The pandemic crisis and its effects on agriculture and finance

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The COVID-19 pandemic has placed increasingly severe constraints on rural and agricultural livelihoods, especially in developing countries. In general terms, the lockdown imposed on most the countries, has resulted in disruptions in food and non-food supply chains because of transport restrictions, quarantine measures and, in turn, labor shortages.

Government restrictions on movement and international disruptions have significantly slowed the arrival of inputs into rural areas and their subsequent distribution. Producers have problems in procuring critical inputs and preparing for the next planting season. Limitations to workers’ mobility has affected countries in mid-harvest or entering the harvesting season. The restricted flows of goods have increased the inventories of perishable food in storehouses, causing great losses. Due to the need to implement social distancing measures within their facilities, processing companies and cooperatives are also less likely to operate at full capacity. Restrictions to ports’ operations and sanitary inspections have further slowed down trade and cross-border exchanges. At all the different stages of the supply chain, the pandemic has had negative effects on employment and incomes. Furthermore, with the crisis hitting most countries at the same time, there has been a significant reduction in the transfer of remittances, both through international and rural-urban channels.

Due to the above, the COVID-19 is having a dramatic impact on smallholder family farmers, other small-scale food producers, and on small and medium sized agribusiness enterprises (SMEs), which are critical to the functioning of food systems. Vulnerable population groups will be most severely affected by the consequences of the pandemic, especially those on informal or seasonal rural employment who struggle to access food and access markets, In many least developed countries, COVID-19 is likely to have cascading effects on rural health livelihoods, food security, and national stability. Net-food importing countries like the rice importing countries in western Africa are on the edge of rising undernourishment among its most vulnerable groups.

This global critical situation is having unavoidable effects on the rural and agricultural finance industry. Input finance has been problematic. Smallholders and small processors do not have the tools and instruments to invest. Their projected loss in sales of their products may lead to increasing defaults in loan repayments which in turn will lead to a growing number of non-performing loans among lenders, increases their risk sensitivity, and, ultimately an increase interest rates the charge on agri loans.. The COVID-19 crisis is indeed putting pressure on financial access of farmers, SMEs, and other actors in agricultural value chains in need of working capital and trade finance to keep their businesses afloat. More specifically, smallholders and SMEs need financial services to cover fixed-costs and liabilities, purchase inputs (for producers) and crops (for processors), pay seasonal labor, and provide a buffer against price volatility. Therefore, there an increased need for highly concessional loans and short-term liquidity to secure the survival of the agri related businesses and sustain their operations.
The constraints that smallholder and agri-SMEs face in accessing financial services are not new, but they are exacerbated by the pandemic. Prior to the COVID-19 crisis, the global demand for agricultural finance was estimated to be around $240bn, exceeding by far the available supply of about $70bn. Only $17bn out of this is supplied by informal financial institutions such as local money lenders and loan associations. In the context of the pandemic, MFIs, credit unions, and cooperatives have less liquidity and are pushing for increased savings. Such organizations and institutions are not used to crisis management, so they find themselves with insufficient tools and processes for coping with their increasing non-performing loans. Several financial institutions have started restructuring their outstanding loans and are expected to significantly reduce their lending by the end of the year.

The most affected categories within the food and commodities value chains are most likely going to be agri-SMEs, particularly the input suppliers, agro-dealers, traders, and processors. Agricultural value chains are highly interdependent. Therefore, any of the effects of the pandemic such as reduced production, limited trade, and limited processing capacities will have a trickle-down effect on agri-SMEs that are critical to food security as backbone of the agricultural value chains. In turn, the impacts of COVID-19 on these businesses are likely to be felt all along the supply chain, from producers to consumers, with significant long-term consequences for rural livelihoods and food security.
Even before COVID-19, agri-SMEs were among those SMEs that have always had more challenges to access finance. Placed between small farmers who can eventually get short-term financing through MFIs, and large-scale enterprises that are clients of commercial banks, agri-SMEs struggle to access appropriate financing for their operations. As a result, they have been renamed “the missing middle” due to several factors. The main ones are:

1) The low returns if compared to other sectors (which is partly due to the high costs of reaching and serving remote rural areas).

2) The constraints of most food chains (fragmented and not well coordinated, especially with regards to staple food); and

3) The overall lack of information on agricultural markets.

This financing gap is even more accentuated for women-led SMEs.

Even in the case of potential business opportunities, banks, non-bank finance institutions (NBFIs) and MFIs, tend to shy away from investing. They lack necessary tools and information to understand such opportunities and lack the expertise to design a strategy and the related financial products and services that are tailored to the specific needs of agri-SMEs.

