DESIGN GRANT CASE STUDY

ACELI AFRICA

NOVEMBER 2020

EXECUTIVE SUMMARY

Aceli Africa ("Aceli") is a catalytic market facility offering concessional financing in the form of financial incentives to lenders that then provide commercial financing to agricultural small to medium enterprises (agri-SMEs) in Sub-Saharan Africa. Aceli was conceived to address the mismatch between the risk-return hurdle of lenders and the demand for capital among agri-SMEs; while lenders are looking for larger loan sizes with a more attractive risk-return profile, demand for financing largely comes from smaller SMEs that are riskier and costlier to serve.

The design and implementation of Aceli was informed by extensive data collection in partnership with Dalberg Advisors. To date, Aceli has reviewed data from 31 lenders in 9,104 transactions totaling $3.7 billion[1] in loan value. The data collection, design, and implementation of Aceli is supported by a number of philanthropic and bilateral donors, including USAID, IKEA Foundation, and the Foreign, Commonwealth & Development Office (FCDO, formerly UK Department for International Development (DFID). In 2019, mid-way through the design and data benchmarking process, Convergence awarded Aceli a grant to help finalize the facility's design, including developing financial incentives criteria, legal costs, and supporting data and research partnerships.

Aceli is housed at the Global Development Incubator (GDI), and launched in September 2020 in Kenya, Rwanda, Tanzania and Uganda, in partnership with 25 accredited financial lenders. The structuring and launch of Aceli provides several insights for other practitioners designing blended finance initiatives, including in the agri-SME sector:

- Data collection is a powerful tool for right-sizing concessional capital when designing blended finance interventions, particularly in nascent markets
- Blended finance practitioners must balance tailoring custom-fit solutions with reducing complexity
- Technical assistance can be useful for addressing both demand- and supply-side constraints
- Blended finance can be used to support the development of local markets

SYNOPSIS

Mandate	To build the market for agri-SME finance in Africa.
Platform Structure	• First-loss cover ($28 million) • Origination Incentives ($12 million) • Technical Assistance ($10 million) • Data and Learning ($8 million) • Innovation Facility (*Fundraising, $8 million)* • Administration ($9 million)
Anchor funders	USAID, IKEA Foundation, Swiss Agency for Development and Cooperation (SDC)
Key Design and Implement-ation Partners	Ceniarth, Convergence, CSAF, Dalberg, Foreign, Commonwealth & Development Office (FCDO),Global Development Incubator (GDI), Good Energies Foundation, IKEA Foundation, MacArthur Foundation, MasterCard Foundation, Mulago Foundation, Omidyar Network, Open Society Foundation, Propel Capital, Rabobank Foundation, Small Foundation, USAID, IKEA Foundation
Partner Lenders	Financial institutions domiciled in East Africa (including commercial banks and non-banking institutions) and international lenders (e.g., members of CSAF)
Priority countries	Kenya, Rwanda, Tanzania, and Uganda
Target impact	Aceli intends to mobilize $700 million in private sector lending, with each donor dollar expected to generate at least three dollars of incremental income for smallholder farmers and enterprise workers.

[1] All $ amounts are expressed in USD.

INTRODUCTION

The World Bank estimates that agricultural growth in Africa is two to three times more effective in reducing poverty than growth in any other sector. In particular, agri-SMEs have the potential to make a significant contribution to the achievement of SDG 1 (No Poverty), 2 (Zero Hunger), 5 (Gender Equality), 8 (Decent Work), 13 (Climate Action), and 15 (Life on Land).

With access to finance and capacity building, agri-SMEs can improve livelihoods for smallholder farmers and create employment for low-skilled workers, particularly women and youth, transitioning into the formal economy. However, agri-SMEs face significant constraints accessing finance due to a phenomenon known as the "missing middle"; they are too large to access microfinance but too small to acquire commercial loans. Lenders often find it difficult to assess the bankability of SMEs, given their less-formal business practices and small size.

