewal of the financing, at each annual renewal date a further one per cent flat shall be payable to the lenders.
<b>Arranger's fee:</b>	% flat payable to the arrangers on signing of the loan documentation. In the event of annual renewal of the financing, at each annual renewal date a further 0.50 per cent flat shall be payable to the lenders.
<b>Commitment fee:</b>	% p.a. calculated on the total undrawn amount of the financing at any one time and on an actual 360-day year. Such commitment fee to be payable monthly in arrears
<b>Security:</b>	<ul style="list-style-type: none"> <li>• Assignment of all export receivables to the lenders by the consortium of Zimbabwean exporters;</li> <li>• All drawings under the financing shall be effected against presentation of export receivables accepted by importers (i.e. the Zimbabwean goods have been accepted by the importers and future payment of the receivables is unconditional);</li> <li>• Special purpose offshore account in the name of the lenders through which all export receivables must flow</li> </ul>

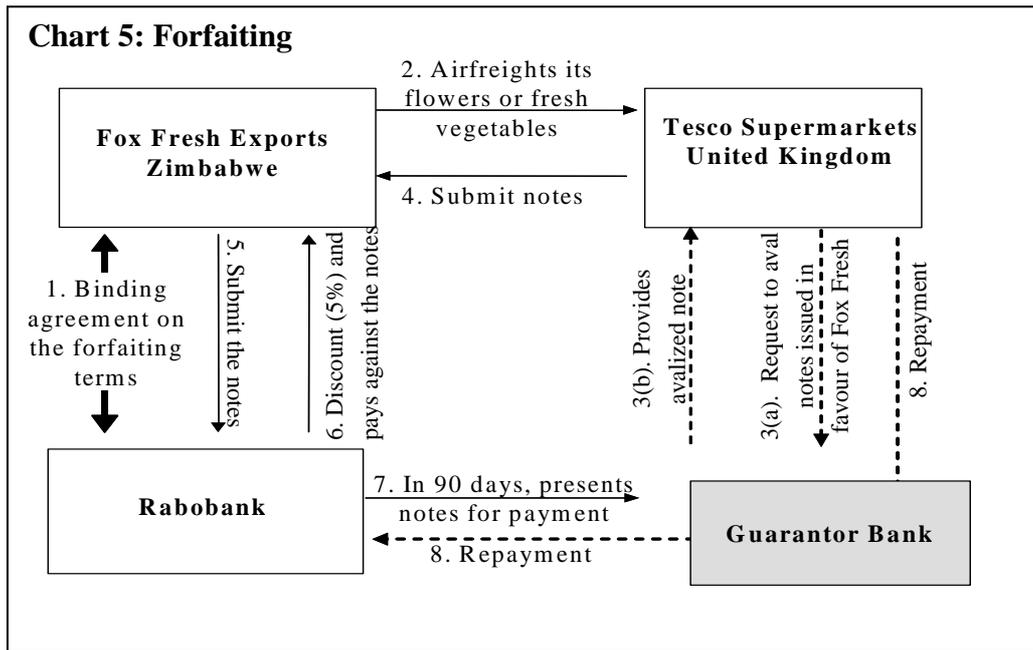
**C. Case study III: Forfaiting – Tesco/Fox Fresh Exports, Zimbabwe**

This example seeks to demonstrate how horticultural exporters in Africa can effectively borrow offshore without any exchange rate risks and obtain cheaper terms of finance through forfaiting, thereby bringing buyers into the financing scheme.

Typically, in a forfaiting transaction, the buyer issues promissory notes which are then endorsed by his bank and which the exporter presents to a bank for immediate payment in foreign currency less a discount rate.

Thanks to this financing structure, the buyer can benefit from deferred payment terms since he will issue promissory notes payable at a later stage, while the exporter, instead of waiting for the buyer's payment at maturity date or borrowing money on the local market to finance his working capital needs, can obtain without recourse financing at favourable international market rates terms as soon as the goods are shipped.

(a) Flow of the transaction



1. A forfaiting agreement between the exporter and its bank is entered to discount without recourse the proceeds of its exports to the UK.
2. Under this forfaiting transaction, the local company, Fox Fresh Exports Zimbabwe, airfreights its flowers or fresh vegetables to a foreign buyer, in this case, Tesco Supermarkets in the United Kingdom. Fox Fresh Exports Zimbabwe receives confirmation of value of its exports and maturity dates from Tesco.
3. Tesco issues a tenored promissory note to the exporter. These notes are then endorsed by Tesco's bank.<sup>23</sup>
4. Fox Fresh Exports Zimbabwe submits the notes to Rabobank for discounting and assigns proceeds to the discounting bank.
5. Rabobank pays the exporter cash without recourse less the discount rate of 5%.
6. At maturity, i.e. after 90 days, Rabobank present the notes to Tesco's bankers for final settlement.

(b) Main terms and conditions of financing

<b>Exporter:</b>	Fox Fresh Exports Zimbabwe
<b>Importer:</b>	Tesco Supermarket, UK
<b>Export Value</b>	US\$ 1,000,000
<b>Discounting Bank:</b>	Rabobank
<b>Discount Rate:</b>	5 per cent flat
<b>Maturity date:</b>	90 days
<b>Discounted Value to Exporter:</b>	US\$ 950,000

<sup>23</sup> This is the traditional way; nowadays, it is done more on a bank-to-bank basis whereby the buyer's bank issue notes to the exporter bank directly.

*(c) Advantages in the Tesco/Fox Fresh Exports Zimbabwe transaction*

*For the buyer (Tesco):*

The buyer (Tesco) will enjoy better credit terms, and as such will not be under too much pressure to pay immediately. The buyer can now get the products, sell, receive the money and invest it before final settlement in 90 to 180 days.

*For the exporter (Fox Fresh Exports Zimbabwe):*

Fox Fresh Exports Zimbabwe is paid within seven days of exporting instead of waiting for the actual maturity date of the promissory note. This will reduce its borrowing costs dramatically, since Fox Fresh Exports Zimbabwe will not have to borrow locally or from offshore for working capital purposes because it will get payment for its exports almost on a cash basis (within seven days).

Fox Fresh Exports Zimbabwe's competitiveness is enhanced because it can afford to give good credit terms to its foreign clients without worrying about cash flow.

This facility does not require any rigorous credit rating for Fox Fresh Exports Zimbabwe and all of the inconveniencing procedures that an exporter usually has to go through to obtain an offshore facility. In this case, all that is required is a promissory note or equivalent guarantee on the part of the foreign buyer, unequivocally indicating through his bank that he will pay within the agreed period.

Now that Fox Fresh Exports Zimbabwe will be getting its payment earlier than before, it can invest any idle portion of its foreign currency (after repatriating what is immediately needed for working capital) for a period of 60 days, in the case of Zimbabwe, before liquidation into Zimbabwe dollars as per the RBZ (Reserve Bank of Zimbabwe) requirements. This in effect means that Fox Fresh Exports Zimbabwe can recover some of the costs or charges incurred in the attempt to obtain prompt payment.

Fox Fresh Exports Zimbabwe can repay some of its local loans, thus avoiding further crippling interest accruals, particularly if the loans are denominated in Zimbabwe dollars.

*For the bank (Rabobank):*

Rabobank (the forfaiter) need not worry about country risk. The facility is based on a transaction basis and the risk that Rabobank is taking is with the foreign buyer Tesco located in the UK, not with Fox Fresh Exports Zimbabwe.

*For the country (Zimbabwe):*

Zimbabwe is now collecting its foreign currency receipts faster than before, thereby improving on its balance of payments foreign currency reserves.

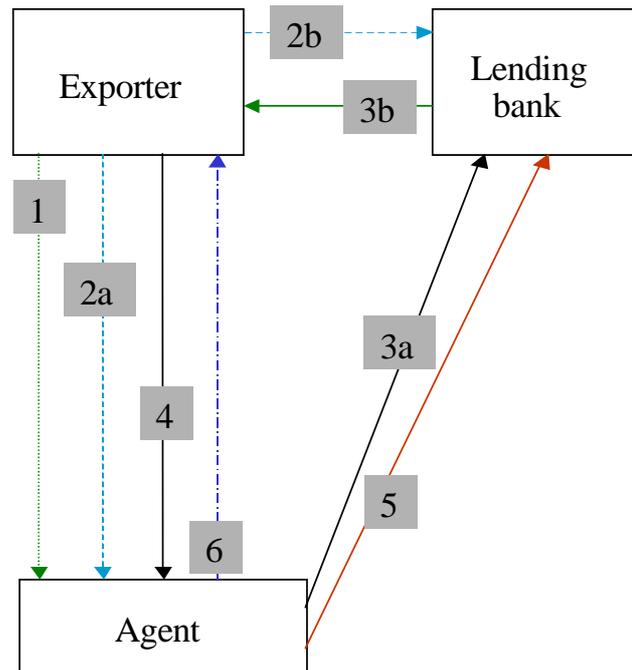
**D. Case study IV: Pre-financing facility for exports of bananas from Côte d'Ivoire**

This example seeks to demonstrate how agents/traders can be brought into the financing scheme, thus allowing African producers to access offshore pre-export finance effectively and without any exchange rate risks.

In our case, a banana producing company located in Côte d'Ivoire enters into a sales agreement with a Swiss horticulture agent to produce and ship a certain tonnage of bananas on agreed schedules. A pre-export finance facility is set up to allow the producing company receiving advances on future exports. This facility is then triggered upon receipt by the lender of notes issued by the agent covering the value of the advance. Each advance is subsequently placed at the disposal of the borrower in a bank account in Côte d'Ivoire.

(a) Flow of the transaction

1. Once the exporter has enough quantity to export on the vessel, he informs the agent. On the basis of the current market price, the agent determines a guiding price to put on his invoice as well as a reference price for the advance (to serve as basis for calculation).
2. The exporter has the loading documents and sends them to the agent, informing him that he has requested an advance (amount to be financed CHF/kg). Simultaneously, the exporter transmits to the lender a request for an advance accompanied by copies of the delivery documents.
3. A note to the order of the bank, issued by the agent, representing the amount of the advance is issued at every drawdown. Upon receipt of the note, the lender grants the advance and officially notifies the agent.
4. The agent takes delivery of the goods and issues his invoices (indicating the quantity, with terms of deliveries, names of the purchasers, terms of payment and expiry).
5. The agent makes payment of the gross value of the advance to the lender.
6. The agent regularizes the account of the exporter and pays the balance of the sale.



(b) Main terms and conditions of financing

<b>Borrower:</b>	A major banana producer in Côte d'Ivoire exporting through an agent located in Switzerland
<b>Agent:</b>	Company based in Switzerland, distributing the imported bananas to various retailers, food processors, supermarket chain retailers and wholesalers. The agent is also a shareholder in the banana producing company in Côte d'Ivoire.
<b>Lender:</b>	International bank based in Europe
<b>Facility amount:</b>	1.5 million Swiss francs
<b>Type of facility:</b>	Revolving pre-export financing facility
<b>Purpose of facility:</b>	To partially finance receivables related to future export of bananas carried out by the borrower to the agent
<b>Facility structure:</b>	Upon production of sufficient stock under the rolling sales agreement with the agent, the borrower requests drawdowns on the facility of an agreed amount on the basis of price estimates established by the agent and communicated to the lender. The lender disburses the amount following the disbursement mechanism described below.

