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FROM THE AMERICAN PEOPLE

USAID Bureau for Food Security Agricultural Financing Strategic Support

Phase 1 & 2 report – Findings from Field Visits
Executive Summary and Kenya Extract

21 July 2017



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- 1. Summary of learnings from field visits**
2. Summary of market challenges
3. Country deep-dive: Kenya



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Summary: Our interviews drew out findings in several areas:

Shared themes from Agricultural Finance markets:

1. Significant **sources of finance** are available across markets in terms of both debt and equity...
2. ...but these are **difficult to mobilize** for agriculture due to constraints affecting both investors and investees
3. The **policy environment** is a critical bottleneck, particularly in less mature markets
4. **Digital solutions** have roles to play especially in product distribution and risk management
5. **Additional products** represent exciting, but longer-term, opportunities

Perspectives on USAID programming:

6. USAID is viewed as having **clear strengths** around quality program delivery and convening / advocacy power although are not a technical leader and should improve contract flexibility ...
7. The **relationship between USAID missions and DC** depends on specific relationships and is therefore non-standard across programs
8. **DCA** guarantees can be effective when institutions are sufficiently supported

Improving Agricultural outcomes through Finance:

9. **Investment** should focus on building market linkages across the value chain
10. There a range of **interventions** for USAID to consider



1. Significant sources of finance are available across markets

Bank finance

Large and Available

- Significant debt is available in the market
 - “Banks have significant amounts of capital available to lend” – Rockefeller
- Typically provided by formal institutions such as Commercial Banks and MFIs
 - “Multiple local MFIs are supplying finance to MSMEs with commercial banks focus on the big projects” – USAID MARKETS Kenya
- As well as community / cooperatives
 - “Local financial cooperatives are the most effective tool to reach smallholders” – FUNDER Honduras

Traditional Equity

Large but Latent

- Latent pool of funding available in the form of formal Private Equity and Impact investors...
 - “There is material equity available in the market” – USAID FIRM Kenya
- ...as well as High Net Worth Individuals
 - “There a material number of wealthy individuals who are looking to invest in business” – USAID NEXT Nigeria

Other Finance

Currently Unobtainable

- Each geography appears to have a source of equity that is untapped due to lack of appropriate policies:
 - “**Remittances** make up about 30% of the GDP of the country but all of this is consumed, government schemes have not been able to catalyze these funds” – World Bank Nepal
 - “**Pension Funds** in Nigeria are prevented from making equity investments by law, representing a material opportunity” – USAID, Nigeria
 - “**Commercial Paper and SACCOs** could be an opportunity for investment in Kenya but policy environment doesn’t exist yet” – FSD Kenya
 - “**Non-debt financing options** in Honduras are nascent” – Across Interviews, Honduras



2. But financing is difficult to mobilize due to constraints that affect both investors and investees

Investors

Agriculture is unattractive vs other sectors due to:

- Lower expected return on investment (ROI)
 - *“Typical agri-business ROI is 20% whereas we expect around 25-30% in other sectors”* – DEG West Africa
- Longer timeline to deliver return
 - *“Investments will take 2 years before they even start delivering cash flow”* – Sahel Partners FISFAP West Africa
- Higher actual investment risk
 - *“Climate change and pest challenges are increasing risk in the sector”* – Ficohsa Bank Honduras
- Higher perceived investment risk
 - *“Lack of understanding around sector dynamics increases risk perceptions”* – USIAD Kenya
- Lack of skill set amongst investees
 - *“Investees lack basic skills around Strategy Design, Governance and Agronomic knowledge”* – CIMMYT Nepal
- Few equity exit opportunities
 - *“The market is immature which means there are few exit opportunities – this is the biggest equity barrier here”* – DFID Sakchyam Nepal

Investees

Agri-businesses are generally smaller and less mature vs other sectors, and:

- Debt products do not meet borrower needs
 - *“Interest rates are prohibitively high for small and medium-sized businesses”* – Banhprovi Honduras
 - *“Disbursement timings are often not optimized for seasonality of agriculture businesses which reduces utility of loan”* – MARKETS USAID Kenya
 - *“Repayment terms ignore seasonality of the business since many businesses have no cash flow for multiple months in the year”* – Fintrac, USAID
- Equity investments are culturally unattractive to many entrepreneurs
 - *“Agri-businesses are run as family enterprises: they have little interest in sharing control of the business with an investor”* – Impact Investor, Nepal
 - *“Entrepreneurs typically remove all cash from a business at year-end, this kind of behavior is unpalatable for equity investors”* – USAID NEXTT Nigeria



3. The policy environment is a critical bottleneck, particularly in less mature markets

Government action

Ag-focused Policy

- Governments are prioritizing ag lending through **interest rate caps and lending quotas**, although these are **not always well-designed** and can lead to de-prioritization of the sector
- Some government **guarantee schemes are being set up** and are effective in stimulating the market, but risk distorting incentives and behaviors over the longer-term
- Land is still **owned by the state in many markets**, eliminating a source of collateral

