UNLOCKING LOCAL CURRENCY LENDING: Foreign Exchange Risk in Agricultural Finance

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Though not often discussed in global conversations on the smallholder farmer financing gap, the challenge of managing foreign exchange (FX) risk is a critical issue facing finance managers who work on the front-lines to provide financial services to farmers. FX risk affects the availability and affordability of credit for smallholder farmers because lenders with foreign currency funding limit their local currency exposure by restricting the types of financial products they offer and the volume of capital they make available. Some lenders pass this risk directly on to agricultural borrowers by offering loans in US dollars or charging high interest rates on local currency loans to account for the risk.

Historically, agricultural lenders have employed a range of internal operational approaches to manage FX risk and limit their exposure, but such approaches often fail to hedge all the FX risk within their portfolios. Conventional hedging instruments available in developed capital markets—such as currency forwards contracts, swaps, and options—are limited and often prohibitively costly in frontier markets.

Lenders in other sectors, including microfinance, have developed tools for managing foreign exchange risk, but factors unique to agriculture complicate the adoption of those tools. The unpredictability and variability of farmer cash flows, along with the variability of loan tenors required, make it difficult for lenders to predict repayment cycles, aggregate repayments, and reliably hedge their exposure. Furthermore, many agricultural lenders have limited expertise with managing foreign exchange risk or employing such tools.

In the long term, deeper and more liquid currency markets will enable greater lending in local currencies and reduce the reliance on international hedging products. However, in the near term, the agricultural lending industry would benefit from interventions that share risk across the financial value chain with support from philanthropic capital providers. We suggest donors support the following interventions to enable such a transition:

- **Overcome limited institutional expertise in FX management** by subsidizing the provision of FX advisory services and/or creating a shared-service back-office for FX risk-management across multiple lenders
- **Support individual agricultural lenders on a bi-lateral basis** by subsidizing costs associated with executing foreign exchange hedges, or establishing currency reserve funds
- **Develop currency-focused risk guarantees sponsored** by one or more development finance institutions or foundations
- **Create local currency notes and adapt other proven currency solutions in the microfinance industry** to the agricultural finance industry

**ABOUT THIS BRIEFING**

This briefing note emerged from conversations with stakeholders at various levels of the agricultural value chain who expressed concerns about managing the foreign exchange (FX) exposure in their businesses – traders who pre-finance farmers and financiers who lend to smallholders and agri-businesses, among others. While a reasonable body of literature covers management of FX risk in microfinance, relatively little research has been conducted targeting FX risk management in smallholder agricultural lending. This briefing seeks to lay the foundation for further research, collaboration, and experimentation that can lead to the development and testing of solutions for managing the FX risk inherent in agricultural value chains. This briefing outlines the particular challenges of FX management in agriculture and profiles the landscape of existing solutions – drawing broadly from microfinance and industry solutions when relevant. The note concludes with recommendations for how lenders, donors, and other partners can develop interventions that will help mitigate these FX risks in the short to medium term.
Introduction: The FX risk challenge and its impact on smallholders

In global economic development discussions around what drives the financing gap for smallholder farmers, management of foreign exchange (FX) risk only rarely surfaces as a critical barrier. However, managers at the financial institutions and agro-enterprises on the frontlines of delivering services to smallholders articulate a very different story, highlighting how volatility in foreign exchange markets decreases the appetite for foreign currency investment into smallholder agriculture. Our past research has highlighted the tremendous gap in supply and demand for smallholder finance; in order to raise foreign capital to address the gap, managing and mitigating foreign exchange risk will be a critical issue.

The table in Figure 1 provides an overview of different types of risk lenders face when operating in multiple currencies, and provides examples of how they affect agricultural lenders.

Of these foreign exchange risks, depreciation and devaluation represent the primary challenge for actors along the agricultural value chain—including financiers, traders and dealers, processors, and aggregators—as well as for smallholder farmers.

Some financiers, depending on the particularities of the countries in which they lend, might experience convertibility and transfer risk; however, all actors along the agricultural value chain face the risk of a currency mismatch that arises from exchange rate fluctuation:

- **Agri-financiers**, such as private equity firms, commercial banks, and microfinance institutions (MFIs), often borrow in hard currency to finance lending in local currency to domestic financial intermediaries or farmers, and are exposed to FX risk as loans are serviced and capital is repatriated.
- **International and domestic traders/agro-dealers** balance sales in international markets and foreign currency contracts with local currency for pre-season delivery and working capital needs.

