The Council on Smallholder Agricultural Finance (CSAF)

2014 Year In Review
The Initiative for Smallholder Finance (ISF) is a multi-donor effort designed to demonstrate how specific products and services can expand the reach of financing for smallholder farmers. The ISF was launched in 2013 with the support of the Citi Foundation, Ford Foundation, KfW, Mastercard Foundation, Skoll Foundation, and USAID. It focuses on building essential infrastructure across the smallholder agriculture financial service market through targeted market research, product development and testing, and investment facilitation in the smallholder finance market.
**2014 At A Glance**

- **$564M** Disbursed
- **658 Businesses**
- **1.2M Farm Households**

56% growth to 21% growth to 50% growth

**Mission**

- Facilitate market entry and increase lending to agricultural businesses in the missing middle.
- Focus the agriculture finance sector on reaching and supporting the livelihoods of the world’s 450 million small-scale farmers.
- Promote responsible lending principles, including social, environmental and governance standards, among all financial institutions serving this market.

**Vision**

CSAF envisions a thriving, sustainable and transparent financial market that generates long-term economic, social and environmental benefits by meeting the financing needs of agricultural businesses that aggregate smallholder farmers in developing countries worldwide.
Introduction

There is increasing global recognition that investing in agriculture is one of the most effective approaches to reducing rural poverty and addressing interrelated challenges of food insecurity, malnutrition, environmental degradation, and youth unemployment. Indeed, past research by the World Bank indicates that GDP growth generated in agriculture is at least twice as effective in reducing poverty as growth generated by any other sector.\(^1\)

At the same time, a growing number of investors and financial intermediaries are channeling capital into the agricultural sector, especially in emerging economies, and they are doing so across the risk and return spectrum. Efforts range from microfinance institutions lending directly to individual farmers to private equity firms investing in large-scale production and processing operations, and a host of capital providers and recipients in between.

After decades of underinvestment in agriculture, donors, multilateral institutions, and national governments have recently reversed course to support the world’s estimated 450 million smallholder farm households and develop the infrastructure they need to be successful. And a growing number of large food and beverage companies realize that their future growth requires investing in the sustainability and resilience of producers at the base of their supply chains. In short, from investors to policymakers, agriculture has become the “next big thing.”

However, at a conservative estimate of $22 billion and growing, the “addressable demand” for finance among smallholder farmers is vast and largely unmet; a far larger “theoretical demand” of $450 billion is on the horizon as farmers take part in more formal value chains and mobile technologies leapfrog traditional financing approaches.\(^2\) Inhibited by risk – both real and perceived – many investors and financial institutions simply avoid agriculture altogether; others are watching from the sidelines and searching for proven models.

Meanwhile, without access to sufficient financing, farmers are unable to invest in their land, increase their productivity, or realize their full potential to feed a growing population.

The Council on Smallholder Agricultural Finance (CSAF) consists of social lending institutions committed to overcoming this challenge by building a thriving financial market for agricultural businesses and the farmers with whom they work. In order to play an additive role in the market, CSAF members target businesses that are historically underserved: small- and medium-sized agricultural enterprises trapped in the “missing middle.” That is, they are too large for microfinance but considered too small and too risky by commercial banks. These businesses — which can take the form of a farmer association or cooperative, or a private business — require loans typically ranging from $50,000 to $2 million for both short-term working capital and long-term capital investments. They frequently source raw materials and/or sell goods and services to hundreds or thousands of farmers who otherwise have limited access to markets.

As members of CSAF, we collaborate on a pre-competitive basis to share learning and promote the development of a vibrant capital market serving this missing middle for the ultimate benefit of agricultural businesses and the farmers they reach. This annual report shares our progress, explores opportunities for expanding the market to reach more of the missing middle, and notes the challenges and risks to doing so.

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2. Dalberg, Catalyzing Smallholder Agricultural Finance.
Year In Review

Industry Growth

- **Top-line lending grew 56% to surpass $550M.** Total lending (measured by value of loan disbursements during the calendar year) increased by 56%, from $362 million in 2013 to $564 million in 2014. Of this total, $207 million (37%) was disbursed to agricultural businesses in South America; $165 million (29%) in Central America; and $104 million (18%) in sub-Saharan Africa. (Note: in this and all subsequent references, the Central America region also includes Mexico and Caribbean nations.)

All three regions experienced growth from the previous year, but some regions grew faster than others. For example, lending in Central America grew 64% — driven in large part by a rebound in global coffee prices following a market dip in 2013. Similarly, lending in sub-Saharan Africa increased by 61% as CSAF members there diversified into new crops, including an early foray into domestic food and agricultural markets to complement a previous focus in export value chains. Lending activity by CSAF members in South and East Asia, which totaled $29 million, or 5% of total disbursements, continues to lag relative to other regions due to a range of factors, including government-sponsored lending activity and regulation on foreign capital in several countries.

