Findings and recommendations

The enquiry into sustainable finance in agrifood 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 to the realization of SDG 2. They are based on inputs from engagement with representatives of 69 organizations and 12 individual experts.

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

KEY FINDING 1: Blended finance can make the biggest contribution to SDG 2 by focusing on the missing middle: agrifood SMEs seeking finance of between US$50,000 and US$2 million (see Box 4).

KEY RECOMMENDATION 1: Donors and DFIs can increase the flow of finance to agrifood SMEs by:

i. building the agrifood expertise and risk appetite of domestic lenders, including developing an agrifood credit risk assessment scorecard, as proposed by the United Nations Economic Commission for Africa;
ii. scaling up priority lending programmes and results-based lending incentives for domestic banks, encouraging them to use their own balance sheets to lend to agrifood SMEs;
iii. increasing finance for affordable, indemnity-based, weather-indexed and crop-indexed insurance;
iv. incorporating bookkeeping and accounting skills into SME technical assistance programmes.

KEY FINDING 2: Every dollar of concessional finance can mobilize four dollars of commercial finance (see Figure 6); however, whether those four dollars deliver a sustainable development impact will determine if blended finance can bring not only financial additionality but also development additionality.

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 (see Box 3) but also lending at commercial rates, where returns on these investments can be ring-fenced for reinvestment into the same or other blended transactions;

iii. continuing to provide grants for technical assistance for SMEs and domestic lenders, as they bring high levels of financial and development additionality;

iv. sharing data, reducing transaction costs and collaborating on cofinancing through the creation of a multi-donor working group, supported by a sustainable finance knowledge hub.

KEY FINDING 3: DFIs 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 DFIs 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, guarantees, transaction advice and technical assistance to domestic financial institutions to build institutional knowledge on sustainable agrifood systems.

KEY FINDING 4: More research and data on the performance of agrifood SME loans that originate from donors are a prerequisite for making ODA more catalytic.

KEY RECOMMENDATION 4: Donors should create a data repository on the performance of agrifood 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. These loans 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 guarantees are guarantees provided by a third party who agrees to repay the loan if the borrower defaults.

Sources: K4D, 2021; SDC, 2017; USAID, 2023


BEINCO

KEY FINDING 1

Blended finance can make the biggest contribution to SDG 2 by focusing on the missing middle: agrifood SMEs seeking finance of between US$50,000 and US$2 million.

KEY RECOMMENDATION 1

Donors and DFIs can increase the flow of finance to agrifood SMEs by:

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iii. increasing finance for affordable, indemnity-based, weather-indexed and crop-indexed insurance;

iv. incorporating bookkeeping and accounting skills into SME technical assistance programmes.

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 US$18,700 on a loan of US$665,000 to agrifood SMEs, excluding the cost of funds. CSAF also found that loans below US$500,000 carried an 80 per cent higher risk of default than larger loans (CSAF, 2018).

BOX 4 WHO IS THE MISSING MIDDLE?

The missing middle refers to agrifood SMEs seeking finance of between US$50,000 and US$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 agrifood 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 and ISF Advisors, 2020, p. 2). They must be able to service an investment of US$50,000 to US$2 million, have more than 5 but less than 250 employees, have an annual turnover of US$100,000 to US$5 million and/or have total assets of at least US$20,000 (SAFIN and ISF Advisors, 2020).

This results in an agrifood SME financing gap estimated at US$106 billion annually across sub-Saharan Africa and South-East Asia (see Figure 4) (ISF Advisors, 2022).

Despite active efforts from impact investors, agrifood 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 rate fluctuations. 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 working 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). Agrifood SMEs and farmers' organizations involved in coffee, cocoa, cashew nuts, soya beans and quinoa received most of the loans, with only 24 per cent going to value chains of other crops for domestic consumption in 2022 (see Figure 5) (CSAF, 2023b).

FIGURE 4 **THE AGRIFOOD SME FINANCING GAP ACROSS SUB-SAHARAN AFRICA AND SOUTH-EAST ASIA IS ESTIMATED AT US$160 BILLION (66 PER CENT OF TOTAL FINANCING NEED) ANNUALLY**

Agrifood SME financing gap across sub-Saharan Africa and South-East Asia in billions of United States dollars

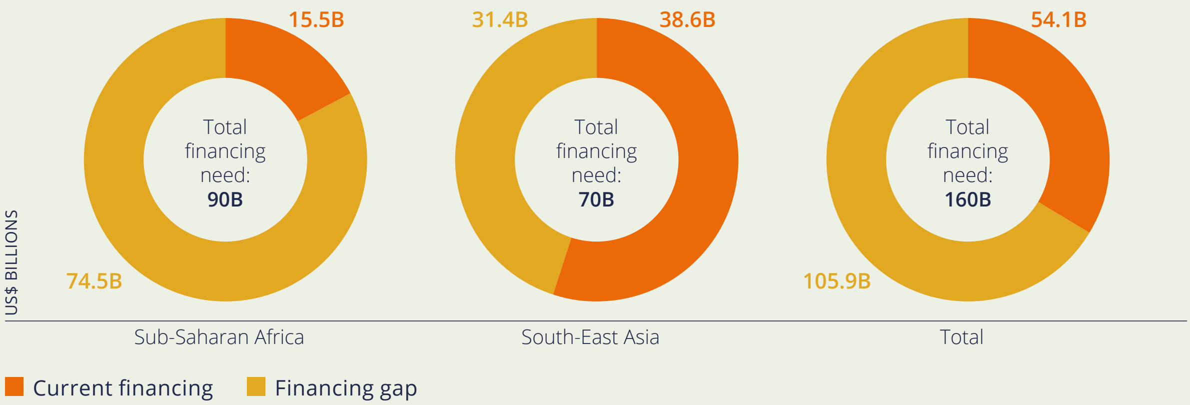


Chart: Lysiane Lefebvre | *Source:* ISF Advisors, 2022

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 agrifood businesses are not often profitable in the shorter term, and because local lenders do not understand the agrifood sector."
>
> (Fund manager, Shamba Centre enquiry into sustainable finance, 2023)

Domestic lenders need both incentives and better data on the financial performance of agrifood 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 per cent in 2000 to 4.3 per cent in 2019 (Koloma and Kemeze, 2022). To address this issue, the representative interviewed from the United Nations Economic Commission for Africa recommended the development of a credit risk assessment scorecard targeted at domestic lenders.

