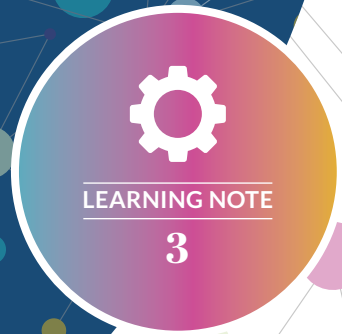




ADDRESSING SUPPLY AND DEMAND CONSTRAINTS IN SCALING GREEN FINANCE FOR AGRI-SMES

SMALLHOLDER
AND AGRI-SME FINANCE
AND INVESTMENT NETWORK



Increasing the volume of capital dedicated to greening agricultural value chains requires a demonstration that existing models can be successfully scaled and replicated. Such models are those that effectively resolve the issues faced by funders and local financial intermediaries who disburse funds on the ground, as well as challenges faced by agri-SMEs and their small producer cohorts in meeting lending criteria and taking on the additional 'green' debt. Efforts to scale green finance should therefore focus on the aspects that are not so easily replicable, including partnership building and the provision of technical assistance for more efficient delivery and use of resources.

Introduction

This is the third Learning Note in a series dedicated to [partnerships in green finance for agri-SMEs](#). This paper builds on issues raised in previous notes on the importance of partnerships in the development of blended initiatives for the deployment of green finance solutions. It also incorporates more recent findings from the knowledge sharing activities led by the Smallholder and Agri-SME Finance and Investment Network (SAFIN) related to scaling and replicating existing green finance delivery models that effectively address supply and demand issues.

Key Challenges

To achieve the targets set by the Sustainable Development Goals and the Paris Agreement of reducing emissions by 45% by 2030 and reaching net zero by 2050, green finance and investment solutions for agriculture need to be scaled considerably. As of 2020, an estimated 3% (US\$20 billion) of global climate financing – a subset of green finance dedicated to adaptation, mitigation and nature based solutions – was allocated to the agriculture, forestry, and land use sectors. Of this, a mere 4% (US\$700 million) reached value-chain actors, including SMEs and farmers organizations.¹ Although total demand for this financing in the agricultural sector is difficult to assess, it is clear that SMEs and farmers organizations (collectively referred to as agri-SMEs) will play a key role in meeting the SDGs through wide adoption and implementation of global climate financing throughout the supply chain. With the limited supply of concessional sources, this will demand a considerable increase in private sector engagement and financial contributions. Yet approaches to scale the deployment of private capital towards green finance remain elusive.

Among the reasons generally cited for the lack of private sector involvement are the high costs associated with developing a pipeline of bankable investments, particularly for smaller ticket sizes; the limited expertise available at the local level to service and monitor green investments; and the lack of commonly accepted terminology and taxonomies to design and regulate green finance interventions.

In addition to these, continued disruptions to the agriculture sector have also contributed to slowing the ongoing progress of expanding the supply of green finance. In particular, increased volatility and risk from destabilized food systems are causing investors to retreat from the sector. The ongoing COVID-19 pandemic, inflationary pressures, global conflicts (e.g. the war in Ukraine), and climate change² are some of the main crises creating this instability. Rising costs in energy, inputs and commodities mean higher working capital needs for agri-SMEs, who must also deal with growing interest rates. This is creating unprecedented pressure for enterprises that are effectively squeezed by increased capital needs and limited supply from risk-averse financial service providers.

¹ [Examining the climate finance gap for small-scale agriculture](#), International Fund for Agricultural Development (IFAD) and Climate Policy Initiative (CPI), Nov. 2020

Key Opportunities

The compounded effect of these crises on agriculture and food security have also contributed to bringing a renewed emphasis on the crucial role played by agri-SMEs. As a result, new opportunities are arising for collaborative action and investment that can support the transformation of food systems towards more inclusiveness, health and sustainability. Such multi-stakeholder initiatives range from public sector coalitions like the [Public Development Bank Platform for Green and Inclusive Food Systems](#), supported by the International Fund for Agricultural Development (IFAD), or the [FARM initiative](#) involving IFAD and Agence française de développement (AFD), to private sector efforts such as ResponsAbility's [science-based impact lending solution](#) targeting food systems transformation in collaboration with the Consortium of International Agricultural Research Centers (CGIAR). As new partnerships are introduced, so too are new digital technologies and advances in delivery models for technical assistance (TA) that aim to reduce the cost and risk associated with investments in a sustainable transformation of food systems.

