PF4SD Perspectives Series

MAKING BLENDED FINANCE WORK FOR AGRI-SMEs: LESSONS LEARNED FROM SELECTED CASE STUDIES

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BETTER POLICIES FOR BETTER LIVES

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A collaborative OECD-SAFIN project on blended finance and agriculture

SAFIN

SMALLHOLDER
AND AGRI-SME FINANCE
AND INVESTMENT NETWORK

Small family farms and small and medium enterprises (SMEs) are the majority of enterprises in the agri-food sector in many developing countries. These enterprises can contribute to eradicating poverty (SDG 1), achieving food and nutrition security (SDG 2), promoting inclusive growth (SDG 8), protecting water, land and biodiversity (SDG 15), and achieving climate action (SDGs 13). Currently, many of them do not have sufficient access to finance to fulfil their potential. This *Perspectives* highlights the role of blended finance in this context and provides insights into how development co-operation actors can utilise blended finance to mobilise finance towards agri-SMEs in support to the SDGs.

Key messages

- Blended finance can enable agri-SMEs to access more capital and targeted financial products to grow their businesses and their contribution to the 2030 Agenda.
- Different blended finance instruments can facilitate the mobilisation of commercial finance for agri-SMEs in different contexts, and risk mitigation instruments often hold particular potential, given that credit risk is often a key obstacle to financing this market segment.
- Blended finance models can improve financial inclusion, by fostering lending to specific targeted projects such as women-owned and youth-led enterprises, initiatives or projects.
- Blended finance models – particularly through technical assistance and/or grants - can stimulate the creation of new markets and value chains around agri-SMEs.
- Blended finance programmes should be designed with room to experiment, innovate and adjust. Close consultation with target groups enable insights into both supply and demand challenges associated with commercial finance.
- Local institutions – including financial institutions, governments, and agri-food market players - are critical partners in developing and delivering on blended finance solutions that can impact not only on individual transaction but also on market factors underlying investment risk.
- The *Perspectives* shows that blended finance works for agri-SMEs – a sector that is challenging and at the same time associated with high ambition and importance for the SDGs. Donor governments have the financial instruments to mobilise private finance for agri-SMEs at hand, via their aid agencies, or development finance institutions (DFIs) or multilateral development banks (MDBs). Now it is important that they act upon it.

Blended finance can increase financial resources available to agri-SMEs[1]

Small family farms and small and medium enterprises (SMEs) are the backbone of agricultural value chains in most developing countries (AGRA, 2019[1]). These agri-SMEs face a number of challenges: lack of capacities and poor quality of physical assets such as land and machinery, participation in poorly functioning value chains, and lack of access to the finance and investment needed to maintain or grow their businesses. Supply-side issues on the financial intermediary side, such as lack of adequate underwriting capacity, and high transaction costs due to small size, information opacity and often remoteness of this client group add to factors resulting in a significant financial gap (Aceli, 2020[2]) (Havemann, 2019[3]) (GPFI, 2012[4]).

Recently, blended finance has been helping to mobilise commercial investment for geographies, sectors, project cycle stages or business models that would otherwise have struggled to attract financing. Blended finance structures use development finance – both concessional and non-concessional – to adjust the risk-

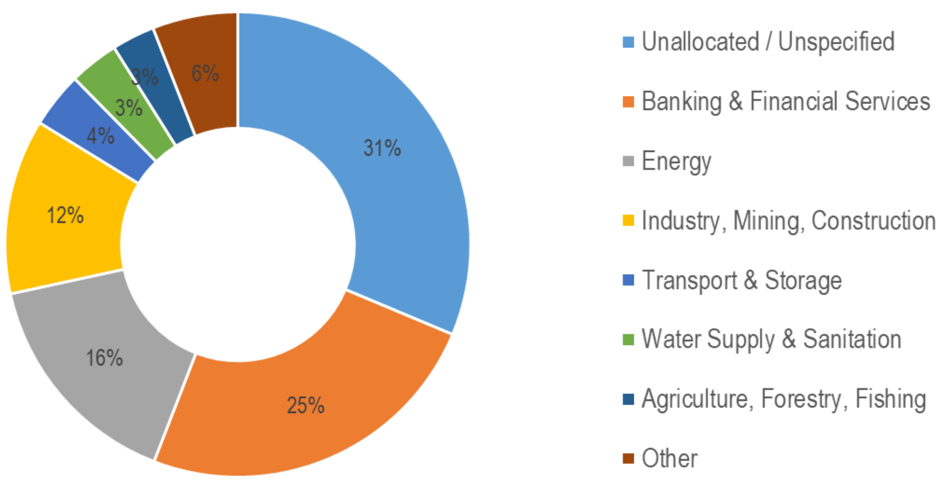
[1] This policy brief synthesises the findings of a two-year collaboration between the OECD and the Smallholder and Agri-SME Finance and Investment Network (SAFIN), whose Secretariat is housed at the International Fund for Agricultural Development (IFAD) to strengthen the knowledge base about blended finance in and for agriculture. It focuses in particular on lessons learned from nine case studies published by SAFIN at www.safinetwork.org in collaboration with the Inter-American Development Bank. It was written by Lasse Moller, Priscilla Boiardi, Wiebke Bartz-Zuccala and Esme Stout (OECD), and Bettina Prato (SAFIN). The paper also benefited from the input, reviews or feedback of Paul Horrocks, Özlem Taskin, and Nestor Pelechà Aigües, OECD.