Financial Sector Regulation

- **Equity investment is curtailed** in some markets both by sector-based FDI restrictions and by prudential regulation of domestic pension funds
- Prudential lending guidelines **restrict lending on moveable collateral or unsecured basis** in many markets, limiting agricultural lending

Government capacity

- Policies and sector promotion schemes are sometimes viewed as **competing or inconsistently / poorly implemented**
- **Contract enforcement is a major roadblock** to development of market linkage schemes

Gov't Investment

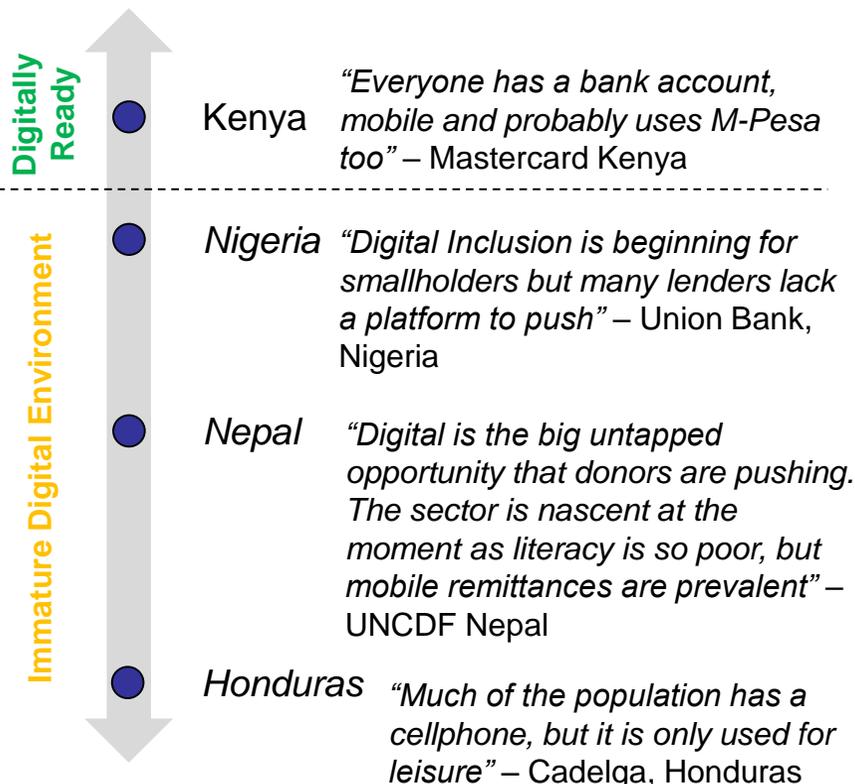
Enabling environment & infrastructure

- **Physical infrastructure** enables bank reach and financial inclusion which drives product awareness and distribution for the most inaccessible communities
- **Digital infrastructure** enables high volume, low value transactions so is particularly pertinent to smallholder farmers
- Countries are developing **central credit bureaus** to reduce risk and build trust, but they are at very low levels of maturity in most markets



4. Digital solutions have a role to play in distribution of financial products as well as risk management

Relative market maturity



Potential role of digital

- **Reduce cost to serve** low value accounts and inaccessible regions where infrastructure is underinvested
 - The immediate opportunity could drive financial inclusion in inaccessible regions / nascent markets, thus acting as branch extensions eg through agent networks
- Enable **remote transactions** to be made between businesses
- Improve **risk management** processes, both by **tracking transaction data** and by **providing alternate credit scoring methods**
- There is an outstanding requirement, across geographies, for a consistent policy framework to sustainably enable digital markets



5. Additional products represent exciting but longer-term opportunities

Intervention	Market Need	Current Product Availability
Equipment Leasing	<p>High</p> <ul style="list-style-type: none"> “Significant latent opportunity for equipment leasing” – GEMS4, Nigeria 	<p>Low</p> <ul style="list-style-type: none"> “Developing the right business model is the critical challenge” – Christoph Walters
Cash flow or moveable collateral-based lending	<p>High</p> <ul style="list-style-type: none"> “Banks cite lack of collateral as the key bottleneck to accessing finance for SMEs” – Invest-H, Honduras 	<p>Low</p> <ul style="list-style-type: none"> “Currently all lending requires collateral, early initiatives around psychometrics tests are promising” – Mastercard, Kenya
Crop and inventory insurance	<p>High</p> <ul style="list-style-type: none"> “Insurance products are not properly understood or implemented by institutions nor trusted by borrowers. The market require innovation” – AfDB, Africa 	<p>Mixed</p> <ul style="list-style-type: none"> “There are no products that cover the real value of the crop, rather than just the inputs” – DFID, Nepal “The government is missing appropriate regulation to stimulate the market” – GEMS4, Nigeria
Warehouse Receipts	<p>Medium</p> <ul style="list-style-type: none"> “Enables price maximization as products can be sold throughout the year and value-add businesses (eg processors) can maintain access to product” – SNV, Kenya 	<p>Low</p> <ul style="list-style-type: none"> “Some local financial cooperatives are doing warehouse receipts but it is nascent” – Fintrac, Honduras “lack of enabling sectors eg cold chain prevent warehouse receipt system” – NEXTT, Nigeria



