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Incentivising Lenders: The Case of the Catalytic Market Facility Aceli Africa (Aceli)

Case study

Snapshot

Aceli Africa (Aceli thereafter) provides support and smart incentives to commercial lenders and impact investors to finance high-impact low-profit agri-enterprises in Africa that would otherwise not be served by financial institutions due to risk and profitability concerns.

Background

Agri-enterprises play a critical role in agricultural value chains and thus contribute significantly to employment, prosperity, and sustainable economic development. The growth and impact of these important players, however, is constrained by a lack of access to capital due to several factors such as higher (perceived) risk, higher transaction costs, lower profitability, the short term decision making horizon of many financial institutions, and opportunity costs for financial institutions given high profit margins in other market segments.

Format

Aceli aims at incentivising capital suppliers to provide more finance to high-impact agri-enterprises than what these lenders would otherwise be prepared to finance given risk and profitability concerns. In that way, Aceli seeks to positively impact livelihoods of farmers, workers, and their communities as well as the local environment. Ultimately, Aceli aims at creating a more effective and inclusive marketplace for high-impact agriculture finance in Africa that will be adopted by governments locally and become sustainable and independent of donor funding in the long term. Aceli adapts a financing innovation that has been co-created by the Swiss Agency for Development and Cooperation (SDC) for social and impact enterprise finance, the so-called Social Impact Incentives (SIINC), to the new context of agricultural lending in Africa.

Aceli has been set up as an US non-profit entity under the Global Development Incubator (GDI). The GDI receives grant funding from bilateral development agencies and philanthropic donors. The grant funding is then deployed in the form of three different kinds of incentive payments, technical assistance, capacity building as well as innovation support to both lenders and borrowers. SDC remains an anchor funder since it has provided start-up funding to the newly established platform in 2020 and continues to play an important role in the platform's governance body together with other donors.

Benefits / Results

Not only are innovative incentives designed in a smart way to mobilise and direct financial capital to high-impact borrowers, but they also contribute to aid effectiveness and enhance "value for money" of scarce public and philanthropic funding. The initial results after the first year in operation are promising: Aceli leveraged 12 times the capital invested while exceeding all its impact performance targets to adequately channel suitable finance to the high-impact borrower segment.

Outlook

The catalytic platform model could be adopted and replicated in other regions and sectors (health, education, off-grid, etc.) and/or applied to venture capital firms and financing institutions other than agricultural lenders. In that way, the platform would scale up its contribution to improved livelihoods and landscapes to build prosperous economies in many other developing countries in Africa and beyond.

1. Context

This case describes a catalytic platform, Aceli Africa (Aceli thereafter) that provides support and smart incentives to commercial lenders and impact investors to finance high-impact low-profit agri-enterprises in Africa. The platform constitutes a paradigm shift from traditional development interventions in a number of ways:

- From donors providing direct funding to high-impact organisations – often non-profits – to encouraging the market to finance high-impact enterprises via an intermediary platform.
- From traditional donor full cost project funding to the smart design of data-based incentives with a view to effectively mobilise, influence, and shift the behaviour of market players while minimising the use of scarce donor funding (maximum additionality, minimal concessionality).
- From mobilising international investors to mobilising local investors and strengthening local capital markets for impact.

2. Challenge

In Africa, as in most developing regions, small and medium sized agri-enterprises are the backbone of agricultural value chains. They link low-income smallholder farmers to markets and provide them with much needed support, technology, and/or financing. In that way, they improve livelihoods for smallholder farmers, create employment for low-skilled workers, women, and youth, enhance prosperity in remote areas, and are key to a country's growth and its transition to a climate smart and resilient agriculture.

Yet, despite the critical role of the agricultural sector and agri-enterprises in particular in developing countries' economies, the growth and impact of these important players is constrained by a lack of access to capital. In fact, the financing gap in this sector is currently estimated at USD 65 billion across Sub-Saharan Africa alone.[1]

What keeps financiers away from agri-enterprises? There are a number of factors that make it unattractive for commercial lenders to provide the amount and type of capital agri-enterprises need:

- **Risk**
  Financial institutions struggle with higher (perceived and actual) risks that are inherent to the agricultural sector such as weather and climate conditions, diseases, or price volatility.