In almost all countries, and especially in developing ones, lines of credit for financial service providers (FSPs) are constrained because of COVID-19. This is particularly true for foreign currency loans. International demand for cash crops is decreasing due to the international recession, therefore countries like Ethiopia, Kenya, and Nigeria that
export commodities such as coffee, cocoa and cotton to Europe and the US are likely to register a decline in foreign reserves. This is also likely to lead to a decrease in the import of essential inputs. Eventually, adherence to safety measures like the restrictions on movement and the social distancing will make it more expensive to finance agri-SMEs, increasingly dissuading banks from lending.

In this context, new stimulus measures need to be put in place to facilitate access to finance using financial instruments, infrastructure, and regulation to ensure business continuity and keep the food chains going. This requires coordinated actions and innovative partnership arrangements among governments, donors, development financial institutions (DFIs), investors, and financial institutions.

As part of immediate responses to the crisis, most governments are putting in place sizable economy-wide stimulus packages and moratoria on EMI payments to formal banking institutions. They are mobilizing and coordinating with existing agtech and fintech companies to promote B2B and B2C marketing of crops including perishables and livelihood support interventions that seek to:

1) Protect those whose incomes are most affected,
2) Address the cash flow crisis among businesses,
3) Limit disruptions in critical segments of the economy, including the food supply chain; and,
4) Deal with the enormous uncertainty and added risks caused by the COVID-19 emergency.
Inevitably, the depth and breadth of the response varies largely between countries, commensurate with their needs, capacities, and their fiscal space. Low-income countries, with limited means and high levels of debt, are obviously far more constrained in their response options. For these countries, the support of the international community through grants and direct funding for priority COVID-19 support programs, will be vital, including debt relief, balance of payments support, increased concessional lending and other types of support.

Central banks are experiencing challenges. They want to keep supporting their countries’ banking sectors without compromising the overall financial stability. In this respect, several measures have been undertaken including lowering policy interest rates, making available direct lending facilities to commercial banks, reducing reserve requirements, and restructuring loans.

Regardless the changed and riskier environment, impact investors are committed to keep focusing on agricultural investments without exacerbating the investment requirements and conditions. Many impact investors have made commitments to sustain the available liquidity in their portfolio companies, trying to manage this particularly challenging period as smoothly as possible with their financial institution partners as well as other stakeholders.

Blended finance schemes which combine concessionary loans and grants to incentivize private non-developmental investments have become more crucial for their role in de-risking the agricultural sector. They create public mechanisms to buffer risk and thus distribute the risks among different actors and provide incentives to invest at a lower cost. The demand for investments in agriculture can be met using a variety of instruments like grants, equity, loans, debt, and risk mitigation products such as guarantees and insurance or hedging products. and All of these can include a "blended" (concessionary) component.

The concessionary element within agricultural blended finance transactions can be used to address different challenges. These may include the use of public funds to ensure adequate training through technical assistance (TA), creating market facilitating infrastructure (e.g. collateral registries, warehouses), establishing public grant funds to match private investments (such as the challenge funds), and setting up subsidized guarantee programs and insurance schemes.

Some FSPs have started changing their policies to relieve the current constraints on the agri-SMEs. In several cases, MFIs, NBFIs and banks have established loan moratoria to allow clients enough time to re-schedule their repayments. Requirements to access loans have been reviewed, allowing clients to be eligible for a loan without the need to document assets to use as collateral, at least for now.

Several donors who engage in rural development and support food security have established facilities to mitigate the effects of the pandemic on food production, market access and rural employment, to ensure that farmers in the least developed countries have timely access to inputs, information, markets and liquidity.
To keep funding and investments flowing into agricultural and food productive activities, some crucial areas for interventions and medium-term investment have been identified for coping with the challenges and constraints of the pandemic. At the same time, we need to build more resiliency in rural and agricultural communities. Among these investments and interventions are the following:

1) **Investing in digitization.** Digitalization would benefit all actors in agri-food systems, as it can help reduce crop losses, decrease herd deaths, improve yields, manage risks, optimize product storage, avoid food spoilage, and maximize profits. The use of technology throughout the value chain translates into tangible improvements in food security and is especially relevant in the most vulnerable populations. For example, it helps to reduce production losses due to better risk management, or to allow for the improved marketing of farm products. Digital information and digital payment systems can allow financial institutions to reduce costs, improve the systems for KYC and the appraisal of risk, and, consequently, increase their outreach into their target communities. E-commerce platforms can increase access to a more diversified range of buyers and farmers. It can help overcome the lack of information on the part of buyers and suppliers, through a shared data bank of volumes, prices, quality of the products, and certifications. Private and public investors, as well as financial services providers, should closely look at existing or potential companies providing e-commerce services. And then, facilitate partnerships to make sure farmers clients can access inputs that can be directly financed. However, the relevance of digitization should not be over-emphasized. It depends on the existence of specific infrastructure and on availability of internet networks, it works most effectively where providers have built capacity and lenders have been equipped with the most appropriate tools and instruments. Furthermore, financial products and services must also respond to the actual needs of clients. This is especially true in the case of smallholders, who need to be included during the design of new products and services. Otherwise, digitization might eventually just end up increasing the financing gap for them.

2) **Investments in storage, cold chains, and warehouses.** Such investments would not only contribute to decreasing food loss, but also to secure a market for producers who can use warehouse receipts for quick access to investment capital for the next coming season. Putting goods in storage allows producers to extend the period in which they can sell their harvested goods and to wait until more favorable market conditions arise. Public and private investments, including through PPPs, should be geared towards warehouse stores of commodities for third parties.

3) **Value chain financing schemes.** Such schemes remain among the most effective ways to overcome barriers which have been accentuated by the limitations arising because of the pandemic such as lack of guarantees and lack of information. Agricultural value chain finance offers an opportunity to reduce the cost and risk in financing and therefore extend the reach out to smallholder farmers. For financial institutions, it allows us to look beyond the direct recipients of finance to better understand the competitiveness and risk in the sector as a whole and to design products that best fit
the needs of the businesses along the chain. At the same time, it can contribute to making value chains more inclusive, by making resources available for smallholders that allow them to integrate into higher value markets more readily. In this respect, to distribute risks among different value chain actors and take part of the burden off the shoulders of smallholder farmers, financial institutions could be incentivized to supply more trade credits and supplier credit downstream. Under the COVID-19 restrictions, the cost of loans, which were difficult before the pandemic, can become almost impossible for small farmers and SMEs. It might therefore be worth working with major suppliers (large buyers, exporters) to set up credit schemes that involve risk sharing so that products can flow down through wholesale and retail networks. In this context, DFIs and donors could also play a key role in assuming part of the risk through buffering mechanisms or assuming the position of underwriter, so that this too, can be shared downstream. If small businesses can be relieved of the heavy cost of commercial borrowing and can get supplier trade credit, it would reduce their costs and help them to manage the pandemic related constraints. Some companies and financial institutions have already used camera capture to develop a qualified buyer’s schedule with major supplier inputs. Pictures of trade sheets and deal sheets are used as a collateral for farmers to access capital for the next planting season. In this respect, supplier credit is made easier since financial institutions can track in real time what is moving in and out of the store and who is paying for the goods.

4) **Promote and invest in shorter value chains and the regional food trade.** Local trade is becoming more and more important, given the restrictions over air and sea transport. Investments in local, traditional indigenous foods should offer new profitable investment opportunities, which, if properly addressed, would also contribute to the improvement of local and regional food systems. Such opportunities are mostly based on the possibility of economies of scale and should focus on the most resilient agri-SMEs.

We have an opportunity to rebuild the world’s food systems along more sustainable and inclusive lines if investors and financial institutions can provide a timely response to the pandemic despite the enormous challenges and the tight conditions through which the rural economies will have to go through in the coming months is. Correspondingly, we can also build the resilience of rural populations to crises and shocks and open rural areas for new investment opportunities. However, this will require a coordinated and strategic collaboration among governments, donors, investors, and value chain players, from the smallest to the largest.
References:

For further readings on the impact of COVID-19 on food and agriculture, you may also want to check the following:


IFAD, Making sure rural communities won't be left behind in the response to COVID-19, April 2020: https://www.ifad.org/en/web/latest/news-detail/asset/41851548

IFAD’s Rural Poor Stimulus Facility: https://www.ifad.org/en/rpsf

For further readings on the impact of COVID-19 on Agri finance, you may also want to check the following:


UNCDF, April 2020, COVID-19 changing the landscape for migrants and remittances: http://www.ruralfinanceandinvestment.org/node/3837

Recorded webinars on the impact of COVID-19 on agricultural finance:

SAFIN Network and AGRIFIN of the World Bank: https://www.safinetwork.org/webinars

FAO: https://youtu.be/XlyrWHQnNqk


Dalberg, Investing in agriculture during the COVID-19 crisis: Perspectives from the impact finance world: https://vimeo.com/425389904