Alternative and Innovative Financing in Agriculture in Africa

Agriculture Sector Dialogue Phase III

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Widening gulf between increasing population & stagnating food yields needs to and can be bridged & corrected.
Proven financing/investment value chain

More choices
(alternative),
innovative &
strategic financing
& investments in
agriculture

Economic
development of
the general
economy & all
sectors

More & expansive
agricultural
businesses &
agricultural
development
• Alternative and innovative financing in agriculture in Africa is holistic, collaborative and strategic financing and multilateral management relationships that stimulate significant and sustainable public and private investment inflows into the agricultural sector in Africa, leading to increased productivity and agricultural development.

• The Leading Group on Innovative Financing for Development has stated that innovative financing for development is characterised by the multilateral management of mobilised massive resources (public and private), is complementary to official development assistance and other traditional finance, is stable, predictable and highly collectable, and promote further new ways for the scaling up of innovative tools (FSTF 2012)
• According to the World bank, investment efforts are optimally connected with efforts in cross-cutting sectors such as economic empowerment, water, energy, education and training and financial services (FSTF 2012).

• These constitute agricultural business support capital and public and private institutional partnerships which attract and catalyse new resources and financial management relationships for agriculture.

Solo, traditional sources and mechanisms of finance and investment in the agricultural sector in Africa cannot and will not achieve the desired results. It is the lessons learnt that have confirmed the need for alternative and innovative financing in the agricultural sector in Africa.
• Benefits include crowding into agriculture massive private investments & making finance and markets work for farmers

• Financial transactions are high in frequency, a small tax on them yields substantial finance easy to collect and channel into agricultural development

• Banks can complement traditional collateralisation of loans with innovative forms of collateral such as warehouse receipts, all assets debenture and appropriate risk management mechanisms to mitigate risks

Can Africa speed up adoption of alternative and innovative agriculture financing, just like the adoption of any other innovative idea? Some early adopter institutions are already engaged in alternative and innovative financing in agriculture in Africa, while awareness and interest (the first stages in the adoption process of any innovation) are beginning to be observed in others.
Finance gaps and investment demands of the agricultural sector

- **Staple food crops subsector**
  - Largest agricultural subsector in Africa, mainly poor smallholder farmers, yet their products generate the highest domestic demand
  - Financing this subsector reduces poverty or increases prosperity for the greatest number of people

- **Agricultural export crops subsector**
  - Major foreign exchange earner in Africa in 1960s to 1980s, now neglected; major financing, produces high returns.
  - Are cash crops more important than staple crops? Food and cash crops are not competitive, both are important and complementary, and both need funding
Finance gaps and investment demands of the agricultural sector

• Food imports
  • Includes rice, maize, sugar, wheat, livestock and fish & is an opportunity for import substitution investment

African food market constitutes a USD313 billion financing and investment opportunity, projected to become a USD1 trillion financing and investment opportunity by 2030.
Finance gaps and investment demands of the agricultural sector

• Crop seeds and animal breeding subsector
  • Knowledge, supply and demand dynamics enable quality seed production and animal breeding companies to enjoy good risk and return profiles.
  • Funding can leverage quality research products along the market value chain to generate good profits for loan repayments

• Livestock and fish products
  • Rapidly increasing African urban population and middle class are generating high demand for protein in the form of meat, fish, dairy products, eggs, etc
  • Livestock production set up costs are higher than for the production of crops but, so too, are the profits.
Finance gaps and investment demands of the agricultural sector

• Agricultural products processing subsector
  • 20–40 percent of agricultural harvests and their derivable wealth go to waste and spoilage in Africa due to absence of storage and processing facilities.
  • African countries are among the world’s top three producers of some agricultural produce, yet they account for less than 1 percent of global value addition to those products (which return over 7 times the income derived from the raw produce)

How and where to add and grow value that reaps high returns in profitable value chains in fast growth markets, which the processing subsector presents, is an investment thesis that appeals to savvy investors.
Finance gaps and investment demands of the agricultural sector

• Domestic Agricultural value chains
  • Value chain financing strategically solves financing challenges of the past, when funding was extended without a plan encompassing the whole picture.

• Global value chains
  • Global agriculture value chains are increasingly having their link activities performed by different countries and companies on the basis of comparative advantages, cost reductions and value addition considerations.

African countries and companies can hook up to global value chain fast-growth industries through strategic quick access points which can fast-track some aspects of Africa’s industrialisation and help it to have some good market share of global corporate profits, and, ultimately, economic development.
Finance gaps and investment demands of the agricultural sector

• Machinery for mechanisation
  • Africa is unable to cultivate its vast arable land, 60 per cent of the world’s total, due to lack of machinery to engage in medium to large scale farming
  • Innovative financing of quality agricultural machinery would change the African agriculture landscape for the better.

