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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 Nepal Extract

21 July 2017



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Contents

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



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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

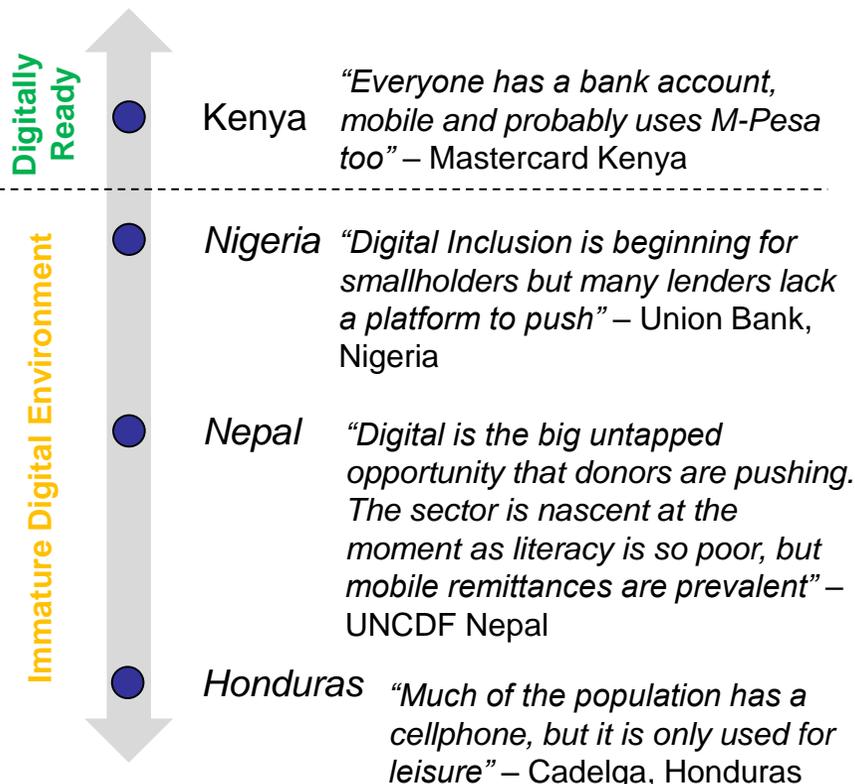
Enabling environment & infrastructure

- **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

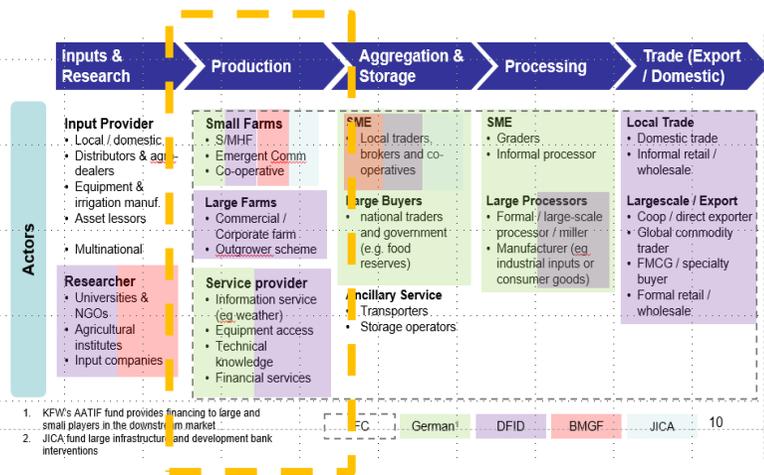
1. Interviews from Nepal, Nigeria, Kenya and Honduras



