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Farmers and agribusinesses at risk under COVID-19: What role for blended finance funds?

KEY MESSAGES

- The COVID-19 pandemic is a major economic shock. The Great Lockdown could turn into the worst recession since the Great Depression. The resilience of the agrifood sector is questionable at this stage, particularly in developing countries where self-employed, wage and informal workers are at risk because of food supply chain disruptions, limitations on movement and trade restrictions. Midstream and downstream activities are also impacted by market shutdowns, the difficulties of the hotel, restaurant and café (HoReCa) sector and a liquidity crunch. While there is major cause for concern, negative impacts across agrifood value chains will be heterogeneous and many chains will be less affected than other sectors like tourism or transport. In this context the agrifood sector still presents promising investment opportunities.
- Fiscal stimulus, tax waivers and liquidity injections, as well as enhanced social protection measures have been designed to alleviate the short-term consequences of COVID-19. Yet these measures are of uneven magnitude and coverage, leaving many economic actors at risk. This is the case of small and medium agribusinesses in low- and middle-income countries.
- When possible, countries have established loan guarantee schemes to push financial institutions to provide loans at affordable interest rates and with concessional terms particularly targeting micro, small and medium enterprises (MSMEs). These schemes fall under the blended finance umbrella and hold promise but are not always easy to implement for countries without the fiscal space or access to support from International Financing Institutions (IFIs). To avoid some of their problems, loan guarantee schemes should be temporary measures with a well-defined exit strategy aiming to address drying credit conditions. In many cases, development partners and, in particular, IFIs have promoted loan guarantee schemes among several possible interventions to support liquidity.
- Reaching out to the underserved segment of small and medium agribusinesses has been one of the objectives driving the development of blended finance funds and facilities in the agrifood sector. These funds and facilities are the key theme of this brief and are now facing a litmus test. While many operators will be focusing on managing their portfolio through these turbulent times, there is an opportunity to step up blended finance´s contribution to mitigate COVID-19 negative impacts and accelerate the recovery, including Build Back Better efforts. Blended finance is naturally not expected to solve all the problems, but it can make a significant contribution thanks to its capacity to mobilize much-needed additional capital, its ability to reach small and medium enterprises (SMEs),

its development mission, public-private nature and integration of technical assistance. In this crisis, low- and middle-income countries need more patient investors that can help bridge critical funding gaps and sustain investors' capacity to address the impacts of COVID-19 and keep agrifood systems functioning.

- Options to achieve this include: i) offering additional liquidity to existing clients in need of working capital financing; ii) deploying specific COVID-19 windows, including targeted technical assistance, to attract potential investors or philanthropies willing to support Sustainable Development Goal (SDG)-aligned agrifood companies operating under a sound business model, as well as those that are willing to transition towards more sustainable models; and iii) enhancing cooperation with development finance institutions (DFIs), donors, funds and banks. The financial support of blended finance could be pivotal in de-risking DFIs and other financing institutions and encouraging them to do more to support farmers and agribusinesses in developing countries now but above all during the recovery.

COVID-19 IMPACT AND FINANCING THE AGRIFOOD SYSTEM

There is already a clear recognition that the direct and indirect impacts of COVID-19 will result in a global recession (Gopinath, 2020; FAO, 2020a) and set the world back in terms of the 2030 SDG Agenda. Experts have highlighted how rural areas may be particularly vulnerable (FAO, 2020b) and that poverty and food insecurity may increase dramatically. COVID-19 is expected to exacerbate already existing market failures that translate into poor households in rural areas having limited or no options in terms of insurance, credit and risk management. Difficulties in accessing liquidity may only be aggravated by disruptions to the flow of remittances because of lost jobs in migration markets, fewer options for casual wage labour and lockdown effects on possibilities to sell produce, namely through informal markets (FAO, 2020c).

The picture may not be rosier for micro and small enterprises or even larger companies in the agrifood sector in developing countries. SMEs are thought to have been disproportionately hit by the current crisis, which has revealed their high vulnerability to the supply and demand shocks particularly in terms of liquidity. For example, in OECD countries, preliminary evidence from SME surveys suggests half of SMEs are already facing severe lost revenue, and up to 50 percent of SMEs fear being out of business within three months (OECD, 2020). The fall in oil prices and local currency depreciation, which followed in some countries, may put another strain on food processing companies depending on imports of raw materials, packaging materials and chemicals, as a recent survey of 106 African food processing businesses has shown (Technoserve, 2020).

