

UNEDITED Draft version 18 October 2023

Unleashing the Catalytic Power of Donor Financing to Achieve SDG 2

Oshani Perera, Carin Smaller, Kamal Elharty, and Lysiane Lefebvre¹

About this Report

This report presents the findings and recommendations of the enquiry on sustainable finance in agri-food systems conducted by the Shamba Centre for Food & Climate for the members of the Global Donor Platform for Rural Development (GDPRD).

The enquiry explored two questions:

- (i) How are donors working to make their financing more catalytic?
- (ii) How are donors using their concessional financing to crowd-in commercial financing from development finance institutions and the private sector (see Box 1)

Interviews took place – under Chatham House rules – with over 50 respondents, including representatives from donor agencies, philanthropic foundations, development finance institutions (DFIs), public and blended funds, fund managers, investment advisors, international organizations, non-governmental organizations (NGOs), investor networks and sustainable finance networks, academic and experts on sustainable finance.

The central message is that if donors and development finance institutions (DFIs) take higher risks with their grants and lending, every donor dollar has the potential to mobilize four dollars in commercial finance. When this happens, agri-food small and medium-sized enterprises (SMEs) will have more financing, domestic lenders will participate, and markets will deliver affordable borrowing prices. This is the catalytic power of aid.

The idea of blending public and private sources of finance is not new, but remains nascent, particularly within agri-food systems. Donors are already complementing their traditional concessional financing with commercial lending. In tandem, DFIs have indicated a willingness to

¹ The authors would like to acknowledge the important and substantive contributions of the following people: Mali Eber Rose, Natalie Mouyal, Nicole Burch, Maurizio Navarra, and Michelle Tang.

work with dedicated funds from their shareholder governments to take on higher risks and accompany domestic lenders and institutions over the longer term. Taking these ideas to scale will require widespread changes by donors, DFIs and their beneficiaries in developing countries and in doing so, they will make agri-food development finance truly transformative.

Box 1

What are concessional and commercial finance?

Concessional finance includes grants, loans that are longer-term and offer below market interest rates, and loan guarantees that are targeted at reducing the risk for private investors and development finance institutions (DFIs). They are provided by donors and philanthropic foundations.

Commercial finance refers to loans that require market interest rates. They are provided by DFIs and private investors.

Table of Contents

| | |
|---|-----------|
| About this Report | 1 |
| Table of Contents | 3 |
| 1. The public investment gap for SDG 2 | 4 |
| 2. What are the main sources of development finance for SDG 2?..... | 4 |
| 3. Blended finance remains nascent but shows promise | 5 |
| 4. Findings and Recommendations | 7 |
| Key Finding 1: Blended finance can make the biggest contribution to SDG 2 by focusing on the missing middle; agri-food SMEs seeking finance between USD 50,000 and USD 2 million. | 9 |
| Key Finding 2: Every dollar of concessional finance can mobilize four dollars of commercial finance. However, whether those four dollars deliver on sustainable development will determine if blended finance is truly additional..... | 13 |
| Key Finding 3: Development finance institutions are governed by rules that discourage them from taking risks to provide finance that would otherwise not be available from commercial lenders. | 19 |
| Key Finding 4: More research and data on the performance of agri-food SME loans that originate from donors is a prerequisite to make ODA catalytic. | 21 |
| Conclusion..... | 21 |
| References..... | 22 |
| Annex 1: List of Stakeholders Engaged | 25 |

1. The public investment gap for SDG 2

A series of reports from leading research institutes and international organizations provided evidence of the public investment gap to achieve SDG 2 by 2030 (von Braun et al., 2020; Food and Agriculture Organization of the United Nations [FAO] et al., 2020; Akademiya2063 and Zentrum für Entwicklungsforschung [ZEF], 2020; Laborde et al., 2020). According to these reports, the estimated additional public investment needed from donors and recipient countries ranges between USD 33 and 50 billion per year until 2030. The research community agreed that the donor share of this total is about USD 14 billion more per year, or roughly double the current level of spending on agriculture and food security, excluding emergency food assistance (von Braun, et al., 2020; Laborde et al., 2020).

2. What are the main sources of development finance for SDG 2?

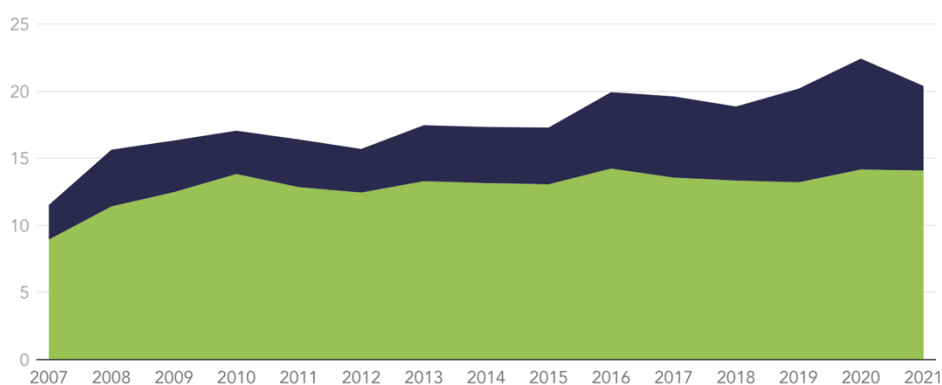
ODA grants to agriculture and food security comprise one of the major sources of development finance in the global effort to eradicate hunger sustainably and achieve SDG 2. For the past 16 years, donors have consistently allocated significant volumes of public finance in the form of grants to agriculture and food security. Overall, between 2007 and 2021, the global volume of ODA grants for agriculture and food security has increased; from USD 8.9 billion per year in 2007 to USD 14 billion in 2021. However, since 2010, they have remained relatively constant, hovering between USD 12 and 15 billion, with no clear upward or downward trend. Comparatively, although still receiving significantly less in total resources allocated to food security, ODA for emergency food assistance has increased by 77% (see Figure 1).

Figure 1

Official development assistance (ODA) grants in constant 2021 USD billions, 2007-2021

ODA for agriculture and food security has stagnated while emergency food assistance has increased.

■ Agriculture and food security ■ Emergency food assistance



Analysis using Ceres2030 definition of ODA for agriculture and food security.

Chart: Eber-Rose, M., 2023 • Source: OECD DAC

<https://www.datawrapper.de/ /V6Gud/>

ODA loans are also being used to fill the investment gap for agriculture and food security to achieve SDG 2. ODA loans are provided on a concessional basis – in other words, with longer

repayment periods and lower interest rates than commercial loans. According to the OECD's Development Assistance Committee (DAC) Creditor Reporting System (CRS), ODA loans to agriculture and food security amounted to USD 10.2 billion in 2021 (constant 2021 prices) (Organisation for Economic Co-operation and Development [OECD], 2023a).