<p><b>Disbursement mechanism:</b></p>	<p>At every request for an advance, the agent estimates the sale price (in kilos). The amount of the advance is then calculated deducting from this estimated selling price a fraction representing an estimation of overall handling costs (including shipping and transit fee as well as commission to the agent) and another fraction as a security margin to cover any price shortfalls.</p> <p>A hypothetical case is presented below:          Estimated sale price == SF 1.5          Less shipping, commission == SF 0.5          Less security margin == <u>SF 0.2</u>          Amount to finance <i>multiplied</i>          by the quantity shipped == SF 0.8 x Kg</p> <p>The advance will be disbursed upon presentation, inter alia, of the following documents:</p> <ul style="list-style-type: none"> <li>• Copy of the shipping documents corresponding to the product being pre-financed by the advance;</li> <li>• Copy of the estimation of sales price addressed by the agent to the borrower;</li> <li>• A note to the order of the bank, issued by the agent, representing the amount of the advance;</li> <li>• Assignment of all types of insurance taken out on the products in transit.</li> </ul>
<p><b>Repayment:</b></p>	<p>Repayment is effected via redemption of notes issued by the agent to the order of the lender covering the value of outstanding advances under the facility. Under normal circumstances, the agent would issue notes to the exporter; however, in this case, the agent is required to remit proceeds of payments directly to the lender, by issuing notes directly in favour of the lender.</p>
<p><b>Security:</b></p>	<ul style="list-style-type: none"> <li>• For each advance a note is issued to the order of the lender by the agent;</li> <li>• Assignment of all marine and other delivery insurance coverage.</li> </ul>

*(c) Risk mitigation*

In order to make a transaction financially viable, one needs to identify all of the risks involved in the underlying commercial transaction and try to mitigate them. The more risks are mitigated and the more effectively this is done, the better the financing terms that are available to the producer.

*i. Performance risk of the borrower*

One of the main risks to be tackled is the performance risk of the exporting producer, i.e. the possibility of the exporter not being able to produce the commodity that he is contractually bound to produce. In this transaction, the risk would be the borrower not being able to generate sufficient bananas for export. However, this risk appears remote given the exporter's standing and production capabilities. The borrower is one of the major banana producers in his country. He is also engaged in the production of various other horticultural products such as pineapples. He produces up to 200,000 tonnes of bananas per annum. He has invested in new technologies to meet quality standards and to comply with ISO 14000.

Moreover, via the discounting of price estimates, the lender finances only a portion of the overall cost of the products on board. This is a key factor that makes the borrower responsible, both financially and morally, to work towards the success of the transaction.

*ii. Risk of fund diversion*

This is the risk of the borrower utilizing the advances for other activities than the export of bananas. There is a sales agreement between the borrower and the agent which gives the agent the sole right to

market the products for the borrower in Europe. In line with this arrangement, no funds will be disbursed until products have been generated, thus eliminating the risk of fund diversion by the borrower.

*iii. Payment risk*

Prior to an advance being made, the agent would issue notes evidencing the debt obligation, further strengthening the repayment prospects and removing the payment risk from the borrower.

*iv. Market risk*

The situation of offtakers of commodities shall be taken into consideration. In this particular case, there is a risk that the products may not be sold even when they arrive in Europe. This risk is, however, unlikely given the agent's sales network. His clients are wholesalers, chain distributors and processors. Eighty per cent of the banana imports are sold to a single main processor, helping to ensure that ripe bananas can be easily processed and to avoid spoilage. Another advantage is that banana consumption is not affected by weather variations. Furthermore, the agent is highly reputable and the European market has a great demand for bananas, which is further strengthened by the fact that they are a tropical product that cannot grow in the region.

*v. Quality risk*

Quality risk is assessed differently for each type of commodity. Quality inspection and insurance may be used to lessen this risk. However, most lenders are not able to assess quality and therefore would not accept quality risk. This means that offtakers, who can assess quality, should check on the quality before accepting the commodity. Insurance coverage is important.

In the event of quality default arising from damage in transit, insurance claims are payable to the lender. Where quality default arises from the borrower, there is no insurance coverage. Therefore, if the goods are rejected by the buyers the bank will not be able to recover its advance. One possibility would be for the bank to take the residual payments from previous exports repayment; alternately, in the case of future exports, the bank would provide a reduced portion of the estimated selling price of the products (i.e. increasing the security margin) until it has recouped its advance on the rejected lot from the repayment received from end-buyers.

*vi. Price risk*

The more volatile the price risk of a commodity, the higher the risk for financiers. As fixed price contracts are difficult to obtain, financiers could either apply an advance ratio for the commodity to be delivered or simply hedge the commodity to be financed.

There is a risk that prices could fall and in that case adversely affect the success of the transaction. This was taken care of by financing only a portion of the estimated price of the products in addition to a security margin; thus, even with extreme price fluctuations, the lender would still recover the value of the facility.

*vii. Delivery risk*

There is also a risk that products generated for export may not find loading space on outward-bound vessels. This risk was mitigated by the financier, through the provision of advances only when goods are on board.

*viii. Country risk*

This does not arise since advances are made only when products are already loaded on the vessel, with payment coming from the agent domiciled offshore.

**E. Case study V: With recourse invoice discounting, Agriflora Zambia**<sup>24</sup>

This case study shows how post-shipment financing is possible even if, unlike Case Study III, no promissory notes but instead only sale receivables, i.e. invoices, are available for discounting.

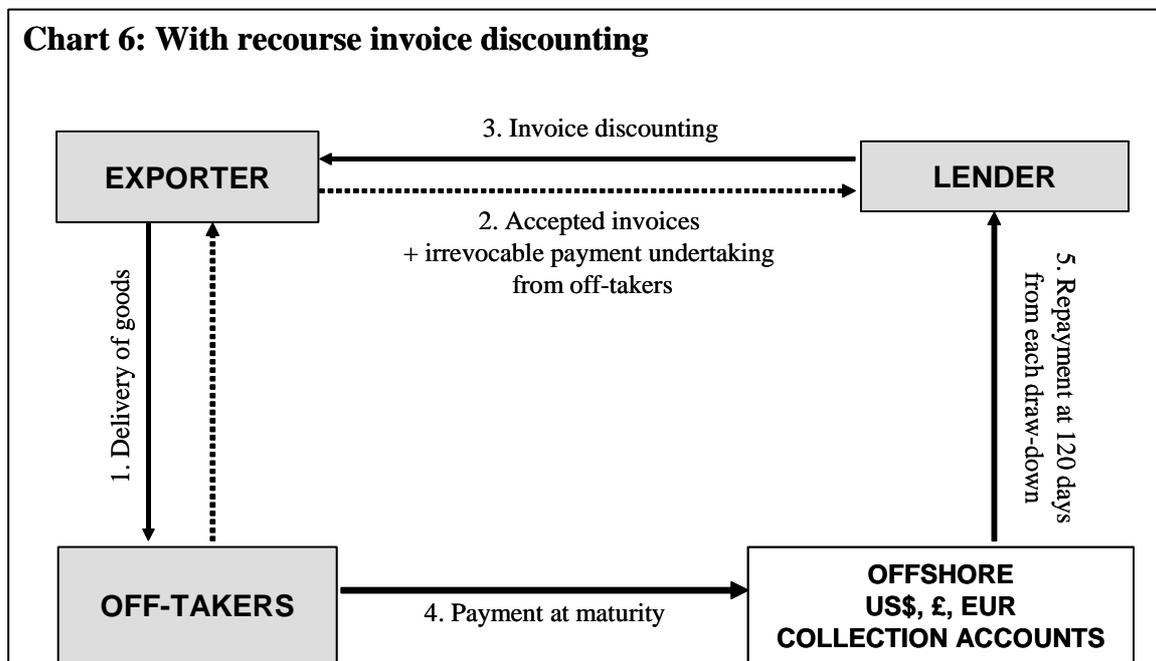
Both mechanisms are designed to improve the cash flow cycle of the producing/exporting company which receives the value of the sale receivables in advance, i.e. before the actual maturity date agreed with the buyer, after deduction of a discount fee. There is, however, a fundamental difference between the two financing mechanisms: while the discount of promissory notes is *without recourse* financing, i.e. the bank takes the full risk of non-payment at maturity, invoice discounting is *with recourse* to the seller, i.e. the seller will have to reimburse the bank if the buyer eventually fails to pay.

*(a) Introduction*

Agriflora Limited is a large Zambian-based horticultural company specializing in the production of vegetables and roses for export mainly to European markets. Whilst the final buyers of the produce are the large supermarkets and chain stores, the produce is sold to a number of agents who arrange for the distribution of the produce.

Agri-flora has signed fixed-price export contracts with its buyers (each an off-taker). Sales are denominated in United States dollars, pounds sterling and euros. Typically, the buyers will expect anything from 30 to 120 days credit terms from Agriflora, and some would stretch these terms out for as long as possible. African Banking Corporation of Botswana Limited was approached to arrange and structure a "with recourse" invoice discounting facility in favour of Agriflora to improve its cash flow cycle.

*(b) Flow of the transaction*



<sup>24</sup> This example was provided by Alistair Tite, Head, Structured Trade Finance, African Banking Corporation (International) Limited, Botswana. For further information, please refer to [www.abcthebank.com](http://www.abcthebank.com).

Exporter ships horticulture products into European markets via agents.

1. Exporter sends the lender accepted invoices and irrevocable payment undertaking from the offtakers in order to obtain advances on these invoices payable at a later date.
2. The lender discounts the invoices and pays the exporter by drawing from the facility.
3. At maturity, the offtakers pay into the offshore collection account.
4. At 120 days from each drawdown, money is transferred to the lender to repay the outstanding loan.

*(c) Main terms and conditions of financing*

<b>Borrower:</b>	Agriflora Zambia Limited.
<b>Arranger:</b>	African Banking Corporation of Botswana Limited
<b>Lender:</b>	African Banking Corporation of Botswana Limited and/or a syndicate of banks
<b>Facility purpose:</b>	The proceeds of the facility are to be used by Agriflora Zambia to finance the production of various horticulture products for export to selected European buyers.
<b>Disbursement:</b>	Each drawdown shall be treated as a separate transaction and shall be effected against presentation of accepted invoices by the off-takers.  Each drawdown shall be debited to a US dollar-denominated "advance account" to be opened on the books of the lender.
<b>Collection accounts:</b>	Accounts denominated in US dollars, pounds sterling and euros, which will be opened at an offshore bank acceptable to the lender, into which the proceeds from the sales contracts shall be paid by the offtakers.  On a predetermined date each month, the credit balances held in the pound sterling and euro accounts will be converted into US dollars at the ruling spot rate of the day and credited to the US dollar account.  On a predetermined day each month, the credit balance held in the US dollar account shall be transferred to the US dollar "advance account" to repay the loan.  Any credit balance held in the collection account shall earn interest at the US dollar deposit rate of interest.
<b>Repayment:</b>	Each drawdown in terms of this facility is to be repaid within 120 days from the date of drawdown.
<b>Coverage ratio:</b>	This is a ratio used to test the adequacy of cash flows generated through earnings for purposes of meeting debt obligations. This ratio shall exceed 1.25:1, i.e. the amount of receivables under export contracts with offtakers to the principal amount of the facility.
<b>Undertakings:</b>	Undertakings required from the borrower to include, inter alia, the following: <ul style="list-style-type: none"> <li>• To exceed coverage ratio of 1.25:1, or such other ratio as agreed between the parties, throughout the life of the facility;</li> <li>• Not to amend, vary or waive any material term of the contracts without the prior written consent of the lender;</li> <li>• Not to sell, transfer, assign or create any security interest on any of its rights to the foreign exchange resulting from the exports.</li> </ul>

<b>Security:</b>	<p>To include the following in favour of the lender:</p> <ul style="list-style-type: none"> <li>• First priority assignment of all rights and claims of the borrower under and pursuant to the export contracts with approved offtakers in form and substance acceptable to the lenders;</li> <li>• Acknowledged notices of assignment from each offtaker to pay all proceeds due under the sales contract directly into an account to be opened in the name of the borrower at an offshore bank acceptable to the lender (the collection account);</li> <li>• Additional assignment of future sales contracts to the lender, if necessary, to ensure repayment of the total outstanding under the facility;</li> <li>• A first charge over the collection account;</li> <li>• Transport insurance policy nominating the lender nominated as loss payee.</li> </ul>
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### **F. Case Study VI: Financing of "indirect exporters" in Zimbabwe<sup>25</sup>**

This case study shows how "indirect exporters" can also benefit from international financing along the supply chain using innovative financing techniques. "Indirect exporters" are all goods and service providers to the export sector activities, i.e. freight, post-harvest handling and logistic activities, inputs (chemicals, fertilizers, packaging etc.) suppliers, marketing agents and breeders, but have little or no access to international export finance facilities.

