

# Technical Brief

## Financing Youth Entrepreneurship in Agriculture: Challenges and Opportunities

By Nii Simmonds, May 2017

### Executive Summary

In this technical brief Nii Simmonds, the founder and program director of Incubating Youth and Entrepreneurs in African Agribusiness at DAIN Network, considers the challenges, and opportunities, facing banks and other financial institutions wishing to expand their financing of entrepreneurial youth operating in the agricultural space. Nii draws on his background of working with young agri-entrepreneurs to explain his thoughts on how these challenges may be overcome. He considers the range of opportunities available for expanding outreach, and how youth may also make themselves more “bankable” and serviceable.

### Introduction

Many developing markets have seen a surge of youth unemployment and many youth and young adults are reacting to lack of formal urban employment options by moving into the agriculture sectors. However, while opportunities exist there are also many hurdles related for youth entering and prospering within the agriculture sector – key among these challenges is the lack of financing.

Due to the growing awareness of both government and civil society about youth unemployment increasing attention is being directed at engaging youth into entrepreneurship in agriculture and rural development. There are many players in the private, public and non-profit sectors with various programs, initiatives and strategies on engaging youth in agriculture. This technical brief considers some of the actors who are financing youth in agriculture; the activities that they are financing; and the financing instruments or arrangements utilized.

### Financing of Youth Entrepreneurship: The Financial Players

In many, if not most, developing markets there a lack of financing for many youth aiming to enter the agricultural sector. The challenge in making financial services accessible for rural youth is similar to the challenge for adults - large distances between borrowers and financial institutions, and a lack of tailored financial products suitable for seasonal-based enterprises

and/or farm-related risks.<sup>1</sup> However there are new players entering this space, who are providing financing or implementing financial innovations to open up liquidity in underserved markets in agriculture. And these innovators may offer the wider financial community some ideas on how to better serve agriculturally focused youth.

As is often the case when formal finance is unavailable, many young entrepreneurs are obtaining financing from friends and family when investing in production activities in a variety of value chains. Where finance for production is unavailable youth may instead venture further up the value chain developing small agribusiness - value-addition services, especially where up-front financing requirements are lower.

On the supply side of financing, there are new players providing financing for youth such as social impact funds and informal financing mechanisms like crowdfunding. These new players have brought a new class and sources of capital for individuals looking to get into agriculture. Even though there is a lack of traditional financing for youth with an idea or concept, many youth have found it quite successful in obtaining financing by partnering with another existing SME or multinational as supplier. Because of this lack of financing, new players have developed strategic partnerships in some of these developing markets to fill a void – and they are taking bold risks in betting on young entrepreneurs, with some nice returns in some cases.

Interesting example of a new source of financing include:

**Africa:** Venture Capital for Africa (VC4A). VC4A is an online community of venture capitalists, angels and entrepreneurs dedicated to building businesses in Africa. Companies on VC4Africa are largely early-stage startups in sectors as diverse as mobile, web, renewable energy, healthcare, education and agriculture, and usually require investments less than \$1 million.

**Latin America:** Agora Partnerships provides entrepreneurs with access to mentoring, networks, and capital. Since 2011, Agora has worked with 125 Latin American companies, helped secure approximately \$46.1MM<sup>2</sup> in capital for accelerator participants, and achieved a survival rate of 89 percent among participating companies.

**Asia:** Livelihoods funds work with smallholders across various developing markets; the Asia market is a key focus for their efforts to address rural poverty through economic development. The Livelihoods Funds are investment funds supported by reputable and committed private sector players which, in exchange for their continued commitment, expect a return on investment in the form of carbon credits with high social value or more sustainable supply chains.

**Regionally,** there are many firms targeting financing in agriculture or in agribusiness. In terms of regional attractiveness for investments of this type; Asia - South Asia and Southeast Asia; America's – Central America, Caribbean and South America; Africa, West Africa followed by East and Southern Africa were attractive for fund capital. Agribusiness investment funds provided

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<sup>1</sup> Youth access to rural finance, IFAD, May 2015

<sup>2</sup> Agora Partnerships Website: [agorapartnerships.org](http://agorapartnerships.org)

capital to agribusiness through diverse instruments, such as equity, debt, debt and equity, and guarantees.

**Globally** an increasing number of investment funds—private equity, venture capital, and impact investing—are targeting investments in agribusiness. Out of this class of investments, a smaller sub-segment of impact focused investors, are making considerable efforts on engaging women and youth in rural areas. Besides a return on capital, impact investors aim for social and community good to come from their investment.