6. USAID is viewed as having clear strengths and weaknesses relative to other donors

Quotes from Interviewees¹

Strength

- **Local Knowledge**
 - *“The missions and implementing partners have a good understanding of the local issues”* – Implementer
- **Quality Capacity Building Programs**
 - *“USAID’s Capacity building activities are generally well regarded, so connecting beneficiaries to institutions would enable lending”* – Implementer
 - *“Stamp of approval from USAID is a big deal for borrowers”* – Implementer
- **Convening power**
 - *“USAID should be working to bring stakeholders together and drive top-down change”* – Government Agency
- **Policy Advocacy**
 - *“USAID have a good relationships with government and can influence the right people”* – Other Donor

Weakness

- **Flexibility** during contract implementation
 - *“Contract flexibility and donor responsiveness is a big issue for USAID, particularly when compared to others like DFID. It is hard to make contract changes or updates, which in turn reduces program impact”* – Implementer
 - *“It took 6 months to add each beneficiary organization, so we lost time. It is a particular issue in seasonal markets”* – Implementer
- **Technical Knowledge**
 - *“Central bureau don’t have the technical expertise nor the field knowledge to design programs, they need to devolve as much of that knowledge as possible and contracts local experts”* – Implementer
 - *“USAID aren’t thought leaders in the tech / financial space. Donors like BMGF and Mastercard are leading that area”* – Sector Expert

1. Interviews from Nepal, Nigeria, Kenya and Honduras



7. The relationship between Missions and DC depends on specific relationships and differs by program

Quotes from Mission Staff¹

	Description	Strength	Weakness
Quality of Central Programming	Central teams should coordinate their program design activities with the missions to align on local needs...	<ul style="list-style-type: none"> “The central team have been effective when they <i>invest in sufficient implementation resources</i> on the project and have a clear program design that we can support on” 	<ul style="list-style-type: none"> “Some research projects have <i>lacked coordination</i> with the mission team, resulting in a program design that couldn’t work”
	...and invest in an appropriate delivery teams to ensure successful implementation	<ul style="list-style-type: none"> “The central team have been effective when they <i>invest in sufficient implementation resources</i> on the project and have a clear program design that we can support on” 	<ul style="list-style-type: none"> “Central projects can be understaffed and we don’t have the resources to run additional projects” “When a centrally-run project is not going well, we need a process to <i>influence central decision-making</i>, this is hard at the moment”
Relationship between Missions and Central Office²	Central office should push relevant information to the missions...	<ul style="list-style-type: none"> “We get a good amount of <i>useful information</i> from the Asia office but that might just be our good relationships there” 	<ul style="list-style-type: none"> “There is too much generic <i>information sharing</i> and central databases are hard to use” “We don’t get enough good <i>information transfer</i> across missions”
	...and focus on leveraging core competencies	<ul style="list-style-type: none"> “As an organization, USAID have <i>convening power</i> – we can certainly get the right people in the room” 	<ul style="list-style-type: none"> “USAID central and BFS are too focused on pushing ideas out but <i>lack understanding</i> of the local or technical issues, including financing”

1. Interviews from Nepal, Nigeria, Kenya and Honduras

2. Honduras commented that “most funding goes to Africa / Asia therefore DC rightly reduce attention on Latin America so the mission is arguably more independent”



8. DCA guarantees can be effective when institutions are sufficiently supported

Quotes from Interviewees¹

Implementation

- Implementation can be **expensive** in terms of **time** spent by employees...
 - *“We were first introduced in 2011, opened in 2016 and we are just now getting 3 weeks of capacity building assistance”* – MFI, Nepal
- ...and the **premium paid** upfront
 - *“The economics didn’t stack up for us, the up front cost wasn’t worth the risk of under-utilization”* – Bank, Nepal
- DCA should be accompanied by **capacity building** to support the institutions
 - *“At my last bank, no one on the sales side knew when to use the DCA. But even when they did, our applications were blocked by the credit team anyway”* – Bank, Nigeria
 - *“The DCA program in Honduras is run through an MFI that lacks knowledge/capacity in the ag sector; as a result loans don’t make it to rural communities”* – USAID Mission, Honduras

Impact

- Lending, backed by the DCA, can drive **material market growth**
 - *“Our DCA-related lending has been for projects that we never would have signed off before”* – MFI, Nepal
- But depends on the strength and capacity of the **institution’s leadership...**
 - *“You need a committed team and expertise across the organization”* – Implementer, Kenya
- ...as well as the **needs of the beneficiaries** which often don’t match the DCA terms
 - *“We can’t make working capital loans, but that is a material challenge for the market”* – MFI, Nepal
- **Further impact** could be delivered by coordinating with other USAID programs
 - *“DCA activities should be coordinated with other programs to multiply the impact”* – Implementer

