The Council on Smallholder Agricultural Finance (CSAF) is an alliance of financial institutions serving small- and medium-sized agricultural enterprises (SMEs) in Africa, Asia, and Latin America. CSAF provides a forum for members to share learning and develop industry standards and best practices for agricultural SME finance.

Mission

- Facilitate market expansion to meet a greater share of the demand for finance among agricultural SMEs.
- Promote responsible lending principles—including environmental, social, and governance standards—so that a growing agricultural SME finance market benefits smallholder farmers, workers, and the natural resources on which we all depend.

Vision

CSAF envisions a thriving financial market that generates long-term social and environmental benefits by meeting the financing needs of agricultural SMEs worldwide.

Target Market

Each CSAF member maintains a portfolio of loans and independently pursues its respective mission to deliver financial solutions that create social and environmental impact. As distinct from micro-lending directly to individuals, CSAF lenders seek to promote environmentally sustainable practices and improve the livelihoods of smallholder farmers by financing businesses that purchase crops from hundreds or thousands of individual producers and then aggregate, process, and sell those crops into domestic or global markets. These businesses vary in size (annual revenues range from $250K to well over $10M) and structure (from farmer-owned cooperatives to private enterprises). In addition to providing economic opportunities for farm households, the businesses served by CSAF members generate substantial seasonal and year-round employment and often function as multi-service providers, offering farmers access to finance, farm inputs, and agronomic training. Many also provide non-agricultural services, such as scholarships for local youth, clean drinking water, or health insurance. With reliable access to finance, agricultural SMEs can play an important role in building prosperity and climate resilience in developing economies.
Letter from the Director

Dear Stakeholder,

In this fifth annual CSAF State of the Sector report, we examine how lenders have responded to increased risk in their portfolios following a period of growth and diversification. We also share our outlook on what is required to expand the finance market for agricultural SMEs and align market growth with social and environmental objectives. With CSAF’s relocation to our new institutional host, the Global Development Incubator (GDI), and progress on the Aceli Africa initiative that is slated to launch in early 2020, CSAF is entering a new phase in which we play a more prominent role in advancing industry knowledge and practice to address market challenges. More on that below and in the report; but first, an overview of lending trends in 2018.

Following a five-year period of growth where lending by the 12 CSAF members more than doubled from $345M in 2013 to $716M in 2017, topline loan disbursements declined in 2018 for the first time since CSAF began collecting data in 2013. The 2018 disbursement figures of $628M to 711 businesses are almost identical to those in 2015.

Given the enormous unmet need for financing among agricultural SMEs in the countries where CSAF members operate, what has happened over the past three years to slow a market that just a few years ago seemed so promising?

The short answer: risk-adjusted returns. Simply put, there is limited addressable demand at risk levels that allow lenders to come close to breaking even with current operating models and cost of capital. Lenders’ experiences in 2018 underscore the myriad and often compounding risk factors in serving agricultural SMEs. To highlight some of the most notable ones:

- **Headline events.** A few years ago, coffee leaf rust, or roya, decimated production in Latin America and precipitated a 12% decline in coffee lending from 2014 to 2015. In 2018, buyers responded cautiously to political instability in Nicaragua and Tanzania—two of the top five lending countries in 2017—and lenders followed suit, with 2018 disbursements declining 19% and 64%, respectively.

- **Market trends.** Structural changes in the coffee and cocoa industries, from price volatility to shifts in buyers’ contracting and payment terms, are forcing difficult decisions on producer organizations and lenders—with farmers, of course, bearing the brunt of the impact.

- **Climate.** There are also slow-drip risk factors linked to climate change—periodically punctuated by extreme events such as roya or drought across East Africa—like warming temperatures that are gradually shrinking the areas where it is viable to produce specialty coffee in Central America.

A few years ago, several CSAF members made a push to diversify their lending beyond certified value chains into specialty products, such as cashews, macadamia...
nuts, and quinoa, as well as horticulture, dairy, and staple grains. A spike in portfolios-at-risk ensued, leading many lenders to retreat to a focus on borrowers and crops that are more familiar and deemed lower risk. In 2018, borrower attrition was the highest since we began collecting data (132 of the businesses financed in 2017 did not receive loans in 2018, compared with attrition of 52 businesses from 2014 to 2015) while the number of new borrowers also fell to its lowest level (49 in 2018 down from 249 in 2013) as lenders struggled to identify borrowers that meet their more stringent risk parameters. While a survey of CSAF members indicates that many expect modest growth in lending in 2019, the trends in 2018 illustrate the tension for lenders between additionality to expand the market and financial sustainability of their portfolios.