To address these challenges, Aceli Africa (Aceli) was established to bridge the financing gap faced by agri-SMEs, both from a demand and supply side. Aceli is a donor-funded facility that seeks to bridge the supply and demand of capital for agri-SMEs in three key ways: i) increasing capital supply through the provision of financial incentives to lenders who provide loans to agri-SMEs, ii) providing technical assistance for agri-SMEs to improve their ability to qualify for financing, and iii) building the evidence base through data and learning to inform policy-making that promote market development on a larger scale.

Aceli launched in September 2020 in Kenya, Rwanda, Tanzania, and Uganda in partnership with 25 accredited lenders.

DESIGN AND FUNDRAISING

Aceli (initially named Prosper Africa) was founded based on experiences of social lending institutions that are members of the Council on Smallholder Agricultural Finance ("CSAF"), an alliance that promotes best practices for financing agri-SMEs. As CSAF members increased their lending in Africa in recent years, they recognized that market growth was constrained by a mismatch between the risk-return hurdle of lenders and addressable demand from agri-SMEs. While most lenders are looking for larger loan sizes (>$1 million) where the risk profile is lower, and where interest and fee income covers the high costs of servicing agri-SMEs in remote areas, there is much greater unmet demand for financing among smaller SMEs. This is evidenced by the estimated $65 billion annual gap for SMEs requiring financing of $25,000-$1.5 million.

Lenders serving these SMEs have traditionally faced high risk and high transaction costs given challenges at both the enterprise level (e.g., weak management capacity) and market level (e.g., price volatility, weather, political risk, legal environment, etc.). As a result, small loans are not profitable for most lenders because of high risk and high operating costs relative to low interest income. Even CSAF members, with their explicit impact focus and below-market cost of funds, struggled to serve smaller agri-SMEs. Simply put, the economics of lending to small enterprises (e.g., loans below $1 million – let alone in the $25,000-$250,000 range where the unmet demand is greatest) is not feasible for most lenders.

In May 2017, CSAF members, led by CSAF Director Brian Milder, gathered at their semi-annual meeting to discuss the challenges of achieving profitability while reaching underserved market segments, and decided to develop an initiative that could address this market gap. Subsequent engagement with potential donors revealed that i) gathering hard data on lending activity would be crucial given the limited evidence available on financing agri-SMEs and reliance on anecdotal experiences, and ii) the interventions would need to involve local financial institutions in addition to international social lenders (e.g., CSAF).

In 2018, CSAF partnered with Dalberg Advisors and USAID to complete the first financial benchmarking study. USAID was seeking evidenced-based research to inform its strategies for agricultural finance, recognizing a paucity of hard data on loan profitability and a reliance on anecdotal evidence. Findings from the initial study, based on the agricultural lending portfolio of nine CSAF members, confirmed the economics of lending to agri-SMEs were challenging; while over 50% of the CSAF loans analyzed were profitable, an average CSAF loan of $665,000 lost about $1,800, not including the cost of funds. These losses were substantially higher for smaller loans; for example, loans below $500,000 had an approximately 80% higher risk of default than loans above $500,000. Findings from the report confirmed that a multi-faceted blended approach was needed, including: i) financial incentives to promote lending in segments with low or negative profitability, ii) risk mitigation, including first-loss capital, to encourage lending in new and underserved segments, and iii) technical assistance to help lenders reduce their operational costs, while allowing SMEs to improve their credit-readiness by strengthening financial management, governance and marketing capacity.

Subsequent data collected from local banks and non-banking financial institutions in East Africa during a second benchmarking study demonstrated that lending in agriculture is twice as risky as lending in other sectors, and that returns are slightly negative (~-0.5% return on assets compared with ~4% return on assets in other sectors). These findings helped explain the challenges lenders face in achieving financial sustainability and the historic reluctance of African banks to serve agri-SMEs. For example, the agriculture sector in East Africa contributes 25-30% of GDP and often employs over half of the labor force. Yet, across Aceli's countries of focus, agriculture accounts for an average of only 6% of domestic bank lending.

