



LEARNING BRIEF

AGRI-SME FINANCE: NAVIGATING VOLATILITY IN THE WAKE OF THE WAR IN UKRAINE



This learning brief summarizes the challenges, opportunities, and responses of agri-SMEs, financiers and development partners to the food crisis caused by the war in Ukraine, as described in an event hosted on 06 July 2022 around this theme. The learning event was hosted by the Smallholder and Agri-SME Finance and Investment Network (SAFIN) in collaboration with the Good Food Hub, the International Finance Corporation (IFC) and the International Fund for Agricultural Development (IFAD) and attended by 140 participants.¹

Highlights

- Small and medium-sized agricultural enterprises (agri-SMEs) are facing unprecedented pressure due to rising prices for food, fertilizer and fuel, with many scaling back their operations, raising prices for consumers or cutting costs to maintain cash flow and margins.
- Some agripreneurs have exploited opportunities to scale up the production and consumption of local crops, and to decrease sector dependency on fossil-fuel based energy and fertilizer.
- Despite excess liquidity, financial service providers (FSPs) perceive growing risks and are backing away from lending to agri-SMEs and small-scale farmers.
- Development partners have proven instruments to de-risk private lending to the hidden middle, and are repurposing billions of dollars in programming to shore up agri-SME finance.
- Urgent collaborative action on agri-SME finance by development partners, FSPs, and SMEs in food insecure countries is needed to mitigate the crisis and support long-term food system transformation.

The big picture: Interlocking crises threaten food security

The world is experiencing the worst food crisis in generations.

The war in Ukraine is supercharging the longer-term trends driving up poverty and hunger. Climate change is compromising agricultural productivity growth, and the conflict and COVID-19 pandemic have significantly deteriorated food insecurity conditions around the world. Rising government debt and energy costs are also further compromising the ability of developing countries to keep up with these challenges and the added rise in food prices². Russia and Ukraine are major exporters of grains and edible oils, providing 26% of the world's wheat and 56% of the world's

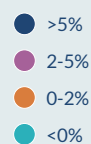
sunflower seed oil. Russia and Belarus provide 20% of the world's synthetic fertilizer. After the outbreak of war, wheat and maize prices spiked while the fertilizer index, already rising sharply since mid-2021, further increased to three- to four-fold above the pre-pandemic level. In response, farmers have acted rapidly to adapt to the new circumstances, including by reducing their fertilizer applications, which may affect volumes in future harvests. Acute food security was already at a high in 2021 following the outbreak of COVID-19, with numbers expected to jump higher in 2022. Data from 53 countries show 193 million experiencing a food

security crisis, and 236 million as food stressed primarily in low-income countries³. Global poverty rose in 2020 for the first time since the 1980s and is projected to do so again in 2022⁴. The number of severely food insecure is nearing 1 billion people globally, with most rapid increases in middle income countries. The price shocks triggered by the war most swiftly hit countries with high

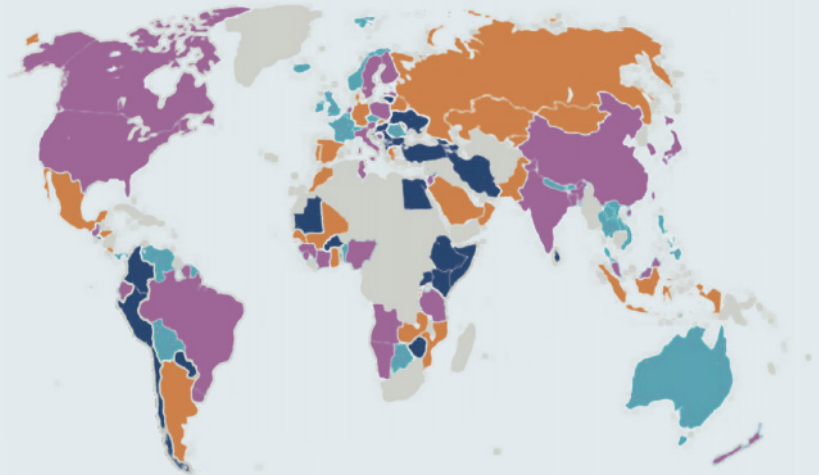
dependence on grain imports from the region, but rapidly spread across all markets with high food imports. Africa, the Middle East, and South Asia currently experience the highest levels of food insecurity, and are the regions least well positioned to cope with price rises for food, fertilizer, fuel, and finance.

