Towards a renaissance of agricultural development banks in sub-Saharan Africa?

While financial products and systems have been improved in many urban areas of the Global South, their provision is lagging behind severely in the rural regions. It has been estimated that an annual capital volume of more than 200 billion euros would be required alone for the modernisation of agriculture in sub-Saharan Africa. Our author argues that despite their chequered history, agricultural development banks have a major role to play in this context.

By Bastian Domke

In sub-Saharan Africa, agricultural development banks and financing facilities (AgFiFs; see Box) were largely introduced in the 1970s as an important way of promoting economic development, wealth creation and employment in rural regions. They were mostly government-owned and financed by governments and international donor organisations. However, apart from some of them being harnessed for political purposes and being caught up in nepotism and corruption, many of these institutions faced considerable problems such as a lack of distribution networks and a focus on the granting of credits without saving options being offered simultaneously. For this reason, most of them were not in an institutional position to generate the effects expected of them and thus achieve their founding purpose. As a result, many of these institutions were closed down and wound up, and from the late 1980s on, German development cooperation with them was largely dialled down or suspended.

Access to finance is a precondition for small entrepreneurs to invest in their activities and for securing their livelihoods and self-sufficiency.

Photo: GIZ Uganda

Over the past years, interest in international cooperation in this type of financing (smallholder) agriculture in sub-Saharan Africa has been rekindled. There are several reasons for this. For one thing, it has become apparent in this period that most other methods to finance smallholder farmers in rural areas in developing countries have been met with limited success; in addition, there has been hope of replicating the success these vehicles had in the rural development of many Asian and South American countries. Moreover, the notion has gained ground that these institutions were able to finance anti-cyclical investments in times of economic crisis.

Assessing the potential of AgFiFs

With its focus on Africa and the objective of the special initiative One World – No Hunger, launched in 2014, Germany's Federal Ministry for Economic Cooperation and Development (BMZ) has significantly extended its agricultural financing portfolio in the region. In 2020, it commissioned Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) to perform an analysis of the potential which promoting AgFiFs holds in several partner countries, namely Benin, Togo, Mali, Burkina Faso, Nigeria, Cameroon and Malawi. The analysis revealed that AgFiFs are widely accepted in their role and for their potential as catalysts promoting transformation, which they achieve by refinancing financial institutions or direct granting of credit via commercial banks or development banks, by credit guarantee mechanisms, or by hybrid forms such as the "*Mécanisme incitatif de financement Agricole*" (MIFA) in Togo and the "Nigeria Incentive-Based Risk Sharing System for Agricultural Lending". Furthermore, it has become clear that AgFiFs play an important role in achieving socioeconomic goals by supporting market areas regarded as unattractive by commercial banks such as remote rural areas, food staple crops as opposed to cash crops, etc.

> Access to finance is the precondition for smallholders as well as small enterprises to invest in their activities and, in addition to securing their own livelihoods and their self-sufficiency, for enabling production for the market and hence increasing both income and the scope for decision-making regarding their enterprises and lives.
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While both the data base and qualitative assessments of these institutions are incomplete, the analysis detected a certain renaissance of AgFiFs. This is reflected in governments as well as some donors, such as the International Fund for Agricultural Development (IFAD) or the African Development Bank (AfDB), again increasingly making use of public banks in agricultural financing, and sometimes even founding new ones. For example, since 2000, twenty AgFiFs have been newly established world-wide, including some in sub-Saharan Africa, such as Burkina Faso's *Banque Agricole Du Faso* (BADF). In this context, efforts have been made to adapt the intervention mechanisms, and above all observing due diligence, in the internal governance structures of institutions, to experience gathered in the region. Furthermore, good practices from Asian regions (particularly the Indian Subcontinent and South-East Asia (e.g. the Bank for Agriculture and Agricultural Cooperatives – BAAC – in Thailand) were taken into consideration. This applies e.g. to considering adequate governance structures, the key role of regulatory frameworks, decoupling of credit decisions from political influence and integration in overarching agricultural and innovation and transformation development strategies. All in all, the analysis has shown that some of the institutions in sub-Saharan Africa are pursuing a sustainable approach with sound governance structures and comprehensive transparency in rendering development-oriented financial services. While there are also positive examples of efforts to master the challenges of the past, a number of institutions have proven to be problematic as distribution mechanisms owing to warped incentives and a lack of transparency.

Government financing mechanisms offer potential to support the implementation of major international agendas, e.g. through financing climate projects addressing adaptation and mitigation and the corresponding transformation of the agricultural and food sector. In the medium and long term, however, this requires efforts to improve the structure, governance and implementability of the institutions involved. It makes sense to also ensure the participation of representatives from the microfinance and the financial sector in general as well as (in a closely controlled way) engaging the private sector in the supervisory committees or in preparatory steps in reforming or newly establishing AgFiFs.

A role to play in the global financial architecture?

Despite increased interest in debt and equity financing in larger agricultural enterprises from institutional and private investors on the one hand and the onset of Impact Investing Funds on the other, access to finance for smallholder farmers and micro-, small and medium-sized enterprises in most African countries remains a huge challenge. It stands to reason that pure market forces have not and will not bridge this gap by themselves in the foreseeable future. Much hope is still being placed into the blending of public and private funds aimed at reaching the United Nations' Sustainable Development Goals, but it seems unlikely that this will be successful if not channelled through financial intermediaries with a strong presence on the ground.

Especially for the successful last-mile delivery of financial services and meeting the needs of small and medium enterprises in the agri-food sector, in training and up-skilling smallholder farmers and their farmer organisations and increasing their business acumen, technical assistance plays a vital role. When donors finance AgFiFs, they are well-advised to accompany their debt or equity positions with tailor-made technical assistance aiming at the internal governance structures. Before supporting AgFiFs with either technical or financial assistance, their governance and functioning need to be thoroughly analysed with adequate due diligence. To this end, GIZ and the German Development Bank KfW have cooperated closely to create a guideline on how to engage with AgFiFs, which satisfies and builds strongly on GIZ and KfW due diligence processes.

The German development portfolio in agriculture, rural development and food security has significantly increased over the last decade, and given geopolitical realities due to Russia's war on Ukraine will continue to do so. After years of focus on technical innovations, new approaches of successful and sustainable transformation of agri-food systems are gaining traction. Here, financing via AgFiFs can make a crucial contribution. Successful cooperation with them requires careful consideration, preparation and a hands-on approach to accompanying long-term technical assistance, but their mandate and role in the financial ecosystem for financing agriculture in sub-Saharan Africa remain strong and relevant.

The investment requirements for the modernisation of agriculture in sub-Saharan Africa have been put at more than 200 billion euros annually.

Photo: GIZ Uganda

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AgFiFs

There are a wide variety of state-owned agricultural banks and financing institutions as well as risk sharing facilities (AgFiFs). The banks act as agricultural development banks at retail or wholesale level, as national development banks with a window for agriculture or as state-owned commercial banks financing agriculture. Further vehicles include credit guarantee mechanisms and a variety of funds or schemes for lending, risk sharing or equity finance. In addition, there are mixed facilities.