



# Concept Note

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Samunnati Value Chain Finance

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# SAMUNNATI - VALUE CHAIN FINANCING FOR INCLUSIVE GROWTH

## BACKGROUND

Just two decades ago, providing credit to low income people was seen as unviable in India. The scale and the reach that Microfinance as a model achieved, amply demonstrated the ability to replicate an approach that made small credits available to excluded markets as well as households. However these excluded households are not operating in vacuum but are dependent on the value chain of the economic activity that they are engaged in. And if that value chain happens to be Agri and Allied activities then the challenge of these households to access formal financial services becomes even more pronounced given that there is no focused intervention to cater to this segment. Their financial needs are generally too large for microfinance, but too small for commercial banks. This gap hampers growth and limits agricultural development.

Agricultural value chain actors need access to finance to develop their businesses. For example take smallholder farmers with fragmented land holdings. Smallholder farmers have very restricted access to markets and lack access to warehouses or storage facilities to store their harvest. Consequently, they are strained to sell their surplus produce during the harvest season, when the prices are low. Intermediaries (traders) who can invest their capital as well as access storage space, time and again take advantage of smallholders' limitations: they accumulate agricultural harvest at very low prices and sell them during the most beneficial market conditions. In addition, farmers face enormous difficulties in obtaining credit for their agricultural activities because of the lack of financial services in rural areas. Existing products from formal financial institutions like Banks, MFIs are usually ill suited to the smallholder farmers' livelihoods and frequently on account of their cash flows. Hence these farmers are constrained to resort to borrowing from informal sources.

Even for small enterprises that constitute the MSMEs (Micro Small and Medium Enterprises), which play a vital role in the nation's economy, the lack of access to finance and timely credit is the most important reasons for below than normal utilization of their capabilities. The MSMEs which add value to the agricultural produce and also play intermediation role in an Agri value chain, need finance to increase their capacity. MSMEs that operate in activities like dairy farms, trading of commodities need funds to procure raw materials, and stock, pay wages to staff, meet other working capital requirements and at the same time for expansion of business.

Despite various efforts of stakeholders in this area, there continues to be huge demand-supply mismatches in financing these value chains and enterprises. Traditionally informal sources have been the main source of internal and external finance for Agriculture value chains and MSMEs. Major challenges constraining Financial Institutions from financing enterprises in agri-value chains in a traditional manner are:

- A. **Access to Information:** One of the decisive inputs that forms part of the credit decision is the access to fair and accurate information about a value chain actor. Many such actors advance in the informal economy, making it strenuous for them to record their business history and demonstrate their economic potential.
- B. **Information Asymmetry:** Asymmetric information makes it impossible to accurately differentiate between “credit worthy” and “not credit worthy” agri-value chain actor/borrowers.
- C. **Lack of collaterals:** Collaterals acts as a screening tool to mitigate the adverse selection risk and also mitigates the moral hazard risk to a certain extent as this is useful in enforcing a contract. But most enterprises and agri-value chain actors are disadvantaged in this regard, due to the fact that they lack collateral that is seen as enforceable and also a proven credit track record.
- D. **Agriculture specific risks** - (i) Pre-harvest risks i.e. risks pertaining to production and yield which are in turn derived from weather, pests and other natural calamities/hazards that agriculture produce is prone to and (ii) Post-harvest risks i.e. market and price risks, particularly where markets are likely to be imperfect and information may be lacking.

There are other challenges that agri-value chains face when it comes to accessing credit. Because of the fractured supply chains and broken market linkages, enterprises in the agri - value chains run the risk of under utilization on investments made, keeping prospective financiers at a distance. But all the above challenges can be dealt with by leveraging relationships between suppliers & buyers and financial institutions can play a critical role in making these value chains more proficient.

When it comes to financing Value chains and the MSMEs operating in these chains, there is a need for a new approach - “**Samunnati**” that is close enough to the actors of the value chain to verify cash flows and income flows of the enterprise and finance them through financing relationships across the value chain. These relationships can be structured by trapping information and cash related to payments in the value chain, instead of only collateral based approach.