The table in Figure 1 provides an overview of different types of risk lenders face when operating in multiple currencies, and provides examples of how they affect agricultural lenders.

### Table 1: Overview of foreign exchange risks

<table>
<thead>
<tr>
<th>Description</th>
<th>Examples</th>
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</thead>
<tbody>
<tr>
<td><strong>Devaluation/Depreciation Risk</strong></td>
<td>Currency mismatches are created on balance sheets when a lender acquires debt in hard currency*, usually USD, and then lends in its domestic currency. Fluctuations (depreciations) in the domestic currency’s relative value leave the lender exposed to losses.</td>
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<tr>
<td><strong>Convertibility Risk</strong></td>
<td>Borrowers with hard currency obligations face repayment challenges or risk defaulting on their loans if the national government restricts the sale or purchase of foreign currency, as the borrower will be unable to access enough hard currency to meet its obligations.</td>
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<tr>
<td><strong>Transfer Risk</strong></td>
<td>Borrowers with hard currency obligations can face similar repayment challenges or default risk if the national government bans or restricts the movement of foreign currency out of the country, as they will be unable to expatriate capital for repayment.</td>
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<tr>
<td><strong>Interest Rate Risk</strong></td>
<td>When loans in a hard currency are indexed to a reference rate (e.g., LIBOR, EURIBOR), borrowers may be exposed to interest rate movements, which may affect their ability to repay.</td>
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</table>

* Hard currencies are globally traded currencies that are stable stores of value, and unlikely to depreciate suddenly or fluctuate widely. Hard currencies are widely accepted and easily convertible globally. The most common ones are the US dollar, the euro, and sterling, as well as the Swiss franc, and the Japanese yen.

Source: CGAP, Foreign Exchange Rate Risk in Microfinance: What is it and how can it be managed, 2006; Construction of a Fund Hedging Foreign Exchange Risks for Microfinance Investment Funds, 2011.
financing to farmers. Given the necessary lead-time between financing, purchase, and final sale, traders face multiple points of currency exposure.

- **Agro-processors and other aggregators** (e.g., producer organizations and large commercial farms) are generally exposed to secondary foreign exchange risk through supply acquisition or offtake arrangements.

Depending on the volatility of the currencies in which loans are denominated, depreciation could translate into significant losses. For example, between the first week of December 2014 and the first week of December 2015, the Brazilian real depreciated by 36% against the US dollar, the Tanzanian and Ugandan shillings by 25% against the US dollar, and the Ghanaian cedi by 27% against the US dollar. At these levels of fluctuation, the losses that lenders would absorb are significant. In the words of one lender, “small portfolios get even smaller” as they are eroded by currency losses. Even currencies that tend to be more stable — such as the Kenyan shilling, Mexican peso, or Peruvian nuevo sol — depreciated by 14-16% against the US dollar in the same time period, preventing even the more diversified lenders from fully protecting themselves.

While lenders, regardless of their position in the value chain, feel the direct impact of this foreign exchange risk, its costs and implications are largely borne by smallholder farmers. FX risk affects the availability and affordability of financial services for smallholders in several ways:

- **High costs of financing in local currencies**: Financial institutions and other enterprises that lend to farmers in local currencies pass on the costs of managing the accompanying risks to farmers and farmer organizations through very high interest rates.

- **Limited range of financial products**: In order to avoid local currency FX risks, lenders focus on export trade finance denominated in US dollars or euros. This narrow focus leaves farmers with limited financing options, in local currency, for their working capital or investment needs. It also means that financing tends to be more readily available for export crops, such as coffee and cocoa, and less so for domestic crops such as maize, rice, and cassava.

- **Limited availability of financing**: The challenges of managing FX risk leads lenders to limit their exposure in certain currencies or to withhold lending entirely in some markets.

- **Direct exposure to FX risk**: To limit their own exposure, some lenders issue loans to farmers or farmer organizations in US dollars rather than in local currency, which leaves farmers exposed to foreign currency fluctuations. This compounds the multitude of other agronomic and market risks farmers already face.