FIGURE 5 **MOST FINANCING IS GOING TO CASH CROPS DESTINED FOR EXPORT RATHER THAN FOOD CROPS MEANT FOR DOMESTIC CONSUMPTION**

Volume of lending by value chain in millions of United States dollars, 2013–2022

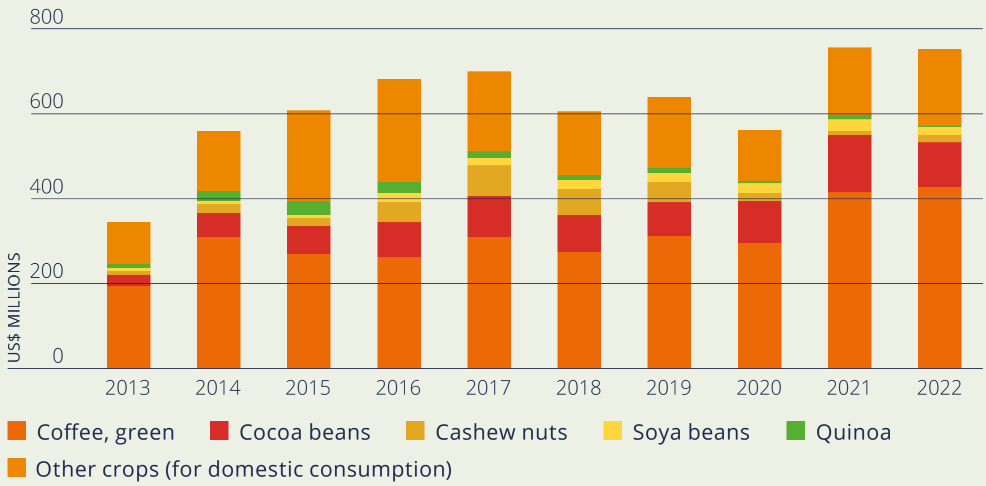


Chart: Lysiane Lefebvre | *Source:* CSAF, 2023a

Credit lines and guarantees may also not be sufficient to increase the risk appetite of domestic lenders. Stakeholders provided anecdotal evidence of credit lines and guarantees that remained nearly unused due, in part, to the lack of agrifood expertise within domestic banks.

New incentives, such as priority lending and results-based financing, are therefore needed to increase domestic banks' comfort and appetite in the sector (see Box 5). The example of Aceli Africa, funded by the Swiss Agency for Development and Cooperation, the United Kingdom's Foreign, Commonwealth & Development Office, the United States Agency for International Development, the IKEA Foundation and Convergence, is a case in point (see Box 6).

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 times, these banks will develop expertise and appetite in the sector and donors can hopefully then step aside."
>
> (Fund manager, Shamba Centre enquiry into sustainable finance, 2023)

Insurance is key to improving SMEs' credit risk profiles and their eligibility for pre-harvest financing. Insurance remains underdeveloped: out of the 600 million farmers in Africa, only 600,000 have insurance coverage (Stevens, 2023). Continued donor financing is needed to increase affordable, indemnity-based, weather-indexed and crop-indexed insurance to the missing middle (see Box 7).

BOX 5 WHAT IS PRIORITY LENDING?

Priority lending programmes are designed and led by central banks to increase lending to economically important but less profitable sectors of the economy that would otherwise not receive affordable and timely credit.

As part of programme implementation, retail banks are issued with sector-specific lending targets that are accompanied by tradeable priority sector certificates. Banks exceeding their lending targets can trade their surplus certificates with those that fall short. In the absence of tradeable priority certificates, central banks can require banks that do not meet lending targets to lend to public institutions at very low interest rates. Priority lending does not require banks to lend at lower interest rates, but rather to develop sector-specific experience and risk appetite.

What is results-based financing?
Results-based financing involves a financier being willing to make payments to an agent who assumes responsibility for achieving predefined results. Results-based financing is thus made available once predefined results have been achieved and independently verified.

Source: OECD, 2014

Technical assistance to SMEs needs to focus on financial skills, such as bookkeeping and accounting, to help them better manage equity and loans from commercial and concessional finance. Stakeholders participating in the enquiry highlighted that many SMEs do not have the financial literacy and accounting skills to work with domestic banks, DFIs and private investors. This lack of skills does not inspire investor confidence, which is key to improving access to finance. Donors also highlighted that technical assistance with bookkeeping and accounting was nascent and provision should increase.

BOX 6 ACELI AFRICA

Aceli Africa provides results-based financial incentives to domestic lenders in Kenya, Rwanda, the United Republic of Tanzania, and Uganda. In the absence of these incentives, local lenders would not be lending to agrifood 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 is given to domestic lenders for loans of between US$25,000 and US$1.75 million.
- Origination incentives for domestic lenders cover the costs of providing loans of between US$25,000 and US$500,000 to SMEs in remote areas or for specific value chains, such as local food crops.
- Impact bonuses are given 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 for agrifood SMEs and capacity-building for domestic lenders.

Aceli Africa's budget for 2020–2025 is US$75 million, more than 50 per cent of which is used to provide incentives. As of October 2023, Aceli Africa's incentives had supported 1,404 loans totalling US$142 million (60 per cent 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 per cent.

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

BOX 7 NATIONAL AGRICULTURE INSURANCE SCHEME, RWANDA

Despite the participation of local insurers and international underwriters, the launch of an agricultural insurance pilot in Rwanda in 2011 was met with low demand for insurance. This was due to the high cost of premiums and low levels of awareness of the benefits of insurance for agrifood SMEs and smallholder farmers.

In 2019, the Ministry of Agriculture and Animal Resources launched the National Agriculture Insurance Scheme in partnership with three insurance companies: SONARWA, Prime Insurance and Radiant. The scheme involved government subsidies that covered 40 per cent of the premium payments for weather-indexed and yield-indexed insurance. This increased the eligibility of smallholder farmers and SMEs for pre-harvest financing.

The One Acre Fund, supported by donor concessional finance, is also a key participant in developing Rwanda's agricultural insurance market.

Source: Access Finance Rwanda, 2020

KEY FINDING 2

Every dollar of concessional finance can mobilize four dollars of commercial finance; however, whether those four dollars deliver a sustainable development impact will determine if blended finance can bring not only financial additionality but also development additionality.

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, where 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 for SMEs and domestic lenders, as they bring high levels of financial and development additionality;

iv. sharing data, reducing transaction costs and collaborating on cofinancing through the creation of a multi-donor working group, supported by a sustainable finance knowledge hub, to share data, save time and collaborate on cofinancing.

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 8).

BOX 8 HOW DONORS ARE PARTICIPATING IN BLENDED FINANCE: TRANCHES AND TYPES OF FUNDING WITH EXAMPLES

First loss
Inter-American Development Bank Invest, the Global Environment Facility and the Government of Luxembourg are among the first-loss financiers of the Land Degradation Neutrality Fund, launched in 2017. The fund has a target of US$300 million, of which roughly 20-30 per cent is reserved for first-loss capital (Principles for Responsible Investment, 2019).

Equity
In 2021, the African Development Bank and the European Investment Bank approved equity investments of US$10 million and US$18 million, respectively, in the ARCH Cold Chain Solutions East Africa Fund (African Development Bank Group, 2021b).

Senior debt
In 2010, KfW Development Bank (KfW) and the German Federal Ministry of Economic Cooperation and Development committed US$88 million to establish the Africa Agriculture and Trade Investment Fund. KfW holds both equity and senior debt (Burwood-Taylor, 2014).