## ABOUT SAMUNNATI

Samunnati is a financial services intervention, focused on Value Chain Finance for Inclusive Growth with a belief that for a value chain to work well, all the chain actors need have access to formal financial instruments including non-asset products customized to suit the requirements of the Value Chain as well as the stakeholders operating within. The organization functions to permeate targeted sectors viz. enterprises and value chains in homogeneous economies (like a district). The key to the interventions of Samunnati is to understand the local needs of a district specifically the major value chains, to develop selective customized financial solutions across these value chains and thus create vibrant local economies that are efficiently connected to mainstream financial markets. Samunnati aims to address major drivers of an economy together with catalytic interventions like Warehousing, Bulk milk chilling plants etc., to make the entrepreneurial and value chain activities operate more efficiently.

## MISSION

Samunnati's mission is to provide the underserved households, access to markets through financial intermediation, market linkages & advisory services so that the enterprises & value chains that they are engaged in, operate at a higher equilibrium thereby creating value for all the stakeholders in the chain.

## SAMUNNATI'S STRATEGY

At the heart of Samunnati's strategy lies the importance of understanding local value chains. Therefore as part of its operating design, Samunnati plans to set up **local strategic business units** for districts it will operate in. For a value chain to work efficiently, all the chain actors need access to finance. But their needs for finance may differ.

This unique model of finance by Samunnati can be viewed as a series of tools and mechanisms, yet, most importantly it is an approach that takes a systemic viewpoint, looking at the collective set of actors, processes and markets of a particular value chain as opposed to an individual lender-borrower within the system. The local value chain perspective of Samunnati allows it to analyze the needs for finance of these different actors in the chain, and provide opportunities to fill their needs.

Hence the outreach strategy that Samunnati embarks on, is

- 1) Point of High Impacts (PHIs): A physical branch set up at a place that is a Point of High Impact (PHI) for the value chain ably assisted by a set of mobile transaction points to provide extended reach to these PHI's. This approach enables Samunnati to transcend the Urban / Rural divide in isolation but gives it a RURBAN reach.
- 2) Channels of High Impacts (CHIs): A service delivery partner route where a partner organization like Producer companies, co-operative societies, MACS, PACS is a Channel of High Impact (CHIs) acting as a gateway agency between Samunnati and the producers/farmers and facilitate origination of high quality loans.