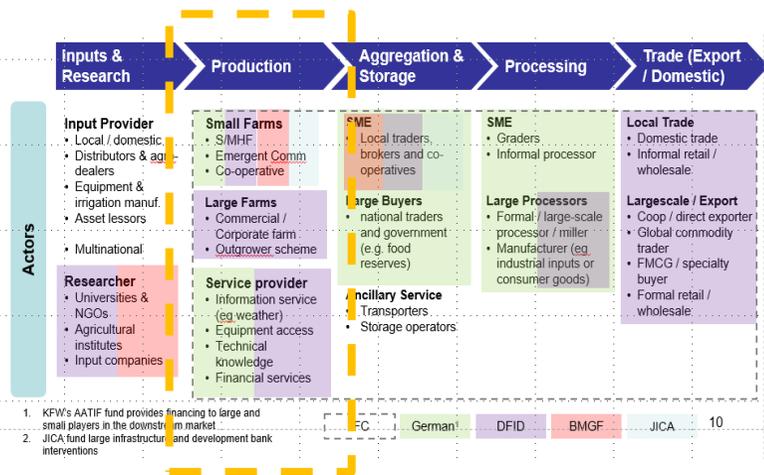
1. Interviews from Nepal, Nigeria, Kenya and Honduras



9. Investment should focus on building market linkages across the value chain

Historical & Existing Programs focused on Production and SMEs...

...the next phase of programming should address market linkages



Historically, donors focused on smallholder farmers and productivity...
...many donors, including DFID and KfW, are emphasizing the systems approach and broadening programming to include the entire value chain

- **Agronomic practices remain important for productivity, but improvements can be made by building market linkages**
 - “Strong market linkages are the critical piece of the puzzle, rather than just agro-training” DEG, Nigeria
 - “Thanks to our agronomic training and technical assistance, producer get the stamp of approval they need to strengthen trust with FIs and access financing” – FUNDER, Honduras
- **Input Supply and Equipment provision are critical bottlenecks for productivity**
 - “Farm productivity remains the critical challenge which means timely / quality inputs and improved post-harvest mechanization” – GEMS4, Nigeria
 - “Timely input provision and application requires integration across suppliers and producers” – FSD Kenya
- **First-level Aggregation and Storage are the key bottlenecks to improving outcomes in rural communities**
 - “The outstanding challenge is aggregation and market linkages post-harvest” – ASI Nepal
 - “Post-harvest linkages are critical for smallholder farmers in Africa” – Technoserve Kenya



10. There a range of interventions to explore in the next phase

Preliminary – Not exhaustive

Donor Interventions

Technical Assistance	Public Information	<ul style="list-style-type: none"> • Build a federated data set of beneficiaries from field programs to match with financing • Analyze and document value chains and integrate findings into lender processes
	TA for organizations	<ul style="list-style-type: none"> • Build pipeline of value chain actors for future investment • Build capacity of financiers to innovate new products reach new investees
	Form Groups	<ul style="list-style-type: none"> • Formalize market linkages between value chain actors • Support formation of cooperatives
Advocacy	Inform	<ul style="list-style-type: none"> • Build internal knowledge sharing capability for best practices and AgFi learnings • Develop thought leadership on a specific topic eg mobile payments
	Convene	<ul style="list-style-type: none"> • Convene US companies to invest in attractive markets eg equipment supply • Convene donors and value chain actors to coordinate interventions in-country
	Lobby	<ul style="list-style-type: none"> • Advocate to government by convening government and the private sector
Direct Funds	USAID Funds	<ul style="list-style-type: none"> • Set up a low ticket size VC fund, offer seed funding / first-loss risk guarantee • Set up a Challenge Fund and prioritize critical bottlenecks for investment • Set up a Loss Fund to mitigate currency risk for private investors
	New Fund	<ul style="list-style-type: none"> • Set up a Peer to Peer lending platform that catalyzes latent funds • Develop a DIB product that others can leverage