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 |

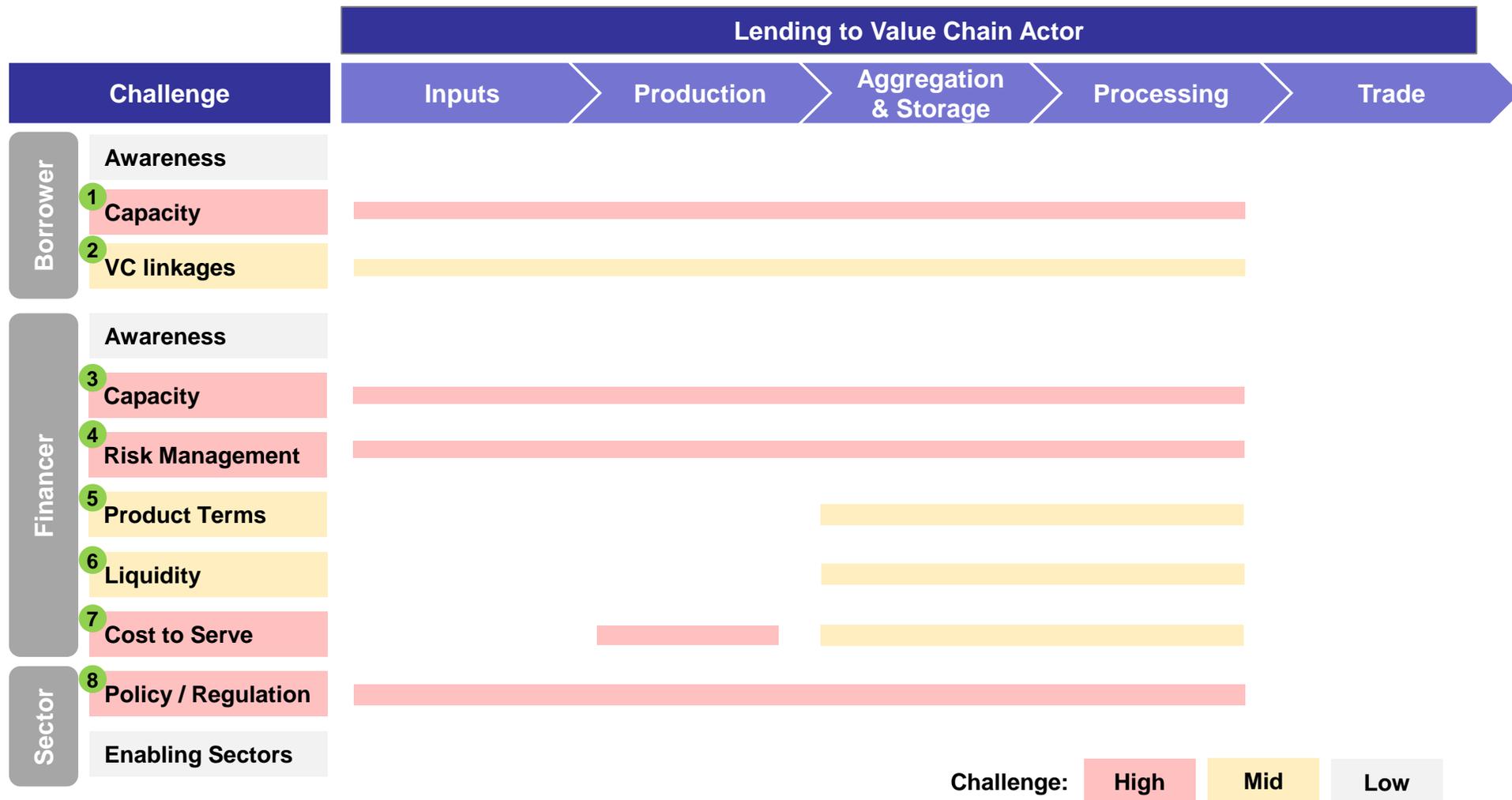


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Key challenges are around capacity building & policy design





Borrowers lack basic skills to attract investment

| Challenge | Description | Impact on Market Actors | Importance | Intervention Example |
|-----------|--|--|---|--|
| Borrower | 1 Capacity Lack of basic skills across: <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 market in Nepal is structurally challenged

Performance vs Average:

Better

Same

Mixed

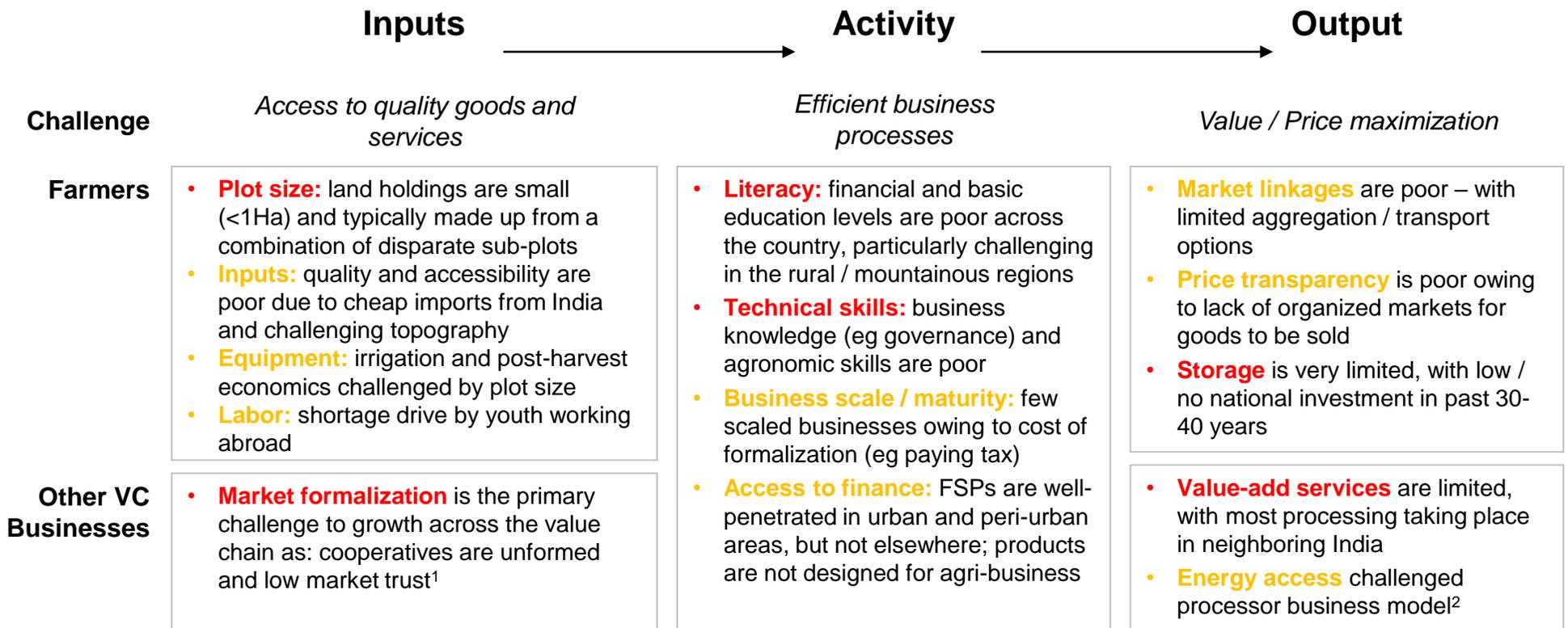
Worse

| | Challenge | Overview | Description |
|---------------|------------------------------------|--|--|
| Borrower | Awareness | Low levels of financial literacy, small plot sizes and nascent value chains | <ul style="list-style-type: none"> Limited financial literacy, inclusion and basic business skills Land holdings are typically very small with average of c.0.7 Ha per household; each plot is split into smaller pieces and spread out Land ownerships caps challenge commercial farming Indian border is porous and the imported products are cheaper, undercutting Nepal's own production and restricting downstream investment |
| | Capacity | | |
| | VC linkages | | |
| Financer | Awareness | Poor knowledge of the agri-space hampers capacity risk management and product innovation | <ul style="list-style-type: none"> Limited organic interest in funding the sector due to the challenges associated with the quality of the opportunity (as described above)... ...as well as poor understanding of the agri-space within financiers. Particularly amongst lenders However government policy interventions require agricultural investments |
| | Capacity | | |
| | Risk Management | | |
| | Product Terms | | |
| | Liquidity | Remittances drive liquidity | <ul style="list-style-type: none"> Significant remittance flow into the country (\$6BN p.a.+), from the large diaspora, offers a large latent opportunity |
| Cost to Serve | Topography and poor infrastructure | | |
| Sector | Policy / Regulation | Pro-ag policy, mixed implementation | <ul style="list-style-type: none"> Mountainous regions and poor infrastructure make communication and service / product distribution challenging Policy design is good but lack of political stability and collaboration during implementation results in a lack of regulatory coherence |
| | Enabling Sectors | | |



Plot size, literacy / business skills and market formalization are the critical barriers to growth

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



1. Rice millers have had some success in formalizing farmer relationships, although side-selling remains a material risk
 2. Energy supply has just become more reliable in Nepal which will likely result in material increase in processing businesses



Agri-Finance is currently delivered through local debt...

| | Debt | Equity | Other |
|----------------------------------|---|---|--|
| Scale of Finance for Agriculture | <p>What is the opportunity for private funding / liquidity?</p> <p>Large</p> <ul style="list-style-type: none"> MFIs, Commercial Banks SACCOs / Cooperatives¹ | <p>Small</p> <ul style="list-style-type: none"> High net worth individuals Private funds | <p>Large, but untapped</p> <ul style="list-style-type: none"> Remittances |
| | <p>Is agriculture a priority sector?</p> <p>Somewhat</p> <ul style="list-style-type: none"> MFIs prioritize rural areas and therefore agriculture is included, although they lack tailored products Commercial banks do not choose agriculture since economics are unattractive... ...however regulation require commercial banks to finance production activities: focus on lending to cooperatives | <p>No</p> <ul style="list-style-type: none"> Limited interest owing to unattractive economics and lack of exit opportunities Although small, sub-scale, side businesses are increasing | <p>No</p> <ul style="list-style-type: none"> Limited since remittances are used for consumption Agri-bond was tried but unsuccessful <u>Note</u>: foreign impact investors & PE funds struggle due to policy constrains and lack of pipeline |
| Lender Delivery Capacity | <p>How available is financing for agri-business?</p> <p>Available <i>(through MFIs & regulatory set-asides)</i></p> | <p>Limited</p> | <p>Limited</p> |
| | <p><i>Market Knowledge</i></p> <ul style="list-style-type: none"> Poor understanding of the different value chains and business model economics | <ul style="list-style-type: none"> Localized understanding of value chains and business economics through investors living in their home region / through family relationships | |
| | <p><i>Risk management</i></p> <ul style="list-style-type: none"> Risk management tools non-existent | <ul style="list-style-type: none"> n/a | <ul style="list-style-type: none"> n/a |
| | <p><i>Insurance / Guarantees</i></p> <ul style="list-style-type: none"> Currently unavailable, would be valuable in assuring financiers of cash flows Lack of crop insurance repeatedly stated as a key barrier to access to finance | | |