Multilateral and bilateral development banks are the other major source of development finance. They not only channel ODA grants and loans from bilateral donors, but they also use their own money to provide concessional and commercial finance at market rates. For instance, in 2023, the Asian Development Bank (ADB), African Development Bank, and the Islamic Development Bank, respectively committed USD 14 billion, USD 10 billion, and USD 5 billion for sustainable agricultural transformation programmes (African Development Bank, 2021).

Despite these efforts, development finance alone is insufficient to fill the additional USD 33 to 50 billion per year investment gap to achieve SDG 2. The investment gap will not be filled by the public sector exclusively. More is needed to make other sources of development finance work, including commercial loans from multilateral and bilateral development banks, and blended finance from both public and private sectors.

3. Blended finance remains nascent but shows promise

[The United Nations Addis Ababa Action Agenda](#) underscored the significance of blended finance as a key instrument for leveraging public and private sector finance to advance progress towards the 2030 Agenda for Sustainable Development (United Nations, 2015). It is an underused but potentially powerful strategy that donors have available to make their aid catalytic (see Box 2).

Box 2

What is blended finance?

Blended finance is the use of concessional finance from donors and philanthropic foundations to mobilise commercial finance from development finance institutions and private investors to invest in projects that are too risky and lack sufficient returns for private investors. Blended finance is therefore an important strategy to bridge the investment gap for achieving SDG 2.

The OECD defines blended finance as “the strategic use of development finance for the mobilization of additional finance towards sustainable development in developing countries, where additional finance refers to commercial finance...” (OECD, 2020, p.5).

For example, the Land Degradation Neutrality Fund launched in 2017, finances projects that reduce and reverse land degradation. The French Development Agency (AFD), European Investment Bank, Government of Luxembourg and IDB Invest provides low-interest loans and grants. The Global Environment Facility (GEF) provides grants for technical assistance. Commercial finance comes from the Fondation de France, Garance Mutuelle, BNPP Cardif, and others.

The amount of ODA that is directed towards blended finance annually is around 2-3% of the total ODA (Convergence, 2021). The Convergence historical deals database shows that up till 2018, both the dollar value and the number of blended finance deals increased, with climate-related financing capturing the largest share. Since 2018, while the dollar value of the blended finance deals dropped, the number of deals remained constant (see Figure 2) (Convergence, 2022).

Figure 2
Annual volume and value (in USD billions) of blended finance transactions, 2011-2021

While the volume of blended finance deals has increased between 2011 and 2021, fluctuations in the value of blended financing suggests a possible shift towards smaller ticket sizes.

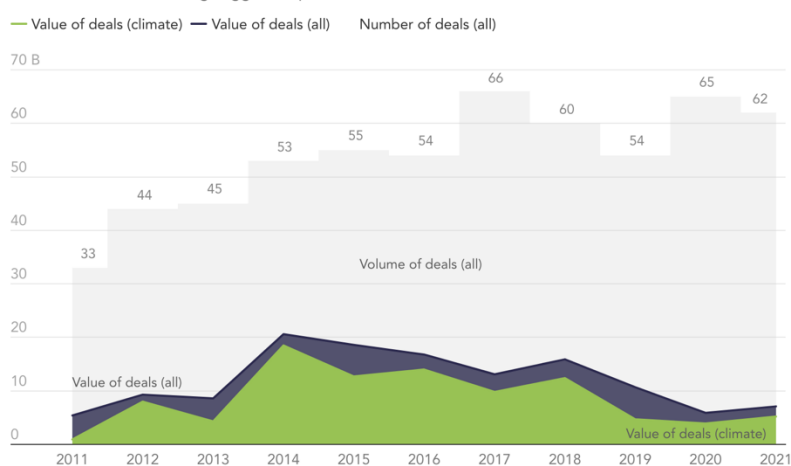


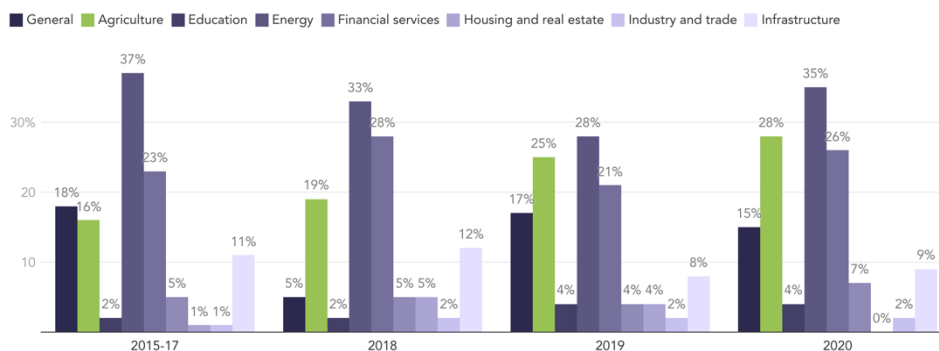
Chart: Lysiane Lefebvre • Source: Convergence, 2023

https://www.datawrapper.de/_/b8NmK/

The proportion of transactions on agriculture is also growing, from 16% in 2015-17 to 28% in 2020 (see Figure 3). This increase has been driven by financing for agri-food businesses, particularly those involved with agricultural inputs, which account for 55% of agriculture deals since 2018 (Convergence, 2021).

Figure 3
Proportion of closed blended finance transactions by sector, 2015-2020

The share of blended finance transactions going to agriculture has grown over the period from 2015 to 2020.



The percentages cannot be summed to 100% as a single transaction may target more than one sector.

Chart: Lysiane Lefebvre • Source: Convergence, 2022

https://www.datawrapper.de/_/DCqEz/

4. Findings and Recommendations

The enquiry on sustainable finance in agri-food systems led to **four key findings and four key recommendations**, all of which aim to increase the flow of financing to sustainable projects and businesses that contribute towards the realization of SDG 2. They are based on inputs from engagement with 69 organizations and 12 individual experts (see **Error! Reference source not found.**).

The four key findings and recommendations are listed below. They are discussed in detail in the section to follow. Definitions of key terms are also provided.

The four findings are:

1. Blended finance can make the biggest contribution to SDG 2 by focusing on the missing middle; agri-food SMEs seeking finance between USD 50,000 and USD 2 million (see Box 4).
2. Every dollar of concessional finance can mobilize four dollars of commercial finance (see Figure 6). However, whether those four dollars deliver on sustainable development will determine if blended finance is truly additional.
3. Development finance institutions are governed by rules that discourage them from taking risks to provide finance that would otherwise not be available from commercial lenders.
4. More research and data on the performance of agri-food SME loans that originate from donors is a prerequisite to make ODA more catalytic.

The four main recommendations emerging from the enquiry are the following.