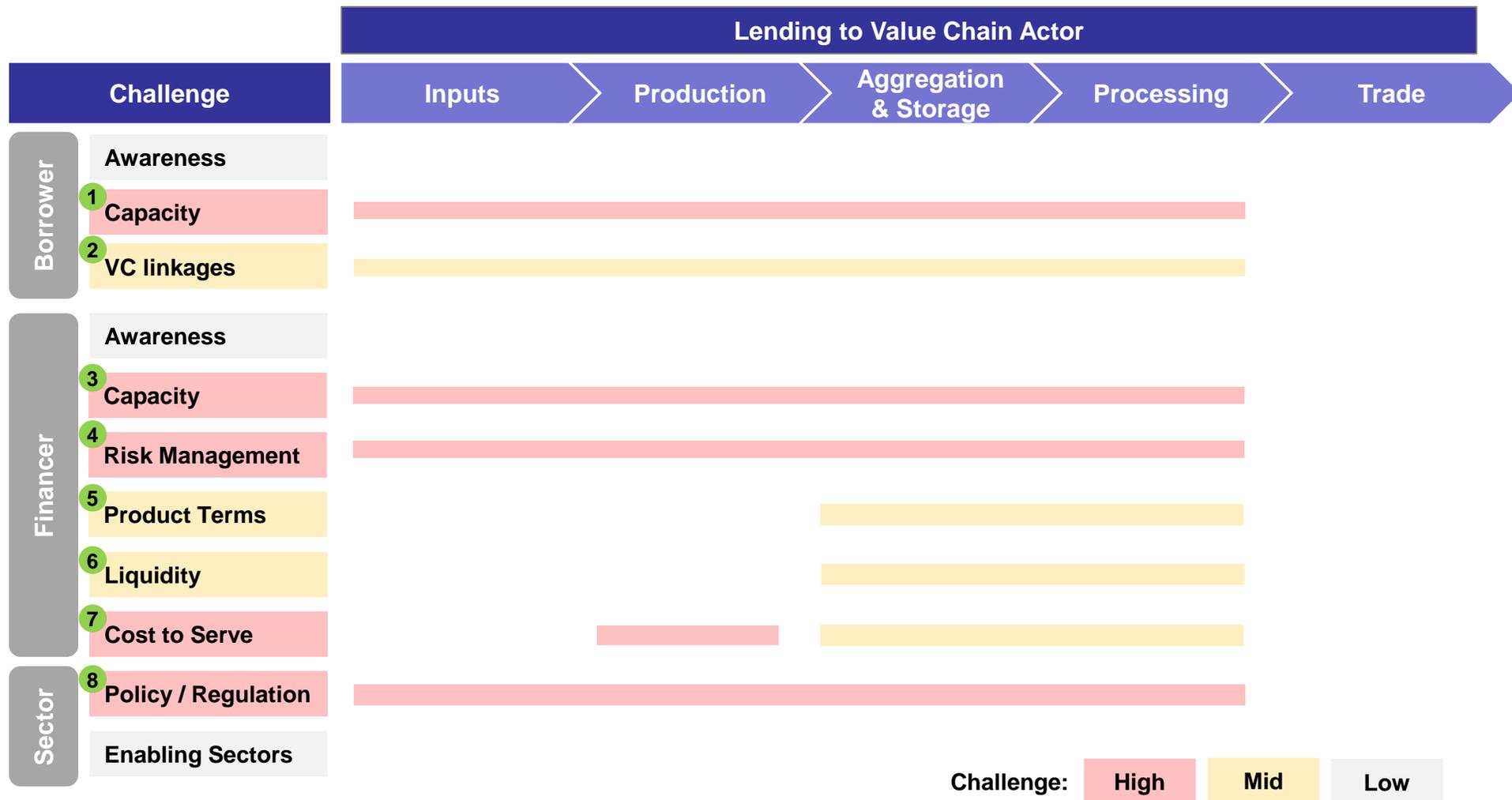


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Key challenges are around capacity building & policy design





Borrowers lack basic skills to attract investment

Challenge	Description	Impact on Market Actors	Importance	Intervention Example	
Borrower	1 Capacity	<p>Lack of basic skills across:</p> <ul style="list-style-type: none"> • Governance structure • Business strategy • Business plan • Financial literacy • Agronomic knowledge 	<ul style="list-style-type: none"> • Financiers cannot invest in entrepreneurs with material skills deficiencies but there is a lack of knowledge across all market actors: <ul style="list-style-type: none"> ○ MSMEs across the value chain lack a clear governance structure, well-articulated business strategy and even agronomic knowledge ○ Smallholder farmers are primarily challenged by financial literacy 	<p>High</p> <p>Critical challenge that prevents investors performing effective / accurate applicant diligence</p>	<ul style="list-style-type: none"> • Capacity build businesses across key skills • Invest for multiple seasons to affect sustained behavior change • Match potential investors with the businesses
	2 Value Chain Linkages	<ul style="list-style-type: none"> • Limited relationship strength between value chain actors • Results in low trust... • ...leading to a loose value chain that is hard to monitor and therefore unattractive to finance 	<ul style="list-style-type: none"> • The lack of assured revenue pipeline and ability to forecast business profitability increases risks for financiers resulting in rejected applications for equity / debt <p>All value chain actors are affected:</p> <ul style="list-style-type: none"> • Agro-dealers lack a ready market for their products • Producers lack access to inputs and a guaranteed buyer of output • Processors / aggregators cannot predict or guarantee input volumes and prices making business plan challenging to rely on • Insurance can be leveraged by VC actors to mitigate production shocks (eg weather) but is not widely used currently 	<p>Medium</p> <p>Formalizing relationships across a value chain de-risks business activities, increasing attractiveness to a financing party</p>	<ul style="list-style-type: none"> • Convene value chain actors to formalize purchasing agreements • Work with stakeholders for multiple successful harvests to instill behavior change • Prioritize tight value chains initially¹

1. Commodities that lack opportunity for side-selling (specialty crops) or where transactions are higher frequency (eg dairy)



Lender challenges are around building internal knowledge and systems (1/2)

