

Bridging the Financing Gap for Agricultural SMEs

An Overview of Aceli Africa





What is Aceli Africa?

Aceli Africa ("Aceli") is a **market incentive facility** that seeks to build a thriving market where capital flows **unlock the growth and impact potential of agri-SMEs**

Drawing on new data re: the economics of agri-SME lending from 31 lenders across East Africa, Aceli aims to **bridge the gap between capital supply and demand** for agri-SMEs in the region

Aceli launched in August 2020 and plans to offer **\$40M in financial incentives to lenders and \$10M in technical assistance** for agri-SMEs and lenders to mobilize **\$700M in lending** by our financial institution partners in Kenya, Rwanda, Tanzania, and Uganda by year-end 2024

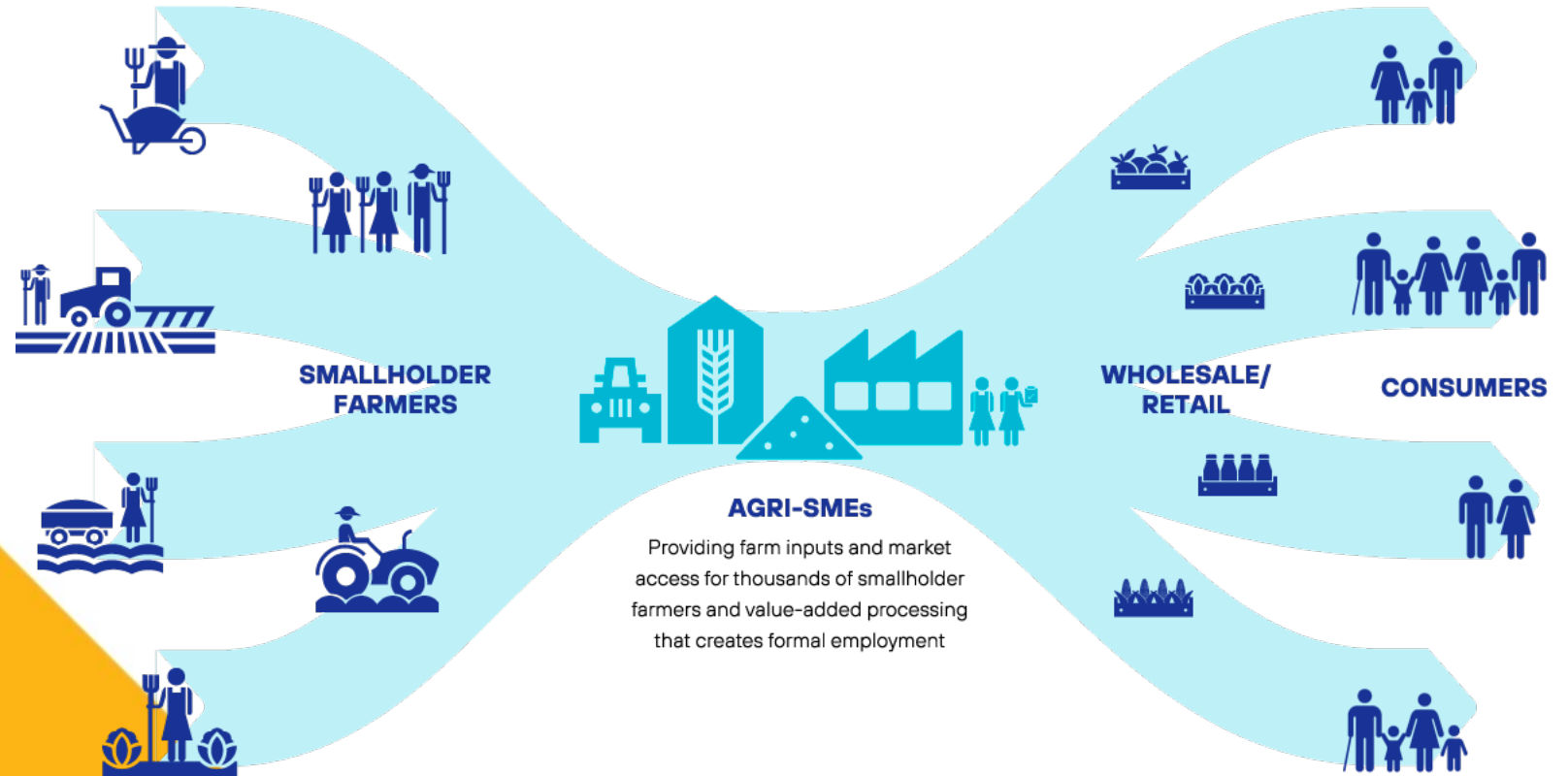
Aceli targets **loans ranging from \$25k-1.5M** to agri-SMEs, producing revenues from \$50k-10M, with a goal of **generating \$200M in incremental income to improve livelihoods** for farmers and workers, **enhance gender inclusion, strengthen food security**, and **expand climate-smart agricultural practices**

Why Agricultural SMEs?