Many of the agribusiness investment funds originated as public-private partnerships with development finance institutions (DFIs) as major investors. Development impact and profitability were the two most important factors driving agribusiness investment funds' decisions. The funds were more likely to set priorities for development impact if a DFI was an investor. Yet, on the whole, a limited amount of effort appears to have been spent on funding for youth by these funds.

Informal sources of finance are generally the most important sources for financing working capital and investment capital for farm and off-farm activities for many youth. In most cases informal financing is easier and simpler to finance. Interestingly, informal financing of youth in agriculture, which enables them to prove their viability over time, can result in improved access to financing from traditional banks, as the borrower builds up a proven business track record.

## Financial Institutions: The Importance of Financing Youth Enterprises

Many commercial banks and their peers are caught in a dilemma when they want to finance agriculture deals – many want to finance, but required an adequate return, comparable to other sector lending. Yet banks often lack the experience of trained staff with backgrounds in agriculture or agribusiness, who as a result lack the requisite technical skills to understand agriculture or to analyze business plans for agribusiness investments. These skills gaps are limiting for the development of innovative financial products and services, such as value chain finance, crop insurance, and warehouse receipt systems. These constraints limit financial institutions from accessing a potentially large subserved area of the economy, and one that once accessed has a long-term client outlook (youth entrepreneurs taken by banks will likely be long term clients).

## Dealflow Opportunities for Financial Institutions

Private investment is gradually becoming a substantial source of financing for agriculture and agribusiness in developing markets. Such investments are driven primarily by rising demand for fast-moving consumer goods (FMCG) (including food and beverage products) and improved profitability projections in the sector. Within the agriculture sectors, agricultural investment funds are growing rapidly as vehicles for financing agribusiness. Many investors, have pooled agricultural investment capital, to look for various dealflow in several emerging markets. By pooling investments, these funds offer investment vehicles that help manage investors' risks through diversification of investments while also providing specialized fund management expertise to investors to support their target clients and improve performance. These

investments, therefore, tend to have positive impacts on job creation and other economic opportunities that support agricultural sector development.

There are some examples of multinationals, off-takers and other value-added mid-tier agribusiness enterprises partnering with some banks and private investors to offer financial products; some of these products have been utilized by some youth. For example, Blue Skies Holdings, a United Kingdom headquartered company which produces cut fresh fruits and juices, with offices in Egypt, Ghana, Brazil and South Africa has a distributor program for individuals looking to become a supplier for its products. Blue Skies does not provide financing or factoring; but it has local arrangements with banks in some markets on partnering with approved suppliers for working capital. Diageo's East Africa subsidiary, East African Breweries Limited (EABL), has a similar arrangement for financing from EABL's partner banks. These banks also provide financial management solutions that enhance their cash flow cycle efficiencies - access to working capital, increased liquidity, improving cash flow, etc. Diageo and other multinationals in many of these developing markets have similar programs or joint programs to access quality inputs. Not many of these multinationals have put much effort into identifying financing opportunities for youth entrepreneurs. Their focus is to get quality supply, at the right time, at a fair price – in many instances there have been efforts to integrate women into a supply chain, but not much from youth participation. Due to this, there seems to be a missing opportunity to engage youth to become quality suppliers for multinationals supply chains.

Are there opportunities for financial institutions such as banks to provide financial innovations for these type of opportunities for youth? Based on the evidence, research says there is an opportunity to provide financing to youth based on some of the previous examples. Additionally, if one can work with youth and assist them to integrate themselves into a supply chain there are many opportunities, however, some banks don't have the risk profile to engage in this lending class, youth entrepreneurs. Conversely, banks could provide innovative financial products specially set up for youth entrepreneurs by partnering with a multinational agribusiness firm.

## What Type of Financial Innovations Could Financial Institutions Implement to Open Up Liquidity to Finance Youth Entrepreneurs?

As previously stated, there is a great opportunity for any financial institution to provide financial products for youth and others along the agriculture or agribusiness value chains. Due to the lack of financing overall in the agriculture sectors, there are opportunities for youth to obtain financing by integrating themselves into a supply chain as a supplier – inputs, services, etc. However, most multinationals and mid-tier firms do not have the capacity to provide financial services, so partnerships with banks or other financial intermediaries makes sense. Furthermore, because of the lack of financing in agriculture, providing financing be mitigated by banks by forming this type of partnership with a multinational or mid-tier agribusiness firm with a track record. By introducing financial innovations into a market for new banking customers and potential suppliers, youth - there could be liquidity for young entrepreneurs to access capital to become a supplier to a multinational or mid-tier agribusiness firm. Furthermore, to

assist these youth suppliers with technical assistance and business skills, partnerships should be developed with capacity providers such as Technoserve. Technoserve provides capacity building efforts for individuals and communities in rural areas with skills, knowledge, and relevant technologies in the agriculture sectors in developing markets.