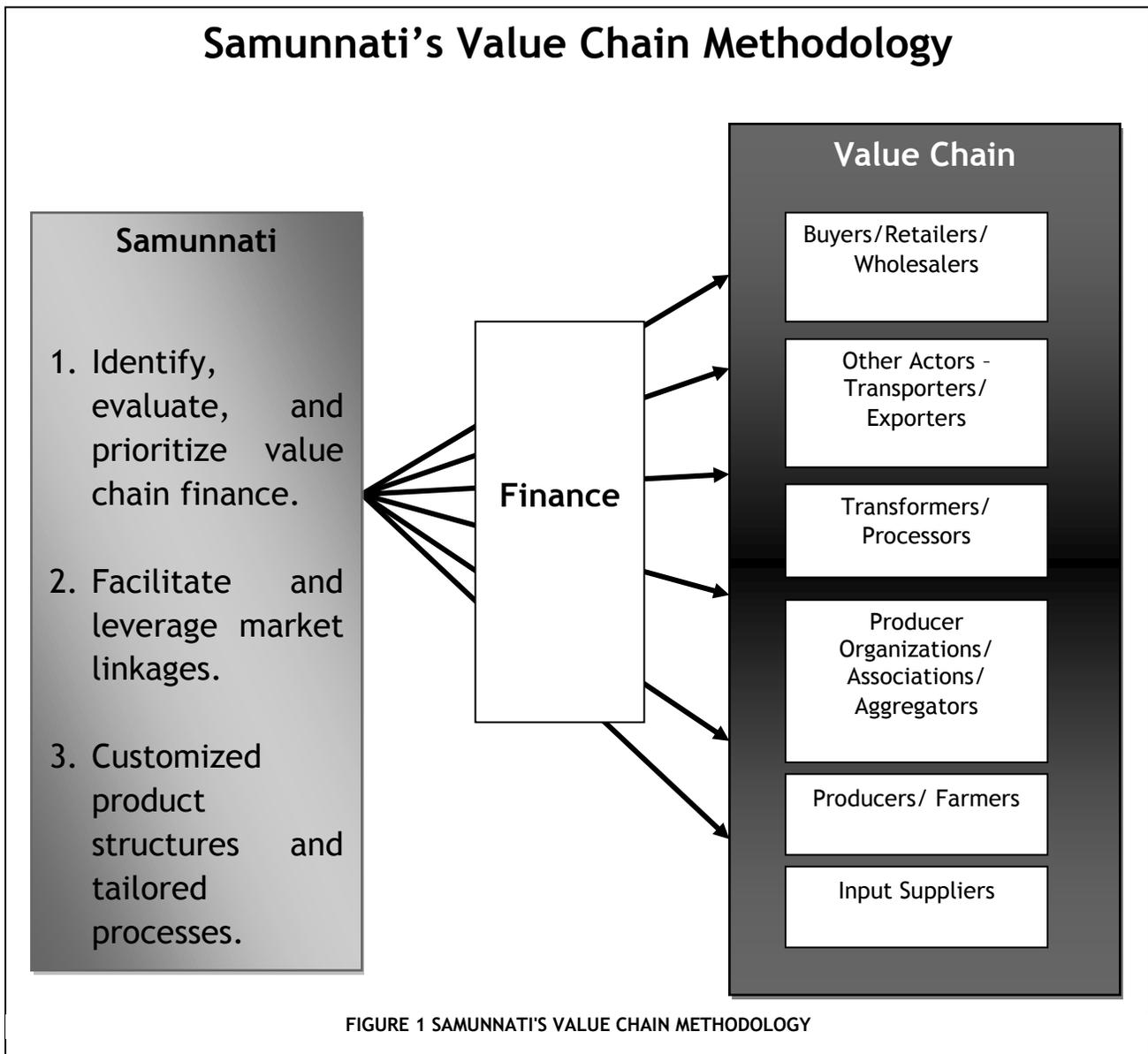
## APPROACH AND METHODOLOGY

In other usual forms of agri finance, whether internal financing within the value chain, such as traditional trader credit, or financing originating externally, such as banking finance, MFI lending etc, the view of the overall activity that the borrower is engaged in, is less comprehensive, and therefore encompasses significant risk. The additional risk is due in large part to 'uncertainty'; not being able to fully understand the risks and consequently not being able to assess and mitigate against those risks.

Under Samunnati's Value Chain Finance approach the decisions about financing are based on the health of the entire value chain, including market demand, and not just on the financial health of the individual borrower. This means that in order to offer value chain-based finance, knowledge of the agricultural system is required.

In general, Samunnati caters to the following needs of different value chain actors:

- Input suppliers - providers of feeds, fertilizers, chemicals, agri equipment etc. Samunnati provides them with small, short-term loans for working capital: and long term, Term-loans to expand business. Through its financial relationships with farmers, Samunnati creates compatible incentives for farmers to buy from empanelled input suppliers thereby mitigating the business risks of suppliers.
- Farmers - Farmers, producers and their families manage the crops or animals, and are involved in sowing to post-harvesting activities including marketing.
  - For Agri-farmers specifically, a lot of pre-harvest risks can be taken care of by seeking group guarantees or third party guarantees, and by say, making equipment available through leasing or asset finance. Using these mechanisms, Samunnati finances the working capital to buy seeds and other inputs and asset loans to buy equipment.



- Also using the network relation with suppliers, Samunnati helps farmers procure required supplies, at discounted rates.
- Samunnati provides access to finance to farmers to purchase livestock/animals or invest in storage spaces and offers them insurance products to protect the assets, price guarantees or derivatives to lock in better revenues.
- For post harvest activities, Samunnati provides traders access to short term finance and help farmers avail liquidity using warehouse receipts and other collateralized lending. These products and mechanisms help farmers and traders manage their working capital needs.

