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Synthesis of the evidence on financing mechanisms for agribusiness development (Asia, Latin America and Eastern and Central Europe)

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Abbreviations

AGF	Afghan Growth Finance
CAPE	Consultancy for Agricultural Productivity Enhancement Program (Philippines)
CRC	Credit Reference Centre (China)
DBP	Development Bank of the Philippines
DFI	Development finance institution
DFID	UK Department for International Development
GRDF	Georgia Regional Development Fund
HARVEST	Helping Address Rural Vulnerabilities and Ecosystem Stability project
IADB	Inter-American Development Bank
IDH	The Sustainable Trade Initiative
IFC	International Finance Corporation
IIC	Inter-American Investment Corporation (IIC), a member of the IADB
LAAD	Latin American Agribusiness Development Corporation
MAP	USDA Marketing Assistance Project (Armenia)
NIA	The National Innovation Agency (Thailand)
PBOC	The People's Bank of China (China's central bank)
PVNI	The Prosperous Vietnam Investment Corporation, an angel/venture capital network
R&D	Research and development
ROE	Return on (Average) Equity
SEAF	Small Enterprise Assistance Funds, a global investment firm
SEP	Social Entrepreneurship Program (Latin America)
SLDP	Sustainable Logistics Development Programme (a programme of the DBP)
SMEs	Small and medium enterprises

1 Introduction

1.1 Purpose of this synthesis

This report sets out the findings from a rapid desk-based review of the evidence on financing mechanisms for agribusiness development in Asia, Latin America and Eastern and Central Europe. The purpose of this synthesis is to inform DFID's work in supporting the development of agribusinesses in Africa.

This desk-based study provides a synthesis of the available material on this subject, and in particular, the review looks at the following elements:

- Investments made in agribusinesses with smallholder farmer engagement: this covers all businesses or enterprises in the agricultural sector – small and medium enterprises (SMEs), as well as large enterprises, operating in various sectors, and at various levels of the supply chain (from pre-production activities through to marketing and trade). The term, 'engagement', for the purposes of this research, will include both direct and indirect relationships that agribusinesses have with smallholder farmers, as primary producers.
- Financing mechanism that combine public and private sector resources or involve public-private partnerships (especially those programmes that are considered large in size/scale).

This synthesis focuses strongly on mechanisms used by or are made available to private sector firms or enterprises, in order to meet their short, medium and long term financing requirements.

1.2 Setting out the limitations and scope of the research

In order to manage this research assignment vis-à-vis the resources available for it, it was agreed that the synthesis will mainly focus on 4-5 countries only – which include those where there have been a notable increase in productivity levels. This includes such countries as India, Thailand, Vietnam and Brazil. The review of available literature revealed, however, that documentation of experience particularly in agribusiness financing in these countries tend to be limited. Most of the literature focus entirely on the extension of financial services (especially credit and insurance) to smallholder farmers and producer groups. There are, nevertheless, some case studies (which are discussed in this review) that involve the extension of financing to both smallholder farmers and the enterprises that operate at various levels of the supply chains.

This report also includes cases from other countries like Armenia, Cambodia, China, the Philippines, Bolivia and Ecuador. It is important to note that much of the available information on these cases cannot be described as extensive: for example, there is often limited information, especially in terms of the effectiveness and impact of financing mechanisms used. But these have nevertheless been included in this review. Lastly, the cases reviewed also include a number of financing mechanisms that are implemented in several countries or have a regional footprint.

1.3 Outline of this report

This report is organised as follows. The following section, Section 2, begins by describing the range of agribusiness development activities that are typically financed

(externally).[1] This is followed by a description of where financing is sourced (i.e. the institutions or types of organisations that typically provide financing), and the instruments used. Case examples are given to illustrate how these financing mechanisms are organised – i.e. the types of institutions that are involved and their relationships / interface with one another – given the experience in specific countries.

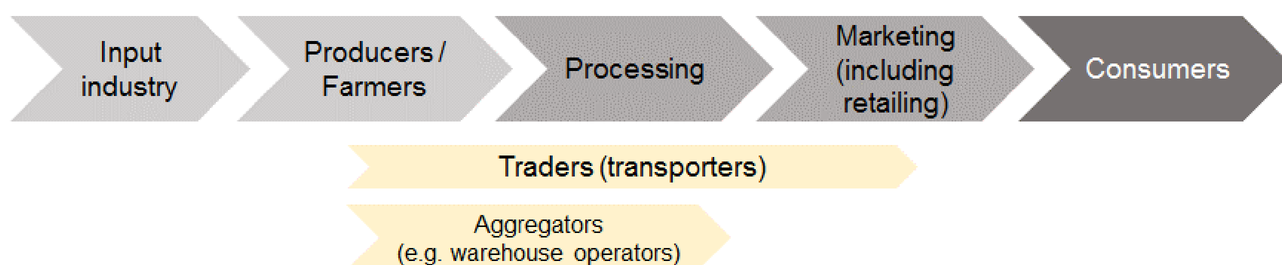
Section 3 then provides a summary of lessons that can be drawn from the use of these financing mechanisms. Where possible, we sought to draw evidence on whether or not these mechanisms have been appropriate and effective in supporting the development of agribusinesses, the main risks involved with the use of these mechanisms, and the pre-requisites and conditions that were required to make these financing mechanisms work.

2 Synthesis on how agribusinesses are financed

2.1 Agribusiness development activities that are typically financed (externally)

Agribusinesses can be found operating at various stages of the supply chains (see Figure 1 below). These enterprises provide such services as selling inputs to farmers/producers; trading or transporting raw, semi-processed or processed goods; processing or providing storage services; through to marketing processed goods to end-consumers. In some cases, larger enterprises operate across various stages in the supply chain, providing a more integrated set of services.

Figure 1: A typical agribusiness supply chain



Agribusinesses, especially small and medium enterprises, typically require external finance when considering plans for expansion. This may come in the form of increasing a buyer's capacity to purchase from farmers/producers, investing in new technology (e.g. at the input and processing stages), or meeting the requirements (e.g. higher food standards) especially among international buyers. Enterprises often require access to capital coming from investments, grants and loans in order to make the required changes in their operations.

Some larger agribusinesses that want to innovate tend to do so by setting up their own in-house R&D departments (and hiring their own technicians and specialists), contracting knowledge and technology service providers, and/or building alliances with

[1] External financing denotes firms obtaining funds from outside the firm. This is in contrast to 'internal financing', whereby a firm uses its profits or retained earnings for undertaking investment. External sources of finance include the acquisition of new or additional capital (e.g. by taking on new business partners), creating long-term obligation (e.g. by issuing equity or bonds), or taking on shorter term debt.

providers of knowledge and technology services. Research across a number of countries in **Latin America** looked at how private sector actors in the region have approached innovation.[2] The study found that many private initiatives were embodied in networks and partnerships between various actors, including agribusinesses, cooperatives, non-governmental research centres, national and foreign universities, government research entities, multinational technology companies, etc. The range of actors involved also included government and donor agencies that provided financing through competitive funds.

