Knowledge Primer

Using Blended Finance to Mobilize Capital for Agricultural Development

USAID FROM THE AMERICAN PEOPLE

Objectives of this Primer

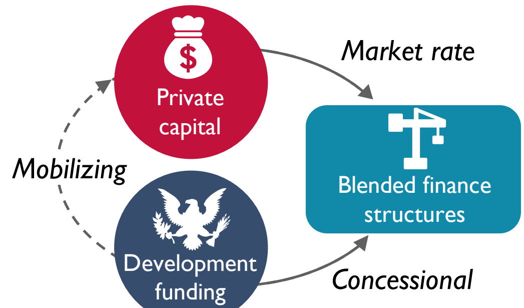
- Provide an overview of blended finance and why it is an important tool for agricultural development
- Share examples of blended finance in practice which focus on the different types of structure as well as their impact

Related Documents

- Driving Impact through Agricultural Finance Interventions (Knowledge Primer)
- USAID Agricultural Finance Tools (Knowledge Primer)

What is blended finance?

- Blended finance is the use of catalytic capital from public or philanthropic sources to increase private sector investment in developing countries and sustainable development.[1]
- There are different types of blended finance models but all are characterized by public and/or philanthropic actors contributing the minimum amount of support necessary to incentivize the private sector to invest in a project it would not otherwise invest in.



Source: Convergence website[1]

Why is blended finance important for agricultural development?

Many commercial investors do not invest in agricultural projects because they perceive the risks to be too high and/or the financial returns too low. Consequently, public and philanthropic actors often invest in agricultural projects on their own without leveraging the experiences, expertise and capital that commercial investors can provide.

Blended finance structures bring commercial, public and philanthropic actors together and drive impact in three ways:

1 Unlocking private sector capital

- Relatively small investments by development actors can catalyze a substantial amount of private sector capital into agriculture projects with social impact

2 Enhancing development impact

- Blended finance combines not only different types of capital but also different types of skill sets, knowledge, networks and other resources

3 Demonstrating the business case for impact

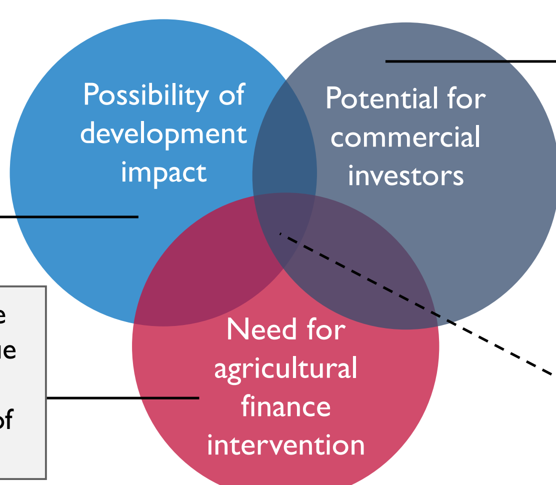
- Commercially-profitable investments in agriculture in emerging markets help prove the business case for impact investing more broadly

When should blended finance be considered as part of an agricultural development program?

Missions should consider using blended finance approaches when there is an overlap of social impact, commercial investment potential and the need for an intervention to correct a market failure.[2]

The project can deliver a sufficient financial return to commercial investors

Increased financing can support progress towards social and/or environmental goals



Commercial investors are not currently investing due to a specific barrier (e.g., high perceived risk, lack of sector knowledge)

BLENDED FINANCE OPPORTUNITY

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What are the different types of blended finance structures that exist?

Blended finance structures can be customized to address specific concerns but they are all characterized by having one of three primary goals: 1) Reducing investment risk 2) Improving returns 3) Increasing the likelihood of social impact.

