



McIlhenny Company and the Rabobank Sustainable Agriculture Guarantee Fund

Tour groups filed past egret nesting boxes, lush gardens, and museum exhibits. They shared the garden pathways with staff on their way to work. It was June 10th, 2010 at McIlhenny Company's corporate headquarters. Steeped in tradition, the family-owned firm resides on the same verdant grounds of Avery Island, Louisiana, where Edmund McIlhenny invented Tabasco Brand Pepper Sauce in 1868. Little did Edmund McIlhenny know at the time that he was creating both an American icon and the global hot sauce industry.

This living heritage is at the core of the McIlhenny Company. Yet new times have certainly introduced new challenges. Few were more aware of these issues than Harold Osborn, Vice President of Agriculture at McIlhenny Company. Most critically, Harold knew that McIlhenny's expanding global sales volumes were seriously testing the limits of Tabasco Sauce's unique supply chain model.

Since the mid-1960's, McIlhenny has procured tabasco chilies primarily through small outgrowers in Latin America organized by small- and medium-sized trading enterprises. Harold Osborn felt this model was essential in order to maintain the quality of the chilies, and thus the final product. However, increasing global sales of Tabasco were now challenging McIlhenny's suppliers. In particular, the chili farmers in Latin America were having trouble self-financing their increasingly large production cycles, and they felt stymied by a lack of working capital credit and other financial services to successfully meet McIlhenny's growing demand. Harold knew from experience that tabasco chili farmers' yields could vary dramatically based on this access to capital, as well as technical assistance. Simultaneously, McIlhenny's board was stepping up pressure to "get out of banking" and reduce pre-financing for suppliers. To complicate the situation further, recently developed supply chains in southern and central Africa were facing significant financing and operational challenges unique to that region. Harold wondered if the situation in Africa could truly be fixed, or if he should re-orient McIlhenny's new sourcing relationships toward Southeast Asia.

Harold needed to address the crucial outgrower financing problem while also balancing other priorities, including overseeing global distribution and sales. Perhaps a new trade finance program being piloted in Peru with Rabobank's Sustainable Agriculture Guarantee Fund held the key? One thing Harold knew is that if he could manage to fix the financing gaps in his supply chain at a reasonable cost of capital, while keeping it off his balance sheet, it could provide simultaneous wins for farmers, volumes, and potentially procurement costs.

American Food Icon

Edmund McIlhenny was a successful independent banker originally from Maryland. Following the American Civil War, he and his in-laws moved to the family plantation on Avery Island, Louisiana. Amidst the lush grounds of the estate, McIlhenny pursued his hobbies of gardening and food preparation. One home pantry development was a pepper sauce made from chilies known as “tabasco peppers”. McIlhenny packed freshly picked peppers with salt, aged them for three years, and then blended the mash with white wine vinegar. The concoction proved so popular with friends and family, particularly given the depressed food options of the post-Civil War South, that McIlhenny decided to go into business. He bottled in small cologne containers utilized for dabbing liquids. The sauce was sold as a premium product for \$1 each wholesale. In 1870, Edmund McIlhenny was awarded a patent for his Tabasco Brand Pepper Sauce.¹

At the end of his life, McIlhenny wrote a letter documenting what he perceived as his significant accomplishments and contributions to the family. This memoir famously did not include Tabasco sauce.² Yet Edmund McIlhenny, along with four subsequent generations of family management, was responsible for creating the American hot sauce industry, with Tabasco persevering as the global leader. Tabasco mini-bottles are included in NASA space flights and in 80% of American MRE’s (military ready-to-eat meals). McIlhenny Company produces over 600,000 gallons of Tabasco Sauce per year (far more than Edmund manufactured in his entire lifetime) sold in over 160 countries and translated into 22 languages.³

McIlhenny Company is a family-held firm that remains close to its roots. Company headquarters are located at their original site on Avery Island. The bottles and recipe strongly resemble the original, and many employees have worked for McIlhenny for several generations, living in cottages on the island. Even the McIlhenny garbage dump is considered an American historic landmark, managed by the University of Alabama. While McIlhenny Company has diversified into condiments, marinades, co-branding with packaged foods, new flavors of hot sauce, and more, sales are led by the original Tabasco recipe. And while most tabasco peppers are now farmed by outgrowers in Latin America, all Tabasco pepper seeds are still produced on Avery Island.

Tabasco Production and Procurement Model

McIlhenny’s tabasco peppers are sourced primarily from small contract growers in Central and South America. In total, McIlhenny currently works with approximately 2,000 farmers on 3,000 hectares in Guatemala, Honduras, Nicaragua, Panama, Colombia, Peru, Ecuador, Zambia, Zimbabwe, Swaziland and recently in Mozambique. The farmers typically sell through small- and medium-sized traders who help coordinate farming activities and perform the first phase of processing. The use of these integrated, yet independent, suppliers in Latin America, beginning in the mid-1960’s, “proved to be an efficient model for us”, says Harold Osborn. The longer growing seasons and availability of pickers have allowed McIlhenny to sustain usage of their classic pepper breed despite surging consumer demand.

¹ “History of McIlhenny Company | TABASCO® History | TABASCO.COM.” *Tabasco.com*. Web. 29 June 2010. <http://www.tabasco.com/tabasco_history/mcilhenny.cfm>.

² Edition, Morning. “TABASCO’s Hot History : NPR.” *National Public Radio*. Web. 10 June 2010. <<http://www.npr.org/templates/story/story.php?storyId=861201>>.