Most of the literature in agricultural finance tend to focus on the provision of financial services (especially credit) to farmer/producers and/or farmer groups only. Some agriculture development programmes, however, incorporate elements of financing agribusinesses, alongside services that are extended to farmers.

In **Armenia**, for example, the USDA Marketing Assistance Project (MAP), a programme initiated by the U.S. Embassy in 1992, sought to revive industrial and agricultural production in the country, following the break-up of the former Soviet Union.[3] MAP provided loans to targeted farmer groups (organised into Production Credit Clubs). Over and above this, a new credit programme was developed, which gave birth to Agro Leasing LLC (launched in 2000). This company facilitated access to leasing services for the purchase of much needed equipment by milk collection centres, and agribusinesses in the fruit/vegetable and wine sectors.

In **Cambodia**, the Helping Address Rural Vulnerabilities and Ecosystem Stability (HARVEST) project (funded by USAID) works with local partners and employs what it calls a "co-investment model" both at the farm and enterprise levels. The approach incorporates the provision of initial co-investments equivalent to about 50% of the value of key inputs directed at smallholder farmers, weekly visits by agronomists, and specialized training sessions for smallholders over at least three successful crop cycles. Following this intensive technical assistance, a smallholder then *graduates* from support. Parallel to this, the project also works directly with almost 400 rural input suppliers/retailers, who are also provided with access to co-investment support (to cover the initial inventory) and technical assistance to facilitate better understanding of new products, managing inventory, targeting the smallholder customer base, embedding farmer extension in product offerings (including on-site demonstration plots), and expanding relationships with reputable wholesalers. At the national/provincial distributor level, the project facilitates the expansion of rural distribution networks and delivery of supplier credit.

The project's rationale for its co-investment approach is to provide enough incentives for actors to adopt new (better) inputs.[4] The project also found that retail input stores in Cambodia are also constrained to access formal credit.[5] The provision of co-

[2] See Pomareda and Hartwich (2005). The study covered 20 cases in Argentina, Bolivia, Chile, Colombia, Costa Rica, and Peru.

[3] See Aines and Grosser (2004). The paper describes that at the time when the MAP project was conceived, farm inputs, machinery, large and medium-sized farms disappeared, while the market for farm products changed radically. Furthermore, critical technical knowledge and understanding of how to participate in a market economy was considered to be inadequate or lacking. And as such, Armenian agriculture went from being high output and export-oriented to subsistence level within the span of five years.

[4] It is important to note that the term 'co-investment', as used in this case in Cambodia, appears to be more along the lines of a grant facility (i.e. the project does not require a monetary return on the 'investments' it makes, whether to farmers or to retailers, except that it carries the expectation of changing behaviours towards the use of new inputs). For more information on this case study, see Keatts / Fintrac (2015).

[5] Only 29% of retail input stores were found to be able to access formal credit, although 81% of retailers obtain supplier credit from their distributors, with an average loan size exceeding $6,000.

investment opportunities to both farmers and retailers was therefore meant to ease financing constraints through embedded market arrangements.

2.2 Sources of financing for agribusiness development activities

2.2.1 Commercial banks

In many countries, while enterprises often turn to commercial banks for their financing needs, many agribusinesses (especially small and medium agro-enterprises) find it very difficult (and at times impossible) to avail of loans from banks. This is a problem common to many developing countries, even those outside Africa. In this section, some of the approaches that have encouraged banks to enter into financing relationships with small and medium agribusinesses are described.

In **Central America**, adopting **a comprehensive approach to agricultural finance** is considered an effective way to facilitate access to financing by agribusinesses and the farmers that these enterprises work with. One of the case examples used to illustrate this approach involves Hortifruti, an institutional buyer.[6] Hortifruti belongs to a consortium built around a supermarket chain. It is composed of three separate but related firms, which together constitute the Agriculture Division of the *Corporación de Compañías Agroindustriales* (Corporation of Agro-industrial Companies). These three firms specialise in the procurement and distribution of fresh fruits and vegetables, basic grains (mostly beans and rice), and the supply of produce, meat and other staples to large institutional buyers (which include hotels, restaurants, hospitals, cruise ships, etc.).[7]

In this arrangement, Hortifruti acts as the lead firm and works in partnership with producers who supply the required goods (fruits, vegetables and other produce). Hortifruti looks for producers who either have already received and/or are working with international technical assistance (TA) providers: it considers these producers to be more likely able to provide the quality and quantity demanded by international buyers. In countries like Nicaragua and Honduras, where Hortifruti operates, the availability of TA services to producers has helped Hortifruti (and other leading firms) to transition from being a net importer to a net exporter.[8] In this value chain, Hortifruti (as the wholesaler) works in close partnership with national and global retailers. The supermarket chain, Wal-Mart, which purchases from Hortifruti, has established quality standards, and these are applied on its behalf by Hortifruti and its network of producers.

Over the years, Hortifruti has gradually developed a bundle of relationships with small- and medium-sized local producers. By the end of 2005, Hortifruti was working with about 1,650 preferred suppliers in Costa Rica (up from 1,200 at the end of 2004), 550 in Nicaragua (up from 300), and 350 in Honduras (up from 300). In most cases, there are no formal (written) contracts with the producers, especially since most producers prefer flexible arrangements. Rather, as the mutually beneficial and stable relationship between buyer and producer evolves over time, an informal or implicit contractual

[6] This is a case study discussed at length in OPM's research on innovative methods that are being successfully employed to extend access to financial services to micro, small and medium enterprises (MSMEs) in the agricultural sector. See OPM (2012).

[7] In 2006, Wal-Mart acquired 51% of the stock in the holding company of the Hortifruti group. Wal-Mart is an important strategic partner, as it is the largest retailer in the world and the largest food retailer in the US.