- Traders play an important market linkage role. They buy produce from the farmers or co-ops and aggregate them before selling them to procurers, processors and marketing firms. Samunnati through financial intermediation will assist traders to manage their working capital flow. It will also provide traders access to finance to invest in assets that allow traders to aggregate and store.
- Processors/ Aggregators who buy products in bulk from farmers or traders, are provided working capital loans to allow them to buy the produce. Through Samunnati, these processors/aggregators can pay farmers and traders electronically. Samunnati through its customized produce solutions helps , processors/aggregators to invest in or lease out processing equipment.

Through tailored value chain solutions based on deeper understanding of the local value chains, Samunnati helps expand the financing for agri activities and improves efficiency through customized financial solutions. These customized solutions strengthen or solidify linkages among participants in the chain. It improves the quality and efficiency of financing agricultural chains by:

- a) identifying financing gaps existing in the value chain;
- b) customize financial solutions to fit the needs of the actors in the chain;
- c) use value chain linkages to mitigate risks of the chain and its partners by structured buy-sell contracts and tri-party agreements;
- d) establish payment ecosystems to bring in transaction efficiency in the value chains and also reduce financial transaction costs;
- e) use payment ecosystem to mitigate operations and credit risk by cash flow trapping at source;
- f) provide risk mitigation tools like insurance to mitigate asset, price and income risks.

## CHARACTERISTICS

Key features of Samunnati's business model are:

### DEMAND FOCUS

Within the geographies that Samunnati operates in, sectors for focus are identified based on the dominant activity (crop, products or services) that are the primary drivers of the economy of the local geography and the involvement of enterprises and households in remote areas.

### BRANCH PLUS

While branches are set up across rural as well as urban locations across the area, these are points of high impact (PHI's), focused on one or more set of stakeholders, with representatives (including agents) also working in areas around the branch to enable and facilitate transaction and credit.



### ILLUSTRATION OF A TYPICAL SAMUNNATI - POINT OF HIGH IMPACT (PHI)

Samunnati's first Branch—Santhavasal, is a “Point of High Impact” (PHI) focused on dairy value chain. Santhavasal is located around 55.5 kilometer away from its district head quarter Tiruvannamalai. The other nearest district head quarters is vellore situated at 32.9 KM distance from Santhavasal . Surrounding districts from Santhavasal are Vellore, Kanchipuram and Chittoor.

Santhavasal's branch service area roughly includes 200 villages with an overall population of 1,25,000. There are 5 major Milk Chilling Plants located in the service area with an overall capacity of 1.44 lakh litres of milk every day. This is 10% of the overall milk chilling capacity of Tiruvannamalai district. The utilization rates of the milk chilling plants average around 60%. In addition to the milk chilling plants there are 5 khova (a milk sweet also known as khoya) plants which consume around 4500 litres of milk a day. Around 900 milk aggregators (in the branch service area) on a daily basis purchase and aggregate milk from individual farmers and small dairy owners. Some 65 milk transporters collect milk cans from aggregators and supply it to the chilling units and the khova plants, twice a day.

Samunnati, through its catalytic interventions in dairy farming, milk automation and measurement systems, network of transporters and bulk milk chilling plants, will strengthen the milk value chain in Santhavasal branch service area and take it to a higher equilibrium than what it currently operates.

