

Report for AGRF Deal Room Climate Finance Session

AGRF 2021 SUMMIT Pathways to recovery and resilient food systems 06-10 September 2021 Nairobi, Kenya

1. Session Introduction/Summary

Session Title: Private Sector Access to Rural Climate Finance in Sub Saharan Africa

- Time: 6th September 2021, 10am EAT
- Number participants (virtually): 118
- Name of the Rapporteur: Sauli Hurri

Introduction note, moderation, conclusion: Dr. Thouraya Triki, IFAD, PMI Director

Session objectives:

- Better understand private sector various roles in the rural climate financing value chains
- Identify constraints and opportunities for boosting rural climate finance in Sub-Saharan Africa
→ Goal: Identify ways of promoting access to rural climate finance

Panelists:

- **Tony Clamp:** Director, Green Climate Fund's Private Sector Facility, South Korea
- **Henrik Franklin:** Director of Portfolio Origination/Management, Nordic Development Fund, Helsinki
- **Esther Muiruri:** Associate Director in charge of Agribusiness at Equity Bank and Foundation, Kenya
- **Kenneth Davis Kasigila:** Senior Manager, Sustainable Finance/Relationships at CRDB Bank, Tanzania
- **Liliane Ndabaneze Chabuka:** CEO and Co-founder of WidEnergy Africa, Zambia
- **Mark Hemsworth:** Co-Founder and Director of Innovation at Rent to Own, Zambia

Summary of key points:

- **Introduction:** The investment demand for CC adaptation response, for developing countries only, is estimated by UNEP Adaptation Gap Report 2020¹ to be in the range of 140-300 billion US\$ annually. For smallholder agriculture and supporting agribusiness, the adaptation investment demand is estimated by a CPI technical report 2020² to be approximately 240 billion US\$ and 130 billion US\$, respectively. On the supply side, the investments flowing to the adaptation and especially adaptation by smallholder communities is only a fraction of the investment demand. In this AGRF session IFAD convened three layers of private sector actors (African SMEs, African Banks and International Financial Institutions) to explore opportunities and challenges to increase private sector investment flow to bridge the climate finance gap in Sub Saharan Africa's agriculture.
- **Challenges and constraints:** (i) cash flow and business volumes of start-ups and small scale producers are small and often too vulnerable for commercial investors, which makes transaction cost and credit risk high, (ii) investment risks in agriculture and especially in climate risk contexts are real and not only in perceptions: erratic events keep impacting the investment climate including floods, droughts, pandemic, locusts, (iii) skills of stakeholders to utilize innovative investment solutions including equipment but also financing tools such as insurance are limited, (iv) investment in macroeconomic contexts of high inflation and forex fluctuation is a challenge for local banks, SMEs and farmers, which have mostly access to local currency revenues and international financiers prefer to lend in forex – margins are lost in fluctuation.
- **Lessons/solutions/recommendations:** (i) PAYGO digital toolkit for leasing at SME level, (ii) connect loans with productive assets and not always need to deal with cash, (iii) to achieve trust between financier and investee one needs transparent and comprehensive flow of information and control points, whereby digital solutions such as affordable satellite imagery to monitor what is happening on the ground could be helpful (iv) IFIs best to work with local intermediary investment managers / financial institutions who manage the direct investments and ensure finance flows locally, (v) IFIs to provide not only resources but also risk mitigation mechanisms, junior position loans, guarantees, insurance tools and grants for local intermediaries and SMEs as end users, to mitigate against the investment risks, (vi) for each intervention, financing is combined with TA to ensure efficient use and sustainability, which could be achieved through partnerships between banks and IFI or UN agencies (vi) in addition to transactional investment projects, need to ensure also enabling policy

¹ <https://wedocs.unep.org/bitstream/handle/20.500.11822/34721/AGR2020.pdf>

² <https://www.climatepolicyinitiative.org/wp-content/uploads/2020/11/Examining-the-Climate-Finance-Gap-in-Small-Scale-Agriculture.pdf>

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environments including for appropriate supervision to avoid greenwashing, enabling digital frameworks and innovations such as satellite images for monitoring, mobile networks and their payment function, and platforms for shared information, and (vi) need to ensure both long term financing to support investment as well as working capital. The latter is particularly needed for SMEs who offer innovative financing solutions without collecting deposits.

2. Panel Discussion

First round of panel questions and answers:

1. **Liliane**, as an African enterprise with ambitious goals, what are your most successful business models in climate finance investments? I understand you use PAYGO for renewables?

- Yes, we focus on lending portfolio and distribution network, offer affordable path to electrification through PAYGO. 90% in agriculture and door to door sales in rural and peri-urban areas. Solar has become key to access to electricity in these places. We provide energy for household lights and production utilities: energy, water and connectivity. We are excited to empower women.

2. **Mark**, as another African innovative SME, how do you promote rural climate finance?