[8] Hortifruti does not extend financial support to the TA providers. (The services provided by TA providers will, in some cases be paid for by producers themselves; but in most cases, these will be financed by development programmes in these countries.)

arrangement is established. These implicit contracts, nevertheless, effectively guarantee a purchase, under certain conditions.[9]

For most of the participating farmers, these implicit agreements are valued as an intangible asset.[10] The implicit contract plays an important role in triggering and enhancing the creditworthiness of producers. The reduction or elimination of some of the market risks helps to encourage improved production performance and facilitate farmers' access to credit. (In some cases, access to external funding allows the producers to take advantage of new opportunities sooner rather than later.) The way credit and other financial services are provided to participating producers is linked to the development of the value chains, the way quality standards are introduced, and how the associated procurement practices and distribution channels are transformed and developed.[11]

Another approach that has helped to facilitate improved access to financing from commercial banks by agribusinesses involves **addressing the issue of collateral**, which is demonstrated in **China**'s experience with the development of an online receivables registry. In many developing countries, the majority of SMEs' physical and financial assets are in the form of equipment, inventory and receivables; and yet most financial institutions do not recognise these movable (or saleable) assets as collateral. The creation of the online registry was part of a much larger IFC Secured Transactions Advisory Project in China, from 2004 to 2011. The People's Bank of China (PBOC, China's central bank) recognised that the majority of Chinese SMEs were facing financing difficulties and therefore elicited the support of the IFC to modernise China's secured transactions system.[12]

The PBOC Credit Reference Centre (CRC) created a national online registry for pledges of receivables for leasing. It is China's first nationwide, central and online registry for secured transactions. The registry enables the use of movable assets such as receivables as collateral for loans. The receivables registry incorporates all the key features of a modern movable collateral registry: it is a single, unified registry; it is easily accessible online; it has user accounts; it uses a notice-based registry in which certain information is limited to the creditor/debtor; and it uses centralised information.[13]

When the IFC first started its secured transactions project in 2004, financial institutions mainly accepted real property as security when lending to SMEs. Less than 7% of their

[9] These implicit contracts provide a production calendar, the volumes required at each stage, and the standards of quality that need to be observed. The calendar allows the farmers to stagger their production, so that their planting and harvesting coincide with the dates and amounts of the purchase agreements.

[10] The implicit contractual relationship between the producers and Hortifruti helps to reduce farmers' market risk. The arrangement ensures that the farmer has a buyer (i.e. it reduces the risks associated with the volume sold), who is willing to pay within some expected price range (i.e. price risk is reduced) and able to make the payment with certainty after a short period (i.e. payment risk is reduced). Among other advantages, farmers value the promise of comparatively stable prices (net prices that are usually, though not always, somewhat above wholesale market prices) and of a guaranteed market, as well as some expertise, TA (which they get free) and market information. The relationship with Hortifruti therefore enables the farmers to plan ahead and to diversify their crops in order to reduce their vulnerability to changes in market conditions.

[11] For example, during the early phases of the relationship between Hortifruti and a producer, financing will be sourced by the producer from more informal sources; however, as the relationship evolves, the farmer is then able to establish a history of production and sales and use the implicit purchase agreements in order to access financing from commercial banks.

[12] The main objective of the project was to increase access to credit for firms, particularly SMEs, through the development of an appropriate legal and institutional framework to allow and facilitate the use of movable assets, such as receivables, as collateral for loans.

[13] Until October 2010, registration was free, but a small flat fee (RMB 100 or US$ 16) has now been introduced to ensure financial sustainability. The receivables registry is easy to use and efficient, and feedback on the user experience in terms of the registration system has been overwhelmingly positive (IFC, 2012).

outstanding business credit was secured exclusively with movable assets, mostly inventory and equipment. As a result of the reforms, the factoring industry was introduced in China and the value of domestic factoring had reached a volume of US$ 21 billion by June 2011. By this date, Chinese businesses had also received more than US$ 3 trillion in credit through more than 385,000 loans derived from accounts receivable financing (IFC, 2012).

Many of the beneficiaries are small businesses: 68,575 SME borrowers have secured loans using accounts receivable. The Chinese SMEs that have secured loans using movable assets are overwhelmingly positive about the impact on their businesses. 88% of respondents to a recent evaluation of IFC's secured transactions project claimed that their businesses grew as a direct result of obtaining accounts receivable funding.[14]

Among the registry's 5,000 users are banks, guarantee companies, law firms, finance companies, and pawn shops. All 21 of China's largest national banks are users of the registry. Financial institutions have generally found movables financing to be low risk and have therefore increased the number of commercial loans involving movable assets. Some of the larger Chinese banks claim that the secured transactions reforms, including the online registry, have triggered some improvements in their risk-management practices. Some banks report that they use movables financing as a way of mitigating the risks of lending to SMEs because it gives them increased access to the performance data of client-businesses.

As a result of the reforms, the movables-financing sector has not only increased in size, but has also expanded its product offerings. This has been viewed as a result of service providers being in closer contact with SMEs and therefore acquiring the necessary market information for product development. Many of the innovations in product are directly relevant to rural and agricultural finance. These include:

- The pledging of standard warehouse receipts from the Shanghai Futures Exchange to obtain short-term financing primarily for liquidity purposes, which allows the bank to monitor the market value of the receipts in order to ensure a minimum coverage ratio on the credit limit;
- Supply chain collaboration, which consists of a core enterprise of good standing and smaller enterprises occupying different parts of the chain - the credit limit to the smaller enterprises is based on the financial information derived from the supply chain collaboration provided by the core enterprise;
- Mutual guarantee/trademark provided as counter-collateral - bean-product businesses belonging to a registered association enjoy the right to use this trademark, which can be used as a counter-collateral;
- Mutual support fund (mutual guarantee) – the guarantee/risk fund draws contributions from each member-enterprise, who are each responsible not only for their own loan repayments but also the potential defaults of other members. This allows companies that trust each other and understand each other's business to enter into group lending;
- Livestock and livestock insurance - breeding pig livestock and its associated insurance can be pledged as collateral. In case of any losses, compensation will go directly to the bank.

[14] Dalberg (2011): Independent Evaluation of the IFC Secured Transactions Advisory Project in China.

2.2.2 Development banks

Government-owned development banks / financial institutions, or DFIs, still dominate in many countries and assert their role in the extension of credit and other financial services to the agricultural sector. The general experience with DFIs in many developing countries, however, has not been very positive. Many of these institutions have been found to do more harm than good: they typically suffer from grave operational inefficiencies, poor quality loan portfolios and exposure to (loan) concentration risks, all of which make them unable to perform as they have been mandated to.[15]

These state-owned DFIs or development banks typically have a specific mandate (from the government) to make long-term credit available to promote economic development in particular regions or sectors.[16] While these banks may be required to operate in a commercial manner, many of them find it difficult to do so while fulfilling their mandate.[17] In some cases, DFIs have therefore considered other business models, such as moving away from retail credit and providing more complex financial services (e.g. guarantees, refinancing, apex/wholesaling facilities), which help to lessen their credit risks and make them less subject to political interference.

While the experience with development banks has been generally negative, there are nevertheless a few cases that can be considered 'success stories', one of which is covered in this review. It is important to note that these successful cases include DFIs that have undergone significant reforms – which entailed a commitment of significant amounts of resources, over and above the re-capitalisation that many (state-owned) development banks required at some point in their evolution. As a result thereof, they are able to address the financing needs of clients in rural areas, including agribusinesses.