- **Cost**
  The costs of lending are significantly higher than in any other sector, as agricultural borrowers are more expensive to reach, especially those in remote areas or first time borrowers.

- **Low profits**
  The combination of higher costs, smaller loan sizes, shorter terms, and lower interest rates makes that lending to agri-enterprises often generates insufficient income to be profitable.

- **Short term horizon**
  While the growth of agri-enterprises has positive spill-over effects on livelihoods, food security and regional prosperity, thus ultimately increasing economic opportunities for lenders in the medium to long term, commercial lenders do not take such long-term economic returns into account in today's investment decisions.

- **Opportunity costs**
  Due to a lack of competition in many African countries, financial service providers earn some of the highest profit margins globally. By lending to less profitable agri-enterprises, financial institutions forego the opportunity to realise these higher returns for at least part of their financing portfolio.

To respond to above challenges, preparations to design and set up Aceli were initiated in 2017 by an alliance of social impact lenders. They were all members of the Council on Smallholder Agricultural Finance ("CSAF"), an alliance that promotes best practices for financing agri-enterprises. After extensive research on the economics of agricultural lending to inform Aceli's incentives and support offer, the platform has been incubated by the Global Development Incubator with support from the IKEA Foundation and the blended-finance platform Convergence. The Swiss Agency for Development and Cooperation (SDC) with the IKEA Foundation and USAID were the first institutions that committed funding to the newly established platform in 2020 and SDC continues to play an important role in Aceli's governance bodies.

[1] Dalberg, KfW (2018).