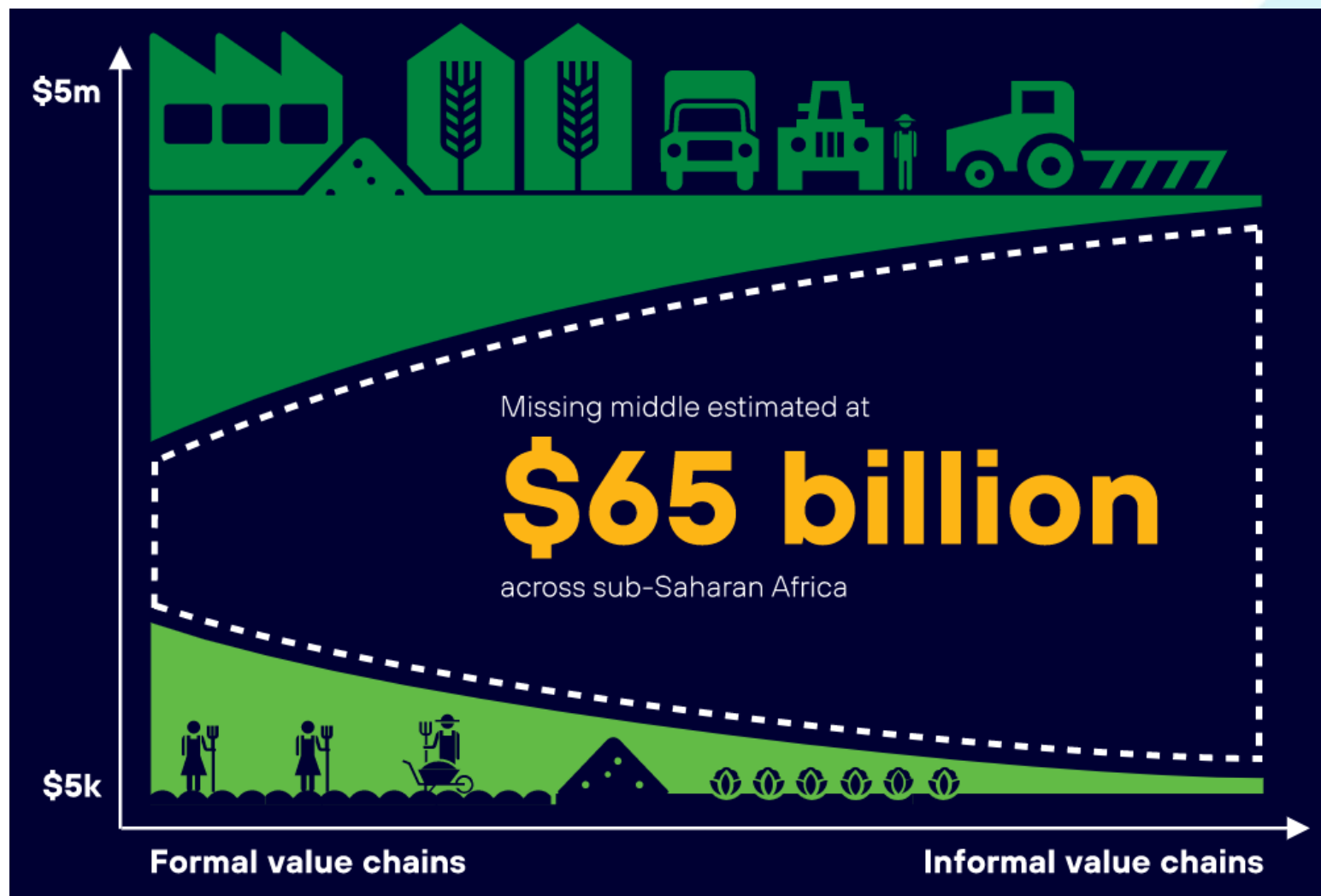
Agricultural growth in Africa is 2-3x times more effective in reducing poverty than growth in any other sector.

Small and Medium Enterprises (SMEs) are crucial to inclusive agricultural transformation that drives economic growth, improves livelihoods for smallholder farmers and low-skill workers, and reduces reliance on costly food imports.

Agri-SMEs need reliable access to finance to realize their growth and impact potential.



3 in 4 agri-SMEs lack access to finance which constrains their growth & impact



Commercial Banking

Large loans to a handful of corporate entities clustered in formal value chains, since informal value chains are considered riskier

Agricultural Missing Middle

Agricultural SMEs that aggregate thousands of farmers and create employment opportunities but are considered too risky and costly to serve, especially when they work within informal value chains

Microfinance

Small loans to many individuals and microenterprises, with more loans going to formal value chains than to informal value chains

31 lenders contributed data to the analysis of agri-SME lending economics that informed the design of Aceli

