Rethinking Approaches to Investment Finance in Agriculture

Background and Context

Under the African Union's 2014 Malabo Declaration, African states re-committed to the Comprehensive Africa Agriculture Development Programme's (CAADP) objective to allocate at least 10% of their budgets to agriculture in order to facilitate an average agricultural productivity growth of 6% annually. Malabo Commitment 2 addresses the need to 'enhance investment finance, both public and private, to agriculture'. More specifically, the commitment calls upon member states

- to uphold our earlier commitment to allocate at least 10% of public expenditure to agriculture, and to ensure its efficiency and effectiveness;
- to create and enhance necessary appropriate policy and institutional conditions and support systems for facilitation of private investment in agriculture, agri-business and agro-industries, by giving priority to local investors;
- to fast-track the operationalization of the African Investment Bank, as provided for in the Constitutive Act of the African Union, with a view to mobilizing and disbursing investment finance for priority agriculture related investment projects.

Achieving inclusive agricultural growth and transformation under these blueprints, and through the allocation of the requisite national resources, would help Africa attain its ultimate stated objective of halving poverty by 2025. New concerns and challenges that have surfaced in the recent past will be addressed in the second generation National Agricultural Investment Plans (NAIPs).

This Knowledge Note provides a brief inventory of trends and opportunities in rural and agricultural investment. It proposes an additional role of the public sector as convenor and facilitator to attract new-style investors to a rapidly growing body of interesting farming and business practices – a process that could take the form of either rural or regional investment clearinghouses.

KEY MESSAGES

- **The Malabo Declaration recognises that the creation of enabling policy and institutional conditions to attract private investments into agriculture is key to achieving agricultural transformation. Priority is given to local investors.**
- **The public sector should assume a revised position as convenor and facilitator of third party investments. To this end, it should strenghten its dealmaking capacity and address concerns such as legal protection, reasonable taxation, consistency, reliability, and repatriation of capital as well as adequate regulation to curb unethical business practices.**
- **Investment clearinghouses mandated to scout, pre-assess and possibly assist ongoing initiatives could be a valuable mechanism to link innovation with investment, as they would reduce assessment costs for investors.**
- **The focus on local investment gives way to unconventional investors such as social or impact investment funds, high net-worth individuals, family funds and crowdfunding.**

Relevance of Agricultural Investment Finance to the Achievement of Malabo Commitments

Attracting private investors in the more commercial, commodity-based segments of agriculture has been a common practice in Africa. In the early years of this century, Africa experienced an uptake in foreign investments, but the global financial crisis of 2007 then resulted in an exodus. (This may account for the Declaration's explicit

preference for local investors). Whether foreign or domestic, all investors, especially those in capital-intensive sectors, need some conditions to be met before placing their capital. Facilitation, therefore, is a major instrument for governments to attract investor capital. Typical concerns in this area include legal protection, reasonable taxation, consistency, reliability, and repatriation of capital. Regulation comes in to create a level playing field and to curb unethical business practices. All of the above can be put in place by governments without having to invest in anything but goodwill.

In order to open up new investment areas or regions, governments can consider a hands-on approach by putting in place the physical infrastructure required to attract foreign investment. Feeder roads, water, and power are common areas of initial focus. This 'leveraging' approach can take the shape of fully-fledged public-private partnerships (PPPs) if both parties formally agree on a consecutive investment pattern before the actual investment is made *(see Knowledge Note: Public-Private Partnerships for Agribusiness)*.

Subsidisation is a special form of leveraging whereby the state takes responsibility for absorbing pre-operational (catalytic) or even operational (ongoing) costs or risks in order to trigger private investment. Subsidisation is generally applied in order to reach out to prioritised producer groups or to showcase special interest areas – environmental, social, geographical and so on. For this reason, subsidisation is increasingly considered an instrument for inclusion, but against the condition that it should not substitute market-based investments – even

SUBSIDY IMPACT MODEL[1]	
CATALYTIC	**ONGOING**
REDUCING PERCEIVED RISK	**REDUCING INTRINSIC RISK**
Market-entry guarantees Support for aggregators Support for farmer groups	Risk-sharing facilities Technical assistance to operate in risky sectors Currency risk hedging
OVERCOMING ENTRY COSTS	**OVERCOMING INITIAL LOSSES**
Technical assistance for Financial Service Providers (FSPs) in agriculture Technical assistance for aggregators Grants for take-off	Special interest rates Special insurance products Concessional debt

though it can trigger them. In short, impact is the keyword for rationalising the application of subsidies in investment strategies. International development banks and funds have built a considerable footprint in Africa when it comes to providing subsidised or discounted loans, often in combination with significant grants. A common concern regularly observed, however, is that the programmatic design of such initiatives may work out well for achieving set targets, but it rarely triggers genuine private investments in the long run. Where such intended investments are conditionally placed at an early phase, the chances for future market consolidation tend to be higher.

The particular focus on attracting local capital could be an incentive to promote innovate forms of finance that may not be easily picked up by international commercial investors. New priority investment areas in agriculture such as climate-smart, safe and organic farming and variety development could be pioneered in a local context by local investors with some public sector support and in cooperation with local agricultural universities and centres of excellence. These are steps towards innovating and broadening the local knowledge base, which is a form of asset building in its own right. Expectedly, Africa will develop a stronger drive towards preservation and especially rehabilitation of natural resources *(see Knowledge Note: Resilience and Climate-Smart Agriculture)*. This will require a robust African investment effort, under which public and private capital can be combined with community resources other than capital such as land, labour and knowledge.