These FX risks are not new. Observers of the microfinance industry will note direct parallels to the challenges microfinance organizations face when borrowing in hard currency to finance local currency loans. But while FX risk management is a challenge shared by microfinance and other industries that require cross-border financial transactions, in agriculture the risk is compounded by several factors specific to the sector:

- **Farmers have variable and unpredictable cash flows**: Loans in the agriculture sector, especially loans made directly to smallholder farmers, experience variable yields and climatic uncertainty. This makes their repayment less predictable than for loans to small businesses in other sectors, such as retail.

- **Agricultural borrowers need unique and variable loan tenors**: Agricultural borrowers require loans with a range of short to long tenors adapted to crop cycles, including flexible repayment around the harvest season, which makes it difficult for lenders to align predictable repayment cycles and aggregate loans in order to achieve reasonable economies of scale for hedging FX risk. In contrast, loans made to urban clients for personal or business needs are relatively straightforward and uniform with standard maturities, which makes hedging easier.

- **Lenders within agriculture value chains often have limited expertise managing FX risk**: Given the resurgence in agricultural lending to smallholder farmers, many lenders are relatively new and therefore lack the expertise to access and deploy the range of hedging instruments, to develop risk mitigation strategies appropriate for their portfolios and activities, and to effectively hedge their exposure. This is also true for value chain lenders, such as traders and processors, who, while not necessarily new, have limited financial sophistication.
Default and FX risk are very value chain-specific: In other small business sectors, such as retail or hospitality, the operational challenges that drive default risk are fairly uniform regardless of the individual product a client seeks to finance. In agriculture, on the other hand, particular crops or livestock have specific production cycles with unique drivers of risk. This leads to a great amount of value chain specificity and variability across the portfolio in the FX risk that lenders face.

Unfavorable regulatory environments can compound the risk-management challenges inherent to operating in multiple currencies. Depending on the country, agricultural lenders may face challenges regarding local domiciliation, licensing, taxation, data access, and privacy. In general, local domiciliation could reduce FX exposure as lenders could access capital in local currency. However, for foreign entities, this local domiciliation can bring additional hurdles in the form of regulatory oversight and reporting requirements, or unfavorable tax regimes, so is not always an easy solution.

Overview of existing approaches and mechanisms

Agricultural lenders have a range of options, both internal and external to their operations, to help minimize their exposure to, or risk from, exchange rate fluctuations (see Figure 2 above). Lenders employ these mechanisms according to their individual needs and on a country-by-country basis, with many employing a multi-

Box 1: Internal Approaches

**Examples:**

**Investment strategies**

- **Indexing:** Domestic currency loans are indexed to the exchange rate of a hard currency (e.g., LIBOR, EURIBOR).
- **Portfolio diversification:** Domestic currency loans are aggregated across different geographies and business segments.
- **Prudential limit exposure:** Aggregation limits for domestic currencies (i.e., liabilities) are established to reduce exposure to exchange rate fluctuations.

**Operational strategies**

- **Re-allocation:** Hard currency loans are directly passed onto the local borrower.
- **Reserves:** Lenders set aside extra cash on their balance sheet to account for any currency loss.
pronged approach. Each option presents advantages and disadvantages in terms of cost, availability, and ease of implementation, which organizations weigh when building their FX risk management strategies.

It is worth noting that organizations do not make a linear progression through these options, and that the order of their presentation does not reflect their relative effectiveness.

Internal approaches

As the most readily available risk management mechanism, many agricultural lenders use a combination of internal approaches to reduce their exposure to FX risk (see Box 1 on previous page). Internal approaches include i) investment strategies such as indexing, portfolio diversification, and exposure limits, and ii) operational strategies such as re-allocation and cash reserves.

These internal approaches are effective in limiting exposure to FX risks, but at the cost of access, affordability, and exposure for the intended market. For example, they only allow control over the amount of FX exposure on a lender’s balance sheet, but do not allow hedging of positions against actual currency fluctuations. To complicate matters further, their implementation often results in higher borrowing costs for farmers or caps on the amount of credit available in certain markets. The other internal strategies lenders can adopt also carry unwanted consequences for them and their clients. For example, tying up capital in reserves can have significant opportunity costs; and indexing loans to hard currencies can increase the default risk of their clients.