The remaining 10% of lending went to borrowers in North Africa, the Middle East, Central Asia, Eastern Europe, as well as a small group of Western European and North American food companies that source from smallholder farmers in the regions where most of the capital was placed directly.

- **Financed 21% more agricultural businesses and reached 20% more farmers.** During 2014, CSAF members extended our reach in the market by lending to 658 businesses that purchased crops from more than 1.2 million farmer households and employed an additional 42,000 workers. The gross increase in businesses reached over 2013 was 40%, although some borrowers from the previous year paid down their loans and did not take new loans, producing a net increase of 21%.

Over two-thirds of these borrowers were producer organizations (i.e., farmer cooperatives or associations), while just under one-third were private enterprises sourcing from or selling inputs and other services to smallholders. In rural economies, these businesses are critical; they link otherwise marginalized producers to better-paying or more stable markets and provide them with much-needed training, crop inputs, and services to facilitate adoption of sustainable practices and attain higher yields.

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3. In 2014, data was added from Rabo Foundation (in addition to Rabo Rural Fund data which was included in 2013 and 2014) as well as from the Fairtrade Access Fund of Incotin, a new affiliate of CSAF. Together, these two institutions account for approximately 10% of the annual growth in disbursements.
As indicated in Figure 2.2, the vast majority of borrowers are evenly disbursed across Central America, South America and sub-Saharan Africa. However, when analyzed by loan disbursements (Figure 1.2), the growth potential in Africa becomes more visible. There, disbursements are half of those in South America, and the average loan size is $512,000, compared to $720,000 in Central American and $670,000 in South America.

- **Ongoing diversification into new crops, yet strong concentration in the coffee sector remains.** As in the previous year, a significant portion of CSAF members’ global lending was concentrated in the coffee sector, although the overall proportion of coffee lending declined from 54% of total disbursements in 2013 to 42% in 2014. Concentration in coffee is especially high across Central America, where 85% of the $165 million disbursed in the region was for borrowers in the coffee sector. Nevertheless, we continue to diversify our portfolios and this year served businesses operating in 61 different commodities, up from 52 in 2013. Disbursements to enterprises operating in other value chains – such as fruit and vegetables, grains, cashews, dairy, soy and sesame – grew at a faster rate than disbursement growth in coffee.

- **Continued expansion into new geographies.** In 2014, CSAF members served businesses in 64 countries, up from 60 countries the previous year. As noted, our lending activity remains concentrated in Central America, South America, and sub-Saharan Africa. CSAF members entered seven new countries in 2014, including Armenia, Burundi, Kyrgyzstan and Vietnam. Countries with the most new borrowers in 2014 included Colombia, Ivory Coast, Kenya, Peru and Uganda – all countries where at least four CSAF members are active.

**Figure 2.1: Total Enterprise Borrowers**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Borrowers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>545</td>
</tr>
<tr>
<td>2014</td>
<td>658</td>
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</table>

**Figure 2.2: 2014 Enterprise Borrowers By Region**

- **South & East Asia:** 4%
- **Sub-Saharan Africa:** 31%
- **Central America:** 24%
- **South America:** 31%
- **Other:** 10%
Where Are Our Borrowers?

In 2014, CSAF members served clients in **64 countries**, up from 60 in 2013.

5. Excludes countries with 1 member: Armenia, Belgium, Bulgaria, Egypt, France, Kyrgyzstan, Moldova, Netherlands, Romania, Serbia, Spain, Switzerland, Tunisia, Turkey, UAE, Laos, Malaysia, Timor-Leste, Vietnam.

<table>
<thead>
<tr>
<th>Central America</th>
<th>South America</th>
<th>Sub-Saharan Africa</th>
<th>South &amp; East Asia</th>
<th>Other Regions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2-4 unique borrowers</strong></td>
<td>El Salvador, Haiti</td>
<td>Burundi, Ethiopia, Madagascar, Malawi, Mozambique, South Africa, Togo, Zambia, Zimbabwe</td>
<td>Sri Lanka</td>
<td>Netherlands, Switzerland, Tunisia, Turkey, United States</td>
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<tr>
<td><strong>5-14 unique borrowers</strong></td>
<td>Dominican Republic</td>
<td>Argentina, Brazil, Chile, Paraguay, Uruguay</td>
<td>Benin, Burkina Faso, DRC, Mali, Senegal</td>
<td>Philippines, India, Indonesia</td>
</tr>
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<td><strong>15-29 unique borrowers</strong></td>
<td>Costa Rica, Guatemala, Honduras</td>
<td>Bolivia, Colombia, Ecuador</td>
<td>Ghana, Ivory Coast, Kenya, Rwanda, Tanzania</td>
<td>Bulgaria</td>
</tr>
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</table>
Understanding the Financial Needs of Smallholder Farmers