Guarantees and risk mitigation
The United States Agency for International Development, through its former Development Credit Authority, provided credit guarantees of up to US$250 million to the IDH Farmfit Fund, launched in 2018, and of US$37.5 million to the Food Securities Fund, launched in 2022 (Chemonics and Kois, 2021).

Technical assistance
The Norwegian International Climate and Forest Initiative is the anchor investor in the &Green Fund, launched in 2021, committing a US$100 million grant. Of this, US$1 million was ring-fenced 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 US$750,000 to help launch blended funds on sustainable agriculture (Restoration Seed Capital Facility, 2023).

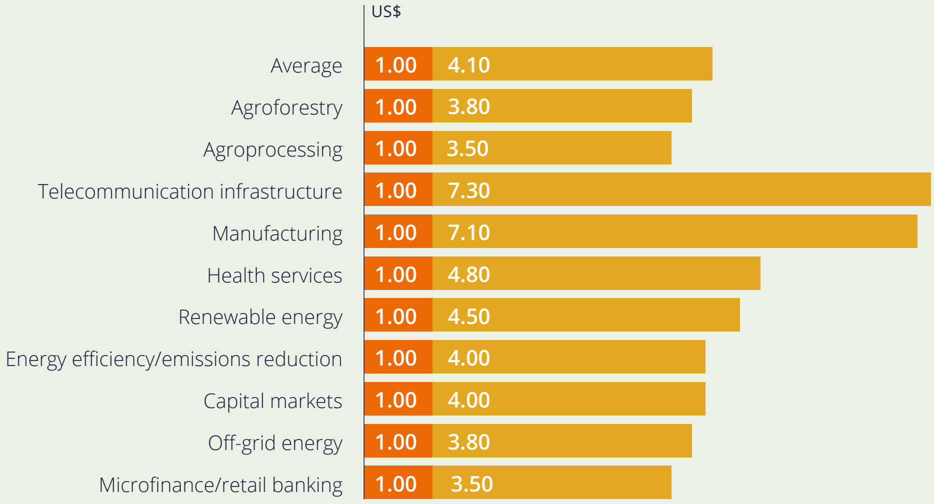
Results-based financing grants
The Swiss Agency for Development and Cooperation funded the Root Capital and Inter-American Development Bank Lab to develop social impact incentives. Using these incentives and a US$1 million initial outcome payment, Roots of Impact disbursed US$12 million in loans to 32 high-impact, early-stage agrifood SMEs (Naeve, 2022).

The data show 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.** 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 (Convergence, 2023) (see Figure 6).

However, of the US$4.10 of commercial financing mobilized, only US$1.80 comes from private investors; the remaining US$2.30 comes mostly from DFIs themselves (see Figure 7). This shows that the blended finance market is dominated by DFIs who benefit from the concessional finance provided by donor governments. When donors take the first loss, DFIs are well positioned to subsequently offer commercial finance using their own funds.

FIGURE 6 ON AVERAGE, EVERY US$1.00 OF CONCESSIONAL FINANCING MOBILIZES US$4.10 OF COMMERCIAL FINANCING

Leverage ratio across sectors

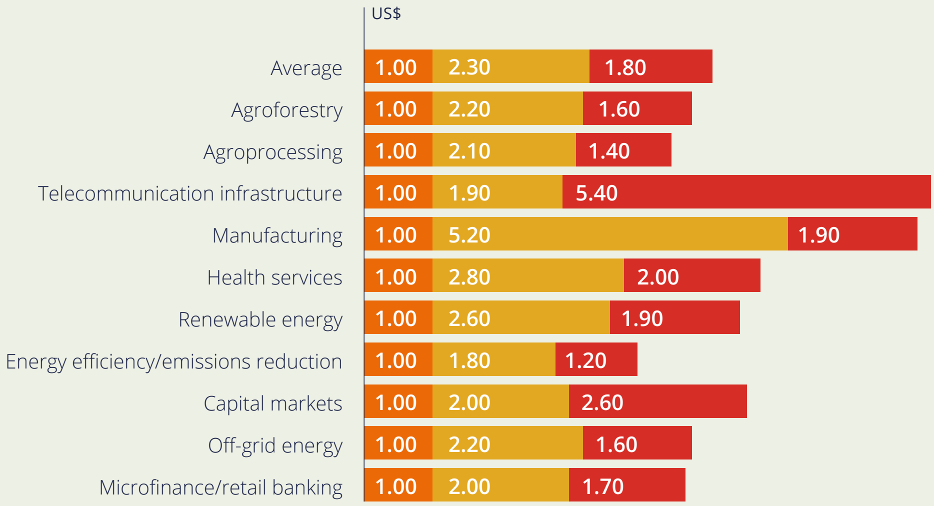


Initial concessional financing
Commercial financing mobilized

Chart: Lysiane Lefebvre | *Source:* Convergence, 2023

FIGURE 7 LESS THAN HALF OF THE COMMERCIAL FINANCE MOBILIZED IS SOURCED FROM PRIVATE INVESTORS

Breakdown of commercial financing in the leverage ratio, across sectors, in United States dollars



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

Chart: Kamal El Harty | *Source:* Convergence, 2023

This speaks to the DFIs' definition of blended finance, which is the combination of donor concessional finance with their own-account and/or commercial finance to mobilize private sector financing (see Box 2). This practice, however, represents a missed opportunity for expanding the pool of blended finance, as DFIs should ideally be complementing donor concessional finance with additional financing provided at below-market rates to anchor and de-risk investment by private investors.

In the **agriculture subsectors**, on average, every US$1.00 of concessional financing going to agroforestry mobilizes US$3.80 of commercial financing, of which only US$1.60 comes from private investors while US$2.20 comes from DFIs and philanthropic financiers (see Figure 7). In the agroprocessing subsector, every US$1.00 of concessional financing mobilizes US$3.50 of commercial financing, of which only US$1.40 comes from private investors and the remaining US$2.10 comes from DFIs (see Figure 7).

Leverage ratios must be treated with caution because they only show part of the picture. For example, leverage ratios do not show how important concessional financing was to launching the project/ fund. Moreover, they do 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 – that is, the alignment with development goals and other factors to ensure that the desired positive outcomes for development are achieved without distorting markets (OECD, 2021).

Leverage ratios can also increase over time. For example, when DFIs provide guarantees to domestic banks to encourage lending to riskier borrowers, the leverage ratio is higher, as it includes the loans disbursed by the domestic banks. Similarly, as blended funds mature and their track records improve, they attract more private investors (see Box 9).

