Blended Finance for Agriculture

CASE STUDY

FILLING A FINANCING GAP IN GHANA

FINANCING GHANAIAN AGRICULTURE PROJECT

Synopsis

Primary investors:
- Ghanaian Financial Institutions
- United States Agency for International Development (USAID)
- Feed the Future Initiative
- USAID's Development Credit Authority

Value chain or sector: Soy, rice, maize

Country: Ghana

Type of risk addressed: Business model risks of lenders to agriculture

Type of blended finance instruments:
Guarantees
Payment-for-results incentives
Business Development Services

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Executive summary

An innovative program implemented by Palladium and financed by the U.S government transformed Ghana's agricultural finance market by realigning incentives to motivate behavior change among local private sector actors. The incentives stimulated commercial lending to "missing middle" borrowers in the long-overlooked segment of agriculture that focuses on the staple crops of maize, rice and soy.

Over the course of five years, Palladium invested $5 million—out of a $22 million program known as the Financing Ghanaian Agriculture Project (FinGAP)—to create "smart incentives" that would encourage business advisory service providers and financial institutions to participate in this sector. Ultimately, FinGAP unlocked $260 million in financing and benefited nearly 3,000 small, medium and large agribusiness enterprises, more than 40% of them owned by women.

The incentives, which included subgrants or subcontracts, were accompanied by demand-driven training and technical assistance on how to lend to agricultural supply chains and how to mitigate risk. Palladium also encouraged the use of blended finance at the project level, using strategies such as packaging financing from multiple sources, creating new financial products and layering risk mitigation instruments such as guarantees or subsidies to the private sector. The combination of these blended finance strategies led to significantly expanded agricultural lending—by both local

and international financial institutions—that continues today. More significantly, Palladium helped create a market where financial institutions now compete, in the absence of donor funding, for market position in agricultural finance.

Introduction

Agricultural finance is key to transforming the global food system and reducing poverty in agrarian developing economies. Yet despite repeated efforts by governments and donor agencies to increase access to finance and investment for agribusiness, formidable finance gaps persist. This was the case in Ghana's agricultural sector due to several factors:

- the widespread perception among financial institutions that financing agribusiness is inherently riskier and less profitable than financing other sectors;
- high costs associated with serving smallholder farmers and small and medium-sized enterprises (SMEs);
- sector inexperience and inappropriate financial products offered by financial institutions; and
- limited availability of financial intermediation services for agribusinesses.

The goal of FinGAP was to stimulate commercial lending to the maize, rice and soy value chains in northern Ghana. The $22 million, five-year project (2013-2018), which was funded by the Feed the Future Initiative and the U.S. Agency for International Development (USAID), did just that.

Blended Finance Approach

FinGAP implemented three main approaches to create new value in Ghana's agricultural finance market system.

Key Approach 1: Realigning incentives for improved markets

Prior to FinGAP, both financial institutions and business advisory service providers struggled to realize the growth and profit potential of the agriculture sector, mainly because the incentives were not in place for them to innovate or invest in new service models that would allow them to meet agribusiness needs. To change this dynamic, Palladium designed a two-pronged pay-for-results approach to address both the supply and demand sides of agriculture finance, geared toward the three target supply chains of maize, rice and soy.

Incentives for providing business advisory services

On the demand side, Palladium identified and contracted with 56 Ghanaian business advisory service providers, placing them on results-based contracts to identify, package and present investment opportunities to prospective investors. Palladium encouraged these providers to obtain financing for SMEs from any source and in many forms, including debt, equity, quasi-equity, lines of credit, government or donor grants and, when appropriate, financing via Ghana's capital markets.

Business advisory service providers were paid success fees upon meeting specific targets for identifying, structuring and closing deals. They were also provided "sweeteners" when they closed financing for female-led agribusinesses using available guarantees or via capital markets. Occasionally, due to the complexity of a larger financing deal, Palladium hired two business advisory service providers at once to support financing closure; for example, one might work on capital expenditure financing while the other sought to access working capital for firms and firm suppliers.