³ Ibid

Tabasco peppers are a traditional varietal. “They’re like heirlooms,” says Osborn. “Most other crops in the world are bred to increase pick-ability or storage stability, but then you give up flavor.” Tabasco production requires careful use of inputs and deployment of trained harvesters. The Tabasco farming cycle lasts nearly one year, not including planting time. The aging and processing cycle lasts over three years, leading to a five-year total production cycle (*see Exhibit B*).

Tabasco pepper prices are particularly sensitive to labor costs, which shape farm size. Whereas a typical harvester can pick 300-400 kilos of cayenne pepper per day, he or she can only pick approximately 35 kilos of tabascos. This difference is primarily due to a tabasco’s size, which is approximately one gram, as opposed to a cayenne pepper’s seven grams. Tabasco peppers must also be picked in a timely manner or risk over-ripening. Tabasco pepper production therefore requires that labor supply and skill be carefully managed by an attentive farmer.

Camilo Restrepo is president of McIlhenny’s largest and most streamlined supplier, managing contract farmers and processing centers in both Peru and Colombia. As Restrepo describes: “We’ve found that the larger the field, the less effective they are at pulling in labor. The peppers are not picked at the right time and over-ripen on the stalk.” Restrepo’s group now targets an optimal plot size for tabasco of three hectares. “In addition to labor,” says Restrepo, “it has to do with the economy. The farmer must be able to summon sufficient capital . . . to make that a really high-quality plot. You need to have sources of finance to fertilize on time, pay your workers on time, etc.” These capital and knowledge requirements limit the supply of tabasco farmers despite higher profit margins compared to other crops.

The close management of tabasco fields to produce a premium product results in a smaller environmental footprint relative to many other commercial crops. While not organic, tabasco production in Peru utilizes Integrated Pest Management (IPM), including careful field design to prevent fungus and mildew, cultivation of wasp populations, and planting of rows of corn or sorghum as predator habitat. Restrepo sends agronomists or technicians weekly to visit each field free of cost (McIlhenny Company also sends technical assistants to all fields globally at least once per growing season). Pesticide usage is monitored following US Environmental Protection Agency standards. As a result of close and capital-intensive management, Restrepo’s tabasco yields and environmental footprint are considered benchmarks for the rest of McIlhenny’s supply chain.

Harold Osborn believes the two primary bottlenecks in his overall supply chain are a lack of access to capital and the need for more technical assistance – the two factors being interlinked. “Production ranges from six to forty tons per hectare”, says Osborn, based on practices such as drip irrigation, weeding, proper fertilization, and proper use of pesticides. “Yet the producers are forced to spend more time figuring out how to raise cash than focusing on farming”. McIlhenny Company currently offers 80% financing at port of embarkation, more generous terms than the industry standard, the result is an average of \$300,000 of tied-up working capital on McIlhenny’s balance sheet. Yet there is continued pressure by the farmers to be paid on a more timely schedule. Simultaneously, Harold feels that “the board is uncomfortable with these numbers and really wants us to get out of the banking business altogether”.

Finance Gaps in the Agricultural Supply Chain

In global agricultural supply chains, farmers, traders, and processors must act in concert to deliver the expected quality and quantity of products. All of these players require financial services to do so successfully. Farmers in the tropical regions, including tabasco producers in Latin America, experience nine to twelve month growing cycles. Working capital is essential in order to fulfill production demands, as well as to invest in equipment, seed, farm improvement, and workers. In the case of tabasco peppers, a premium product, availability of capital for inputs is essential in order to enter the market. Meanwhile, traders require working capital to compensate farmers in advance of netting payment from buyers. Processors require long-term financing for capital investments in warehouses and machinery.

Unfortunately, agricultural value chains in low-income countries can face debilitating finance gaps. Local banks often view the agriculture sector as a pariah, due to long cash-flow cycles, lack of fixed assets, and high risk from weather, pests, etc. The sector also often faces a bad reputation. From the 1950's to 1980's, governments and international aid organizations subsidized heavy lending with insufficient due diligence or accountability, particularly in Africa. The resultingly high number of defaults and bad credit deterred private lenders and created reliance on donors.⁴ Furthermore, in countries where monetary policy, and even governments, can change quickly, the extended horizon of agricultural lending is considered overly risky for banks.

Agricultural producers and entrepreneurs can also be challenged by the “missing middle” phenomenon. Regional banks in the Global South are geared toward large-scale finance for urban industry. Microfinance institutions have begun extending credit to the bottom of the financial pyramid. Yet small- and medium-sized enterprises (SME's), with financial needs ranging anywhere from \$5,000 to \$1 million, often lack options, inhibiting the growth of this entire segment. According to a 2003 global study commissioned by the World Bank, in high-income countries SME's contribute to an average of 51% of national GDP and 57% of the national employment. However, in low-income nations, SME's only make up 16% of GDP and 18% of employment (*See Exhibit C*).⁵ It is therefore widely believed that the financial “missing middle” phenomenon may create a serious impediment to overall economic growth in the developing world. Between rural redlining and the “missing middle”, agricultural SME's are doubly constrained, crippling the agrarian economy.