Estimated at roughly 450 million to 500 million, the world’s smallholder farmers are incredibly diverse and have a wide array of financial needs: from simple savings accounts to multi-year farm renovation loans. To better understand how we and other capital providers can sustainably meet demand, it is helpful to size and segment this vast and rapidly evolving market, recognizing that efforts to do so will almost always be coarse and imperfect.

There have been several attempts to differentiate smallholders based on one or more variables: the size of landholding, type of asset ownership, and level of commercialization in farming, for example. Traditionally, a common measure for defining who exactly is a “smallholder” farmer is by landholding, with a de-facto threshold of less than five hectares. However, this too is subject to debate and varies by country. For example, this year’s analysis of CSAF lending revealed a wide spectrum of land sizes depending on region, with a global average of 2.9 hectares per farmer.

A more nuanced exploration of the world’s smallholder producers was recently proposed by the Consultative Group to Assist the Poor (CGAP), which outlined three distinct, but by no means rigidly delineated, categories for segmenting smallholder farmers:

- **Non-commercial Smallholders:** Subsistence farmers who are often net buyers of food
- **Semi-commercial Smallholders:** Operating in informal and loosely organized value chains
- **Commercial Smallholders:** Selling to organized and well-coordinated value chains

*Segmentation of Smallholder Households: Meeting the Range of Financial Needs in Agricultural Families, CGAP, April 2013*
Responsible Lending

Growing the market is necessary for meeting the outsized demand but focusing on growth alone is not sufficient. As we have learned from other financial inclusion movements, such as microfinance, industry standards are critical for guiding responsible lending practices and orienting new entrants to this market. We are therefore working to build an inclusive, sustainable, responsible and transparent financial market. We envision a market that generates long-term economic, social and environmental benefits for smallholder farmers, rural communities and developing economies — and feeds our growing global population. Recent work toward this vision includes:

- **Defining Responsible Lending Principles.** While upholding fiduciary duty to our investors, CSAF members have defined and committed to seven principles for responsible lending. Over the past year, additional like-minded financial institutions have embraced these principles, and participation in CSAF continues to grow. For example, Incofin Investment Management, signed on as a CSAF affiliate in late 2014. We anticipate ongoing expansion of CSAF’s membership and affiliate base over the next few years as more lenders aim to responsibly serve the smallholder segment.

- **Strengthening Social & Environmental Due Diligence.** As we continue to diversify our individual portfolios into new value chains and new countries, the complexity and cost of designing and conducting social and environmental due diligence rises, especially in the absence of internationally recognized sustainability certifications (e.g., Fair Trade, Rainforest Alliance, Utz) or similar governance and compliance regulations. Through CSAF’s Impact Working Group, we are collaborating on approaches to evaluate and mitigate the social, environmental, and governance risks in emerging agricultural value chains.

- **Improving Price Risk Management.** With ongoing volatility in agricultural commodity markets as well as wide fluctuations in currencies throughout 2014, CSAF members partnered to organize price risk management training sessions for our lending staff in Lima, Nairobi, and Amsterdam. The workshops included a total of 71 staff across all CSAF members and were led by Twin, an international development organization that seeks to increase fair and sustainable access to international markets for smallholder producers.

**Responsible Lending Principles**

1. **Promotion of Inclusive Finance.** We embrace the concept of additionality in our lending; specifically, we will seek to expand the addressable market to serve an ever-greater number of underserved agricultural businesses and a wider range of their financing needs.

2. **Responsible Credit Decisions.** We will act in the best long-term interests of a sustainable financial sector and work together to integrate environmental, social and governance (ESG) standards into policies and reporting.

3. **Transparency.** We will maintain a high degree of transparency regarding loan terms, conditions, and processes by communicating clear, sufficient, and timely information in a manner and language our clients can understand.

4. **Harmonization of Standards.** We will collaborate to set more harmonized lending and performance standards to reduce the burden for borrowers and contribute to further comparability in the industry.

5. **Prevention of Over-indebtedness.** We will take adequate care in all phases of the credit process to determine that clients have the capacity to repay our loans without becoming over-indebted. For example, to support clients in times of unanticipated financial distress, we are collectively designing guidelines for use during loan restructurings involving mutual clients.