• Organic and inorganic fertiliser
  • Africa fertilizer usage is the lowest in the world
  • Cost of fertiliser to Africa farmers is the highest in the world
  • Africa imports nearly all the fertiliser it uses
  • Production of organic and inorganic fertilisers in Africa is a huge investment opportunity
Finance gaps and investment demands of the agricultural sector

• Irrigation and energy linked synergies
  • Yield from irrigated land is about 3.5 times that from rain-fed production, a 3.5-times return on investment
  • Innovative financing of irrigation would put African land to work during the 6–9-months dry season, achieving double to triple cycles of current agricultural output.
  • Some water and energy sources have natural synergies in the supply economics of complementary independent products.

One Key Takeaway: There are many areas of need in the agricultural sector in Africa that demand investment, but the supply of financial resources are low. Each country must adopt strategic and innovative ways to get the best mileage out of the scarce funds that are available to the agricultural sector.
Some traditional mechanisms for financing agriculture in Africa

- **Taxes**
  - Developed countries are able to collect much of their traditional taxes, which mainstream large revenue inflows into their budgets, making them available for financing the agricultural and other sectors, African governments are not able to do the same.

- **Bank loans**
  - Loans to agriculture are less than 4 percent of total bank loan portfolios in many African countries
  - Banks perceive agriculture as a high-risk sector to be avoided
  - Farmers have low financial literacy, and do not know how to approach banks for loans
  - Government credit guarantees for agricultural sector loans encourage banks to give out more loans to agriculture, but many farmers are not aware of such products.
Alternative and innovative financing mechanisms

- Innovative special levies on special sectors extraordinary profits
  - License protection, regulatory frameworks and market dynamics enable some companies and sectors to operate as near monopolies or oligopolies, which help them to make extra-normal profits that can be specially levied.
  - Some telecom, mineral and oil companies face unique market supply and demand dynamics that aid them in making their extraordinary profits, a portion of which can be returned to the economy through special sector levies.
  - Banks are custodians of huge quantities of money belonging to other businesses, the government and citizens, which the banks trade back to them for handsome profits. Having major public resources at one’s disposal to freely profit from, and which privilege others do not have, will always produce extraordinary profits, which can be specially levied to the benefit of society at large.
  - A small percentage levy on the massive extraordinary profits of these business giants would affect them little, yet pooled together would realise a very substantial inflow for public financing of the agricultural and other key sectors for the general good.
Alternative and innovative financing mechanisms (cont)

• Tax on sugars, fats/oils and other items widely consumed products that are harmful to the health
  • Many African countries spend billions of dollars yearly to import sugar, oils/fats, and so on. In excess amounts, these are harmful to health. Like levies on cigarettes and alcohol, taxes on sugars, oils/fats and other widely consumed products that are injurious to health can be invested in agriculture & relevant sectors

• Innovative commercial banking products/loans to the agricultural sector
  • Bank loans will remain the everyday source of financing for the agricultural sector.
  • Many farmers belong to the informal sector and do not have legally registered property to be used as collateral, effectively excluding them from obtaining loans from the banks.
  • Banks can deploy active operational mechanisms to mitigate risks that ensure loan repayment, while using innovative collaterals, while combining lending with advisory services and very innovative monitoring (and other security measures) to achieve loan repayment and to protect their loan portfolio
Alternative and innovative financing mechanisms (cont)

• Strategic and innovative leasing
  • Through innovative leasing, structured with options of finance lease, operational lease or daily usage rental payments, agricultural machinery services and agricultural products preservation/processing equipment could be provided to numerous small farmers in Africa, who do not have money to buy them.
  • This would empower small farmers to use commercial machinery for slices of time, while remaining owners of their own growing businesses, like small and medium enterprises (SMEs), a country’s growth engine room, existing side by side with the big players in the industry.
  • Agricultural machinery companies have financing options that African countries can take advantage of. They could be invited into PPP arrangements, with domestic private sector agriculture leasing companies, commercial/microfinance banks, insurance companies and so on playing different roles in the leasing PPP
Alternative and innovative financing mechanisms (cont)

- Business Partners’ innovative financing model
  - Business Partners (BP) of South Africa has an innovative financing model for small and medium enterprises (SMEs), be they in the agricultural sector or other sectors, which works well in the African terrain.
  - First implemented in South Africa, now extended to Kenya, it can be extended to more African countries. This model is an SME mass production line churning out high numbers of quality financed SMEs
  - It uses revenue sharing amongst a variety of financing instruments combined with business advisory/business support services that mitigate risks and ensure business success and repayments
  - BP has built a good reputation as a reliable fund manager amongst global and regional fund sources, with huge funds at their disposal, and who are ready to move with BP to where it goes
Alternative and innovative financing mechanisms (cont)