The need for financial services becomes increasingly acute when volumes are expanding through the supply chain, as is currently the case with Tabasco. McIlhenny's top supplier, Camilo Restrepo, describes the challenge:

The usual problem is you're doing things right, and then the customer wants to buy twice what he bought last year. But the local bank only wants to loan based on sales last year. I tell them: 'Yes, but now we have a customer for \$2 million!' The bank just says: 'Well, we don't do that. That's called project finance.' So you're stuck in the middle. You're locked into a growth cycle of only 10-15% per year. Or you have to find more fixed assets as collateral.

⁴ Peppelenbos, Lucian. "Chapter 2: Finance for Rural Entrepreneurs." *Value Chain Finance beyond Microfinance for Rural Entrepreneurs*. Amsterdam [etc.]: Royal Tropical Institute (KIT) [etc.], 2010. 8. KIT Publishers. Web. <<http://www.kitpublishers.nl/smartsite.shtml?id=33693&ItemID=2740&ch=FAB>>.

⁵ Aspen Network of Development Entrepreneurs, and Dalberg Global Development Advisors. *Aspen Network of Development Entrepreneurs 2009 Impact Report*. Rep. 2009. Web. 10 June 2010. <<http://www.aspeninstitute.org/sites/default/files/content/docs/ande/ande-impact-09.pdf>>.

The decision is now on the table: do we pursue more growth, or do we stop, cash in everything we have now, build a reserve, and use it in the future to grow more? But will we then miss out on a market opportunity, and someone else will come to take our place?

Restrepo's constraints affect the entire supply chain. Only once the harvest period is well underway can Restrepo fulfill shipping size requirements and send to McIlhenny, at which time he receives payment. Yet Restrepo pays farmers weekly throughout the growing season. These earnings are critical for the farmers' own working capital and survival. Yet the only way Restrepo's business can grow significantly without additional working capital finance would be to reduce these terms, harming both the farmers' well-being and the quality of the product.

Restrepo is also a light processor, grinding and salting the tabasco peppers and then storing the mash for thirty days before shipping to McIlhenny. He currently needs new equipment to house increased volumes of mash. "It's really grinding," says Restrepo. "We want to buy a new tank, and they last twenty years. But the bank wants me to pay them back in one year! It's impossible." Restrepo also holds large containers of mash in storage undergoing both a month of fermentation and waiting to meet order sizes. Restrepo has succeeded over time in convincing a Peruvian bank to offer 90-180 day credit lines based on these assets. "It allows me to use my stocks for fast cash to pay farmers." But he has thus far been unsuccessful in developing this credit line in Colombia. While offering finance for "stocks in country" is typical for manufacturing, agricultural products are generally seen as too illiquid.

The challenge to rural SME's is ultimately a combination of lack of financing and the cost of capital when financing is available. Current financing methods for agricultural producers and businesses in the developing world typically include personal savings, pre-financing from downstream buyers, credit from suppliers of agro-chemicals, and small credit lines that farmers utilize from agricultural banks. In Peru, where Restrepo sources chilies for Tabasco, there are also some larger loans available from the government "at subsidized rates". However, interest rates in Peru on local debt-financing in U.S. dollars are historically approximately 12%. At the time of writing, interest rates had fallen to 8-9%. Local currency loans are higher. Overall, these facilities rarely sufficiently cover working capital or capital expenditure needs for rural SME's to grow, and the cost of capital is high.

A Global Bank Rooted in Agriculture and Rural Livelihoods

Rabobank Group is a global financial services provider based in the Netherlands. The institution is owned by 147 independent Dutch banks and includes a number of global banks and subsidiaries. Rabobank employs over 59,000 people serving 9.5 million clients in 48 countries. The company's assets currently total over €607 billion, with a private sector loan portfolio of €415 billion. The bank maintains a Triple A rating.⁶ Rabobank is the premiere financier for the global food and agriculture industry and has been a pioneer in "sustainable banking" concepts.

Like McIlhenny, Rabobank is a heritage firm with origins in the 1860's. Unlike McIlhenny, however, Rabobank was not launched by a banker. Rather, the company is rooted in the ideas of Friedrich Wilhelm Raiffeisen, a local mayor in Germany who founded the cooperative credit union movement in 1864. Raiffeisen sought to combat the severe poverty he witnessed in the German countryside. At first, he operated charities. Yet he then closed them in favor of launching a collective bank that would allow farmers to pool resources and help themselves. By the 1890's, Dutch clerics and farmers had mimicked the model to create two major cooperative banks in Holland, which later combined to form Rabobank.

Although no longer solely a farmers' credit union, Rabobank's history informs its contemporary principles. "Rabobank was founded because some rural parts of society were denied access to financial services. So they started their own bank," states the company website.⁷ Core to the bank's strategy is maintaining global leadership in financing food and agriculture businesses – dominated by private individuals and small and medium enterprises. The firm also manages a number of unique, socially responsible investment vehicles, including "green loans", "green bonds", and sustainable private equity funds.⁸ Rabobank's commitment is exemplified by the Rabobank Foundation, a branch of the bank which provides grants for social development in Holland and in the developing world, with a focus on micro-credit. In 2007, Rabobank Nederland contributed €7 million to the Foundation, which funded approximately 150 projects.⁹

The Rabo Sustainable Agriculture Guarantee Fund (SAGF)

Driven by these values and a perceived financial and social need, Rabobank Foundation, in partnership with Dutch government, launched the Rabo Sustainable Agriculture Guarantee Fund (SAGF) in 2006. The mission of the fund is to "enhance access of small- and medium-sized producers of sustainable agricultural products in developing countries to working capital credit (pre-export trade finance) on the basis of commercial and sustainable terms."¹⁰ By reducing risk for local banks, Rabobank hopes to

⁶ "Downloads | Rabobank Annual Reports 2009 | Rabobank Annual Reports 2009." *Rabobank Annual Reports 2009*. Web. 10 June 2010. <http://www.annualreportsrabobank.com/downloads/cEN156_Downloads.aspx>.