Main goal of structure	*Tools used*	*Example*
Reduce risks for investors	To reduce the risks for commercial investors, donors can provide **loan guarantees** or **insurance products** that reimburse investors in the case of a default. In this model, public money is blended with private capital through a risk-sharing mechanism.	• **Mobilizing Credit for Agriculture (Cambodia)**: USAID sponsored a 50% **loan loss guarantee** on a portfolio of 274 agribusiness loans provided by three financial institutions in Cambodia, lowering the potential amount of losses significantly and facilitating USD 1.8 million in additional lending.[3]
Increase returns to incentivize commercial investment	Blended finance structures can use donor funding to create **debt** or **equity** products with a sufficiently high expected return for catalyzing commercial investment. In this case, donors provide financing with lower returns specifically as a way to make room for other finance products which provide higher returns.	• **Agribusiness Capital (ABC) Fund**: To attract commercial investment for IFAD's ABC Fund donors such as the EU are expected to provide up to EUR 60 million in **first-loss equity**, a type of equity that is first to absorb any losses from the fund (thereby protecting other investors). As a result IFAD anticipates raising an additional ~USD 180 million in senior debt at market rates from private investors.[4]
Increase likelihood and size of social impact	To strengthen the connection between investment and impact, donors can use financial tools such as **performance-based contracts** or **development impact bonds (DIBs)** that provide financial rewards to investors if certain social impact milestones are met. This use of conditional additional payments encourages commercial investors to ensure that social goals are met after they invest in a project.	• **Sustainable Cocoa and Coffee Production DIB**: The Common Fund for Commodities (CFC), Schmidt Family Foundation (SFF) and Rainforest UK set up a **DIB** to increase cocoa and coffee production for an indigenous Peruvian co-op. CFC, the sponsor, committed to pay SFF, the investor, up to USD 110,000 if the DIB could meet four pre-defined criteria related to income, productivity and commercial activities. The DIB met three of the four so SFF received most of this conditional payment.[5]

Most blended finance structures work best when they are paired with **additional support services** that help agribusinesses become more commercially attractive to investors, such as:

- **Grants.** Donors may fund the launch of new agricultural products or services for portfolio companies which, if successful, can catalyze additional commercial investment.
- **Technical assistance**. Donors may fund skills development trainings designed specifically to complement a blended finance investment to help ensure an agricultural project is successful.

Cambodian rice farmers benefit from USAID's use of blended finance via a loan portfolio guarantee.[3]

Senegalese farmers accessed equipment via a USD 5.6 million blended finance deal between USAID and an African finance provider.[6]

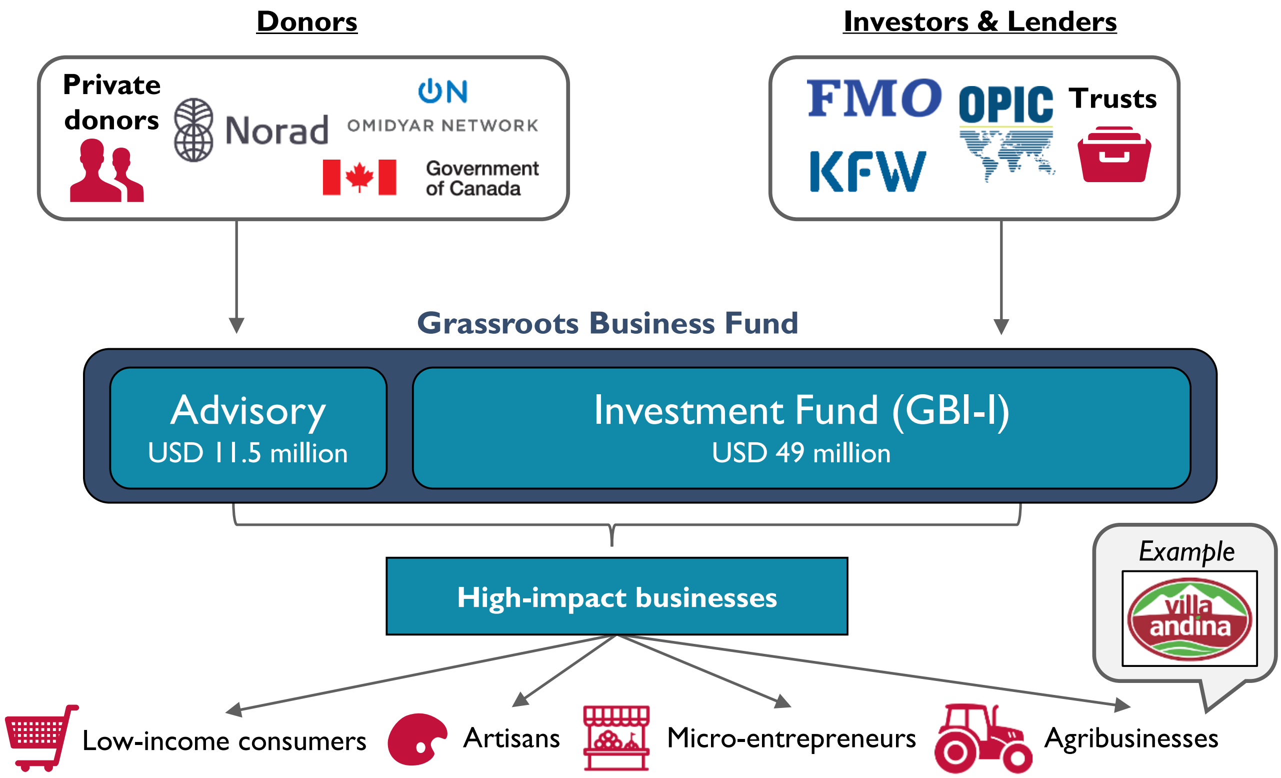
Case studies of blended finance in practice in the agricultural sector