Supply-side measures to incentivize loans and investment

Palladium designed a parallel pay-for-results incentive for financial institutions, which included community banks, commercial banks, equity investors, impact investors, leasing companies, nongovernmental organizations (NGOs) and even government banks. This incentive was used to encourage expanded lending in all shapes and sizes to the target agribusiness sectors. The project competitively selected 39 Ghanaian financial institutions and placed them on performance-based grants.

The institutions invoiced FinGAP upon achieving the increased lending outcome targets that they had set for themselves. The focus on results rather than process helped to ensure efficient use of project funds. The project did not mandate how the institutions had to use grant funds; they were free to innovate as needed to reach their lending targets. Partner financial institutions attest that this design was a critical success factor, as it gave them the flexibility to make necessary internal changes in order to expand their lending portfolios and mitigate the associated risk.

Key Approach 2: Improving skills and knowledge among partners

Alongside the pay-for-results strategies implemented to increase financing, FinGAP also built the capacity of project partners so that they could take full advantage of these incentives. Over the course of the project, FinGAP provided more than 9,000 hours of demand-driven training and technical assistance to 93 financial institution participants and 53 business advisory service providers, who collectively designed 31 new products for the agricultural market.

Demand-driven training

Palladium provided both group and institution-specific training to financial institutions on a variety of topics, including agricultural value chain finance methodologies, financing of agricultural machinery and equipment, customer relationship management, management information systems, environmental due diligence, gender and financial inclusion, and financial product development. Over time, the banks increasingly defined their own training priorities and requested support on a rolling basis as they identified training needs. This focus on demand-driven training supported the project's success.

New product development

Business advisory service providers also took a demand-driven approach. Rather than developing a generic loan product and then attempting to convince financial institutions of its suitability for their target market, the service providers worked with specific financial institutions to co-design new loan products based on actual opportunities in the relevant geographic area.

Capacity building

Among other things, the project gave business advisory service providers group training to build capacity in value chain finance, opportunity identification and development, deal initiation and closing mechanisms, financial analysis, equity investment facilitation, and the listing of agribusiness securities on capital markets. For cost efficiency and networking purposes, much of this training was provided in collaboration with financial institutions.

Key Approach 3: Building mutually beneficial partnerships and business relationships

Given the fragmented nature of the agricultural finance system in Ghana, one of the key opportunities for value creation was to forge formal partnerships between actors in a value chain, to enable them to obtain financing to increase sales and exports, as well as to strengthen informal relationships. The goal was to encourage participants in the system to work together, trust each other and better understand each other's needs.

Value chain partnerships

Palladium helped incubate dozens of strategic partnerships among farmers, agribusiness lead firms and financial institutions to encourage blended finance solutions and collectively unlock financing at scale throughout the agricultural value chain in northern Ghana. For instance, the use of financing, guarantees and other public or private incentives (see Box 1) helped support the formation of stable markets and ensure a continuous supply of raw materials for agricultural processing. These partnerships enabled lead firms to gain access to financing, which allowed them to provide smallholder farmers with inputs, credit mechanization services and extension support. Smallholder farmers, in turn, were able to access financing, in-kind inputs, tools and machinery, as well as other services (such as harvesting or machine/tool repairs) to increase yields, boost their income and provide the lead firms with more produce of a higher quality. At the same time, financial institutions and business advisory service providers were able to significantly expand their clientele and portfolios.

Box 1. Blended finance at project level

> Palladium's team built a relationship between the U.S. agricultural equipment company John Deere via its primary distributor in Ghana, AFGRI, and four Ghanaian financial institutions with guarantees backed by the USAID Development Credit Authority (DCA). Under the arrangement developed, all financing deals for John Deere equipment were brought to these financial institutions. In addition to the collateral coverage provided under the DCA instrument, John Deere covered 4 percentage points of the interest rate charged by the partner financial institution to the bank client and offered borrowers training and equipment warranties for the life of the loan.

