

# IMPROVING THE FINANCING LANDSCAPE IN INDIA

SUSTAINABLE LANDSCAPE GUARANTEE PROGRAM

## Synopsis

### Primary investors:

- Rabo Foundation
- United States Agency for International Development (USAID)
- Samunnati Financial Intermediation and Services Private Limited (SAMFIN)
- Ananya Finance for Inclusive Growth Private Limited (Ananya)

**Value chain or sector:** Agro-forestry and sustainable forestry

**Country:** India

**Type of risk addressed:** Business model risks associated with financing the sector

**Type of blended finance instruments:**  
Loan portfolio guarantee

## Executive summary

Being able to sustain quality forests is critical to facing the challenges of climate change. Rabo Foundation and USAID/India are supporting local financing for agroforestry, sustainable forest management and low-emission agriculture. The goal is to promote a sustainable landscape, one that will increase the income of small farmers and optimize farm productivity while also lowering greenhouse gas emissions.

To encourage financing to businesses in this sector, Rabo Foundation and USAID/India partnered with two local financial institutions to support loans totaling more than \$15 million, through a loan portfolio guarantee structure. The financing is geared toward small and medium-sized private enterprises (SMEs), cooperatives, producer companies and microfinance institutions that are directly or indirectly engaged in sustainable landscapes through agriculture, forestry and other land uses.

## Introduction

Rapid climate change is one of the most challenging concerns today. From shifting weather patterns to extreme weather events—including droughts, floods, heat and cold waves, and cyclones—the potential impacts of climate change on the planet are devastating. Perhaps ironically, given its own vulnerability to adverse effects, agriculture has contributed significantly to climate change.

### Contributed by

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For instance, the past few decades have seen manifold increases in agricultural productivity, in order to make food available, accessible and affordable for an ever-growing population across the globe. However, this has come at significant environmental costs: the clearing of forests for agriculture, rising greenhouse gas emissions from soil and usage of chemical inputs, emissions from livestock, burning of residues and biomass, and more. The Intergovernmental Panel on Climate Change has estimated that this sector—collectively referred to as agriculture, forestry and other land use—contributed 23% of total anthropogenic greenhouse gas emissions from 2007 to 2016.<sup>i</sup> While the overall percentage of greenhouse gas contribution of agriculture, forest and other land use is progressively decreasing, absolute emissions from the sector are on the rise.

Approximately 24% of India's territory (78 million hectares) is covered by forests and trees; this supports a rich collection of biodiversity, provides a range of products and ecosystem services, and maintains the livelihood of 300 million forest-dependent people in the country. However, the clearing of land for agriculture and the need for fuel wood, timber and other forest products are putting pressure on the country's ability to sustain quality forests. This pressure is expected to increase due to rising populations and accelerated economic growth. Consequently, forest degradation is a growing concern, even though forest cover has remained almost constant in the past two decades. About 41% of India's forest cover has already been degraded, and many dense forests have seen negative impacts, leading to increased greenhouse gas emissions from forestry.

Clearly, efforts must be made to decrease the impact of agriculture, forestry and other land use on overall emissions. More importantly, the sector's impact on climate may ultimately challenge the ability to maintain a food surplus. Thus, there is a need to promote a strategy that allows agriculture to flourish without compromising the forest ecosystem and biodiversity. This includes activities that will reduce land-based emissions, such as agroforestry, sustainable forest management and low-emission agriculture—all of which go into creating a sustainable landscape, one that will increase the income of small farmers and optimize farm productivity while also lowering or controlling the corresponding greenhouse gas emissions. The mitigation potential through sustainable landscapes is high, since it is derived from both removal and reduction of greenhouse gases; the former happens as a result of increased carbon sequestration, through afforestation and increased biomass, and the latter through proper management of land, inputs and livestock.

The government of India is committed to reducing the intensity of greenhouse emissions by 33-35% of its 2005 levels by 2030, under the Climate Action Plan of the United Nations Framework Convention on Climate Change. To achieve this, the focus is on increasing tree and forest cover to create an additional carbon sink of 2.5 to 3 billion metric tons of carbon dioxide equivalent and promoting sustainable agriculture practices.<sup>ii</sup>

While sustainable landscapes offer opportunities to reduce the carbon footprint, the agricultural and forestry sector remains largely disorganized, making it difficult for the private sector to make a meaningful contribution. Among the challenges: a dearth of high-quality tree saplings; lack of institutional finance and knowledge on improved agricultural and forestry practices; inadequate post-harvest processing mechanisms; legal barriers to tree felling and transportation; lack of infrastructure; and opaque market information.