Traditionally, many banks believe that only those generating hard currency revenue can borrow in hard currency, while local currency earners are relegated to much more expensive local currency finance. However, by considering service and goods providers to the export sector as "indirect exporters", they can also benefit from hard currency finance with innovative financing schemes.

Such schemes would normally make use of Special Purpose Vehicles (SPVs)<sup>26</sup>, which could be owned by growers, marketing agents or others. The SPV would be under contract with the marketing agent to provide certain goods (e.g., inputs) or services (e.g., freight), and the marketing agent could in turn allocate parts of the expected export proceeds for the (offshore) payment of these services. Banks, in turn, would be willing to lend to the SPV against the security of these future export proceeds; the tenor would depend on their trust in the ability of the exporters to continue exporting.

#### *(a) Background information*

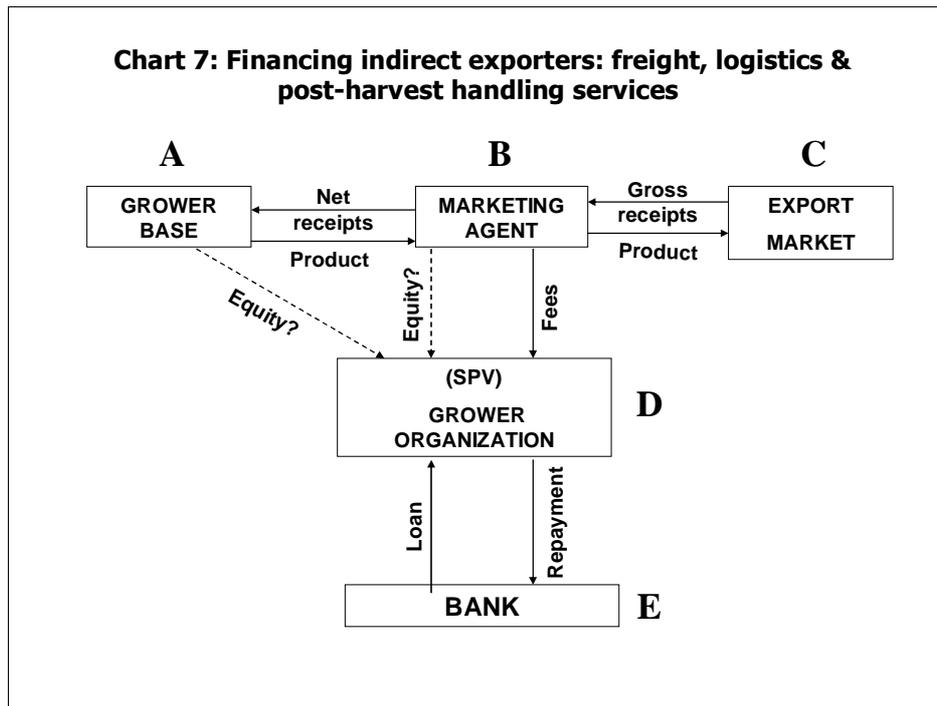
In Zimbabwe's floricultural sector, the costs of bringing flowers to the international markets are higher than actual production costs. Furthermore, a significant share of production costs consists of inputs and packaging costs. Given that producers are price-takers, they will receive lower prices if these services are not provided efficiently and at reasonable cost. The creation of the following scheme has allowed funding for multiple activities all supported by one cash flow, i.e. export receipts.

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<sup>25</sup> This case study is based on the presentation "Financing indirect exporters in the supply chain: The case of export agriculture" by Chris Goromonzi at the Pre-Event to the Expert Meeting on Financing Commodity-Based Trade and Development, UNCTAD, 15 November 2004. For a case study showing the usage of SPV, please refer to next case study.

<sup>26</sup> SPV is a legal entity created by a company to achieve specific objectives such as securitization of financial instruments and isolation of risks.

(b) Flow of the transaction



- A. Grower base consolidating production through an export agent under contract
- B. Marketing agent tasked with marketing product, handling of export receipts and organization of handling logistics
- C. Export market
- D. Special purpose vehicle specializing in freight, logistics and/or post-harvest handling of export services. Could be a grower organization or an independent body or be owned by a group of marketing agents
- E. Bank providing facilities to the SPV, using contractual receipts or fees payable by marketing agents as security. SPV normally operates a retention scheme boosting its cash flow - hence offshore bank loans serviceable from cash flows

**G. Case Study VII: Infrastructure financing – The Contango Project in Zambia (2004)**<sup>27</sup>

This case study presents a practical situation where trade finance has been structured to meet the needs of infrastructure finance in both Zambia and Zimbabwe. It demonstrates how structured finance can be successfully used to develop infrastructures in developing countries. It also shows how infrastructure finance is very much a function of trade finance and why international banks should accept it as part of the commodity supply chain.

(a) Background information

Contango is an established, large-scale operation in Lusaka, Zambia, specializing in the production, processing and exporting of vegetables. Contango products (pre-packed mangetouts, sugar snaps, fine beans, baby corns and runner beans) are exported to retailers in the UK, who, in a context of increasing demand for high-value horticulture products and dwindling European supply caused by the sudden decline in Zimbabwean production, have been requesting annual volume increases of 20 per cent from their suppliers.

<sup>27</sup> This case study was prepared by Edwin Moyo, CEO, Trans Zambezi Industries Ltd, a horticulture exporting company with production and processing operations based in Harare, Zimbabwe and Lusaka, Zambia. For further information, please refer to their website [www.wezim.co.zw/tzi](http://www.wezim.co.zw/tzi).

Contango is owned by a partnership of seasoned horticulturists who have and continue to run formidable operations in Zimbabwe. They are the largest horticulture exporters in Zimbabwe. The owners wanted to leverage their management team's 10-year experience in horticultural exporting to create and manage the Contango operation in Zambia. This managerial experience, combined with Zambia's agricultural conditions and relative stability in terms of economic and political structures, ensured the project's success.

Marketing for the venture is handled by Exotic, one of the largest and most respected primary marketing organizations in the UK. Logistics are outsourced to Rollex and M.K. Airlines. This has allowed Contango to focus on production and processing of vegetables. Production is split between base farm production on Contango's 3020 hectares of commercial farms and leased farm production by out-growers who are small-scale farmers contracted to grow for Contango. The company's quality standard includes inspecting, grading, cutting, cleaning and packaging all products in packaging sheds. All export products comply with EUREPGAP and HACCP accreditations, i.e. typical forms of accreditation granted by UK supermarkets.

*(b) Out-grower production programme: Risk management and financing*

Contango's owners and managers have extensive experience building and managing EUREPGAP accredited out-grower programmes. This experience was instrumental in the success of the Contango programme. The owners understand that a strong programme must be beneficial to both Contango and the out-growers via a focus on performance management and transparency, continued stability, education and the creation of profits for both parties.

Using this experience, Contango selected some 250 out-growers around Lusaka. These growers were organized into groups of 50 and carefully trained to grow export crops. Five special purpose vehicles (SPVs) comprising 50 farmers were created.

*i. Contract with out-growers*

Contango will receive a supply programme from Exotic. Contango will then split this programme into production from base farms and out-growers' farms. Individual out-growers will be allocated a volume to produce based on their historic performance and experience. Care will be taken to ensure that all growers have relatively stable programmes. Contango will then enter into an agreement with each out-grower to buy the relevant volume from each grower at the time the crop matures. A fixed price is agreed upon with the out-grower in pounds sterling prior to commencement of planting. Payment is made every month for delivered product from the previous month.

*ii. Provision of inputs*

One advantage of an out-grower programme is that local farmers can gain access to otherwise unavailable benefits of scale. These benefits include ability to purchase lower priced inputs and the use of expensive equipment. To support the programme, Contango will make inputs available to out-growers. Contango will also rent equipment to out-growers for short periods of time. As out-growers often do not have cash flow to pay for these products and services, Contango will offer a credit service, where full payment for the inputs is deducted from out-growers' future payment.

*iii. Monitoring, support and EUREPGAP accreditation*

In addition to providing access to inputs, employees in Contango's out-grower programme will visit each grower regularly to supply agronomic and technical advice to help out-growers maximize their return. Critical for export is EUREPGAP/HACCP accreditation. The Contango project will involve

managers from Canvest,<sup>28</sup> a team that has achieved accreditation with over 50 out-growers in Zimbabwe. They will ensure that all Zambian growers are EUREPGAP-compliant in order to meet the strict standards required by EU markets. Contango and its clients adhere to a strict code of practice encompassing chemical usage, hygiene practices, and environmental and social issues. Our technical advisors conduct regular audits, and any non-compliance will result in crop rejection.

*iv. Training*

The Contango team found that the creation of a fully-fledged training and facility team provided great benefits to the out-grower programme in Zimbabwe, and plans to replicate the programme in Zambia. Courses will be conducted covering such subjects as scouting techniques, pest identification, chemical usage, safety operational procedures, and equipment calibration and maintenance. Further courses covering social and ethical issues of workers' rights and education will also be encouraged. All supervisors are trained in various aspects of crop and labour management.

*v. Outputs and payments*

Contango's first priority is to ensure a reliable supply of top-quality produce to its customers. This forms the basis for Contango's payment policy. The onus is on growers to deliver high-quality produce at the volume specified in their customized programme. If growers fail to do this, their programme may be reduced or removed. In return, Contango agrees to purchase all of the agreed volume, regardless of changes in market demand or market dumping.

Contango provides crates to out-growers and picks up all produce from their farms. All products are given a batch number, allowing for traceability from the field to the supermarket. Upon arrival at the packing facility, a quality analysis is performed on the produce, the results of which are notified to the grower, detailing the export and defect percentages. These percentages are then factored in to calculate each grower's payment at the end of the month.

*vi. Major risks in the out-grower programme*

The following constituted major risks:

- Lack of agricultural knowledge. The farmers largely lacked agricultural knowledge to grow such kind of crops, a factor that posed a serious risk to the programme;
- Poor infrastructure. The farmers lacked proper infrastructure such as water facilities and electricity;
- Lack of collateral security. The farmers did not have the security required by financial institutions as collateral for the loans needed;
- Lack of markets. The farmers did not have access to markets for selling their produce.

