

Leveraging Climate Finance for Agribusiness SMEs to Scale Up Climate Resilient Agriculture in East Africa: Lesson from the CRAFT Project

Introduction

Small- and medium-sized enterprises (SMEs) play an important role in supporting sustainable development and increasingly towards building adaptation and resilience in Africa's food and agriculture sectors. However, most agribusiness SMEs operating in small-scale agriculture are in dire need of business finance to help them flourish and climate-proof their value chains as variable weather increasingly threatens their supply sources of raw materials, disrupt their operations, and increase costs of maintenance and materials.

Climate-related risks hazards not only increase the risk and unpredictability of SMEs' revenue streams but also reduce private sector investments into the sector even further. Financial institutions such as banks may avoid the risk by not financing agribusiness SMEs or increase the cost of financing, such as enforcing more stringent collateral requirements or higher interest rates (Csaky et al., 2017).

With growing pressure to reduce greenhouse gas emissions and to facilitate large-scale adaptation to climate-induced shocks, the last decade has also seen increases in global climate finance, particularly from bilateral and multilateral public sources.¹ These investments rose steadily per annum, from USD 364 billion in 2012 to USD 632 billion in 2020 (Climate Policy Initiative 2021) and are largely distributed via initiatives such as the Green Climate Fund, the Global Environment Facility, and the Adaptation Fund. Agriculture together with forestry, and land-use sectors only received about USD 20 billion of this share in 2020, of which close to USD 10 billion was dedicated to small-scale agriculture (Chiriak et al., 2020). Funding for small-scale agriculture, therefore, represents only a mere 1.6% of the total climate finance tracked (ibid). In Africa alone, the Initiative for Smallholder Finance (ISF) estimates that agri-business SMEs require at least USD 74 billion per annum to sustain their current growth, accelerate their business growth potential to meet market demands, and adapt to climate change (ISF 2022).

This joint CRAFT-AICCRA policy brief draw lessons from the **Climate Resilient Agribusiness for Tomorrow (CRAFT)** project (2018–2023) in East Africa to illustrate how a dedicated consortium of development partners has responded to this climate finance gap for agribusiness SMEs

in the region by coordinating and leveraging co-investments from this latter group.² CRAFT supports agribusiness SMEs and farmer cooperatives, or business champions, to increase investments in climate smart solutions, such as climate smart agriculture (CSA) practices among smallholder farmers, as well as upgrades in technologies and facilities related to post-harvest handling, storage, and transportation. To date, CRAFT has awarded co-investment grants to 51 business champions (36 SMEs and 15 farmer cooperatives), with € 7 million committed by the project while €13 million came from the on-boarded agribusinesses. These business champions have reached over 258,800 smallholder farmers operating in several crop value chains comprising pulses, oil seeds and potatoes in Kenya, Uganda, and Tanzania (CRAFT 2022). Results indicate that most of these farmers have adopted at least two or more CSA practices and between 50–60% of them saw increases in their income in the short term (CRAFT 2022).

Despite commendable project efforts by CRAFT to stimulate climate finance for agribusiness SMEs in East Africa, there remains significant challenges with regards to leveraging additional public and private sector investments needed to scale up climate smart solutions to achieve meaningful impact at scale. To catalyze a sustainable growth of climate resilient agribusiness SMEs in East Africa and beyond, development partners and policymakers must support the implementation of blended finance options for this sector, to efficiently connect different pools of capital while serving as a risk-sharing mechanism. Among blended finance tools are guarantee mechanisms, whereby development financial institutions serve as guarantors for loans that commercial lenders extend to agribusiness SMEs.

1 Climate finance refers to domestic or international financing—drawn from public, private and alternative sources of financing—intended to support climate change adaption and mitigation and adaptation actions. In small-scale agriculture sectors of Africa, climate finance is especially crucial for adaptation, due to adverse effects of climate change on agricultural productivity and commerce.

2 These partners are SNV, Rabo Partnerships, CGIAR's Climate Change Agriculture and Food Security Program (CCAFS) which is renamed as ILRI/AIC-CRA-ESA, Wageningen University (WU) and Wageningen Environmental Research (WEnR) and Agriterrra.