The experience of the Development Bank of the **Philippines** (DBP) is useful to highlight. As a DFI, DBP's key mandate is to provide medium- and long-term financing to address the needs of agricultural and industrial enterprises, with a focus on small- and medium-scale industries, particularly in the countryside. DBP also supports the growth of domestic capital markets and is the country's major conduit for international funds from multilateral and bilateral institutions for official development assistance programmes and grants. Its 60-year history is, however, marked by a number of difficult periods, particularly in the 1980s when the bank's viability was undermined by an increasing number of non-performing loans. DBP went bankrupt and required recapitalisation by the government. The bank, however, went through significant reorganisation and a reform process that included a thorough revision of its credit process and a training programme for all bank staff to ensure that its new lending thrusts were internalised and implemented. By 1995, DBP was granted a universal banking license, and three years later had its charter revised. Under the revised charter, DBP's authorised capital

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[15] There are a number of papers that discuss the (negative) experience with development banks, which are also sometimes referred to as development finance institutions (DFIs). See (1) Barr, Michael; Kumar, Anjali; Litan, Robert (eds.) (2007); and (2) Klapper, Leora and Zaidi, Rida (2005).

[16] The sectors typically include agriculture, manufacturing, SMEs, etc.

[17] There seems to be an inherent contradiction between the social policy mandates of development banks and the pressure to maintain commercially sound operations and avoid losses. Their social policy mandates expose them to a high-risk clientele and limit their capacity to diversify risks (whether across economic and geographic sectors or across target segments of the population). These institutions therefore tend to achieve low profits or incur losses, which are often magnified by their weak risk management systems, high administrative expenses, and their being subject to political interference. In order to minimise losses (which create a huge fiscal burden), some development banks are placed under the same regulatory and supervisory standards as private commercial banks. In some cases, this leads them to operate less risky and more lucrative lines of business, competing with other private banks. However, as their activities become increasingly inconsistent with their social policy mandate, political pressures re-emerge, which then push their activities back towards meeting their social mandates. Hence, a new cycle of losses and recapitalisations ensues. This point is also discussed in OPM (2012).

increased sevenfold from PHP 5 billion (about US$ 100 million) to PHP 35 billion (US$ 700 million). Today, DBP continues programme-type lending to strategic sectors such as infrastructure, transportation, telecommunications, power and energy, SMEs, agriculture and food security, education, health care, housing, microfinance, and the environment.[18]

DBP plays a strategic role in supporting supply chains. As a DFI, DBP is considered an important vehicle for accelerating sustainable economic growth in the country. The bank's flagship programme is the Sustainable Logistics Development Programme (SLDP), which is aimed at addressing the needs of logistics or the physical distribution of goods and services. As an archipelago with more than 7,100 islands, distribution is critical to the Philippines' food security. SLDP financial assistance is focused on the physical asset requirements of a sustainable distribution system of maritime transport and related transport by land. The programme supports the development of progressive long-haul shipping, which constitutes the country's national backbone in terms of transporting bulk agricultural products, as well as the development of short-haul ferry systems to link the islands to the various growth centres of the country. The programme facilitates close collaboration between the private and public sectors to bring about cost-effective ways of moving goods, services and people, all through the provision of financial assistance and TA. Through SLDP, investments to improve the transport, warehousing and distribution infrastructure are supported. This includes investments in post-harvest activities, such as processing, bulk drying, storing, handling and trucking, as well as establishing a connected refrigerated chain (from producers to consumers).

DBP's lending under the SLDP covers a broad range of projects in the distribution and supply chain, encompassing farmers, traders, consolidators, warehousing and transport operators, and including wholesale and retail distributors. The working capital needs of small-scale producers, traders and entrepreneurs are addressed through a separate facility - DBP's micro and SME lending programmes.[19] Larger investments to support capital equipment and fixed asset purchases, on the other hand (e.g. vessels and bulk carriers, cargo handling and storage equipment) are supported through DBP's project financing programmes. As of 2008, DBP has supported the financing of more than 200 projects (with financing amounting to more than US$ 300 million).

2.2.3 Specialised investment funds

There are a number of investment funds that have been set up with the aim of providing financing to enterprises, including those specifically operating in the agricultural sector. In some cases, investment funds have been set up to meet explicit developmental objectives (e.g. to support projects that help to fight hunger and poverty). These funds often involve the participation of 'social lenders and investors' – these are institutions that have an interest in supporting viable projects, but are at the same time interested in "the other bottom line". Private sector investors are, however, also increasingly playing a role in many agriculture investment funds, recognizing the potential of generating returns from some agribusiness development projects.

Some investment funds are focused on supporting enterprises in specific countries:

- In **Vietnam**, for example, the Prosperous Vietnam Investment Corporation (PVNI) is an angel/venture capital network, which provides pre-seed, seed,

[18] This is one of the development bank 'success stories' discussed in OPM (2012).

[19] In 2009, loans to small-scale farmers and fisher-folk reached PHP 29.5 billion (about US$ 590 million). These loans were extended through 1,054 accredited cooperatives and 393 countryside financial institutions (which include rural and cooperative banks). It is estimated that almost 500,000 small-scale producers benefited from these loans. In January to June 2012, DBP released PHP 11.6 billion in loans to 236 partner financial institutions, benefiting 129,792 small-scale farmers and MSMEs nationwide.

and early stage venture capital financing in highly innovative ventures. Its focus is predominantly in high quality consumer goods and services, green food, high tech, social media, and education.

- In the **Philippines**, the Consultancy for Agricultural Productivity Enhancement (CAPE) Program, a government programme, promotes the application of science and technology innovation in agriculture-based enterprises (covering aquaculture and horticulture). The Programme provides consultancy services aimed at transferring farm technologies and management strategies to individual farmers (including large farms with processing capabilities), farmer cooperatives, NGOs, and local government units. It also runs a Venture Financing Program, aimed at speeding up commercialization of inventions and innovations by extending funds for start-up companies and financing technology-based expansion activities of SMEs. The financial assistance covers limited working capital and also the acquisition of the necessary production equipment. Seed money for SMEs adopting new technology consists of 70% of the total project cost. The programme also helps beneficiaries look for other sources of funding.
- Devenco is also a venture capital and investment consulting firm operating in **Cambodia**, established in 2007. Devenco participates in investment opportunities that have the potential to contribute to the social and economic development of the country. It works across a wide range of sectors: this includes the agribusiness sector, as well as manufacturing, healthcare and life science, infrastructure, water supply, and waste management. It plays an active project management role in all of its portfolio companies.

On the other hand, there are also investment funds that operate in multiple countries. The **Small Enterprise Assistance Funds (SEAF)**, for example, is a global investment firm focused on providing growth capital and operational support to businesses in emerging markets and those that are underserved by traditional sources of capital. It makes structured debt and equity investments in locally owned enterprises with high growth potential.[20] It started in Europe in 1992, with the establishment of its first fund in Poland: CARESBAC Polska. Since then, SEAF has opened numerous fund offices throughout Central and Eastern Europe and has invested in **Poland, Bulgaria, Croatia, Romania, Macedonia, Estonia, Latvia, Lithuania, Georgia, Serbia and Montenegro**.

