CASE STUDY

Published November 2021

Aceli Africa: Incentivizing Lending to Underserved Agri-SMEs

*Delivering a **just rural transition** by incentivising capital markets to better serve agri-SMEs - the engines of prosperous rural economies*

Just Rural Transition

supported by

wbcsd

MERIDIAN INSTITUTE

An Incentive Scheme for Agri-SME Lending by Aceli Africa

A data-driven, marketplace approach to mobilize private sector lending

Location

East Africa

Context

Agricultural Small and Medium Sized Enterprises (agri-SMEs) in East Africa are unable to access the finance they need to grow their businesses, despite accounting for 70% of the region's workforce and holding a key role in supply chain resilience. Agriculture in Africa faces a sector-wide USD $180 billion annual financing gap, with a USD $65 billion gap existing just for agri-SMEs, which fall into a missing middle of capital markets, where loans between USD $25,000 - USD $500,000 are too large for microcredit providers, but have overheads too costly and risks too high to qualify for commercial bank loans.

Challenge

When credit providers consider lending to agri-SMEs, risk is consistently the biggest barrier. Aceli's analysis has highlighted that banks incur twice as much risk when lending to agri-SMEs compared to other sectors.

This is compounded by the high operational and administrative costs related to the rural setting of many agri-SMEs, which mean that banks receive returns on agri-SME lending portfolios that are typically 4-5% lower than in other sectors.

This results in a substantial financing gap across the agri-SME sector.

> **"To create attractive 'pull' mechanisms for lenders to meet the financing needs of agricultural SMEs, risk and return constraints must be addressed to overcome decades of inertia."**
>
> Aceli Africa's Statement of Approach

Solution

To bridge this financing gap, Aceli Africa takes an innovative approach to mitigating risk for lenders. Based on extensive data on the loan-level and portfolio-level economics of agri-SME lending in East Africa, Aceli offers first-loss cover at a portfolio level (a partial insurance on loans covering potential defaults up to a pre-agreed amount) to credit providers willing to lend to the 'missing middle

By providing this partial insurance against default, Aceli removes a portion of the significant financial risk posed by lending to agri-SMEs. The level of first-loss coverage available to a lender accumulates with each loan they provide, incentivising them to increase their lending to under-served enterprises.

Just Rural Transition

To address the unattractiveness of lending to agri-SMEs relative to other sectors, Aceli also compensates lenders for the lower revenues they receive when making smaller loans to early-stage SMEs. Payments range from USD $2,000 - USD $10,000 per loan, and allow lenders to earn a reasonable return on small-ticket loans without increasing interest rates or fees for SME borrowers.

In this way, both lenders and borrowers directly benefit from Aceli's work in reducing friction in agri-SME capital markets.

> **"Aceli's original dataset optimises the donor funding required to unlock private capital for impact today, while building a more competitive and efficient market for tomorrow."**
>
> Aceli Africa's Impact Statement

Impact

Under its initial 2020 - 2025 workplan, Aceli aims to mobilize USD $600 million of private sector investment in agriculture, with each dollar provided by donors generating at least three dollars for smallholders and enterprise workers. In their first year of operations, 203 loans were offered to SMEs, purchasing from 241,000 farmers and employing 3600 full-time workers.

All loans meet minimum social impact criteria, and lenders are incentivized to make high impact loans through a bonus system which offers higher first-loss coverage and cash incentives for loans to first-time borrowers and businesses that are gender inclusive, strengthen food security in Africa, or practice climate-smart agriculture.

Aceli's approach catalyzes a more competitive and efficient market for investing in agriculture, while developing the track-record of the local agribusiness sector to make it a more attractive investment opportunity. They hope to demonstrate a replicable model that governments could adopt as part of a stronger enabling environment for a just rural transition.

> **"A thriving finance market for agricultural SMEs will nurture profitable businesses that pay taxes, generate export earnings, reduce the need for food imports, and increase cash circulating in rural economies."**
>
> Aceli Africa's Vision for Impact

Photo by: CIFOR - www.flickr.com/photos/cifor

Just Rural Transition