SAFIN

LEARNING NOTE

2

THE ROLE OF BLENDING IN GREEN FINANCE FOR AGRI-SMES

SMALLHOLDER
AND AGRI-SME FINANCE
AND INVESTMENT NETWORK

Addressing climate change in food and agriculture, both in terms of mitigation and of adaptation, requires large-scale investments of both public and private resources. Blended finance can be an important part of the financial toolbox used to mobilize and align a variety of private financial flows towards such investments, not only by de-risking financial flows but also by expanding pipeline and facilitating ecosystem alignment around what constitutes green business models for small and medium-sized enterprises active in food and agriculture (agri-SMEs).

Introduction

This second Learning Note[1] on green finance for agri-SMEs focuses on the role of blending concessional sources of green finance – either alone or alongside various types of development finance – to mobilize commercial capital for agri-SMEs. This note builds on information gathered through activities related to this theme in the SAFIN learning agenda for 2021.[2] The objective is to share learning points of relevance to industry practitioners interested in catalyzing green investments for agri-SMEs.

Key Learnings

Blended finance solutions, which leverage development-orientated capital to de-risk investments towards the Sustainable Development Goals, have been a central concern for SAFIN since its inception, given the importance of risk and the cost of capital in shaping the capacity of lenders and investors to serve agri-SMEs.[3] Green finance is a specific type of capital that comes with an agenda of environmental impact that requires high risk tolerance to enable change and innovation. As such, it can be an important element in blended solutions designed for financial service providers (FSPs) and investors to enable agri-SMEs to make climate-positive investments or to deliver services that increase the climate resilience of farmers.

Significant challenges lie on both the supply and demand sides when using green finance in blended solutions for agri-SMEs. On the supply side, the size of public green finance flows to agriculture is limited, and the appetite of ESG-minded investors interested in green assets and projects in this particular sector is also limited in many emerging markets. On the demand side, there is a dearth of financial products and services fit for the development of green assets or projects, including long-term (4-7 years) products aligned with the timeline of growth or sourcing of sustainable crops or the purchase of equipment and technologies to shift to sustainable practices. There is also limited demand for green finance among FSPs serving agri-SMEs. Limited demand could be due to lack of awareness, the complexity of application and reporting processes with official sources of green finance, low appetite or capacity to adapt FSP portfolio management systems to align with a green impact agenda, and limited SME-level pipelines.

1 The first Learning Note in the series (SAFIN Learning Note #1) was published in November 2021 and focused on the development of effective partnerships to mobilize and deploy green finance for agri-SMEs.

2 The learning agenda prioritized by SAFIN partners for 2021-2022 includes green finance for agriculture, digital innovations in agri-SME finance and finance for farmers' organizations. Activities hosted by SAFIN on the theme of green finance this year include a Landscape Note, covering existing knowledge by SAFIN partners and other prominent actors; a workshop on green finance for sustainable agriculture co-organized with CABFIN; a webinar on a partnerships in green finance for agri-SMEs, featuring Rabobank and Samunnati; and a workshop on effective partnership models in green finance co-organized with CGIAR.

3 SAFIN and Convergence, Deploying Blended Finance to Mobilize Investment at Scale in Food and Agriculture. Working Paper 8 (Rome and Toronto: SAFIN and Convergence, 2021), https://5724c05e-8e16-4a51-a320-65710d75ed23.filesusr.com/ugd/e03597_f3903ab8490244a4a87a66bdbe09b7ff.pdf.

Blending solutions can help to address some of these supply and demand challenges. On the supply side, green finance providers, like the Global Environmental Fund or the Green Climate Fund, can enter into blended structures to de-risk or reduce the cost of capital for institutions that want to finance green investments. They can enter either alone or with providers of development finance, like public development banks, international development finance institutions, philanthropies or public donors. However, there is also need for green finance to be used through blending for project preparation and technical assistance. Indeed, investments at the intersection of climate and agriculture may particularly benefit from this type of application of blending, notably for **pipeline development** and for proof of concept for **green agri-SME business models**.

Pipeline development

With green finance, the development of a pipeline of investable agri-SMEs is complicated by the need to identify assets or projects that align with specific green impact objectives around carbon, adaptation, biodiversity, water use, waste reduction, or others. While there may be many agri-SMEs whose business models also deliver in these areas, many more are likely to require support to increase their capacity to deliver such impacts. On their side, FSPs and front-line investors in emerging markets often have limited visibility on the agri-SME market and the mandate or capacity to grow the market of green and investable SMEs. Therefore, for blending to have impact beyond de-risking specific transactions it needs to support FSP outreach and investment capacity through pipeline generation. To this effect, it is important to integrate enterprise support organizations (ESOs) into theory of change around blended structures that involve green finance with the sector, as well as to use a variety of blended approaches and tools (including guarantees, first loss capital, and project preparation funding or technical assistance) to both de-risk or enhance specific investments and to support longer-term FSP capacity to invest in green agri-SME portfolios.

Funding pipeline development in the Subnational Climate Finance (SCF) Initiative

The SCF is a blended private equity fund investing inter alia in nature-based solutions, with an ambition to deliver measurable and certified Sustainable Development Goal impacts at the local level. A key area of use of concessional capital around this fund is its technical assistance facility, which supports deal sourcing, impact monitoring and certification, and local government capacity for regulatory work and contract enforcement.

Green agri-SME business models

Unlike more established sectors of application for green finance (e.g. renewable energy), there is little agreement on the definition of "green" in agriculture and for agri-SMEs, and there is a lack of taxonomies of business models associated with green impact. While this is a constraint for blended solutions, especially from a scale of mobilization perspective, such solutions can be used to advance alignment among different actors about what constitutes green business models in the agri-SME space. Specifically, blended solutions can be designed to support proof of concept transactions or portfolios through strong monitoring and evaluation (M&E) systems and an explicit innovation agenda. The coming together of green finance and development finance providers in a blended structure can accelerate the process of identifying green agri-SME business models that also deliver positive impact in other key areas (e.g. gender, nutrition, employment and livelihoods), which can then feed into standardizing impact metrics for this sector. This is because such combinations can bring to the same table the expertise and metrics of green finance providers, the expertise of development finance providers in a range of other development impact areas, and the sector-related and M&E capabilities of local FSPs. In this context, de-risking investments in digital data generation and management for FSPs, enterprise support organizations and agri-SMEs can also be a key area of investment, as digital tools can greatly reduce the cost of generating and managing credible information around multiple impact areas to support both green business model development and standardization of metrics.

Diversifying impact areas and harmonizing metrics in the Inclusive Green Financing initiative (IGREENFIN)

IGREENFIN is an "IFAD-green finance brand" and the first Green Climate Fund lending regional programme to be implemented at scale in five West African countries. It uses concessional funding from GCF, IFAD and government to leverage participation from local financial institutions to finance climate change adaptation and mitigation actions, including with an SME focus, and to help harmonize green lending, climate risk management and impact assessment practices across the five countries and in the GCF portfolio.

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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.

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