Global Social Lenders



Domestic Commercial & Development Banks

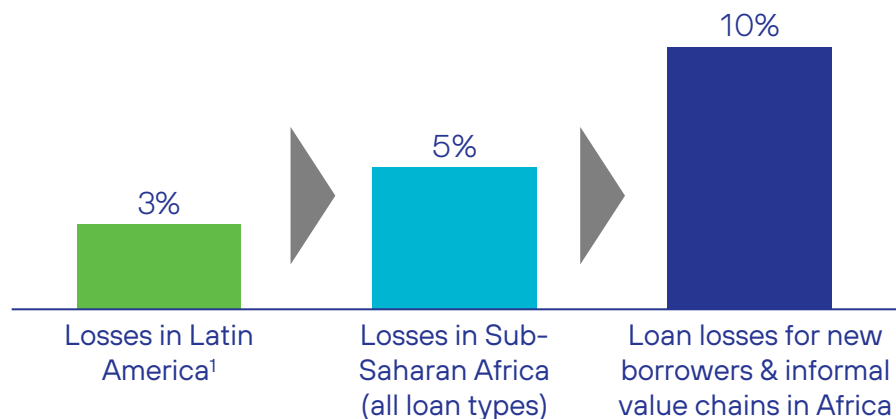


Regional Non-Bank Financial Institutions

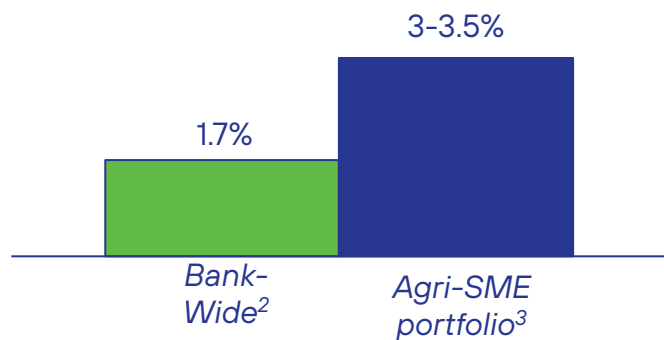


Data findings: Risk is 2x higher and returns are 4-5% lower for lending to agri-SMEs vs. lending to other sectors in East Africa

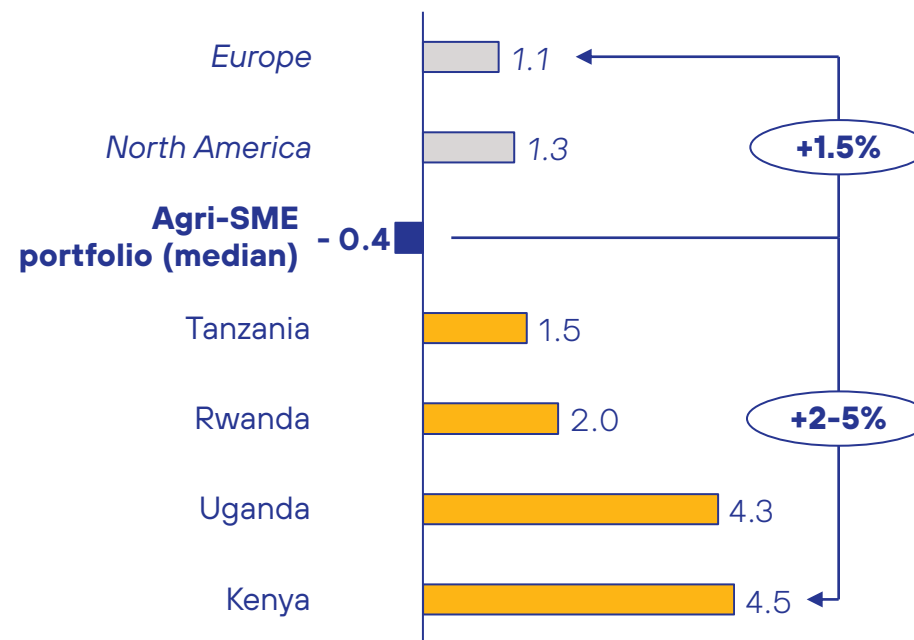
1. Risk of agri-SME lending in Africa vs Latin America for social lenders (write-off %)



2. Risk in agri-SME vs overall lending for commercial banks in East Africa (write-off %)⁴



Bank Return on Assets by region and country compared to agri-SME portfolios in our dataset (in bold) %, 2017 (latest year available)



Due to limited competition, African commercial banks earn some of the highest returns in the world. Therefore, activities that are less profitable such as agri-SME lending, present a high opportunity cost for lenders.

While agri-SME lending is often unprofitable, the economics could shift if the impact generated by these capital flows were included

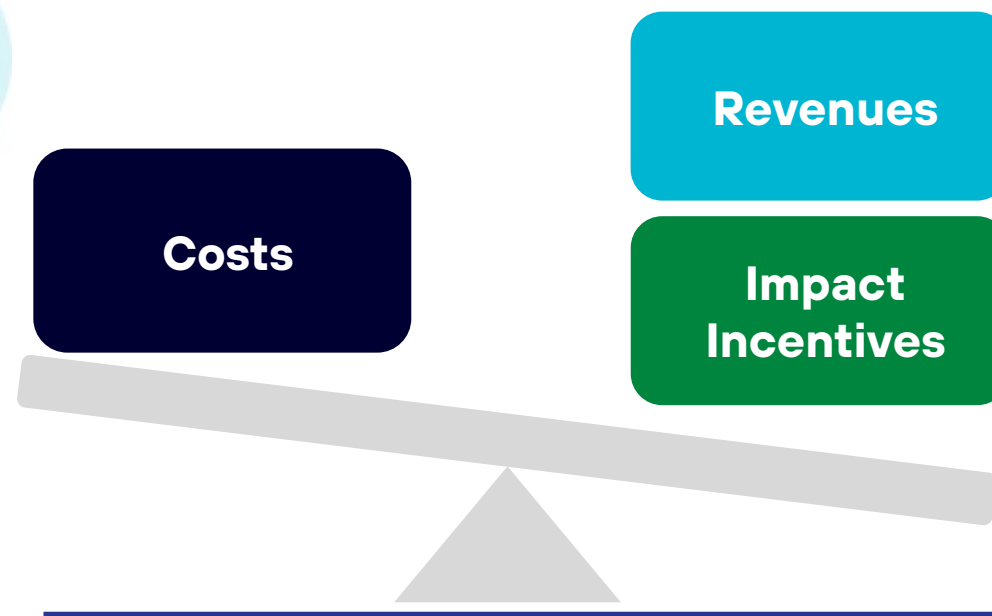
The status quo

Lenders shy away from financing agri-SMEs – and their impact potential goes unrealized – because these loans are unprofitable and lenders do not derive financial value from the positive benefits (e.g., farmer & worker livelihoods, food security) of reaching these underserved borrowers.