After becoming aware of these risks, Contango decided to employ the following mitigation techniques:

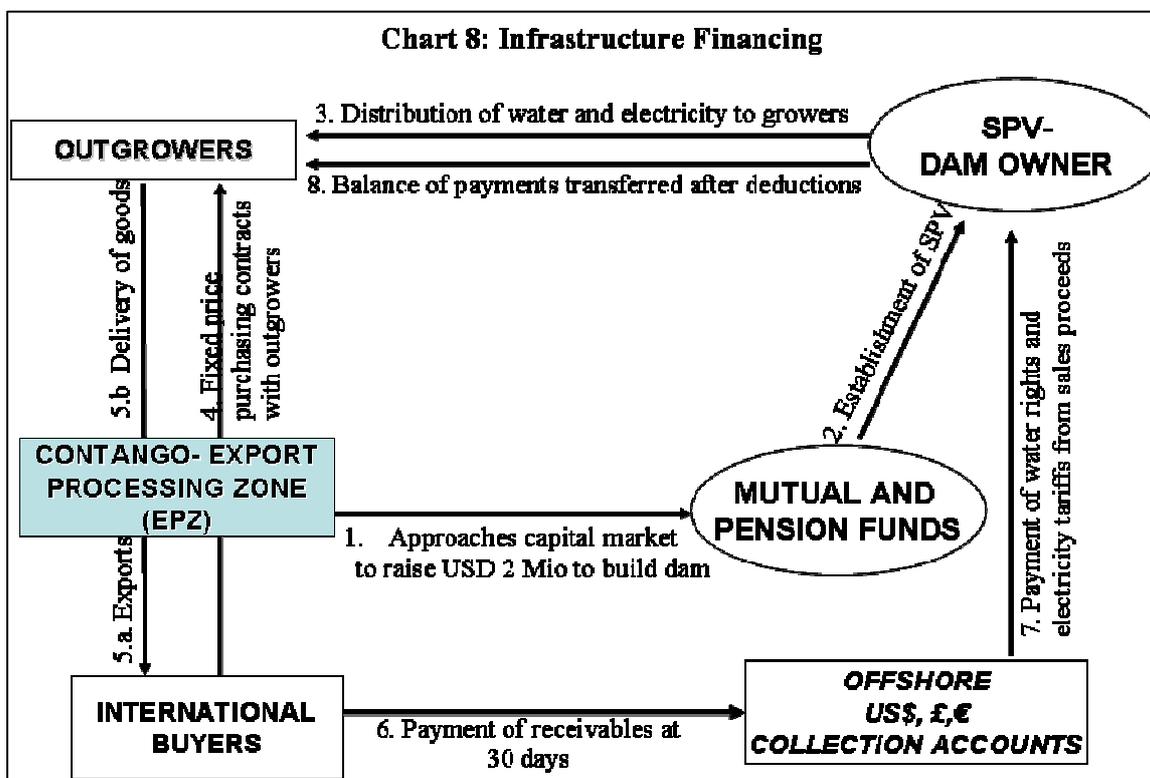
- Provision of an extensive service of equipping farmers with in-depth knowledge on how to grow the crops;
- Identification of new sources of water such as dams, and various irrigation projects;

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<sup>28</sup> Canvest, also known by the name of Kondozi Limited, was one of the largest horticultural production groups in Zimbabwe until 8 April 2004, when the Government of Zimbabwe closed the company because of the latter's agrarian reform plan.

- Creation of special purpose vehicles (SPVs) as legal entities to motivate financial institutions to lend, disburse and repay loans;
- Encouragement of farmers to grow for specific market programmes identified through Contango.

vii. Flow of the transaction



1. Contango used its Zimbabwean experience<sup>29</sup> by approaching mutual and pension funds to raise some US\$ 2 million for constructing dams in order to provide out-growers with irrigation and electricity.
2. The mutual and pension funds were asked to form a Special Purpose Vehicle company (SPV) which took ownership of the dam and the distribution of water and electricity to the community.
3. Some 2500 small-scale farmers were placed together along the area where the dam was constructed, given growing programmes, and provided with irrigation and electricity.
4. Cotango will receive a supply programme from Exotic, a UK-based marketing agent, and will assign a production volume to each out-grower. A fixed price in pounds sterling is agreed with the out-growers before starting planting.
5. Horticulture products are then exported to retailers in the UK.
6. International buyers would pay receivables at 30 days onto the SPV's offshore account managed by an international bank.
7. The SPV would be paid water rights and electricity tariffs on a monthly basis by each out-grower. This money would be deducted from each out-grower's export receipts at source and paid directly onto the SPV's offshore account. In turn, this would create value for investors in the SPV.

<sup>29</sup> This model was also used in Zimbabwe by Mitchell and Mitchell to build a dam for its out-grower programme in 2000. The mutual and pension funds generated up to US\$ 5 million to build the dam, which is now owned by a SPV. Today, the SPV has some US\$ 5.3 million invested in various instruments, giving value and payback to investors of four years. Therefore, mutual and pension funds continue to invest in the SPV.

8. The balance of payments is transferred to each out-grower after deduction of water rights and electricity.

*viii. Situation of farmers before and after the creation of the SPV*

Before this project, farmers mainly cultivated maize, a crop that was grown once a year and was highly dependent on rainfall. During the drought years, farmers suffered heavily, and even when there was sufficient rainfall, they did not receive sufficient benefits from their farming efforts because of a lack of infrastructure.

After the formation of the SPV, the farmers earned more money from their crops because they now harvested four times a year. They used the proceeds to repay the infrastructure. Moreover, the project has had significant social and community benefits since the SPV has allowed farmers to gain access to the following necessities: water, electricity, jobs, health services, basic education, telecommunications, and banking and transportation services.

By 2007, the project is expected to generate an additional 2,000 jobs and an improvement in workers' education, health, and food security. A total of US\$ 13 million will be injected into the community during the initial five years of operation in the form of wages, payments to out-growers, and purchases of inputs and services. In the long term, the venture will pay US\$ 250,000 per annum in taxes. Contango will serve as a precedent for businesses looking to expand into Zambia. Overall, Contango was exceptionally suited to capitalize on Zambia's growing market because of a well-balanced ownership structure, managerial experience with extensive horticultural expertise, a proven track record of success, and strong relationships with primary marketing organizations.

The project has also created significant financial benefits since its launch in early 2004. Even under conservative assumptions, Contango is expected to have a positive cash flow already by the second year of operation, and will generate annual revenue of US\$ 19 million and an operating cash flow of US\$ 2 million. By 2009, Contango is expected to average annual revenues of US\$ 50 million.



## CONCLUSION

The horticulture sector offers Africa considerable potential for diversification, in terms of agricultural development and increased exports to regional and international markets. This is mainly due to the increase in global demand for high-quality products and the phasing-out of agricultural subsidies in developed countries under WTO agreements, as well as the rationalization of tariffs and trade restrictions on food items. This should provide African countries with access to larger export markets and make them more price-competitive in international markets in both processed foods and fresh produce.

The horticulture sector in both the processed and the fresh produce sector, if properly utilized, can provide African countries with real export market potential and can offer a significant economic opportunity in terms of foreign earnings and GDP. Since the US\$ 7 billion international trade in fruits and vegetables is dominated by processed foods, it is here that the bigger opportunity lies. If current related issues such as infrastructure problems and product quality and packaging are significantly minimized and improved, African countries will become competitive exporters of horticultural products.

The introduction of new measures and related issues in the horticulture industry would require working capital, credit and investment support. However, there are many constraints that hamper access to credit at reasonable terms. This is mainly due to widespread mistrust, technical barriers and mis-understanding of the credit institutions, which consider horticulture to be a high-risk industry and therefore insist on substantial collateral and stringent terms and repayment programmes for their loans. However, there are possibilities of arranging international structured finance transactions that would respond to the needs and requirements of the industry and increase the competitiveness of players in the industry by mitigating risks and reducing transaction costs, thus making exporters more competitive, stimulating diversification and increasing the price that producers can expect to receive.

Financiers need to be aware of the industry's prospects since their role in the development of the sector in Africa is very important. They should play a facilitating role and provide their expertise where necessary. The potential offered by the use of structured finance mechanisms may be considered and adapted to the horticultural sector in Africa. This paper has reviewed the development and prospects of the world horticulture sector and its relevance to African export diversification and the role of the relevant parties in the drive to expand the production and export of African horticultural products. The risks that pose concerns to the financiers have also been examined, and some forms of mitigation and successful experiences have been evaluated as well. It is hoped that with determination and some confidence on the part of local banks and the international financing community, African exports of horticultural products will succeed in making a substantial contribution to the continent's overall trade portfolio.



## Annex I

### **The impact of supermarkets in the supply chain on small growers in Africa: Financing challenges and options<sup>30</sup>**

Since the mid-1990s, a major development in the operational dynamics of the horticulture industry in Africa has been the vertical integration of the supply chain enacted by supermarkets. As more supermarkets emerged in Europe and within sub-Saharan Africa throughout the 1990s and early 2000s, competition among major supermarkets intensified to win the loyalty of customers. Thus, supermarkets began implementing an aggressive competitive strategy that centred on product differentiation of horticultural products<sup>31</sup> to gain a comparative advantage over their competitors. Whereas the traditional supply chain involved more intermediaries providing standardized products to consumers, the integrated supply chain over the last 15 years has been characterized by fewer firms contracted under the management of major supermarket companies for greater control of end-products. As consumers have become more aware of a healthier lifestyle, they have increasingly demanded greater variety in fruits and vegetables offered year-round at competitive prices.

#### **Box 7. Characteristics of the integrated supply chain**

The competitive strategies of supermarkets have created a supply chain of fresh fruits and vegetables emphasizing the following features:

- *Quality:* With consumers more attuned to a healthier diet of fresh produce, supermarkets are expected to respond with higher quality;
- *Consistency:* Customers now demand produce with consistent taste and appearance year-round;
- *Variety:* Supermarkets have offered variations of basic produce while introducing new, “exotic” products such as papayas, mangos, etc.;
- *Processing:* In response to a busier lifestyle of consumers, supermarkets have increased their range of pre-washed, pre-chopped prepared foods;
- *Packaging:* Supermarkets pre-pack speciality produce for presentation and consumer appeal;
- *Reliability of supply:* Supermarkets seek to provide fresh fruits and vegetables year-round across growing seasons;
- *Price:* With markets shares of competing supermarket chains reaching saturation point at the end of 1990s, supermarkets strive to provide products at the lowest price for consumers. Thus, strict management of the supply chain has created pressure to source produce at minimal costs while maintaining high quality.

*Source:* Dolan, Catherine and John Humphrey, “Governance and Trade in Fresh Vegetables: The Impact of UK Supermarkets on the African Horticulture Industry”, Journal of Development Studies, Vol. 37, No. 2, 1 December 2001.

Moreover, developed countries have upgraded the food safety, environmental, labour and quality standards of products imported from developing countries. These two factors converged to place more emphasis on tighter supply chain governance that, in turn, would result in the consolidation of firms at each hub of the production, processing, transporting, marketing, and retailing activities along the supply chain. Thus, the African horticulture industry is now dominated by a few large exporters who source from large commercial farms or from production farms they either own or lease. Access

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<sup>30</sup> The analysis in Annex I is based on two major sources:

1) Dolan, Catherine and John Humphrey, “Governance and Trade in Fresh Vegetables: The Impact of UK Supermarkets on the African Horticulture Industry”, Journal of Development Studies, Vol. 37, No. 2, 1 December 2001.

2) Dolan, Catherine and John Humphrey, “Changing Governance Patterns in the Trade in Fresh Vegetables Between Africa and the United Kingdom”, Environment and Planning, Vol. 36, March 2004.

<sup>31</sup> Although this section will focus on the fruit and vegetables sector in horticultural production, some aspects of the impact of supermarkets on the supply chain can also be applied to the floriculture sector. However, the differences are in matters of degree, with cut flower sales still largely conducted through auction floors and various intermediate buyers. For more information, see Box 2 on page 4.

to affordable credit has been the key to staying afloat in an increasingly competitive industry, because funds are needed for upgrading production facilities and technology while implementing sophisticated logistic systems that allow supermarkets to ensure due diligence and traceability of fresh produce along the supply chain from supermarket shelves back to farming fields. For small growers who have not been integrated into the vertical supply chain, the greatest challenge has focused on finding alternative methods to survive in the horticulture industry. Most financiers are not willing to directly invest in small growers or, if they do so, charge exorbitantly high interest rates because of several reasons: (1) the small scale of production with low volumes of output makes financing per unit of transaction costs too high; (2) lack of experience in growing non-traditional crops, especially those that must satisfy high food safety and quality standards; and (3) a natural inclination on behalf of financiers to reject loan applicants who do not have a previous working relationship, possess low collateral, or have no proven history of creditworthiness.

#### *Options for staying competitive*

There have been two financing alternatives for small farmers. As seen in case study VII of the Contango project in Zambia, contract farming has been an effective means of integrating small growers into out-growers' schemes whereby independent farmers are contracted to grow for major exporters or agribusinesses. In addition to the technical knowledge and expertise needed to grow non-traditional crops that are better suited to today's European markets, small growers are financed by large exporters through the latter's ability to provide modern equipment, inputs and facilities on credit that would be repaid after harvest. However, contract farmers are hindered from developing further in certain areas in Africa because agribusinesses are fearful of contract default and the high costs that would be incurred in bringing farmers' scale of operations up to a competitive level of exporting.