Expanded networks and business relationships

In addition to creating formal partnerships, the project also cultivated expanded relationships between agribusinesses, financial institutions and business advisory service providers, and acted as an honest broker to mitigate risk for all actors to engage in partnerships. The project held annual investment summits, as well as periodic "mini-summits" closer to production zones. This was to stimulate networking and transactions for enterprises with smaller financing needs, in particular women-led businesses. Frequent networking opportunities, joint training sessions between financial institutions and business advisory service providers, and participation in industry events helped build trust among participants and help them better understand the constraints and opportunities faced by their counterparts.

Implementation process

The FinGAP model designed and implemented by Palladium simultaneously addressed barriers limiting the supply of and demand for finance, as well as those inhibiting the enabling environment. This was achieved by pairing a range of incentives for financial institutions and business advisory service providers, using pay-for-results methodologies, and offering intensive technical assistance and risk mitigation tools to all the players involved, including SMEs and key government institutions.

As illustrated in Figure 1, USAID FinGAP's interventions helped restructure the market for agribusiness finance and business services, drawing both financial institutions and business advisory service providers into this underserved market and strengthening commercial relationships between lead firms and smallholder farmers.

Figure 1. Ghana's agricultural finance ecosystem after the FinGAP intervention

Source: Palladium.

Note: BAS: Business advisory services

The project provided multiple benefits to several key groups:

Smallholder farmers

Before FinGAP, low productivity, high post-harvest losses and inadequate access to markets limited smallholder farmers' income-generating potential. Smallholders also lacked sufficient access to finance and were thus unable to make the necessary improvements in productivity and quality to boost incomes. FinGAP was designed to channel financing to these farmers indirectly, by opening up financing for SMEs in the value chains for maize, rice and soy. These SMEs would then be in a position to on-lend to the farmers who were supplying them.

Agribusinesses

In 2013, SMEs in Ghana's agriculture sector consistently cited access to financing as the principal barrier inhibiting business growth. These SMEs were unfamiliar with the financial system and weren't sure which sources of funds were best aligned to their needs or how to create bankable financing applications that met the requirements of financial institutions. The financing requirements of these SMEs fell in the "missing middle" of amounts that financial institutions are unwilling to disburse: between $10,000 and $500,000. FinGAP's original financing target was to provide 250 SMEs with $75 million in financing at an average loan size of $300,000—lending targets that had never been achieved before in Ghana under previous U.S. government-funded programs.

Business advisory service providers

Prior to FinGAP, business advisory service providers who focused on the agriculture sector lacked a commercial orientation and relied on the government and on donor-funded projects for funding. Two major barriers prevented these providers from making inroads in the market for agribusiness advisory services: (1) their lack of subject matter expertise, and (2) potential clients' skepticism concerning the value of their advisory services. FinGAP designed and delivered demand-driven capacity building for 53 business advisory service providers and 93 financial institution participants to increase their understanding of the value chains for maize, rice and soy. It placed 56 of these on pay-for-results contracts to identify, package and close agribusiness financing deals for financial institutions. What set this methodology apart from previous efforts was that compensation was structured around success rather than simple effort.

Financial institutions

Citing high systemic risks, negative previous experiences and lingering substandard agriculture portfolios, financial institutions were allocating only 5% of their collective lending assets to agriculture at the start of FinGAP. Rural community banks and non-bank financial institutions were dedicating a higher percentage of their lending portfolios to agriculture, but even so, their portfolios did not reflect the size of the agricultural sector. Few financial institutions required use of agriculture insurance, and the institutions were not availing themselves of Ghana's government-supported guarantees offered through EximGuaranty. Palladium designed a flexible, pay-for-results grants program targeting 39 financial institutions to stimulate innovation, increased use of mitigation tools and behavior change in agribusiness lending.