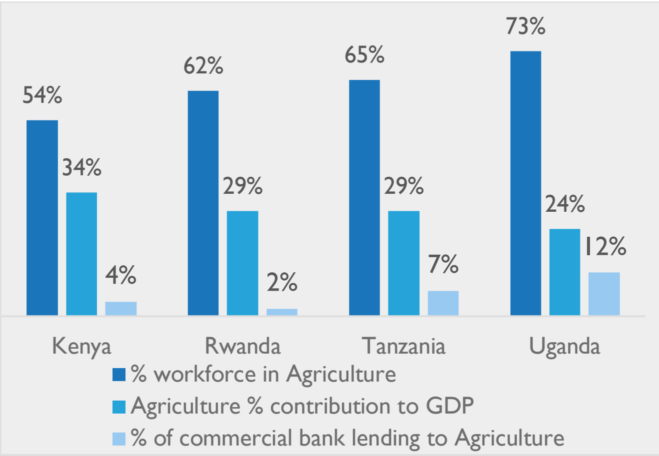

Figure 1: Agriculture as a share of select East African countries' employment, GDP and bank lending (%, 2019). (Source: Aceli Africa.)

As the design of Aceli began to take shape, one major consideration pertained to whether Aceli would be housed under an existing institution or as its own standalone entity. In 2018, GDI was selected to incubate the design and launch of the facility. During this time, Aceli became independent from CSAF with GDI hosting a small and growing Aceli team to lead the design of the model. As a U.S.-based non-profit, GDI has extensive experience designing and incubating initiatives in blended finance and smallholder agriculture.

The Aceli team calibrated its proposed financial incentives in line with findings from its growing pool of data. Results from local banks and financial institutions in East Africa revealed meaningful differences in the market; for example, Uganda and Tanzania had a more dynamic market at lower ticket sizes than Rwanda and Kenya – as a result, Aceli has adjusted the minimum qualifying loan size in Uganda and Tanzania. At the same time, the Aceli team sought to maintain a balance between tailoring incentives for specific markets and standardizing to offer more simple solutions for lenders. For example, while the Aceli team initially looked at calibrating financial incentives based on lender type, standardization and simplicity – which would offer a level playing field to all market actors – was ultimately prioritized.

In addition, findings from the data also informed the type of technical assistance Aceli could offer. While technical assistance was initially envisioned to be used to address demand-side constraints, namely to support capacity building for agri-SMEs, Aceli recognized that lenders, especially commercial banks, also required capacity building support to better tailor loan products, improve systems and processes, and build expertise in underwriting agri-SMEs. As a result, Aceli Africa plans to offer technical assistance to lenders.

Fundraising Strategy

Given its data-driven, marketplace approach, Aceli initially planned to raise a critical mass of funding before its launch, rather than start with a small pilot and scale up from there. Specifically, it aimed for a first-close of $30 million from a five-year budget of $75 million.

Aceli attempted to coalesce prospective funders into a club to align procurement timelines and build momentum off each other. To achieve these objectives, Aceli organized meetings with potential funders during stakeholder events and encouraged bilateral engagement between donors throughout the design process.

Identifying Donors

The data produced by Dalberg and the following factors made Aceli a compelling funding opportunity to donors:

1) Industry-led: Aceli was initiated by CSAF, an alliance of private sector lending practitioners
2) Development of local markets: Aceli aims to support the development of local markets and committed early that most of the participating financial institutions would be banks and non-bank lenders domiciled in East Africa (i.e., not just CSAF members domiciled internationally)
3) Establishing a track record: Aceli's mandate is to build a track record for the agri-SME sector with targeted subsidies declining over time
4) Private sector focus: Aceli is a market-based solution with a mandate to increase the participation of commercial lenders in the agri-SME space as a tool for development

Aceli approached several donors starting in 2018. The team adapted a flexible approach to fundraising, allowing donors to fund their preferred interventions for both the design and implementation phases. For example, some donors restricted funds by country or program area.

