



Financing Climate Smart Agribusinesses

Options, Challenges and Way Forward

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Context

- **Agribusinesses are critical to food security, poverty reduction and economic prosperity of GMS**
 - Contribute over 23% to GDP and generate income for both large corporates and smallholder farmers
 - Global demand for food is projected to increase by 70% by 2050 to meet dietary requirements of over 9bn people. It will need investment of over \$200bn annually.
 - Food and agribusiness companies on average have shown higher total returns (17%), than energy (13%), and information technology (10%).

Context

- Financial institutions lend a disproportionately lower share of their loan portfolio to agriculture as compared to agriculture's contribution to GDP
- Given its size, financial capacity and commercial perspective, the private sector will need to meet most of this demand.
- In this context investment in the agribusiness sector provides a tremendous opportunity for 500 million smallholder farms to achieve growth and increase income.

Financing Requirements

- Smallholder farmers require short-term credit facilities for procuring agricultural inputs such as seed, fertilizer, pesticides, leasing farm equipment or employing additional labor during harvesting.
- Long-term finance required for crop and land renovation, purchase of land, irrigation systems, logistics infrastructure or other large investments.
- Productivity enhancing technologies (quality fertilizers, better seeds, improved livestock and micro-irrigation) yielded 80%-140% income gains whereas those focusing on value chain inefficiencies achieved 20%-60% gains.
- Successful and competitive agribusiness involve a series of interlinked activities performed by various stakeholders comprising the value chain from farm to plate all of whom have differing requirement of funds ranging from trade finance to infrastructure and marketing.

Financing requirements

- Agribusiness value chain assist in matching buyers and sellers, grading and quality assessment, consolidating small lots, pricing, sharing market and technical information and risk management.
- As agricultural value chain transactions are designed to improve efficiency, productivity and profitability and to minimize costs and risks, they demand financial instruments that are flexible and respond to changing market requirements.
- R&D in agribusiness products, processes and technology requires financing to disseminate knowledge, transfer skills and share best practices. These are usually financed through grants or technical assistance programs.



Financial Instruments & Options

- Savings or internally generated resources: usually inadequate for adoption of new technologies or efficient farm management and production processes.
- Pooling of finances at community level - informal cooperatives and credit unions: small value credit to buy agricultural inputs and meet financial obligations.
- Inclusive finance or microfinance institutions (MFIs) provide financial services - deposits, loans, payment services, money transfers and insurance to poor and low income household and their microenterprises. MFI services offered by rural banks / cooperatives and NGOs.
- Formal banking sector: Debt, equity finance and leasing. Short term credit instruments - overdraft, bridge financing, mezzanine financing, factoring, pooling or warehousing and senior and subordinate debt options. These are utilized by large agribusinesses and corporates for trade finance.

Financial instruments & options

- Blending of traditional funding options is being adopted for green infrastructure investments to develop innovative financing mechanisms: Green Bonds, crowdfunding, structured notes, PPPs, combining commercial and concessionary debt instruments, securitization, leasing options and results based financing.
- Conservation finance and impact investments are gaining support from financial institutions (pension funds, insurance companies and fund managers) and private investors (family foundations, religious and philanthropic organizations and individuals) as it provides a new asset class for investments.
- Warehouse receipt system (WRS) enables farmers and agribusiness producers facing collateral constraints to obtain credit for working capital, purchase of agricultural inputs and invest in equipment by using commodities as collateral.



Financial instruments and options

- The Baitang Community – Rice Bank experience in Cambodia – provides agribusiness services to over 65,000 household members in 3 provinces.
 - The absence of climate proofed warehousing facilities and the unavailability of valuers is a constraint that inhibits this type of financing.
- Risk reduction financial instruments intended to de-risk investments for lenders and borrowers: crop and weather index linked insurance, credit and portfolio guarantees (covers first loss up to a limit).
 - Green Bonds are fixed income debt instruments that raise capital for sustainable environmental and climate related projects. Green Bonds accepted as a new asset class and in 2018 its issuance soared to \$130 bn worth of investment worldwide. With the exception of China and more recently Thailand (first \$60 million Green Bond issued by TMB Bank with International Finance Corporation as an investor) Green Bonds have not been issued in GMS countries.