Grassroots Business Fund (GBF)[7]

"To grow viable, sustainable and inclusive businesses"

Problem: The majority of agricultural SMEs in emerging markets have difficulty accessing financing due to the perceived riskiness of their business models. These firms also require additional knowledge, skills and training to improve the financial performance of their agribusinesses.

How blended financing was applied: **Grassroots Business Fund (GBF)** set up both a non-profit business advisory service as well as a for-profit private investment fund (GBI-I). Donors provided grants to the advisory branch (USD 11.5 million) while private sector investors provided capital to GBI-I (USD 49 million). GBI-I makes equity, debt and quasi-equity capital investments in SMEs while the advisory service supports business development, firm management and strategy for GBI-I investees.



Example investee: **Villa Andina**, a Peruvian crop aggregator and processor, used a loan from GBF to buy land, expand its plant and increase working capital. GBF's advisory service helped Villa Andina to improve both its financial management systems and strategic planning in order to earn fair trade and organic certifications.

Results achieved to date: GBF has invested in 12 agribusinesses to date. Between April 2017 and March 2018 GBF's agribusiness portfolio companies supported almost 20,000 farmers and agricultural workers as well as generated over USD 17 million in income.

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Case studies of blended finance in practice in the agricultural sector

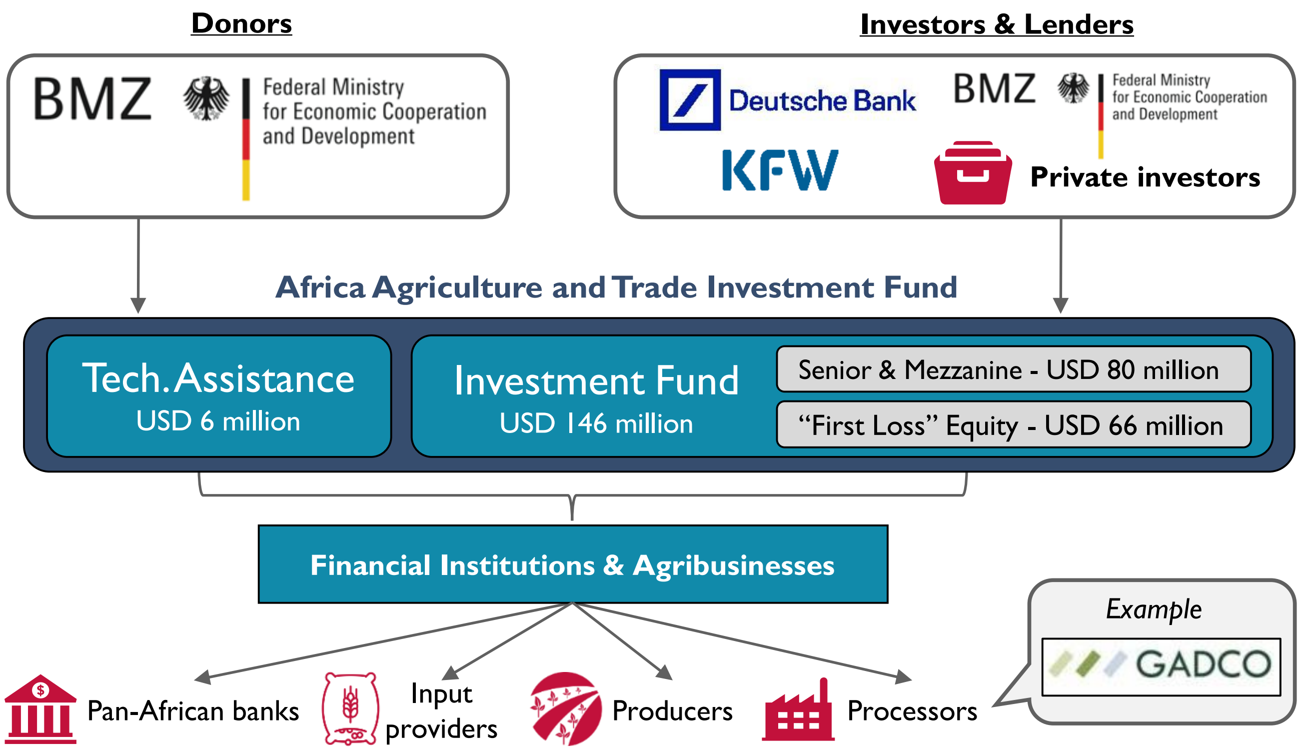
Africa Agriculture and Trade Investment Fund (AATIF)[8]