- Key is to connect lending with productive assets. By utilizing asset lending/leasing we have achieved 95 percent repayment rate even customers earn just 3 dollars per day. We believe in our clients but don't rely on "trust" but need evidence on key information. Our client businesses or households with the new equipment need to be able to pay back the payments and we work with them on this. The usual statement "Yes we know how to use the equipment" is not enough but we prefer to train and have the clients demonstrate the skills before we leave the equipment at the clients. This ensures cash flow and repayments. The equipment is the collateral and no need for other collateral. We have informed MFIs about the model and see traction.

3. **Esther**, you are in charge of agriculture in a large African regional bank. What type of climate finance products you offer in agriculture at Equity Bank?

- We look at challenges as financing opportunities. We learn from farmers / agriculture stakeholders, who need livelihoods. Examples of challenges turned to opportunities: how to manage dairy waste – solution is biogas and as such a potential viable investment target. Lack of water – irrigation investment to have access to water and increase yields is a potential investment target. Post-harvest issues and food waste – storage investments increase income streams and marketing opportunities tremendously and improve bankability.

4. **Kenneth**, as sustainable finance senior manager in a commercial bank, how do you see we can unlock climate resilience investment of smallholders in your country, Tanzania?

- We are Tanzania's largest lender to the agriculture sector (45% of all credit to agriculture borrowers). Agriculture is an important economic sector in Tanzania that plays great role in the National economy. In the year 2020, the sector contributed 26.9 percent of the National GDP. Most of Tanzanians engaged in agriculture are smallholder farmers. How to unlock more financing which is direly in need: (i) implement innovative financial products related to adaptation lending, supported by guarantees and insurance, (ii) policy interventions needed: reduce the perceived risk to lending, introduce green finance policies and regulations, impact assessments to ensure the financed are friendly to environment, (iii) include specific agro-technical interventions that are tailored to local contexts and available natural resources, (iv) climate finance needs to progressively become the norm.

5. **Henrik**, we have heard from African stakeholders, how can an institution like NDF based in Helsinki can help in promoting rural climate finance schemes in Africa?

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- NDF is the joint Nordic International Finance Institution, which makes available concessional financing in the form of grants, loans and equity, applied flexibly for both public and private operations (50% in grants at portfolio level). NDF typically joins as junior investor to crowd in financing from senior investors. About 60% of NDFs investments are targeted to SSA. NDF invests in both climate mitigation and adaptation, with an increased focus on adaptation. Gender equality is also a priority theme. NDF currently manage two facilities that serve as innovative business incubators: 1. Energy and Environment Partnership (EEP) for Africa, and 2. Nordic Climate Facility (NCF), in addition to its investments in various blended finance funds. NDF also have booster grants up to EUR500k, i.e. to prepare a GCF proposal or support an enabling intervention.

6. **Tony**, we know of the large scale resources and leading role GCF has to promote climate investment. Could you describe GCF's private sector investment approaches and instruments in support of rural and agriculture sector in Sub-Saharan Africa?

- GCF was set up with substantial resources with critical focus on Africa, at least 50% of investments. Adaptation funding is also 50% and rural agriculture in Africa is key for this theme especially due to dire needs caused by droughts, CC, Covid-19 among other. We work with other partners on the ground and internationally, such as IFAD, NDF and CRDB. We provide concessional financing for proposed and approved projects. In East and West Africa support is made for investments in small scale agriculture such as processing, efficiency, storing, etc. Often we provide credit lines to support the local FIs with their investments through local presence. We promote focus on capacity building to support investments.

Second round of panel questions and answers:

1. **Liliane**, the business model you described earlier is very interesting but entails important risks. How do you manage the investment risk of lending to deep rural customers in Zambia, and sustain your growth?

- Indeed we have a challenging environment, not to even speak of the pandemic. Challenge is to get to the scale to attract investors. Initially need grants to manage growth: we buy on cash and sell on loans and thus cash flow inevitably becomes an issue. Access to bank loans in local currency is tough due to inflation and currency fluctuations. If you as alternative take on loans to pay back in international currency, and support the repayments by domestic cash flow, it's a very risky business, actually a no-starter. For country like Zambia we need flexible term loans or equity in the company that allows to mitigate currency risks.

2. **Mark**, from your enterprise point of view, what are the constraints and opportunities of boosting rural climate finance?

- The more we grow the less cash we have at hand. Local currency working capital is the key to grow. Currency fluctuations and inflation can be mitigated by grants but not sustainable. Efficiency increases are taking place by introduction of technology to reduce transaction costs. PAYGO tech including digital payments is a fantastic and big step into right direction. We need to continue and take it further i.e. by satellite images on the farms, weekly basis. Would be great to be able to monitor what is happening at the farms without every time mobilizing a physical visit.

3. **Esther**, what challenges do you face in deploying climate finance products to SMEs and small producers operating in agriculture?

