



Case Study:

Fair Trade as a Rewarding Business Model in the Horticulture Sector

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Introduction

East Africa offers an ideal climate for horticulture and all-season production, and Kenya has emerged as the top supplier of cut flowers to Europe (with a market share of nearly 40%) and the world.

The sector has an annual average growth rate of 20%, and employs an estimated 90,000 people directly while up to 2m benefit from it indirectly. The production is human capital intensive, and technology can only be used to a limited extent. Like the tea sector, horticulture is an important foreign currency earner.

In terms of the environmental footprint of exporting cut flowers to Europe, a recent study has revealed that its CO₂ balance (including transport, packaging and cooling) is considerably better than for cut flowers produced in less favorable climates such as in Holland.

However, the industry is often criticized for poor working conditions; furthermore, the amount of water used and the wastewater generated have a significant impact on the environment.

In conjunction with promoting best practices in Sustainable Finance, this case study outlines the opportunities arising from fair trade certification in the horticulture sector.¹

Fair trade is a prime strategy for accessing the European market, where consumers and importers are increasingly concerned about the conditions under which flowers are produced. Additionally, fair trade products sell at a minimum price protecting producers when prices fall and typically command a premium. It constitutes an excellent opportunity not only to mitigate the E&S risks typically associated with horticultural production, but also to create additional benefits for employees and the community without impacting financial returns.

Background

A medium size flower growing and exporting company employing around 2,000 workers has requested a corporate financing facility of \$2.5m over 7 years. Their existing rose farm comprises around 40 ha of greenhouses, grading hall and cold storage, housing for a back-up generator, shower block, chemical store, medical centre, labour camp, machinery shed and office.

The facility is being requested to increase the greenhouse capacity by 25% and to sustain their growth strategy.

Before the Bank accepted the loan request, it carried out a detailed E&S due diligence in line with its standard E&S procedures: questionnaires, site visit, and E&S contractual clauses. The Bank rated the risk as “medium”.

¹ The study is based on actual facts. Names have been changed or removed to protect confidentiality

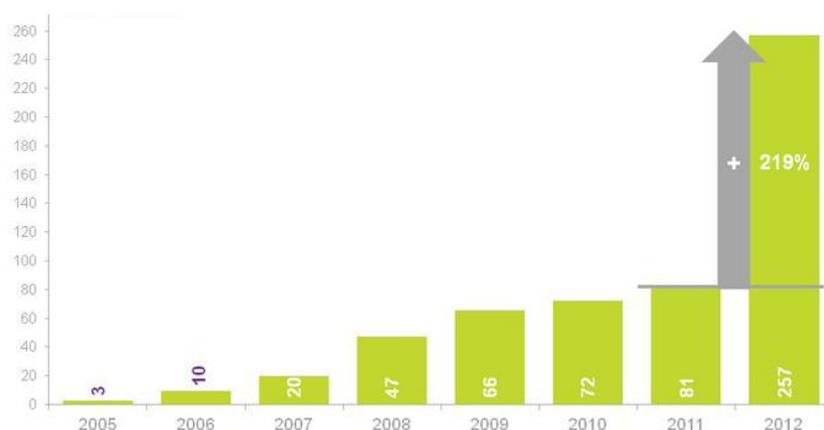




Findings of the Bank's E&S Due Diligence Inquiry

The Bank's E&S due diligence revealed that:

- The company, which has strong links to the European market, was certified to use a series of environmental and/or social flower labels, and was the first in Kenya to adopt such certification.
- A short market study highlighted the financial benefits associated with the fair trade label. The 2012 free on board price for a bunch of ten fair trade roses was €0.95, compared with €0.55 for a bunch of conventional roses. This difference easily covered the extra costs related to fair trade certification. Furthermore, the market for fair trade roses was growing, by more than 200% in 2012 alone.



Development of sales of fair trade flowers in Germany (in 1,000 pieces)

- Beyond legal labour commitments, the Company had implemented additional measures to improve working conditions. These include the establishment of salary accounts for all employees and a secure cash point



allows them to withdraw money when they require it. This has been particularly beneficial to the female employees, who make up a significant proportion of the labour force, as it reduced the risk they faced of their salary being claimed by their husbands on pay day.

- Other employee benefits include free transport to and from work, health insurance, low-cost housing, in-company training, and regular occupational health checks to screen for exposure to harmful substances such as pesticides.
- The company has taken a number of initiatives to benefit the community, including support for the basic education and vocational training of orphans, provision of land for a primary school, financial support to a local hospital, a shelter for street children and an HIV/AIDS outreach programme. The positive relationship generated by this, meant that the community has felt confident in seeking sanctuary at the company's premises during ethnic tensions in the past.
- One aspect not sufficiently addressed by the client or certifications was the long-term availability of water resources, and so the bank required the company to conduct a hydrology study to establish the future availability of water resources and to establish the impact of withdrawals. This turned out to be a wise move, as the rose farms subsequently came under pressure from NGOs over the impact of their water use. The company was able to refer NGOs to this study and to demonstrate their understanding of the impact, the potential consequences of declining water sources as a business risk, and how they were responding.

Following the E&S due diligence the bank and company agreed on a number of measures to include in the facility agreement, in particular a requirement for the company to maintain the fair trade certifications. These were considered to be an adequate assurance to the bank that the company was managing its E&S impacts appropriately. Furthermore, the certification audit and monitoring reports, as well as providing valuable information for the E&S due diligence, would also be forwarded to the bank during the period of the facility. These reports served to satisfy the bank's E&S reporting requirements, and in turn obviated the need for the company to produce separate reports for the Bank.

