Challenges of agribusiness investment in emerging markets

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Who we are

Cambridge Economic Policy Associates (CEPA) is a global economic and financial policy consultancy, with considerable experience of working with both investors and investees to support investment in agribusinesses in emerging markets.

Here we offer a few examples of CEPA's relevant experience, before we discuss some of the challenges and opportunities for agribusiness investment in emerging markets.

Previous projects include:

Agribusiness diagnostics (2015 - 2017)

CEPA was appointed to complete agribusiness country diagnostics for: Cote d'Ivoire, Mozambique, Mali, Myanmar, Tanzania, Bangladesh, and Nicaragua for the IFC and their Global Agriculture and Food Security Programme.

Each diagnostic first involved a review of selected value-chains to assess the potential to support investment, and to identify priority agribusiness sectors.

For targeted sectors we then worked to identify specific agribusiness investment opportunities for consideration by IFC/ GAFSP-PrSW. This has involved meeting with the agribusinesses, reviewing their business plans and providing advice to IFC about the potential scope for investment.

Transaction advisory services for the Irrigation Development Support Project (IDSP) in Zambia (2011 – date)

A CEPA-led consortium is currently advising the Zambian Ministry of Agriculture for a US$200m World Bank-funded irrigation PPP programme, with an initial grouping of three irrigation schemes. CEPA is advising on all financial, organisational and legal aspects of the PPP arrangements.

The project's goal is to align with recent legislative work done on PPP processes in Zambia and to support and develop further infrastructure PPP projects under the IDSP.

Supporting investment in Tanzania’s agribusiness sector (2013 – 2014)

AgDevCo was approached by DFID Tanzania to identify 2-3 possible investment opportunities in the agriculture space in Tanzania. In particular, DFID was looking to provide donor funding to support blended partnerships.

CEPA helped identify and assess potential pipeline investment opportunities in order to develop an initial ‘long list’ of projects.

The CEPA team then conducted more detailed analysis of the projects on the long-list to develop a shortlist. This involved site visits/meetings with sponsors and an assessment of the market opportunity for each project.

CEPA then carried out due diligence of selected projects. CEPA assessed the corporate viability of the businesses, the capacity of project sponsors, the projects’ expected development impact, and any perceived risks – among other things. CEPA then advised AgDevCo on which projects to take forward as potential investments. CEPA’s support led directly to over $20m of investmnet in Tanzania.

Design of investment vehicle for the Better Cotton Initiative (BCI) and IDH (2013 – 2014)

CEPA was contracted to work with BCI and IDH to set objectives for its new investment fund. We completed a cotton value chain study and held extensive consultations with a range of interested stakeholders to better understand what sort of activities the new vehicle could support in its main emerging economies. A key question for this project was what opportunities might exist for providing more commercial finance to farmers and ginners that could support the scale up of Better Cotton.

From the perspective of an investor

Agriculture is risky

A number of the agriculture projects looking for finance are typically greenfield, so they involve start-up risk…

…but, really, all start-ups are risky

You typically only hear about the successful start-ups.

In the USA, “nine out of 10 start-ups fail”

Fortune

In the UK, “more than half of new businesses don’t survive beyond five years, with the UK tax system, a lack of bank lending and the cost of running a business cited as the top reasons for failure.”

Telegraph

There are, however, several risks specific to agriculture that make it less attractive than sectors such as energy generation or telecommunications in emerging markets.

Agriculture sector specific issues

Features of the agricultural sector make it less amenable to investors

The sector is very costly to serve; rural financing involves relatively high transaction costs – often for investments targeted at smallholders these costs can become prohibitive.

The financing needs of African agribusinesses often do not match what many investors are looking to provide. For example, some investors want to invest \$20m+ but opportunities of that size are few and far between in African agriculture. Given the high transaction costs, however, many investors can’t invest in the smaller opportunities on a commercial basis.

A number of agricultural products require long-term finance, e.g. crops that require a long-time before they reach their yield potential. Set against the risks associated with the agriculture sector, it can become difficult for many investors to provide longer-term finance for the sector.

In some developing countries the level of information required to support investment is not available, again adding to the transaction costs of investors.

There may also be a mismatch in the type of finance that investors want to provide and what investees are seeking. For example, agribusinesses often prefer debt, but lenders rightly see their risk as equity risk.

Agricultural sector specific risks

Agribusinesses (particularly smaller ones) often lack technical skills and/or financing knowledge, both in terms of financial and on-farm management skills.

Lack of access to security and issues around land tenure continue to be a constraint; further, rural to urban migrarion has reduced the availability of cheap labour in many contexts.