Private investment, though necessary, remains scarce. Mainstream investors still consider the risk associated with this sector to be high for multiple reasons:

- There is a lack of awareness of technical and economic data on different agroforestry and sustainable forestry models. Added to this are the technical and economic parameters required by financial institutions to evaluate the finance needs and viability of projects.
- The gestation period in agroforestry—that is, the period before which the investment in commercial forestry starts providing a return—is quite long (usually five to eight years), making the sector inherently risky.
- Drawing a comparison with forestry's closest peer, agriculture, agricultural cycles are short-term (six months to one year) and more predictable. Consequently, efforts to develop financial products have largely remained limited to agriculture.
- Owing to long gestation, the motivation in the farming community to pursue commercial forestry or agroforestry is limited, which in turn limits interest among financial institutions.
- The value chains of forest products are highly fragmented, which necessitates dependence on middlemen and creates opaque market structures for the sale of produce. This further limits the interest of farmers and financial institutions alike.
- Indian forests are largely owned and operated by the government, allowing for limited private sector intervention.
- Knowledge around low-emission and sustainable agriculture is limited. A sustainability premium is not available for crops grown through low-emission agriculture.

## Blended Finance Approach

While the Indian government is framing suitable policies for developing and promoting the sustainable landscapes sector—alongside like-minded national and international agencies—access to finance at various points in the value chain is virtually unavailable from mainstream financial institutions. Interestingly, even among impact-focused financial institutions with a mandate to support the livelihood of smallholders while promoting climate-resilient agriculture, few have shown an inclination to provide the necessary access to finance, whether working capital or term loans. For the reasons cited above, the

perceived risk is too high even for these financial institutions to take significant exposure.

To encourage lending to this sector, in September 2018, Rabo Foundation and USAID/India partnered with two local financial institutions to support loans totaling more than \$15 million (Indian rupee equivalent) in local financing through a loan portfolio guarantee structure. The financing is geared toward SMEs, cooperatives, producer companies and microfinance institutions that are directly or indirectly engaged in sustainable landscapes through agriculture, forestry and other land uses. This effort includes facilitating financing to SMEs and farmer producer organizations involved in value addition of sustainable forestry and agroforestry products; promoting climate-smart agriculture; and encouraging on-lending by microfinance institutions that are willing to provide loans to individuals or MSMEs exclusively for forestry/agroforestry and low-emission agriculture.

Rabo Foundation participates as a first-loss guarantor, while USAID acts as a second guarantor, sharing risk equally (*pari passu*) with the partner financial institution at the portfolio level, after application of first loss. The program size is \$15.3 million with a duration of 10 years. The local financial institutions selected for the program are mission-aligned and have created impact-oriented portfolios that show their commitment to sustainable agriculture.

Through this blended finance approach, Rabo Foundation and USAID share the risk with the two local financial institutions, allowing the local institutions to become more familiar with the sector and more comfortable taking on the associated risks. This is the first-of-its-kind program in India to channel commercial funds to this otherwise underserved sector. The program is a perfect example of development and commercial organizations coming together to blend soft money with commercial funds to attain larger objectives of financing climate-smart agriculture and sustainable forestry and agroforestry. The ultimate goal of this blended approach is: (i) to create a demonstration effect in the market, showing other financial institutions that investing in sustainable landscapes is financially viable; and (ii) to increase support for sustainable landscape projects in order to slow, halt or even reverse greenhouse gas emissions from land use.

## Implementation Process

Rabo Foundation seeks to improve the position of smallholders in the value chain by offering various credit, risk enhancement and technical assistance products to farmer organizations and other farm impact-oriented businesses that have little or no access to financing and the market. For its part, USAID/India, in partnership with the Indian government, is running multiple projects under

its Environment and Global Climate Change Program, including Forest PLUS, Innovations for Forest Resources Management and Forest-PLUS 2.0. As such, the two institutions play complementary roles. While USAID has a great body of work in sustainable forestry and agroforestry, Rabo Foundation brings years of experience of working with smallholder farmers and their cooperatives to address their credit requirements. Rabo Foundation also has a network of farmer organizations, implementation partners, international donors and financial institutions that would be willing to participate in investments in sustainable landscapes. Both institutions have necessary risk capital, which could be structured for the benefit of local financial institutions that have the required legal structure, mission alignment, risk and operational capability to finance the retail transactions.

While reaching out to financial institutions, Rabo Foundation and USAID realized that:

- Financial institutions tend not to have policies or designated loan products for lending to this sector because they lack awareness about the lending potential involved.
- Financial institutions are not necessarily mission-aligned and do not specifically target the sustainable landscapes sector, which is perceived to be risky.