The green finance industry now includes a wide range of partnership models combining funding with technical support, including those providing debt (e.g. [Clarmondial's Food Security Fund](#)) or equity (e.g. [Acumen Resilient Agriculture Fund](#)) directly to agri-SMEs, or those working through local financial intermediaries such as Rabobank's [India COVID Response Program for Agri transition](#). The landscape also includes more project-driven interventions, which are generally slower to develop and scale due to the complex partnerships involved. This can apply to initiatives with a narrow focus on specific value chains, geographies or communities (e.g. [Ecotierra](#)), or to much larger scale initiatives targeting countries' infrastructure such as green bonds. Learnings from the activities led by SAFIN in the area of green finance, however, suggest that to unlock private sector capital and significantly boost the flow and availability of green finance for agri-SMEs, solutions should engage and involve financial service providers (FSPs) at a local level, developing localized expertise around greening practices and leveraging existing client networks. Ultimately, the objective should be to mainstream green finance alongside traditional financing products and services.

Key Learnings

Developing strong partnerships with local FSPs

Local FSPs already provide the vast majority of financing to agri-SMEs, accounting for 85% in Sub-Saharan Africa and South East Asia³. It is no surprise that when faced with an emergency, agribusinesses turn to these institutions to secure additional funding. In the case of climate change, emergencies can be linked to issues related to water scarcity, volatile commodity and energy prices, or irregular input supply, all of which can impact the enterprise's bottom line and in some instances may prompt a pivot to a new product or business model. In this sense, FSPs already play a key de facto role in the delivery of green finance by providing funding that is used to reduce vulnerability and increase the sustainability of agri-SMEs. However, financial institutions generally lack the expertise or the risk appetite to develop a range of dedicated products and services aimed specifically at addressing climate-related issues faced by their clients, let alone to help build

their resiliency to future shocks. To significantly grow the supply of targeted and effective green finance, this capacity must be increased at the FSP level by supporting both the development of knowledge as well as the availability of dedicated funding and risk mitigating solutions.

Blended finance facilities are well suited to help address these limitations. These facilities provide FSPs with the funding required to develop a dedicated portfolio of green finance activities and reduce associated risks and costs. They also offer technical assistance to develop the knowledge and capacity required to administer such funding. Although the financial instruments (e.g. guarantees, debt or equity) are easily replicable and scalable, the partnerships around these blended facilities are unique and require special attention. Lessons learned from the experiences of SAFIN partners, including AFD's [AGREENFI](#) label or the "India COVID Response Program for Agri transition" launched by Rabobank and USAID, both highlighted the importance of dedicating time and resources to the identification, evaluation and capacity development of FSPs to ensure their full engagement in the deployment of green finance solutions, and to create the potential for long term participation and eventual mainstreaming of such solutions. This requires commitments from both the funding and FSP partners to develop a relationship of mutual trust based on a shared understanding of the nature and objectives of green finance, clear roles and expectations of each partner, and alignment on what success looks like and how it is measured.

AGREENFI: Aligning support to local FSPs with local needs

As the AFD Group's agricultural and rural finance label [AGREENFI](#), aims to promote a more sustainable model of agricultural development by supporting the transformation of the practices of partner financial institutions. In this context, the group's partnership development process builds on an initial alignment with its philosophy and objectives. Based on this shared understanding, AGREENFI and its partners set sustainability objectives adapted to local needs and develop the means to achieve them, with a view of affecting long term social and environmental change at a regional level. In 2019, a credit line provided to Crédit agricole du Maroc contained four components: one to support a transition to sustainable energy for agri-SMEs; another on technology to improve water use; one on green production practices; and finally one on the development of organic farming in Morocco⁴.

