GDI ISSUE PERSPECTIVE: AGRICULTURE FINANCE

WHY IT MATTERS:

Globally, an estimated 500 million households consider smallholder farming an integral part of their livelihoods.[1] Agricultural small and medium enterprises (SMEs)—including producer organizations, input providers, storage and transportation facilities, traders and offtakers, processors and distribution service providers—play a key role in driving economic prosperity for rural areas. SMEs play many roles: they aggregate otherwise dispersed smallholder farmers; provide inputs, training, credit, and access to markets; and create formal employment opportunities. In Africa alone, agricultural SMEs generate 25% of rural employment and are responsible for processing and selling 80% of food produced for local consumption.[2] There are many aspects of smallholder farming that deserve attention, including innovations in productivity technology or upgrades in information provision. However, finance seems to be the tip of the spear for delivering information and creating access to any productivity improvements, and it is a sector that is currently under-addressed by governments and large companies.

Short- and long-term agricultural needs, such as optimizing farm operations by investing in high-quality agricultural inputs, require short- and long-term capital. While there is no comprehensive global sizing of the demand and supply, a recent report[3] estimated an annual lending gap of $120B to agricultural SMEs in sub-Saharan Africa alone, the majority requiring less than $1.5M in financing per deal. Further, smallholder farmers also require capital for non-agricultural expenditures, such as school fees, home improvements or other life events. Current estimates pin total household need around $240B worldwide.[4] The latest data suggests that financial service providers are currently supplying $70B to smallholder households, leaving a gap of $170B: 70% of overall smallholder finance needs go unmet. And particular segments are particularly underfinanced. 98% of demand for long-term agricultural finance is unmet, for example. Despite a growing number of financial service providers focused specifically on the smallholder population, there is still widely perceived risk in lending to these households and enterprises, both because of external factors such as climate change and price volatility, as well as internal factors such as poor management capacity and record keeping. The challenge remains clear: we need to expand addressable demand, while working to align the economics of capital supply.

THE CURRENT STATE / THE OPPORTUNITY:

Since GDI began work on this issue in 2013, there has been enormous market movement. There is a more expansive landscape of policies, programs, and investments related to rural agricultural finance than ever before. There is a deep recognition of the ways that rural agricultural finance intersects with critical global agendas, such as climate change, food security and nutrition, gender equality, and youth. The capital market for rural agricultural finance has also expanded, from a relatively small set of host country governments, agribusinesses, and donors, to a larger ecosystem of capital providers with differing objectives and investment philosophies. The work done by GDI and an extensive group of partners has contributed to this progress and continues to push the agenda. The opportunity now is to continue to crowd in players, highlight successful models, scale what works, and suggest new ways forward.

Three trends shape the particular opportunity we see now: (1) financial service providers have begun to shift risk-adjusted return expectations for smallholders, recognizing the lifetime customer value of rural households; (2) digitally-enabled services and approaches have exploded, changing what products are

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[1] http://www.fao.org/3/ca6956en/ca6956en.pdf

[2] Sumba, Daudi (ed), The Hidden Middle, 2019: https://msu.edu/user/reardon/AASR2019-The%20Hidden%20Middle(web).pdf

[3] Dalberg and KfW, *Africa Agricultural Finance Market Landscape*, 2018

[4] https://pathways.raflearning.org/wp-content/uploads/2019/11/2019_RAF-State-of-the-Sector.pdf

being offered and how providers conduct their business; and (3) an increasing number of providers are offering bundled services, recognizing that to meet farmer needs requires a more holistic approach — one where finance is not an end in and of itself, but rather an enabler of greater impact and profitability. The rapid evolution of the rural agricultural finance sector over the last ten years requires us to re-examine old frameworks and build out new models to align finance needs with financial service provision.

The goal of a successful financial inclusion strategy is not a single interaction, but rather a long-term engagement that enables smallholder households and agricultural SMEs to improve their lifetime economic standing. For financial service providers, this is closely tied to the concept of "customer lifetime value," where profitability is increased by a relationship that endures and matures over time.

GDI, its initiatives, and key industry actors have developed such a new "Rural Pathways" model. Smallholder households have different needs at different times, especially as they move along development trajectories or pursue agency through various livelihood strategies, an observation that leads us to champion a framework that uses broad categories of livelihoods matched with evolving financial tools and capital needs. We have identified four centers of gravity that could help financial service providers and donors tailor products and bundle offerings: farming as a business, rural services entrepreneurship, rural labor, and urban migration. Perhaps the most striking aspect of the model is the simple recognition that many rural households will not remain smallholder farmers long-term. Therefore, delivering inclusive economic development over time will require a wider range of non-agricultural products and services, such as productivity enhancing, capacity building or market access services, as well as traditional financial services like credit, savings, payments, insurance and asset financing.

GDI'S WORK:

GDI has supported all aspects of this sector expansion, from market definition and service provider coordination, to piloting new financial mechanisms, to incubating entities that can accelerate scale. Beginning with the launching of the Initiative for Smallholder Finance (now ISF Advisors) in May 2013 and the release of the Catalyzing Smallholder Agricultural Finance report, GDI has worked to define and establish a field, while supporting efforts within it along the financing continuum.

- **Intermediaries**. ISF Advisors works with public and private investors to develop new financial and partnership structures that can drive capital to rural clients and transform their economies. This typically includes a combination of partnership development and enterprise growth strategy while layering in financial inclusion and investment structuring expertise.
- **Market-enabling Facilities.** Aceli Africa aims to mobilize $700M in private sector lending for agricultural SME lending and $200M in incremental incomes for smallholder farmers in Kenya, Rwanda, Tanzania, and Uganda by 2025. To achieve these goals, Aceli Africa will provide financial incentives to increase the risk appetite of 20+ financial institutions (both global and local) while facilitating technical assistance to expand the ability of high-potential SMEs to qualify for and manage financing.
- **Ecosystem Connectors**. Council on Smallholder Agricultural Finance is the industry association of global "social lenders" (e.g. Root Capital, Rabobank, Responsibility) that lend ~$1 billion to agricultural SMEs, sourcing from over 2 million smallholder farmer communities. Rural Agricultural Finance Learning Lab is a center of excellence that brings programmatic focus, research and data development, and resource deployment support to the Mastercard Foundation portfolio, a market mover in agriculture financing.