⁷ "Rabobank - Rabobank Foundation." *www.rabobank.com*. Web. 10 June 2010. <http://www.rabobank.com/content/csr/rabobank_foundation/index.jsp>.

⁸ "Rabobank Annual Reports 2009 | Rabobank Annual Reports 2009." *Rabobank Annual Reports 2009 | Rabobank Annual Reports 2009*. Web. 10 June 2010. <http://www.annualreportsrabobank.com/downloads/cEN156_Downloads.aspx>.

⁹ "Rabobank - Rabobank Foundation." *www.rabobank.com*. Web. 10 June 2010.

<http://www.rabobank.com/content/csr/rabobank_foundation/index.jsp>.

¹⁰ Bogers, Ellen. "Rabo Sustainable Agriculture Guarantee Fund." *Rabo Sustainable Agriculture Guarantee Fund*. Web. 10 June 2010. <http://www.rabobank.com/content/images/G5334%20RI_MVO_fund-LR_tcm43-50951.pdf>.

induce regional financial institutions in emerging markets to enter the under-capitalized agriculture SME sector.

SAGF's model is to provide partial credit guarantees of the principal in amounts ranging from \$500,000 to \$1.5million. The client pays an average fee of 2% of principle directly to SAGF in return for the guarantee. Holding the future sales contract with an established international buyer as collateral, and buffered by the SAGF loan guarantee, the local financial institution then provides working capital financing for the enterprise. This annual financing allows the producers to purchase, process, and export their products. At the end of the season and according to the conditions of the sales contract, the international buyer remits payment for goods purchased. Finally, the local financial institution subtracts the principle plus interest from this sum, and remits the remainder to the clients. (See Exhibit F, "SAGF Guarantee Structure" diagram.)

SAGF has thus far successfully operated in Tanzania, India, Nicaragua, Peru, and Tajikistan, backing shipments of coffee, cocoa, cotton, sesame, artichokes, and peppers. The fund has guaranteed a total of \$10 million. Actual loan sums extended by partner banks to clients are significantly higher, depending upon percentage of coverage.

By helping build credit track-records for SME clients, while demonstrating to local financial institutions how to work with the agriculture sector and utilize sales contracts as collateral, SAGF's strategy is to phase itself out of each investment over a three-to-five year timeline. The fund's model is to typically assume approximately 90% of risk in Year 1, 70% of risk in Year 2, 50% of risk in Year 3, and then scales down to 0% in Year 4 or 5. SAGF is now negotiating its first Year 3 contracts. "The impact is that the local bank is taking more and more risk each year," states Ellen Bogers, Fund Manager of SAGF. "They still want a guarantee, but now partner banks are starting to find new clients on their own and present them to Rabobank. In some countries, it's actually too many." Although not yet fully phased-out of any engagements, the Guarantee Fund has experienced no defaults or late payments.

Overall, the impact objectives of SAGF, listed below, are closely aligned with the founding principles of Rabobank:

1. *Improved access to formal finance*
2. *An acceptable commercial rate and/or less restrictive loan conditions*
3. *Development of credit history with a local bank*
4. *Enhanced access to markets for sustainable agricultural produce*
5. *Ability for producers to increase return on investment*¹¹

One of the bottlenecks to growth of the SAGF is human capacity. "Reviewing banks, due diligence, legal documentation, government approval, etc. – all that takes a lot of time," states Bogers. "Then you also have to spend time on acquisition, creating a pipeline." Rabobank is therefore currently considering new ways to structure and possibly expand the Rabo Sustainable Agriculture Guarantee Fund.

¹¹ Bogers, Ellen. "Rabo Sustainable Agriculture Guarantee Fund." *Rabo Sustainable Agriculture Guarantee Fund*. Web. 10 June 2010. <http://www.rabobank.com/content/images/G5334%20RI_MVO_fund-LR_tcm43-50951.pdf>.

The Rabo-Tabasco Deal

In early 2009, Camilo Restrepo, McIlhenny Company's largest supplier, was contacted by a representative from Banco Interamericano de Finanzas (BIF) in Peru. BIF had an existing relationship with the SAGF and suggested that Camilo reach out to Ellen Bogers. "We looked at [the project], and it fit with our social, commercial, and financial criteria," states Bogers. After several months of processing, the SAGF agreed to guarantee \$255,000, or 85%, of a \$300,000 working capital credit line from BIF to Restrepo, secured against a sales contract to McIlhenny Company. In return, Restrepo paid a one-time 2% fee for the guarantee to Rabobank. The presence of Rabobank's loan guarantee brought BIF's interest rate offer down to 7.5%. "I think this is truly giving me access to credit I wouldn't have otherwise", says Restrepo. "Now we can also go to local banks and say we've been approved by Rabobank. It helps us get more loans as our volumes continue to expand."

In June 2010, SAGF approved a second-year loan of nearly \$1 million to Restrepo. SAGF reduced its coverage to 70% and intends to further reduce to 50% in Year 3. "I don't know what's going to happen," wonders Restrepo, referring to next year. "Will the bank accept only 50% outside coverage?" Yet he remains hopeful based on what he has seen so far.