	Challenge	Description	Impact on Market Actors	Importance	Intervention Example
Financier	3 Capacity	<ul style="list-style-type: none"> Lack of knowledge across value chains and typical agri-business economics Systems optimized for other sectors cannot support agri-businesses 	<ul style="list-style-type: none"> Financier Understanding of agri-businesses is poor, particularly within informal markets, so they cannot reliably diligence an application resulting in inflated interest rates on loans or applicant rejection Although information availability is better within tight value chains¹ which increases financier comfort Financier Systems are not optimized for MSMEs in terms of a high volume of low transaction value, so much invest in new capabilities / platforms 	<p>High</p> <p>Critical challenge that prevents investors performing accurate applicant diligence and fund disbursement</p>	<ul style="list-style-type: none"> Work with senior management to change strategy from top-down Employ experts to capacity build the bank's team Invest in appropriate systems / staff
	4 Risk Management Tools	<ul style="list-style-type: none"> Lack of understanding drives inflated risk perception Appropriate risk mitigation tools required to manage a portfolio 	<p>Lenders are particularly affected:</p> <ul style="list-style-type: none"> Financiers should be able to design products and systems that flag risks early, trigger an appropriate intervention and mitigate aggregate risk at a portfolio level Failure to do so overly-inflates risk estimation, resulting in application rejections and inflated lending rates 	<p>High</p> <p>Critical challenge that enables appropriate investment terms (eg interest rate)</p>	<ul style="list-style-type: none"> Build better credit scoring and data-sharing systems Work with financial institutions to develop an insurance product that de-risks value chain financing

1. Commodities that lack opportunity for side-selling (eg tobacco) or where transactions are higher frequency (eg dairy)



Lender challenges are around building internal knowledge and systems (2/2)

Challenge	Description	Impact on Market Actors	Importance	Intervention Example	
Financer	5 Product Terms	<ul style="list-style-type: none"> Existing products do not meet the needs of customers 	<ul style="list-style-type: none"> SMEs across value chain are particularly affected: <ul style="list-style-type: none"> Lenders typically require material collateral, often exceeding the value of the loan, SMEs are unable to supply this, preventing disbursement. Lenders won't rely on SME financial reporting (cash flow lending) given short business history and low reliability of borrowers MFIs are able to leverage community groups to de-risk payments and therefore offer products with affordable terms 	<p>Medium</p> <p>Follows from capacity building and risk management tools (previous page)</p>	<ul style="list-style-type: none"> Understand customer needs Develop products that meet these needs Trial, test and iterate to drive scalability
	6 Liquidity for Agriculture	<ul style="list-style-type: none"> Availability of financing for agriculture sector 	<ul style="list-style-type: none"> SMEs across value chain are particularly affected: <ul style="list-style-type: none"> Financiers do not allocate liquidity for agribusinesses as higher returns are often available from lower risk sectors (eg Oil & Gas in Nigeria); But, lenders can be forced to invest in agribusiness through the use of regulatory quotas 	<p>Medium</p> <p>Generally an attractive investment pipeline would drive liquidity into the market, although constraint varies by market</p>	<ul style="list-style-type: none"> Offer guarantees / risk sharing agreements Set up funds that target particularly unserved value chain segments
	7 Cost to Serve	<ul style="list-style-type: none"> Existing diligence, disbursement and investment management systems are too costly 	<ul style="list-style-type: none"> Financiers do not offer mid-size loans (eg between \$10k-200k)¹ since disbursement is unprofitable resulting in a Missing Middle Rural MSMEs are supported by poor infrastructure and far from central hubs (eg non-urban) are expensive to serve 	<p>High</p> <p>Required once proposition to the market is well-defined</p>	<ul style="list-style-type: none"> Innovate new delivery mechanisms by leveraging existing market actors and technology to increase efficiency



Government policy is often a critical challenge

	Challenge	Description	Actors Affected	Importance	Intervention Example
Enabling Sectors	8 Policy / Regulation	<ul style="list-style-type: none"> Existing policy framework hinders market eg constrains liquidity or prevents market formalization 	<ul style="list-style-type: none"> Entire value chains can be affected by subsidies and grant schemes Some investors seeking to build portfolio are cut out of ag sector lending due to prudential regulation or investment restrictions Agribusinesses may choose to not access formal financing since business formalization increases tax burden 	<p>High - Mid Depends on market maturity</p>	<ul style="list-style-type: none"> Understand market dynamics and bottlenecks in AgFi supply Build policy platform to advocate for change Support government to design and deliver policy improvements

1. However: (1) do not have significant assets to offer as collateral, (2) lack sizeable / reliable cash flows (3) are expensive to serve through traditional products



There were some clear nuances within each market

Performance vs Average of Surveyed Markets:

Better

Same

Mixed

Worse

Challenge		Kenya	Honduras	Nigeria	Nepal
Borrower	Awareness	High levels of financial inclusion and more mature value chains (eg coffee)	Consolidated set of mature agri-businesses as well as low-skilled smallholders; few SMEs		Low levels of financial literacy, small plot sizes and nascent value chains
	Capacity				
	VC linkages		Strong market linkages		
Financer	Awareness	Leading market for Innovative financing (eg digital) drives improvements across financier capabilities, risk management and product innovation	Good understanding of the sector	Lenders tried and failed to enter market	Poor knowledge of the agri-space hampers capacity risk management and product innovation
	Capacity		Banks perceive material risk in production, resulting in limited products and liquidity for producers; but they readily serve large agri-businesses elsewhere in the market		
	Risk Management				
	Product Terms				
	Liquidity	Material liquidity and investee accessibility reduces cost to serve	Capital constrained since competing with profitable O&G ¹ sector	Remittances drive liquidity	
	Cost to Serve				
Sector	Policy / Regulation	Mature Framework	Pro-ag policy, but mixed implementation	Catalyzing gov. guarantees	Pro-ag policy, but mixed implementation
	Enabling Sectors	Digital is advanced			