COVID-19 impacts will depend on the policy response (and, in particular, lockdowns and related disruptions), but also on the characteristics of the agrifood sub-sector where the companies work and the country or region where they are established. Factors such as labour and capital intensity, typology of processing and need for intermediate production inputs and income elasticity of demand for the product are just some that contribute to understanding how specific agrifood supply chain actors may be negatively or eventually positively hit in the short and medium term (Schmidhuber, Pound and Qiao, 2020). According to Reardon, Bellemare and Zilberman (2020), SMEs operating in post-farm activities in urban areas will be impacted the most, namely those operating in midstream (wholesale, logistics and processing) and downstream (particularly the informal sector SMEs operating in labour-intensive retail and food services).

Already before the crisis, SMEs were often considered to be credit-constrained and also extremely vulnerable to shocks; they have limited cash reserves and little access to risk management tools. Although literature suggests that returns from investment in microenterprises could be significantly higher than the market interest in developing countries, evidence remains patchy and more compelling in the middle-income than in the low-income country group (de Mel, McKenzie and Woodruff, 2008; McKenzie and Woodruff, 2008). In low-income countries, smallholders and agri-SMEs are underserved, or served at a high cost, by conventional financial institutions. As an example, Crick, Eskander, Fankhauser and Diop (2018) found that about 7 percent of 301 surveyed SMEs in Kenya and Senegal operating in agriculture (including livestock), trade and agro-processing had insurance, and 17 percent had access to loan finance for recovery from climate disasters.

Countries around the world have taken major fiscal actions to mitigate COVID-19 impacts amounting to almost USD 8 trillion, and have also used monetary measures to support liquidity (International Monetary Fund [IMF], 2020a). Assistance to businesses, including delays in loan and tax payments, continuity grants and credit guarantees, have been set up on a temporary basis for businesses to stay afloat, with marked differences across countries (Overseas Development Institute [ODI], 2020). Calls have multiplied to the IMF for emergency financing with over 90 countries formally requesting IMF support, and while many developing countries are taking bold moves in support to their economies, they have “far less firepower than their rich-country counterparts” (IMF, 2020b). The average economic stimulus in sub-Saharan African countries slightly exceeds 2 percent of gross domestic product (GDP), and is about 9 times lower than in G20 countries according to ODI Policy Tracker (Raga, 2020).

To help manage household risks, sustain livelihoods and avoid further spread of hunger, more than 400 social protection measures have been adopted or expanded in countries worldwide (FAO, 2020e data as of 3 April 2020). If adequately implemented and resourced, such measures can have important effects in terms of supporting insurance systems and access to credit and relax liquidity constraints for farmers and rural consumers. However, most of these measures have so far been implemented by high and upper middle-income countries and face specific implementation challenges in developing country settings (because of high informality and low coverage of national social protection systems). In this regard and without rapid steps to innovate and implement far reaching social protection measures, the magnitude of the number of farmers and rural dwellers reached may be limited, and the rural economy will need further liquidity injections.

Equally, in the case of MSMEs and the self-employed, countries are putting in place major emergency measures including deferral of payments (for example, taxes, social security and other), wage subsidies and supply of extra and more easily available credit. Still, according to evidence from developed countries, such measures are not always simple from an administrative standpoint and are also not rapidly implemented. Interestingly, on the credit front and despite loan guarantees, there are reports of banks being reluctant to provide additional credit (Organisation for Economic Co-operation and Development [OECD], 2020). Liquidity enhancing measures may remain out of reach for agrifood sector SMEs, particularly in those countries were commercial banks already struggled to reach this segment before the crisis. Few developing countries have tried to support their private sector at scale, either through monetary, fiscal or financial measures (ODI, 2020). Ethiopia has extended credit facilities to strategic sectors, including manufacturing and horticulture. Ghana has put in place a six-month moratorium on principal repayments to entities in the airline and hospitality industries. “But this is a timid response with too few funds”, as ODI (2020) emphasizes, leaving

many MSMEs without support to face up to the economic consequences of COVID-19, including in the agrifood sector. As a result, it is very likely that in developing countries with major constraints in terms of fiscal room and administrative implementation, the different emergency measures (including macro measures) may not be enough to avoid major disruptions and losses in productive capacity in the agrifood sector.

BLENDING FUNDS FACING ANOTHER TEST

The SDGs and the promise of blended finance

Reaching out to agri-SMEs in dire need of capital, improving their access to affordable and predictable financing and in this way having a positive impact on the whole value chain, starting from farmers, has been one of the primary objectives of blended finance in the agrifood sector.