1. **Donors and development finance institutions can increase the flow of finance to agri-food SMEs** by:
 - i. Building the agri-food expertise and risk appetite of domestic lenders;
 - ii. Scaling up results-based incentives for domestic lenders; and
 - iii. Supporting the development of an agri-food credit risk assessment scorecard targeted at domestic lenders in developing countries.
2. **Donors and the wider blended finance community can expand the pool of blended finance** by:
 - i. Reducing transaction costs related to the exploration, negotiation, and conclusion of blended finance transactions;
 - ii. Exploring how donors can provide not only first-loss financing, but also lending at commercial rates. Returns on these investments can be ringfenced for reinvestment into the same or other blended transactions;
 - iii. Continuing to provide grants for technical assistance and results-based financing, both of which present opportunities for high levels of additionality; and
 - iv. Setting up a multi-donor working group, supported by a knowledge hub, to share data, save time, and collaborate on co-financing.

3. **Donor governments must provide development finance institutions with dedicated funds that allow them to:**
 - i. Offer higher risk loans, such as first loss and mezzanine debt, that have well-defined targets on sustainable food and agriculture (see Box 3);
 - ii. Provide long-term credit lines, loan guarantees, transaction advice, and technical assistance to domestic lenders to build institutional capacity (see Box 3); and
 - iii. Accompany institutions, funds, and projects over the long term.

4. **Donors should create a data repository on the performance of agri-food SME loans,** building on the experience of the [Council on Smallholder Agricultural Finance \(CSAF\)](#) and [MIX Market](#).

Box 3

What are first loss, senior debt, mezzanine debt, and loan guarantees?

First loss is a type of concessional finance where the lender is the first in line to take a loss if the project or fund fails.

Senior debt is a type of loan with commercial interest rates. They are the first to be repaid before any other creditors or shareholders, if the project or fund fails.

Mezzanine debt can be concessional or commercial finance. It gives the lender the right to convert to an ownership stake (equity) if the borrower does not repay the debt on time and in full.

Loan guarantee is a guarantee provided by a third party who agrees to repay the loan if the borrower defaults.

(Source: K4D, 2021; SDC, 2017, USAID n.d.)

Key Finding 1: Blended finance can make the biggest contribution to SDG 2 by focusing on the missing middle; agri-food SMEs seeking finance between USD 50,000 and USD 2 million.

Key recommendation 1: Donors and development finance institutions can increase the flow of finance to agri-food SMEs by:

- i. Building the agri-food expertise and risk appetite of domestic lenders;
- ii. Scaling up results-based incentives for domestic lenders; and
- iii. Supporting the development of a credit risk assessment scorecard for agri-food SMEs.

Lending to the missing middle is challenging because of the high risks and costs (see Box 4). For example, CSAF reported an average loss of USD 18,700 on a loan of USD 665,000 to agri-food SMEs, excluding the cost of funds. CSAF also found that loans below USD 500,000 carried an 80% higher risk of default compared to larger loans (Council on Smallholder Agricultural Finance [CSAF], 2018).

Box 4

Who is the missing middle?

The missing middle refers to agri-food SMEs seeking finance between USD 50,000 and USD 2 million. They face challenges in accessing finance because they fall within a range that is too small for commercial banks to serve and too large for microfinance institutions.

Defining agri-SMEs

“Agri-SMEs are profit-oriented enterprises that are involved in the agricultural value chain either directly or by providing enabling services to value chain actors.” (SAFIN & ISF, 2020, p.2). They must be able to service an investment of USD 50,000 to USD 2 million, have more than 5 but less than 250 employees, have annual turnover of USD 100,000 to USD 5 million, and/or have total assets of at least USD 20,000 (SAFIN & ISF, 2020).

This results in an agri-food SME financing gap estimated at USD 106 billion annually across sub-Saharan Africa and Southeast Asia (see Figure 4) (ISF Advisors, 2022).

Figure 4

Agri-food SME financing gap across Sub-Saharan Africa and Southeast Asia

The agri-food SME financing gap across Sub-Saharan Africa and Southeast Asia is estimated at USD 106 billion (66% of total financing need) annually.

■ Current financing ■ Financing gap



Chart: Lysiane Lefebvre • Source: ISF Advisors, 2022

https://www.datawrapper.de/_UVfXF/

Despite active efforts from impact investors, agri-food SMEs that supply domestic markets are still largely missing out.

Impact investors use purchasing contracts, contract farming agreements and offtake agreements as guarantees, which allows them to provide loans without requiring collateral. But these contracts are in hard currency because impact investors want to avoid risks associated with exchange rates. Therefore, a significant proportion of impact financing flows to SMEs producing for export. Those SMEs producing indigenous grains, fruits, and vegetables to serve local markets and work in local currencies are largely left out. Impact investors are increasingly moving to finance local market producers in local currencies but lending to this segment involves higher risks and costs.

In 2022, lenders from CSAF primarily directed their lending to cash crop value chains (CSAF, 2023a). Agri-food SMEs and farmer organizations involved in coffee, cocoa, cashew nuts, soya beans, and quinoa received most of the loans, with only 24% going to value chains in crops for domestic consumption in 2022 (see Figure 5) (CSAF, 2023b). According to one fund manager interviewed:

“If you are growing organic coffee designed for foreign markets, you can find lenders. But if you are growing cassava or carrots for local markets and want lending in local currency, there is practically nobody. Local lenders have to fill this gap. They are not doing so because sustainable agri-food businesses are not often profitable in the shorter term, and because local lenders do not value the agri-food sector.”

(Fund manager, Shamba Centre enquiry on sustainable finance, 2023)

Figure 5

Volume of lending by value chain in USD millions, 2013-2022

Most financing is going to cash crops destined for export rather than food crops meant for domestic consumption.

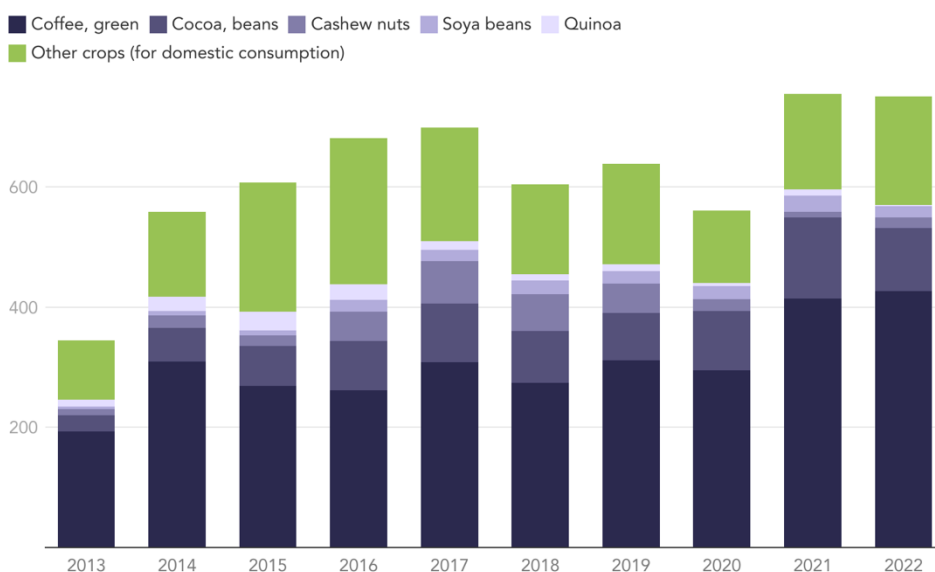


Chart: Lysiane Lefebvre • Source: CSAF Open Data Portal

https://www.datawrapper.de/_/N772j/

Domestic lenders need both incentives and better data on the financial performance of agri-food SMEs to increase lending to the missing middle.