Financiers

– Formal Financial institutions

- State-run and private commercial banks not accessible or do not provide credit to smallholder farmers due to lending criteria, requirement of collateral, fragmented and remote location of the farmers, high transaction costs and absence of specific low value credit schemes.
- MFIs provide agricultural and non-agricultural lending to smallholder farmers. In Cambodia and Myanmar excessive lending, high interest rates and lack of financial literacy has led to indebtedness and loss of assets in some cases.
- MFI Success stories: Amret in Cambodia has established over 150 branches and 90% of its lenders live in villages. Vietnam Bank for Social Policies which is recognized as a 'green bank', has provided micro finance and technical support to 43,000 households in Central Vietnam to cultivate over 76,500 hectares of forest and undertake infrastructure improvements.
- Impact financing investments undertaken by smaller private financial institutions provide short term credit to producer organizations backed by buyer contracts. Root Capital improves lives of rural farmers by connecting them with formal markets that purchase agricultural produce from smallholder farmers and helps improve farming practices. Oikocredit, a worldwide cooperative, promotes sustainable development by providing loans, investments and capacity building in the agriculture and energy sectors and provides microfinance in Vietnam.

Financiers

- Interest in agriculture and in agribusiness has increased due to strategic concerns of rising commodity prices and leveraging commercial opportunities.
- GMS received record levels of FDI inflows in 2017: Cambodia \$2.7 bn, Lao PDR \$1.59 bn, Myanmar \$4.68 bn and Vietnam \$6.3 bn. Agriculture is a major investment sector in Cambodia and Lao PDR especially in rice processing.
 - Vietnam: CJ Group from Korea in partnership with Ninh Thuan People's Committee established chilli farm and processing plant as a Corporate Shared Value project.
 - Thailand: Friesland Campina (Dutch), one of the largest dairy producers in the world provides capacity building and training to farmers to increase quality and quantity of milk production. Reduces import tax implications.
- NGOs provide agronomic and financial training to non-commercial smallholder farmers through a field agent network that mobilizes farmers into producer groups.

Financiers

- The One Acre Fund (Africa over 300,000 clients) offers smallholder farmers an asset-based loan that includes distribution of seeds and fertilizer, financing for farm inputs, training on agricultural techniques and market facilitation to maximize profits. Each service bundle is about \$80 in value and includes crop insurance to mitigate the risks of drought and disease. The fund plans to expand into South East Asia.
- International donors, MDBs, government bilateral funding agencies, trust funds, private institutional finance establishments, foundations, specialized environmental funding agencies, etc., provide grant and loan financing to support government projects and fulfill international program commitments (MDG, SDG, NDC).
 - GEF, GCF, Livelihoods Fund, Livelihood and Food Security Trust Fund, Agrifin, Forest Carbon Partnership Facility, Climate Investment Funds, Bill and Melinda Gates Foundation, etc.
- Non-financial institutions
 - mobile network operators, value chain stakeholders, village savings and loan associations, savings and credit unions, cooperatives and informal actors such as moneylenders.

Financing Needs, Gaps & Challenges

- The challenges of population growth, climate change, economic uncertainty and rising food commodity prices are demanding improvements in productivity of smallholder farmers to meet global food requirements.
- Smallholder farmers cannot leverage this opportunity and optimize returns as:
 - Capital limitation – access, availability and ability to repay
 - Exposure to weather events
 - Market price fluctuations
 - Lack of knowledge of sustainable production techniques, markets and financial instruments
- This market segment suffers from a huge underinvestment.
- As state sponsored subsidy and guaranteed price program were dismantled the financing gap has increased.
- SME sector is most affected as funding requirements are larger than MFI's credit envelope and formal banking institutions consider them to be risky investments.