Unlike other forms of local finance, Rabobank utilizes the future sales contract with an international buyer as collateral. "Rabo's loan guarantee is not in your name, but rather to the local bank. We don't have to put in fixed asset collateral. It allows us to grow without necessarily raising our fixed costs," says Restrepo. Indeed, close relationships are critical to the functioning of this trade finance model. "The role of McIlhenny is very important to the agreement," says Bogers. "We will only finance if there is a signed sales contract. If the supplier doesn't have the sales contract on time, Rabobank can't finance them." A strong relationship with local lenders is essential as well. SAGF's loan guarantee model encourages the local bank to perform its own due diligence and then share information with Rabobank. All parties –

Root Capital and the Rabo SAGF

Root Capital is a 501(c)3 non-profit incorporated in Cambridge, Massachusetts. Root Capital functions as a lending institution and specializes in one-year working capital debt-finance for socially and environmentally-responsible agriculture SME's in the developing world. The organization was founded in 2000 with a focus on financing fair trade coffee cooperatives in Latin America. They have since extended over \$175 million in credit to 265 SME's in 30 countries, maintaining a 99% rate of repayment.

Unlike SAGF, Root Capital is a direct lender, performing its own due diligence and holding the full asset of the loan. Their typical range is also smaller: approximately \$50,000 to \$750,000. Yet like SAGF, Root Capital uses a future sales contract as collateral. They also arrange a similar triangular relationship – Root Capital refers to their system as "Factoring" – in which the global agricultural buyer remits payment directly to Root Capital, and then Root remits to the borrower minus principle and interest. Like SAGF, Root Capital's "Theory of Change" is to encourage local banks to finance the "missing middle". However, they aim to do so primarily through demonstration rather than direct financial involvement.

Root Capital currently provides \$700,000 in working capital finance to Camilo Restrepo in Peru, and \$400,000 to his operation in Colombia, thus working side-by-side with SAGF. Their global interest rate is a minimum of 10%, the rate paid by Restrepo, plus additional closing fees. SAGF and Root Capital recently signed a Memorandum of Understanding in Africa. Although not yet deployed, the agreement would allow Root Capital to transfer clients who need longer-term financing to SAGF, while SAGF may transfer clients whose funding needs are too small for their target range to Root Capital.

buyer, trader, local banks, and Rabobank – must work together and share a strong mutual understanding in order to implement the model.

The working capital debt finance that the SAGF guaranteed in Peru – now at \$1 million – allows Restrepo to fulfill McIlhenny’s growing demand for peppers. The cost of capital is reduced, loan size increased, and the need for expensive fixed assets side-stepped. Restrepo’s primary working capital need is to pay farmers weekly throughout the growing season. SAGF’s loan guarantee ensures that he can continue to provide such payment terms, upon which farmers rely for preparing land and sustaining their families, while simultaneously expanding and contracting more farmers for increased pepper sales. The local lender also learns how to work with, and unlock value from, a previously ignored sector. According to Harold Osborn, “this model has been successful in Peru and we would like to see it extended to other Latin American countries in which we operate.”

Scaling to Africa

In 2002, McIlhenny began sourcing tabasco chilies from Zimbabwe. Production of tabasco peppers in Africa has since expanded to include Zambia, Swaziland, and South Africa, with test plots currently operating in Mozambique. A total of sixteen containers of tabasco chilies shipped from Africa in 2009 – approximately 3-4% of McIlhenny’s supply. African operations are managed independently by Loki Osborn, brother of McIlhenny Vice President of Agriculture Harold Osborn. Production in Africa is a standalone project, however, with no direct investment from McIlhenny Company.

Loki Osborn is a trained biologist and elephant specialist. “Chili production in Africa really flowed out of my wildlife work,” states Loki. Chilies are one of the few foodstuffs that wild elephants will not eat, providing a source of income for farmers without incentivizing poaching. Yet Loki also believes strongly that, despite challenges, developing a supply chain for McIlhenny in Africa makes strategic sense. “We realize we work in pretty messed up, difficult areas. Diversifying is part of the idea,” states Loki. “Furthermore, central and southern Africa really aren’t Third World anymore. It’s a half-step up. Short of shipping and transit time, I see it as a place of great opportunity”.

In the case of Tabasco, that opportunity is availability of labor. While hundreds of hectares of wheat can be tended by a small number of people and harvested with machinery, Loki Osborn’s fifteen hectares in Zambia required 400 pickers per day for six months in 2009. He believes that “it is getting harder and harder for all of us to find people to grow and pick. There are a lot of other competing crops out there. I think Camilo [in Peru] finds it can be challenging to get people motivated when they have other options these days.” Maintaining a diversified supply chain positioned around large pools of affordable labor is critical to McIlhenny’s business.

Due to its reliance on labor, tabasco production creates relatively significant social impact. Loki believes that thousands were affected from the picking work in Zambia last year. “We provided jobs for over 300 women in Livingston last year who never worked before. It makes me think my past development work was a total waste of time. I’m a born again capitalist. It’s incredibly satisfying – just to do business with Africa.” The tabasco operation in Africa pays slight premiums over prevailing wages, and picking chilies is particularly conducive to employing women. Managers can hire anyone available

that day, on a flexible schedule, paying in cash at the end of the day or week. Trade finance has also been important for generating social benefits. Root Capital (*see Greybox above*) recently extended Loki a line of credit which “allowed us to even *talk* about payment terms with suppliers. Before that,” states Loki, “we just had to wait until we got paid.” Loki, and others within McIlhenny, believes farming in Africa plays a role in the overall fair trade commitment of the firm.