3. Format

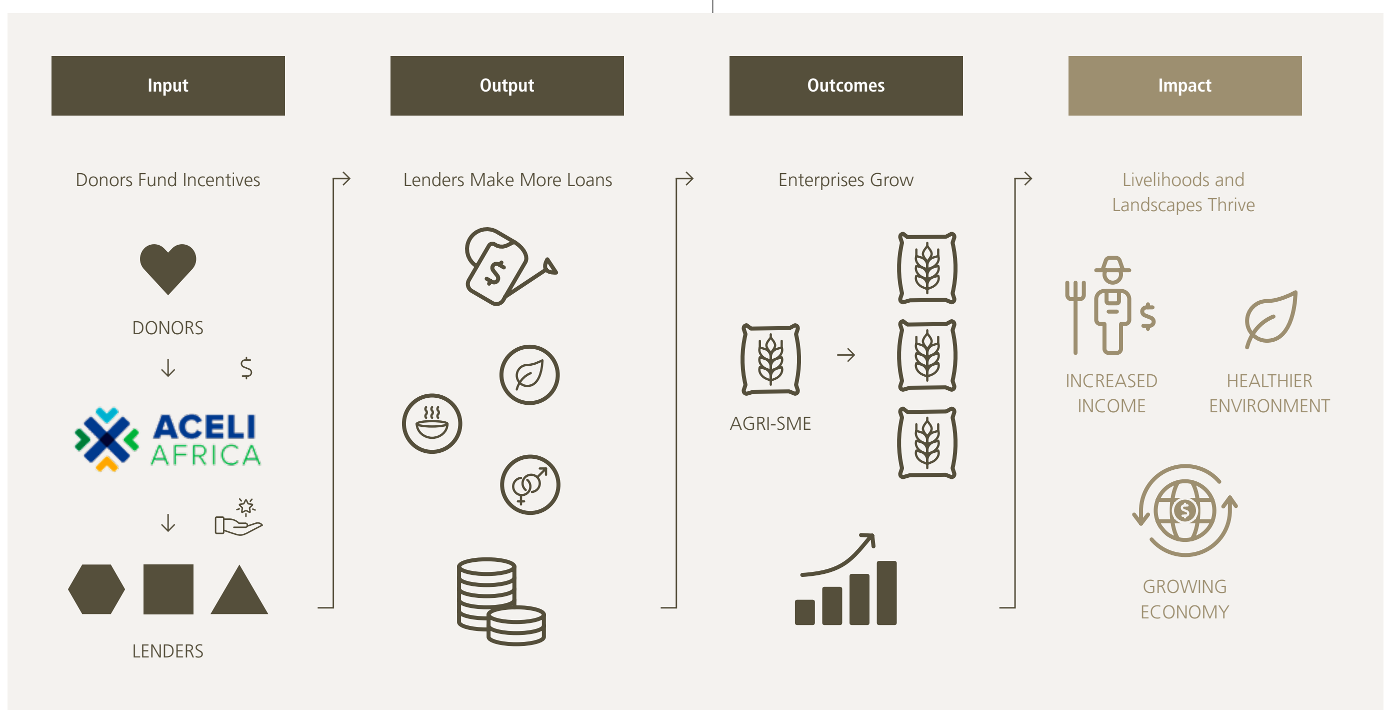
Objectives

Aceli uses public and philanthropic grant funding to incentivise international and local financial institutions to make more loans to high-impact small and medium enterprises (SMEs) than what these lenders would otherwise be prepared to finance given risk and profitability concerns. Aceli adapts a financing innovation that has been co-created by the Swiss Agency for Development and Cooperation (SDC) for social and impact enterprise finance, the so-called Social Impact Incentives (SIINC), to the new context of agricultural lending in Africa.

Aceli also supports capacity building for borrowers to ensure they can repay the loans. Furthermore, it provides technical assistance to lenders to adjust their financing products to the specific needs of the agri-enterprise market segment. The combination of incentives and support to both agri-enterprises and financial institutions is expected to result in the financial sustainability and growth of agri-enterprises, which again positively impacts farmers', workers' and the community's income and livelihoods, the environment, and thus ultimately economic growth (Figure 1).

In the long run, Aceli aims at creating a more effective marketplace between the supply and demand side of capital in a given country. It is expected that as borrowers strengthen their business operations thanks to the financing received, some may eventually not need incentivised lending anymore and would then be able to access finance at market terms. On the other hand, it is recognised that others may still require continued but reduced support as loan sizes will increase and risks as well as costs of lending will be reduced over time. In the long-term, the expectation is that policymakers and government agencies in Africa (and elsewhere) adopt Aceli's approach on a larger scale after the platform's founding and anchor donors decide to exit.

Figure 1. Aceli's intervention logic
Source: Aceli Africa (2021b), p 8.