In 2019, mid-way through the design and data benchmarking process, Convergence awarded Aceli with a grant to help finalize the facility's design, including developing financial incentives criteria, legal costs, and developing data and research partnerships. Convergence's funding was tied to Aceli's commitment that most of the participating lenders would be domiciled in East Africa.

The IKEA Foundation committed $500,000 for the initial design of the platform in early 2019. The Foundation subsequently approved a $10 million grant for implementation in November 2019, contingent on Aceli raising matched funding. However, because of delays in the fundraising process due to COVID-19, Aceli chose to launch in September 2020 with an initial funding of $10 million from USAID. Meanwhile, IKEA provided another $500,000 for the design and launch phase, allowing Aceli to demonstrate a market for other funders while securing more time to find matched funding. This strategy worked; in September 2020, Swiss Agency for Development and Cooperation (SDC) approved a $10 million grant, thereby unlocking IKEA Foundation's funding.

In short, Aceli's attempts to coordinate a "funder's club" did not materialize due to competing institutional timelines and priorities, and budget complications resulting from COVID-19. Donors ultimately proceeded on their own timelines and came together post-approval to align in the Steering Committee.

Identifying Partner Lenders

Aceli sought to engage a mix of social lenders, including CSAF members, commercial banks, and non-bank lenders serving the agri-SME sector. Aceli drew on its initial pipeline of lenders from those that participated in its data analyses.

Aceli appealed to lenders that already had some presence in the agriculture sector but were restricted from increasing their lending by the unattractive economics. For many banks, agriculture is not a priority due to risks that banks struggle to manage (e.g. drought or price volatility), plus the high cost of serving rural customers. Moreover, when lending to agri-SMEs, local financial institutions often require costly guarantees and pass on the resulting fees to end borrowers. Aceli compensates local institutions for higher costs of lending while, importantly, reducing end-costs for borrowers. This is a compelling opportunity for local institutions that recognize the significant demand in the agri-SME sector, who until now, have lacked the risk appetite to extend credit. Through Aceli, lenders can extend far greater lending to meet market demand, while simultaneously building a track record for the sector.

Aceli requires lenders be accredited to qualify for origination incentives and portfolio first-loss cover on qualifying loans. Institutions that participate in the financial benchmarking and meet lending requirements are eligible to apply for accreditation. Additional considerations for accreditation include: the lender is in good legal standing; has appropriate policies in place to ensure responsible lending (i.e., including Know Your Customer safeguards), and meets environmental, social, and governance (ESG) standards in both its due diligence and its own operations.

STRUCTURE AND GOVERNANCE

PLATFORM STRUCTURE

The blending component of Aceli occurs downstream, at the underlying loan level (and portfolio level). It is a grant-funded facility which provides concessional financing to lenders that provide commercial financing to agri-SMEs.

Aceli works across five workstreams:

1) Portfolio First-Loss Coverage: Aceli will offer lenders first-loss coverage at a portfolio level for qualifying loans ranging from $25,000-$1.5 million. With each qualifying loan, a lender participating in Aceli will earn money in a reserve account. As the lending volume increases, the reserve account will grow and become available to cover first-losses on the portfolio of qualifying loans. This structure avoids the moral hazard commonly associated with first-loss on a loan or deal basis. Instead, it incentivizes lenders to make more loans that meet Aceli's impact criteria. Incentive levels range from 2-8% depending on whether the loan is made to a new or repeat borrower, if the lender is in a formal or informal value chain, and whether the loan qualifies for an impact bonus (details below).

2) Origination Incentives: Lenders are deterred from serving some market segments because of the lower revenues and/or higher operating costs. To address this challenge, Aceli will provide origination incentives – cash payments to top up lender revenue from loan interest and fees – for high-impact loans. These origination incentives will target smaller ticket sizes ($25,000-$500,000) and loans for food crops that would not otherwise be profitable, even if the loan repays at a market interest rate. Origination incentives will vary from $1,000 to $14,000 for loans based on loan size, additionality, and alignment with impact areas (details below).