1. SACCOs and cooperatives will often borrow from commercial lenders to meet group needs



...to smallholder farmers, often via cooperatives

| | | Smallholder Farmers | Commercial Agri-Businesses |
|---------------------------------|--|--|---|
| Opportunity | What is the size of opportunity by customer segment? | <p>Large</p> <ul style="list-style-type: none"> Number of inaccessible farming communities Financial cooperatives are organized, but small | <p>Small</p> <ul style="list-style-type: none"> Commercial farmers struggle to scale owing to market nascence and regulation curtailing maximum land holding Other agribusinesses lack skills & appetite to grow Input suppliers receive credit from wholesalers |
| | Does the segment have access to finance? | Growing: small ticket debt products | Limited: no private equity and nascent debt market unless for large companies (although product innovation is beginning) |
| Penetration of Current Services | Source of finance | MFI and Banks via cooperatives | Commercial banks |
| | Product Design for customer | <ul style="list-style-type: none"> Small ticket loans designed for smallholder farmers Limited other product options available Limited market knowledge results in poor product design eg repayment terms do not account for business seasonality | <ul style="list-style-type: none"> 'Missing Middle' product (between \$30k and \$150k) are unavailable owing to diligence cost and collateral required Some banks (eg Megabank) are introducing products that can be collateralized on land ownership without a valuation but generally there are limited options for the segment Repayment terms do not take into account the business seasonality – bank's own systems are not set up for such collection processes |
| | Pipeline Quality | <ul style="list-style-type: none"> Limited given financial literacy and market formalization | <ul style="list-style-type: none"> Limited, given lack of commercial skill-set and lack of appetite for investment |
| | Cost to serve | <ul style="list-style-type: none"> High cost to serve given small ticket size and topology Lenders leverage agents models to reach communities, tech opportunity | <ul style="list-style-type: none"> High cost to serve across the market Economics make serving organizations outside of large conurbations unprofitable |



Nepali policy environment is interventionist, but creates some challenges for sector

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

| | | |
|-------------------|---------------------------------------|--|
| Government action | Ag-focused Policy | <ul style="list-style-type: none">• Agricultural Lending Quotas: government requires 5% of bank loans to go to agriculture• Land Ownership: land is owned by farmers although challenging to leverage small plots in practice• Agricultural investment is targeted by subsidy schemes which are poorly implemented e.g. fertilizers and seeds are subsidized but are of low quality, hindering productivity• Competition from Indian imports across the porous border makes Nepalese products uncompetitive; local cartels are a challenge in many sectors as they prevent local market entry e.g. transport / storage |
| | Financial Sector Regulation | <ul style="list-style-type: none">• Equity availability: specific sectors (trade, poultry) are unavailable for foreign investments• Collateral requirement: Unsecured loans available up to \$700 from MFIs; government recently set up movable asset register to facilitate loans on wider range of collateral• Formal Contracting: is unreliable as farmers do not adhere to obligations and there is a lack of recourse |
| | Government capacity | <ul style="list-style-type: none">• Policy Dynamics: the policy design target key bottlenecks in the market• Regulatory Framework: poor policy implementation due to lack of industry collaboration and political churn• Contract enforcement is not possible in an environment where communities control their region |
| Gov't Investment | Enabling environment & infrastructure | <ul style="list-style-type: none">• Physical Infrastructure: lack of effective government investment• Digital / Mobile: nascent technology although being pushed by donors in-country• Credit History: CRB exists for larger transactions of >\$10k, but the system is overly aggressive in black-listing and cross-defaulting borrowers following missed payments, limiting the attractiveness of equity investment |



Interviewees proposed interventions, with a focus on TA

Donor Interventions

Mentioned in: **Nepal** 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 |