Knowledge Primer

USAID Agricultural Finance Tools

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Objectives of this Primer

- Provide an overview of the tools available to USAID to catalyze agricultural finance
- Guide decision-making on if, when and how these tools should be used
- Share examples on how agricultural finance tools have been applied

Related documents:

- Driving Impact through Agricultural Finance Interventions (Knowledge Primer)

Why is agricultural finance a priority for USAID?

- USAID's Global Food Security Strategy aims to fortify food security through increasing agricultural capacity and productivity
- Investment in agriculture is critical for growth but only 4.7% of adults in rural areas in developing countries have a formal loan and only 5.9% have a bank account[1]

What are the principal barriers to investment in agriculture?

External barriers (market imperfections)

- Insufficient local credit markets, high interest rates
- Risk-averse lenders
- Challenging regulatory environment (restricted foreign investment, weak contract enforcement, import/export tariffs)

Internal barriers (borrower-specific)

- Limited credit history, collateral and technical skills

How can USAID stimulate investment in agriculture?

Catalyzing financial flows

- Facilitating access to debt
- Facilitating access to equity

Managing risk

- De-risking loans through guarantees and insurance

Building enabling infrastructure

- Strengthening the financial ecosystem and improving the regulatory environment

What USAID tools can missions use to stimulate investment in agriculture?

Financial tools

1. Grants
2. Guarantees

Non-financial tools

3. Policy advocacy
4. Convening
5. Technical assistance

Financial Tools		
	Grants	**Guarantees**
Description	USAID provides funds directly to support early stage products, firms and programs that aim to improve human welfare. Grants are linked to social and environmental objectives such as gender or youth representation, and do not need to be repaid.	USAID's Development Credit Authority (DCA) provides a lender with a 50% guarantee to cover potential loan losses on commercial debt. One-third of guarantees by value are in agriculture.[2] There are five types of guarantee products: 1. Loan guarantee 2. Loan portfolio guarantee 3. Lease portfolio guarantee 4. Portable guarantee 5. Bond guarantee
Purpose	Missions generally use grants when it is important to demonstrate program viability and/or scalability as well as to overcome first-mover resistance in financial markets.	Guarantees are used when a borrower or sector's risk profile is not otherwise acceptable to a third-party lender without guarantees or other risk-sharing instruments. The objective of guarantees is to reduce collateral requirements for borrowers so it is easier for small businesses to obtain credit.

Non-financial tools

	Policy Advocacy	Convening	Technical Assistance
Description	USAID engages with policymakers, multilaterals, central banks and other government stakeholders to advocate policy changes that can increase access to finance as well as help achieve broader development objectives.	USAID brings together different stakeholders (financial institutions, policymakers, civil society, etc.) for collaboration and knowledge exchange in meetings, forums, conferences and other settings.	USAID provides expert guidance to help firms better understand markets, improve performance, reduce transaction costs and/or negotiate with third parties.
Purpose	Advocacy is used when: • There are economic, financial and/or regulatory challenges that make it difficult to start a business or access finance, and; • Identifiable changes could tangibly improve policy Ideally, host governments are also responsive to mission recommendations.	Convenings are used when key actors have the ability and interest to collaborate but lack a forum, clear communication channels or relationships. Convening may also be useful in situations in which a middleman 'broker' may help competitors collaborate.	Technical assistance is used when firms need additional support (technical, managerial or logistical) to improve their credit profile, resolve systemic performance limitations or negotiate important contracts.

How can missions decide which tools are appropriate for a given situation?

	Understand the situation	Analyze barriers to financial access in agriculture	Identify potential solutions	Select appropriate USAID tool
Description	Understand the economic, political and regulatory challenges firms are facing as well as the inherent limitations of each stakeholder	Identify the main constraints that limit a firm's ability to access finance, both at the macroeconomic and policy level as well as for a specific borrower	Determine which types of solutions would best resolve the identified barriers	Review which tools would address the root cause, both individually and in conjunction with other tools
Example #1	Local markets do not provide adequate and/or affordable financing to otherwise viable agribusinesses that need working or growth capital	Firms lack sufficient collateral and/or lenders lack sector expertise, resulting in high interest rates and transaction costs	Provide grants or loan guarantees to demonstrate financial viability and incentivize borrowing; build skills among financial institutions	Grants Guarantees Technical Assistance
Example #2	Value-added processors of crop X are not as competitive compared to the same product grown in other markets	Processors lack know-how on how to improve throughput, access fair market prices, complete funding applications, manage book-keeping, and scale	Provide expert guidance on improving production; convene similar processors to brainstorm solutions / share learnings	Convening Technical Assistance

Case Studies: Agricultural Finance in Action

1 *Economic Prosperity Initiative[3] (Georgia)*

Background: While agriculture accounts for 9% of GDP and employs nearly half of the Georgian workforce, only 1% of loans go to the sector despite the need for credit and the opportunity for improved yields. The agricultural sector as a whole is very sensitive to volatile weather (e.g., early frosts, hail and rainstorms).

Problem: Agriculture is considered highly risky by Georgian lenders. Hazelnut and mandarin farmers lack adequate collateral credit to access loans.