What must also not be ignored is that it is the billions of dollars in long-term ODA grants that create the foundation for blended finance. It is these grant investments that help to reduce poverty and support agrifood 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 into sustainable finance, 2023)

BOX 9 **LEVERAGE RATIO OF THE AGRI3 FUND**

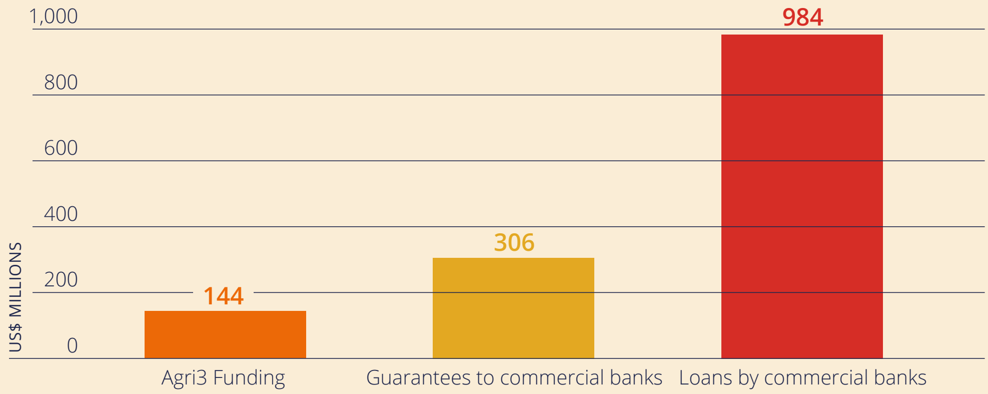
The AGRI3 Fund, launched in 2020 by the United Nations Environment Programme and Rabobank, together with the Sustainable Trade Initiative and the Dutch Entrepreneurial Development Bank (FMO), aims to unlock at least US$1 billion for DFIs, commercial banks and private investors to finance deforestation-free, sustainable agriculture and land use. The fund will accomplish this mission by offering partial loan guarantees to commercial banks, referred to as partner banks. These guarantees cover 30 per cent to 50 per cent of the exposure on loans ranging from US$5 million to US$10 million for sustainable agriculture projects in developing countries, which the partner banks would typically consider too risky. The fund also provides technical assistance to commercial banks.

The AGRI3 model is based on extending guarantees to Rabobank, a commercial bank, with extensive expertise in agriculture credit risk assessment, and other commercial banks. This enables commercial banks to provide senior debt with extended repayment periods to projects that would have been deemed too risky for financing without these credit enhancements. In addition, AGRI3 offers pre- and post-investment technical assistance to the financed projects. Consequently, AGRI3 can tap into Rabobank's existing client network and leverage their private capital in Brazil, India, Indonesia and Mexico.

The fund aims to achieve a target size of US$144 million to be used to offer guarantees of up to US$306 million to commercial banks, enabling them to unlock nearly US$1 billion in commercial lending to sustainable agriculture projects in developing countries. This will allow the fund to achieve a leverage of seven times that of internal funding (see Figure 8).

FIGURE 8 **AGRI3 FUND EXPECTS TO ACHIEVE A LEVERAGE RATIO OF SEVEN TIMES ITS FINANCIAL RESOURCES**

Expected commercial lending to be mobilized by the AGRI3 Fund
(in millions of United States dollars)



Source: SEO Amsterdam Economics, 2019

Innovation in agrifood blended funds is noteworthy. Blended funds have demonstrated additionality in crowding in domestic investors. They have made continued lending conditional on improved environmental and social performance, targeted investment in women-led businesses, strengthened trust and business links between SMEs, wholesalers and traders, and more (see Boxes 10 and 11).

BOX 10 THE FINANCING FOR AGRICULTURAL SMALL AND MEDIUM ENTERPRISES IN AFRICA (FASA) FUND

In September 2023, the United States Agency for International Development (USAID) and the Norwegian Agency for Development Cooperation, each with a preliminary contribution of US$35 million, launched the FASA Fund to increase financing for smallholder farmers and agricultural SMEs in Africa with financing needs of between US$200,000 and US$5 million. The initial commitments from USAID and the Norwegian Agency for Development Cooperation are expected to attract additional contributions from other donors totalling US$200 million. This multi-donor fund will then act as a fund of funds, providing first-loss financing to 30 to 40 funds with expertise and a good track record regarding smallholder agriculture. By reducing the investment risk for these funds, the US$200 million donor contribution is expected to unlock US$1 billion in commercial financing.

The FASA Fund focuses not only on the leverage ratio – the amount of commercial financing mobilized for every dollar of concessional financing – but also on development additionality. The US$1 billion of commercial financing mobilized is expected to support 500 agrifood SMEs, create 60,000 private sector jobs, benefit 1.5 million smallholder farmers and positively affect about 7.5 million people.

The FASA Fund will provide first-loss financing to funds that invest in climate adaptation, crop diversity, regenerative agriculture and the restoration of soil health. The objectives of the fund are to:

- improve market access for small-scale producers;
- strengthen local value chains;
- promote climate-resilient and gender-inclusive food production;
- enhance food security, with a focus on nutrition and biodiversity.

Sources: Marketlinks, 2024; Norwegian Ministry of Foreign Affairs, n.d.; USAID, n.d.