## COMPREHENSIVE PRODUCT BASKET

The various financial instruments that Samunnati uses for Agriculture Value chain finance are as following:

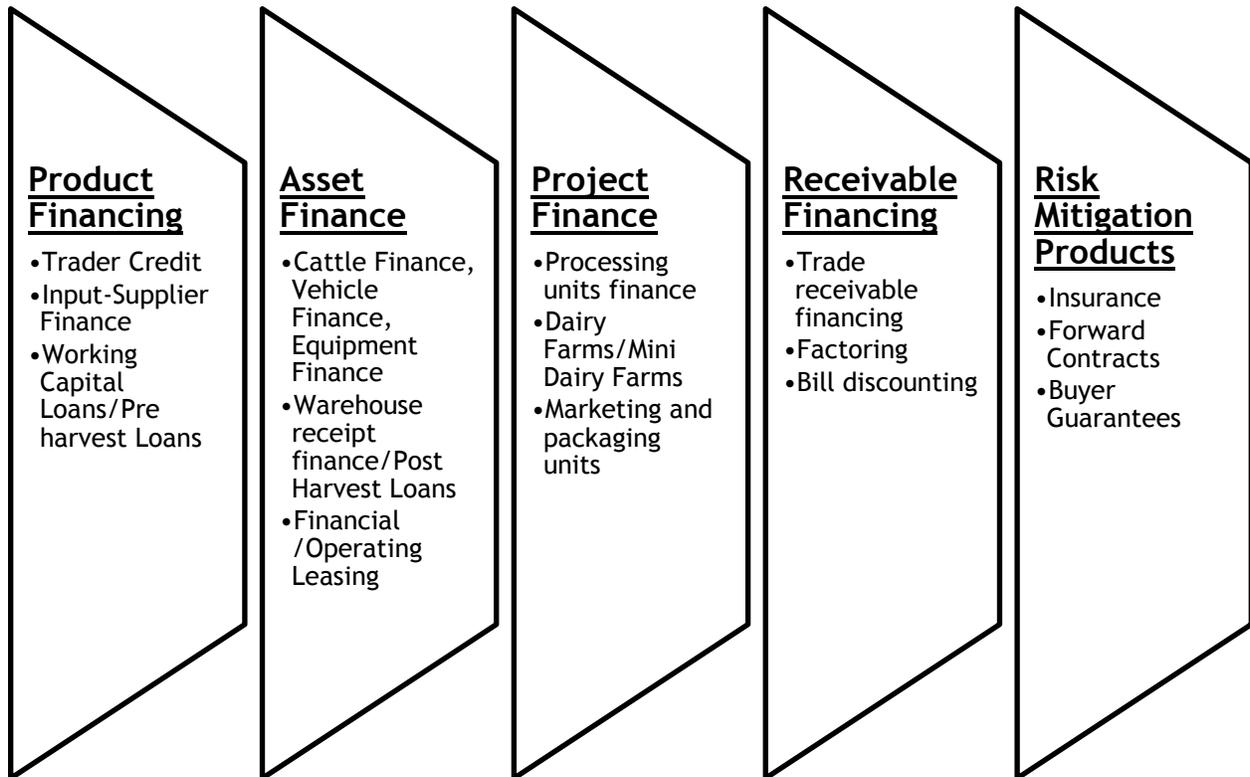


FIGURE 2: VALUE CHAIN FINANCE - PRODUCT BUCKETS

Most of these instruments can be used stand alone, and it is important to note that the use of one or more of these financial instruments does not in itself constitute value chain finance; rather, value chain finance is an approach that applies instruments appropriate to the value chain. Therefore Samunnati will engage in using several of these instruments within each value chain that Samunnati works with.

Such a variety of sizes and types of financial solutions can be offered only through a combination of financial service providers. Therefore Samunnati sees itself as a **financial intermediary** where it will work with range of financial services providers like banks, insurers, payment services providers etc., to create a complete enabling ecosystem of financial services delivery at the front end.

## TECHNOLOGY DRIVEN

At the heart of Samunnati's operations lies technology enabled efficient process work flows. Its technological innovations include the application of mobile based information and communication technologies and improved management information systems to accommodate tailored financial services - all of which have made value chain finance feasible for Samunnati. Samunnati uses the latest technology to ensure not only transaction convenience for clients but also for implementation of best in class client protection principles. Analytics layered on the technology helps to sharpen focus on client relevant products.

At the front end state of the art mobile technology is used to capture customer information. The front end modules are well designed to optimize the time engaged in generating credit applications, by automating the application processing, cutting unnecessary steps and gathering the minimum amount of applicant's data needed.