Credit enhancements and use of incentives

Although agri-SMEs already seek financing to address the impact of climate change on their operations, today this demand is mostly driven by immediate and isolated climate shocks. Meanwhile, opportunities to scale demand for green finance to increase long term sustainability and resiliency remains a problem. On one hand, limited knowledge about the availability or intended use of green finance by the targeted recipients complicates efforts to assess potential demand, making it difficult to engage FSPs in what is often a new area for them. On the other hand, the offer of additional debt with restricted use for potentially long and costly projects is not seen as a compelling proposal by agri-SMEs. According to representatives of the Latin American and Caribbean Network of Fair Trade Small Producers and Workers (CLAC), for many of their members the introduction of substantive and long-term changes to the operational practices of their business raises concerns related to additional cost and associated debt.

² [Agri-SME Finance: Navigating Volatility in the Wake of the War in Ukraine](#), SAFIN, August 2022

³ [State of the Sector Report: Agri-SME Finance](#), ISF Advisors, March 2022

⁴ [AGREENFI : Pour une Finance Agricole et Rurale plus Verte](#), AFD, October 2021

Such concerns often further extend to potential income losses incurred during the project implementation. Strong incentives therefore are needed for both the intermediaries (FSPs) and agri-SMEs to fully engage in green finance projects.

Incentives can take different forms and must be adapted to each specific context. Each offering is therefore not easily replicated and requires dedicated focus. For the financial intermediary, incentives are typically provided by their funding partners alongside a financial component. They can include risk mitigating tools such as guarantees or first loss facilities, as well as Business Development Services (BDS) to help develop in-house knowledge and expertise or support product design. Incentives targeting agri-SMEs are at the heart of the partnership between funders and local FSPs. These can include the offer of products that meet the needs of the intended target user, as well as technical assistance to support the transition towards climate resilience and biodiversity practices while improving their income generating potential. It may also include financial literacy to better understand the potential economic upside of investing in sustainability.

Actors on both sides (supply and demand) can now also benefit from a range of digital tools that have emerged over recent years to assess the agriculture and climate-related risks and opportunities of different counterparties. These include innovations such as credit scoring solutions for FSPs proposed by [ADAPTA Earth](#), efforts by Palladium to support the adoption of geomapping tools (e.g. [Cropin](#)) by FSPs and agri-SMEs, or even an environmental impact tracking tool introduced by [Cool Farms](#). Through different approaches, each of these tools ultimately aims to support a better assessment of the risks and impacts related to climate change across agriculture value chains to inform decisions on the adoption of effective solutions that are tailored to each business.

Cool Farms: Leveraging data to improve economic impact and financial performance

The Cool Farm tool has been piloted with coffee producing cooperatives in Latin America to track the environmental impact of their production practices and support the selection of efficient organic practices to improve their resilience. This project brought together a broad partnership including coffee producer cooperatives, members of the scientific community and SAFIN partners including Root Capital and the Inter-American Development Bank's innovation laboratory (IDB Lab). The tool introduces digital solutions to collect and analyse the environmental impact of current production practices to help select and promote the best organic practices for climate resilience as well as improved crop health and productivity using scientific expertise. The results are then used to link production to off-takers willing to pay a carbon premium, and leverage this information to attract new sources of finance from local providers. The project is expected to benefit more than 12,500 farmers with outreach, replication and eventual climate resilience investments by creating a model that can be readily scaled to serve all interested producer partners within the Cooperative Coffees producer network, and beyond.

Conclusions

Although a number of existing models targeting FSPs for the deployment of green finance to agri-SMEs have been implemented over the years, efforts to scale them have met the same constraints related to pipeline development, lack of expertise and a shared taxonomy. Indeed, these are the elements that are most difficult to replicate in the process of expanding a model to cover new FSPs, countries or value chains. To effectively scale and replicate existing models, efforts to address these constraints should focus on the development of strong partnerships with local FSPs, in order to develop a common understanding of the purpose and potential of green finance solutions. They should also focus on identifying the appropriate support solutions to incentivize the adoption of green finance by FSPs and agri-SMEs, through improved capacity to efficiently deploy climate-smart solutions. In the short term, these relationships and the support they provide are key to expanding the provision of green finance solutions. In the long term, mainstreaming such solutions within standard financial product and service offerings will help build resilience across agriculture value chains and lower risk across the sector.

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About

The Smallholder and Agri-SME Finance and Investment Network (SAFIN) is a partnership of over 50 institutions committed to scaling up access to financial services for agri-SMEs and small farmers.
www.safinetwork.org

Contact

Micheal von During
Technical Specialist, SAFIN
m.vonduring@ifad.org

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