As of 2009, SEAF manages approximately $ 500 million in aggregate committed capital across 30 countries, of which $ 300 million have been invested in 285 companies (data as of March 2009). The returns generated cannot be considered particularly high (when compared, for example, with funds that are more commercial in nature). As such, development finance institutions and other donors play an important role in the fund, as purely private sector investors would generally seek much higher returns. Moreover, international development finance institutions and other donors can utilize an agribusiness development fund as a vehicle to achieve or enhance a strategy for agricultural development. Investors in SEAF-sponsored funds represent a cross-section of public and private institutions, including government-sponsored economic development organizations, multilateral financial institutions, private foundations, pension funds, insurance companies, banks and other independent financial institutions.

SEAF has a track record of investing in SMEs in emerging markets in Eastern Europe, Latin America and Asia, and is in the process of expanding operations into sub-Saharan

[20] SEAF was founded in 1989 as the private equity investment subsidiary of an international development organization – CARE International. In 1995, it became an independent organization that specialises in the sponsorship and management of investment funds targeting growth-oriented enterprises in emerging economies.

Africa. It sponsors and overseas the management of venture capital/private equity funds focused on providing emerging enterprises with structured debt and equity growth capital, and extensive post-investment business development assistance to increase sales and improve operational efficiency. A significant portion of SEAF's funding activities has been directed towards supporting agribusinesses, which represent about 40% of the enterprises it supports / sponsors.

SEAF recognises that access to capital and credit for SMEs, especially those in the agribusiness sector, is often hindered by underdeveloped or risk-averse local financial sectors, poor knowledge of agribusinesses among many commercial banks, and capacity constraints on the part of many small and medium agro-enterprises. Despite these constraints, many agro-enterprises still have the potential for growth, which offer promising investment opportunities.

SEAF's view of agribusinesses is that they present opportunities for stable and reasonable returns.[21] Its focus is on agribusinesses such as processors, aggregators and exporters, which present viable opportunities for investment in emerging markets. SEAF recognises that this sector typically offers stable and consistent returns, assuming that proper management and expertise are in place. Although weather risks and global commodity prices and overall demand can have an adverse effect on primary agriculture, the impact is softened for businesses higher in the value chain due to their greater flexibility in the market and their ability to reflect input price changes in their products. The sector is also less exposed to other market factors than are other sectors.

The funds that are currently being managed by SEAF include the Georgia Regional Development Fund (GRDF) and Afghan Growth Finance (AGF), both of which have a strong focus on agro-SMEs. In Bulgaria and Poland, in particular, due to regional development priorities associated with SEAF's first funds in these countries, nearly 60% of the investments were made in agribusinesses. SEAF is also raising two new agribusiness funds – one in India and the other in East Africa, both of which will invest across the value chain. SEAF has significant experience with agribusiness investments, ranging from primary production to processing, retail and wholesale operations. It has provided enterprises with the necessary access to resources and know-how to improve not only their production, but also their fundamental business operations. This has helped enterprises to acquire new technologies and modern inputs, build working capital and access the necessary markets for expansion. SEAF-managed funds have invested nearly $ 75 million in the agribusiness sector across its funds' geographies.

Another example of an investment company that operates across several countries is the **Latin American Agribusiness Development Corporation (LAAD)**.[22] LAAD is a private investment and development company, which finances and develops private agribusiness projects in Latin America and the Caribbean, across various stages of production, processing, storage, services, technology and marketing in agriculture, livestock, forestry and fishing. It was founded in 1969 by a group of leading international agribusiness and financial companies, with the aim of financing small and medium-sized, export-oriented agro-enterprises in Latin America and the Caribbean. LAAD financed mostly family-owned agribusinesses across 15 Latin American countries, which include **Brazil, Ecuador, Dominican Republic, Chile, Honduras, Bolivia, Costa Rica, Guatemala, Peru, Uruguay, Colombia, Nicaragua, Venezuela, Belize, and El Salvador**. LAAD provides loans of less than $3 million to small and medium-sized

[21] SEAF's investments in the agribusiness sector through its currently active funds have yielded an internal rate of return (IRR) of 16.2% and a multiple of 1.6 times the capital invested.
[22] See: http://laadsa.com/.

farmers to help modernize and expand their operations. The company operates entirely under market conditions, lending on a secured basis at prevailing market rates.

Box 1: Agro-enterprises that have availed of financing from LAAD

Florecot in Ecuador

In 1994, Florecot (Flores del Cotacachi S.A.) decided to embark on a project to produce summer flowers for export. Unlike seasonal flowers, summer flowers are used as fillers and must be produced all year round, which requires permanent and longer term financing. The business first turned to three local banks to explore financing options, but was turned down by the banks. Florecot's young shareholders thereafter approached LAAD; and after careful review of Florecot's loan application, LAAD was able to extend a $200,000 loan to the company, designed with a flexible interest and principal repayment schedule fit to fund its start-up project. Since then, and with LAAD's continued support, Florecot has grown to become one of Ecuador's largest summer flower producers. Production area expanded from four hectares of Gypsophila flowers and ten employees in 1994, to over 47 hectares that yield 50 varieties of 12 different types of flowers. The company had 700 field workers, and generated an estimated annual revenue of $8 million in 2008. Florecot exports its flowers directly to the U.S., Canada, The Netherlands, Italy, France, England, Russia, Chile, Venezuela, the Dominican Republic, and Kuwait.

Agropecuaria Sara, Bolivia

Agropecuaria Sara was established in Santa Cruz, Bolivia in 1993 to produce soybeans on a 250-hectare farm. By the year 2000, the company had already expanded soybean production to 3,420 hectares. In early 2001, LAAD extended a US$500,000 loan to the company to purchase farm machinery. Since then, LAAD has provided over $2 million in loans to fund expansion and increases in working capital requirements of the company. The agro-enterprise currently plants over 9,000 hectares of grain crops and 800 hectares of sugarcane, manages a 620-hectare forestry operation, and owns 700 heads of cattle. Annual revenues of the business have grown from $1.1 million in 2001 to over $2 million in 2008, and the company has become one of the largest farming operations in Santa Cruz.

Source: IFC (2009): The Latin American Agribusiness Development Corporation (LAAD): A case study of the development impact on rural enterprises in Latin America

While LAAD is able to access funds from commercial banks, it is also a client of the IFC (since 2002): IFC's financing tends to have longer maturity (than what commercial banks are prepared to offer), which is beneficial to LAAD's operations. The IFC initially provided a $20 million loan for on-lending to agro-SMEs, and a further loan of $30 million in 2006. The extension of long term financial resources by the IFC has allowed LAAD to safely scale up its business and expand its reach to a growing number of countries. In 2009, IFC provided an additional loan of $16.5 million and became one of the 12 shareholders of LAAD to further support the growth of the company's lending operations.