The backend loan processing module covers the complete lending process from application submission to loan disbursement. The platform provides the flexibility of customizing dedicated modules for each user. It allows hosting multiple credit scoring models and supports for a variety of reports without manual intervention to aid better Portfolio management. It also provides the ability to seamlessly integrate with multiple frontend solutions using its APIs and Web Services.



## CASHLESS OPERATIONS

Handling cash is an expensive proposition. Samunnati, therefore has designed its operations to be cashless from day one. Samunnati disburses the loans directly into the customer's bank account. Where customers do not have bank accounts, Samunnati encourages them to open savings banks accounts and disburses loan amounts directly into these accounts using NEFT or IMPS.

The loan repayments are collected through direct debit to customer's account using NACH facility of NPCI or are collected under the cash flow trapping mechanism where the buyer or aggregator of the agri produce deducts the loan repayment from the produce sale amount and deposits it directly in the customer's loan account with Samunnati.

This has helped Samunnati completely avoid costs of cash management (cash in transit cost, cash movement insurance, cost of safety equipment like cameras, safe etc, cost of managing fake notes), including the inconvenience of reconciling cash at multiple branches every day. This also reduces the opportunities for frauds at front-end.

## **LEVERAGE INFORMAL INFORMATION NETWORKS**

Samunnati's approach to value chain finance is very simple. It rides on the existing buyer seller relationships established in a value chain and leverages information within the value chain to assess creditworthiness even when small producers have little or no formal credit history. Existing value chains often contain information that can serve as a proxy for a rural producer's credit history. Producer associations, technical assistance providers, or buyers may have records of individual producers' production performance, their track record of delivering quality products, or even repayment of in-kind credits, such as agricultural inputs or land preparation services. Samunnati investigates such proxy information to ascertain a producer's ability and willingness to service a loan.

## **BEYOND HARD COLLATERAL**

Samunnati deals with actors engaged in Agri value chains, most of whom are small producers who rarely have the kinds of assets that can act as collateral for a financial institution. For Samunnati personal guarantees are equally valuable as is the hard collateral. In fact, an interesting form of personal guarantee that Samunnati works on - is from a rural producers' company/association or aggregator in value chain who buys from small farmers, to serve as the guarantor for each member who borrows from Samunnati. If the producer company/association agrees, it can be involved in the process of deciding which members receive credit and how much they are eligible to receive. The producer companies/associations or aggregators/buyers commit to covering the obligation to Samunnati, and follow up with the member on its own accord and many a time take the responsibility of loan repayment out of proceeds of the product sale.

## **WAY FORWARD**

Using the value chain finance model Samunnati is providing quality, affordable financial services for small-scale producers and other value chain actors in Tiruvannamalai district where it commenced its operations in November 2014. The willingness of Samunnati to examine value chain relationships and make financing decisions based on third-party agreements rather than conventional collateral is one of the most significant innovations in expanding agricultural finance to small farmers and agro-enterprises. The value chain finance model developed and implemented by Samunnati is adaptable to diverse contexts, products, and environments. Samunnati is now expanding its footprint across various food and agri value chains by setting up new Points of High Impacts and new Channels of High Impacts.

In the coming months Samunnati plans to expand its operations to geographical areas where the potential to offer a range of financial services is bolstered by the strength of value chains existing in those areas. Most of these areas are low on the banking index but offer huge opportunities in financing large numbers of producers and multiple value chains. Some such areas, where Samunnati will expand its footprint over the next few months are plains of Madhya Pradesh, interiors of Orissa, Rajasthan, AEZs of Karnataka, and heart of Gujarat. In these geographies Samunnati will work with farmers and farmers' groups and agribusinesses in the agri value chain to understand their needs and risks, and then adapt loan terms, collateral and repayment mechanisms to match the value chain and demand. In addition to adaptation of the loan products mentioned above, Samunnati will adopt new financing instruments, such as leasing arrangements and financing of warehouse receipts, and insurance products to help smooth cash-flows, accrue assets for times of need, and to reinvest into their businesses.