McIlhenny’s supply chain in Africa, however, has also met serious challenges. First, while product from Latin America arrives at Avery Island in a month, African chili mash takes at least two months, with recent extensions due to US anti-terrorism laws. Second, political corruption is endemic, generating, among other problems, delays at inner-African national borders. Third, as African operations are newer, technical capacity and yields from farmers are lower than in Latin America. Fourth, there is significant political instability. “Zimbabwe fell apart,” says Loki. “We’ve had to move and set up in new countries every couple of years. Each time we have to buy new equipment, train staff, etc.” Fifth, there are few deepwater ports. All shipping runs through Durban, South Africa. Sixth, there is a complete lack of local finance. Loki describes Zimbabwe and Zambia banking as “lost causes.” “In South Africa,” he states, “the banks offer some finance. But we don’t have much production there, the rates are high, and they want my mortgage as collateral. It’s a little scary.” All of these factors create an obstacle course for cost-effective production in central and southern Africa.

The negative effects of these challenges are compounded by the lack of competitive finance. For example, extended shipping times means that Loki’s line of credit from Root Capital, at a 10-12% interest rate, generates significant interest payment liabilities. In an example of politics and ports, in 2009 McIlhenny had several containers of Tabasco mash tied up for months in a rail strike in Durban. “But you can’t talk to your growers about a strike. You have to pay them. You have to hope your pockets are a little deeper to be able to handle it,” states Osborn. These challenges can be crushing for a small or medium-sized business. Due to a lack of local financial vehicles, the cash-flow volatility from operations in Africa results in McIlhenny’s suppliers simultaneously “sailing pretty close to the edge,” as Loki calls it, and financing unusually large working capital interest payments. In sum, Osborn states: “Financing is absolutely essential to succeed in Africa.”

Conclusion

With nearly a five-year production cycle and a warehouse full of pepper mash, Harold Osborn knew it would be easy to focus on sales, and to delay tackling the supply chain challenges, with no immediate crisis. But Harold’s job entailed preserving the time-honored tradition of Tabasco Brand Pepper Sauce. Changing the recipe would be akin to heresy. Rather, he had to find a reliable way to source increasing quantities of high-quality tabasco peppers while preserving company margins. Volumes were so large now that the days of farmers, traders, and processors being capable of self-financing were long gone, as was the era of McIlhenny operating as a bank to its dispersed suppliers. Expanding delivery times in the African supply chains were only amplifying these challenges. Harold knew he needed a plan that would capitalize growth through the value chain, and further professionalize farmers, while conserving the unique environmental, social, and taste requirements of tabasco pepper production.

Thought Questions

1. *What are the best options for McIlhenny Company to finance growth in their value chain?*
2. *What value does the Rabo Sustainable Agriculture Guarantee Fund provide to McIlhenny Company compared to other existing value chain financing options?*
3. *How active a role should McIlhenny play in securing financing for its suppliers?*
4. *How should McIlhenny assess the value of new production regions? How prominent a role should production in Africa play in McIlhenny's supply chain?*
5. *What additional social or environmental impact metrics, if any, should McIlhenny Company collect and compile from their value chain? What metrics should the SAGF collect and compile?*
6. *What value does the Sustainable Agriculture Guarantee Fund create for Rabobank International? How extensively should the SAGF be deepened or expanded?*
7. *How can the SAGF more effectively and rapidly expand to other regions and value chains?*

Exhibit A: Tabasco Heritage Brand Imagery



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Edmund McIlhenny, Tabasco Creator¹²



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Tabasco Sauce Today¹⁵

¹² "History of McIlhenny Company | TABASCO® History | TABASCO.COM." *Tabasco.com*. Web. 29 June 2010. <http://www.tabasco.com/tabasco_history/mcilhenny.cfm>.

¹³ "History of McIlhenny Company | TABASCO® History | TABASCO.COM." *Tabasco.com*. Web. 29 June 2010. <http://www.tabasco.com/tabasco_history/mcilhenny.cfm>.

¹⁴ "Tabasco Sauce." *Wikipedia.org*. Web. 10 June 2010. <http://en.wikipedia.org/wiki/Tabasco_sauce>.