Ghanaian government institutions

FinGAP was partially financed with U.S. government resources under the Partnership for Growth initiative, which helped a set of developing countries accelerate, sustain and broaden their economic growth by addressing key constraints that inhibited private sector development and participation in the economy. Ghana's key constraints were included in a Joint Country Action Plan that was stalled at the beginning of FinGAP. The FinGAP team provided technical assistance to the government in evaluating progress with the plan, shaping implementation strategies and supporting a comprehensive system to help Ghanaian SMEs prosper. The FinGAP team also provided technical assistance to the national Securities and Exchange Commission (SEC) to strengthen its capacity for oversight, regulation and enforcement, as well as to ensure its compliance with the new securities industry law. Lastly, at the beginning of FinGAP, in 2013, the Ghana Alternative Stock

Exchange (GAX) had existed for several months and had not listed any SMEs. The FinGAP team provided technical assistance to the GAX to help SMEs raise debt or equity and remove the obstacles SMEs faced when attempting to list securities.

Impact

The FinGAP blended finance experiment created significant economic and social value for everyone involved.

Economic value for smallholder farmers

- The number of smallholder farmers receiving loans increased by 344%.
- 44% of smallholder farmers who received support established commercial relationships with lead firms.
- Smallholder farmers' gross revenue increased by 57%.
- Production of maize, rice and soy increased by an average of 18% among smallholder farmers.
- Smallholder farmers' average annual profits increased by 74%.

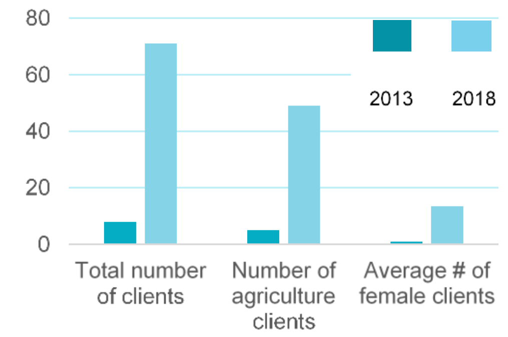
Economic value for agribusinesses

- As a result of FinGAP, 2,995 agribusinesses (41% of them owned by women) accessed $168 million in new financing across the value chains for maize, rice and soy. The financing took the form of debt, equity, quasi-equity, lines of credit and grants.
- Agribusinesses increased their investment in seeds by 1,191% and in fertilizer by 158%.
- $565 million in new, incremental sales were generated by participating firms over the life of the project.
- Two agribusiness firms accessed capital market financing (HOARDS Ltd. and Produce Buying Company, or PBC, the latter with business advisory service support). PBC listed debt on the Ghana Stock Exchange and the Ghana Fixed Income Market, and with SEC approval, created a note program and raised funds from the National Pension Regulatory Authority. This marked the first time in Ghana that a company in the agricultural sector had secured this type of alternative financing. These two SMEs collectively raised $91.1 million in capital market financing.

Economic value for business advisory service providers

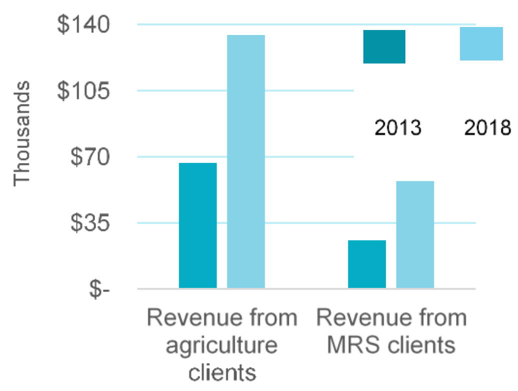
- Participating service providers increased their client base almost eight-fold, with 69% of the new clients engaged in agriculture (Figure 2).
- Business advisory service providers also saw similar increases in the number of female clients and revenue (Figures 2 and 3).
- Revenue generated by agriculture clients for business advisory service providers increased by 102% (Figure 3).
- The service providers increased the number of agriculture clients on average from 8 clients to 71 (Figure 3).