## **CASE STUDY: TAILOR MADE PRODUCTS AND PROCESSES FOR DAIRY**

### **VALUE CHAIN**

The Dairy value chain can be defined as the full range of activities required to bring milk or a milk product to final consumers passing through the different phases of production, processing and delivery. It can also be defined as a market-focused collaboration among different stakeholders who produce and market milk and related value-added products. When Samunnati commenced its operations in Tiruvannamalai district, the research showed that Dairying was an important secondary source of income for more than 70% of families in the district and had assumed the most important role in providing employment and income generating opportunities particularly for women. At the same time, the milk processing infrastructure and capacity set up in the district remained underutilized. Samunnati found this value chain to be promising; where it could make a difference to the dairy value chain actors by its financial services interventions.

### **THE DAIRY VALUE CHAIN MAP**

At this stage, Samunnati collected more information to identify points along the dairy value chain, where the delivery of credit could increase the efficiency of the value chain and add the most value to the actors.

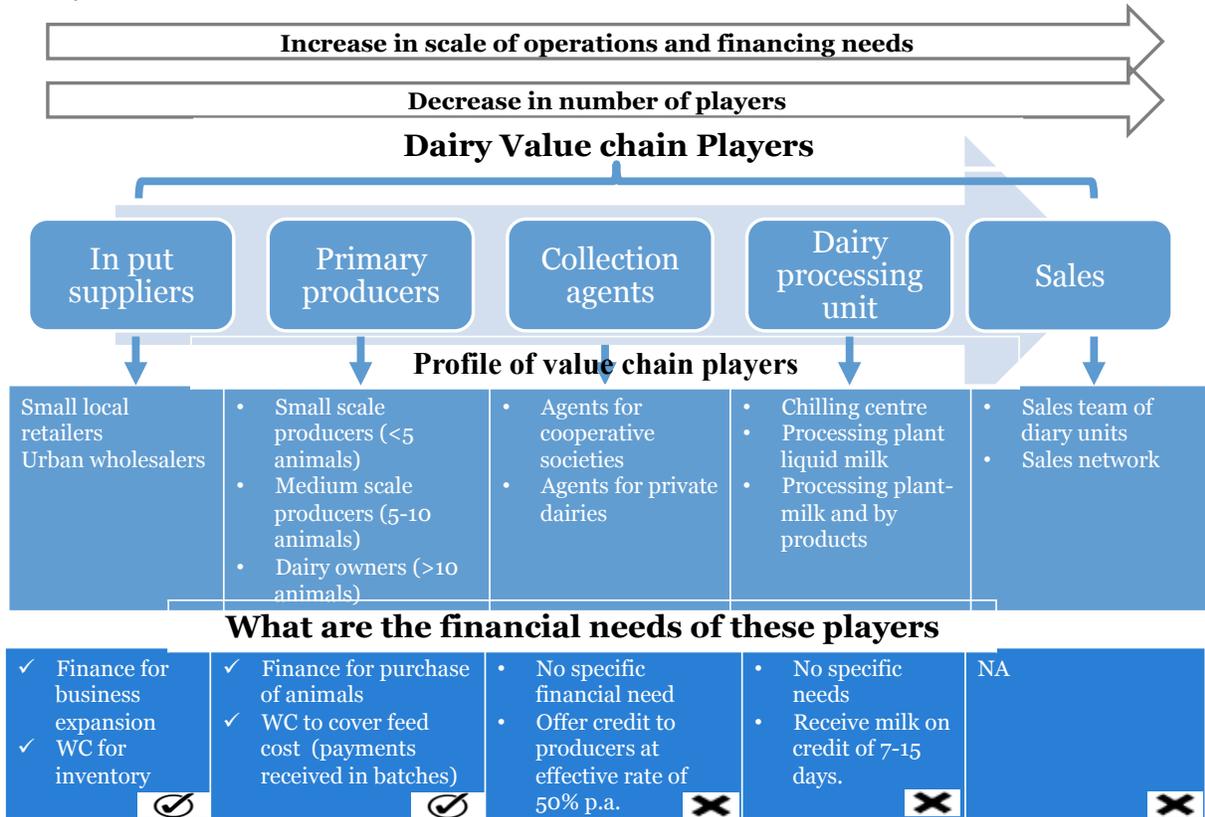


FIGURE 3: TIRUVANNAMALAI'S DAIRY VALUE CHAIN MAP

### SAMUNNATI'S INTERVENTION IN DAIRY VALUE CHAIN

In Tiruvannamalai, Samunnati has designed and implemented two general dairy value chain finance products:

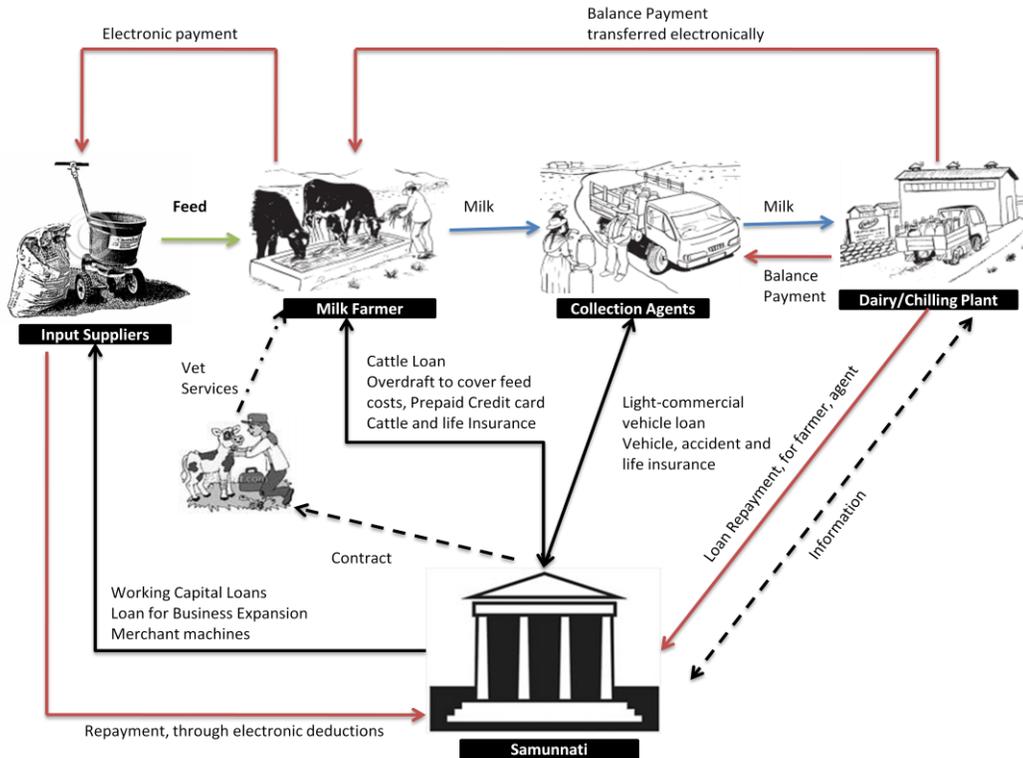
1. Short term loans for input suppliers and milk aggregators/collection agents;
2. Asset finance loans for purchase of cattle, commercial vehicles, and equipments;

These products are targeted:

- To promote increasing milch animals per household or setting up of modern dairy farms for the production of clean milk;
- To encourage self employment and to encourage set up of small businesses around milk like tea shops, ice creams manufacturing units, khoya plants;
- To encourage setting up of milk transportation activity by financing LCVs;
- To facilitate up-gradation of quality using advanced technological equipment to handle milk on a commercial scale.

In addition to the above, risk mitigation products (insurance for lives and cattles, vehicle insurance etc) were introduced to de-risk the value chain from external events.

Concept Note: Samunnati Value Chain Finance



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