devex
Do Good. Do It Well.™

Global Views
Development Finance

Opinion: How blended finance can catalyze private capital for agriculture

It will take billions of dollars annually to end hunger. Government aid and development funding aren't enough — which is where blended finance can come in to crowd in private dollars.

*By **Federica de Gaetano**, **Bruce Campbell** // 01 October 2024*

Farmers prepare to transport bags of rice in Mwea, Kenya. Photo by: Thomas Mukoya / Reuters

Current levels of government aid aren't enough to achieve Sustainable Development Goal 2: zero hunger by 2030. Aid budgets are stretched thin and are unlikely to grow. This is why governments and development agencies need to maximize the impact of their available resources to attract commercial capital — and here's how blended finance can work towards that goal.

How much will it cost to end hunger? According to the latest figures from the University of Bonn's Centre for Development Research, it will take an estimated $27 billion annually over the next six years, from 2025 to 2030, to bring 500 million people out of hunger.

The United Nations, in its flagship food security report, estimated that hunger affected 733 million people worldwide in 2023. This number has risen sharply since 2019, as we face the fallout from geopolitical conflicts, the COVID-19 pandemic, worsening climate conditions, and economic downturn.

The agriculture sector, particularly in low- and middle-income countries, faces high risks that deter commercial capital. This raises a pressing question: How can governments and development agencies make their aid more catalytic to encourage development finance institutions and private sector investments in agriculture in LMICs?

Blended finance, which combines public and private sector funds to leverage additional investment, is a promising approach gaining traction. It uses concessional finance, such as grants or below-market-rate loans, to spur private investment with a positive impact on sustainable development.

According to a recently published report by the Global Donor Platform for Rural Development, or GDPRD, and the Shamba Centre for Food & Climate, noteworthy innovations are taking place across blended funds and instruments. Encouragingly, development financial institutions and donor governments are indicating a readiness to embrace these innovative financing mechanisms. The rise of climate finance, as witnessed at the United Nations Climate Change Conference, may serve as an impetus for more blended finance in the coming years.

The question is: How can we make this happen?

1. Invest in the missing middle

One critical area for intervention is the so-called missing middle – the small- and medium-sized enterprises, or SMEs, in the agriculture and food sectors.

These SMEs face an estimated financing shortfall of $106 billion annually across sub-Saharan Africa and Southeast Asia. Typically, their financing needs are too large for micro-finance institutions, yet too small for commercial banks. Furthermore, those SMEs serving domestic markets in local currencies struggle to attract international impact investors, who prefer contracts in hard currency.

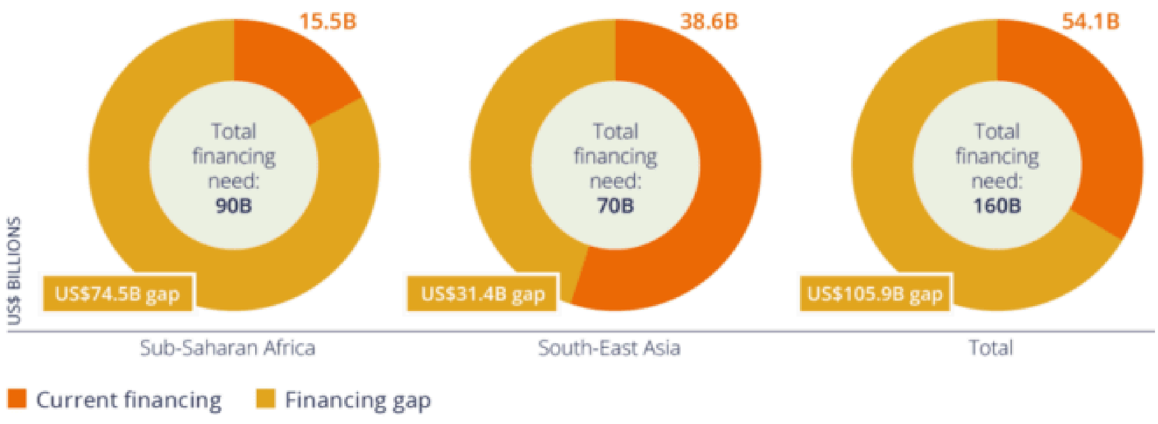


Chart: Lysiane Lefebvre. *Source:* ISF Advisors, 2022

The agrifood SME financing gap across sub-Saharan Africa and Southeast Asia is estimated at $106 billion (66% of total financing need) annually.