The prevalent perception of risks driven by lack of data, knowledge, and transparency, impedes domestic lenders from lending even when credit lines and guarantees from donors and DFIs are available. Historically, financing for agriculture by domestic lenders in developing countries has been very low and remains so. For example, the proportion of total credit extended to the agricultural sector in Africa increased from 3.9% in 2000 to 4.3% in 2019 (Koloma & Kemeze, 2022). To address this issue, the representative interviewed from [United Nations Economic Commission for Africa \(UNECA\)](#) recommended the development of a credit risk assessment scorecard targeted at domestic lenders.

Credit lines and guarantees may also not be sufficient to increase the risk appetite of domestic lenders.

New incentives are needed to encourage domestic lending. According to one fund manager:

“Traditional loan guarantees provided by donors to local banks don’t often result in lending, as they don’t increase the risk appetite of the local banks to explore the food and agriculture sector. What we therefore need are incentives that motivate and even prompt local banks to say: ‘we are being invited to explore a new market and donors will pay for us to do it.’ In good time, these banks will develop expertise and appetite in the sector and donors can hopefully then step aside.”

(Fund manager, Shamba Centre stakeholder enquiry on sustainable finance, 2023)

Therefore, donors are financing results-based lending that may, over the longer term, increase local lenders' comfort and appetite in the sector. The example of Aceli Africa, funded by the Swiss Development Corporation (SDC), United Kingdom's Foreign, Commonwealth & Development Office (FCDO), USAID, the IKEA Foundation and Convergence is a case in point (see Box 5).

Box 5

Aceli Africa

Aceli Africa provides results-based financial incentives to domestic lenders in Kenya, Rwanda, Tanzania, and Uganda. In the absence of these incentives, local lenders would not be lending to agri-food SMEs. The incentives are designed based on lending data from 31 financial institutions, including local banks, international social lenders, and members of CSAF:

- A partial loan guarantee to domestic lenders for loans between USD 25,000 and 1.75 million.
- Origination incentives for domestic lenders, which cover the costs of providing loans between USD 25,000 to USD 500,000 to SMEs in remote areas or for specific value chains, like local food crops.
- Impact bonuses to domestic lenders for loans extended to SMEs that meet higher requirements on environmental and social performance, gender inclusion, food security, and nutrition.
- Aceli Africa accompanies these incentives with technical assistance to agri-food SMEs and capacity building to domestic lenders.

Aceli Africa's budget for 2020-2025 is USD 75 million, more than 50% of which is used to provide incentives. As of October 2023, Aceli Africa's incentives have supported 1,404 loans totalling USD 142 million (60% of loans to first-time borrowers). The SMEs receiving loans employ 25,000 workers and provide market access to 834,000 smallholder farmers. Enterprises returning for a second loan have increased revenues by 27%.

Sources: SDC, 2022; Brian Milder, personal communication, 12 October 2023

Key Finding 2: Every dollar of concessional finance can mobilize four dollars of commercial finance. However, whether those four dollars deliver on sustainable development will determine if blended finance is truly additional.

Key recommendation 2: Donors and the wider blended finance community can expand the pool of blended finance by:

- i. Reducing transaction costs related to the exploration, negotiation, and conclusion of blended finance transactions.
- ii. Exploring how donors can provide not only first-loss financing, but also lending at commercial rates. Returns on these investments can be put aside for reinvestment into the same or other blended transactions.
- iii. Continuing to provide grants for technical assistance and results-based financing, both of which present opportunities for high levels of additionality.
- iv. Sharing data, saving time, and collaborating on co-financing through a multi-donor working group that is supported by a knowledge hub.

The appetite among donors to experiment with blended financing is growing. This is reinforced by the 2015 Paris Agreement, the 2022 Kunming-Montreal Global Biodiversity Framework, and national policies on climate, nature, and green finance (see Box 6).

Box 6

How donors are participating in blended finance: Tranches and types of funding with examples

| | |
|---------------------------------------|---|
| First Loss | IDB Invest, the Global Environment Facility (GEF), and the Government of Luxembourg are amongst the first loss financiers to the Land Degradation Neutrality Fund, launched in 2017. The fund has a target of USD 300 million, of which roughly 20-30% is reserved for first loss capital (Principles of Responsible Investment, 2019). |
| Equity | In 2021, the AfDB and the European Investment Bank approved equity investments of USD 10 million and USD 18 million respectively, in ARCH Cold Chain Solutions East Africa Fund (African Development Bank Group, 2021). |
| Senior Debt | In 2010, KfW and BMZ committed USD 88 million to establish the Africa Agriculture Trade and Investment Fund (AATIF). KfW holds both equity and senior debt (Burwood-Taylor, 2014). |
| Guarantees and risk mitigation | USAID, via its former Development Credit Authority, provided credit guarantees of up to USD 250 million to the IDH Farmfit Fund, launched in 2018; and of USD 37.5 million to the Food Securities Fund, launched in 2022 (Chemonics and Koiss, 2021). |
| Technical assistance | The Norwegian International Climate and Forest Initiative is the anchor investor in the &Green Fund, launched in 2021, committing a USD 100 million grant. Of this, one million was ringfenced for a dedicated technical assistance budget (&Green, 2023). |
| Project Development grants | The governments of Germany and Luxembourg are funding the Restoration Seed Capital Facility, providing grants of up to USD 750,000 to help launch blended funds on sustainable agriculture (Restoration Seed Capital Facility, 2023). |
| Results-based financing grants | SDC funded Root Capital and Inter America Development Bank's Lab to develop Social Impact Incentives (SIINC). Using SIINC and a USD 1 million initial outcome payment, Roots Impact disbursed USD 12 million in loans to 32 high-impact, early-stage agri-food SMEs (Naeve, 2022). |

The data shows that every dollar of concessional finance, on average, is mobilizing four dollars of commercial finance. The rate at which concessional finance mobilizes commercial finance is known as the **leverage ratio**. Based on data from Convergence, the average leverage ratio across sectors has remained consistent over the last five years, with every dollar of concessional financing mobilizing four dollars of commercial financing (see Figure 6).