As each CSAF member navigates difficult strategic decisions at an institutional level, our dialogue at an industry level has focused on the question: What can we do as CSAF to grow the finance market for agricultural SMEs while promoting responsible practices aligned with social and environmental impact? We have begun with two related initiatives:

1. Bringing transparency to the lending economics of serving agricultural SMEs and establishing appropriate operating benchmarks. CSAF members’ experience indicates that there is a mismatch between the risk-return expectations of capital providers, including many development finance institutions and impact investors, and the addressable demand in the market. We believe that this mismatch is the driving factor in the continued financing gap for agricultural SMEs in the “missing middle.” In 2018, we set out to test this hypothesis and build an evidence base to advocate for solutions by collaborating with Dalberg Advisors to conduct an analysis of the economics of agricultural SME lending. To date, 20 financial institutions have participated in this financial benchmarking exercise, including 11 CSAF members and 9 lenders that are not members of CSAF; a follow-on effort is currently underway in East Africa with an additional 10 commercial banks and local non-bank financial institutions. The results begin to fill in the picture about where the commercial markets are functioning and where targeted interventions may be required.

2. Creating blended finance mechanisms that can serve as demonstration models for larger-scale programs and policies. In 2018, CSAF came together with GDI to design a new concept that is now called Aceli Africa (it is also housed at GDI and independent from, but affiliated with, CSAF). Aceli Africa will draw upon the financial benchmarking data to raise a grant-funded facility that will provide $40M in financial incentives for lenders paired with $10M in technical assistance for SMEs to mobilize $700M in high-impact loans in East Africa by 2025. Aceli Africa is described in more detail on page 10 of the report and at aceliafrica.org.

To support this expanded agenda, members voted in 2018 to shift the structure of CSAF from a part-time coordination team located within one of the founding members, Root Capital, to a more formal structure with a dedicated team housed at the Global Development Incubator. During the second half of 2019, we will be conducting a strategic planning process and seeking input from stakeholders on how CSAF can build upon our efforts to date and accelerate our dual objectives of growing the finance market for agricultural SMEs while aligning that growth with responsible lending practices and long-term social and environmental impact. We look forward to engaging you in this strategy process and welcome your feedback.

Sincerely,
Brian Milder
CSAF Director

CSAF Members
2018 at a Glance

Reduction in Lending

- Aggregate lending by the 12 CSAF members decreased by 12% in 2018 from $716M to $628M, the first decline since data collection began in 2013.
- This decline in disbursements was shared by the majority of members and impacts all leading value chains. In coffee, the decline comes primarily from loans >$500K and is linked to low prices and delays in buyers issuing contracts.
- Decline in disbursements varied across regions, with lending in South & East Asia (-43%) decreasing the most. Lending in South America made a small recovery (+6%) after three years in decline, while lending in sub-Saharan Africa decreased by 11%.
- CSAF members now provide financing to 711 businesses, a decline of 10% from 2017 (794 businesses).
- Survey responses indicate most CSAF members are optimistic about a growth in lending disbursements in 2019.

Risk Management & Portfolio Consolidation

- CSAF members further consolidated lending to existing clients, representing 93% of businesses in the portfolio (vs. when member portfolios were growing rapidly in 2013, and existing clients were 57% of borrowers). More than 50% of disbursements in 2018 went to clients financed continuously since data collection began in 2013.
- Overall “portfolio at risk at 30 days” (PAR30) declined slightly to 7.4% from 8.5% in 2017. Risk levels for loans under $500K increased to 15% from 11% in 2017.
- Coffee remains the most financed value chain, remaining steady at 45% of members’ lending. Overall, lenders continued to concentrate lending in coffee, cocoa, and cashew nuts in 2018, though the absolute volume of disbursements decreased in all three value chains versus 2017.
- CSAF client retention rate declined to 77% in 2018 after three years at a steady level of 85%. Along with a slowdown in new borrowers, borrower attrition resulted in the 10% decrease in total client base.

Continued Impact & Additionality

- Reached enterprises providing market access to 2.2 million smallholder farmers, 30% of whom are women, and employing 71,000 workers.
- The vast majority of borrowers (79% globally, 89% in Africa) received financing from only one CSAF member. However, the 21% of borrowers receiving financing from more than one member accounted for 55% of total disbursements as these enterprises tend to have larger financing needs.

We delve into these trends in more detail in the full report.
Strengthening Food Security in Tanzania through Financing and Capacity Building for Agro-Processing

Based in Dodoma, central Tanzania, Chamwino Super Sembe Supply Ltd sources maize from smallholder farmers and processes fortified maize flour for domestic food consumption.