Role of Agribusiness SMEs in Adaptation to Climate Variability and Change

Over the last several years, development actors increasingly promote inclusive business practices among agribusiness SMEs in ways that not only link smallholder-farmers to reliable markets but offer skills training in the use of climate resilient technologies and practices and access to financial services (Groot et al., 2019). This trend is partly a response to calls to accelerate the scaling of climate change adaptation measures by leveraging business opportunities that promote economic benefits and build the capacity of smallholder farmers, contributing to more productive, resilient and lower-emission agricultural systems (Rosenstock et al., 2020; Steiner et al., 2020).

In SSA, agribusiness SMEs already play an important role in driving agricultural transformation—making up about 80 % of the private sector that operate in wholesale, logistics, and processing value chains (AGRA, 2019). With the right support, Africa’s agribusiness SMEs can provide important benefits associated with scaling climate resilient agriculture practices and improving rural livelihoods. However, these actors often face major obstacles to grow their business, particularly poor access to finance. Financial institutions are often wary of serving them due to various risks associated with operating in small-scale agriculture value chains, such as low profitability, lack of traditional collateral, and geographic isolation. Limketkai et al. (2019) explains that financial institutions tend to have a low-risk appetite for lending to initiatives in small-scale agriculture despite increased climate finance available to support adaptation and mitigation investments. Evidently, this sector lacks a deep pipeline of bankable projects with (proven) attractive risk-adjusted returns; limited primary data and information asymmetries on viable investment opportunities and appropriate risk-mitigating mechanisms; and uncertain financial/environmental upside.

Rabobank Foundation, as part of Rabobank, is among a few leading financial institutions which offers financing to agribusiness SMEs and farmer cooperatives that want to grow but are not eligible for funding by micro-



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credit organizations or other commercial banks. In 2012, Rabobank Foundation established its Rural Fund that has so far invested USD 143 million in the small-scale agriculture sectors of Africa, Asia, and Latin America (Rabobank 2022). Rabobank is also one of the consortium partners implementing the CRAFT project in East Africa, where they respond to the climate finance gap in the region by stimulating the development of SME agribusinesses that are commercially, ecologically, and socially sustainable under the prevailing climate change conditions. With nearly two decades of experience assisting SMEs and farmer cooperatives in developing countries, Rabobank offered technical backstopping to selected business champions to develop climate responsive investment plans with potential to attract further climate finance. Selected grantees also received inclusive business model training to foster strong integration linkages for farmers into selected value chains, increase production efficiency and technology adoption, and to achieve economies of scale. This private sector development approach helps to facilitate the scaling of systems change, by leveraging the resources and dynamism of local systems and actors to expand business services that create lasting change for the poor (Ledgerwood, 2021).

Methodology: Assessing CRAFT's Contributions to Scaling CSA through Agribusiness SMEs in East Africa

Since mid-2019, scaling readiness research in the CRAFT project has supported the identification of potential scaling barriers to the large-scale roll-out of SME-driven CSA interventions and to initiative action to resolve them, where possible. The research on scaling sought to understand well the system dynamics and interdependencies that determine the 'scalability' of an intervention and achieving impact at scale based on existing contextual conditions such as end-user incentives, required services and resources, conducive policies, and regulations, etc. (PPPLab, 2017). Methodologically, the research adopted a triangulation approach to data collection and analysis. The first step was to undertake a desk review of peer-reviewed and grey literature as well as project documents to start to identify potential key scaling barriers in selected value chains. This was followed by consultation workshops with country project teams (6-8 staff per country) to validate and engage in further analysis on the identified scaling barriers and to begin to outline the key players and their roles in helping to resolve them. This exercise followed an iterative process involving multiple engagements with project teams from 2019-2020 to characterize more accurately the identified scaling barriers as well as to shed light on broader agricultural systemic contexts in which the selected crop value chains, agribusiness SMEs, smallholder farmers are embedded.