Figure 6

Mobilisation of commercial financing by concessional financing

On average, every USD 1 of concessional financing mobilises USD 4.10 of commercial financing.

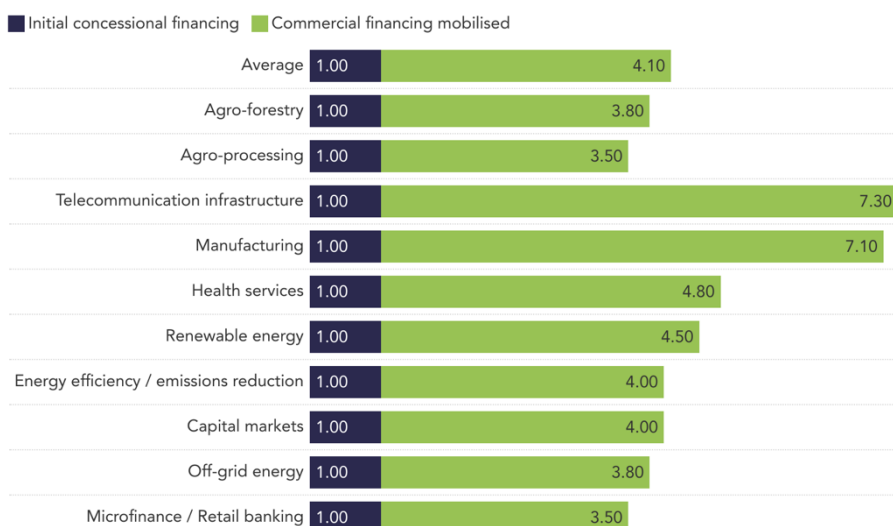


Chart: Lysiane Lefebvre • Source: Convergence, 2023

https://www.datawrapper.de/_zUXiK/

However, of the four dollars of commercial financing mobilized, only USD 1.80 comes from private investors; the remaining USD 2.30 comes mostly from DFIs themselves (see Figure 7). This shows that the blended finance market is dominated by DFIs who are quick to benefit from the concessional finance provided by donor governments. When donors take first loss, DFIs are well positioned to subsequently offer commercial finance using their own funds. This practice represents a missed opportunity for expanding the pool of finance provided by DFIs. DFIs should ideally be offering concessional financing to anchor, de-risk and bring private investors to the table.

Figure 7

Mobilisation of commercial capital by source of financing

Less than half of the USD 4.10 commercial financing mobilized, only USD 1.80, comes from private investors.

■ Concessional financing ■ Commercial financing from development finance institutions and philanthropic sources ■ Commercial financing from private sector investors

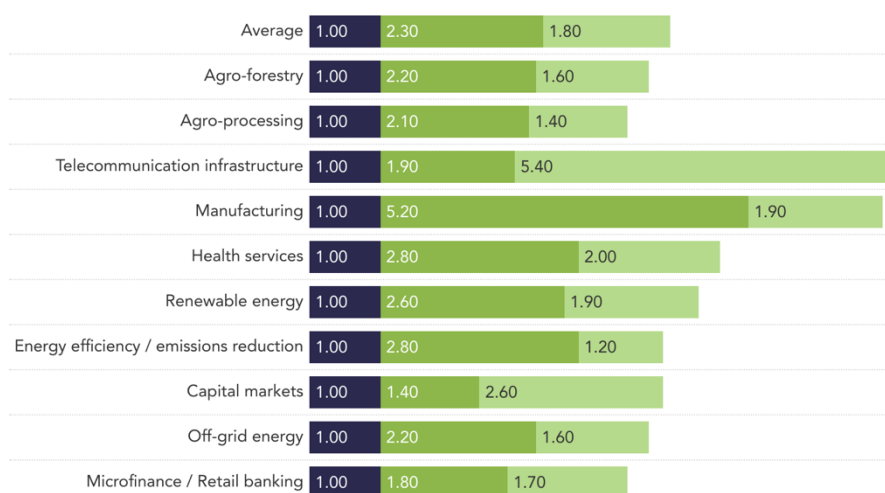


Chart: Lysiane Lefebvre • Source: Convergence, 2023

https://www.datawrapper.de/_/KjYyn/

In the agriculture sub-sectors, on average, every dollar of concessional financing going to agro-forestry mobilizes USD 3.80 of commercial financing, of which only USD 1.60 comes from private investors, and USD 2.20 coming from DFIs and philanthropic financiers (see Figure 7). In the agro-processing sub-sector, every dollar of concessional financing mobilizes USD 3.50 of commercial financing, of which only USD 1.40 comes from private investors, and the remaining USD 2.10, from DFIs (see Figure 7).

Leverage ratios must be treated with caution. They only show part of the picture. For example, leverage ratios do not show how much concessional finance was needed to launch the project or fund. Moreover, it does not demonstrate whether development outcomes were achieved. This is at the heart of the debate around additionality. Using leverage ratios must therefore be accompanied by a comprehensive analysis that considers additionality, i.e., the alignment with development goals and other factors to ensure that the desired positive outcomes for development are achieved without distorting markets (OECD, 2021).

What must also not be ignored is that the billions of dollars in long-term ODA grants create the foundation for blended finance. It is these investments that help to reduce poverty and support agri-food SMEs as they survive, learn, and mature to the level where they may eventually benefit from blended financing. As one blended fund said:

“It is public money that is creating the baseline for us to take companies and farmers organizations to the next level of growth, innovation, and maturity. Without donors patiently building markets and taking the associated risks of failure, we are nowhere.” (Blended fund, Shamba Centre enquiry on sustainable finance, 2023)

Uncertainties on the additionality and opportunity costs of blended finance are undermining efforts to scale up. Some donors remain cautious about blended finance as a large cross-section of the agro-economy remains poor and not sufficiently profitable to meet the expected returns. They also question if the political mood for collaborating with private investors outweighs the opportunity costs, and if scarce ODA grants should even be deployed to explore blended transactions, as many of them may not materialise.

“There is too much attention on the photo opportunity in the launch of a blended fund. Politicians want to be seen to be working with the private sector, but the reality is that agrarian communities remain too poor for blended financing. Should we not continue traditional long-term grants to build these communities rather than invest in exploring blending which, at the end of the day, does not help relieve poverty?”
(Donor agency, Shamba Centre enquiry on sustainable finance, 2023)

“Completing the due diligence on a blended financing transaction takes a lot of time. We need to make sure that the project financial and development impacts [are] feasible, and that commercial lenders will not make excessive gains. We also need to study how we can increase additionality. All this takes times.”
(Donor agency, Shamba Centre enquiry on sustainable finance, 2023)

But donors are innovating on how they participate in blended financing. They view it as an inevitable strategy and one that they need to better understand, manage, and lead. Donors are building internal expertise on structuring funds and exploring how they can directly finance projects (as opposed to financing a financial intermediary).