• Risk and patient capital – venture capital and private equity model
  • Risk and patient capital deployed by VC and PE companies is well suited to the risky and patient agricultural sector in Africa, if properly adapted and structured.
  • It may not be suitable for informal smallholder farms, but it is suitable for medium to large agricultural companies, which have innovative individuals and good management teams with products/services in agricultural growth subsectors/niches.
  • There are general PE funds with sizeable agricultural sector portfolios and there are PE funds specific to the agricultural sector, there are global, African regional, sub-regional and country-specific VC/PE funds.
  • Very large sources of funds, such as global, regional and country pension funds, sovereign funds, financial institution funds, wealthy family offices and individuals, are usually available to PE firms.
Alternative and innovative financing mechanisms (cont)

- Stock exchanges and commodity exchanges
  - Profitable, well-managed, well-reported and well-positioned agricultural companies in the public view can list on stock exchanges, issue initial public offerings or sell un-allotted shares on stock exchanges to raise finance for further expansion and growth.
  - Some of the best performing stocks on the Nigerian Stock Exchange are of agricultural sector-related companies.
  - Stock & commodity exchanges put the engine and full weight of financial markets directly behind the agricultural sector to drive and stimulate more growth and development in diverse agricultural value chains/commodities. They transcend barriers of space to connect farmers, sellers, buyers, processors, transporters, financial institutions and so on to commonly shared market information and trading and financing platforms.
  - Through commodity and financial gate ways, provided by stock & commodity exchanges, players from everywhere in the world can link up to the African agricultural business space. South Africa, Ethiopia and Rwanda are already taking some positive steps in this direction.

Through commodity and financial gate ways provided by stock & commodity exchanges, players from everywhere in the world can link up to the African agricultural business space pulling in lots of finance
• Market-smart subsidies
  • Subsidies driven by governments are always inefficient and not market-smart
  • Subsidies driven by the market and the private sector are always more efficient.
  • When fertiliser subsidy schemes are strictly government undertakings, less than 11 percent of targeted farmers receive the fertilisers, and parallel fertiliser black markets with exorbitant prices, product hoarding and corruption are rampant.
• When they are driven by the private sector and market, over 94 percent of targeted farmers get the fertiliser, and supply timeliness and other market efficiencies are observable.
• Strategic public-private partnerships (PPPs)
  • PPPs are strategic financing and organisational collaborations by private and public sector participants with synergies to achieve a goal for the whole.
  • A strategically successful PPP model in African agriculture has a holistic agricultural value chain approach with a nucleus and cluster structure with international, regional and in-country partners
  • The nucleus is comprised of a heavyweight private sector-driven, large-scale farm, a comprehensive processing facility and large marketing outlet
  • The connected spheres are clusters of numerous smallholder farms
  • The revenue or business model is built on market demand-driven services – domestic or export demand

PPP synergies provide farmers with access to financing, improved seeds, training, inputs and ready market access in key market-driven added value chains, providing holistic solutions to challenges facing farmers and the African agricultural sector
• Innovative agricultural development and rural banks
  • Agricultural and rural banks in Africa are traditionally structured and run as ineffective government bureaucracies, thus unable to function as financially and commercially sustainable enterprises that can accomplish strategic agricultural business growth and attain market targets.
  • Innovative agricultural and rural development banks are key strategic institutions in rural economies that facilitate financial and economic transactions, which accelerates rural economic and monetary velocity, which is acknowledged in economics as fundamental to economic growth and development.
  • The reform of the agrarian and rural bank in Guatemala, Banrural SA, which transformed it from a poorly performing, traditional public agricultural bank into an innovative and profitable PPP agricultural and rural development bank, shows a workable model that African countries can adapt to their particular situations
Conclusion

• Can more financing be channelled into agriculture in Africa?

• Can the financing of agriculture in Africa be more innovative, strategic, holistic and better applied to pivotal investment areas that are able to achieve far more agricultural development than obtained in the past?

• Can existing and new players in agricultural financing and investment value chains be brought into linkages and collaborative PPPs, with each partner executing the roles it is best suited for and that best complement the whole?

• These questions, which this paper has presented, are worthy of further dialogue.

Strong, effective and innovative institutions providing innovative satisfying services to those whom they serve are necessary for strategic intent to be realised. Pivotal leaders that drive strategic achievements are critical to the accomplishment of strategic goals. In agriculture, these leaders are not those who come with government red-tape mind-sets, nor are they those who necessarily come from academic or development backgrounds (for agriculture is not an academic or philanthropic issue); instead, they are those who come with practical business and impact-solutions attitude.
Thank you