Figure 1

Real Food Inflation Heat Map
(Feb-May 2022)



Note: Real food inflation is defined as food inflation minus overall inflation.
Source: International Monetary Fund, Haver Analytics, and Trading Economics



Agri-SMEs:

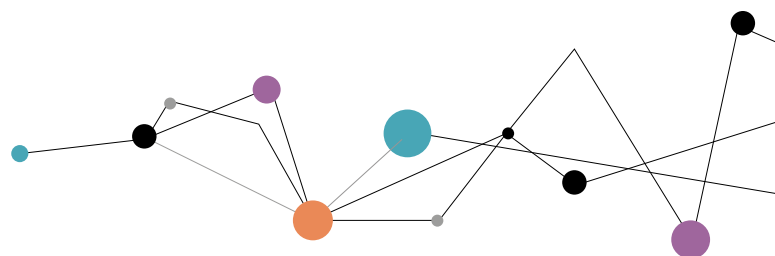
Adapting to volatile markets and seizing unexpected opportunities

Agri-SMEs, particularly those in production, logistics, and input distribution, and/or dependent on imports from the zone of conflict, have been hard hit by the simultaneous price rises, forcing some to scale back their operations and reduce costs to stay within cash flow constraints. Patience Bature of Parkea Ventures in Nigeria for example has reduced its baking tin sizes to maintain margins on its bread. SMEs are also inevitably passing on rising costs to their consumers. SMEs that directly service farmers with advisory and product off-taking services report that their clients are currently unable to afford their services. Nekesah Nafullah of Crop Nutrition Services Ltd in Kenya reported that demand for their soil testing service has dropped since the beginning of the year despite the increasing need to identify fertilizer more precisely.

On the positive side, some agri-preneurs have seized business opportunities with positive social and environmental benefits in this crisis and showing agility to adapt. For instance, with the prices of imports rising, some SMEs are pivoting fast to innovate and scale solutions in favour of domestic, nutrient-rich and often climate resilient alternatives. In India for example, Ruchi Jain and her team at Taru Naturals have started working with small-scale farmers to expand production and

consumption of local Ayurvedic grains such as millet and amaranth while Parkea Ventures is integrating fonio, a local nutrient-rich, climate-resilient grain, into flour for bread. SMEs also report shifting the sector away from its increasingly expensive and unpredictable fossil fuel dependency for energy and fertilizer. Nouran El Said of Plug n' Grow has seen an uptick in the demand for her hydroponic and aquaculture technology to produce premium quality vegetables and fish, as agri-SMEs turn to local production to shield themselves from the combined impact of climate change and volatility in their supply chains. In Kenya, Dajowan Waste Management is scaling up organic fertilizer to replace synthetic imports.

Despite such efforts to turn this crisis into an opportunity, these entrepreneurs are constrained by access to finance. They seek affordable credit to expand their working capital to cover salaries, rent, and inputs. They need longer-term debt or equity to cover asset investments for machinery, land, or buildings. While investment needs vary by context, the availability of affordable capital will determine whether in the long run agri-SMEs can enhance the resilience of local supply chains or contract their operations and exacerbate the effects of the crisis on the sector.



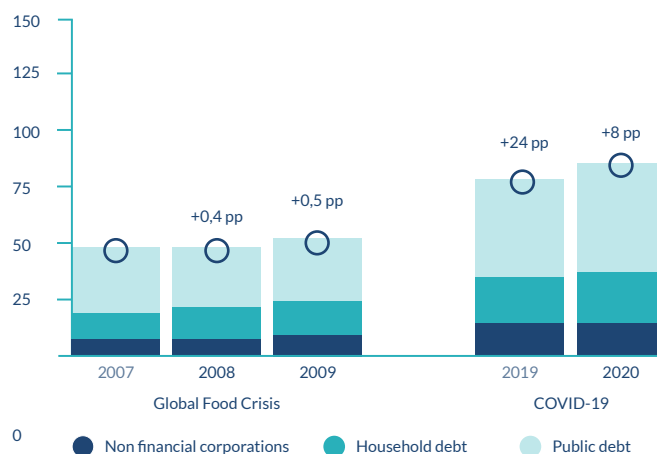
Financial Service Providers: Maintaining liquidity and innovating to mitigate risks