"to combat poverty and improve food security"

aatif Africa Agriculture and Trade Investment Fund

Problem: Many agricultural SMEs in Africa are unable to grow because they are unable to obtain financing. Despite a large financing gap, most local financial institutions and investors do not invest in agriculture due to high perceived risks relative to the expected returns on their investments.

How blended financing was applied: The **Africa Agriculture and Trade Investment Fund (AATIF)** is a USD 146 million investment fund created by German donor agencies and banks to improve food security in Africa through investing in agribusinesses directly as well as local finance institutions that loan to agribusinesses. To incentivize private sector investment in the fund, public donors took "first loss" junior equity positions (63% of the fund) which allowed commercial investors to take more favorable senior equity positions with higher risk-adjusted returns.



Example investee: AATIF provided **Global Agri-Development Company (GADCO)**, a Ghanaian rice producer, with a USD 5 million commercial loan to install a state-of-the-art rice mill.[9] The investment represented GADCO's first step towards moving into rice processing and developing an integrated value chain. AATIF also provided technical assistance to GADCO to train staff on how to reorganize their processes in order to reduce machinery downtime and increase efficiency.

Results achieved to date: As of March 2018 AATIF had disbursed USD 75 million directly to four agribusinesses and three additional companies that act as aggregators for smallholder farmers. AATIF had also disbursed USD 85 million to four financial institutions that provide financing to 250 additional agribusinesses in 15 countries. Alongside these investments AATIF had spent or committed to spending EUR 2.4 million on 38 separate technical assistance projects for the agribusinesses that received funding.[9]

Concluding thoughts

Principles to keep in mind for USAID mission staff

- **Blended finance can be a powerful tool but it is not a panacea**. Blended finance can only work in markets where private sector involvement is sustainable in the long term. Blended finance should also be considered only once the specific problem has been identified.

- **Before designing a blended finance initiative, build a common understanding of what it is and how it works.** There are many different definitions and misconceptions about blended finance, and only with a shared understanding can you ensure alignment among stakeholders.

- **Blended finance instruments can be customized to fit specific needs but this flexibility can also result in longer time cycles**. As part of designing a blended finance solution, ensure there is a long-enough timeline and that you have also recorded development objectives upfront.

- **Remember that blended finance structures are meant to be temporary interventions.** Incentives need to be provided to the private sector in the beginning so that they will invest resources, but the long-term goal is private sector participation without accompanying support from public and/or philanthropic sectors.

GADCO's new state-of-the-art rice mill in Ghana, made possible by a loan from AATIF.[10]

A Peruvian farmer inspects produce for Villa Andina, an agribusiness supported by GBF.[7]

Sources

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