It is clear that the fair trade model constitutes an excellent way of mitigating E&S risks linked to horticulture, while facilitating a rewarding market access strategy.

If the company had not been pro-actively identifying and managing their E&S risks, the bank could have been faced with consequences such as:

- Complaints by the companies' employees about wages, working hours, social insurance and additional benefits, which could have led to strikes and violent protest.
- Negative effects on the environment, e.g. through insufficient treatment of waste water and inappropriate use of harmful pesticides.
- Disputes with the local communities, e.g. conflicts over the availability of water and the negative impacts of wastewater discharges and pesticides.
- Fines or sanctions from regulatory authorities.
- Critical reports being published by NGOs, and related community action, resulting in time being diverted to manage the reputation risk and the possibility of the campaigns resulting in market boycotts.



All these have the potential to impact on the capacity of the company to adhere to loan repayment schedules, and potentially to default entirely.

Banks Advice Provided to New Market Entrant

The bank was able to use its positive experiences with the company in discussions with other flower farms. As a result, one of these (a mid-size company interested to set up a greenfield flower farm) was convinced to opt for fair trade flower certification. This decision was welcomed by the bank, as the repayment capabilities of company were considered positive and it would be proactive in managing its E&S impacts.

This technologically innovative company had also adopted hydroponic cultivation, which uses less water and fertilizer, simultaneously saving money and protecting the environment.

Furthermore, as the sales figures later showed, the technology resulted in a superior quality product, attracting prices 10% above the average at auctions across Europe.

By collecting best practices in the flower sector, the bank was able to evaluate future deals in the sector better and more quickly and become a more competent financing partner.

Implications and Lessons Learnt by the Bank

The following key lessons can be drawn from this case study:

- **Carefully assess E&S risks and opportunities from the outset:** A bank needs to have a clear understanding of its client's E&S performance in order to identify any potential risks or opportunities that could affect the client's business model. Appropriate data and stakeholder opinions need to be gathered and processed for an informed opinion on the E&S concerns. If necessary, qualified external expertise can be sought. E&S related certifications are a very useful indicator of a client's commitment to these issues and certification audit reports are an excellent starting point for the bank's E&S due diligence. Any reliable certification systems provide for increased transparency and regular annual auditing. However, care is needed in reviewing the scope of the certification audits, as they may only cover a part of related E&S risks required by IFC Performance Standards.
- **Learn from others:** In almost every sector, a range of good international industry practices exists which can be referred to for ideas about mitigation measures for typical social and environmental risks. As such, a company with research capacity can identify good practices to adopt to protect the future value of the business.
- **"Difficult to measure" costs and benefits:** Costs and benefits are often difficult to measure and as a result are not always reflected in the business's financial models. They include less versus more motivated staff, support from local communities rather than having to spend time managing grievances, project delays versus no project delays, and factory closures versus no closures. Where possible, a company should be encouraged to adopt more



comprehensive financial models as a way of focusing on the opportunity cost of absent or ineffective E&S impact management practices.

- **Opportunity to differentiate the bank through sector insights:** Banks can position themselves as providers of value added advice to their clients by being fully aware of the market opportunities evolving from fair trade, sector certification schemes and emerging E&S issues. This demands that in-house knowledge needs to be developed and maintained.



Annex

Benefits of Fair Trade?

With the growing emphasis among consumers and importers for ethically, socially and environmentally sound consumption, more attention is being paid to the conditions under which flowers are produced, and the market share of flowers certified under the environmental and social labels is increasing each year. In Germany, cut flowers rate as the second fair trade product after coffee.

Certified flowers are sold mainly through two channels, retail florist shops, and supermarket and garden center chains. In the second channel in particular, certification is becoming a growing requirement for market entry as a result of consumers' preferences and critical awareness.

Given the many actors involved in the various sales chains, a large number of environmental and social certifications and labels have emerged. Fair trade certification in particular is linked to a range of commitments for the benefit of the company, its employees and customers, and community and environment. Although up to 75% of all cut flowers imported to Europe adhere to one or another of the various standards and labels, only 10-15% have a fair trade label.

Fair trade certified flower farms produce and operate in compliance with clearly defined social and ecological standards, including minimum wages, secured basic rights, liberty of trade union membership, prohibition of child labour, measures to ensure health and safety at work and protection of the environment. As the standards define a minimum price to be paid to the producers, the price for fair trade flowers for importers, traders and consumers is typically up to double that of conventionally produced flowers.

The higher market price granted by importers and consumers results in higher-than-average salaries for employees. In addition, a fair trade premium (10% of sales) is paid by the importers, to be used for the benefit of the employees and their families and communities. A joint committee composed of employers and employees decides on the usage of the premium.



Benefits of Fair Trade Certification for Businesses, Employees, the Environment and the Community

- ✓ Easier access to international markets through an established and respected fair trade mark.
- ✓ Participation in the growing market for ethically, socially and environmentally sound products.
- ✓ Enabling a better business deal for the benefit of producers, workers and the community through stable minimum prices independent of world market price fluctuations, and the additional fair trade premium.
- ✓ Highly positive appreciation among consumers, offering the opportunity for socially and environmentally sound consumption.
- ✓ International visibility, appreciation and credibility of company's engagement towards good working conditions, fair prices and the environment.
- ✓ Improved business practices with benefits from more efficient use of resources and a better motivated workforce.