This strategy stands in the continuation of a decades-long transformation of agricultural risk management systems, and the marked shift to market-based financing and risk managing solutions since the turn of this century (Larson, Anderson, Varangis, 2004; Dana and Gilbert, 2008). Blended finance is not a financial instrument per se but is rather a “structuring approach” to investment that can take many different forms (Convergence, 2019). This brief considers the funds and facilities launched by public and private investors to finance, via debt or equity, private sector projects presenting both a positive development impact and positive financial return expectations.

BOX 1 | Blended finance definitions

Blending is commonly referred to as “the use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development” (Convergence, 2019). The OECD definition is slightly broader and posits that blending is “the strategic use of development finance for the mobilization of additional finance towards sustainable development in developing countries”, with “additional finance” including, for instance, capital from DFIs. The European Union, which has pioneered various innovative forms of blended finance instruments and is a major actor in this field, defines blending as “the strategic use of a limited amount of grants to mobilize financing from partner financial institutions and the private sector to enhance the development impact of investment projects” (EC, 2015).

The mobilization of additional finance towards sustainable development is facilitated by three core features of blended finance, namely its ability to i) de-risk investments (through first-loss or guarantee mechanisms); ii) enhance investors’ return (profits can be distributed to each investor under a waterfall structure, with different levels of returns being pre-agreed with each investor); and iii) improve investees’ capacity and knowledge (thanks to the implementation of technical assistance programmes).

The number of blended finance vehicles targeting the agriculture sector in developing countries has been growing over the last decades in a context of low cost of borrowing for most DFIs, and the pressing need to move from “billions to trillions” and “plug the SDG financing gap” (Schrevel, 2020). While not exclusively focused on blending, a 2010 review of agricultural investment funds (AIFs) operating in developing countries, found 31 active funds, two-thirds of

which invested in agribusiness and agro-industries (Miller *et al.*, 2010). In a second review eight years later, the estimated number of funds had reached 63 (Miller *et al.*, 2018). Africa has been the most popular region among the AIFs since 2005, representing about 40 percent of the funds analysed (Miller *et al.*, 2018).

Technical assistance in particular has played a strategic role in the development of blended finance in the agrifood sector. The dissemination of information, knowledge, innovation and capacity building among borrowers can de-risk investments in a sector characterized by a high level of uncertainty and volatility (regarding weather, market and climate). Such technical assistance programmes are usually financed or co-financed by grants and can take the form of trainings, advisory, studies, platforms or facilitation of dialogue among key stakeholders in a specific agrifood value chain.

Seductive on paper, the idea to blend concessional funding with non-concessional finance has been facing many challenges however. Still an infant industry, it raises concerns about its capacity to leverage additional private capital – and not public DFIs' capital only – and reach out to the "last mile" and impact smallholders at scale (Attridge and Lengen, 2019). Not yet an "asset class" in its own right, "agri blended finance" is a polymorphic vehicle in the development finance ecosystem, which is still in a learning phase. The COVID-19 pandemic comes across as another important test for this young and growing industry.

Adjusting strategy and portfolios as circumstances demand

The combination of supply and demand shocks due to COVID-19 and lockdown measures has increased the vulnerabilities of agrifood companies, hence their likelihood to underperform. This means that the quality of blended finance portfolios is affected and some funds may even struggle depending on their risk diversification profile. Companies' valuations are impacted, covenants might be in breach while borrowers may struggle to respect their repayment schedules. Some of them will default on their loans, and the number of bankruptcies is likely to increase.

To live up to these challenges, fund managers have intensified their communication with investees as well as local authorities, regulators and IFIs in order to assess the impact of the virus, the magnitude and speed of the policy response to manage the portfolio accordingly. This means paying extra attention to how COVID-19 and policy responses affect specific value chains and liquidity, and closely monitoring existing clients in order to anticipate potential operational or liquidity issues leading to breaches of covenants, payment delays or defaults.

In parallel, fund managers are fostering internal communication between their public and private investors, investment committee members and risk officers. Blended finance gathers very different stakeholders who often have different objectives. In these turbulent times, sharing information and agreeing on a common diagnosis and approach can help to ensure a smooth and efficient decision-making process. Hence the need for information, knowledge and dialogue facilitation, something that most blended finance operations have difficulties undertaking on their own as per their institutional set-up (e.g. governance, resources and structure of funds).

In some cases, covenants breaches will need to be waived and debt service relaxed. This effort should be coordinated with companies' other financiers. It is about helping good clients to breathe and preserving projects' impact. Yet these decisions should be made on the basis of transparent and pre-agreed criteria to avoid the risk of moral hazard. Companies that were already under-performing before the crisis may be tempted to use the pandemic as an

opportunity for attracting cheap financing. Regulation constraints are a key parameter to take into account, as it is important to ensure that the interests of the funds' investors are preserved. Any major action or change regarding the funds' portfolio should be discussed and agreed by different stakeholders.