Box 2: Key highlights of LAAD's performance

Financial performance

Over the 2005-2008 period, LAAD has substantially increased its lending. Disbursements in 2005 stood at $72 million, and rose to $99 million by 2008. Its disbursed portfolio rose from $185 million to $265 million over the same period. LAAD's financial performance as measured by its Return on Average Equity (ROE) was satisfactory as well: over the same period, the ROE varied between 9.5% to 11.2%, with an average of 10.4%. (This is higher than the IFC-estimated required ROE of 7.1%.) This performance was achieved while

maintaining a high quality portfolio, with non-performing loans averaging less than 4% of total disbursements.

Economic performance

Despite the challenges in the global economy, the Company managed to increase its services to 152 companies in 2008 (from 124 financed in 2005). This was considered remarkable considering that most commercial banks were, at that time, reducing their exposure to SMEs.

Almost 60% of LAAD's portfolio is concentrated on horticulture products (fruits, vegetables, flowers), a sector which is quite labour-intensive. The Company estimates that in 2008, the projects it financed resulted in the creation of 16,200 jobs, mostly in rural areas. In addition, it is estimated that about 23,000 part-time jobs were created, on account of enterprises being able to expand their operations. Given that LAAD's primary focus is on export-oriented agro-SMEs, LAAD's investments are expected to make a significant contribution to the countries' foreign exchange earnings. In 2008, the Company estimates incremental exports worth $120 million.

Source: IFC (2009): The Latin American Agribusiness Development Corporation (LAAD): A case study of the development impact on rural enterprises in Latin America

In September 2012, the Austrian Development Bank (OeEB) has also signed a long-term credit line amounting to $ 15 million for financing agricultural enterprises in Central America, which is extended through LAAD.[23]

2.2.4 Other facilities provided by non-financial institutions

Financing can also be provided to agribusinesses by non-financial institutions – such as a coalition of international buyers or international networks. For example, the **Sustainable Trade Initiative (IDH)** is an international network that seeks to accelerate and upscale sustainable practices within mainstream international commodity markets.[24] It works on building public-private coalitions of companies, civil society organizations and governments in high-impact programmes; it currently maintains partnerships with over 350 companies, 60 NGOs and numerous governmental organizations. These public and private sector partners bring in funds, entrepreneurship and procurement power. With a €155 million co-funding grant from the Dutch, Swiss and Danish Governments, IDH runs public-private, pre-competitive market transformation programmes in 18 sectors.[25]

The initiative runs programmes that aim to increase the number of companies, traders and producers that are able to produce commodities in a socio-environmentally responsible way, and works in partnership with companies that have committed to invest in their supply chains to make production and trade more sustainable. It does this by raising awareness and broadening public support for responsibly-sourced goods in markets in Europe, South America, as well as in some of the emerging economies, such as in India and China. It brings together many of the larger international traders and processors; but it also engages with small and medium sized producers in many developing countries.

[23] See: http://www.oe-eb.at/en/projects/Pages/agricultural-enterprises-central-america.aspx.

[24] See: http://www.idhsustainabletrade.com/.

[25] These include commodities such as cocoa, coffee, tea, soy, cotton, timber, palm oil, natural stone, aquaculture and electronics.

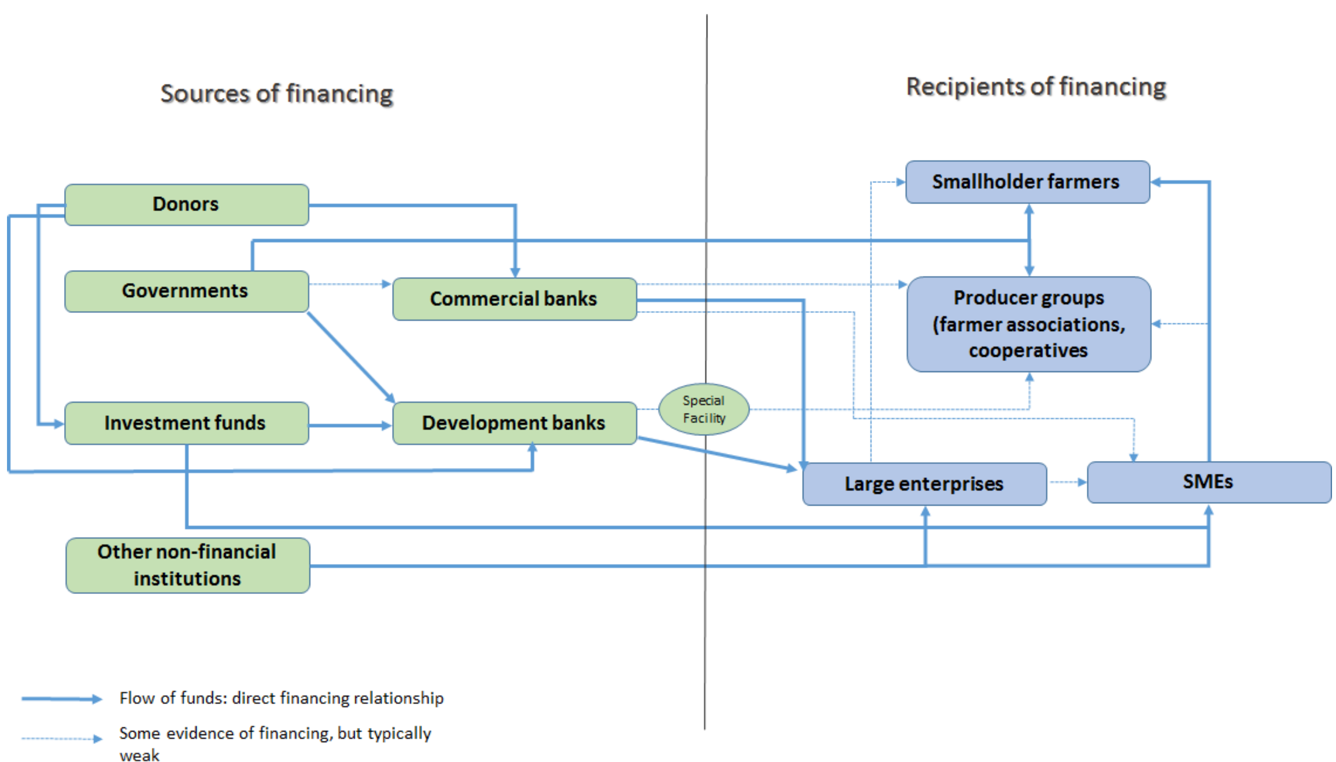
The IDH programme includes a Fast Track Fund, which leverages investments of producers, processors and/or buyers to increase volumes of responsibly-sourced goods in the coming years. The driving mechanism is a match funding of private investments up to a maximum of 50%.[26] The private investments can consist of extra buying costs and/or investments in good agricultural practices. Projects are proposed by supply chain actors. IDH are open to all companies that want to transform their supply chains and want to achieve 100% sustainability.