6. **Trusted Information Sharing.** To promote the development of a healthy agricultural lending sector, we will share appropriate information pertaining to market dynamics, due diligence, and risk management while respecting the confidentiality of our borrowers’ business and financial information.

7. **Fair Treatment.** We commit to ethical behavior in all credit decisions, including loan approvals, servicing and collections, and due processes for resolving disputes.
Impact Measurement

United by the common goals of supporting agricultural businesses to, in turn, unlock their potential to improve livelihoods for small-scale producers and enhance environmental sustainability, we continue to invest in measuring and monitoring our impact.

Within the past year, we agreed upon six shared impact metrics. Members used the Impact Reporting and Investment Standards (IRIS) taxonomy developed by the Global Impact Investment Network (GIIN) as our standard to gather the following information about our borrowers:

- Number of borrowers
- Number of smallholder farmers selling to the enterprise
- Percentage of farmers who are female
- Permanent employees
- Sustainable cultivated land area
- Earned revenue by borrower enterprises

CSAF members and affiliates provide this data on a confidential basis to the Initiative for Smallholder Finance, which aggregated and analyzed metrics for the second consecutive year. Although not all lenders are tracking every metric, there has been increased adoption and progress toward full harmonization.

Individual CSAF member organizations complement these impact metrics with more detailed case studies and evaluations. For instance, responsAbility recently released a report on the quinoa market in Bolivia, and Root Capital published an impact study on four coffee enterprises in Guatemala.

Challenges

There is an evolving set of challenges at both the micro and macro levels constraining the growth in capital supply for smallholder farmer enterprises:

- **Overcoming the financing gap for early-stage enterprises.** As the field of smallholder agricultural finance continues to evolve, we have observed that the majority of lending activity is targeted toward relatively developed businesses that typically require loans in the $500,000 to $2M range, an upper segment of the broader market. There is a dearth of financing available for earlier-stage businesses that require smaller loans, especially loans within the $50,000 to $200,000 range. In 2014, fewer than 10% of loans approved by CSAF members were for amounts below $300,000. Providing financial services to these early-stage enterprises and the geographically dispersed smallholders from whom they source remains a significant and costly challenge; few financial institutions, CSAF members or otherwise, have designed effective lending models to serve this market segment at scale.

- **Diversifying beyond the coffee sector.** Coffee is among the world’s most valuable traded agricultural commodities and is cultivated by approximately 25 million farm households, the vast majority of whom are smallholders cultivating fewer than five hectares. Over the past two decades, significant funding and technical assistance from public, philanthropic, and private sector sources have nurtured a cadre of producer organizations in
Latin America and East Africa. At the same time, rising consumer demand for specialty coffee has been accompanied by growing interest in the social, environmental, and economic conditions of its production and trade. For these reasons, the coffee value chain is uniquely integrated and formalized, making it far easier – or at least less challenging – to finance cooperatives and other enterprises. However, only an estimated 10% of smallholder farmers overall are linked to formal value chains, with most concentrated in specialty coffee and other high-value, export-oriented cash crops. While all CSAF members actively finance agricultural value chains beyond coffee, it is the largest sector for all of us. And for the foreseeable future, no other value chain offers conditions nearly as conducive to lending at scale as coffee.

- **Enhancing the absorptive capacity of early-stage businesses.** Small and medium-sized businesses represent one of the most effective channels through which smallholder farmers can integrate into formal markets. In addition to generating much-needed income for individual producers, these enterprises also frequently provide reliable and affordable access to credit, equipment and training. In many cases, they also create substantial seasonal employment linked to annual harvest cycles and/or full-time employment for crops such as bananas that are harvested year-round. When well-functioning, they create a virtuous cycle between the farmer and the firm.

However, even when these enterprises have adequate access to credit, they often lack the capacity to absorb and properly manage it. For this reason, demand-side technical assistance and financial advisory services – for example, to develop a business plan or forecast cash flows and related credit needs – to early-stage businesses is critical. This support can significantly lower transaction costs for loan underwriting while reducing risks for borrowers and lenders alike.