Maize is the staple food for the majority of Tanzanians and it is a critical crop for food security. Most maize in Tanzania (80 percent) is produced by small-scale farmers and it is grown both for subsistence and as a cash crop. Yet very little of the maize that is domestically grown is nutritionally fortified before it reaches consumers. By contrast, Chamwino mills maize into flour while fortifying it with iron, zinc, folic acid, and other vitamins. Chamwino supplies its products to wholesalers, retailers, and government agencies, as well as hospitals, public schools, and colleges across the country.

Chamwino annually purchases and processes 5,500 metric tons of maize sourced from 1,800 smallholder farmers, the majority of whom (~60%) are women. The company also employs 30 full-time staff in its factory and 40-50 part-time employees depending on production volumes.

Since accessing its first loan from CSAF member SME Impact Fund in 2015, Chamwino has doubled its processing capacity in a new factory with modern equipment and also expanded distribution of its fortified flour by adding six delivery trucks. In that time, the enterprise has transformed its basic factory into an improved facility complete with modern milling and drying equipment.

SME Impact Fund has also provided Chamwino with technical assistance in creating a business plan and financial projections, introducing a robust financial management and record-keeping system, and developing business and human resources management skills. This investment in the management capacity of Chamwino is an essential accompaniment to financing in support of the business’ ability to produce nutritious products for a growing consumer base.
In late 2017, CSAF began developing a concept that has evolved to become Aceli Africa, which is now a separate but affiliated initiative of CSAF housed at the Global Development Incubator. Aceli Africa is in the process of raising funding and expects to launch in early 2020 with a combination of CSAF members and local financial institutions participating to increase lending to agricultural SMEs in East Africa. This section provides background and an update on the initiative. (Note: Aceli Africa was originally called “Prosper Africa” but renamed after the U.S. government adopted Prosper Africa as the name for its Africa policy in December 2018.)

**Agricultural Financing Gaps**

Agriculture employs 60% to 70% of the population in most countries in sub-Saharan Africa and accounts for 25% to 30% of GDP, yet the sector receives less than 5% of commercial bank lending. A 2018 study commissioned by KfW and conducted by Dalberg Advisors estimated that across Africa there is a financing gap of $120B for agricultural enterprises requiring $25K to $5M loans, with more than half of this unmet demand concentrated among enterprises requiring less than $1.5M. A 2018 report by the Kenya Bankers Association (KBA) sheds light on this disparity, noting that “the primary underlying reason for [low-levels of bank lending in agriculture] is that the risk-adjusted returns to capital are too low to justify commercial lending to agriculture when other opportunities exist.” This finding is consistent with CSAF members’ experience lending in Africa—and indeed in other regions as well—and is the motivation for developing Aceli Africa.

Aceli Africa is founded on the three-fold premise: i) as the KBA report finds, the financial returns for agricultural SME lending are too low to attract commercial capital at scale; therefore, ii) targeted interventions are required to bring capital supply and demand into alignment; and, perhaps most importantly, iii) these interventions should be market-based, informed by data on the actual lending economics of serving different segments of borrowers, and structured in ways that will transition the market to becoming increasingly commercial.

For decades, governments around the world have provided financial incentives or subsidies to promote investment that advances the public good. Investment subsidies are the norm in everything from large infrastructure projects to oil and gas to agribusiness. Of course, subsidies are often influenced by politics or designed with perverse incentives. But valid critiques of faulty design or implementation should not be conflated with a more fundamental point: commercial markets are often not aligned with the public good, so some corrective measures are required.
At a global level, the United Nations Sustainable Development Goals (SDGs) map a path for social, economic, and environmental progress by 2030 that has been embraced and signed by 193 countries. Analysts estimate that there is a $2.5 trillion annual financing gap to achieve the SDGs and take it as a given that the risk-adjusted returns are insufficient to attract commercial capital at the scale that is required. “Blended finance” whereby concessionary capital from public and philanthropic sources is combined to mobilize commercial capital has become the catch-all solution. Yet very few of the blended finance vehicles in the market today are based on actual data of the underlying economics so that concessionary capital can be optimized for highest leverage in any given asset class or investment.

A Data-Driven Approach

Aceli Africa aims to bridge the gap between theory and practice for blended finance, starting with lending for agricultural SMEs in East Africa. To do so, Aceli Africa has collaborated over the past year with Dalberg Advisors to gather data on the lending economics for serving various types of agricultural SMEs by loan size, geography, value chain, financial product, and borrowing history. This financial benchmarking sought to bring quantitative analysis to the following hypothesis: Larger loans to repeat borrowers in more formal value chains, such as coffee, are more profitable for lenders than smaller loans to new borrowers in less developed value chains. Given Aceli Africa’s initial focus in East Africa, we also wanted to supplement CSAF members’ data at a global level with data from commercial banks and non-bank financial institutions (NBFIs) operating at a country and regional level in order to get a sense of how lending economics varies across the market.