1. Oil and Gas



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The Agri-Financing market in Kenya is relatively advanced

Performance vs Others: Better Same Worse

	Challenge	Overview	Description
Borrower	Awareness	High levels of financial inclusion and more mature value chains (eg coffee)	<ul style="list-style-type: none"> • Smallholders, SMEs and larger businesses are aware of the financing opportunity • The majority of the population is financially included and literate
	Capacity		
	VC linkages		
Financer	Awareness	Leading market for Innovative financing (eg digital) drives improvements across financier capabilities, risk management and product innovation	<ul style="list-style-type: none"> • Kenya is one of the leading markets for innovative financing • Significant innovation developed through both Private sector and DFI investment • High interest lending rates of c.15-20% make debt unattractive, long times to obtain returns in agri-business exacerbate this
	Capacity		
	Risk Management		
	Product Terms		
	Liquidity	Material liquidity and investee accessibility reduces cost to serve	<ul style="list-style-type: none"> • Material equity and debt in the market through both formal and informal channels as well as foreign investors (private, DFIs, etc) • Existing Financial Inclusion reduces cost to serve
Cost to Serve			
Sector	Policy / Regulation	Mature Framework	<ul style="list-style-type: none"> • Policy framework is relatively advanced as the private sector drives innovation, however there remains space for improvement • Digital is advanced
	Enabling Sectors	Digital is advanced	



Key market challenges are around: input & equipment supply, business skills and market linkages

Key: **Bottleneck** Challenge **Enabler**



Challenge	<i>Access to quality goods and services</i>	<i>Efficient business processes</i>	<i>Value / Price maximization</i>
Farmers	<ul style="list-style-type: none"> • Inputs: lack of quality and timely supply of inputs (seeds, fertilizer and pesticide) hampers farm productivity • Equipment: Pre- and post-harvest equipment is unavailable and critical to maximizing productivity 	<ul style="list-style-type: none"> • Literacy: high levels of financial literacy and digital solution familiarity • Entrepreneur Skills: business governance, strategy and agronomic expertise are lacking • Business scale / maturity: most businesses are sub-scale but there are a growing number of mature, scaled and professionalized businesses • Access to finance: FSP penetration through SACCOs, MFIs and telecoms players is high 	<ul style="list-style-type: none"> • Market linkages: cooperatives exist for aggregating crops in tight value-chains; although side-selling continues in loose chains and aggregators lack the skills to work with multiple farmers • Price transparency through digital • Storage networks are underdeveloped, requiring farmers to sell when supply is highest and reducing aggregation opportunities
Other VC Businesses	<ul style="list-style-type: none"> • Market Linkages: some producers are setting up out-grower schemes successfully, gaining traction with smallholder farmers although this is not the norm • Cooperatives: exist but are not well-managed 		<ul style="list-style-type: none"> • Value-add services: are available in tight value chains where contractual obligations are upheld as trust has been built successfully



Debt funding is considered expensive but obtainable, equity is limited

	Debt	Equity	Other
Scale of Finance for Agriculture	<p>Large, but competed</p> <ul style="list-style-type: none"> Commercial banks and MFIs SACCOs offer lend savings and borrow from banks 	<p>Large, but competed</p> <ul style="list-style-type: none"> PE Funds / Impact Investors 	<p>Potentially Large, but untapped</p> <ul style="list-style-type: none"> SACCOs Commercial Paper
	<p>Somewhat</p> <ul style="list-style-type: none"> Business dynamics (seasonality) and borrower risk profile make agri-businesses less unattractive Need for growth outside of traditional industries is increasing interest in Agri-Sector 	<p>No</p> <ul style="list-style-type: none"> ROI and risk profile make this market unattractive to investors Further, potential businesses for investment lack appropriate skills to meet diligence requirements and... ...seek small investments which would be unprofitable 	<p>No</p> <ul style="list-style-type: none"> Policy environment prevents Pension Funds investing directly in agri-businesses
Lender Delivery Capacity	<p>Available, but expensive <i>(through MFIs and regulation)</i></p>	<p>Limited</p>	<p>n/a</p>
	<p><i>Market Knowledge</i></p> <ul style="list-style-type: none"> Lenders have limited understanding of value chains economics and business models 	<ul style="list-style-type: none"> Limited interest, given attractiveness of other sectors, therefore poor knowledge 	
	<p><i>Risk management</i></p> <ul style="list-style-type: none"> Many lenders made early entries into the agri-markets (eg off-taker agreements) but lost significant sums so limited appetite 	<p>n/a</p>	
	<p><i>Insurance / Guarantees</i></p> <ul style="list-style-type: none"> Limited mention of guarantees driving market growth 	<ul style="list-style-type: none"> Risk sharing with DFIs can spur investment 	<ul style="list-style-type: none"> n/a