Since youth in most cases cannot access financing and markets are illiquid or are not sophisticated, financial innovations such as guarantees could be set up to open up these illiquid markets. For example, USAID's Development Credit Authority (DCA) provides partial loan guarantees backed by the full faith and credit of the U.S. Government to private lenders, particularly for loans made in local currency. These guarantees typically cover up to 50% of the principal of loans to entrepreneurs, SME's, and other projects that advance USAID's international development objectives.<sup>3</sup> Since the inception of this program, liquidity has opened up financing for local lenders such as banks, to provide more lending to the local market. This type of financial innovation has the opportunity to increase a bank's profile, its outreach and expand its customer base.

Guarantees have their advantages, they are designed to open up liquidity, and if there is a risk of default, the guarantor, provides the backstop. In this case, the U.S. Government is the backstop through its department of treasury. One disadvantage for guarantees is that it doesn't force participating financial institutions to actually provide more liquidity in the marketplace via loans, etc. Because of this and the fact most developing markets lack sophisticated financial markets (most bourses or stock exchanges in developing markets have paltry capitalizations, and institutional and retail investors are not exchanging securities due to lack of liquidity) a secondary market for securities could be administered. For example, if a financial firm or development bank creates a security product and pools the financial products and securitizes them in the local market – stock, bond, etc., and provides tranches of this security. This type of financial innovations could be used to open up liquidity for youth entrepreneurs and others over time by bringing in liquidity to an illiquid market. And, because these financial products are backed by strategic partners with ongoing operations – agribusiness multinationals, mid-tier firms and service providers, there could be a new class of investment opportunities to provide to youth and other entrepreneurs.

Many multilateral development banks (MDBs) already provide guarantees to developing markets, many of these guarantees are not designed to assist the young entrepreneur, but for existing projects. Inter-American Development Bank (IADB) has been successful in providing guarantees in Latin America and Caribbean countries to open up liquidity, however, there is not much done in using guarantees to allow banks or other lenders to provide loans for youth. In an IADB paper, *Financing Agriculture Value Chains in Central America*, authors Jeremy Coon, Anita Champion and Mark Wenner identify the importance of financial innovations in value chain financing (VCF) in Nicaragua and Honduras.<sup>4</sup> This paper is a good resource on what is being done to open up liquidity by utilizing financial innovations in Latin America and Caribbean. Other MDB's like the Asian Development Bank, African Development Bank, etc., have various guarantee programs for agriculture value chains. Are any of these MDB's using guarantees for

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<sup>3</sup> USAID. USAID's Development Credit Authority (DCA).

<sup>4</sup> IADB. *Financing Agriculture Value Chains in Central America*.

youth entrepreneurs? There is not a dedicated guarantee program for youth, there are efforts to get youth connected to value or supply chains and linking them up to investors – impact, etc. In many cases, guarantees and other types of financial innovations will only work by partnering with a technical assistance provider.

A market can have all the liquidity it wants, however, without a technical assistance provider – a firm providing knowledge, business or technical skills, and mentorship, many youth who obtain financing will be doomed to failure. Furthermore, financial literacy and business management skills are key resource gaps for many youth in some of these developed markets. Firms like Technoserve are attempting to bridge this resource gap with their programs in these developed markets.

## Case Study

In 2016, Tanzania Agricultural Development Bank (TADB) developed a program to issue loans to over 1000 young Tanzanians during a period of five years. TADB is hoping this financing can usher new jobs and employment for the rural areas in Tanzania. These loans are being issued at rates of between seven and 12 percent. There are positive signs of hope; many young entrepreneurs are excited for the opportunity to be given loans for their ventures. TADB expects a transformation of the agricultural sector in the country through mobilization of these loans, they see these loans providing the needed financing, as well as promoting supportive policies for development of the agriculture sectors.

The bank also provides technical assistance through partnerships with local providers. This helps to ensure that young entrepreneurs get the technical support to build sustainable enterprises. Many of the youth are also forming guilds or agriculture clubs to share best practices and mentorship support. This program by TADB is a good example of how a development bank, in partnership with the private sector is putting its efforts in mobilizing financial and resource support for youth in Tanzania.

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