Over the years, several mechanisms have been implemented to prevent default (see box below). According to field research conducted in Zimbabwe, contract farming is most effective when combined with farmer cooperation principles according to which agribusinesses contract farmers with a range of financial and technical services organized into a farmers' cooperation scheme.<sup>32</sup> This method has helped geographically dispersed farmers achieve economies of scale as unified production units, allowing agribusinesses to monitor and trace the quality of products with greater logistic ease.

#### **Box 8. Mechanisms for reducing contract farmer default**

- 1) *Lending through groups:* Providing credit to groups of farmers who are jointly and severally liable offers several advantages. Besides the peer pressure and self-monitoring among group members that can be intensified when the group is required to put up joint collateral, farmers often have information on the creditworthiness of community members. This in turn helps financiers screen out potential defaulters.
- 2) *Good communication with and close monitoring of farmers:* Groups aid in the communication line between farmers and financiers by providing a streamlined conduit for information dissemination. Also, intra-group monitoring is important to ensure quality and tracking of produce along the supply chain, where supermarkets require due diligence in the fresh produce sold to consumers. Close communication between financiers and groups of farmers helps build a relationship of trust, deepening farmers' commitment to their contractual obligations.
- 3) *Increase the quality and variety of services offered:* By responding adequately to the financial and technical needs of farmers, financiers can ensure that farmers realize that they stand to lose more by breaking off the relationship. In a relationship of deepening co-dependency, farmers will have more incentive to honour their contractual obligations.

<sup>32</sup> Coulter, Jonathan and et al. "Marrying Farmer Co-operation and Contract Farming for Agricultural Service Provision in sub-Saharan Africa", *Natural Resources Perspectives*, Volume 48, November 1999.

- 4) *Create a system of incentives for repayments and punishments for defaults:* For farmers who have proven a good track record of repayment, financiers might reward them by allowing cash loans instead of providing input credit by kind, a common practice used by financiers to prevent diversion of loans to other expenditures not agreed upon by the parties. In cases of default, financiers have taken such measures as asset seizure and group exclusion. Although the expediency of asset seizure is heavily dependent on the country's contract and property laws, many African Governments have made efforts since the late 1990s to reform the legal system in an effort to attract foreign investments.
- 5) *Promote cooperation between financiers:* If companies who engage in contract farming were to work together in setting up the local practices of responding to contractual default, then farmers would operate in a regulatory framework of rewards and punishments that bypasses a nation's weak legal system. Although this approach has been implemented in some agricultural sectors in Africa, more advocacy is needed to make this approach a common practice.

*Source:* Coulter, Jonathan and et al. "Marrying Farmer Co-operation and Contract Farming for Agricultural Service Provision in sub-Saharan Africa", Natural Resources Perspectives, Volume 48, November 1999.

Another alternative for small farmers is growing horticultural products in niche markets such as organic farming or high-value produce where mass production is not an advantage. One example would be Kenya entering the niche market of producing "Asian" vegetables in the late 1990s. Not only did Kenyan farmers receive a high premium for diversifying into a unique and dynamic market, they also upgraded into value-added activities by packaging and barcoding these items.<sup>33</sup> Moreover, certain vegetables like French beans are naturally suited to small-scale production because of the labour-intensive requirements needed to grow them for European markets.

Although organic farming is a rather new development in Africa, it is a dynamic market with profitable potential. Given that today's consumers in Europe and North America are constantly aware of the health hazards associated with pesticides and toxic agricultural chemicals, a growing number of supermarkets and grocery retailers are including organic produce in their competitive strategy of product differentiation. In the US, an entire supermarket chain called Whole's Food is dedicated to selling nothing but organic food and has increased in popularity in major cities. The company's division in managing fresh produce has implemented a local produce programme of directly buying and financing organic growers in local areas where the supermarket does business. Often, these local growers are small, family-owned farms.<sup>34</sup>

Several factors suggest that organic produce will continue to expand in European markets. Demographic projections for the decades after 2000 indicate that population growth will decrease while the current high level of fresh produce consumption will be maintained.<sup>35</sup> Additionally, the trade liberalization policy adopted by the EU is expected to create intense sourcing competition outside of Africa after 2008. Thus, as the horticultural industry becomes more buyer-driven, consumers will demand more fresh produce with greater quality in taste, texture, and positive health effects. While countries in East Africa like Kenya, Uganda, and Tanzania have engaged in organic farming<sup>36</sup>, an increasing number of investment projects sponsored by the IFC and private organizations have been implemented to assist small growers in receiving certification under the strict standards of organic farming.

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<sup>33</sup> Farfan, Oscar H., "Understanding and Escaping Commodity-Dependency: A Global Value Chain Perspective", Report prepared for the Investment Climate Unit of the IFC, World Bank Group in October 2005

<sup>34</sup> Source at <http://www.wholefoodsmarket.com/products/locallygrown/index.html>.

<sup>35</sup> Singh, Bharat P., "Non-Traditional Crop Production in Africa for Export", Trends in New Crops and New Uses, ASHS Press, 2002.

<sup>36</sup> Mursal, Ahmed and et al., "Organic Farming in East Africa: The Potential for Small Farmers", 8 December 2004.

Small growers can achieve relatively high profit margins because of price premiums from organic produce. According to a Rabobank study<sup>37</sup>, price premiums for organics can be sold for up to 15 per cent more than normal produce in conventional stores. If the produce is only available through specialty stores, premiums can reach 20 to 25 per cent. Estimates from *Organic Monitor* show that the organic food industry had revenues of US\$ 26 billion in 2002, with revenues expected to rise to US\$ 80 billion in 2008 and to US\$ 102 billion in 2010.<sup>38</sup>

### ***Trends within the supply chain beyond 2000***

Current business practices within the horticulture industry indicate that the tendency for vertical integration of the supply chain will intensify in the next few decades, resulting in an industry that will be increasingly dominated by large firms that can provide the most cost-effective production, processing, transporting, marketing and retailing along the supply chain. In financial terms, possessing a large working capital base or the ability to access cheap credit will be crucial to staying ahead of the continual pressure to invest in the technology and logistical systems needed to remain competitive.

In addition to the food safety, environmental and labour standards imposed by the EU and the quality standards of individual supermarkets operating within specific geographical markets, a third standard of sectoral codes has been implemented by industry-wide organizations and trade associations to ensure best practices in the production and sourcing of fresh produce. One example is the Eurepgap protocol used by a network of retailers in the UK to create a benchmark of quality. Besides insisting on due diligence along the supply chain, the protocol mandates traceability of fruits and vegetables back to the origin of production so that retailers can reduce liability should food poisoning or injury-causing events occur among local consumers.

Secondly, supermarkets have begun a practice called category management in the fresh vegetables chain. By grouping products into specific categories that will be further consolidated under the management of a “category captain”, the sourcing of vegetables becomes narrower, and only those growers who can produce vegetables containing specified characteristics are likely to be included in the supply chain. Thus, large supermarkets or agribusinesses will have more incentive to provide accessible credit only to these growers.

Considering the vertical intensification in supply chain governance, small growers will face more complex challenges in financing their operations in order to remain competitive with commercial farms. For these growers, leveraging offshore can only be achieved through the layering of multiple mechanisms such as the Contango project's use of contract growing in the out-growers' scheme to generate export receivables, which in turn would provide the collateral basis to support a SPV to attract international funding. Therefore, innovation in structured finance continues to be more pertinent if small growers in developing countries are expected to compete on a level playing field.

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<sup>37</sup> "Organic food: An opportunity, at whose expense?" by Gillian Turco, Rabobank International, Industry Note, Food & Agribusiness Research, February 2002.

<sup>38</sup> *Organic Monitor* is an important provider of business intelligence on the international organic food industry; <http://www.organicmonitor.com/>.

## Annex II

### **The role of multilateral financial institution in financing horticultures: Facilities from and deals structured by Afreximbank<sup>39</sup>**

#### **1. INTRODUCTION**

The African Export-Import Bank, or Afreximbank, which has its headquarters in Cairo, Egypt, is an international EXIM Bank established in October 1993 on the basis of the concept of global partnership. The Bank, which has a broad objective of promoting intra- and extra-African trade, owes its origin to the African Development Bank (ADB). At the 1987 Annual Meeting of the Board of Governors of the ADB, held in Cairo, Egypt, African Ministers of Finance adopted a Resolution requesting the ADB Management to conduct a study on the desirability of establishing a regional institution to provide trade finance facilities for the promotion of trade, particularly intra-African trade. The greatest concerns of the African Ministers consisted of the following: the very low level of intra-African trade (then at about 8 per cent of total trade); the decline in financial flows to Africa; Africa's loss of global market share with its trade share of global trade standing at about 2.2 per cent; the worsening external debt situation of many African countries; and the sharp reduction of lending to Africa by international commercial banks. They were convinced that a specialized continental financial institution was needed to spearhead the expansion of African trade.

The feasibility study, initiated in 1987, was completed in 1992 and formed the basis for the establishment of the Bank in October 1993. The Bank was established under the constitutive instruments of an Agreement, signed by member States, and which confers on the Bank the status of an international organization; and a Charter, signed by all shareholders, which provides the general framework of the Bank's governance. The Bank's shareholders are divided into three categories. The first category (Class "A") consists of African States, as well as African regional and subregional financial institutions. The second category (Class "B") consists of African national financial institutions and African private investors. The third category (Class "C") consists of international financial institutions, economic organizations and non-African private investors. The Bank's authorized share capital is US\$ 750 million.

It is intended that when fully subscribed, the Bank's equity will be held 35 per cent, 40 per cent and 25 per cent, respectively, by Class "A", "B" and "C" shareholders. The shareholding structure is intended to ensure that the philosophy of partnership upon which the Bank was built will be maintained.

This Annex is divided into five sections. This section provides a brief history of the Bank. Section 2 discusses the programmes and facilities that the Bank has used to support horticulture exports, while Section 3 discusses other programmes and facilities that can be useful in supporting the sector. Section 4 explains basic eligibility requirements for accessing the Bank's financial services, and Section 5 concludes.

#### **2. PROGRAMMES AND FACILITIES USED BY THE BANK TO FINANCE HORTICULTURE EXPORTS**

##### **2.1. Key issues in financing horticulture**

Horticultural products which include fruits, vegetables and cut flowers normally pose some financing challenges, especially in a situation, as is usually the case in Africa, where the exporter represents a poor direct credit risk. In such instances, a prudent financier would prefer to design a structure that

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<sup>39</sup> This Annex was contributed by Okay Oramah, Director, Planning and Development, at the African Export-Import Bank (the "Bank") in Cairo and Christiane Abou-Lehaf, Principal Research Associate at the Bank.

would transfer the payment risk away from the exporter to an acceptable buyer if the exporter's performance capability is considered acceptable.

In horticulture financing, however, this traditional structuring opportunity is constrained by the factors illustrated previously in this paper which may be summarized as follows:

- The trade items are perishable and therefore have a short shelf-life, with attendant risks as well as very high operating costs;
- Given its peculiar nature, horticulture depends on very functional transportation infrastructure such as cold storage, good air links, good port handling facilities, etc. These are, however, rare in Africa;
- Most growers and operators in the horticulture sector in Africa are small family enterprises. They make no attempts to inject equity funds into the business, even waiting on the banks to provide start-up funds;
- Limited technical and managerial skills of African operators to acquire and apply appropriate, up-to-date production and post-harvest handling technology to run a horticultural farm as a profitable business;
- Lack of local markets to absorb orders cancelled by offshore buyers due to force majeure;
- Negative perception of international banks relative to African country risk;
- Difficulty of using receivables as a mean of mitigating risks owing to the fact that the horticulture trade is often conducted on a consignment basis;
- The above reasons result in much effort in structuring finance deals that, in most cases, involve small enterprises with little income-earning potential.

Despite the above, Afreximbank has continued to support the sector using other means of risk mitigation. Two main products that have been used in supporting the sector are:

- (1) Line of credit
- (2) Securitization of credit-linked notes

We will now discuss in some detail how these programmes have been used to support horticulture exports.