Key: Bottleneck Challenge Enabler



SMEs apply for commercial debt, farmers use MFIs

	Smallholder Farmers	Commercial Agri-Businesses
Opportunity	<p>Large</p> <ul style="list-style-type: none"> Lots of small farms (c.2Ha) Typically part of organized cooperatives within tight value chains or tied to out-grower schemes Also members of SACCOs Cooperatives and SACCOs effective means of finance distribution in much of the country 	<p>Growing</p> <ul style="list-style-type: none"> Commercial farmers challenged by lack of scaled off-takers, integrated operations have some success Some sizeable businesses (eg processors in tight value chains like coffee / tea) Aggregators and last-mile input suppliers are generally sub-scale
Penetration of Current Services	<p>Does the segment have access to finance?</p> <p>Growing, small ticket debt products</p>	<p>Limited debt accessibility due to high cost of credit and few equity investors offering attractive ticket size</p>
	<p><i>Source of finance</i></p> <p>MFIs and Commercial Banks (via SACCOs)</p>	<p>Commercial Banks</p>
	<p><i>Product Design Tailored to customer</i></p> <ul style="list-style-type: none"> MFI products are effectively tailored Commercial banks do not understand the sector and offer standardized products that do not meet needs so farmers access finance through personal or business loans 	<ul style="list-style-type: none"> CAPEX from commercial banks (with scheme) OPEX products from development banks 'Missing Middle' product (between \$30k and \$150k) required but unavailable owing to diligence cost and collateral requirement
	<p><i>Pipeline Quality</i></p> <ul style="list-style-type: none"> Large pipeline of investees who are sufficiently literate to take micro-investments Transitioning these businesses further is challenging owing to the Missing Middle challenge 	<ul style="list-style-type: none"> Poor governance, business strategy and agronomic knowledge Low interest in, and readiness for, equity investments
	<p><i>Cost to serve</i></p> <ul style="list-style-type: none"> High cost to serve although sufficient volumes are available to justify investment Served profitably through SACCOs and agents 	<ul style="list-style-type: none"> Small ticket sizes and low volumes make diligence unprofitable for most investors



The policy environment is relatively advanced and stable: collateral is the critical bottleneck

Key: **Bottleneck** **Challenge** **Enabler**

Government action

Ag-focused Policy

- **Debt for Agriculture** is catalyzed by interest rate caps which are c.4% above central rates; however the resulting lending rates of 15-20% are challenging for agri-businesses to support
- **Land** is leased from the government, rather than owned, so cannot be used as collateral

Financial Sector Regulation

- **Equity** investors are able to invest across businesses
- **Collateral** in the form of a fixed asset is the critical requirement for loan disbursement. But borrowers lack assets to leverage, particularly since Land cannot be used
- **Formal Contracts** are used in tight value chains between input providers, producers, off-takers and banks. These work particularly well with exported commodities such as coffee and tea

Government capacity

- **Regulatory framework** is relatively well-scoped and consistently implemented which increases system trust and reduces chance of perverse policy incentives
- **Contract enforcement** is poor, resulting in material side-selling and challenges market linkages

Gov't Investment

Enabling environment & infrastructure

- **Physical infrastructure** is well-invested with quality roads, telecoms penetration etc
- **Digital infrastructure** is well-penetrated with much of the population financially included and familiar with digital platforms
- **Credit History**: CRB exists but low uptake by financial institutions and limited useful data available which hinders impact, alternative methods such as psychometric tests are being piloted



Kenyan interviewees proposed a range of interventions

Donor Interventions

Mentioned in: **Kenya** Other Country

Technical Assistance	Public Information	<ul style="list-style-type: none"> • Build a federated data set of beneficiaries from field programs to match with financing • Landscape value chains and integrate findings into lender processes
	TA for organizations	<ul style="list-style-type: none"> • Build pipeline of value chain actors for future investment • Build capacity of financiers to innovate new products reach new investees
	Form Groups	<ul style="list-style-type: none"> • Formalize market linkages between value chain actors • Support formation of cooperatives
Advocacy	Information	<ul style="list-style-type: none"> • Build internal knowledge sharing capability for best practices and AgFi learnings • Develop thought leadership on a specific topic eg mobile payments
	Convene	<ul style="list-style-type: none"> • Convene US companies to invest in attractive markets eg equipment supply • Convene donors and value chain actors to coordinate interventions in-country
	Lobby	<ul style="list-style-type: none"> • Advocate to government by convening government and the private sector
Direct Funds	USAID Funds	<ul style="list-style-type: none"> • Set up a low ticket size VC fund, offer seed funding / first-loss risk guarantee • Set up a Challenge Fund and prioritize critical bottlenecks for investment • Set up a Loss Fund to mitigate currency risk for private investors
	New Fund	<ul style="list-style-type: none"> • Set up a Peer to Peer lending platform that catalyzes latent funds • Develop a DIB product that others can leverage