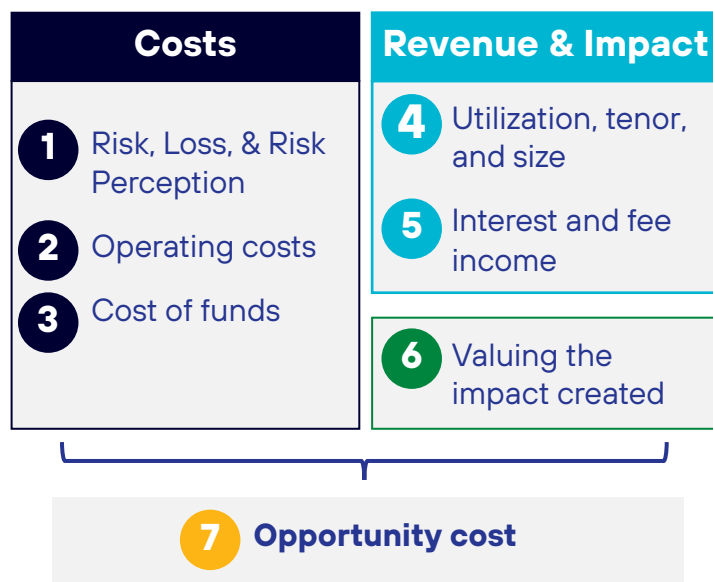


Re-balancing the scale with impact

By valuing the social and environmental impact generated by agri-SMEs lending and compensating lenders for the risks and costs of making these loans, we can increase capital flows and unlock substantial impact on farmer and worker livelihoods, food security, gender inclusion, and climate resilience.



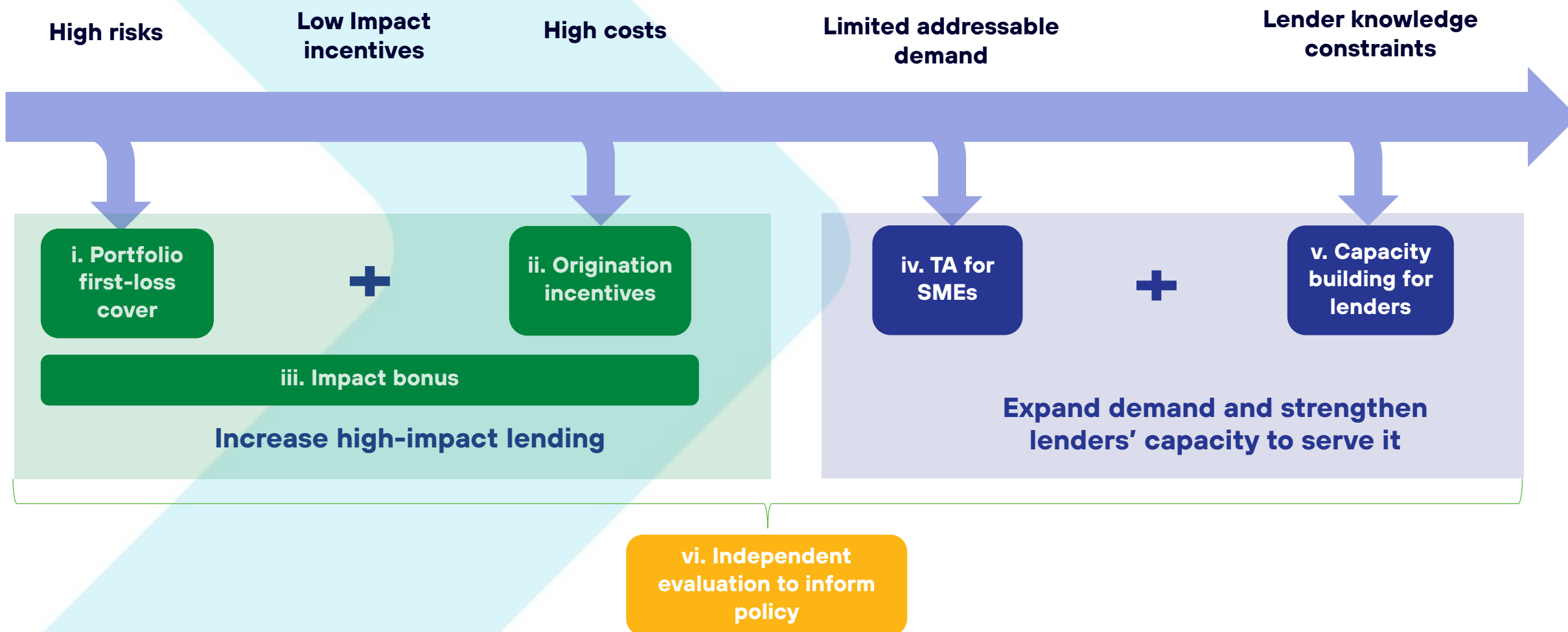
Multiple challenges combine to make the economics of lending to agricultural SMEs unattractive