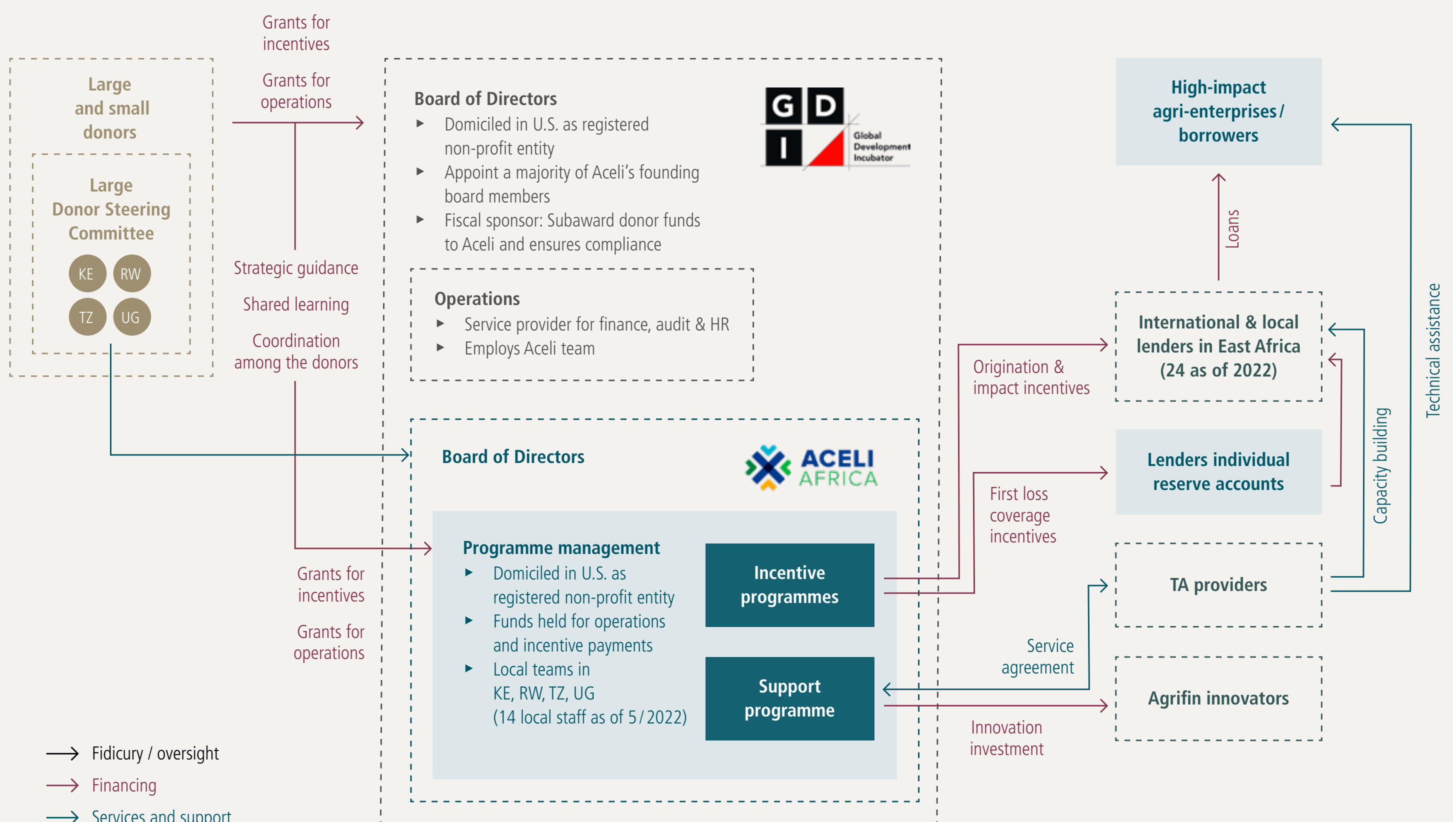
Institutional set up

Aceli is housed at the Global Development Incubator (GDI), an independently registered U.S. nonprofit organization. GDI has three sole-member controlled entities, one of which is Aceli. Aceli is an official subsidiary of GDI and itself registered as independent non-profit organization in the U.S.

GDI has certain governance authorities such as the right to appoint a majority of the founding board members of Aceli. GDI's external audit is consolidated with the audit of Aceli and the other two controlled entities. Aceli receives finance, accounting, and operational support from GDI through a shared services agreement. GDI serves as a fiscal sponsor, i.e. GDI receives donor funds on behalf of Aceli and subawards these funds while exercising oversight and ensuring compliance commensurate with its responsibilities as a prime recipient of funds.

Aceli has its own board, but there is an intentional overlap between Aceli's and GDI's board members to ensure appropriate coordination and to streamline decision making. Aceli's Steering Committee is comprised of anchor funders that have committed funding above USD 10 million. The Steering Commitee provides strategic guidance and serves as a forum for shared learning and coordination among the donors. The Steering Committee currently consists of the Dutch Ministry of Foreign Affairs, the IKEA Foundation, SDC, UK FCDO, and USAID.

Figure 2. Aceli's institutional set up and financing flows
Source: based on Aceli Africa



Aceli's budget for 2020 to 2025 is USD 75 million, out of which more than 50 percent are used as financial incentives to unlock a multiple of additional private capital from lenders. Other program costs include support to agri-enterprises and lenders (around 17 percent), program management (around 15 percent), evaluation and learning (around 8 percent), and innovation (around 10 percent).