Moreover, donors are studying how they can move from providing concessional to commercial financing. The latter bringing market-rate returns, which donors are seeking to ringfence, and reallocate to results-based financing within the same fund. This is already evident in blending data. Between 2015 and 2020, development agencies and multi-donor funds predominantly offered concessional financing: 87% of their blended finance commitments were provided under concessional terms, with the remaining 13% priced at commercial rates (Convergence, 2021). As one donor said:

“We need to make our de-risking financing work even more. Traditionally, we provide first-loss. But now, we are looking to change the way we are governed to invest in blended funds directly and to take mezzanine debt. This is new for us – as donors, we receive returns on our investments, so we need to organise how to deal with these returns. We are now studying how these returns can be retained and reused – either in the same blended fund and/or for outcome-based financing (or pay-for-performance financing).”
(Donor agency, Shamba Centre enquiry on sustainable finance, 2023)

During the enquiry, most of the stakeholders voiced support for a multi-donor working group and knowledge hub that would allow for the experience sharing. They said the additional benefits of such a service would be:

- Providing a single window gathering project sponsors, fund managers, investment advisors, DFIs, and NGOs.
- Reducing transaction costs through joint due diligence, stakeholder consultations, and expert advice on fund structures.
- Collaborating on an aggregated project development seed facility – perhaps along with the UNEP Restoration Seed Capital Facility.
- Collaborating and co-financing outcome-based schemes (also called pay-for-performance financing and blended financing).

"There is value in 'aggregating' due diligence, co-financing and experience on blended finance and pay-for-performance financing. This will help us scale blended financing more quickly."

(Donor agency, Shamba Centre stakeholder enquiry on sustainable finance, 2023)

Key Finding 3: Development finance institutions are governed by rules that discourage them from taking risks to provide finance that would otherwise not be available from commercial lenders.

Key recommendation 3: Donor governments must provide development finance institutions with dedicated funds that allow them to:

- i. Offer higher risk loans, such as first loss and mezzanine debt, that have well-defined targets on sustainable food and agriculture;
- ii. Provide long-term credit lines, loan guarantees, transaction advice, and technical assistance to domestic lenders. to build institutional capacity; and
- iii. Accompany institutions, funds, and projects over the long term.

Ensuring that development finance institutions offer financing that no commercial provider would otherwise provide is the real testament to additionality. DFIs are governed by prudential rules and statutes that prevent them from lending to high-risk projects. DFIs also hold investment-grade credit ratings (rated AA or AAA by Standard and Poor and Fitch Ratings) and, to maintain these high ratings, their prudential regulations discourage excessive risk-taking. As the food and agriculture sector tends to offer lower financial returns compared with other sectors, DFIs are usually hesitant to lend to food and agriculture projects. When they do, they tend to provide senior debt, rather than first-loss financing (see Box 3).

There are some exceptions. For example, the United States International Development Finance Corporation (DFC) is financed almost entirely through budget allocations and therefore may be able to take on more risks than other DFIs which may need to uphold their credit rating. On the other hand, DFIs that maintain investment-grade credit ratings can raise cheaper capital and lend to projects in higher-risk countries (Horrocks, n.d.).

The debate heightens when considering whether senior debt loans provided by DFIs crowd out commercial lenders. Stakeholders interviewed had different views on this matter. According to one commercial lender interviewed:

“Development finance institutions are almost a competitor to us. They take senior debt, and we ask: ‘what is their additionality?’”

(Commercial bank investing in agriculture, Shamba Centre enquiry on sustainable finance, 2023)

Similarly, one fund manager remarked:

“Development finance institutions must take on more risk. What is their value when they don't provide first-loss financing?”

(Fund manager, Shamba Centre enquiry on sustainable finance, 2023)

However, DFIs were unequivocal in saying that they compete more amongst themselves than with private commercial lenders. They also considered their role to be that of an anchor lender, bringing comfort to other commercial lenders that they may then invest alongside them (see Box 7).

Box 7

Proparco and the Food and Agriculture Resilience Mission (FARM)

An example of how development finance institutions (DFIs) can increase their risk tolerance is the Food and Agriculture Resilience Mission (FARM) initiative, announced by French President Emmanuel Macron at the G7 Summit in March 2022. Through FARM's third pillar, which focuses on strengthening local agricultural production in vulnerable countries, AFD enabled Proparco, the French DFI, to allocate a grant of EUR 230,000 to Advans Côte d'Ivoire, a microfinance institution, to support a pilot program. The programme aims to extend loans to corn cooperatives for the acquisition of quality inputs and provide technical assistance to significantly enhance crop yields (Proparco, 2023). In the absence of this dedicated finance, Proparco would have unlikely been able to support this high-risk pilot programme.

European Bank for Reconstruction and Development (EBRD) provides portfolio guarantees as an implementing partner of the European Union's InvestEU EU Programme.

Through the Invest EU programme, the EBRD is providing portfolio guarantees of up to EUR 470 million to eligible financial intermediaries. The guarantees will cover loans for improving energy efficiency and reducing greenhouse gas emission from buildings and transports (EBRD, 2023).

Key Finding 4: More research and data on the performance of agri-food SME loans that originate from donors is a prerequisite to make ODA catalytic.

Key Recommendation 4: Donors should create a data repository on the performance of agri-food SME loans, based on the experiences of the [Council on Smallholder Agricultural Finance \(CSAF\)](#) and [MIX Market](#).

To scale lending and blending, donors need research and data on the loans they provide to agri-food SMEs. They also need to be able to compare their own portfolios of agri-food enterprise loans with those of other donors and DFIs. While donors may be collecting this information, there is no public data repository where this data could be recorded, cleaned, and prepared for investment decisions. The lack of comparable data impedes transparency and the development of market insight that is so critical for building inclusive markets.

CSAF, a network of impact investors, is a successful example on the value added of sharing and analysing data collectively. CSAF broke new ground in collecting and analysing data on loans that originate from donor funds which are disbursed by CSAF members to agri-food SMEs in developing countries. Data is collected on loans by region, sizes, existing versus new borrowers, informal and less developed value chains, and contract duration. CSAF members benefit from comparative analyses and on finding solutions to common challenges. [Aceli Africa](#) was launched, in part, to address some of these challenges.

Other examples include MIX Market, a data catalogue for financial service providers targeting the unbanked in developing countries, and the [Smallholder and Agri-SME Finance and Investment Network \(SAFIN\)](#) which provides resources and designs clinics to help SMEs prepare due diligence for investors.

During the enquiry, several stakeholders voiced support for a wider data repository on agri-food SME loans, based on the experiences of CSAF and MIX Market.