To date, 20 financial institutions, including 11 CSAF members and 9 local banks and NBFIs, have contributed data on close to 4K transactions totaling $2.7B in combined lending. Additional data collection is currently underway with at least 10 local banks and NBFIs in East Africa expected to participate; the results from this latest round will be available in August. The first round of data covered CSAF member lending and identified five factors that make lending economics less profitable:

1. Smaller loan sizes;
2. Geography (risk is twice as high in Africa as in Latin America and operating costs for lenders are 20%+ higher);
3. Value chain (less formal value chains are riskier and costlier to serve vs. coffee and cocoa);
4. New borrowers; and
5. Long-term loans (more than 12 months).

The second round of data focused on local lenders in East Africa and found that risks and costs to serve agricultural SMEs are substantial barriers to portfolio growth. Notably, the banks surveyed in this round do appear to be profitable on much of the agricultural lending that they reported. But this is in the context of conservative risk parameters typically requiring collateral that is 200% of the loan value; thus, they are reaching a very limited portion of the market. We expect that the forthcoming report will provide much more insight into lending activity and economics by local banks and NBFIs.

Aligning Financial Incentives with Impact

There are already several guarantee mechanisms that offer agricultural lenders 50% risk-sharing on a loan-by-loan basis and, while these facilities have had some impact, they tend to be under-utilized by lenders, who often view them as an insurance policy on loans they would otherwise make (as opposed to an incentive to increase their risk appetite). Aceli Africa aims to take a different approach in aligning financial incentives for lenders with impact objectives to increase access to finance for SMEs that both improve rural livelihoods and strengthen domestic food security and nutrition. Drawing on the financial benchmarking data, Aceli Africa is creating a new facility that will take in grant funding from bilateral and philanthropic donors and offer two types of financial incentives to lenders:

1. 1st-loss coverage at a portfolio level to increase lenders’ risk appetite so they are incentivized to make more high-impact but risky loans (e.g., to first-time borrowers in food crop value chains). Each lender will have its own reserve account that will be credited every time it makes a loan that meets Aceli Africa’s impact criteria, which include additionality of the loan and livelihood benefits for smallholder farmers and enterprise employees. Top-up incentives will also be offered for loans that contribute to domestic food security and nutrition, meet the 2X Challenge criteria for gender inclusion created by the G7 development finance institutions, or meet similar standards for youth inclusion. The amount of each credit will depend on the riskiness of the loan as well as its impact (i.e., loans in food
crop value chains will be credited more than those in coffee. The more high-impact loans the lender makes, the larger its reserve account becomes. When there are losses in the lender’s portfolio, it can draw upon this reserve account as a first-loss.

2. **Incentive payments** to mitigate higher operating costs of making smaller loans to earlier-stage enterprises that tend to be unprofitable even when the borrower repays. These incentive payments will complement the revenue generated from interest and fees so that lenders can charge SMEs affordable rates while covering the higher operating costs to serve them. As with the first-loss coverage, baseline payments will be tied to impact criteria related to loan additionality and livelihoods benefits, while top-up payments will be offered for loans that meet additional impact criteria.

Financial incentives to lenders will range from an estimated 3% to 8% of the value of each loan, with specific amounts informed by the round of data collection currently underway and tied to risk factors and impact criteria. We project that $40M in financial incentives will mobilize $700M in lending across Kenya, Rwanda, Tanzania, and Uganda by year-end 2024 and that every dollar of donor-funded incentive will generate at least $4 of incremental income for smallholder farmers. Alongside CSAF members, at least half of the lenders participating in Aceli Africa will be local banks and non-bank financial institutions. The incentives will be designed such that at least half of the loans are going to food crop value chains for domestic and regional consumption in East Africa.

In addition to the financial incentives for lenders, Aceli Africa also aims to expand the addressable demand by facilitating pre- and post-investment technical assistance for agricultural SMEs. The initiative is exploring an innovation window for supporting technologies and business models (e.g., low-cost credit scoring models) for both lending and technical assistance that lower the cost to serve agricultural SMEs and reduce the need for smart subsidy in the long term. Ultimately, Aceli Africa aims to be a demonstration model with two-fold objectives:

1. Catalyzing a more competitive and efficient financial market that drives down the costs to serve agricultural SMEs and reduces the need for donor funding— in this way, increased impact can be generated at reduced cost over time.

2. Building the evidence base for the impact return on investment of these approaches and collaborating with partners to advocate for policies at the country level that sustain growth and investment in agricultural SMEs.

More information about Aceli Africa is available at [aceliafrica.org](http://aceliafrica.org).