BOX 11 AGDEVCO INVESTMENT IN JACOMA TROPHA

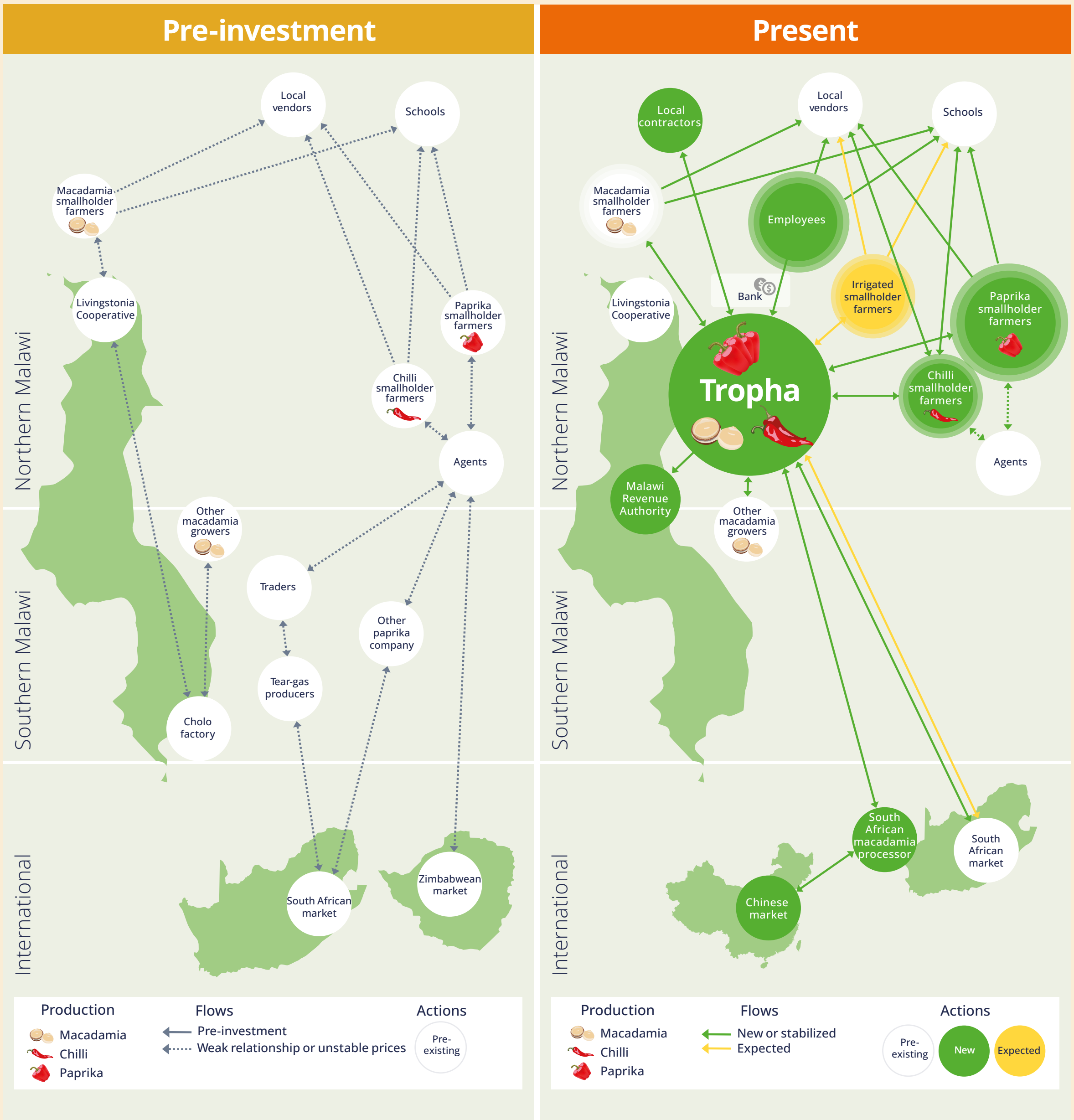
AgDevCo has been an investor in Tropha since 2014, committing US$6.1 million in loans and US$2 million in equity. Tropha is the Malawian subsidiary of the United Kingdom-based farming company Jacoma Estates. The subsidiary owns irrigated farming estates growing macadamia, chili and paprika in northern Malawi. Tropha buys, markets and processes crops from smallholder farmers who, as part of the Tropha outgrower scheme, are also provided with credit and technical assistance. The entire Tropha outgrower scheme supports 4,000 smallholder farmers, 47 per cent of whom are women.

As a shareholder of Tropha, AgDevCo contributes to the strategic direction of Tropha's outgrower scheme and has catalysed an additional US$8 million of equity from British International Investment (previously the CDC Group) and grant funding for a 100-hectare community irrigation scheme. Jacoma Tropha has also received investment from British Investment International and Old Mutual, the South African pension fund.

The key development additionality of this project is the expansion of the outgrower scheme and the links that the scheme has developed with the wider market (see Figure 9). Before the AgDevCo Tropha investment, farmers worked with intermediaries who, taking advantage of their incomplete knowledge of markets and prices, bought their crops at very low prices. Farmers experienced great instability in demand and revenues. Since the investment, farmers have become more tightly integrated into their respective value chains. Tropha purchases the crops directly from the farmers and provides technical advice and pre-harvest credit. Tropha also handles part of the processing of macadamia and the full processing of chilli and paprika at its own facilities.

BOX 11 (CONTINUED)

FIGURE 9 **FOOD VALUE CHAIN NETWORK BEFORE AND AFTER THE AGDEVCO INVESTMENT IN TROPHA**



Source: AgDevCo, 2019

Sovereign wealth funds must join donors in de-risking and improving the domestic environment of both blended and commercial financing. As sovereign wealth funds are state-owned investment funds that invest in domestic industries and usually prioritize long-term returns over short-term liquidity, they are ideal stakeholders to partner with donors and DFIs in blended finance. The example of participation by the sovereign wealth fund of Rwanda, the Agaciro Development Fund, in the establishment of Africa Improved Foods is a case in point (see Box 12).

Sovereign wealth funds are also increasingly receptive to SDG-aligned opportunities. The International Forum of Sovereign Wealth Funds and the One Planet Sovereign Wealth Fund Network report that over 91 per cent of funds address climate change as part of their mandate, and sustainable agriculture and food security are among the preferred investment sectors (see Figure 10) (International Forum of Sovereign Wealth Funds and One Planet Sovereign Wealth Fund Network, 2023, p. 21).

FIGURE 10 **SUSTAINABLE AGRICULTURE AND FOOD SECURITY ARE AMONG THE PREFERRED INVESTMENT SECTORS**

Climate investment preferences of sovereign wealth funds

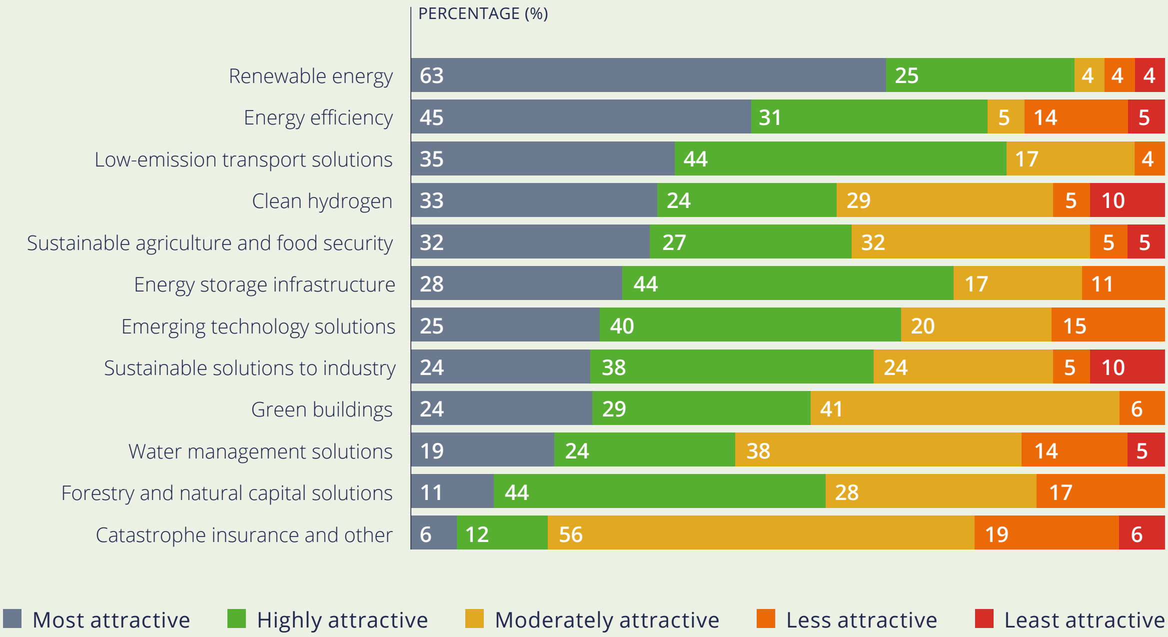


Chart: Kamal El Harty | *Source:* International Forum of Sovereign Wealth Funds and One Planet Sovereign Wealth Fund Network, 2023