### **2.1.1. Line of credit**

Purpose:

This programme was designed to enable the Bank to assist small and medium-sized exporters whose size and export volumes would not qualify them for the Bank's direct lending. Through this programme, the Bank provides funded and unfunded credit lines to creditworthy banks designated as Trade Finance Intermediaries (TFIs) for on-lending to sub-borrowers. This programme accounted for the largest share of all approvals since the Bank's inception, reflecting the Bank's strategy of using banks as vehicles for risk mitigation and reaching medium-size exporters. Cumulative approvals under this programme amounted to US\$ 823 million at the end of December 2002.

Beneficiaries:

- Central banks
- Commercial banks
- Finance companies
- Export houses
- Institutions active in trade finance in Africa
- Similar institutions in non-participating States of the Bank (for financing of imports from participating States).

Available facilities under the programme:

- Pre- and post- export financing
- Letter of credit confirmation and refinancing
- Export credit guarantee facility
- Import financing

Tenor:

360 days but extendable

Pricing:

Linked to the Libor and related to country risk, transaction risk, and market conditions

Documentation:

This may include a facility agreement, a sales contract assignment, and security assignment deeds.

How to access the programme

Prospective participating banks can access the programme by making a direct application to the President of Afreximbank. The application must contain detailed information on the entity, ownership, history, organization, management's three years of financial statements, a detailed description of the envisaged transaction, and the country from where the entity operates. Sub-borrowers, African exporters and importers, and non-African importers of African goods can access the programme by contacting a participating bank in the country where they intend to do business (a list of participating banks is available on request).

Afreximbank achievements

Through this programme, the Bank provided funded and unfunded credit lines to creditworthy banks for on-lending to sub-borrowers engaged in horticulture exports.

A typical deal that the Bank arranged in Zimbabwe involved the financing of exports of paprika and fruits to Europe through a local bank.

The risks in the deal were identified as follows:

- i) Performance risk of the exporter;
- ii) Product rejection risk;
- iii) Payment risk; and
- iv) Country risk.

In the deal, the Bank transferred the first three risks to the Zimbabwean local bank. To further support the credit of the local bank, the facility was secured by the pledging of Zimbabwe Government Treasury bills, effectively ensuring that there was an implicit government guarantee on the deal. The convertibility and transfer risks (country risk) arising therefrom were considered acceptable given that the Zimbabwean Government was a signatory to the Bank Agreement and was therefore obligated to grant the Bank preferred creditor status. The deal went well and there was indeed no need to cash the Treasury bills.

The strength of the deal arose from the fact that the local bank knew the exporters and was on the ground to control and monitor their activities. Sales went largely to major names and supermarkets in Europe who met their obligations in order to keep the supply line open because Zimbabwe was a major supplier of some of the items.

### **2.1.2. Securitization**

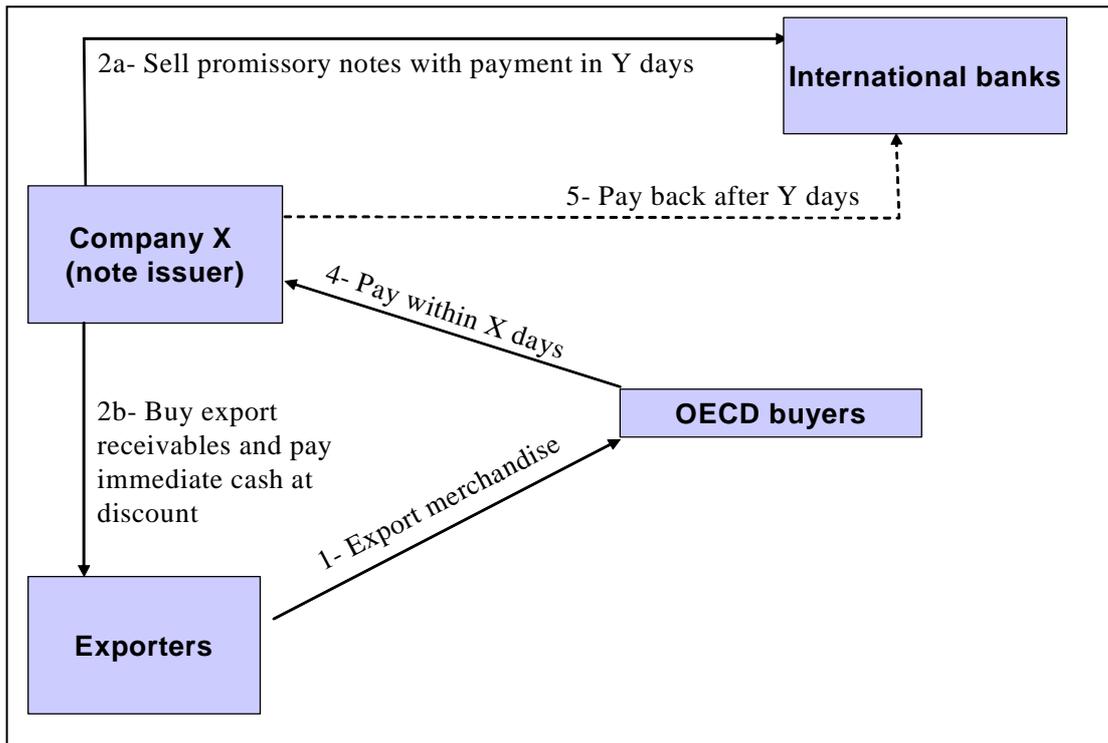
In another landmark deal that was structured on a multi-country basis, the Bank structured a securitization of credit-linked notes arising from horticulture exports from four African countries.

*Main terms and conditions of the deal:*

<b>Note issuer:</b>	A company (the “company” or “note issuer”) created for the sole purpose of purchasing debt instruments arising from exports made by African horticulture exporters to entities in OECD countries
<b>Note buyers:</b>	A group of international banks put together by the arrangers
<b>Facility amount:</b>	US\$ 50 Mio
<b>Facility purpose:</b>	The proceeds of the facility were used by the note issuer to purchase export receivables arising from exports already made by African exporters to acceptable buyers in OECD countries and secured by eligible debt instruments issued by those buyers.
<b>Eligible debt instruments:</b>	The eligible instruments that the company could purchase with proceeds of the facility were: <ul style="list-style-type: none"> <li>• Promissory notes</li> <li>• Bills of exchange</li> <li>• Drafts</li> <li>• Letters of credit</li> </ul>
<b>Eligible importers:</b>	<ul style="list-style-type: none"> <li>• Prime corporates acceptable to the arrangers</li> <li>• Other corporates, provided that the instruments issued were endorsed or guaranteed by a bank, corporate or sovereign entity acceptable to the arrangers</li> </ul>
<b>Security:</b>	<ul style="list-style-type: none"> <li>• Eligible instruments issued by eligible importers and endorsed to note buyers and held by the agent</li> <li>• Assignment to the note buyers of all assets owned or held as security by the company</li> </ul>

*Flow of the transaction:*

The company issued promissory notes which note buyers purchased, the proceeds of which were used by the company to purchase from African exporters eligible debt instruments issued by their OECD buyers. The African exporters were paid cash at a discount price and assigned the proceeds arising from the eligible instruments to the company. In turn, the company, by way of security for the note buyers, endorsed the eligible instruments purchased from the proceeds of the facility, to the note buyers. These instruments were held by the agent, who presented the debt instruments for redemption at maturity.



This deal, with a sticker price of USD50 million, was considered a landmark and attracted a great deal of interest in the market. It was designed to effectively transfer the risks of financing horticulture to the credit risk of leading names and to enable the exporters to give credit terms to their buyers in a very competitive market.

### 3. OTHER PROGRAMMES AND FACILITIES

There are other programmes and facilities provided by the Bank that can be useful in promoting horticulture exports. We review some of these:

#### 3.1. Country Risk Guarantee Facility<sup>40</sup>

This programme is aimed at making the sovereign risk of African countries more acceptable by transferring this risk to Afreximbank. Under this programme, Afreximbank guarantees international and African banks with credit exposures to Africa against certain country risk events. Guaranteed trade papers can be traded. The holder of the paper at maturity will be reimbursed in case certain country risk events occur.

Purpose:

- To enhance the financing of Africa’s trade debts;
- To share risk with banks financing African trade, or credit insurance companies, providing coverage against African trade risks;
- To cover financing banks where African country risk is deemed unacceptable;
- To reduce the stringent requirements for lending to Africa;
- To enhance the credit of African borrowers.

Beneficiaries:

- Banks and export finance companies; and
- Insurance institutions active in trade finance in Africa.

<sup>40</sup> See Chart 9 on page 55.

*Leveraging Offshore Financing to Expand African Non-Traditional Exports:*

Tenor:

360 days but extendable

Eligible transactions:

Bank and trade credit, including contingent obligations. Old (existing or previously contracted) debt and commercial credits would not qualify.

Eligible countries:

Afreximbank participating States

Operational modality:

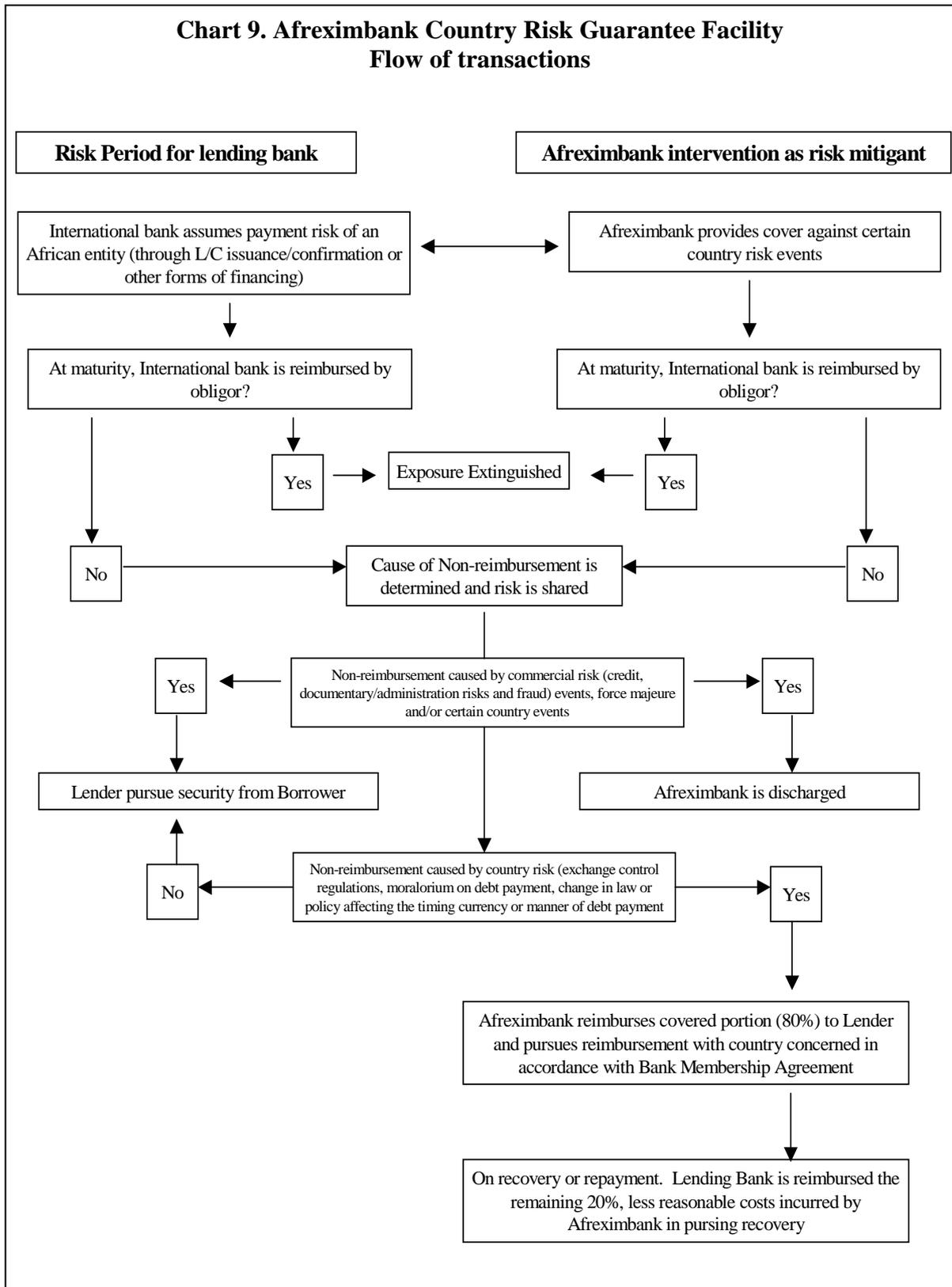
Coverage is for up to 100 per cent of lender's exposure with respect to specific country risk events, namely:

- a) Exchange control regulations;
- b) Moratorium on debt payment; and
- c) Change in law or policy affecting the timing, currency or manner of debt repayment.