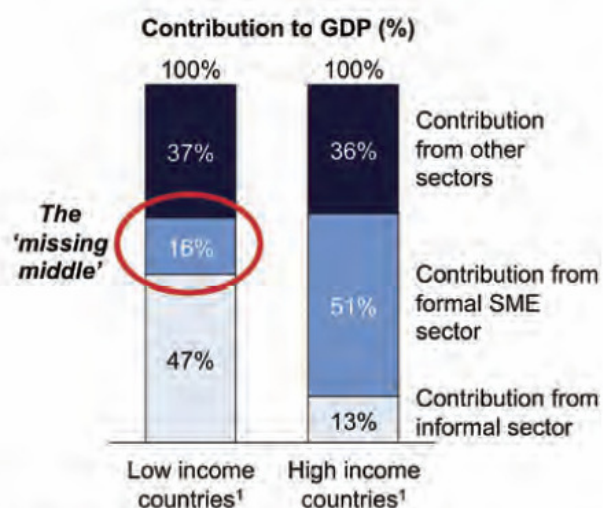
¹⁵ Ibid

Exhibit B: McIlhenny Four-Year Production and Procurement Cycle

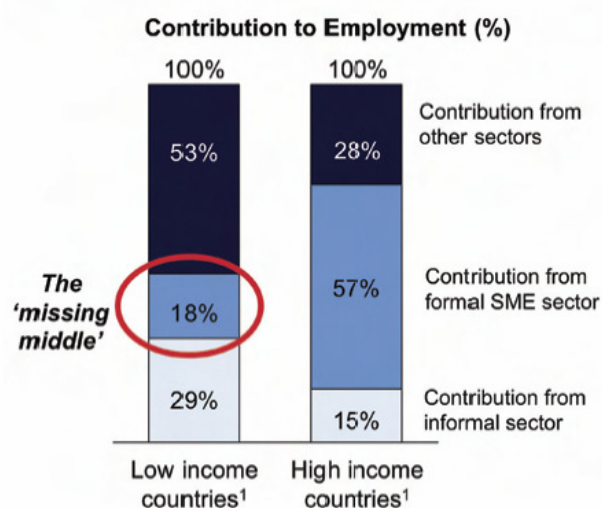


Exhibit C: SME Contribution to Global Employment and Economy

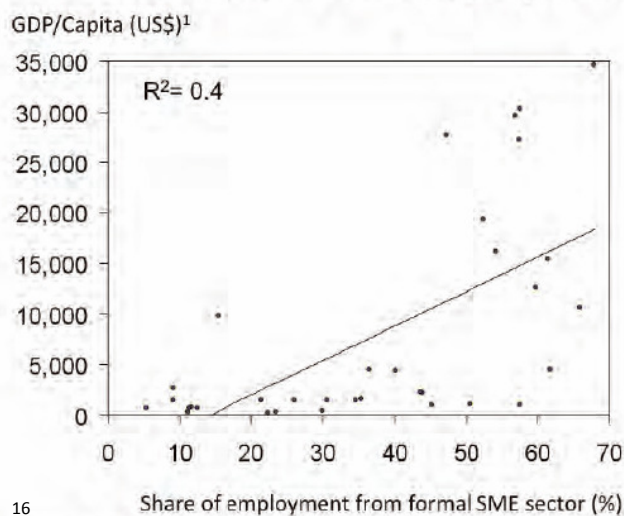
SME Contribution to GDP



SME Contribution to Employment



GDP and formal SME employment



¹⁶ Aspen Network of Development Entrepreneurs, and Dalberg Global Development Advisors. Aspen Network of Development Entrepreneurs 2009 Impact Report. Rep. 2009. Web. 10 June 2010. <<http://www.aspeninstitute.org/sites/default/files/content/docs/ande/ande-impact-09.pdf>>.

Exhibit D: Rabobank Group's Fourth "Basic Value" and Relevant Codes of Conduct

IV. Sustainability: The Rabobank Group is committed to contributing to the sustainable development of society in the financial, social and ecological sense.

- The Rabobank Group believes that all sections of society should have access to financial services. It does not exclude anyone from its services, other than on the basis of creditworthiness and morality.
- The Rabobank Group is closely involved in the society in which it operates; it wishes to be an accepted member of the community.
- The Rabobank Group respects human rights. It does not wish to be involved in matters that infringe upon human dignity.
- The Rabobank Group respects the local culture, customs and views and adheres to them, inasmuch as they do not contradict its mission and values.
- The Rabobank Group is committed to a balanced development of society; it contributes to promoting a healthy social and economic climate and to initiatives in the field of self organization.

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¹⁷ "Code of Conduct: Rabobank Group." *Code of Conduct*. Rabobank Group. Web. 10 June 2010.
<http://www.rabobank.com/content/images/Code_of_Conduct_Rabobank_Group_tcm43-37320.pdf>.

Exhibit E: Draft Text of Proposed Rabobank Food & Agribusiness Principles

1. Aiming for sufficient and safe food production

The first priority of food & agri chains is to feed the world with healthy and safe products at reasonable prices. This production should not endanger the food supply of future generations. Experts predict it will be necessary to double global food production by around 2050 in order to feed the growing world population. The challenge linked to meeting this growing demand and safeguarding food safety worldwide is to increase crop yields and improve distribution in a sustainable manner. Biodiversity and forest areas should be preserved in regions in which available agricultural lands are put into production. Businesses in the food industry are presented with the challenge of encouraging consumers to adopt healthy eating habits.

2. Using natural resources responsibly

A responsible and prudent approach should be taken to the use of natural resources with a view to ensuring the continuity of food production. The natural resources that are vitally important within the food and agricultural sectors are soil, water, air, biodiversity and climate (influenced by greenhouse gas emissions). The challenges facing businesses in the food & agri chains include preventing soil degradation and erosion, preventing soil and surface water pollution as much as possible, carefully using available water, avoiding overfishing and protecting valuable nature reserves (the so-called high conservation value areas, such as forests and wetlands). Further challenges include preserving genetic starting materials, reducing greenhouse gas emissions, limiting waste and safeguarding biodiversity.

3. Promoting social welfare

Safeguarding the social welfare and living environment of people is important with a view to attaining sustainable production in food & agri chains. Promoting social welfare also means that businesses should refrain from committing corruption and bribery, discriminating against employees and abolishing the right to freedom of association and assembly. They should likewise renounce forced labour, harmful child labour, poor working conditions, the irresponsible use of poisonous substances and violations of the rights of indigenous, local and other vulnerable sections of the population. The fact that many food & agri companies have an integral connection with the rural countryside means that they can fulfill a key role in improving socio-economic conditions in rural communities. The related challenge is to limit the negative external effects on local communities and to promote positive effects.