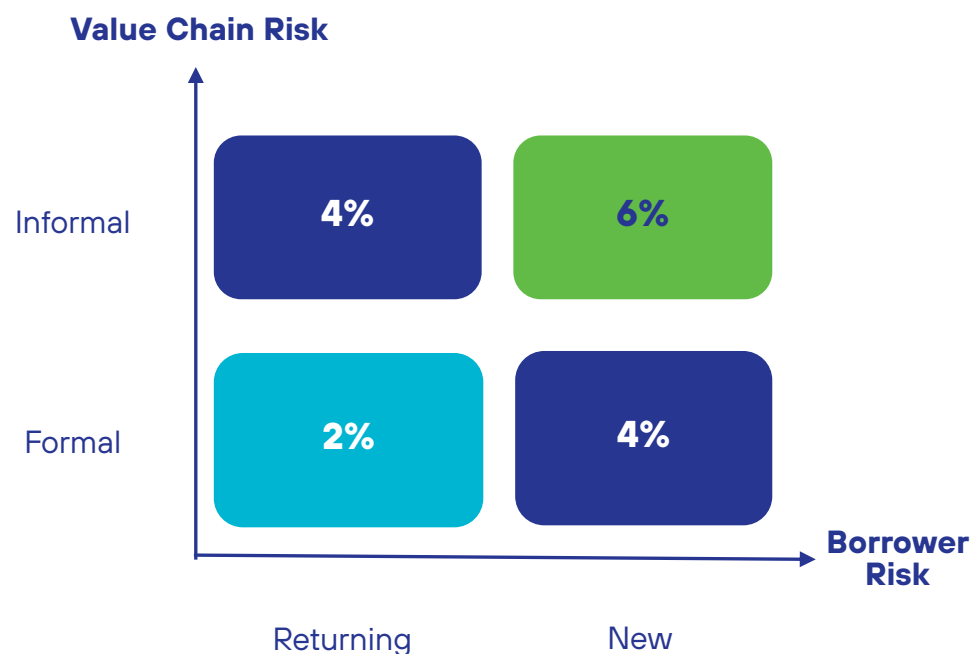
Key findings on profitability drivers from our research into agri-SME lending

- 1** Lending to agri-SMEs compounds the high inherent risks of agriculture with the informality of SMEs. As a result, lenders experience relatively high losses and often face pressure from their leadership and investors to limit exposure to the sector
- 2** Agricultural borrowers are more expensive to reach, especially for lenders with limited local presence; the cost of assessing new value chains or new borrowers is even higher
- 3** Banks and social lenders have access to relatively low-cost funding so capital providers would need to accept returns close to 0% to shift their lending economics; innovative non-bank lenders focused on smaller loans struggle with high funding costs but capital providers would need to be comfortable with additional risk and/or currency exposure
- 4** Due to the nature of loan economics (where there are significant fixed costs and revenues are linked to loan size, term, and price), lending to smaller borrowers or those with only short-term, seasonal needs is especially unprofitable
- 5** Revenues are rarely sufficient to provide a comfortable lending margin, and raising interest rates further would cause difficulties for borrowers
- 6** Many agri-SMEs are at the center of complex webs of interaction; increasing their ability to grow has positive spillover effects on livelihoods and food security, among others – but lenders cannot capture this value today so are not taking these benefits into account in their strategies
- 7** While banks have significant ability to mobilize funding for agriculture, they also face the biggest opportunity costs given the profitability of African banking overall (i.e., non-agriculture lending). Similarly, innovators are attracted to other markets with lower barriers to entry and higher returns, perpetuating the unattractive economics for agri-SME lending

Aceli Africa addresses these challenges with solutions tailored to the least served segments of the market



First-loss guarantee (% awarded per loan)



In addition to the amounts shown here, lenders can earn **up to an additional 2%** through this mechanism for certain high-impact loans to help ensure that impact is “part of the equation” for lenders evaluating potential borrowers