Of the $40 million in financial incentives that Aceli will offer to lenders by year-end 2025, it expects approximately $28 million will be allocated for portfolio first-loss cover and $12 million for origination incentives.

Impact Bonus: Building on the two types of financial incentives lenders can receive, Aceli will offer increased first-loss coverage (up to an additional 2%) and origination incentives for any loan that meets a higher standard in the following areas:

1) Food security & nutrition: 50% or more of the loans supported by Aceli will go to SMEs that derive most of their revenues from food value chains serving African consumers (v. exports)
2) Gender inclusion: 30% or more of the loans supported by Aceli will meet the 2X Challenge criteria adopted by leading development finance institutions (DFIs) for gender inclusive investment
3) Climate-smart and resilient agriculture: 20% or more of the loans will meet a higher standard for agricultural practices related to soil and water management, waste and energy

The impact bonus will create additional incentives for lenders to seek out and serve higher-impact SMEs.

3) Technical Assistance Facility: Aceli will facilitate pre- and post-investment technical assistance so that more SMEs are qualified to access and manage credit. Technical assistance packages will be tiered according to their agri-SME profile, with light touch models (under $2,000/SME) at entry level, and deeper engagements (up to $20,000) for SMEs demonstrating high growth and impact potential. Recognizing that many lenders have not optimized their products and processes to the agri-SME market, Aceli is also developing capacity building services to support its lending partners.

4) Data & Learning: Ongoing data collection will allow Aceli to lower financial incentives as the market becomes more competitive and efficient. Aceli will partner with the International Growth Centre (IGC), a research and policy institute housed at London School of Economics, that will serve as an independent evaluator for both the financial incentives and technical assistance. For financial incentives, evaluation will focus on the effectiveness in shifting lending behavior and the benefits of access to finance in terms of growth at the agri-SME level and impact on farmer and worker livelihoods. The technical assistance evaluation will assess the effectiveness of technical assistance delivery, how to align technical assistance with lending, and models to transition away from donor subsidization.

Aceli will also draw on its partnership with IGC, which has an established presence in each of the focus countries, to link research to policy. Specifically, IGC aims to engage national governments and international actors to advocate for policy reforms that promote agri-SME finance and align it with impact objectives. It will engage stakeholders through reports and conference participation to circulate learning and strengthen the ecosystem for blended finance and impact investment.

5) Innovation Facility (*In development*): To accelerate market development, Aceli intends to create an Innovation Facility to seed and grow business models that align capital supply and demand for agri-SMEs. It envisions that the innovation window might offer challenge grants and capacity building (e.g., systems, processes, IT, staff development) to prepare market innovators for investment and scale. Potential investees include: local agri-SME finance companies with low cost of delivery for serving market segments that are unprofitable to reach today; fintech companies that offer agri-SME financing; and fintech companies that improve operational efficiency for other lenders (e.g., credit scoring, matchmaking with prospective borrowers).

LEGAL STRUCTURE AND GOVERNANCE

Aceli is housed within the Global Development Incubator (GDI), a non-profit organization registered as a 501(c)(3) in the United States with a legal affiliate registered in Kenya. Aceli's funding will be ring-fenced under a distinct nonprofit entity with its own Board of Directors that will exercise legal oversight. A Steering Committee (SC) of anchor funders will provide strategic guidance and align budgeting and reporting of the various funders (see below). Aceli's operations are managed by staff employed by the GDI legal entities in the U.S. and Kenya.

ANTICIPATED IMPACT

Aceli estimates that during the implementation period (2020-25), its total financing of $75 million will support 1,500 loans totaling $700 million that generate $200 million or more in incremental income for farmers and enterprise workers. It is estimated that every dollar of donor funding for financial incentives, technical assistance, and administration will leverage $12 in private sector lending and generate $3 in incremental farmer income.

NEXT STEPS

Aceli launched in September 2020 with 25 accredited lenders; a mix of eight internationally domiciled social lenders and 17 banks and non-bank lenders domiciled in East Africa. The team will continue to fundraise going forward.