Financing Needs, Gaps & Challenges

- Demand for biofuels has intensified the pressure to grow crops to meet renewable/alternate energy targets
- Supply side disruptions will severely impact agricultural production
 - Scarce natural resources such as land and water will be pressured and this will impact commodity price levels.
 - Urbanization will contribute to a decline of arable land and this coupled with rural-urban labour migration will shift employment to the non-farm sector.
 - Climate change, global warming and the frequent extreme weather events will contribute to land degradation and sub-optimal productivity.
 - Insufficient infrastructure investments in the agriculture sector especially in constructing and upgrading irrigation networks and supply chain (warehouses, roads, shipping facilities etc.) will impact the marketability and delivery of the agri-product in addition to higher wastages.
 - Slow adoption and inadequate investment in new technologies to improve quality and productivity.

Financing Needs, Gaps & Challenges

- Global Climate finance flows have increased but agriculture receives low allocation.
 - Agriculture, Forestry, Land Use and Natural Resource Management received an average \$5bn of the \$22bn invested in adaptation projects and an average of \$4bn out of \$436bn for mitigation projects during 2015-16.
 - South Asia received \$22bn out of a total of \$463bn invested globally.
 - Despite agreeing to allocate \$100bn each year in climate finance by 2020 under the Paris climate deal, developed nations and their developing counterparts had pledged only \$10.13bn to GCF.
 - The future viability of the Fund is not guaranteed as USA has withdrawn from the Paris Agreement and will not provide the outstanding \$2bn pledged amount.
 - Till date only 12% of the total pledged amount to multilateral climate funds has materialized into disbursements.
 - Both GEF and GCF have a long procedural system of reviewing and approving projects for financing and could take over 18 to 24 months from the initiation of the proposal process. Global Climate Finance: An Updated View 2018; Climate Policy Initiative.

Financing Need, Gaps & Challenges

- Factors inhibiting investment in GMS
 - Lack of climate smart infrastructure that should form the backbone of an efficient supply chain management system linking farmers to markets.
 - Weak local government support
 - Inadequate commercial laws and financial regulatory systems to ensure that smallholder interests are protected.
 - Inadequate commercial and socio-economic opportunities that provide alternate and additional sources of income.
 - Poor market information and limited technical support.
 - Poor coordination between markets
 - Absence of sufficient affordable credit and de-risking instruments and other risk management mechanisms
 - Financial interventions not adapted to local context.

Financing Priorities & Way Forward

- Development of sustainable and competitive agribusinesses will hinge on public support for agricultural markets and private sector capacity to leverage investment opportunities.
- Agribusinesses must be able to rapidly adapt to shifting technology, markets, consumer preferences and competitive challenges.
- Governments should improve policy and regulatory framework, encourage privatization and wean smallholder farmers from subsidies to make them self-sustaining through the development of entrepreneurial capacity and organizing them into industry and producer associations or cooperatives.
- Adopt Digital financial services to gain access to credit, quicker payments, produce higher value crops and connect seamlessly to markets.
 - Impact Terra, a Myanmar company launched an application for providing digital solutions to farmers on cropping systems, agricultural inputs and market conditions. The app customizes the content based on user circumstances, offering information on weather forecasts, crop market prices, best practices and financing opportunities. It provides information on the usage, quantity, prices and availability of agricultural inputs and where users can get best prices for their products. It also includes risk assessments on different pests, diseases and water level concerns based on where users live and what they grow.