To create more incentives for producers, IDH has aligned with international and local banks (e.g. Rabobank International) and local producer organizations. Together they work to enhance preferential access to (better) finance and agricultural services that will be provided for farmers who are legally compliant and certified.

2.3 Summary of financing mechanisms

Figure 2 (below) gives a snapshot of the sources of financing to agribusinesses and farmers, and the financing instruments that are typically offered by various sources are shown in the table (Table 2) that follows. Financing sources differ, not only in terms of the financing instruments (loans, equity, or grants) that are typically offered, but also in terms of the types of agribusinesses that are usually able to access the facilities on offer. In this context, a distinction is made between large agribusinesses and SMEs. Larger agribusinesses, which tend to have more integrated operations (i.e. they operate across various stages of the supply chain), tend to enjoy better access to financing provided by most institutions. SMEs, on the other hand, are noted to generally face constraints, especially when availing of financing from commercial banks. Some investment funds (especially those that have been set up with developmental aims) are able to address the financing needs of agro-SMEs.

Figure 2: Overview of sources of financing to agribusinesses and farmers



[26] A prerequisite for any IDH investment is a minimum of 50% co-funding by participating companies.

Table 1: Financing instruments typically used, according to funding source

Sources of financing	Type of financing offered	Recipients of financing
Commercial banks	• Loans	• Financing often favours larger enterprises • Some are able to extend loans to SMEs and producer organisations, especially in the context of donor-funded financing programmes
Development banks	• Loans	
Donors (including international financial institutions)	• Loans and equity investments are typically made through commercial and development banks and specialised investment funds, but some are able provide financing directly to firms • Some offer credit guarantees • Grants	• Various types of agribusinesses are targeted, but financing facilities targeting SMEs are often supported
Governments		
Specialised investment funds	• Loans and equity investments	• Various types of agribusinesses are targeted, but financing facilities targeting SMEs are often supported (especially in the context of funds that carry developmental objectives)
Other financing facilities set up by non-financial institutions	• Loans	• Large enterprises

Participation by donors and governments

Donors and governments that provide funds to support agribusinesses and farmers often do so through commercial or development banks. This is usually done in the context of market development programmes by making available funds for on-lending or through the provision of credit guarantee mechanisms.

Some donors (i.e. international financial institutions) also provide loans and equity investments through specialised investment funds, while some extend financing directly with private sector companies. For example, the **Inter American Investment Corporation** (IIC), a member of the IADB, provided a $2 million loan to Ecofair, a Colombian banana exporter. At the same time, the IIC also collaborates and participates in specialized investment funds, such as the LAAD, which in turn extends loans and invests in agro-SMEs in the region.

The IADB has also created a special vehicle to make loans and grants to rural microfinance organizations and farmer cooperatives in the 1970s, which has evolved into the Social Entrepreneurship Program (SEP). The SEP finances a combination of loans and technical assistance packages to support value chain financing initiatives and rural microfinance organizations. Many of the projects financed by SEP are executed by farmer associations, cooperatives, agribusinesses, and non-profit organizations working with small farmers. The philosophy of these projects, which are run as pilot initiatives

of around $1 million, is to assist in their early stages of development, so that they can eventually become fully bankable operations.

Governments participate in financing the development of the agribusiness sector often by establishing specialised funds to support on-lending to targeted sectors (delivered through participating commercial banks and state-owned development banks). In many Central and Eastern European countries, for example, governments are active in providing credit to agriculture and to enterprises in rural areas often through a credit guarantee fund, or establishing special facilities that offer subsidized interest rates.

In **Thailand**, the National Innovation Agency (NIA) implements financial support programmes for SMEs, with a strong focus on innovative technologies and commercialization of high value-added products. It assists innovative businesses in dealing with the risks of innovation investment and commercialization, and offers a range of financial programmes to help entrepreneurs manage risks and drive innovations. This includes the provision of interest-free loans for an innovation project up to a maximum of $160,000 for the first three years; the provision of grant support (to cover up to 75% of total expenses) up to $160,000, for a maximum of three years; supplying full grant support for cluster platform-based innovation projects and joint venture innovation projects (up to $800,000, for a maximum of seven years).

3 Lessons learned from the use of various financing mechanisms

While a great deal has been written on addressing the financing needs of smallholder farmers and producer groups, the available literature that particularly tackle financing of agribusinesses appear to be much more limited. In many cases, only very general information is provided – e.g. the institutions or actors that are involved in the provision of financing, and the activities and sectors that are supported.

The available literature on this subject do not include robust analyses of the effectiveness of financing mechanisms used. Where data on performance is provided, most of the time, this tends to focus solely on ‘volume of disbursements’ (in the case of loans) and the number of enterprises accessing the facility. Most case studies remain silent when it comes to any information about portfolio quality. While some case studies feature ‘success stories’ of agribusinesses that have availed of financing, it cannot be determined whether all the other enterprises that have availed of these financing services have also developed and grown, and whether any observed development of these enterprises could have indeed been driven by their having access to financing from various sources. In the case of an investment fund like LAAD, for example, the IFC notes that the current information collected by LAAD does not permit an adequate quantification of its impact. Both the LAAD and the IFC are exploring how to collect additional data to document and analyse LAAD’s developmental impact and its projects’ multiplication effect.

That said, there are some useful lessons that can be drawn from the case studies, which are summarised in this section.

A comprehensive approach of combining financing and technical assistance helps to ensure effectiveness.

Many of the case studies involve an approach whereby financing is offered in combination with technical assistance to agribusinesses (and to other actors in the value

chain). The experiences of Hortifruti in Central America and BASIX in India, for example, in developing value chains, underscore that the provision of financing alone (in this case, loans) is not enough. A more holistic approach is needed, which includes a range of financial and non-financial services, such as business development services and agro-related TA.

Agribusinesses (especially many agro-SMEs) also need access to critical non-financial services that will enable them to grow their businesses and expand value chains. The development of agribusinesses can also create market opportunities for other value chain actors (and particularly, for smallholder farmers / producers). But this often requires the integration and consolidation of agricultural value chains. This can happen organically with time, but the process can be speeded up with TA. Governments and development partners can play an important role in helping to accelerate the consolidation of agricultural value chains.[27]

Similar observations were made in some of the case examples on specialised investment funds. In Georgia, where SEAF is implemented, TA funds and/or grants, combined with an investment fund, have been found to be valuable to enhance or ensure the success of agro-SMEs. Access to capital alone is rarely sufficient when dealing especially with small companies in difficult environments or markets.