return relationship of an investment opportunity.[2] Blended finance structures work either on the risk side – i.e. allocating risks differently among participating parties or mitigating risks – or on the return side, e.g. by altering returns or proposing different models of return allocation, thereby making commercial finance more available to under-invested parts of the economy.

Blended finance certainly does not fit every context or type of investment. Within agriculture, some types of investments – e.g. those in public goods and services - require public funding. Even for investments that generate private goods, first-time transactions or early stage investments usually attract little commercial finance, or even no finance at commercial rates. However, incentivising actors to engage in the sector through the contribution of development finance and through other means can address some of the factors underlying both real and perceived investment risks, increase the familiarity and comfort with the sector of investors, and develop a track record for both investors and investees. Over time, less and less development finance may then be needed to unlock commercial finance, with the ultimate goal to enable functioning capital markets (OECD, 2018[5]).

Today, commercial engagement in financing agriculture remains limited. The amounts mobilised from the private sector by official development finance going towards the agriculture sector averaged USD 1.4 billion in 2019, which reflects 3% of the total amounts mobilised in that year (OECD, 2021[6]) Figure 0.1). The data set covers a range of blended finance instruments that can be used to calibrate the risk-return profile of projects and tackle other barriers to private investment, including guarantees, shares in collective investment vehicles (CIVs), direct investment in companies, credit lines and syndicated loans.

Figure 1. Amounts mobilised form the private sector, by sector, 2019, USD billion



Note: Unspecified sectors are mainly a result of IFC reporting data at aggregate level due to confidentiality constraints.
Source: Amounts mobilised from the private sector for development, https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/mobilisation.htm (OECD, 2021[6])

[2] Blended finance is the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries (OECD, 2018[5]).

A case study approach shows some key areas of application of blended finance

This Perspectives synthesises insights from nine case studies on blended finance across the agri-SME sector[3]. These studies illustrate how blended finance instruments have been used in recent years to incentivise more inclusive agri-market ecosystems, i.e. increasing access to finance for female or young entrepreneurs, new business models or value chains.

Table 1. Overview of blended finance case studies

Case	Country	Providers of finance and/or technical assistance	Financing structure and instruments used
Financing Ghanaian Agriculture Project (FinGAP)	Ghana	USAID, Palladium	Payment by Result (PBR) Guarantees, TA
Programme For Rural Outreach Of Financial Innovations And Technologies (PROFIT)	Kenya	IFC, Agricultural Finance Corporation of Kenya,	Credit Lines, Guarantees, TA
Private Agriculture Sector Support (PASS)	Tanzania	DANIDA, SIDA, Tanzanian Government, Agriculture Sector Programme Support (ASPS)	Guarantees, TA
Blending Happiness, Hazelnuts and Finance in Bhutan: IFC's Blended Finance Investment in Mountain Hazelnuts	Bhutan	ADB, IFC, Private Sector Window of GAFSP	Equity, Quasi-equity
Development of a Macauba-Based Silvopastoral System and Value Chain implemented by Inocas	Brazil	IDB, Forest Investment Programme (part of the Climate Investment Fund), Althelia	Grant, Equity, TA
Social Trust Fund to incorporate vulnerable Smallholder Farmers into Paraguay's Chamomile Value Chain	Paraguay	Government of Paraguay, Fundación Capital, Private Investors	Grants
Sustainable Landscapes Portfolio Guarantee	India	USAID, Rabobank foundation	Guarantees
Family Farming Financing Programme (PROAF)	Mexico	Mexican Agriculture Development Bank (FIRA)	Guarantees, TA
CARD SME Bank	Philippines	Canadian International Development Agency (CIDA), IFC, CARD Bank	Debt, TA

