

The Credit Crisis and Fair Trade – possible consequences for producers, wholesalers and retailers.

September 23rd 2008

A string of financial problems within the US and world economy, triggered by a US housing crisis, have arisen in 2008. The question becomes how may these global problems manifest themselves within the Fair Trade world? When it seems that sales are solid - and many fair trade businesses are continuing to outshine the others on Main Street - why should we be concerned?

Fair Trade differs from regular trade for many reasons, one of which is the role that wholesalers play in financing production. By providing interest-free advances and full payment on shipping, buyers are paying months before receipt of the goods. Most wholesalers borrow these funds and pay the interest charged on this capital.

As the credit crunch lurches towards a full blown crisis, we need to ask ourselves if this credit will be available in 2009 and, if not, how we can continue to function and maintain our values as Fair Traders? It is very likely that credit will be much harder to find and that even existing lines of credit may be withdrawn. How will this situation affect Fair Trade?

Implications for Wholesalers/ Importers

The most obvious and direct effect will be on wholesalers who, quite simply, may not have access to the funds they need to pre-finance production at the same levels they have in the past. So how can this possible crunch be managed?

- Planning will be key. Wholesalers will need to place orders strategically, considering production lead times and pre-financing needs. Not every producer is equal. Some are able to work on smaller deposits and produce faster; both of these factors lead to less capital requirements.
- Reducing shipping time by using faster services may not be cost effective in normal times, but, when cash flow is at a premium, it may be worth ordering less, ordering more often, and shipping faster to increase inventory turns and reduce the inventory being held in the warehouse.
- Other strategies that can help wholesalers reduce their requirement for credit include a reduction in inventory levels, reductions in fixed costs, and reduction of accounts receivables.

The irony of this potential situation is that Fair Trade has outperformed regular trade. The wholesalers most likely to find themselves in a difficult situation may be those that have used credit to grow successfully.

Implications for Producers

These strategies have implications for producers who may see reductions in orders, the size of orders, and the ability of wholesalers to provide finances. Producers may need to be careful in their consideration of orders, taking a deeper interest into the financial security of wholesalers, examining annual reports and asking tougher questions to be sure the wholesaler can settle the accounts when due.

True long term partnerships between producers and wholesalers may become a much more valuable currency in Fair Trade. When wholesalers need flexibility on pre-financing from producers, producers need to be concerned about providing generous terms to wholesalers they do not know enough about.

Fair Trade would be seriously damaged if producers feel the pain of the credit crunch through payment defaults. Kevin Ward of Global Crafts says, "I would encourage wholesalers to seek help from within the Fair Trade community in a worst case scenario; and, I would encourage other wholesalers to be open to taking on the commitments of others to safeguard the producer."

Implications for Retailers

Retailers should expect to see

- Less inventory held by wholesalers,
- More out of stock items, and
- Wholesalers seeking to renegotiate payment terms.

Retailers can play a crucial role in supporting wholesalers by trying to pay on time, if not early, and offering to pay on credit cards - thus transferring the financing from the wholesalers' accounts to the retailers' bank accounts.

General Advice

Shobna Dhewant of RSF Social Finance offers this advice for any type of fair trade organization: "For general business preparation and conservation, right now is the time to be conservative and anticipate possibly slower sales cycles and a possibly lower spending holiday season.

Businesses should:

- Secure their contracts with suppliers before placing orders for production.
- Work only with reliable producers with previous history and experience.
- Hold off on expansion of number of stores or large scale rollouts of products until 2009.
- Do not use personal assets, such as home lines of credit, to expand business operations. Either scale down or look to angel investors or partners for capital financing.
- Limit exposure to economically volatile regions and have additional sources of products to cover any missed product shipments.
- Stay positive, as with any business cycles, what goes down will surely rise again."

The Future

Fair Trade's long term future remains strong. In the event of a serious tightening of credit, we must all work together, producer, wholesaler and retailer, to understand the pressures each of us face, maintain strong sales, and keep the flow of capital moving from consumer to producer, in the most fluid way possible.

If Fair Trade Federation members find themselves under pressure from conventional banks, there are two alternative funding organizations who have agreed to speak with you:

- Shared Interest: www.shared-interest.com – Contact Elisabeth Wilson (Elisabeth.wilson@shared-interest.com) or Jane Burns (jane.burns@shared-interest.com)
- RSF Social Finance - www.rsfsocialfinance.org – Contact Shobna Dhewant (shobna.dhewant@rsfsocialfinance.org)