Local investors, with their extensive networks and specialized expertise, are well-positioned to reach these SMEs. However, they need incentives. Aceli Africa, a market incentive facility, is an example of how blended finance can provide such incentives to domestic lenders. The results are impressive: Aceli has supported 1,867 loans totaling $173 million to SMEs which have, in turn, created market access for 990,000 smallholder farmers and employed 33,000 full-time workers.

2. Enable DFIs to take more risk

Development finance institutions are governed by prudential rules and statutes that prevent them from lending to high-risk projects. They hold high investment-grade credit ratings that discourage excessive risk-taking. As the food and agriculture sector is characteristic of higher risk and tends to offer lower financial returns than other sectors, DFIs often hesitate to participate.

For this reason, DFIs would benefit from dedicated funds that would allow them to take higher-risk loans with defined targets on sustainable food and agriculture. If they can take a first loss in financing, more concessional finance will be available to mobilize commercial finance. As a result, the overall pool of development finance would significantly increase.

3. Share data and knowledge

To scale lending and blending, research and data about loans provided to agrifood SMEs are needed. Donor governments need to be able to compare their own portfolios with others, including DFIs. The current lack of comparable data impedes transparency and the development of market insights critical for building inclusive markets.

One of the recommendations in the GDPRD and Shamba Centre report calls for a multidonor working group to share data and knowledge, collaborate on cofinancing opportunities, and advocate for increased blending mechanisms in agriculture and rural development. Heeding this call, GDPRD established, in March 2024, the Thematic Working Group on Sustainable/Blended Finance for Food Systems to provide donors with a forum for sharing information about where to take risks and what financial instruments work best.

The case for additionality

Every dollar of concessional finance has the potential to mobilize four dollars of commercial finance. However, leverage ratios, which are a measurement of this mobilization, should be used with caution as they do not guarantee successful development outcomes.

The concept of additionality suggests that concessional financing should only be allocated to projects that would not otherwise be implemented without such support. Whether those four dollars deliver a sustainable development impact will determine if blended finance brings additionality.

Uncertainties around the additionality and opportunity costs of blended finance could hamper further investment. For this reason, leverage ratios must be accompanied by a comprehensive approach that considers additionality – that is, the alignment with development goals to ensure that the desired positive outcomes for development are achieved without distorting markets.

A window of opportunity

We cannot overlook the fact that long-term official development aid has created the foundations for blended finance. These grants support agrifood SMEs as they survive, learn, and mature to the level where they may eventually benefit from blended financing. They have created the conditions to enable SMEs and farmer organizations to reach the next level of growth and innovation.

Bold decisions are paramount to making agrifood development finance more affordable and accessible. As global food crises persist, it is imperative to use government aid strategically to catalyze additional investment. This approach promises to transform agrifood development finance, making it a potent tool for eradicating hunger and fostering sustainable development in low- and middle-income countries.

Editor's note: *The views expressed in this opinion piece are solely those of the authors and do not necessarily reflect the official policies or positions of any affiliated organizations.*

More reading:

► Opinion: What additionality brings to blended finance

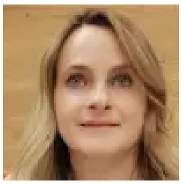
► Opinion: How blended finance at country level can deliver on the SDGs

► Can this new blended finance model work for conservation goals?

Agriculture & Rural Development | Banking & Finance | Funding | Private Sector | United Nations (UN)

The views in this opinion piece do not necessarily reflect Devex's editorial views.

About the authors



Federica de Gaetano

Federica de Gaetano joined the Italian Agency for Development Cooperation, or AICS, in 2020 as food security project officer. She is a focal point for food security, contributing to international working groups. Prior to AICS, she worked for the Italian Ministry of Agriculture, Food, and Forest Politics, and the European Commission. She holds a Ph.D. in chemical engineering and a master's in food law. She is also a co-chair of the Global Donor Platform for Rural Development.

Bruce Campbell

Bruce Campbell is the senior policy advisor at the food systems section of the Swiss Agency for Development and Cooperation, SDC, and the focal point of the SDC Agriculture and Food Systems Network. He previously worked for the Swiss Permanent Mission to the U.N. organizations in Rome, Italy. He has an academic background in rural engineering, international development, and conflict analysis. He is also a co-chair of the Global Donor Platform for Rural Development.