How first-loss protection works

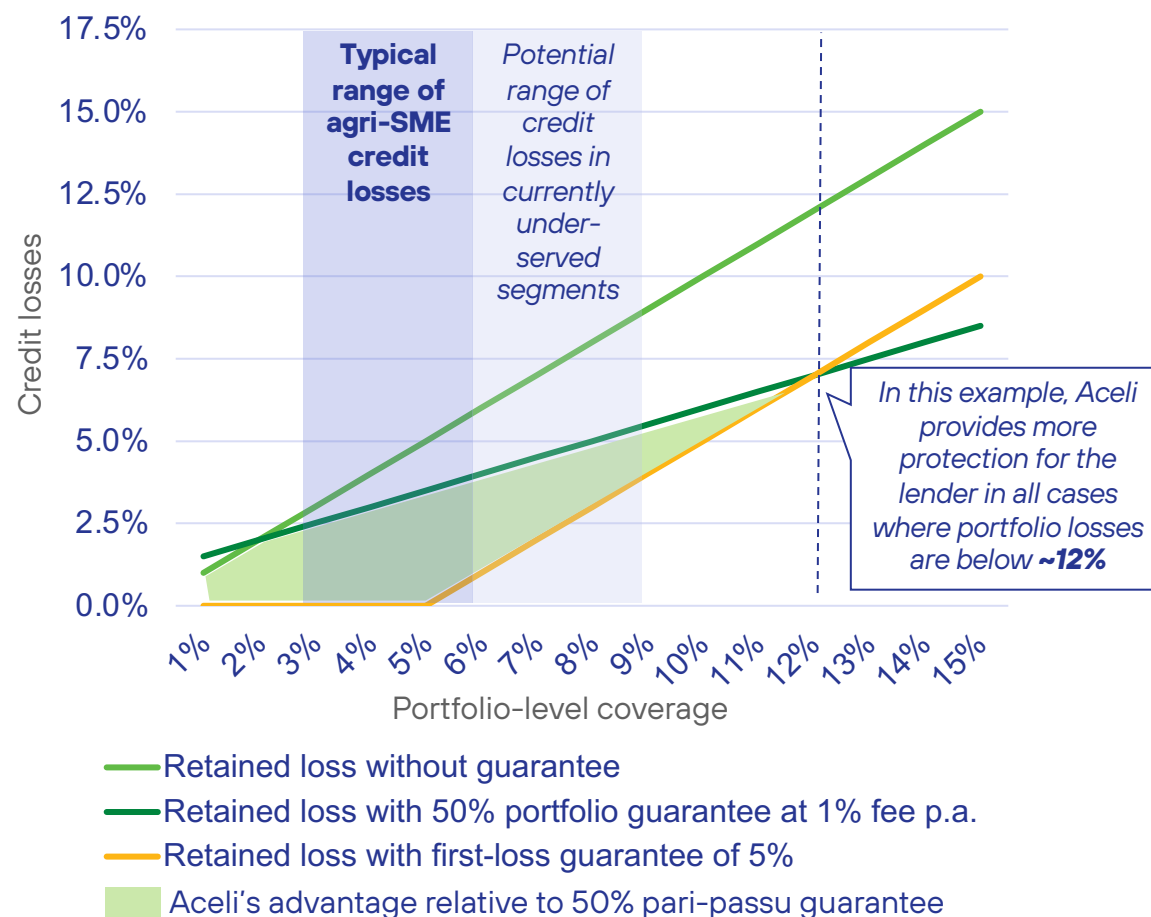
- Lender makes a qualifying loan between \$25K-\$1.5m
- Aceli makes an **upfront deposit** into the lender’s reserve account
- The upfront deposit ranges from **2-6% of the disbursed loan amount**, depending on the borrower type: more coverage is provided for a new borrower and for one operating in an informal value chain (as data indicates that these are higher risk)
- Lender’s reserve account **builds up with each loan**; lender can draw on reserve as a first-loss loss cover for **any losses of loan principal from the portfolio of loans** registered in its account

Loan example: Loan of \$100k to coffee cooperative (formal, new borrower) qualifies for 4% coverage = \$4K

Portfolio example: \$10m with avg coverage of 4%. The lender builds up a reserve of \$400K that can be drawn as first loss in event of any losses in portfolio of qualifying loans.

Portfolio first-loss coverage is more advantageous than partial credit risk guarantee for the typical agri-SME loss range

Comparison of lender retained portfolio-level losses

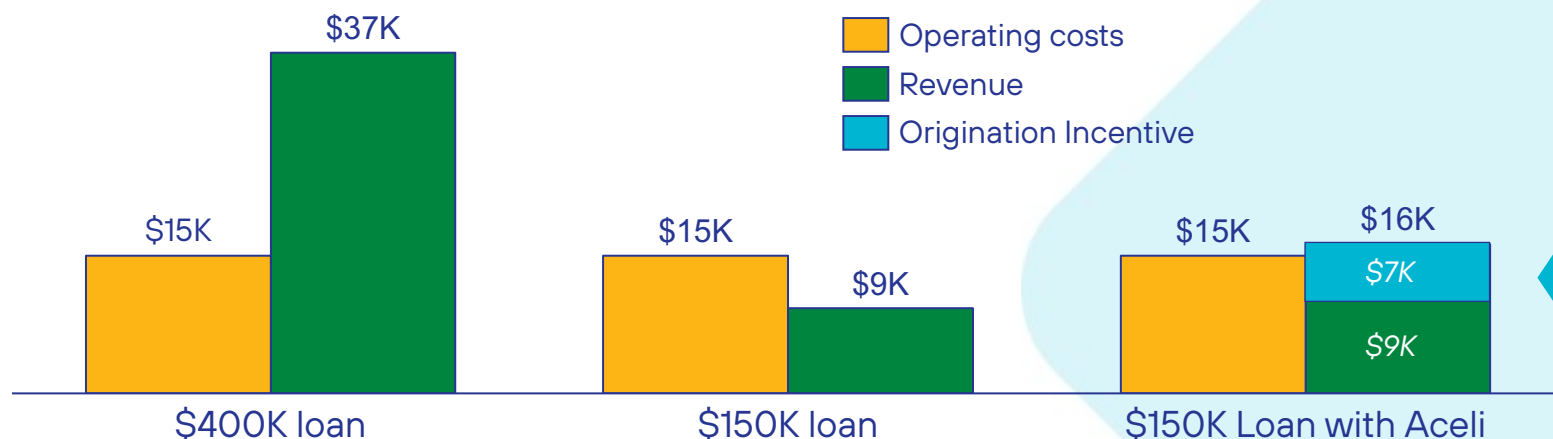


- **Partial credit guarantee schemes** usually **cover 50%** of a specific loan portfolio's or individual loans' losses after recovery
- While these schemes are effective in reducing net losses, they **don't** necessarily incentivize lenders to expand their reach to higher-risk but also high-impact segments, such as new borrowers in informal value chains or higher ticket sizes
- Current guarantee schemes also come with **fees that further impacts loan profitability**:
 - Upfront fees vary between 0-3%
 - Annual commissions are between 0.5-2% of the guaranteed amount
- Within the typical range of agri-SME credit losses (3 to 6%), **first-loss protection is stronger than a partial credit risk guarantee**

Cost: Origination incentives increase returns by compensating for higher per-loan operating costs for smaller loans