According to panellists at the event, disruptions to capital flows resulting from the COVID-19 pandemic have resulted in **banks and other financial service providers (FSPs) holding excess liquidity**. They have been forging recovery plans that in certain cases included increased investment into the agri-food sector. This builds on years of increased in-house skill development and product innovation at many FSPs in developing economies to increase financing for the sector, often as a result of government incentives. However, Liliana Pozzo from the International Finance Corporation (IFC) and Dr. Prasun Kumar Das of the Asia-Pacific Rural and Agricultural Credit Association (APRACA) underscore that in a reversal of these trends, **the current economic volatility is increasing risk perceptions, causing capital to pull back**, especially for longer-term lending. This is underpinned by early signs that more agri-food SMEs are defaulting on their loans as they struggle with the changing market conditions, as described during the event.

Some FSPs are finding ways to mitigate risks to match their excess liquidity with bankable projects. George Macharia of Equity Bank described how they have tried to cushion the blow for farmers from recent market disruptions, through direct financing and the introduction of sustainable practices. Investments into agri-SMEs are primarily made in manufacturing to ensure the availability of reliable off-takers. Hussein Abou Bakr launched Mozare3, Egypt's first agri fintech, during the COVID-19 pandemic to take advantage of growing liquidity levels and match farmers with buyers, and then leverage digital contracts to secure financing for seeds and other inputs. Nonetheless, amidst an escalating crisis, there are limits to the risk mitigation that FSPs can achieve alone. FSPs need support from governments and the development community to de-risk the sector and to nurture a pipeline of investment-ready SMEs. Inflation and foreign exchange volatility were noted as additional threats requiring government policies and actions.

One trend emerging from the crisis is that food security concerns have brought the focus back on agricultural productivity, moving away from a more holistic view of value chain development needs and former priority areas perceived to present higher risk or less transparency such as agri-SMEs and climate resilience, as revealed in a survey by APRACA on public and private sector banks across 24 countries in Asia. This shift away from climate resilience may secure short-term productivity gains at the cost of embedding long-term risks such as declining soil health or dwindling groundwater. Panos Varangis of the IFC mentioned the need to consider investments all along the value chain, warning that an exclusive focus on productivity will miss economic opportunities in processing, production, transport, storage, and retail. The current crises have shown the need to focus on investments along the whole value chain.

Figure 2.
Debt as percent of GDP Low income developing countries



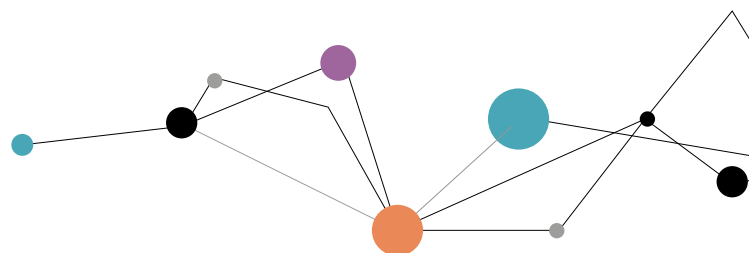
Source: IMF, April 2022. Dangerous Global Debt Burden Requires Decisive Cooperation.

Development partners: Pivoting programmes in response to the crisis

Multi-lateral Development Banks, Development Finance Institutions, and Donor Governments all have proven instruments that could be leveraged and scaled up to de-risk private finance such as grants, concession loans, guarantees, and insurance. They can also stimulate markets by promoting smart policies, well targeted cash transfers and input subsidies, business development services and technology transfers, while supporting the aggregation of farmers and micro-enterprises to improve risk-return ratios.