Conclusion

The political mood for high-risk financing has perhaps never been greater and the innovations that await a high-risk appetite will produce the food systems of tomorrow. It is hence time for bolder financing strategies to make the donor dollar stretch even further.

The Shamba Centre's enquiry on sustainable finance in agri-food systems demonstrates how donors are exploring ways to complement their traditional concessional financing with commercial lending. In tandem, DFIs appear to be ready to work with dedicated funds to take on more risks and accompany institutions, funds, and projects into the longer term.

Implementing these ideas will require widespread changes by donors, DFIs, and their beneficiaries in developing countries. The catalytic power and the demonstration effect of donor financing must not be underestimated. If donors and DFIs change their risk-return sentiment to aim for even greater additionality, they promise to make agri-food development finance truly transformative.

References

- &Green. 2023. *Our Structure*. [Online]. [Accessed 22 September 2023]. Available from: <https://www.andgreen.fund/about-us/>
- African Development Bank. 2021. *Dakar 2 Summit: Development partners commit \$30 billion to boost food production in Africa*. African Development Bank. [Press Release]. [Accessed 14 September 2023]. Available from: <https://www.afdb.org/en/news-and-events/press-releases/dakar-2-summit-development-partners-commit-30-billion-boost-food-production-africa-58598>
- African Development Bank Group. 2021. *African Development Bank approves \$10 million equity investment to boost cold storage and distribution of food, pharmaceuticals, in East Africa*. [Online]. African Development Bank Group. [Accessed 14 September 2023]. Available from: <https://www.afdb.org/en/news-and-events/press-releases/african-development-bank-approves-10-million-equity-investment-boost-cold-storage-and-distribution-food-pharmaceuticals-east-africa-46442>
- Akademiya2063 and Zentrum für Entwicklungsforschung (ZEF). 2020. *From Potentials To Reality: Transforming Africa's Food Production. Investment And Policy Priorities For Sufficient, Nutritious And Sustainable Food Supplies*. Program of Accompanying Research for Agricultural Innovation (PARI). Available from: https://www.zef.de/fileadmin/downloads/ZEF_Akademiya2063.pdf
- Burwood-Taylor, L. 2014. *German impact fund supports African agriculture*. [Online]. Agri Investor. [Accessed 23 September 2023]. Available from: <https://www.agriinvestor.com/kfw-led-agri-fund-lends-african-agriculture/>
- Chemonics and Kois. 2021. *Blended Finance for Agricultural Finance*. [Online]. [Accessed 21 September 2023]. Available from: https://chemonics.com/wp-content/uploads/2021/07/Blended-Finance-for-Agricultural-Finance_Final.pdf
- Convergence. 2021. *The State of Blended Finance 2021*. [Online]. [Accessed 17 September 2023]. Available from: <https://www.convergence.finance/resource/the-state-of-blended-finance-2021/view>
- Convergence. 2022. *The State of Blended Finance 2022: Climate Edition*. [Online]. [Accessed 17 September 2023]. Available from: <https://www.convergence.finance/resource/state-of-blended-finance-2022/view>
- Council on Smallholder Agricultural Finance (CSAF). 2018. *State of the Sector 2018*. [Online]. Council on Smallholder Agricultural Finance. [Accessed 27 September 2023]. Available from: https://www.csaf.org/wp-content/uploads/2018/08/CSAF_State_of_the_Sector_2018_FINAL.pdf
- Council on Smallholder Agricultural Finance (CSAF). 2023a. *CSAF Open Data Portal*. [Online]. [Accessed 20 September 2023]. Available from: <https://data.csaf.org>
- Council on Smallholder Agricultural Finance (CSAF). 2023b. *State of the Sector 2023*. [Online]. Council on Smallholder Agricultural Finance. [Accessed 21 September 2023]. Available from: https://csaf.org/wp-content/uploads/2023/07/CSAF_State_of_Sector_2023.pdf

- European Bank for Reconstruction and Development [EBRD]. 2023. InvestEU Green Uncapped Portfolio Guarantee Framework. [Accessed 15 October 2023]. Available from: <https://www.ebrd.com/work-with-us/projects/psd/54186.html>
- Food and Agriculture Organization of the United Nations [FAO], International Fund for Agricultural Development [IFAD], United Nations Children's Fund [UNICEF], World Food Programme [WFP], and World Health Organization [WHO]. 2020. *The State of Food Security and Nutrition in the World 2020 - Transforming food systems for affordable healthy diets* [Online]. Rome: FAO, IFAD, UNICEF, WFP and WHO. Available from: <http://www.fao.org/3/ca9692en/CA9692EN.pdf>.
- Horrocks, P. n.d. *Does the development finance system have the right level of risk, return and impact to mobilise the private sector and deliver development?* [Online]. EDFI. [Accessed 17 September 2023]. Available from: <https://www.edfi.eu/insight/does-the-development-finance-system-have-the-right-level-of-risk-return-and-impact-to-mobilise-the-private-sector-and-deliver-development/>
- ISF Advisors. 2022. *The state of the agri-SME sector – Bridging the finance gap*. [Online]. Commercial Agriculture for Smallholders and Agribusiness (CASA). [Accessed 14 September 2023]. Available from: https://isfadvisors.org/wp-content/uploads/2022/04/ISF_AgriSME-Finance-state-of-the-sector-report.pdf
- K4D. 2021. *K4D International Nature Learning Journey. Session 5: Increasing financial flows and the role of finance in sustaining nature*. [Online]. K4D. [Accessed 24 September 2023]. Available from: <https://www.ids.ac.uk/download.php?file=wp-content/uploads/2021/07/K4D-International-Nature-Learning-Journey-Session-5-summary.pdf>
- Koloma, Y., and Kemeze, F. H. 2022. *COVID-19 and perceived effects on agricultural financing in Africa: Evidence and policy implications*. [Online]. [Accessed 25 September 2023]. Available from: <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC9349708/>
- Laborde, D., Murphy, S., Parent, M., Porciello, J. and Smaller, C. 2020. *Ceres2030: Sustainable Solutions to End Hunger - Summary Report*. International Food Policy Research Institute (IFPRI), International Institute for Sustainable Development (IISD), and Cornell University. Available from: https://ceres2030.iisd.org/wp-content/uploads/2021/03/ceres2030_en-summary-report.pdf.
- Naeve, K. 2022. *How Impact-Linked Finance Incentivizes High- Impact Investment in Agricultural SMEs. A Case Study of Root Capital's Social Impact Incentives (SIINC) Project*. [Online]. Root Capital. [Accessed 19 September 2023]. Available from: <https://rootcapital.org/wp-content/uploads/2022/01/How-Impact-Linked-Financing-Incentivizes-High-Impact-Investment-in-Agricultural-SMEs.pdf>
- Organisation for Economic Co-operation and Development. 2020. *Blended Finance Principles Guidance*. [Online]. [Accessed 20 September 2023]. Available from: [https://one.oecd.org/document/DCD/DAC\(2020\)42/FINAL/En/pdf](https://one.oecd.org/document/DCD/DAC(2020)42/FINAL/En/pdf)
- Organisation for Economic Co-operation and Development. 2021. *OECD DAC Blended Finance Principle 2: Design blended finance to increase the mobilisation of commercial finance*. [Online]. Organisation for Economic Co-operation and Development. [Accessed 19 September 2023]. Available from: https://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/documents/Principle_2_Guidance_Note_and_Background.pdf