Costs vs revenue for 1-year working capital loans made by a more efficient¹ bank

Aceli is the first program to offer tailored “origination incentives” aimed at the \$25k-500k segment



1

For large loans, revenue comfortably exceeds costs, even for shorter-term loans

2

But at small sizes, revenue fall short of costs even among more efficient lenders, creating a disincentive to serve new & smaller borrowers

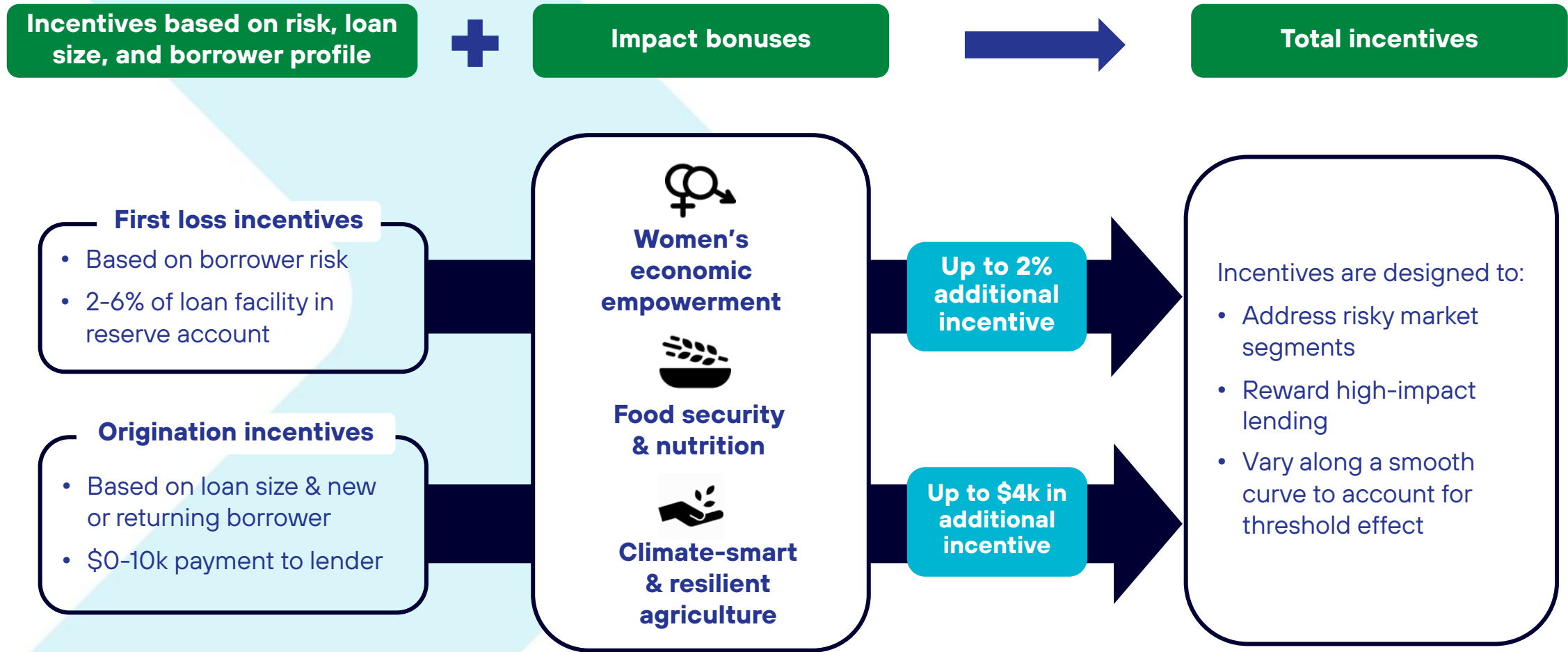
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Aceli origination incentives, provide additional revenue to make smaller loans more attractive

- Aceli provides **up to \$6K in origination incentives** for returning borrowers
- This is raised to **\$10K for new borrowers**, to compensate for higher costs²
- Incentive levels are fixed for all lenders, **creating a level playing field that attracts competition and rewards efficiency**
- Lenders can earn **up to an additional \$4K** for high-impact loans (see next slide), lowering the break-even size even further
- **Incentive levels are adjusted down** as the market becomes more efficient