Afreximbank's comparative advantage in providing the guarantee:

- Afreximbank is an international financial institution that is not subject to controls in any of its participating States. Thus, the credit risk of the Bank is the only consideration in determining any exposure to Afreximbank.
- The Bank is owned partly by African countries which are signatories to the Bank Agreement. Under the Agreement, the Bank's property, assets and operations are in each participating State free from restrictions, regulations, supervisions, controls, moratoria, and other executive, administrative, fiscal and monetary restrictions of any nature (Article IX Afreximbank Agreement). Thus, Afreximbank enjoys preferred creditor status in member countries (similar to that enjoyed by the World Bank, African Development Bank and some multilateral organizations).

**Chart 9. Afreximbank Country Risk Guarantee Facility  
Flow of transactions**



*Benefits:*

***For African traders:***

Facilitates access to credit on better terms

***For lending banks:***

Makes it easier to grant more competitive terms and to be more active in trade finance in Africa

This facility can be made available to international banks that are interested in financing horticulture either directly or through local banks but are concerned about country risk of the home of record of the exporter. Such a risk may arise from the introduction of a policy requiring mandatory surrender of export revenues, retroactive imposition of export restrictions or similar measures. Should such deals fail because of any of those events, the Bank would pay the lender and would look to the country for reimbursement in line with the obligations into which such countries entered under the Bank Agreement. Direct foreign investors in the horticulture sector may also be covered under this guarantee.

### **3.2. Export and project financing**

Through this programme, the Bank could support the continent's horticulture export product diversification effort by providing foreign currency financing to horticulture projects involving value addition, e.g. canning, to enable them to acquire equipment and raw materials for processing Africa's horticultural produce into semi-manufactured and manufactured products. Project financing may also be used in establishing horticulture export infrastructure, such as cold storage facilities.

*Purpose:*

Through this programme, the Bank provides foreign currency financing to private promoters of export projects so that they can acquire equipment and raw materials for processing Africa's raw commodities into semi-manufactured and manufactured products.

*Beneficiaries:*

- African corporates engaged in export manufacturing; and
- Entities that are seeking to expand export processing activities and already have export contracts.

*Instruments for programme delivery:*

The programme operates through:

- Lines of credit to banks;
- Direct financing;
- Syndication; and
- Risk participation.

*Tenor:*

The maximum tenor of advances under this facility is seven years.

*Pricing:*

Linked to Libor. Spread is determined by obligor, transaction and country risk as well as the tenor of the loan.

*Eligibility requirements:*

The Bank also operates certain procurement rules; various key aspects follow:

- The procurement of second-hand or used equipment is not encouraged;
- Procurement procedure must be conducted in a manner that involves competitive bids and multiple quotes;
- Cash disbursements are not made to parties other than suppliers;

- Additional funding requirements are to be warehoused with Afreximbank or participating banks. Alternatively, project promoters should show evidence that arrangements to meet additional funding requirements are in place;
- Down payments must be supported with acceptable performance bonds from suppliers;
- A raw materials and critical input plan must be provided;
- There is no provision for equipment leasing;
- Start-ups must show evidence of considerable previous experience in products to be produced;
- All corporate and governmental approvals are to be in place;
- Environment and facility building must be fully provided for;
- Suitable suppliers' warranty must protect Bank and promoter against deviations of equipment from order.

Documentation:

Appropriate loan and guarantee agreements, sale contract, assignment, project (technical) documents, supporting documents, security documents project, expert opinions, etc.

How to access the programme:

By application to the Bank, providing all necessary information concerning the organization, including history, ownership, management, most recent audited financial information, recent export performance in that line of business, technical details of the project, etc.

### **3.3. Afreximbank Trade Information Programme**

The Bank provides African banks, exporters and foreign investors with an interest in African trade with relevant information on African economies, commodities and markets. It also publishes a biannual trade journal through which it disseminates African trade information. Arrangements are in progress to introduce an online African trade database, accessible via subscription for entities interested in African trade. The available trade information in the Bank can be accessed by contacting the Bank's Planning and Development Department.

## **4. BASIC ELIGIBILITY REQUIREMENTS FOR ACCESSING THE BANK'S FINANCIAL SERVICES:**

### **4.1. Eligible entities and countries**

The Bank credit facilities are available only to:

- a) Shareholders and/or non-shareholders in "participating States", namely those States whose Ministries of Finance or Central Banks have subscribed to the Bank's share capital and/or whose Governments have signed and ratified or acceded to the Bank Agreement.
- b) Shareholders in non-participating States; and
- c) Non-shareholders in non-participating States but only to the extent that such financing will be used to pay for imports from a participating State.

### **4.2. Eligible transactions**

The following transactions are eligible for financing by the Bank:

- a) All eligible exports for participating States;
- b) All eligible imports of participating States; that is, export-generating African imports including raw materials, equipment, spare parts and other essential items;
- c) Intra-African trade in eligible items;

- d) South–South trade in eligible items; and
- e) All eligible imports of non-participating States from participating States.

## **5. CONCLUSION**

This annex gave a brief history about the Bank and presented the programmes and facilities that the Bank has introduced to enable it to meet the challenges of enlarging Africa's access to external financing and in promoting African trade. It also presented the Bank's programmes and facilities which have been put into use to serve horticulture exports.

As can be seen throughout this annex, Afreximbank is valuable in enhancing the development of the horticultural sector as it has the capacity and experience to structure trade finance mechanisms in the horticultural sector. This would bridge performance and country risks inherent in African deals and meet the needs of the African market.

Annex III

**Term sheet**

The term sheet gives a bird's-eye view of the main elements of a facility structure. It forms the basis for further negotiations between lender and borrower and is the platform on which future facility documentation is based. Since term sheets capture the basic elements of the terms and conditions of a proposed facility, it is therefore very important to ensure that adequate care is taken in understanding the underlying transaction and in preparing the term sheet to ensure that no details are left out.

A term sheet does not imply any obligation on the bank to lend per se. For this reason, it usually opens or ends with a disclaimer notifying the prospective borrower that it does not commit the bank until further internal approvals are obtained. Furthermore, the lender has the right to renegotiate the terms and conditions with the borrower or to return the mandate, should any event or circumstance occur or arise, from the date of acceptance of the offer by the borrower to the date of signing of the facility, that in the reasonable opinion of the lender constitutes a material adverse change in international financial economic or political conditions or in the business or financial condition of the borrower and which, in the sole opinion of the arranger/lender, would make it inadvisable to proceed with the facility.

At the end of the term sheet, there is a section where the potential borrower may express his acceptance of the terms and mandate the bank to commence further procedures leading to the eventual conclusive approval of the facility. It is important to ensure that only an officer with valid signatory power or a valid power of attorney to commit the organization signs the term sheet. A notable implication of this acceptance is that the potential borrower, by signing this term sheet and returning it to the bank, agrees to reimburse the bank for any costs incurred in the bid to put the facility in place. This applies whether or not the facility is eventually granted. The aim of this provision is to discourage frivolous requests which are later not drawn down.

Although every financial institution has its own templates, the items listed here below can give a general idea of how a term sheet is normally structured.

<b>Exporter:</b>	Legal name of the producing/exporting company, as it appears in the commercial contract
<b>Importer/Buyer:</b>	Legal name of the buyer/importing company, as it appears in the commercial contract
<b>Borrower:</b>	It can be a public or private company or an SPV. It is important to mention the registered corporate name of the applicant; otherwise, it is of no substance in law.
<b>Lender:</b>	The lending entity
<b>Underlying transaction:</b>	It is important to understand what goods are exported, in which quality and quantity, and on which delivery terms.

*Leveraging Offshore Financing to Expand African Non-Traditional Exports:*

<b>Contract terms and amount:</b>	The total amount of the contract and the payment terms shall be mentioned.
<b>Facility amount and currency:</b>	The currency of the facility may be different from the currency of the underlying contract. In this case, hedging instruments shall be also considered, since repayments shall be in the same currency as the loan.
<b>Facility purpose:</b>	Defines the purpose for which the facility has been put in place
<b>Availability period:</b>	Period of time during which the facility can be drawn upon, provided that all conditions preceding the entry into force of the facility have been fulfilled
<b>Drawdown mechanism:</b>	The facility will be drawn against the presentation of specific documents which will be agreed between the parties including, but not necessarily limited to, the following: <ul style="list-style-type: none"> <li>• Commercial invoices</li> <li>• Transport documents</li> <li>• Insurance documents</li> <li>• Warehouse receipts, if any</li> <li>• Assignment of proceeds</li> <li>• Promissory notes, if any</li> <li>• Irrevocable payment undertaking from buyer/off-taker</li> </ul>
<b>Tenor:</b>	Indicates the maximum period from the first repayment date during which the facility has to be repaid in full
<b>Repayment:</b>	Indicates how and when the loan shall be repaid. Depending on the nature of the transaction, it can be repaid in one lump sum or in X equal semi-annual repayments commencing at the date of signature of the facility agreement or six months after such date.  Repayment shall be in the same currency as the loan.
<b>Calculations:</b>	Interest, commitment fees and arranger's fees are calculated on an actual 360-day year basis.
<b>Interest rate:</b>	A floating rate determined by reference to the six-month Libor/Euribor (depending on the currency of the facility) plus a percentage per annum margin that will depend on the transaction risk, collateral and security provided by the borrower  The interest rate is fixed two business days prior to each interest period and payable semi-annually in arrears.
<b>Arranger's fee:</b>	A flat percentage calculated on the total amount of the facility and payable from the date of signing. The arranger's fee is non-refundable.
<b>Management fee:</b>	A flat percentage calculated on the total amount of the facility and payable from the date of signing. The management fee is non-refundable.
<b>Commitment fee:</b>	A percentage per annum, payable monthly, quarterly or semi-annually in arrears on the undrawn and uncanceled amount of the facility as from the date of signing until the expiry of the availability period
<b>Out-of-pocket expenses:</b>	This relates to all other expenses not listed above which the lender may incur in structuring the transaction, i.e. legal opinions, printing, advertisement, local approvals. Since it is sometimes difficult to identify exactly the nature and amount of expenses, this clause is generally drafted as being open-ended. In case the borrower requires the establishment of a cap, lenders should estimate carefully because once a cap has been set, any extras would be borne by the bank.