BOX 12 AGACIRO DEVELOPMENT FUND COFINANCES AFRICA IMPROVED FOODS

Africa Improved Foods is a social enterprise producing affordable fortified foods for pregnant and lactating women and for infants. It was established in 2015 as a joint venture between the Agaciro Development Fund, Royal DSM, FMO, the Dutch entrepreneurial development bank, the Department for International Development Impact Acceleration Facility managed by the CDC Group and the International Finance Corporation (FMO, n.d.). This private–public partnership is built upon the innovative collaborative funding model, whereby each stakeholder contributes financing, expertise, technology or sustainable infrastructure to the project.

The Agaciro Development Fund invested in Africa Improved Foods by providing the company with warehouses and silos. This enabled the Agaciro Development Fund to monetize these former state-owned assets, assigning them a commercial financial value and thus integrating them into the pool of assets that are owned and managed by Africa Improved Foods (Hamirani, n.d.). The Agaciro Development Fund therefore played a key role as an anchor investor and concessional financier in the establishment of Africa Improved Foods.

Using these warehouses and silos to source, process and store maize from domestic cooperatives, African Improved Food reduced post-harvest losses and increased the income of 450,000 smallholder farmers (FMO, n.d.).

In 2023, the Agaciro Development Fund also partnered with Hinga Wunguke, a USAID-funded Feed the Future initiative, to cofinance companies that assist farmers in accessing markets, improving post-harvest practices and increasing access to processing infrastructure, thereby minimizing post-harvesting and processing losses (The Chronicles, 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 materialize.

> "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 into 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 time."

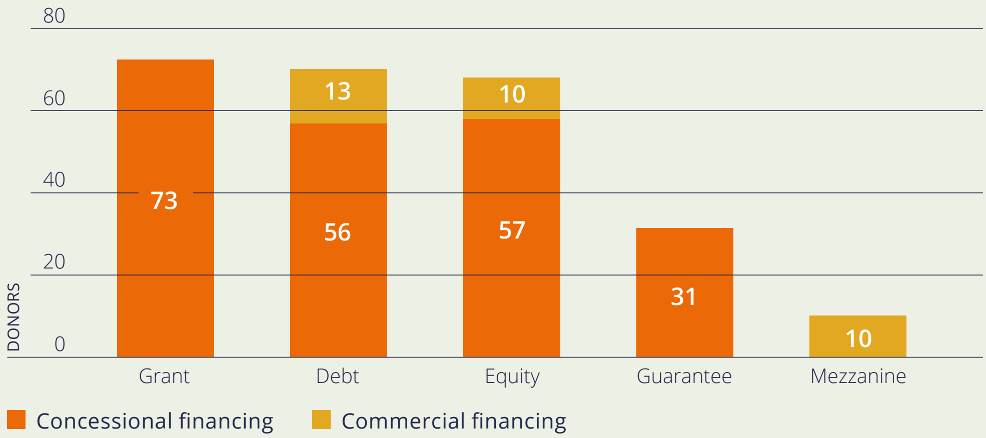
(Donor agency, Shamba Centre enquiry into sustainable finance, 2023)

But donors are being innovative in 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, with the latter bringing market rate returns, which donors are seeking to ring-fence and reallocate to results-based financing within the same fund. Between 2015 and 2020, development agencies and multi-donor funds predominantly offered concessional financing: 87 per cent of their blended finance commitments were provided under concessional terms, with the remaining 13 per cent priced at commercial rates (Convergence, 2021) (see Figure 11).

FIGURE 11 **DONORS ALLOCATED A PORTION OF THEIR COMMITMENTS TO BLENDED TRANSACTIONS UNDER COMMERCIAL TERMS**

Donors' commitments to blended transactions in concessional and commercial terms by instrument, 2015–2020



Note: 71 undisclosed donor commitments not included in the total grants.

Chart: Kamal El Harty | *Source:* 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 organize 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 into 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 experience sharing. They said the additional benefits of such a service would be:

- providing a single window for gathering project sponsors, fund managers, investment advisers, 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 United Nations Environment Programme's Restoration Seed Capital Facility;
- collaborating and cofinancing outcome-based schemes (also called pay-for-performance financing and blended financing).

> "There is value in 'aggregating' due diligence, cofinancing and experience on blended finance and pay-for-performance financing. This will help us scale blended financing more quickly."
>
> (Donor agency, Shamba Centre enquiry into sustainable finance, 2023)

KEY FINDING 3

DFIs 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 DFIs 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, guarantees, transaction advice and technical assistance to domestic financial institutions to build institutional knowledge on sustainable agriculture and food systems.**

Ensuring that DFIs offer financing and technical assistance that no commercial financier will provide is the real test of 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's Ratings 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 than other sectors, DFIs are usually hesitant to lend to food and agriculture projects (see Figure 12). 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, which is financed almost entirely through budget allocations, may be able to take more risks than other DFIs, which may need to uphold their credit rating. DFIs that need to maintain investment-grade credit ratings, such as FMO and Proparco (the French development finance institution), can raise cheap financing on capital markets 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 into 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 into sustainable finance, 2023)

The DFIs that participated in this enquiry were, however, unequivocal in saying that they compete more among themselves than with private commercial lenders. They also considered their role to be that of an anchor lender, bringing comfort to other commercial lenders so that they may then invest alongside them.

DFIs view themselves as change agents and drivers of innovation. They view their additionality as their role as financiers of early-stage start-ups in agricultural technology and green fintech in low- and middle-income countries. When financing these high-risk ventures, DFIs predominantly use public funds under their management. If these ventures reach a certain size and produce more stable cashflows, DFIs then seek to finance them using their own balance sheet until commercial investors can take over (FMO, 2022) (see Figure 13).