The current structure of Aceli under GDI is intended to be for an interim of period of 5 years. Depending on strategic alignment with another entity, Aceli plans to migrate to a more permanent structure at the regional level with country-specific windows. It is expected that this will offer the best balance of economies of scale, expertise from applied learning, and the ability to target funding and interventions.

Aceli predicts that the demonstration effect and evidence base from the first 5 years of implementation will make the case for country governments to commit funds by 2025. Initially, donor funds may provide a match for national government commitments with the expectation that donor funds would phase out within 10 years of program launch.

KEY INSIGHTS

The structuring and launch of Aceli provides several insights for other practitioners designing blended finance initiatives, including in the agri-SME sector:

- Data collection is a powerful tool for right-sizing concessional capital when designing blended finance interventions, particularly in nascent markets: Given the lack of data on the economics of lending to agri-SMEs, identifying appropriate blended finance products to incentivize lending, while avoiding market distortion, was a challenge. As a result, data played a crucial role to inform the design of the facility and types of financial incentives most appropriate for the market. To date, Aceli has conducted multiple rounds of data analysis with over 31 market actors, requiring each lender to participate in financial benchmarking to become accredited and access financial incentives. While data gathering was an arduous exercise, it was important to meaningfully calibrate levels of subsidy in blended finance.

- Blended finance practitioners must balance tailoring custom-fit solutions and reducing complexity: Data from the benchmarking analyses revealed meaningful market differences, including across geographies and lender types. However, aside from some minor differences, Aceli has opted not to tailor financial products based on types of participating lenders (e.g., social lenders vs. local financial institutions). While it is important to adapt to local markets and ensure products fit the market, complexity can also be counterproductive if it increases transaction costs and discourages user uptake. Practitioners should determine where added complexity is needed and where it may be a hindrance to adoption and scale.

- Technical assistance can be useful for addressing both demand and supply constraints: Aceli initially envisioned technical assistance to be a tool to address demand-side constraints, namely, to support the capacity of borrowers (agri-SMEs). However, lender interviews also revealed that capacity building could be important to help lenders tailor loan products to the agri-SME market, improve systems and processes, and build staff expertise in underwriting agri-SMEs. While Aceli will first pilot technical assistance for SMEs, it plans to phase in capacity building for lenders once additional funding has been secured and an appropriate cost-sharing model with lenders is determined.

- Blended finance can be used to support the development of local markets: Aceli is an industry-led initiative that aims to address both local capital supply and demand constraints using multiple types of blended finance. First, Aceli draws on concessional capital, including first-loss capital, to unlock private capital and incentivize local financial institutions (and international social lenders) to scale up their lending to the agri-SME market. In turn, Aceli also draws on technical assistance to develop the capacity of borrowers (agri-SMEs), thereby increasing the number of SMEs that qualify for financing. Ultimately, Aceli intends to build the track record for agri-SME lending in its target countries and will decrease the amount of subsidy needed over time. Aceli aims to demonstrate that blended finance can be an important tool for developing and sustaining local markets.

SOURCES

Interviews with Alterfin, IKEA Foundation, Opportunity Bank, and USAID.

Documentation provided by Aceli Africa.

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ABOUT CONVERGENCE

CONVERGENCE is the global network for blended finance. We generate blended finance data, intelligence, and deal flow to increase private sector investment in developing countries.

BLENDED FINANCE uses catalytic capital from public or philanthropic sources to scale up private sector investment in emerging markets to realize the SDGs.

Our GLOBAL MEMBERSHIP includes public, private, and philanthropic investors as well as sponsors of transactions and funds. We offer this community a curated, online platform to connect with each other on blended finance transactions in progress, as well as exclusive access to original market intelligence and knowledge products such as case studies, reports, trainings, and webinars.

Our DESIGN FUNDING PROGRAM offers a unique market acceleration opportunity for practitioners to secure feasibility study and proof of concept stage design funding to develop and launch catalytic blended finance vehicles that aim to attract private capital to sustainable development at scale. Aceli Africa is a Convergence design funding grantee.