Financing Priorities & Way Forward

- Encourage and create Innovative partnerships that bring together public, private and other stakeholders.
 - PPPs are a mechanism for mobilizing finance and reducing the risk associated with the agriculture sector.
 - Agri-PPPs provide wider sectoral investment opportunities to private investors and contribute to development that is inclusive of smallholder farmers.
 - Agri-PPPs can be classified into four types of collaborations: i) agricultural value chains; ii) joint agricultural research, innovation and technology transfer; iii) building and upgrading market infrastructure; and iv) delivery of business development services to farmers and SMEs.
 - A study by FAO of 70 Agri-PPPs revealed that the PPPs ‘offer a number of potential benefits by the combination of the operational and economic efficiency offered by the private sector and with the public sector’s role as the creator of an enabling environment and regulator to ensure that societal interests are safeguarded.

Financing Priorities & Way Forward

- Agri-PPPs in the sector have provided significant investment and satisfied the CSR obligations of the corporates.
 - In Vietnam a PPP between Nestle, the Ministry of Agriculture and Rural Development, Western Highlands Agriculture and Forestry Science Institute and local agricultural extension bodies in 5 Central Highlands provinces supports a coffee value chain from farmers to consumers. Nescafe has provided training to over 200,000 farmers on sustainable farming, assisted 21,000 farmers to acquire 4C international certificates and increase incomes by 30%. It helps conserve the environment through reducing irrigated water usage by 40% and chemical fertilizer and pesticide by 20%.
 - In the Indonesia Domestic Biogas Programme (IDBP), Hivos is working with Nestlé to encourage small dairy farmers to invest in biogas digesters as an affordable and sustainable source of cooking fuel using renewable local resources. This program, which also involves the Indonesian Ministry of Energy and Mineral Resources and SNV, has led to the construction of almost 9000 bio-digesters, more than 5500 of them for Nestlé's milk suppliers.

Financing Priorities & Way Forward

- Several innovative finance measures have been developed that use conventional capital market structures to provide funding for sustainable agribusiness development.
 - A tax on agricultural commodity derivatives markets, especially wheat, maize, soy and sugar, with a ‘double effect’ tax could be introduced. This is especially the case with derivatives markets where complex financial products (such as futures, swaps, etc.) are exchanged without any actual exchange of the commodity in the physical markets. The tax can be levied only in countries where trading markets are well developed and regulated.
 - Contributions could be obtained from private agro-food companies and income derived from a ‘Q’ mark or logo or label to be put on all kind of food products, could be a source of financing.
 - Increasing farmer productivity and income by reducing wastage is an indirect form of providing capital to the farmer by lowering his operational cost and expenses. The farmer could be offered tools, supplies, packaging materials and various types of simple, low cost equipment that can be used to reduce food losses in transit between harvest and the consumer.

Priorities for Action

- Assess barriers for financial preparedness of agricultural SMEs in the GMS
- Strengthen marketing and business planning and entrepreneurial skills of agricultural SMEs to improve their financial preparedness
- Build capacity of climate-friendly agribusiness on financing options, including warehouse receipt financing.
- Stimulate the usage of digital financial services to reduce costs, increase market awareness and transact transparently.

Priorities for Action

- A dedicated climate smart agri-financing facility (AFF) with a small corpus of funds should be set up to assist agribusiness stakeholders and potential investors to access financing for projects.
- AFF will invite competitive climate friendly project proposals, in the format of a business plan, from stakeholders and institutions.
- AFF will review proposals based on their impact, climate friendly manufacturing and production practices, reduced vulnerability to impacts of climate change while reducing GHG emissions, inclusiveness, gender focus and financial viability.
- Proposals will be shortlisted and an assessment made to determine the likely sources of funding that can be accessed for the project.
- AFF will assist in the preparation of comprehensive investment proposals to financial institutions, donors, etc.
- Corpus funds will be utilized to fund pilot project, conduct workshops and knowledge management events and disseminate technical and market information. AFF will provide M&E services and will liaise with funding agencies by overseeing reporting obligations of the lenders.

Panel Discussion

- 1. Key Challenges for your country or organization**
- 2. Current efforts undertaken and best practices adopted**
- 3. Key priorities for action**
- 4. Major advantages and disadvantages in adopting a regional or transboundary approach**

Thank You!