Production and yield risks are high due to reliance on weather as well as the costs of irrigation. and climate risks are becoming increasingly important. Exposure to persts and diseases in many sectors is also high.

Operational risks are high due to a lack of supportive infrastructure. For example, it can be very difficult get replacement parts for their machinery if and when they break down.

The business environment in many countries can be unsupportive: high import/export tariffs, unpredictable policy/regulation, and overly burdensome bureaucracy.

Major constraints for investees

Access to finance issues

There is a general concept of the 'missing middle' in agri-finance:

- Few providers of finance in the $0.5m-$10m space
- More providers in the space for investments up to $0.5m, and for investments over $10m

Accessing finance can be overly burdensome/bureaucratic for small scale entrepreneurs: often agribusinesses 'most able' to engage with the processes don't actually need development finance – i.e. could secure commercial debt

Standard lending terms don't fit with crop cycles or accommodate long lead times for greenfield development

It can be difficult to access local currency finance, which means that agribusinesses can become exposed to to currency risks, which they are ill-equipped to manage.

Despite these issues, we have identified a variety of agribusiness investment opportunities, each with different risk factors – though all offering the opportunity for an investor to achieve a development impact. We profile some in the following slides:

Case study: SME Lychee farm in Mozambique

Profile of investment

Lychee farm with ~250 Ha of land, but only 25 Ha was being used to produce lychees. 50 Ha devoted to producing another tree fruit.

Turnover was <$500k PA with around $200k from lychees.

Yielding around 30kg lychees per tree; compares to 50kg – 100kg by more productive producers.

They believed they could double productivity with additional investment in inputs esp. irrigation.

There was also scope to extend their small out-grower scheme.

Rough investment cost around $10k per Ha, approx. $2.5m of debt investment required to redevelop their existing lychee farm.

Assuming yields double (& relatively stable world prices) they could achieve an extra $8k to $15k per Ha PA.

Factors of the investment

Land: Farm potentially has access to land required to increase productivity and expand production.

Management: Not clear that the manager has the required skills and expertise to make them a viable investment partner.

Markets: They have been having contractual difficulties with their off-taker, which have been proving difficult to resolve.

There is proven global demand for their product; if their contractual issues can be resolved, they will have access to export markets.

They had the potential to get their product to market early to exploit seasonal demand for lychees.

Case study: Cocoa plantation in Nicaragua

Profile of investment

Large-scale cocoa farm, with over 4k Ha under production. Farm has cost approx. $15k to $20k per Ha to develop (including outright purchase of land & preparation, purchase of irrigation equipment).

The farm employs 200 – 500 workers to support development of their farm, currently they are focused on preparing land for cocoa. Only a small number of trees have been planted – so it is effectively a greenfield.

The farm has an estimated yield of ~3 tonnes per Ha of certified cocoa – given global cocoa prices of $2k to $3k per tonne, estimated revenue per Ha is between $4k to $9k when their cocoa trees are fully yielding.

If they do achieve expected yields they will be a profitable business.

They want to expand to 10,000 Ha of production, so potential need for approx. +$100m of investment.

Factors of the investment

Land: Located in a country where it is currently possible to purchase land relatively easily – govt. actively trying to facilitate investors to purchase land and develop it for agriculture.

However, the land that they have may not be best suited to the productive production of cocoa; further the location is quite exposed to extreme weather creating risks of damage to their trees.

Management: Experienced management, with track-record of establishing similar sized cocoa farm in another company.

Markets: Established market for their product and existing relationships with large chocolate makers, so expect to have access to markets when farm reaches maturity.

Business environment: Govt. policy has been supportive, offering a range of incentives and support to external investors to ease their access to the country.

Case study: PPP irrigation in Zambia

Profile of investment

Four irrigation PPP opportunities all of which are for concessions to operate and invest in commercial farms on high-potential, irrigated land. All are Greenfield investment opportunities.

The bulk water irrigation systems for each project are being paid for largely through a mix of government and grant finance, and will be owned by the government and leased to the investors. Investors are responsible for developing their on-farm irrigation infrastructure and for other costs including the land lease fees at three sites and provision of agronomic support services to smallholder farmers at all sites.

Three of the opportunities have been designed for cultivation of wheat/ soya and the fourth opportunity for bananas. Commercially farmed wheat and soya in Zambia can yield 8 tonnes/ha for wheat and 3.5 tonnes/ ha for soya and get a market price of ~$450/tonne and $500/tonne respectively. Commercially farmed bananas in Zambia can yield 20 tonnes per hectare and get a market price of $300/tonne.