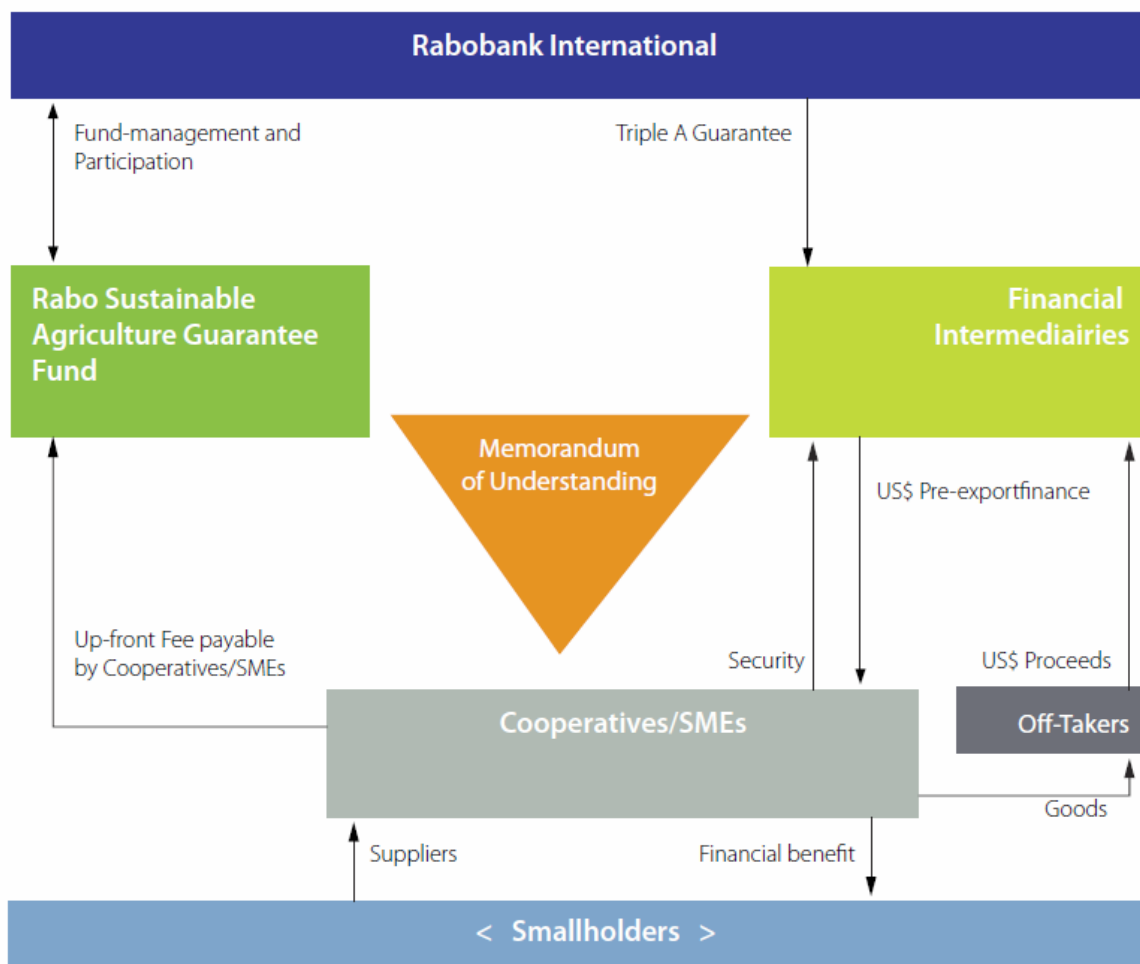
4. Keeping and caring for animals responsibly

The applicable ethical standards should be leading for livestock farmers, (including fish farmers), livestock dealers and livestock transporters with respect to keeping and caring for animals. The so-called 'license to produce' is derived from these standards. The treatment of animals concerns both the health of the animals (and in this context also the appropriate use of medications) and their well-being. The challenge for livestock farmers, livestock dealers and transporters is to base continual adjustments to changing circumstances on these ethical standards. Improving animal welfare and preventing and monitoring (infectious) animal diseases pose key challenges for the years ahead.

5. Helping promote well-considered consumer and citizen choices

Many consumers make only semi-conscious choices concerning the foods they eat. Customs and habits play a key role in this regard. In order to achieve these Food & Agribusiness Principles, it is important that consumers and citizens are made aware of how they can contribute to making food & agri chains more sustainable. Educating consumers and increasing citizen involvement are key contributory factors towards achieving this aim. The challenge will be to attain a situation in which consumers are willing and able to change their consumption patterns in a more sustainable direction. Food & agri companies can provide consumers with more information about the origins of products in order to enable them to make well-considered choices based on sufficient information.

Exhibit F: SAGF Guarantee Structure



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¹⁸ Bogers, Ellen. "Rabo Sustainable Agriculture Guarantee Fund." *Rabo Sustainable Agriculture Guarantee Fund*. Web. 10 June 2010. <http://www.rabobank.com/content/images/G5334%20RI_MVO_fund-LR_tcm43-50951.pdf>.