The international community is redirecting billions of dollars in development programmes in response to the unfolding crisis. Thouraya Triki of IFAD highlighted the role of development partners in making counter cyclical investments during times of crisis, and that now is the time to scale up urgently. Nabil Ghaleb of the Islamic Development Bank also explained how the institution is realigning their 10-year strategy to support their member states through the crisis.

With public spending constrained following the pandemic, there is a need to be smarter about the support delivered to agri-SME finance. Leonard Mizzi of the European Commission highlighted the massive bottlenecks between bankable SMEs, finance, and policies. Concerted effort across all three areas is needed to unlock the required financial flows. Conclusions drawn from the panel discussion included:



- **Think green:** Development finance should scale up agroecological and other sustainable production practices and avoid funding short-term productivity gains that degrade the ecological systems.
- **Leverage private finance:** Development finance must seek to leverage the high liquidity available in the financial sector by introducing de-risking solutions, while avoiding to crowd-out private finance. This includes using blended finance approaches that target the high-risk, low-return projects that deliver public good outcomes but are not viable for commercial investors.
- **Repurpose subsidies:** Governments spend US\$ 640 billion each year on agricultural subsidies. These could be redirected to advance a more regenerative, inclusive, nourishing, and resilient food system, whilst leveraging more private finance.
- **Improve coordination:** In each country, development partners must strengthen coordination and consolidate their programming better to avoid duplication or even counteraction at the cost of scale and impact.

Conclusions: Towards collective, bold action

Averting long-term repercussions from the food crisis requires collective action. If SMEs, financiers, and the development community act boldly together, there is a real opportunity to forge more resilient, inclusive, nutritious food systems. Priority actions include:

- **For SMEs:** Seek business opportunities to affordably nourish communities, such as by scaling up local, diversified cropping using agroecological and other sustainable production practices.
- **For financial service providers:** Thoughtfully expand portfolios of agri-food SME financing by offering both liquidity and de-risking tools in ways that capitalise value chains over the short and long-term.

- **For development partners:** Coordinate among development agencies, governments and FSPs to urgently scale-up proven country-level interventions that de-risk and reprioritize finance for SMEs, while offering a smart combination of financial services and technical assistance to support a long term transformation of value chain actors toward more resilience and sustainable operations.

Bettina Prato of IFAD called for institutions to resist the urge to start new initiatives, but instead to redouble existing efforts to elevate the innovative business models and financing mechanisms that are already moving us towards more resilient, nutritious, localised, inclusive supply chains.

What next for SAFIN?

Some important questions were left unanswered and offer a future agenda for SAFIN. How can we learn from successful examples of coordinated country-level efforts to further scale and replicate responses to the crisis? Do anecdotal reports of staff redundancies by food SMEs signal the beginning of rises in rural unemployment? How can we strike the right balance between the need to drive-up productivity, including through potential subsidies for synthetic fertilizers, and ensuring

resilience and sustainability? How can we collect better real-time quantitative data on how SMEs and FSPs are navigating the volatility? SAFIN brings together a diverse group of actors from the agri-food SME investment community, and can elevate innovations by agri-food SMEs and the solutions to finance them, while crafting key messages to accelerate collaborative action within its membership and beyond.

Notes

- 1 Details of event participation: Geographic location- Sub-Saharan Africa: 39%, Asia and the Pacific: 16%, Near East and North Africa: 16%, Latin America and the Caribbean: 15%, Europe and North America: 8%. Institutional representation- Agri-SMEs or farmers' organizations: 19%, Development Finance Institutions: 22%, Enterprise Support Organizations: 19%, Technical Service Provider: 11%.
- 2 Ortiz-Bobea et al (2021) Anthropogenic climate change has slowed global agricultural productivity growth. *Nature Climate Change*. 11: 306-312.
- 3 Data from Global Network Against Food Security Crises.
- 4 World Bank. 2020. *Poverty and Shared Prosperity 2020: Reversals of Fortune*. Washington, DC: World Bank. doi: 10.1596/978-1-4648-1602-4.

ACKNOWLEDGEMENTS

This brief was prepared based on the insights and experiences of a wide array of speakers who participated in the learning event held on 06 July. The views and opinions expressed in the brief solely belong to these speakers and do not reflect those of SAFIN, the Good Food Hub, IFAD or IFC.

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