Factors of the investment

Land: Projects designed so the land lease, water abstraction, and other farming-related permits are in place for when the private sector partner comes on board. Land is leased to the partners for 25 years & multiple agronomic studies have been carried out at each site to confirm the soil and climate's feasibility for the target crops.

Management: Private sector will invest in, operate, and manage the commercial farm and irrigation schemes. Projects designed as PPPs as the private sector is best placed to carry out the activities efficiently.

Markets: Demand risk because Zambian Government often places export bans on maize to maintain food reserves which results in depressed prices as domestic markets are flooded. Farmers then shift to producing wheat and soya, depressing prices for those crops.

Drought & market conditions have drastically affected the costs of these investments due to higher electricity costs, borrowing costs and worsening commodity prices. Although, this downturn is expected to be temporary.

Government: Bought-into & pushing projects forward & the domestic policy environment is very supportive of irrigation PPPs.

Case study: Equipment leasing in Tanzania

Profile of investment

A company that provides agricultural equipment leases of $2,000-$50,000 through a branch-based operation that relies on a high degree of customer-supplier interaction.

The business model is to work with small businesses and already successful entrepreneurs that have ‘outgrown’ micro-finance. The company provides loans to an investee to allow businesses and entrepreneurs to access equipment and to fund related delivery and installation costs. The investee must secure working capital from other sources and pay a share of the equipment investment cost upfront.

When the investee company secures access to equipment, the investee does not receive the loan. Instead, all relevant equipment and installation costs are paid by the leasing company straight to the supplier.

Loans are highly standardised (i.e. same grace period, tenor, etc.) and lending follows highly standardised processes. Late payments incur penalty charges. Early repayment triggers savings.

Factors of the investment

Management: Well-managed company using standardised products & processes. Repayment risk is managed through strong investee screening & active monitoring.

Costs are difficult to manage at scale as overheads are high. Start-up costs are high relative to the current scale of the business. This is expected to improve as scale is achieved

Markets: Clear market - Tanzania’s private sector is mostly made up of small enterprises unable to access finance to grow, as they lack the necessary collateral required by commercial banks. There is no other pure leasing institution in Tanzania focused on the small enterprise sector.

By lending in Tanzanian shillings, implementing a zero-collateral approach, using alternative credit assessment methods, and standardising investment appraisals, the lending company enables SMEs that may otherwise be seen as “unbankable” to access finance.

Some competition from a few commercial banks that have launched equipment finance offerings.

Questions for the future

How to address existing lack of management skills in the sector?

The Council for Smallholder Agricultural Finance notes that the largest number of non-performing loans have occurred where management capacity was limited.

A potential solution is to provide targeted technical assistance to agribusinesses and projects where it can unlock high impact investment opportunities.

Technical assistance, however, is expensive and can take time to achieve the intended results. Therefore, it is not always clear that it fits neatly with investment activity.

Perhaps a way forward is to assess an investee's managerial capacity a more formal part of the investment process.

For opportunities where technical support is required, the investor would have to make a business case for the funds for technical assistance. For example, a lack of capacity was identified as a concern, but there is potential that technical assistance could address these concerns, unlocking a more viable investment opportunity. Funders could provide support on a case-by-case basis or develop a technical support facility to which agricultural investors have access.

What can be done to increase the supply of agri-finance?

One of the key questions is how to increase the supply of finance, particularly to support SMEs too big for microfinance institutions and too small/risky for commercial banks and development finance institutions. CEPA's paper on the market for agribusiness finance illustrates the nature of this gap clearly.

The problem is that the cost of providing finance to these SMEs is often too high to enable investors to break even, let alone make a commercial return.

Social investors focused on agriculture should work with their funders to consider the case for subsidies targeted at addressing the gap in financing for agri-SMEs. Alternatively, they should consider what potential there is for investors to develop a blended portfolio approach in which they use investments in larger agribusinesses to generate the returns to support their investment in SMEs. This does, however, raise concerns about whether the investors are crowding out commercial investment in larger agribusinesses; and more fundamental questions about whether the pipeline exists to make such an approach viable.

How we work

CEPA has extensive expertise in delivering projects involving:

- Review and feasibility of agricultural investments
- Transaction advice
- Financial and economic modelling
- Market analysis and economic due diligence of potential interventions and investments
- Policy and strategy development
- Monitoring, review and evaluation of agricultural policies and programmes

Project teams

For each project CEPA assembles a bespoke team of in-house consultants and, when required, external associates with specific country or industry expertise. The CEPA team has experience across the range of disciplines and its established network of associates provides clients with access to the best expertise worldwide.

Get in touch

If you're interested in working with CEPA, in the first instance please contact Michael Obanubi for an informal discussion.

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