- The climate challenges and respective investment risks are not only perception but reality. We have floods, droughts, locusts. So we try introduce solutions such as insurance. Knowledge on insurance is low, however, and need partners to help with capacity building. Need also partnerships for long term financing, enabling end client capital repayment periods long enough for climate friendly capex such as fruit trees? From partnerships, need also risk sharing arrangements to lessen the bank exposure when testing new types of investment opportunities. We have worked with IFAD and FAO etc. and these are great to share risk between partners. As a show of corporate responsibility, we have our own project to plant 35 million trees representing our 35 years of operation.

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4. **Kenneth**, what are the key challenges facing smallholders farmers in accessing climate financing from your bank in Tanzania?

- Limited access to credit is a key challenge by smallholders. Many small scale farmers and entrepreneurs lack key documents for KYC and risk assessment, and they also lack stable access to markets. Due to small and dispersed nature of transactions, as well as the risk level, cost to bank and therefore lending rates are quite high which is an obstacle for many smallholders. We are working with GCF to increase our concessional window to offer reasonable pricing. We want to also start insurance products to support climate finance, and overall, CRDB does its best to provide technical assistance to our clients.

5. **Henrik**, what challenges and solutions has NDF experienced when engaging in rural climate finance?

- SMEs are the engine of growth and are key for achieving the SDGs, including for climate change adaptation and mitigation. Rural SMEs in SSA generally have challenges to obtain affordable financing. Commercial banks and institutional investors are generally risk averse. Blended finance funds with tiered structures can unlock finance, where a junior tranche can crowd-in and attract more senior investors. Funds focusing on lower income countries are typically too small for large institutional investors, and they often do not have the experience to evaluate and manage such investments. In this context, so called 'fund of funds' could enhance impact and scale. Also, as part of our strategy, we identify strong local fund managers, and aim to set up strong and timely business development services to end clients, based on identified demand.

6. **Tony**, from GCF perspective, what is the one most critical challenge do you see in providing private funding to the agricultural sector climate finance in sub Saharan Africa, and what solutions do you foresee?

- There are unfortunately no secret magic bullets regarding how to tackle this critical need of CC adaptation in rural Sub Saharan Africa. We need to work hard to identify and then support economically viable solutions. GCF has resources and is willing to help by providing financing to facilities that work on the ground and have knowledge of local opportunities. We offer financing tools such as credit lines, risk mitigation frameworks, and grants for technical assistance. This boils down to a diversity of investments for agriculture value chains increased resilience, protection, efficiencies, and financing supplemented with TA as part of our core strategy, to ensure long term sustainability.

3. Panel Q&A

1. **Q1: How to facilitate flows to local level?**

Esther from Equity Bank answered: The moment we understand the challenge, we can identify the right investment tools and can facilitate the flows. To try out new types of targets, we bring in IFAD or KFW or another similar partner. As an example, Risk Sharing Facilities have a big impact. We worked with Kenya government and were able to invest significantly more into forestry sector. The repayment is good, just needed the proof of concept which was possible through partnerships and risk sharing.

2. **Q2: How IFIs can boost local investments?**

Answer by Tony from GCF: Our main tool is to mobilize sizeable funding packages through local intermediary arrangements, such as credit lines with local banks with required concessionality and flexibility. It's an aggregation model with partners on the ground. We are seeing an uptake also in investments for rural adaptation, although can't yet say its really speeding up.

Answer by Henrik from NDF on the same: For sustainability, agreed we need to work with key local financial institutions. At NDF we different windows for facilities/intermediaries at different stages, including for starting up but also for catalyzing higher volumes at a more developed stage, which can further move the agenda and investments.

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3. Q3: How can we work together to lower the cost?

Answer by Kenneth: Smallholder farmers many times have to pay the highest cost of financing, although they are heavily contributing to wellbeing and economic growth in my country. At CBRD we need affordable and flexible sources of funds, as well as guarantees and insurance support, to assist solve this issue of farmers.

4. Concluding summary by moderator, Dr. Triki

Firstly, many thanks to all panelists and participants! Key takeaways:

(i) We need to perceive our glass half full given the promising existing models currently available by private sector and financiers. Two SMEs shared with us today great solutions, banks are committed, and the IFIs are mandated to support the process and address current market gaps.

(ii) Different players along the chain require different types of support, including grants and flexible financing arrangements for start-ups to foster sustainability, support to innovative solutions including through digital solutions such as satellite images to better manage credit risk. All players need solutions to solve externalities for agriculture and economy such as Covid, erratic climate events, and foreign exchange rate fluctuations, which include guarantees, insurance and other mitigation instruments.

(iii) We need to solve the challenges but there is no silver bullet. Need to work together and interlink as an ecosystem from IFIs to banks to SMEs to smallholders.

On behalf of IFAD we thank the organizers and panelists and we have a strong commitment to take action per technical discussion and agreements. At IFAD we have a strong ongoing POLG and following good replenishment now plan for our next cycle. We also have new instruments with strong climate finance focus including ASAP+ and our newly established Private Sector Financing Programme. Aim is to close the missing middle gap for SMEs, and in particular, act as a strong technical convening partner to contribute to setting up significant scale impactful solutions.