<b>Taxation:</b>	All payments under the loan agreement are to be made free and clear of all present and future taxes, charges, deductions, liabilities, and if any withholding is required all relevant payments will be grossed up by the borrower accordingly.
<b>Documentation:</b>	<p>In order to set up the facility and obtain all necessary Credit Committee approvals, the lender will require the following documentation, including but not necessarily limited to:</p> <ul style="list-style-type: none"> <li>• Certified copy of the certificate of incorporation and articles and memorandum of association of the borrower;</li> <li>• Certified copy of the board resolution empowering management to commit the company for the requested loan;</li> <li>• Signatory powers of the person signing the term sheet and the following documents:</li> <li>• Copy of borrower's financial statements covering a period of three years;</li> <li>• A valid commercial contract between buyer and seller.</li> </ul>
<b>Security:</b>	Any collateral, assignment of rights or any other measures that in the opinion of the lender may help mitigate the risks. These will vary depending on the underlying transaction structure.
<b>Undertakings:</b>	Any measure or act that the lender may require the borrower to take/do or not to take/do during the life of the loan.
<b>Assignment:</b>	At its sole discretion, the lender may assign and or transfer any of its rights or obligations under the facility agreement or any related agreement, without the borrower's prior approval.
<b>Governing law and jurisdiction:</b>	Governing law and jurisdiction depend on where the lender is located. Arbitration is always preferable to ordinary litigation.
<b>Entry into force of the facility:</b>	The facility shall enter into force on the date when all the conditions precedent have been fulfilled.
<b>Conditions precedent:</b>	<p>The facility will be available for drawdown by the borrower upon fulfilment of the following conditions:</p> <ul style="list-style-type: none"> <li>• All documentation shall be in the form and substance satisfactory to the lender;</li> <li>• All requested securities have been put in place;</li> <li>• Insurance policies are acceptable to the lender;</li> <li>• All necessary governmental and other approvals have been obtained;</li> <li>• Legal opinions from the legal counsel of the lender, borrower and, if necessary, also from an independent third party have been issued</li> </ul>



Annex IV

**The Contango project: Market opportunities and risk evaluation**

**I. Market and products**

Contango is a large-scale, high-value vegetable grower and packager whose primary market is in the UK. By 2006, Contango will be producing over 6,000 tons of small packages of baby corns, mangetouts, sugar snaps, fine beans, and runner beans for export to large retailers in the UK. Entering the UK’s market for packaged vegetables is ideal for an African operation because of four reasons:

- Firstly, the UK market can generate prices two to five times higher than those locally available.
- Secondly, demand for labour-intensive, pre-packaged products in the UK is increasing rapidly.
- Thirdly, Africa’s relatively low labour costs and favourable growing conditions allow production at significantly lower costs than in Europe.
- Fourthly, UK retailers are seeking new growers to fill the supply gap left by the recent decline in production by Zimbabwe, one of the largest suppliers of horticultural produce to the UK (see Table 2 below).

**Table 2. Zimbabwe’s horticultural export performance from 2000 – 2003**

YEAR	TOTAL KILOGRAMS EXPORTED
2000	+/- 12 million
2001	7.5 million
2002	8.8 million
2003*	4 million (*forecast)

Source: Horticultural Promotion Council, Harare, Zimbabwe.

**SWOT Analysis of Contango**

<p><b>STRENGTHS</b></p> <ul style="list-style-type: none"> <li>• Dynamic, experienced and integrated management team that successfully ran an almost identical operation in Zimbabwe</li> <li>• Guaranteed year-round developed market for products</li> <li>• Established pound sterling price</li> <li>• Established and developed IT, logistics, and business systems</li> <li>• Experience with Eurepgap and Nature’s Choice accreditation</li> </ul>	<p><b>WEAKNESSES</b></p> <ul style="list-style-type: none"> <li>• Security</li> <li>• Requirement to quickly recruit skilled staff</li> <li>• Relative lack of experience in Zambia</li> <li>• Relatively low sophistication of local out-growers</li> </ul>
<p><b>OPPORTUNITIES</b></p> <ul style="list-style-type: none"> <li>• Annual market demand set to increase by 12 per cent</li> <li>• Current Government climate in Zambia</li> <li>• Climatic and soil conditions in Zambia</li> <li>• Symbiotic relationship with local communities resulting in a “win-win” situation</li> </ul>	<p><b>THREATS</b></p> <ul style="list-style-type: none"> <li>• Shortage of locally available inputs</li> <li>• Cold chain of product to market</li> <li>• HIV/AIDS</li> <li>• Cross-rate fluctuations between USD, GBP and Kwacha</li> </ul>

## **II. Geography**

Contango is based in the Central Province of Zambia. Endowed with good growing conditions, the province has easy access to export channels. The altitude of 1300 metres above sea level, annual rainfall of 1000 mm, and the sandy/clay loam soils of Lusaka are perfect for growing fresh vegetables. All chosen sites are close to good water sources and suitable for year-round growing, except for the small-scale sites of out-growers that are dependent on annual rainfall. However, a dam has now been constructed to permit year-round irrigation.<sup>41</sup>



Contango’s processing plant is located just six km away from Lusaka International Airport. This proximity allows Contango to deliver produce to the airport at the right temperature. In addition, the proximity has made it possible for Contango to staff the operation with skilled, experienced managers who have successfully grown vegetables in similar conditions across the Zimbabwean border. Most Zambian managers have vast experience working with the people of the region and are fluent in the local language. Moreover, the high unemployment rate in the Lusaka region allowed Contango to quickly build up a highly motivated workforce.

## **III. Major risks to the success of Contango**

Unlike other countries in the region, Zambia has a relatively stable currency, economy and political environment. Although historic currency fluctuations cannot be used to predict future fluctuations, Contango believed that the relatively stable currency was indicative of a stable economy and a Government with a sound foreign exchange policy. These factors were expected to ensure a stable currency in the future. Currency stability is particularly important to an export horticulture business because costs are incurred in local currency and revenues are received in another (USD or GBP), leaving the business somewhat exposed to exchange rate fluctuations, or else required to purchase expensive hedging tools.

Overall, the key risks can be broken into operational, financial and political risks. Yet the risks that may pose the most serious deviation from any expected profitability are exchange rate changes,

<sup>41</sup> For a detailed explanation of the dam project, see “Major risks in the out-grower programme” in chapter III, part G.

decreases in prices obtained from retailers, and transport breakdowns or border problems. The following tables summarize foreseeable risks to Contango's success.

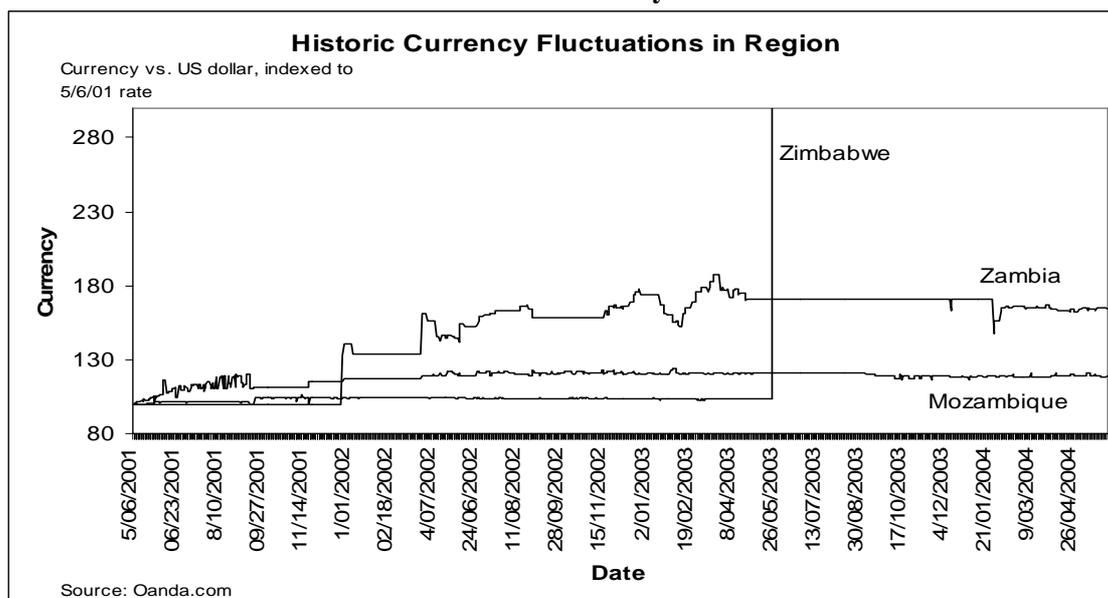
**Table 3. Contango's operational risks**

<b>Risk</b>	<b>Likelihood</b>	<b>Impact on financial forecast</b>	<b>Explanation</b>
Decreases in price paid by retailers	Medium	High	Price stability is a feature of the UK market, but with consolidation, retailers' bargaining power is increasing. Price changes will significantly impact the project's financial forecasts.
Product demand decreases	Low	Low	The trend has been towards increasing product demand. As volumes are small relative to the market and demand for African product exceeds supply, Contango's sales are unlikely to be affected.
Out-grower programme does not work due to low technical skills of local farmers	Medium	Low	Given the uncertainty that Zambian out-growers would be able to initially produce to the required standard, no out-grower production was included in Contango's financial forecast for the first year because most of them will be undergoing training.
Disease destroys crops	Low	Medium	Contango has a sound agronomy team to minimize the risk of disease. Moreover, disease would be one-off and not affect all crops.
Labour shortages	Low	High	Significant unemployment in the region. With transport, labour could be sourced from neighbouring areas.
Power failures	High	Low	Standby generators will be constructed.
Low rainfall	Medium	Low	All sites have river water, dam, and boreholes available.
Poor yields	Low	Medium	Contango has eight years of experience. Growing conditions are ideal. Other enterprises in the region have experienced excellent growing conditions.
Degeneration of relationship with Exotic	Low	High	Exotic holds all our market relationships and has strongly promoted Zambian products. Contango products will generate large profits for Exotic.
Transport breakdowns and border problems	High (short-term) & Low (long-term)	High	The established relationship with transporters will ensure rapid replacement of transport vehicles.
Loss of produce in transit	Medium	Low	Contango has insurance coverage.

**Table 4. Contango's financial risks**

Risk	Likelihood	Impact on financial forecast	Explanation
US\$ or Kwacha strengthens against £	Medium	Medium	Conservative exchange rate has been used and price of produce from out-growers is agreed in £, thus somewhat mitigating the risk.
Interest rate increase	Medium	Low	Loans will be denominated in US\$, and changes in interest payments will only have a minor impact on profits and losses.

**Chart 10. Historic currency fluctuations**



**Table 5. Political risk in Zambia**

Risk	Likelihood	Impact on financial forecast	Explanation
Change in Government that significantly destabilizes the economy	Low	High	Zambia is rated as one of the most stable countries in Africa. If destabilization occurs, however, tax benefits may be removed and Zimbabwe-like changes to exchange rate policy could occur, greatly impacting the business.
Land acquisition	Low	High	Zambia is underpopulated and the Government is currently assisting with underutilized land to ensure food and employment.

**Table 6. Political stability index by Kaufmann et al. (2002)**

Country	Rating (higher ratings reflect higher political stability)
South Africa	-0.09
Zimbabwe	-1.62
Zambia	-0.02
Mozambique	0.55

Source: World Bank.

In addition to political stability, the Zambian Government, a number of NGOs and foreign governments are providing support to new ventures which make Zambia particularly attractive for new export businesses in horticulture. The highlights of these initiatives are:

- Tax incentives that will allow Contango to operate on a tax-free basis for the first 5-6 years of operation;
- Support from NGOs for capacity-building activities and establishment of out-grower programmes;
- Availability of low-interest loans and grants from NGOs and organizations such as the EU institutions for potential out-growers.

Despite the high-level support for foreign ventures in Zambia, starting and operating an export business remains constrained by bureaucracy and inexperience at lower Government levels. Although this remains a primary concern for Contango, the speed of improvement on this front, as evinced by existing ventures, indicates that these issues will become less relevant in the medium term. Contango has already begun to develop strong relationships with senior Government officials.

UNCTAD has been at the forefront of efforts to mainstream and promote new financing techniques and mechanisms that open up new horizons for the financing of commodity sector participants.

UNCTAD activities, targeted to both public and private sectors, include:

- Building perspectives on broad trends in financing and pinpointing the implications for development of commodity sectors and the institutions that serve them;
- Advising on the structuring of financing mechanisms for specific products and markets;
- Engaging in institution- and capacity-building to implement new commodity financing schemes and commodity risk management;
- Providing advice to Governments on optimal legal and regulatory systems for commodity finance;
- Arranging tailor-made training programmes for banks and others;
- Organizing large awareness-raising and networking workshops and high-level conferences on financial and risk management.

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