The final research step involved 25 individual semi-structured interviews, conducted in 2021 with CRAFT-funded agribusiness SMEs and farmer cooperatives that have been in the project for at least 12 months. Interviews solicited a discussion on scaling lessons from business champions, to learn about how agribusinesses were

operationalizing their proposed inclusive business models, whether they see long-term commercial viability/competitiveness in their delivery models, and what types of partnerships and institutional arrangements were leveraged upon to facilitate the scaling process. While the overall study generated deep insights on multiple barriers³ to scaling CSA through agribusiness SMEs in East Africa, this policy brief focuses attention on one aspect: the challenge of accessing business finance.

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Study Findings: Related to Challenges with Access to Business Finance



As mentioned above, CRAFT sought to strengthen the business acumen of its grantees, in anticipation that they would attract commercial funding for follow-on investments and scaling, including credit provision for smallholders. However, nearly all interviewed CRAFT grantees raised concerns over stringent collateral security requirements and high interest rates that most commercial banks in the region still have in place for agricultural actors, albeit commitments to lend more to those engaged in sustainability initiatives. One interview participant explains that “while we can rely on financial institutions to obtain [loans] they charge high interest rates, especially commercial banks charge above 13 %. They also take a long time to approve loan applications...”⁴ Even financial institutions with agri-finance programs, including micro-finance banks, remain largely inaccessible, and generally offer their services to more established SMEs or clients operating in more structured value chains, such as coffee, tea, and dairy (Wattel et al., 2019).⁵ As such, many business champions face significant challenges in raising the 50% co-contribution requirement to be eligible for the CRAFT project.

Poor access to business finance is also partly attributed to the types of value chains CRAFT-supported business champions operate in, with most supporting food crops such as common beans, potatoes, sesame, and soybeans, which tend to have fragmented or poorly coordinated markets. While these value chains are more responsive to the food security needs of poor households, they also have higher investment risks as produce sales are characterized by numerous transactions involving small volumes, many traders with variable capacity, and overall low produce quality and profitability (LTS International, 2017). CRAFT-supported agribusinesses sought to address some of these risks by reaching large numbers of farmers with targeted technical assistance in CSA agronomic practices and ready markets. Indeed, all business champions committed to increase the number of farmers they work with, usually from a baseline of 500-1,000 producers to over 3,000 or more over the two-year period of being supported by the project.

This approach is a form of agriculture aggregation, i.e., integrating large numbers of organized smallholder farmers into formal market systems, which helps to reduce transaction costs, meet produce quality standards, and achieve economies of scale in the purchase of CSA farm inputs as well as in production and marketing (Csaky et al., 2017).

Responding to greater numbers of smallholder farmer clients, and moving from pilot to scale, however, necessarily require business champions to enhance their capabilities to meet various demands, including leveraging on efficiency, produce quality, and competitive advantage (WBCSD, 2013). Among key investments that interviewed business champions highlighted were hiring more field staff or village agents to provide CSA extension and purchasing farmers’ produce on behalf of companies and/or acquiring additional equipment and machinery to increase their processing lines.⁶ Multiple business champions were unable to meet their targets promised to CRAFT—mainly citing problems with cash flows and limited business finance, though there were also logistical delays in setting up their operations for training and service delivery in the wake of COVID-19.⁷

Recognizing that institutional/structural barriers to scale up private sector finance for agribusiness SMEs persisted even after strengthening grantees to develop bankable climate smart business plans, CRAFT and partners plans to explore alternative financing options beyond mainstream financial institutions for the remainder of the project. Among these are blended finance options from impact investors as well as traditional donor granted targeted towards agribusiness SME growth and development. This initiative also aims to create awareness among financial institutions on supporting climate change adaptation efforts and how investments in the sector can benefit their sustainable business models.

4 Interview with BC representative, 19 March 2021.

5 Some suggestions to scale up inclusive financial services strengthening proxy finance models, for instance fintech operators who provide financial services to farmers and SMEs (Wattel et al. 2019).