Opportunities

There are several opportunities on the horizon as we push further into new value chains and geographies to reach a larger segment of smallholder farmers. The following set of needs reflect common challenges that we have identified in the market and that constrain the healthy growth of agricultural lending and the realization of its full potential:

- **Expand addressable demand.** Over the past several years, CSAF members have developed lending models and loan products that take into account the unique financial and non-financial constraints of small and medium-sized agricultural businesses in emerging markets. For example, our lending typically focuses on enterprises that aggregate smallholder farmers. However, research from leading sources finds that only 10% of smallholders are organized, whereas an estimated 90% operate exclusively in loose or informal value chains. While a substantial segment of these farmers are subsistence farmers who are not currently producing a surplus, a percentage are considered “semi-commercial” in that they produce a modest surplus typically sold through informal channels on the local market. Therefore, targeted technical assistance to organize farmers and link them to businesses or associations that can facilitate improved market access and deliver other services (e.g., farm inputs, credit) is critical. Over time, such investments can help move unorganized producers into more formal value chains that are characterized by consistent buyer-seller relationships, enforceable contracts, and incentives for quality.

- **Increase longer-term credit.** In 2014, over 90% of CSAF member disbursements were for working capital and trade credit loans – the vast majority of these were backed by purchase agreements and export contracts. While these short-term, seasonal loans provide businesses with much-needed liquidity to purchase crops from farmers during the harvest, there also exists a large and unmet need for multi-year finance: for example, investments in processing equipment or storage facilities at the enterprise level, or investment in micro-irrigation systems or farm renovation at the farmer level. The ability and willingness of financial institutions to provide long-term finance is critical for supporting agricultural growth and development.

- **Design appropriate hedging products to address foreign exchange risk and commodity price risk.** Over the past several years, soft commodity markets have seen a series of volatile price swings – from the dramatic increase in world food prices during 2007/2008 to the relatively abrupt rise and fall in coffee and cocoa prices a few years later. At the same time, instability in foreign exchange markets have led to increased risk for all actors along cross-currency agricultural value chains.

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Although it originates far from the farm gate, such volatility continues to adversely affect smallholder farmers, who are least able to cope with financial shocks. As global agri-food value chains become more inclusive, financial institutions have an important role to play in helping to hedge and protect producers against major price movements, especially before and during harvest seasons.

- **Scale crop insurance and other risk management solutions.** Equally as important is the need for crop insurance and other tools to effectively manage production risk in response to a changing climate. Despite the logistical hurdles and high costs of designing and implementing weather-indexed insurance, its importance is growing as more unpredictable weather events occur and other climate-related shocks impact the volume and quality of agricultural production. These tools are an integral part of the agricultural sector in more developed economies and are essential for the long-term growth and viability of climate-smart agriculture globally.

- **Leverage targeted subsidy to mitigate risk and attract private investment.** Government and multilateral support in the form of loan guarantees, risk-sharing facilities, and other credit enhancements has already played an important role in allowing lenders to enter new geographies and serve client segments previously considered too risky. Partial loan guarantees offered by the Development Credit Authority operated within the U.S. Agency for International Development (USAID) are one example of a risk-sharing mechanism that has been successful in growing the market. By reducing potential losses for financial institutions, this type of targeted subsidy, if further scaled and responsibly implemented, can help to lower barriers to entry for others lenders, especially those supporting high-risk, high-impact opportunities in fragile economies. Indeed, experience from some of the world’s largest and most advanced agricultural economies shows how, over time, agricultural policy, including the use of loan guarantees, has been most effective when governments design policies to enhance rather than replace credit provided to farmers by private actors.8

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Looking Ahead

The field of smallholder agricultural finance continues to expand and evolve. Today, an increasingly robust and dynamic ecosystem of actors – financial intermediaries, their investors, donors offering targeted smart subsidy, research organizations, agricultural buyers farther up the value chain, certifiers, and technical assistance providers – are designing market-driven approaches to meet the financing needs of smallholder farmers through different pathways and aggregation points. The important role that finance plays in agriculture development and food security is beginning to receive the attention it deserves, with local savings and credit cooperatives lending directly to farmers, commercial banks financing high-potential enterprises, and global food and beverage companies investing in sustainable supply chains.

As CSAF members, we are achieving increasing impact yet reaching a relatively small portion of a large market. As more capital flows into this sector, we believe it is essential to draw on our collective experiences and help build a supportive infrastructure from which the entire sector will benefit, rather than pursuing a fragmented and uncoordinated approach. As we each independently pursue our own missions to advance financial inclusion that benefits smallholder farmers, rural communities, and the natural resources on which we all depend, we recognize that our ability to do so is inextricably linked to the success of the entire sector.
Disclaimer

The data contained in this report was compiled by the Initiative for Smallholder Finance (ISF) in coordination with CSAF. Each member of CSAF submitted its individual lending and impact data to ISF under a non-disclosure agreement that ensures data is treated confidentially. ISF then organized the data, analyzed it, and shared the aggregated information back to CSAF. The report was completely written by and is the full responsibility of CSAF.