Source: Authors

Some of the case studies look specifically at the use of blended finance to de-risk financial institutions' business models associated with serving small-scale borrowers or investments with high impact potential in terms of social inclusion or environmental sustainability. Often, financial institutions are constrained in lending to small-scale enterprises or to female and young borrowers – both in agriculture and in other sectors - due to lack of knowledge and capacity on the financial institutions' side, high real and perceived risks and high transaction costs. Blended finance can facilitate credit risk sharing or transfer between commercial financial institutions and development actors. For instance, the Programme for Rural Outreach of Financial Innovations and Technologies (PROFIT) in Kenya incentivises commercial and microfinance banks to increase the volume of their agricultural lending, diversify their services and products to rural areas, and increase their focus on innovation to reduce the cost of services and technical assistance to producer groups. The Private Agriculture Sector Support (PASS) in the United Republic of Tanzania is a guarantee scheme that provides Business Development Services alongside guarantees to foster lending to specific targeted projects such as women-owned and youth-led enterprises or initiatives. The Sustainable Landscape Portfolio Guarantees in India, supported through a partnership between Rabobank

[3] The case studies can be found here, an overview in Overview of blended finance case studies.

Foundation and USAID, aims to enable lending by local partner financial institutions to SMEs, co-operatives, producer companies and microfinance institutions directly or indirectly engaged in sustainable landscape investments. Finally, the Center for Agricultural and Rural Development – Small and Medium Enterprises Bank (CARD SME Bank) partners with IFC to onlend to agri-SMEs in the Philippines.

Other case studies illustrate the application of blended finance to build up capacity on both the demand and supply sides of finance. For instance, the Financing Ghanaian Agriculture Project (FinGAP) stimulates commercial lending to agribusiness and smallholder maize, rice and soy farmers in rural Ghana, through grants in the form of pay for result incentives schemes for both financial institutions and business development services, as well as through guarantees. With a different approach, the Family Farming Financing Program — PROAF for its Spanish acronym - in Mexico builds on a government guarantee scheme to stimulate commercial loans from co-operatives to family farmers combined with technical assistance from the public development finance institution FIRA (Trust Funds for Rural Development).

Finally, a third group of case studies illustrate the use of blending to support innovation around agricultural value chains to enable greater smallholder inclusion along with other development benefits (e.g. environmental impact, nutrition, and others). In particular, these studies show that blended finance solutions can be used to develop innovative business models and/or new value chains by incentivising investments into proof of concept and to prepare to scale. For instance, the Mountain Hazelnut programme of IFC involved a blended investment in creating a new market for hazelnut production in Bhutan, using degraded land, training farmers and facilitating access to markets for a medium-large scale enterprise. In the IDB INCOAS programme, blending went towards creating a new structured commercial value chain for growing a native palm tree call Macauba in Brazil. Finally, in the Social Trust Fund (STF) in Paraguay Fundación Capital and other partners worked to incorporate vulnerable smallholder farmers into the chamomile value chain by de-risking investments into product development and value chain transactions.

Investigated case studies reflect the early stage of the blended finance industry in the agri-SME sector

Guarantees and other risk sharing instruments can nurture more inclusive agri-market ecosystems

Guarantee schemes can help de-risk investments for financial institutions, and thus increase their willingness to lend to agri-SMEs, although the evidence for sustainability of impact beyond the lifetime of guarantees remains limited. The Programme for Rural Outreach of Financial Innovations and Technologies (PROFIT), for example, includes a risk-sharing facility to boost rural and agricultural lending by commercial financial institutions by deploying concessional development finance from IFAD and the government of Kenya. PROFIT targets in particular smallholder farmers, small farmer co-operatives, and agro-input suppliers. The commercial financial institutions involved in the programme, such as the Agricultural Finance Corporation or Barclays Bank of Kenya (now Absa), have expanded their lending to these groups by developing new loan products tailored to smallholder farmers, and stopped using traditional collateral based lending that was resulting in a high non-performing loan portfolios. A credit risk sharing facility allowed the institutions to address their credit-risk related concern lending to these segments. The risk facility would cover between 10% for large institutions to 50% of the loan amount for smaller and riskier actors.

Similarly, the Private Agriculture Sector Support (PASS) in Tanzania provides credit guarantees issued by development agencies Danish Danida and Swedish Sida to commercial banks and local development finance institutions (DFIs) to incentivise their engagement in agri-SME lending by de-risking their loan activity to agribusinesses. PASS guarantees provide high coverage ratios for specific loans, as they cover 60 % (up to 80% for women and youth) of the loan amounts. Guarantees also played a role in the FinGAP programme, jointly with the payment-by-results (PBR) scheme, provided by the Ghanaian government as well as USAID's DCA. However, financial institutions participating in the PBR programme have not made substantial use of said guarantees. The financial institutions eligible for such guarantee instruments considered them burdensome from an administrative perspective as well as too costly.