DFIs also see themselves as drivers of sustainable development, investing in sustainable ventures, providing technical assistance and building sustainable financial markets in developing countries that may, in the longer term, invest in sustainable enterprises. Climate change, food security and sustainable livelihoods are key investment priorities for DFIs. Their lending is therefore increasingly

FIGURE 12 **DFIS DEPLOYED LESS FINANCING TO FOOD AND AGRICULTURE PROJECTS THAN OTHER SECTORS**

Total volume of DFI blended finance projects in millions of United States dollars, 2021

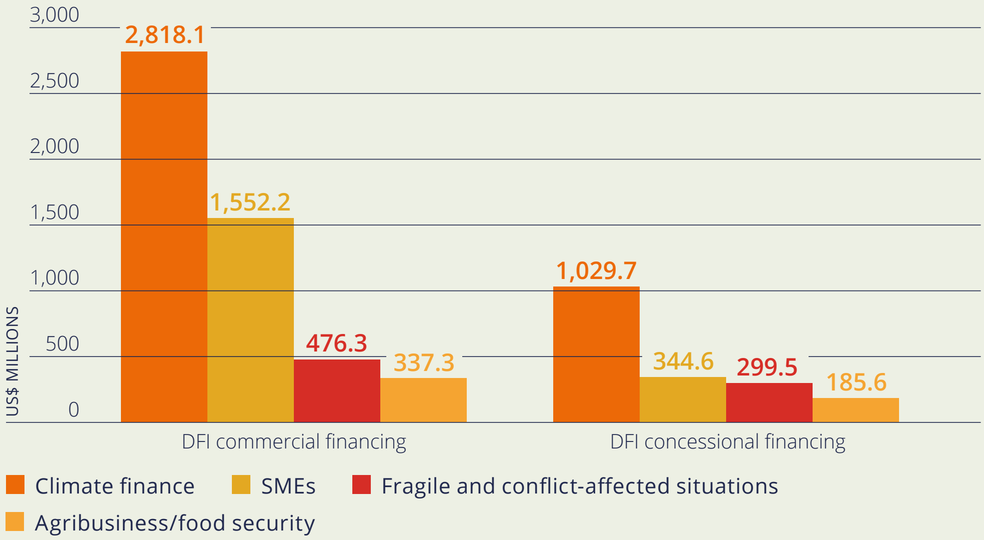


Chart: Kamal El Harty | *Source:* DFI Working Group on Blended Concessional Finance for Private Sector Projects, 2023 tied to improved performance against environmental, social and governance criteria and in measuring and managing climate risk. Reporting on climate risks, including scope 3 emissions – indirect emissions that organizations trigger across their value chains – is becoming a mandatory requirement when working with DFIs.

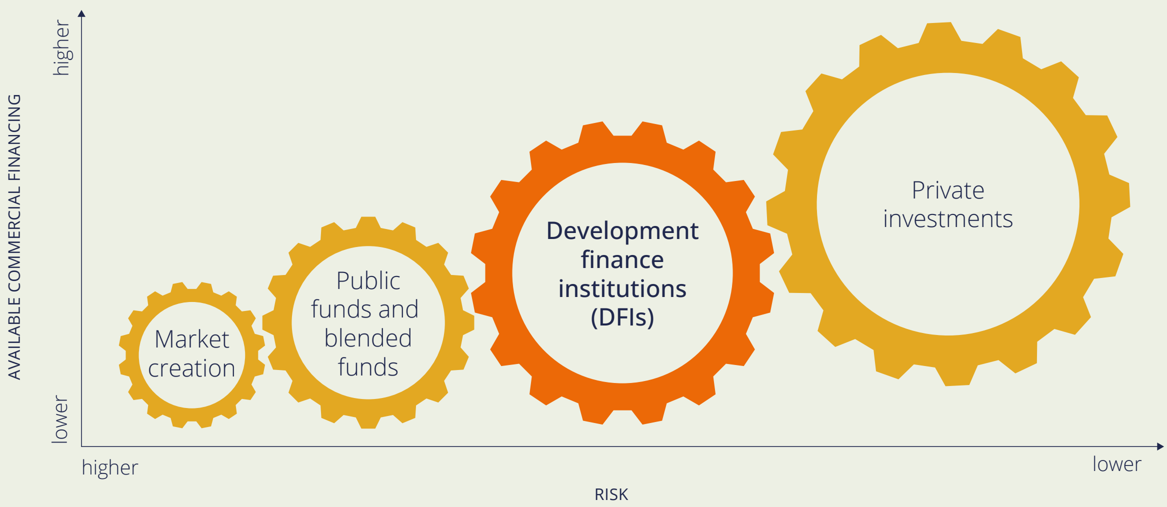
> "We are not only financiers, but we are also technical advisers, facilitators, brokers and advocates for sustainable development. We have a lot of pressure from our shareholder governments to invest in nature-positive, new carbon and circular alternatives. We are increasing financing for renewable-energy-powered food processing, companion cropping and mineral fertilizer production – all areas where our technical assistance and our role as market brokers is perhaps more important than our role of financiers."
> (DFI, Shamba Centre enquiry into sustainable finance, 2023)

Given the impact of climate change and biodiversity loss, combined with difficult economic conditions linked to high sovereign debt and inflation, **DFIs are seeking mandates and opportunities to take more risk and offer affordable and longer-term commercial financing.** In particular, they welcome the flexibility to:

- consider longer-term loans and provide longer-term technical assistance and transaction advisory services to accompany domestic lenders and businesses through different stages of growth and maturity;

FIGURE 13 **HOW DFIS VIEW THEIR ADDITIONALITY**

DFIs view themselves as anchor investors cofinancing along with private investors and supporters of blended funds and public funds in market creation



Source: FMO, 2022

- work with dedicated pools of financing to provide first-loss financing (see Boxes 13 and 14);
- increase the use of grantees, hedging instruments and liquidity facilities to fund riskier projects and mobilize commercial financing.

Early examples of these pools of financing are the Food and Agriculture Resilience Mission (FARM) private sector initiative and the InvestEU guarantee programme (see Boxes 13 and 14).

A similar sentiment was echoed by the multilateral development banks that participated in the enquiry: **they welcomed the option to use their callable capital (capital that has not yet been paid in by shareholders) to take additional risks.** In tandem, the World Bank Evolution Roadmap, published in October 2023, reports on several in-progress reforms, including a lowered equity-to-loan ratio from 20 per cent to 19 per cent and greater use of callable capital and guarantees. This increased lending capacity – together with the reinvigorated priorities on poverty alleviation, shared prosperity on a liveable planet and transnational global challenges – is likely to see more risk-taking across the World Bank Group and the multilateral development banks' systems more widely (Development Committee, 2023).

BOX 13 PROPARCO AND FARM

French President Emmanuel Macron announced the FARM initiative at the EU summit in March 2022. Through FARM's third pillar, which focuses on strengthening local agricultural production in vulnerable countries, the French government launched the first pilot phase of the FARM private sector initiative. With an initial budget of EUR 40 million, this initiative will be implemented by Proparco and other French public financing institutions.

Proparco will use this budget to finance African and French agrifood SMEs across the entire food value chain. The starting ticket size will be EUR 100,000, and, by working through intermediaries, Proparco aims to reach SMEs with financing needs as low as EUR 1,000. Financing will be provided in the form of loans, guarantees and technical assistance to local and French banks and microfinance institutions that will on-lend to SMEs (Proparco, direct communication, 2023). The objective is to provide an incentive for local and French banks to increase lending to SMEs with limited collateral and those based in rural environments (Proparco, direct communication, 2023) (see Figure 14).