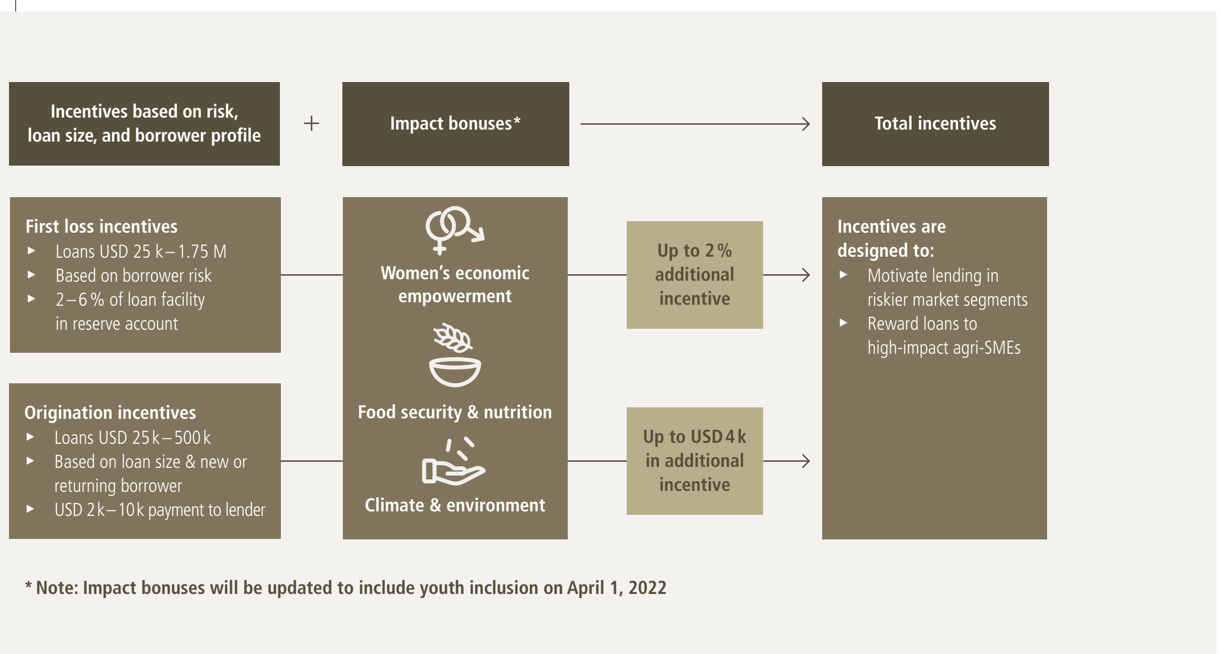
Key mechanism

At the core of Aceli is an incentive programme that provides risk mitigation incentives to encourage lending in more risky, new and underserved segments and revenue enhancement incentives to promote lending in high impact segments with low or negative profitability. Furthermore, a support programme strengthens the capacity of lenders and borrowers and promotes innovation.

There are three types of financial incentives: portfolio first loss coverage, origination incentives, and impact bonuses (see Figure 3):

- The portfolio first loss coverage covers some of the inherent risks for agricultural loans ranging from USD 25 k – USD 1,75 million. The size of the coverage depends on the borrower type and ranges from two to six percent. Higher coverage is provided for a new borrower and for one operating in an informal value chain for which borrower's risks are highest.
- Origination incentives top up lenders' revenues for smaller loans of USD 25 k – 500 k that would not otherwise generate sufficient revenues to cover the (transaction) costs of lending. Loans that qualify for origination incentives tend to be allocated to agri-enterprises in more remote regions or which operate in specific value chains, such as food crops that are sold locally for consumption.
- The platform offers impact bonuses for any loan that meets a higher standard in one of the predefined impact areas gender inclusion, food security & nutrition, and climate & environment. The impact bonuses can increase the incentive amounts by 30 – 50 percent potentially resulting in an additional two percent on top of the two – six percent baseline incentive for portfolio first loss and incentivise lenders to seek out and serve the highest-impact agri-enterprises.

Figure 3. Total incentives
Source: Aceli Africa (2021a)



If a loan qualifies for all three incentives, the return on asset can be approximately five percentage points higher than without Aceli's incentive programme, bringing financial returns of lending in line with more profitable bank lending performance despite higher risk and lower profitability.

In addition, Aceli provides for the following accompanying measures to support lenders, to reduce the risk of default, and increase the growth potential of agri-enterprises:

- Technical assistance for agri-enterprises to strengthen their financial management capacity to access and manage credit at both the pre- and post-investment stage.

- Capacity building for lenders to adapt their product offering, enhance their staff expertise, and improve their systems and processes so they are better suited for the agri-enterprise market.

- Innovation investments to promote technological and other business model improvements that drive down the costs of agri-enterprise lending, so the market becomes more competitive and requires less support in the medium-term.

4. Benefits, Insights and Results

Benefits

- **Designed for financial leverage**
  Aceli has been designed in a way to use concessional finance as effectively as possible to leverage additional commercial financing from financial institutions. The leverage target was set at 1:12 which means that for USD 1 of grant capital provided by donors, USD 12 of additional non-concessional capital would be mobilised by financial institutions that would otherwise not have engaged. There is the expectation of increasing the financial leverage to 1:18 in the next programme phase.