A first-loss *guarantee* backs two financial institutions in India in facilitating finance to SMEs involved in the production of sustainable forest products, agroforestry products, the promotion of climate smart agriculture, onlending to microfinance institutions (MFIs) willing to provide loans to individuals/MSMEs exclusively for forestry/agroforestry and low emission agriculture, and more. The guarantee is issued by Rabobank Foundation; USAID is providing a pari passu guarantee sharing risk equally with the partner financial institution at the portfolio level, after application of first loss. Through this blended finance structure, Rabobank Foundation and USAID sell protection to these partner financial institutions, allowing them to get more comfortable with taking the risks associated with this new area of lending. This included taking risks associated with offering loans with longer tenure than what is required in other sectors, to address the need for long-term finance for investments in agroforestry – particularly for afforestation. At the same time, this shows that incentives provided through blending are sometimes not sufficient to enable local financial institutions to expand to specific types of investments or clients in the sector. The case illustrates the need to adapt expectations both in terms of type of local financial institution targeted and in terms of ticket size, and to work on demonstration effect rather than on achieving scale right away. The initially foreseen size of the programme was five times greater (USD 75 million). However, the demand from financial institutions was limited; as a result, a USD 15 million pilot project is launched with the potential to be scaled up based on responses from other financial institutions.

Liquidity instruments and direct investment can help to build new products with high development potential

The case studies illustrate how *credit lines* can incentivise lending to agri-SMEs by providing additional liquidity to financial institutions. For instance, as part of the PROFIT programme in Kenya, a complementary credit facility was set up to provide liquidity to commercial finance and MFIs that lack the funds to disburse loans to rural and agriculture portfolios.

Loans can also mobilise financial institutions to onlend to agri-SMEs by providing additional liquidity paired with the financial institution's own funds. For instance, a 7-year loan by IFC enabled CARD SME Bank to engage in lending relationships with agri-SMEs and women- owned enterprises in the Philippines. In advance of this intervention, CARD SME and IFC worked together on technical assistance to (i) develop its agribusiness segment and (ii) attract private investors and partners. To that effect, IFC deployed a *grant* from the Canadian International Development Agency (CIDA) to help reach underserved potential clients in agriculture.

Equity investments can fuel such new business models by providing patient capital enabling to grow a business model, providing valuable capacity and increase shareholder and stakeholder confidence. The Mountain Hazelnut project received start-up capital from the private sector in its funding phase. For further expansion, however, additional liquidity was needed. In a blended finance structure, IFC and ADB agreed to each invest USD 3 million of equity, which was matched with USD 6 million in quasi-equity from the private sector window of the Global Agriculture Food Security Programme (GAFSP)[4]. At the same time, the founder of MH and existing shareholders converted USD 3 million of existing bridge loans into equity. By enabling the capital increase, the hazelnut production could be put on solid feed.

[4] GAFSP investment is taking the form of cumulative redeemable preferred shares (CRPS).

Grants and technical assistance can unlock commercial finance

Guarantees can be more effective in mobilising commercial finance when paired with *technical assistance* for capacity enhancement. In the case of PROAF, this combination was deployed to address lack of access to finance for family farms by enhancing the capacity to handle credit risk and generally provide financial services of participating cooperatives. The technical assistance was provided with resources from FIRA, the Ministry of Economic Affairs in Mexico, the German LS&CCs Foundation for International Cooperation and the German Confederation of Cooperatives. The guarantee scheme was funded by the Ministry of Agriculture and Rural Development (Sader).

Grants and technical assistance can be used both on the supply and demand sides of agricultural finance – separately or in combination. For instance, in the Financing Ghanaian Agriculture Project (FinGAP), Palladium deployed USD 5 million funded by USAID in a PBR scheme to incentivise FIs to develop tailor-made products for agri-SMEs. Initially, lending to this market segment was very limited, due to loan products failing to meet user needs in terms of size, tenure, and seasonality of cash flow matching and collateral requirements. In the Kenyan PROFIT programme, a risk sharing facility and a credit facility complemented with technical assistance from the Alliance for a Green Revolution in Africa (AGRA), supported the participation of financial institutions as well as business support services.

For projects at an earlier stage with unproven business models, *grants* for example in the form of convertible grants may be needed to develop the market. For example, IDB Lab provided a contingent recovery grant of USD 1 million to INCOAS, which addressed the relatively high technology risks (Macauba derivatives) and business model risks (integrating smallholders into a new value chain). This grant has to be repaid only if the project succeeds. This is complemented by an additional USD 3 million equity investment from the Forest Investment Program, or FIP (part of the Climate Investment Funds), will fund cost of capital for the farmers. By building markets with the use of grant instruments the way for commercial investment may be paved by showcasing functioning business models. *Grant contributions* - by both development actors such as Fundación Capital and commercial actors related to the value chain - are pooled into a bank-held STF. This allows the establishment of a value chain as it enables smallholder farmers to participate in a graduation pilot project aiming at the production of the new crop camomile.

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Links

https://www.safinetwork.org/safinresources/Blended-finance-for-agriculture