External products

A second course of action lenders take is to source formal hedging products from an external provider. Lenders can pursue this strategy in parallel to the adoption of internal approaches.

In developed capital markets, large commercial banks, along with brokers and financial intermediaries, offer a range of well-established derivatives products (see Box 2 below). These include futures or forward contracts, swaps, and options.

While fairly accessible in developed economies, conventional hedging instruments in emerging markets are limited, and those that are available are frequently expensive. Only a few large international financial institutions such as Citibank, Deutsche Bank, ING, Standard Chartered, and Rabobank are able to offer hedging services for agriculture in a wide range of emerging market currencies. However, currency markets in countries where agricultural lenders operate are rarely liquid enough to enable the sustained existence of hedging products at a reasonable cost.

The nature of agricultural finance compounds the limited availability of conventional hedging. Even in markets where hedging products are available and

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<th>Box 2: Conventional Hedging Products</th>
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<td><strong>Examples:</strong></td>
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<tr>
<td>• Future/forwards: An agreement to sell or exchange currency at a pre-determined price at a specific date in the future.</td>
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<td>• Swaps: An agreement to simultaneously sell or exchange an amount of foreign currency now, and then to resell or repurchase that currency at a particular date in the future.</td>
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<tr>
<td>• Options: A financial instrument that provides the option, but not the obligation, to buy (“call”) or sell (“put”) foreign currency in the future once a certain previously agreed-upon strike price has been reached.</td>
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</table>
understood, those instruments are often misaligned with the needs of agricultural lenders in multiple and, sometimes, contradictory ways:

- **Misalignment of hedge tenors:** Agricultural lenders provide a wide range of credit products, and consequently, need to be able to hedge against a range of time horizons. For example, general loans (to cover school fees, emergencies, etc.) and working capital loans may have extremely short maturities, of one to three months; trade finance or seasonal loans often have six- to twelve-month maturities; and asset financing or other long term loans (like resource rehabilitation) may have tenors of one to three years or more. The high volatility of emerging market currencies, however, often results in maximum hedge tenors of six to nine months. This makes it extremely difficult for lenders to access hedging products that can cover the risk of long-term loans. Complicating matters further, it is often extremely expensive for lenders to find products that would enable hedges on portfolios for shorter periods.

- **The costs of hedging agricultural loans in emerging market currencies are often prohibitive:** A number of dynamics drive these costs, including the size of hedge required (the portfolios of agricultural lenders are often too small to create economies of scale for hedging), spot rates offered on the instrument (often conservative and inflexible), as well the margins or transaction fees that may be charged by the provider (frequently in the range of 5%-10% of the hedge’s notional value).

Faced with similar challenges, the microfinance industry has developed innovative products and structures that enable hedging of FX risk without the use of traditional instruments and capital markets (see Box 3 below). Lenders focused on smallholders have not widely adopted these tools, but they may be more readily accessible to them than conventional hedging instruments. These tools provide a useful blueprint for the design of products better suited to the needs of agricultural lenders.

As with conventional hedging instruments, these alternative instruments have their advantages and disadvantages. They are not particularly complicated to

**Box 3: Alternative Hedging Products**

**Examples:**

- **Back-to-back loan:** An organization enters into a hard currency loan with a foreign lender; deposits that hard currency into an interest-bearing deposit account at a local bank and pledges the hard currency amount as collateral for a local currency loan.

- **Letter of credit:** An organization enters into a hard currency loan with a foreign lender, and the hard currency of that loan functions as collateral to secure the issuance of a letter of credit by the foreign lender to a local bank against which the organization can access a local currency loan.

- **Currency devaluation accounts:** An organization takes on a hard currency loan to be repaid in hard currency and at the original interest rate. Throughout the duration of the loan and in addition to the interest payments, the organization makes hard currency deposits of an agreed-upon size and regularity into a separate “currency devaluation account”. In the case of a devaluation, this account is used to cover any shortfall in the value of domestic currency that could affect repayment of the loan.