- **Focus on impact**
  Aceli measures its own success beyond the amount of additional private capital mobilised, namely in terms of the extent to which the additional financial resources will have supported enterprise growth and, in turn, resulted in improved livelihoods and landscapes to build prosperous rural economies.

- **Data based incentives**
  Comprehensive data collection informs the design and pricing of incentives to ensure that scarce donor funds are spent as effectively as possible and to achieve high capital leverage, additionality, and impact without distorting local markets.

- **Non-financial support**
  Financial incentives to lenders are embedded into accompanying measures that increase capacity of borrowers in accessing and managing finance, help lenders develop new products and adapt their product offerings, systems, processes, and call for financial innovations for specific challenges.

- **Positively influence market dynamics**
  Aceli has a strong theory of change on how incentives will mobilise local capital providers and positively influence the behaviour of capital providers, the growth of agri-enterprises, and the overall market dynamics to reduce dependence on concessional finance.

- **Encourage local adoption and replication**
  The programme aims at removing existing policy barriers to agri-enterprises lending and encourages government adoption of the incentive programme so that external donors can gradually exit from their catalytic engagement and grant making. Ideally, the experience of Aceli would also serve as a blueprint for applying a data-driven marketplace approach to mobilize increased capital and/or services to other high-impact, low-profitability sectors.

Insights

The first year of operations of Aceli already provided some important insights on the design and operations of Aceli:

- **Value of data**
  The Aceli platform and the design of its incentives benefited from a comprehensive data collection effort prior to its launch to understand (and quantify) the economics of agricultural lending and to inform the size and pricing of incentives. The effort made resulted in well-designed and targeted incentives with the ability to change the behaviour of lenders and increase capital for agri-enterprises without wasting scarce grant funding.

- **Value for money**
  Aceli links the value created, for example additional capital leveraged or income generated, to the full cost of the incentives and the amount of funding provided. In that way, it created much needed transparency in the international blended-finance debate on the value for money.

- **Clarity on trade-offs**
  The effectiveness of the incentives depends on using the above data with rigor and precision while recognising the limitations of available data and a certain level of uncertainty about how financial institutions would respond to highly targeted incentives. Indeed, there is a need to keep the incentive (and support) offering as simple as possible to ensure financial institutions' acceptance and effective communication with important stakeholders such as governments and funders.

- **Maturity of markets matters**
  When adopting the Aceli approach in a new geographical context, it is recommendable to ensure that there is a critical mass of both private financial institutions and suitable borrowers that have the capacity to apply to and absorb repayable finance to grow. These important preconditions may not exist in conflict or fragile states or in countries where state-owned banks predominate.

Results: Aceli platform

While long term performance data on behavioural change, entrepreneurial growth or impact is not yet available, a first review one year after Aceli's establishment in 2021 confirmed the fundamentals of Aceli's theory of change as follows:

- After one year, it partners with 24 financial institutions out of which more than half are domiciled in East Africa.
- Aceli has been able to mobilise twelve times the capital invested in incentives – USD 26.6 million in lending at a cost of USD 2.2 million in donor-funded incentives. This is significantly higher than the industry financial leverage benchmark of around four times.[2]
- The platform managed to incentivise both international and local lenders to significantly expand the number of loans to agri-enterprises.
- The platform outperformed on its additionality, inclusion, and impact targets and the performance anticipated at the design stage:
  - Almost half of the loans supported by Aceli's incentives went to first-time borrowers (vs. a pre-COVID target of 30 percent) – a segment that struggles in particular with access to finance.
  - The average loan size was smaller than expected (~ USD 130 k vs. USD 400 k) due to a high first-time borrower rate resulting in a need for higher incentives for capital mobilisation. This underscores that Aceli is indeed targeting a market segment that has not been served previously.
  - Aceli-supported finance also exceeded all of its targets for the impact bonus programme: 63 percent of Aceli-supported loans by far exceed the industry benchmark of a gender inclusive investment portfolio, more than half of the loans were directed towards SMEs that served local markets (54 percent compared to a target of 50 percent), and a projected 25 percent (compared to a target of 20 percent) of the loans qualified for Aceli's climate smart & resilient agriculture impact bonus.