Blended finance is also directly impacted at an operational level. Funds' employees have been working from home and may not have the Information Technology (IT) and administrative resources to guarantee the same level of efficiency. This is hitting funds' productivity, both in the back-office (treasury and disbursements) and the front-office. Also, most of the funds do not have local offices in their countries of operation. Due diligence trips have been cancelled. This slows activities with new clients, as often public information on potential borrowers or investees does not exist.

SUPPORTING COVID-19 MITIGATION AND LONGER-TERM RECOVERY

Blended finance by itself cannot address all the complexity of the pandemic and the response needed. It is a useful additional instrument to the many responses already taking place and those planned. Before the outbreak of the crisis estimates of private finance mobilized through blended finance by multilateral development banks, DFIs and donors in low-income countries and middle-income countries range from USD 3.3 billion to USD 27 billion annually across all sectors (Attridge and Lengen, 2019; Horrocks, Boiardi and Bellesi, 2020). This amount rises to USD 59.4 billion when using the latest data on total direct and indirect mobilization (World Bank *et al.*, 2018). In 2018, the agriculture, forestry and fishing sectors made up 3.3 percent of all the private sector investments mobilized by blended finance, or USD 1.4 billion (OECD, 2020).

Still, blended finance can make a significant contribution to support financing of specific agrifood supply chain actors thanks to its ability to mobilize additional capital, its development mission, its public-private nature, integration of technical assistance and ability to reach SMEs. Different blended finance responses could be articulated during the crisis, in its immediate aftermath and in the mid- and longer-term. The objectives of these responses from blended finance would be many: provide additional liquidity to agribusiness to keep the agrifood sector running (with smallholders benefiting indirectly from this liquidity support); save jobs; tackle food insecurity; and make sure that the development impact that has been created or is planned is not lost or jeopardized because of this crisis. Many responses aimed at SMEs and people who are self-employed will be addressing revenue losses. However, blended finance can enhance the entrepreneurial capacity and innovation of SMEs. These responses could be coordinated with other actors like local banks, impact funds and DFIs, keeping in mind the specific context, needs and challenges of each country.

Current circumstances are actually increasing the demand for blended finance. One of its purposes has been to improve the agrifood sector's access to financing. The challenge now is to safeguard this access to finance and step it up during the recovery phase. Early evidence shows that commercial investors are unlikely to provide the needed level of financing because of risk concerns (FAO, 2020d). Hence the demand for investors combining a good understanding of private sector needs and features, together with the development mandate, investment horizon and risk appetite of the public sector.

From this perspective, blended finance risk-mitigating features could help to attract additional financing, public or private, to support agrifood systems. Especially since the sector still offers promising investment opportunities compared with more affected industries. Moreover, agrifood SMEs are often too large to work with microfinance institutions but too small to

benefit from financing from local banks or DFIs (IFAD, 2014). Blended finance funds can play an important role to provide much-needed liquidity to this segment as they generally have the flexibility to finance smaller tickets than DFIs.

The provision of technical assistance addressing some of the operational challenges created by the COVID-19 pandemic would further enhance the impact of blending response to the crisis. The purpose of such technical assistance would be to help companies to adjust their business to COVID-19 through the dissemination of best practices in terms of health and safety, physical distancing, staff rotations or digitalization. Through technical assistance, blending could also help to disseminate resilience-enhancing innovations that have already been tested and help to scale-up innovation in the agrifood space.

Short-term response – supporting existing clients

Blended finance could offer additional liquidity to existing clients in need of working capital financing. This would be similar to the emergency liquidity packages set up by multilateral development banks like the European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB) or International Finance Corporation (IFC).[1] The idea would be to provide financing for existing clients with strong business fundamentals and a positive development impact but experiencing temporary credit difficulties (see, for example, EBRD, 2020). It would also help to mitigate the impact of the economic crisis on agribusiness suppliers like smallholders who will suffer if midstream and downstream companies have a reduced access to working capital financing. This should be paired with the provision of technical assistance supporting clients to face the operational challenges deriving from COVID-19.