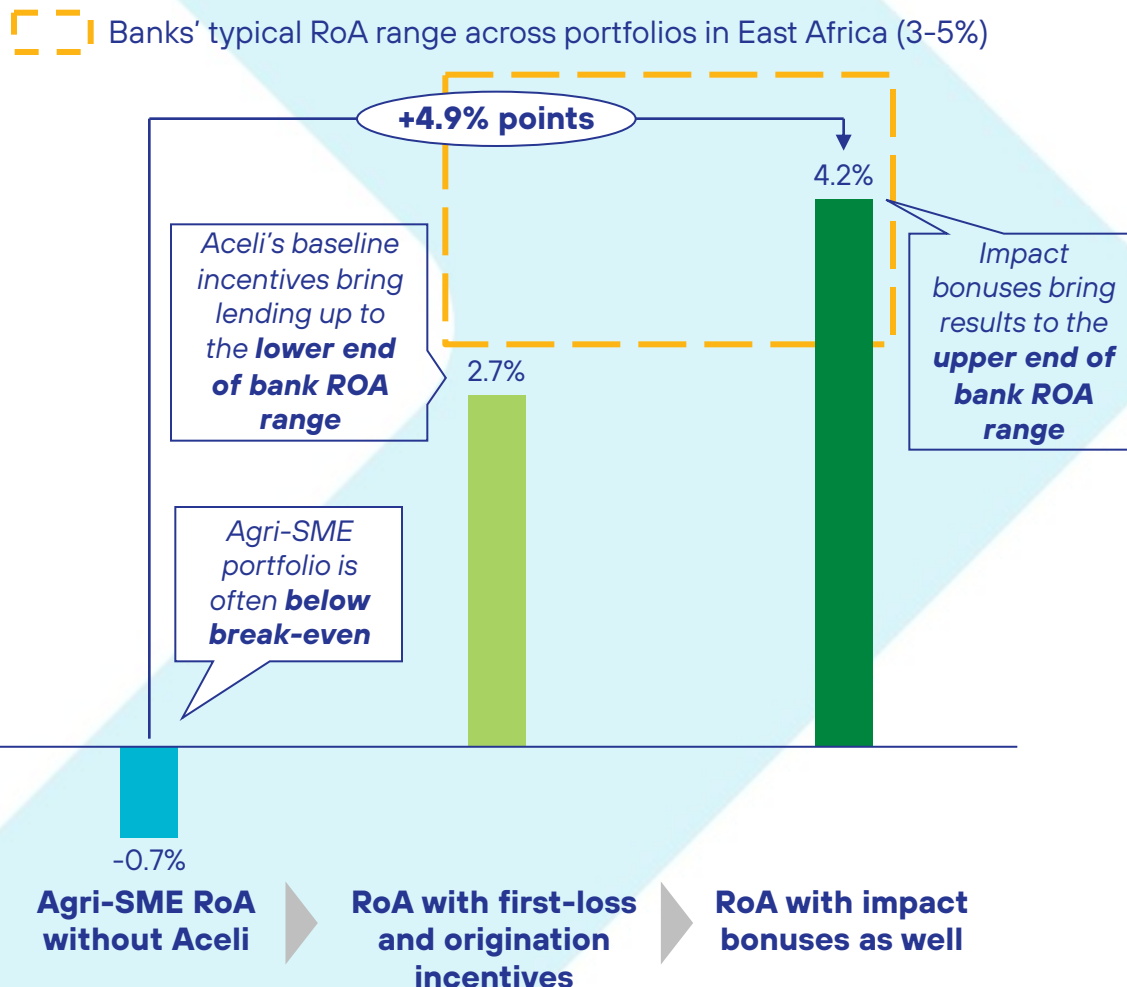
1. I.e. for a bank at the 75th percentile of annualized operating costs in our dataset. 2. For example, in our cost-allocation exercise, social lenders reported up to 50% higher origination costs, due to the need for in-person visits and more research to understand the dynamics in a new value chain or market

iii Impact bonuses incentivize lenders to seek high-impact borrowers



Aceli's solutions bring agri-SME lending risk-returns closer to other sectors

Agri-SME portfolio loan economics pre- and post-Aceli incentives (% return on assets, annualized)



RoA is 3.5 points higher with the Aceli portfolio first-loss coverage and origination incentive (but before impact bonuses) and is close to typical bank-wide RoAs in East Africa

If the loan meets all three impact criteria, RoA is **~5 points higher than without Aceli funding**, bringing results in line with more profitable bank lending

Aceli will also build capacity for both lenders and SMEs to bridge the financing gap

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Technical Assistance for Agri-SMEs

- **Pre- and post-investment stage TA** focused on **business and financial management** so more agri-SMEs can access and manage financing
- First program launching in October targeting agri-SMEs with revenues in \$50k-500k range: six-month, fully online program in partnership with Africa Management Institute
- Other TA programs to be launched in 2021 both for agri-SMEs in the \$50k-500k revenue size and large SMEs
- Approach includes referrals from lenders, value chain development programs, and other ecosystem actors; coordination between TA and lenders; cost-share with agri-SMEs

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Capacity Building for Lenders (*under development*)

- Objective to **increase staff expertise, tailor product offering** to agri-SME needs, and **improve systems and processes** for agri-SME lending
- Considering mix of **standardized training for front-line loan officers** and more **custom training for managers and key staff** in other units (e.g., risk, treasury, senior management) that inter-face with agri-units and make decisions re: strategy and capital allocation
- In addition, may offer cost-share for strategic engagements focused on **change management** to build culture and processes to grow agri-SME lending at institutional level

Independent evaluation by expert data & learning partners to build evidence base and inform policy engagement

Aceli seeks to **build the evidence base for scaling up Aceli-like product offerings** in East Africa and across the continent, and has established partnerships with three leaders in their respective fields:

Dalberg

- Mission-driven strategic advisory firm focused on emerging and frontier markets
- Performs **financial benchmarking of loan- and portfolio-level economics** to inform calibration of Aceli financial incentives



- Research center based at LSE whose aim is to promote sustainable growth in Africa & South Asia by providing demand-led policy advice based on frontier research
- **Evaluates impact of Aceli's financial incentives for lenders and TA for SMEs** on enterprise growth and farmer & employee livelihoods
- Engages policymakers on findings to promote stronger enabling environment for agri-SME finance, including long-term support of Aceli-like product offerings



- Housed at Accion as a unit within the Center for Financial Inclusion, MIX's catalytic data initiatives encourage the growth of inclusive markets and support informed thinking on the future of financial services
- Creates a **data platform with aggregated & anonymized lending & financial performance** data to support market growth

Aceli is supported by leading donors

The funders shown below have contributed to the design and implementation of Aceli Africa. We look forward to more partners joining to support implementation.



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