[2] Aceli Africa (2021b). P 5. The leverage result, while very positive, has been slightly less than targeted due to higher than anticipated demand by borrowers that achieve high impact – as a result of which the leverage is lower.

Results: Lenders and borrowers

1. How has Aceli shifted the behaviour of lenders?

One of Aceli's partners, the SME Impact Fund Tanzania, shared the impact the Aceli programme had on their lending practices:

"By covering a portion of our operating costs and sharing the risk, Aceli's financial incentives have helped us to serve many new borrowers. And we have been able to make smaller loans: just in the past year, we have made eleven loans in the USD 25 k – 50 k range."

"In the future, we expect even more enrolment of our SMEs into Aceli's technical assistance program, which is crucial for both their success and ours. (…) Looking ahead, Aceli will be a game changer to make a real difference in the life of so many small and medium size entrepreneurs all around East Africa and an inspiration for the rest of the world!"[3]

Another partner of Aceli, Opportunity Bank Uganda, highlighted that the partnership with Aceli has:[4]

"(…) built our confidence to lend more to the SME agriculture finance segment including the riskiest stages of the agriculture value chain (…). Aceli also helped us to manage our liquidity through various interventions. (…) We believe that Aceli will greatly improve the lending culture by strengthening sustainability and impact considerations, help create more jobs for youth and women, and improve our data collection."

2. What has been the experience of the borrowers?

A borrower of the SME Impact Fund (SIF) – one of the financial institutions in Aceli's programme – reported that in the past, as an agribusiness it had been difficult to get loans from other lenders and if so, they had to obtain an expensive credit guarantee. The interviewee stressed that:

"(…) the loan from the SME Impact Fund had very positive outcomes as it enabled me to purchase enough stocks from many smallholder farmers and consequently my final product (rice) reached more markets."[5]

A borrower shared the benefits of borrowing money from another Aceli partner, Opportunity Bank Uganda:

"In the past, financing has often not been granted when I needed the money most: to purchase raw material at the time when prices are low. Normally, they give you money when it is off-season. Now interest rates are lower and turnaround times are much shorter and more predictable. (…) With the help of the loan, I have been able to invest in a refining machine, which has improved the quality of my oil and made me more independent of seasonal fluctuations." [6]

[3] Based on an interview in February 2022, with Allert. J. Mentink, Founder & CEO SME Impact Fund Tanzania.
[4] Based on an interview in February 2022, with Bonna Amo, Chief Relationship Officer of Opportunity Bank Uganda.
[5] Based on an interview conducted in February 2022, with a managing director of a Rice processor & trader in Morogoro Region in Tanzania.
[6] Based on an interview in January 2022, with a managing director of an oil processing enterprise in Lira District, Uganda.

5. Outlook

The Aceli platform is an innovative way of supporting and incentivising lenders to finance agri-enterprises by providing risk mitigation, enhanced revenue and technical assistance. Beyond generating tangible impact in terms of income increase of farmers and their families, better livelihoods, and the environment, Aceli works towards catalysing a more effective marketplace for high-impact and low-profit market segments. Additionally, it seeks to spur adoption and replication in other regions, sectors (health, education, off-grid, etc.), and/or to establish partnerships with other types of financial institutions.

Partnering with the same financial institutions in related areas, such as off grid energy, climate adaptation or forestry, would provide insights for other sectors. Furthermore, in a different programme similar incentives could be used to shift behaviour not just of lenders to agri-enterprises but also of equity providers investing in a range of impact business models.

If the model was to be applied to new markets, the following steps could be followed:

1. Identify high-impact, low-profitability sector or markets that are already attracting or have the potential to attract interest of public and philanthropy funders as well as commercial investors.

2. Thoroughly analyse the economics, current barriers, and capacity needs for generating targeted impact.

3. Design financial incentives based on data about the most relevant private actors' risk-return-impact strategies, motivation, and specific economics.

4. Communicate the new offer directly and via existing partners, mobilise international and local actors, and form partnerships to create a viable market place.

5. Shift market dynamics to ensure sustainability and local (government) adoption.

6. Additional Resources

(All accessed May 2022)

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