Such short-term response would face two obstacles. The first one is internal, as some blended finance investors may be reluctant to adjust their investment strategy. Indeed, many blended funds have been designed to fund capex projects via long-term financing. This was based on the observation that in low- and middle-income countries, securing long-term financing was more problematic than raising short-term credit lines. Hence blended-finance would be more helpful if it focused on long-term financing. This diagnosis was debatable before the crisis. In some countries, agrifood companies have little access to trade finance or short-term credit lines. Capex projects need working capital lines to be viable. What is certain is that the current circumstances are likely to reduce the availability of short-term liquidity.

The second obstacle concerns regulation. Investors have contributed financially to blended vehicles on the condition that they will invest in certain categories of companies, defined among other criteria by their risk profile. The current crisis has obviously downgraded the risk profile of many existing clients, so fund managers may not be authorized to provide them with additional liquidity. The answer to this would be for existing funds to deploy new windows specific to COVID-19 to support the functioning of the agrifood sector, taking into account the specific context of each country and agrifood system. Such windows would include a “sidecar” technical assistance facility. They would be funded by investors willing to contribute to the fight against the crisis on a country and commodity chain case-by-case basis. In the current circumstances, convincing commercial investors to invest in such windows could be challenging. But the public sector as well as philanthropic investors could be interested.

Setting up new specific blended vehicles can take a lot of time and is quite complex because of the variety and high number of stakeholders involved. Time is precious, and the advantage of

[1] https://thegiin.org/covid19

the aforementioned response is that disbursements would be swift because these blended vehicles are already running, with potential borrowers easy to identify. Extending this short-term response to new clients is likely to be difficult and to take too much time due to the operational challenges faced by the funds because of lockdowns and travel restrictions. However, providing financing to new clients should be part of the blended finance mid-term response.

Mid- and longer-term response – more blending for an accelerated recovery

In the mid-term, blended finance can support economic recovery. Companies will need more patient investors bringing long-term funding, who are at the very heart of blended finance´s mission, including for resilience enhancing investments. Such long-term financing could be coupled with technical assistance, capacity development and innovation designed against the pandemic. The support of blended finance can help build longer-term resilience, make the recovery more sustainable and ultimately SDG-aligned.

Blended finance could become an important window to support SMEs in low- and middle-income countries. Given the scale of the reconstruction effort, more funding will need to be raised for the blending response to be meaningful. This is also an opportunity to scale up existing blended initiatives that have proven their relevance.

But financing new clients will not be straight-forward in the current circumstances. The crisis is deep but the heterogeneity of its impacts within the agrifood sector means there are also many opportunities for blended finance operations depending on the country and value chain context. The corollary is that blended funds need to more carefully assess risks in specific value chains and understand local dynamics as the crisis unfolds. In this regard, collaboration with DFIs, funds and banks will be crucial. Some coordination in terms of understanding agrifood sector dynamics in specific settings and also sharing information on financing modalities will be useful to ensure an efficient response to the private sector's needs.

The financial support of blended finance could also help to de-risk DFIs as well as other investors to encourage them to do more to support agrifood SMEs in low- and middle-income countries. Twenty European politicians, professors, economists and managers have actually published a letter[2] calling for European governments and DFIs to act urgently in order to support the African private sector, which represents 90 percent of the continent's jobs. The letter states that the 15 European DFIs have already EUR 15 billion invested in Africa. Blended finance risk-sharing mechanisms and technical assistance tools could play an important role to reinforce the DFIs' capacities to respond to this crisis. The "Response, Recovery, and Resilience Investment Coalition" launched by the Global Impact Investing Network (GIIN)[3] is another good example of an initiative aimed at streamlining impact investing efforts to address the large-scale social and economic consequences of COVID-19.

From an operational point of view, due diligences being limited due to travel restrictions, sharing information and due diligence reports will be important to speed up the approval of new projects. Funds will need to rethink the need for local presence, including country offices and enhanced collaborations at local level with other institutions such as other funds, consultancy firms and financial institutions.

[2] https://www.edfi.eu/news/callforaction/

[3] https://thegiin.org/assets/GIIN%20LAUNCHES%20COALITION%20FOR%20COVID-19%20RESPONSE%20AND%20RECOVERY_Immediate%20Release.pdf

While blending can contribute towards keeping current clients in business and accelerating their recovery, it can also play a critical role in guiding future investments by providing the right incentives to private and public actors in the system and support Build Back Better efforts. This transformative potential can help companies adapt better to the fall in demand that will inevitably result from the COVID-19 induced recession. While to some extent still under-explored, blended finance could also be a critical catalyst for spreading innovation and in particular adoption of digital technologies in the agrifood sector, enabling enterprises to tap efficiency gains in their day-to-day business, improve resilience and in turn increase their bankability towards potential private investors.

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