Solution: USAID brought together the Bank of Georgia and Aldagi BCI, an insurance company, to create a pilot program to offer loan and crop insurance for smallholder farmers. The insurance served as collateral and allowed the farmers to qualify for a loan. USAID provided grants to cover insurance costs for the first year of the program and designed a three-week crop insurance training.

Georgian producers inspecting mandarins for shipping. Credit: CNFA.[4]

Results: By year 4, the program had catalyzed USD 13.7 million in new loans. USAID also worked with the Government of Georgia to scale up the program.

USAID tools used: Technical assistance, convening, policy advocacy, grants

2 *Economic Development Program[5]* (Cambodia)

Background: 70% of Cambodians rely on agriculture (especially rice) but the sector is highly vulnerable to adverse climatic shocks such as flash floods, droughts and variable rainfall. Consequently, lending to agriculture is highly unpredictable and financial institutions are wary of loaning to the sector.

Problem: Lenders require high collateral pledges from borrowers to compensate for the intrinsic unpredictability which can severely hinder access to finance, productivity and growth.

Solution: USAID partnered with two Cambodian microfinance institutions and a local leasing institution to design and provide new loan and lease products to SMEs and smallholders along the agricultural value chain. DCA also negotiated a loan portfolio guarantee to de-risk loans for these institutions, stipulating in the provision that half of the loans would go towards women-led enterprises.

Rice farming dominates the agriculture sector in Cambodia. Credit: IRRI[6]

Results: USAID's intervention enabled collateral requirements to relax by 50% of loan value (from 200% to 100%), enabling USD 15 million in new loans and leases. Half of the loans were given to women.

USAID tools used: Loan portfolio guarantee, technical assistance

Case Studies: Agricultural Finance in Action

3 *Agriculture LPG[7] (Mozambique)*

Background: Agriculture represents 80% of Mozambique's GDP and a quarter of its employment, but banks make few commercial loans to SMEs due to insufficient credit and collateral.

Problem: Mozambican financial institutions have been largely unwilling to provide unsecured loans to agriculture-related SMEs, leaving a large market for working capital loans for business owners and farmers in particular.

Solution: USAID partnered with Banco Oportunidade de Moçambique (BOM) and Banco Terra (BT) to provide two 7-year Loan Portfolio Guarantees (LPGs) which targeted borrowers across the value chain including producers, processors, retailers and exporters. USAID also engaged with the Swedish development agency, Sida, in designing a third LPG in coordination with BT. Loans were to be repaid after 6-12 months.

Banco OPORTUNIDADE

BANCO TERRA

Results: With BOM, 429 group loans were provided (5-6 members per group) valued at USD 3,100 on average. With BT, 115 loans were provided with an average loan value of USD 38,000. Almost 70% of recipients were first-time borrowers and 25% were women.

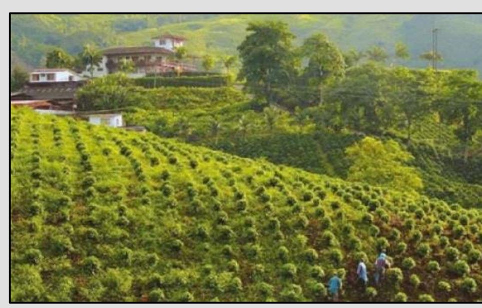
USAID tools used: convening, loan portfolio guarantee, technical assistance

4 *Rural Finance Initiative[8] (Colombia)*

Background: Partially due to the decades-long internal conflict that isolated much of rural Colombia, Colombia's agricultural sector remains under-served. Limited access to financial services in rural areas remains a major constraint to productivity and also exacerbates inequality. In Colombia, only 16% of its four million farmers have ever received a formal loan.

Problem: Few farmers have sufficient collateral or land title to access credit. Financial institutions lack connections and distribution channels to service potential rural clients.

Solution: USAID launched a Rural Finance Initiative (RFI) in conjunction with its implementor Chemonics and several Colombian financial institutions (FIs) with the aim of reaching 200,000 smallholders with loans and insurance. USAID connected FIs to new delivery channels, helping them tailor financial services to rural clients. USAID used grants to incentivize banks to open new branches and explore new financial products.



Colombia's rural economy hinges on coffee, flowers, bananas and rice. Credit: The Worldfolio.[9]

Results: Over 146,000 smallholders were reached in 197 municipalities. Over 49,000 loans and 15,000 insurance policies were made with a USD 200 million provision of commercial bank capital from FIs.

USAID tools used: convening, grants (performance-indexed), technical assistance

Concluding thoughts

Principles to keep in mind for USAID mission staff

- **Understand the stakeholders' needs and context in depth before designing the intervention.** Identifying the most important drivers and constraints as well as what is feasible is a prerequisite to developing a solution.
- **Engage stakeholders early to test and refine your understanding.** Direct feedback on early ideas can generate important insights even if the client's context is well understood.
- **Ensure the solution is additive to what is already in place.** Understand the other types of support that exist to validate that the solution is addressing a distinct and unmet need.
- **Remember that tools are generally most effective when used in conjunction with other tools.** Products such as guarantees, for example, are generally more effective when combined with other tools such as technical assistance.

A rural Colombian family enjoying the fruits of financial inclusion through USAID partnerships.[10]

Workers at an Ethiopian coffee plant that benefited from USAID programming.[11]

Sources

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