In the early stages of engaging with targeted agro-SMEs, SEAF and company managers are able to develop a clear understanding of where attention and support are needed. In SEAF's experience, grant funds are proving useful to deploy for this purpose, without weighing down or overleveraging the company's financial position. However, to be effective, it is important that both SEAF and the investee believe in the value of the consultants being brought in.

The choice of institution and financing instrument will depend on the specific types of agribusinesses being targeted for support.

Investment funds such as SEAF prefer supporting proven business models that are "closer to cash" and that can be expanded or introduced into the emerging market (over those that test new or unproven technology or business models). In SEAF's experience, this was where investment success has been demonstrated. Such businesses, for example, include a cold storage facility start-up investment that would supply existing wholesalers and retail stores, which in turn would service local consumers or producers. SEAF has also invested in companies that provide farmers with automatic poultry feeding systems or sheds, where the cost advantages for such investments are easy to prove and the payback period is rapid. SEAF has also invested in opening grocery stores in some cities where no such stores had existed before (in Macedonia, Romania and Poland); in snack food companies where consumer demand is rapidly rising as working hours increase (in China); in organic fruit marketing companies looking to integrate backwards into processing (in Poland and Peru); and in distribution companies supplying hotels and restaurants with everything from kitchen equipment to selected food items (in Croatia), where such hotels and restaurants are expanding to meet rising tourist demand. SEAF prioritizes investments for which an existing or clearly latent demand exists, rather than invest in a processing plant for a product for which a ready market does not (yet) exist.

[27] The horticultural sector in Honduras, for example, has benefited from TA, with targeted education of small farmers helping to integrate small producers into their supply chains. Various technical assistance providers (e.g. Fintrac, ACDI/VOCA, TechnoServe, etc.) play an important role in improving producer quality, building market research capacity, and demonstrating successful integration mechanisms. Moreover, by playing the role of honest brokers, they can bring value chain actors together in a way that provides mutually beneficial opportunities that strengthen the competitiveness of value chains as a whole.

Some investment funds may also hesitate to operate in difficult environments. In the case of LAAD, for example, the political turmoil in several countries in Latin America in 2006 forced the company to reassess its risks and reduce new business, and to focus on supporting existing clients. The uncertain political situation in Bolivia prompted LAAD to limit its operations in the country at that time, and to concentrate on improving portfolio quality through problem-loan work-out operations.[28]

In developing programmes to support the development of agribusinesses, identifying partners with aligned incentives in order to create a 'demonstration effect' is crucial. Commercial banks are often conservative and risk averse, especially in environments where the repayment culture may have been damaged; they may not therefore be the best initial partners for agricultural finance or may not be willing to participate. Once agricultural finance can be proven to be profitable, however, financiers will be keen to expand their investments and more financial institutions are expected to be attracted to the market.

The importance of an enabling environment

While the demand for financing can escalate with the presence of an institutional buyer (especially if purchases are made on behalf of a well-known supermarket chain, as in the case of Hortifruti in Central America), there will not always be an adequate response in terms of the supply of financing. In some cases, the capacity or the interest (among financial service providers, especially commercial banks) may be lacking. In Hortifruti's experience, for example, there have been substantial differences in the capacity and interest of various types of financial intermediaries in the three countries where it operates (Costa Rica, Honduras and Nicaragua). Many other factors that are outside the realm of what Hortifruti does help to explain the differences in how financial intermediaries respond to opportunities to provide financing.

In Honduras, for example, the collapse of a state-owned agricultural development bank and severe political intrusion in financial markets (including the passing of legislation for the pardoning of loans) have seriously affected the country's credit markets and explain the lack of appetite among banks to extend services to the agricultural sector. There are also regulatory asymmetries in Honduras, which penalise those financial intermediaries willing to extend their services in rural areas, even when the associated risks are not necessarily excessive.

Encouraging banks to provide financing and other financial services to agro-SMEs can be met with challenges, especially if enterprises have little or no real-estate collateral. As the case in China demonstrates (and as what can be observed in many developing countries), banks are often reluctant to accept movable assets as collateral because of the unfavourable legal framework and their lack of knowledge and experience in dealing with movable assets.

The experience of the secured transactions project in China demonstrates the importance of developing a more conducive enabling environment to encourage financiers to support and engage with SMEs, especially those operating in the agriculture sector. The IFC notes that taking a structured and holistic approach to addressing the challenges in the market was essential. The project first established a

[28] Despite the challenging situation that combined very high commodity price volatility, a global credit crunch and a global recession, the IFC notes that LAAD still had a remarkable performance in 2007 and 2008. The Company still managed to grow its lending by 23% (in 2007) and 15% (in 2008). This was partly explained by the strength of global agricultural prices until mid-2008 and the strong demand for term financing from its clients, many of whom began to encounter difficulties obtaining funding from traditional sources (e.g. commercial banks).

conducive enabling environment before attempting to develop the movable assets registry or indeed encouraging banks to work with SMEs.

The secured transactions project in China has indeed achieved impressive results: approximately $ 3.5 trillion of accounts receivable financing was registered between 2007 and June 2011, following the reform. It is important to note, however, that similar results cannot be expected in other countries, given the size of their economies compared to China. The project benefited from the remarkable growth and development in the Chinese economy during the project period. It is unlikely that replication in other countries (especially in African countries), with less favourable macroeconomic environments, would produce as impressive results as those in China.

The effectiveness of credit guarantee schemes in facilitating financing

The purpose often cited for setting up credit guarantee schemes is to help financial institutions (such as commercial banks) to overcome problems of asymmetric information by demonstrating the real risk to lenders who may perceive the risk to be higher than what it is – e.g. the risks that may be associated with lending to agro-SMEs. While credit guarantees can play an important facilitating role, the medium term objective is to enable financiers / banks to better understand the market and develop the appropriate tools to appraise risk, develop the right products and identify credit-worthy borrowers within the pool. There therefore needs to be an interest in banks to build capacity within their organisations that will allow them to extend financing to agribusinesses.

When considering the implementation of a credit guarantee fund or scheme, the key questions that need to be addressed are:

- To what extent will the availability of a credit guarantee fund help encourage financial service providers / banks to explore new mechanisms to better serve agribusinesses?
- And could the availability of guarantees (to some extent) keep banks from going beyond their comfort zones – especially in terms of adopting more effective methodologies and practices?

The second question considers the possibility of how the guarantee may to some extent act as a disincentive to truly seek out methods that work – which might be expected of an institution that knows it does not have anything to fall back on, and therefore, would be keen to discover and employ methods that truly work. The experience of many institutions globally demonstrate the limitations of credit guarantees – essentially, that these guarantees could not help financial institutions that were not at the same time investing in developing their own institutional capacity.

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