- Organisation for Economic Co-operation and Development. 2023. Creditor Reporting System (CRS). *OECD.Stat.* [Online]. [Accessed 16 September 2023]. Available from: <https://stats.oecd.org/Index.aspx?DataSetCode=crs1#>.
- Proparco. (2023, June 9). In Côte d'Ivoire, Advans supports small corn producers, with support from Proparco. <https://www.proparco.fr/en/actualites/cote-divoire-advans-supports-small-corn-producers-support-proparco>
- Principles for Responsible Investment (PRI). 2019. *PRI Awards 2019 case study: Land Degradation Neutrality Fund.* [Online]. [Accessed 15 September 2023]. Available from: <https://www.unpri.org/showcasing-leadership/pri-awards-2019-case-study-land-degradation-neutrality-fund/4845.article>
- Restoration Seed Capital Facility. 2023. *About Us.* [Online]. [Accessed 24 September 2023]. Available from: <https://restorationfacility.org/about/>
- SAFIN and ISF. 2020. *Agri-SME Taxonomy: Learning Brief.* [Online]. SAFIN and ISF. [Accessed 16 September 2023]. Available from: https://safinetwork.org/wp-content/uploads/2023/03/e03597_6cc65702918e4bdeae734f54b3585b32.pdf
- SDC. 2017. *SDC Handbook on Private Sector Engagement.* [Online]. Swiss Agency for Development and Cooperation (SDC). [Accessed 18 September 2023]. Available from: https://www.eda.admin.ch/dam/deza/en/documents/die-deza/strategie/Handbook_PSE_EN.pdf
- SDC. 2022. *Incentivising Lenders: The Case of the Catalytic Market Facility Aceli Africa (Aceli). Case Study.* [Online]. Swiss Agency for Development and Cooperation (SDC). [Accessed 18 September 2023]. Available from: <https://www.shareweb.ch/site/EI/Documents/PSE/PSE%20Toolbox/SDC%20Case%20Study%20Catalytic%20Market%20Facility%20Aceli%20Africa%20%28Aceli%29.pdf>
- United Nations. 2015. *Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda).* [Online]. Addis Ababa, Ethiopia. [Accessed 18 September 2023]. Available from: https://sustainabledevelopment.un.org/content/documents/2051AAAA_Outcome.pdf
- United States Agency for International Development (USAID). n.d. *Glossary Terms and Definitions.* [Online]. [Accessed 25 September 2023]. Available from: <https://www.usaid.gov/energy/mini-grids/glossary>
- von Braun, J., Chichaibelu, B.B., Torero Cullen, M., Laborde, D. and Smaller, C. 2020. *Ending Hunger by 2030 – policy actions and costs* [Online]. International Institute for Sustainable Development (IISD), International Food Policy Research Institute (IFPRI), Cornell University, and Zentrum für Entwicklungsforschung (ZEF). [Accessed 19 September 2023]. Available from: https://www.zef.de/fileadmin/downloads/SDG2_policybrief.pdf.

Annex 1: List of Stakeholders Engaged

The Shamba Centre engaged with 69 organizations and 12 individual experts as part of its enquiry on sustainable finance in agri-food systems.

| | |
|---|---|
| Banks / Asset Managers | Climate Asset Management CRDB Bank Equity Group National Bank of Commerce Tanzania NMB Bank Tanzania Rabobank UBS Investor Watch |
| Blended Funds | ABC Fund Investment Committee Aceli Africa Acumen Fund AgDevCo AGRI-3 ASN Fund / Aqua-Spark Council on Smallholder Agriculture Finance (CSAF) Food Securities Fund Incofin Land Degradation Neutrality Fund (LDN Fund) |
| Consulting Firms | JBQ Africa McKinsey & Company Sahel Consulting |
| Development finance institutions | Agence Francaise de Developpment (AFD) Dutch Entrepreneurial Development Bank (FMO) KfW Proparco |
| Donors | Dutch Ministry of Foreign Affairs (MINBUZA) European Commission (EC) European Commission (EC) - DG CLIMA European Commission (EC) - DG ENVIRONMENT French Ministry for Europe and Foreign Affairs German Federal Ministry for Economic Cooperation and Development (BMZ) GIZ Swiss Agency for Development and Cooperation (SDC) UK Foreign, Commonwealth & Development Office (FCDO) US Agency for International Development (USAID) |

| | |
|--|--|
| Finance Networks | <p>Convergence</p> <p>Ecosystems Knowledge Network</p> <p>Global Impact Investor Network (GIIN)</p> <p>Good Food Finance Network</p> <p>Green Fintech Network</p> <p>International Investor Group on Climate Change (IIGCC)</p> <p>Sustainable Finance Geneva</p> <p>Swiss Sustainable Finance</p> |
| International Organizations | <p>International Finance Corporation</p> <p>OECD Green Finance</p> <p>Smallholder and Agri-SME Finance and Investment Network (SAFIN)</p> <p>United Nations Development Programme Sustainable Finance Hub</p> <p>United Nations Environment Programme (UNEP) Economics of Ecosystems and Biodiversity (TEEB)</p> <p>World Bank</p> |
| Investment Research & Knowledge | <p>CICERO Shades of Green</p> <p>Institutional Investor</p> |
| Non-Governmental Organizations | <p>Africa Enterprise Challenge Fund (AECF)</p> <p>AGRA</p> <p>Climate Policy Initiative (CPI)</p> <p>Environmental Defense Fund (EDF)</p> <p>IDH</p> <p>International Union for the Conservation of Nature (IUCN)</p> <p>Landscape Finance Lab</p> <p>Taskforce on Nature-related Financial Disclosures (TNFD)</p> <p>World Resources Institute (WRI)</p> <p>World Wildlife Fund (WWF)</p> |
| Philanthropies | <p>Bill and Melinda Gates Foundation</p> <p>Mastercard Foundation</p> <p>Rockefeller Foundation</p> |
| Private Companies | <p>AFEX</p> |
| Public Funds | <p>European Bank for Reconstruction and Development (EBRD)</p> <p>Global Environment Facility (GEF)</p> <p>Good Agriculture & Food Security Program (GAFSP)</p> <p>Green Climate Fund (GCF)</p> <p>International Fund for Agricultural Development (IFAD)</p> |
| + 12 Individual Experts | |