Figure 2. Client base of business advisory service providers



Source: Palladium

Figure 3. Client revenue from business advisory services providers



Source: Palladium

Economic value for financial institutions

- Participating financial institutions increased their loans to agribusinesses by 80% and their loans to the maize, rice and soy sectors by 160% (Figure 4).
- Financial institutions doubled their number of agribusiness clients over the life of the program (Figure 5).

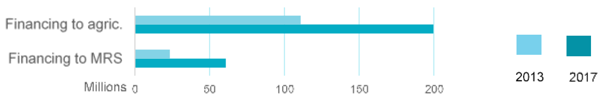
- The average loan approval turnaround time for financial institutions decreased by 55%, from 49 days in 2013 to 22 days in 2017.

- Financial institution revenues from agricultural loans increased on average by 303% between 2013 and 2017.

- Average non-performing loans for financial institutions on loans to the maize, rice and soy value chains decreased by nearly 60%, from 11.8% to 4.8%.

- To address the limited number of appropriate products offered by financial institutions, FinGAP's partner banks and business advisory service providers created 31 new products to lend to the agriculture sector.

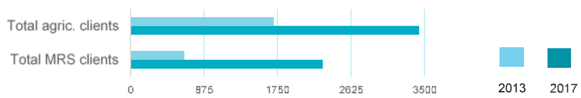
Figure 4. Financial institution loans to agribusinesses



Source: Palladium.

Note: MRS-Maize, rice and soy.

Figure 5. Number of agribusiness clients



Source: Palladium

Note: MRS-Maize, rice and soy.

Economic value created for the Government of Ghana

- Five new firms were listed on the GAX.

- The 2,995 agribusinesses supported by the project created an estimated 17,900 full-time jobs as a result of the support received under FinGAP.

- The project unlocked $260 million in new financing ($127 million in working capital, $41 million in capital expenditures and $91 million from capital markets). About 65% of this financing ($168 million) went to the maize, rice and soy supply chains.

Social value created through FinGAP

- Women's empowerment. By the end of the project, 1,231 women-led businesses (41% of the total) accessed financing directly through the program, and 72,225 women accessed financing and other agribusiness support indirectly, through other actors that received loans and investment from financial institutions.

- Household investments. Smallholder farmers reported that in the last three years of the project they increased their savings, investments in education for both boys and girls, and expenditures on health care for their families.

- Improved quality of life. In 2018, 43% of smallholder farmers reported that they were able to make improvements to their sanitation facilities, 25% reported improved access to water and 73% reported improved access to electricity, thanks to FinGAP.

- Food security. FinGAP's financing support to firms and farms meant that fewer vulnerable families in northern Ghana suffered days without eating (from 6.4% in 2013 to 4% in 2018).

- Widespread impact. Through expanded financing, FinGAP ultimately helped 169,000 farming families in northern Ghana improve their economic well-being.

Lessons learned

- The lion's share of the loans to agribusinesses were made by commercial banks; however, rural community banks successfully made loans to 59% of the 2,995 SMEs served by FinGAP.

- The largest percentage of financing went to input providers (47% or $78 million) followed by output processors ($35 million), agricultural producers ($32 million) and traders ($16 million). The remaining 4% went to other actors in the value chain.

- Loans to agribusiness proved to be less risky than other loans among FinGAP-supported financial institutions. Their non-performing loans were under 5% in the target sectors, compared with their average rates of 15%. Non-performing loans for the agriculture sector as a whole were reported at 22.7% by Ghana's Central Bank.

- Financial institutions noted that the aspects of the program that they valued most and that they believed contributed to success were—in the following order—training and technical assistance, participation in networking events, access to flexible grant funds, high-quality technical support from the FinGAP team and introductions to business advisory service providers.

- For their part, business advisory service providers most appreciated networking events, followed by tailored training and capacity building.