Policy Recommendations for NAIPs

In many countries, the process of integrating Malabo Commitments into second generation NAIPs and wider policy processes is either already underway or nearing completion. However, the 10% resource allocation is a challenge due to competition with other benchmarked budgets, as well as to the strict formulation of agricultural expenditure provided in the African Union Guidance Note (AUC and NEPAD 2015). What can be derived from the available information in NAIP preparations is promising,

1 Adapted from: Dalberg Global Development Advisors (2016).

nonetheless. Whereas traditionalist approaches aimed to shield smallholders from the rigorous workings of international markets, today the tendency is to embrace the market under a broader supervisory framework that values social and environmental concerns as well.

This movement towards a 'people-profit-planet' approach allows for a revised position taken by the public sector: part investor – so as to stimulate innovative investments – but increasingly both convenor and facilitator of third-party investments. This convening role can be understood in terms of taking stock of investment opportunities in agriculture that meet government priorities concerns. The government can already indicate how it will prepare and facilitate investments, how partnerships could be structured, and how local and external investors could play a role. In fact, this would go towards formulating hypothetical deal books. Transformative issues and concerns such as food security and safety and climate-smart farming should form an integral part of such deal books.

This approach can also break through the historical divide between a modern, profitable commercial sector and a traditional, inert smallholder sector. Both sectors could be considered unsustainable before long, however: the former relies too much on mono-cropping, which can bring about massive degradation and depletion of resources, while the latter does not any longer provide the livelihoods to sustain a rapidly growing population. In dynamic rural markets, local processes of transformation are already noticeable, often stimulated by capital and knowledge input from relatives in urban centres and / or overseas.

TYPOLOGY OF AFRICAN AGRICULTURE

COMMERCIAL	SMALLHOLDERS
Capital intensive	Capital extensive
Labour extensive	Labour intensive
High support	Low support
Secure marketing	Insecure marketing
High profitability	Low profitability

For governments, the quickest way to move into convenor and facilitator mode is to study what is already happening on the ground in a non-bureaucratic manner. This is done by making quick visits to take stock of what is happening already, and then to identify ways of adding value, especially in brokering outside capital provision. Of critical importance here is to **fully engage rural youth**, since they are well-informed and networked, have an eye for innovation and scaling and are keen for opportunities to become (self-) employed in agricultural value chains rather than leave for semi-unemployment in the city *(see Knowledge Note: ATVET)*.

SUGGESTED ROLE EVOLUTION OF THE PUBLIC SECTOR

ROLE	POLICY
Investor	Direct capital placement Special lending facilities
Co-investor	Initiate PPPs Improve infrastructure
Convener	Scout investment opportunities Build hypothetical deal books
Facilitator	Engage new-generation investors Form clearinghouses

Investment clearinghouses could be a valuable mechanism to link innovation with investment. The formal financial sector has a persistent challenge in penetrating and servicing rural areas: costs and risks are perceived as too high relative to other lending and investment opportunities. Even specialised rural banks tend to focus on savings and money transfers. In order to build a more productive environment, therefore, governments can support the formation of multi-party rural clearinghouses. These could be mandated to scout, pre-assess and possibly assist ongoing initiatives to the point at which professional investment or business plans can be presented to a group of preselected investors. This would reduce assessment costs for investors and also allow the government to ensure proper representation of priority investment concerns.

On the rise, meanwhile, is a growing number of unconventional investors who apply a variety of capital sourcing and investment strategies. Capital is not attracted in conformist capital markets, but rather from social or impact investment funds, high net-worth individuals, family funds and crowdfunding. Typically, funders do not exclusively or primarily focus on superior financial returns, but rather on a wider range of results and outcomes, usually in the realm of environment, youth, women or innovative IT applications. Most do not have extensive deal identification capacity and are interested in engaging in new models of cooperation. Rural investment opportunities are therefore often highly appreciated. The crux of the matter, from this perspective, is that the time for a new approach may have come. There is a growing body of innovation and progress already in place in many countries.

In light of the above observations, therefore, it could be a sensible strategy for the public sector to play an active role in linking those most in need with new-style investors and, thus, invest in dealmaking capacity in its growing role of convenor and facilitator. This adjusted role concept could be introduced and formalised in NAIPS wherever it is considered opportune.

How Investment Finance is Measured in the Biennial Review

Malabo Commitment	Commitment Performance Category	Objectives	Indicator	Targets value
Enhancing Investment Finance in Agriculture	2.1 Public Expenditures to Agriculture	Allocate enough funds for agriculture in national budgets	2.1i- Public Agriculture Expenditure as share of total public expenditure	10%
			2.1.ii- Public Agriculture Expenditure as % of agriculture value added	19%
			2.1iii- ODA disbursed to agriculture as % of commitment	100%
	2.2 Domestic Private Sector Investment in Agriculture.	Put in place or strengthen mechanisms to attract domestic private investment in agriculture	2.2- Ratio of domestic private sector investment to public investment in agriculture	
	2.3 Foreign Private Sector Investment in Agriculture.	Put in place or strengthen mechanisms to attract foreign private direct investment in agriculture.	2.3- Ratio of foreign private direct investment to public investment in agriculture	
	2.4 Access to finance	Increase access of smallholder farmers/rural households to and use of financial services for the purposes of transacting agricultural business (purchasing inputs, machinery, storage technologies, etc.)	2.4- Proportion of men and women engaged in agriculture with access to financial services	100%

Further Information

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Published by: African Union Commission - Department for Rural Economy and Agriculture (AUC-DREA) and African Union Development Agency – NEPAD

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Designed by: Twaai Design

Supported by: Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH

ISBN-Number: 978-0-6399233-0-7

Date: June 2019