6 Interview with BC representative, 24 March 2021.

7 Interview with BC, 17 June 2021.

Policy Recommendations to Unlock Climate Finance for agribusiness SMEs at Scale:



As illustrated above, agribusiness SMEs face significant challenges related to climate-proofing their value chains to adapt to the variabilities of climate change as well as accessing business finance to do so. Policymakers and development partners in SSA must consider allocating greater resources to increase blended finance options to help attract financial institutions and investors the small-scale agriculture sector, and support agribusiness SMEs to scale up climate smart business models. This will help to efficiently connect different pools of capital while serving as a risk-sharing mechanism. Considering high risk, early-stage investments from blended finance tend to rely more heavily on public donor capital, including social impact investments such as incubator/accelerator platforms for new business models (Limketkai et al., 2019). As new CSA business models in a broad range of crop value chains develop over time, the private sector, including commercial banks, are expected to

take up more responsibility in financing and scaling their operations.

Overall, building a strong enabling environment for agribusiness SMEs to thrive can help drive the scaling of CSA interventions and climate-resilient agriculture at scale while fostering inclusive rural economic development. While addressing SMEs' and farmer cooperatives' financial constraints is crucial to help these actors upgrade their technologies, practices, and business models - this is not sufficient. There needs to be more deliberate policy and institutional actions to facilitate the development of climate finance markets that offer a package of additional solutions, including training in climate knowledge products, subsidies on climate-smart technologies and affordable insurance. Key policy recommendations to help unlock climate finance for agribusiness SMEs at scale are:

Increase blended finance for agribusiness SMEs and farmer cooperatives operating in small-scale agriculture.

Public finance providers multilateral and bilateral donors, international finance institutions and regional development banks must facilitate sub-commercial lending through various blended finance mechanisms. Among these are, (i) concessionary loans that offer below-market terms, such as zero interest rates, to reduce the cost of borrowing for SMEs; (ii) guarantee mechanisms

to reduce lending risks; and (iii) grant-funded technical assistance facilities to strengthen commercial viability (ISF 2022). Blended finance approaches should attract private sector finance, e.g., from local banks, as it helps to reduce the real and perceived risks of lending to SME agribusiness entrepreneurs and reduce the high costs of serving rural areas.

Build Consistent and Reliable Data Sources Related Small-Scale Agricultural Commercial Activities and Access to Finance.

Data is needed to resolve the gap between financial institutions' limited understanding of climate smart business models in agricultural value chains on one hand and agribusiness SMEs' weak capacity to develop robust business plans with potential to attract funding on the other hand. Agricultural development projects supporting SMEs must prioritize strengthening their knowledge as well as ability to build bankable business plans with clear financials, e.g., investment plans vs. financing plans, profit and loss forecasts, and calculation of future cash flow, etc. which are understandable to bankers. At the same

time, stimulate financial institutions to enhance their knowledge and technical capacity in various agricultural value chains and climate smart options therein, via hiring more agri-business experts and investing in agriculture knowledge centers. For instance, Rabo Partnerships has supported its partner banks, such as NMB Tanzania and DFCU Uganda, to build such agri departments and with appointing and training agri specialists as agri loan officers in the past 10-15 years which has increased their willingness to finance companies that are active in the Food and Agri sector.

Build the Capacity of Financial Institutions to Serve SME Agribusinesses

International development financial institutions must work with financial institutions to enhance their capacity and technical skills in assessing climate smart agribusiness SMEs and investment projects, and to develop specific tools for the financial analysis of such clients to create new loan products focusing on this market sub-segment. The IFC (2011) recommends that

local banks can train staff or hire agronomists and value chain specialists to provide research and analysis of key agricultural sectors. Commercial institutions could also put in place specialized credit scoring and rating for the SME agribusiness sub-sector based on a few key parameters, such as financial records or guarantee mechanism.

Expand the Business Facilitation and Knowledge Management of Climate Resilient Small-scale Agriculture.

Expand technical assistance and capacity building in the business facilitation and research and knowledge management of climate resilient small-scale agriculture not only to agribusiness SMEs but to a range of stakeholders including government agencies, multi-stakeholder platforms, and service providers. Capacity

building efforts, particularly training public and private-sector extension workers in climate resilient agronomic practices and creating awareness for climate resilient agriculture practices among smallholder farmers, hold potential to scale up such innovations to more beneficiaries beyond project boundaries.

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