- FinGAP improved the range and quality of advisory services for agricultural firms, as intended, and motivated financial institutions to lend significantly more to agribusiness in the "missing middle" category. The vast majority of both groups now see supporting SME agriculture clients as good business.

- The program changed the conversation in Ghana for SMEs. Over the life of the project, they went from seeking mainly debt financing to pursuing alternative financing options and facilitating $7.7 million in equity (principally from equity investors and in some cases business advisory service providers themselves). They also obtained pension fund involvement for the first time in agribusiness investment on the capital markets.

- Loan size makes a difference, if having a gender focus is a priority. Early in the program, a focus on facilitating the larger deal sizes had the effect of excluding direct support to female entrepreneurs. This was because of their location in the value chains. The FinGAP team had to restructure its incentives and loan qualification rules to serve more female-run agribusinesses. Hiring female-led business advisory service providers had the most direct and positive impact on the number of women served by FinGAP.

- FinGAP also proved the connection between increased access to finance and SME growth. SMEs supported by the program increased gross revenues by 30% between 2013 and 2018, increased employment by 85% and improved women's decision-making across SMEs by 60%.

- Financial incentives placed with financial institutions were more effective at mobilizing large amounts of capital for agribusiness than they were at subsidizing pipeline development and deal closure among business advisory service providers. Financial institutions placed $126 million in financing with roughly $2 million in pay-for-results incentives; with the same amount in incentives, business advisory service providers closed deals worth $48 million.

- Simply having access to better data from the online investment management system created by FinGAP was not enough to motivate new investments. On the other hand, these technological tools can provide excellent support in the due-diligence process required for new investors in staple food sectors.

- Few loans were backed by guarantees, despite the existence of many guarantee instruments funded by the Ghanaian and U.S. governments and the pay-for-results incentives intended to motivate their increased use. Financial institutions cited the administrative burden and costs related to use of these tools as the main reasons for not using them more often.

Key factors that contributed to the success of this project

- The results-based methodology had buy-in from the donor (USAID), and the donor delegated the task of how funds or incentives were managed to the implementing partner.

- The budget was sufficiently aligned with the development impact being sought.

- The proactive FinGAP team in Accra and Tamale provided consistent, high-quality customer service to everyone involved, providing additional risk mitigation.

- The project had capable back office systems for procurement, risk mitigation, financial management and oversight.

- The implementation process included rigorous monitoring and evaluation and constant adaptation geared toward obtaining results.

- The quality of services provided was closely monitored, and the FinGAP team intervened quickly when participants reported dissatisfaction with the services provided.

Outstanding gaps that require new policy and practice

- Interest rates charged to farmers continue to be high.

- Farmers receiving financing still lack sustainable technical assistance and market linkage support.

- Adjustments in the agricultural insurance market are needed to provide a sustainable, market-based tool appropriate for farmers and financial institutions.

- There is a need for continued investment in warehousing and irrigation to support expanded production and to reduce production risk, especially in areas prone to drought or inconsistent rainfall.

- Agribusiness firms would benefit from continuous education to encourage capital market development and expanded equity investment. Education is also needed among financial institutions to better define the real risks in agribusiness financing.

- Ghana needs a wider range of local business advisory services with more expertise in complex deal structuring involving equity, stock exchange listing and pension fund involvement.

- The potential exists to use pay-for-results incentives to mobilize expanded finance in agribusiness (given the estimated unmet demand for financing of $2 billion annually) and to target additional sectors (such as health, education, environment or sanitation)

Overall, FinGAP was a market disruptor project that completely changed the landscape for agriculture finance in Ghana. With a USAID investment of $22 million, Palladium facilitated $260 million in private capital into the agricultural sector ($168 million for the maize, rice and soy value chains). It also pulled local financial institutions into sustainable agricultural lending and created a robust market for agribusiness advisory services. FinGAP should serve as a model for other countries regarding best practices to change lending behavior in the agriculture sector.

Coverphoto: ©IFAD/ Bernard Kalu

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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