Rabo Foundation and USAID convened a meeting with a preselected group of financial institutions that were interested in knowing more about the program mandate and qualifications and the structure of credit enhancement available. Subsequently, Rabo Foundation convened a roundtable discussion with financial institutions and other organizations already working on the ground in agroforestry, forest management and sustainable agriculture. The German development agency GIZ made a presentation on its flagship program on Natural Resources Management; the International Fund for Agricultural Development (IFAD) on its Integrated Livelihood Support Project; and the World Wildlife Fund (WWF) on its work in reducing the carbon footprint, among others. The discussion helped participating financial institutions realize the lending potential in the sector, with its broad pipeline of opportunities, and identify potential risks from lending and scale perspectives.

After additional discussions and due diligence with potential local financial institutions, USAID and Rabo Foundation decided to partner with Samunnati Financial Intermediation and Services Private Limited (SAMFIN) and Ananya Finance for Inclusive Growth Private Limited (Ananya) to support sustainable landscapes lending. The role of the two financial institutions is to identify qualifying borrowers and underwrite and administer the loans. Under the risk-sharing partnership with Rabo Foundation and USAID, the local institutions still hold substantial risk themselves. To the extent possible, USAID and Rabo Foundation agreed to help both financial institutions develop a business pipeline.

## Impact

After the launch of the Sustainable Landscape Guarantee Program, in late 2018, the two local financial institutions spent the first few months developing a pipeline by engaging with relevant stakeholders. At the time of this writing, SAMFIN and Ananya together have identified three borrower beneficiaries and plan to fully disburse the total loan amount in 2020. One of the three beneficiary borrowers is an enterprise involved in collection of honey (a non-timber forest product) through an environmentally friendly business model.

Traditionally, honey collectors or extractors—who generally belong to forest-dwelling communities—create smoke to drive bees away from their hive. This practice causes pollution and risks igniting an accidental forest fire, producing a negative impact not only on the bees and trees but also on the larger forest ecosystem. Some harvesters cut off the whole hive from the branch, instead of just extracting a slice of the honeycomb; others chop down the entire tree to get to the hive. This particular borrower developed a scientific, sustainable, smoke-free method whereby honey collectors locate the wild beehives during the day and then return at night, when bees are naturally more docile, to harvest the honey. They cut away just the top portion of the hive, ensuring that it remains a renewable resource; the hive takes two to three weeks to regenerate and is then ready to be harvested again. The absence of smoke protects the forests from accidental forest fires.

Given the uncertainty, risks and limited scale, financial institutions are generally reluctant to meet the credit requirements of such businesses. The guarantee product was developed precisely to support enterprises that are having a positive impact on the environment and leading to a reduction in greenhouse gas emissions. As time goes on, USAID and Rabo Foundation may involve consultants to evaluate the impact of the program and the progress made in reducing or reversing greenhouse gas emissions, using tools developed in-house.

## Lessons learned

The initial discussed size of the program was five times greater (\$75 million). However, the response from financial institutions was limited; therefore, it was reduced to a \$15 million pilot, to be scaled up based on interest from other credit providers. This

clearly indicates reluctance among lenders to provide credit to the sector. Historically, mainstream banks have been disinclined to finance uncollateralized loans. As that describes most of the loans that would originate from this sector, the program was limited to non-banking financial institutions that are mission-aligned and have products to finance loans without collateral. Planting new trees for agroforestry or afforestation is a long-term project which necessitates long-term financing. The partner financial institutions in the program usually have access to short- to medium-term liquidity, which makes it difficult for them to take exposure for the long term. Plus, given the relatively high cost of lending of such financial institutions (*vis-à-vis* banks), it might not be possible to service debt for long-term loans at these higher rates.

The development world is increasingly moving away from grant-based support to semi-commercial support with clear, impact-driven key performance indicators. One way to achieve this is to facilitate working capital and term loans required by impact-oriented businesses. In India, restrictive foreign lending guidelines make it difficult for development agencies to channel support to businesses. Thus, converting development support to credit guarantees to enable lending through local financial institutions seems to be an effective option. The agencies not only help businesses access credit without any market disruptions but also help local financial institutions build capacity to lend in unexplored and riskier sectors.

Based on this experience, it seems that it will be hard to encourage private sector investment in forestry and agroforestry without leveraging the expertise of different sectors. USAID and Rabo Foundation were able to bring other partners to the table to add a focus and develop an approach that incentivizes private sector lending. However, more such collaborations would be required to achieve impact at scale.

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### Notes

i. IPCC, 2019: Summary for Policymakers. In: Climate Change and Land: An IPCC Special Report on climate change, desertification, land degradation, sustainable land management, food security, and greenhouse gas fluxes in terrestrial ecosystems.

ii. For more on India's climate action goals, see <https://in.one.un.org/page/sustainable-development-goals/sdg-13>.

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### About

This case study is part of an effort by the Smallholder and Agri-SME Finance and Investment Network (SAFIN), the Inter-American Development Bank (IDB) and the Organization for Economic Co-operation and Development (OECD) to document the use of blended finance to strengthen agri-SME finance supply.

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