This pool of off-balance-sheet financing presents new opportunities and challenges for Proparco as it works to put in place due diligence processes to manage smaller, high-risk loans for agriculture and agrifood logistics.

As a representative of Proparco remarked:

> "The FARM financing is new for us, as we are taking first loss, working with smaller ticket sizes, investing in riskier businesses with the goal of addressing food security and climate change. Our success is critical to the catalytic potential of the FARM initiative."
>
> (Representative of Proparco, Shamba Centre enquiry into sustainable finance, 2023)

In June 2023, through the FARM initiative, Proparco allocated a grant of EUR 230,000 to Advans Côte d'Ivoire, a microfinance institution, to support a pilot programme of pre-harvest lending and technical assistance to 1,500 corn cooperatives (Proparco, 2023). In the absence of this dedicated financing, Proparco would not have been able to support the high-risk pilot programme (Proparco, 2023).

BOX 13 (CONTINUED)

FIGURE 14 **OVERVIEW OF THE FARM PRIVATE SECTOR INITIATIVE**

Beneficiaries	**Start-ups and incubators in Africa**	**SMEs in Africa**	**Agro-industrial enterprises across the food value chain**
Ticket sizes	Between EUR 1,000 and EUR 1 million	Between EUR 1,000 and EUR 5 million	Starting from EUR 5 million
Financing from the Agence Française de Développement Group, including Proparco	Financing for start-ups directly and through investment funds	Financing for SMEs in partnership with domestic banking and microfinance institutions	Financing and technical assistance for agro-industrial enterprises across the food value chain
In partnership with French public financing institutions	Support for the acceleration of start-ups	Financing for SMEs in partnership with French banks	Financing and technical assistance for agro-industrial enterprises seeking to establish themselves in Africa

Source: Proparco, direct communication, 2023

BOX 14 **THE EUROPEAN UNION'S INVESTEU PROGRAMME**

InvestEU provides an EU budgetary guarantee to the European Bank for Reconstruction and Development (EBRD), allowing the bank to provide unfunded guarantees to financial intermediaries.

Under the InvestEU guarantee agreement signed between the European Commission and the EBRD in December 2022, the EBRD will extend an EU budgetary guarantee valued at EUR 470 million to eligible partner financial institutions in 12 EU Member States. This guarantee will be partially covered by the first-loss cover provided by the European Commission (EBRD, 2023).

With the support of this EU budgetary guarantee, EBRD gains the capacity to take on risk at the first-loss level and have skin in the game by going beyond its typical risk-taking capacity. It is estimated that EBRD will unlock EUR 2.1 billion of financing by extending these guarantees to financial institutions. This financing will support projects across a wide range of sectors, including sustainable infrastructure, energy, food, the green and blue economies and digitalization (Ahlemeyer, 2022).

Since this guarantee is provided by InvestEU, EBRD does not set aside reserves from its own financial resources to cover potential loan losses in the case of default. The freed-up financial resources, traditionally earmarked for guarantees, can be used to increase EBRD's lending capacity to support more beneficiaries.

In addition, under this agreement, financial institutions that benefit from the risk reduction on their portfolios of loans through the EBRD guarantees will be required to improve the conditions of the loans extended to end-borrowers. This improvement may include lower collateral requirements, lower interest rates and long loan terms (Investment Committee of the InvestEU Fund, 2023)

Due to the additionality of the InvestEU guarantees, the EBRD is considering increasing its guarantees to up to EUR 805 million. This was to be decided in December 2023 (EBRD, 2023).

KEY FINDING 4

More research and data on the performance of agrifood SME loans that originate from donors are a prerequisite for making ODA more catalytic.

KEY RECOMMENDATION 4

Donors should create a data repository on the performance of agrifood SME loans, based on the experiences of the Council on Smallholder Agricultural Finance and MIX Market.

To scale lending and blending, donors need research and data on the loans they provide to agrifood SMEs. They also need to be able to compare their own portfolios of agrifood enterprise loans with those of other donors and DFIs. While donors may be collecting this information, there is no public data repository where these data could be recorded, cleaned and prepared for investment decisions. The lack of comparable data impedes transparency and the development of the market insight that is so critical for building inclusive markets. The experience of Acumen illustrates this point (see Box 15).

Similarly, CSAF, a network of impact investors, is a successful example of 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 and are disbursed by CSAF members to agrifood SMEs in developing countries. Data are collected on loans by region, size, existing versus new borrowers, informal and less-developed value chains, and contract duration. CSAF members benefit from comparative analyses and can find solutions to common challenges. Aceli Africa was launched, in part, to address some of these challenges.

BOX 15 ACUMEN RESILIENT AGRICULTURE FUND

Acumen, through grant financing from donors, invests in marginalized SMEs and receives revenue of US$0.87 for each US$1.00 invested (Shamba Centre for Food & Climate, 2023). Acumen continues to support these SMEs, carefully recording their progress on climate resilience, sustainable farming and processing practices and the management of their assets and cashflow.

Using these data, Acumen, through Acumen Capital Partners, launched the Acumen Resilient Agriculture Fund in 2022. The fund takes equity stakes in SMEs to support the increase of climate-resilient farming and processing practices. Concessional financing for the fund was provided by Acumen and the Green Climate Fund, with additional commercial financing from FMO, the Soros Economic Development Fund, Proparco, the Children's Investment Fund Foundation, Global Social Impact, the IKEA Foundation and others (ARAF, n.d.).

Other examples include MIX Market, a data catalogue for financial service providers targeting unbanked people in developing countries, and the Smallholder and Agri-SME Finance and Investment Network, 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 agrifood SME loans (see Box 16), based on the experiences of Acumen, IDH, CSAF and MIX Market.

BOX 16 THE VALUE OF LOAN-LEVEL DATA: THE IDH–NEUMANN KAFFEE GRUPPE ADVANCE PAYMENT PROGRAMME

The Neumann Kaffee Gruppe (NKG) launched the NKG Bloom advance payment programme with a first-loss guarantee from the IDH Farmfit Fund and a second-loss guarantee from USAID. Implementation began in Uganda in 2017. NKG Bloom operates through farmer services units, which are set up within NKG export companies. These units provide coffee farmers with service bundles, including mobile money advances, fertilizer inputs and training, to enable them to run their farms at full potential and maximize their incomes. Farmers are provided with the preferred option to repay the money advances with harvested coffee.

Assessing the credit risk of smallholder farmers is challenging due to the lack of reliable data on their productivity. NKG Bloom overcame this challenge by assessing the credit risk and the debt level of farmers based on transactional data from the sales of coffee by farmers to NKG export companies. The credit a farmer can obtain is contingent on the volume of coffee they supplied in the prior season (FRP and Rural and Agricultural Finance Learning Lab, n.d.). NKG Bloom aims to expand its risk appetite and additionality by offering longer-term loans to farmers with well-established track records of repaying short-term loans.