- **Guarantee/grant:** An organization takes on an external guarantee or grant on their foreign exchange reserves. A secured facility fund is used for foreign exchange losses; such mechanisms require matching amounts of private capital as a backstop.

Source: CGAP Foreign Exchange Risk Mitigation Techniques, 2006
structure, and do not rely on capital markets. As such, they are more easily available and accessible to organizations that lack deep financial expertise. However, depending on the product and provider, lenders might face high setup or access fees, and the cost of servicing could still increase if the currency fluctuates. Another disadvantage of these mechanisms is their sub-optimal use of capital; the hard currency they lock up in deposits could otherwise be lent directly to smallholders and other actors along the agricultural value chain.

Specialized Institutions

To implement and advise on the approaches explored above, a small number of providers have emerged to offer specialized hedging instruments that support the management of FX risk for currencies not covered by commercial banks or other financial service providers (see Box 4 above).

These specialized service providers offer advantages over traditional hedging products from banks, particularly in terms of collateral requirements and availability to cover emerging market currencies. MFX and TCX, for example, often require no collateral from borrowers, and charge very low margins—at times foregoing them entirely. Commercial banks, on the other hand, can demand up to 50% of the portfolio value as collateral, and charge margins of 5%-10% on the notional value of the hedge. However, even with little to no collateral and low margins, the cost of hedging currency in low-liquidity markets can still be extremely high. For example, one lender estimated the annualized implied cost of hedging a portfolio in Ghanaian cedis to be 20-25% of the portfolio’s value, whereas it would be 8-10% of the value of a portfolio in Kenyan shillings. The lower cost reflects the reduced volatility and greater liquidity of Kenya’s currency. The high costs of hedging means that the interest rate premium lenders must charge their smallholder clients are also high.

Still, agricultural lenders face limitations in accessing these services. As such, lenders may use these services to partially hedge their portfolios, if at all. TCX offers hedges in emerging market currencies for large development finance institutions, but was not designed to engage with smaller lenders. MFX was born from a desire in the microfinance industry to hedge currencies by pooling exposures with TCX, but many agricultural financiers are not familiar with MFX, particularly if they do not come from a microfinance background. At an operational level, agricultural lenders find that TCX and MFX have several limitations, as they can only offer swaps or non-deliverable instruments, and cannot provide options on currencies. On top of that, the minimum tenors of their hedges often fail to align with the needs of agricultural lenders. For example, a one-year lock-in is difficult to manage for a lender that finances farmers on a six-month cycle, as the farmer’s cash flows are not predictable enough over the full tenor of the hedge.

Examples:

- The Currency Exchange Fund (TCX) is a special purpose fund that provides derivatives to hedge currency and interest rate mismatches in emerging markets. TCX acts as a “hedger of last resort” for currencies and maturities not covered by commercial banks or other providers. TCX’s investors are predominately development finance institutions and microfinance investors that are active in long-term debt markets or emerging markets.
- MFX Solutions is a socially-oriented company that supports microfinance lenders in emerging markets by brokering access to hedging products through TCX and other commercial providers, as well as providing risk management education. In the past 5 years, MFX has hedged nearly 1 billion USD in loans to small entrepreneurs in developing countries in over 30 currencies.
- Chatham Financial merged with its subsidiary Cygma in 2012 to provide currency and interest-rate risk management services to clients in emerging and frontier markets. These services include education and advisory services, portfolio analysis, and transaction management. Chatham has executed hedges in over 50 currencies, and hedges 350 billion USD annually.
What’s next: short- and medium-term solutions

Given the challenges outlined above and the imperfect solutions currently available to agricultural lenders, the industry needs a combination of short- and medium-term solutions that can mitigate these risks for lenders until longer-term solutions resolve their underlying causes.

Lenders will find protection from extreme FX risk at an organization level by diversifying and scaling up their portfolios. But this will take time. Diversification of currencies, commodities, and loan maturities, among other factors, will allow them to “internally hedge” this risk by spreading it across products and markets. Growing to greater scale will allow lenders to use external hedging products that are currently inaccessible due to the high costs associated with hedging small balances.

In the meantime, the industry would benefit from targeted interventions that share risk across the financial value chain with support from philanthropic capital providers. These interventions would allow financial intermediaries, agro-enterprises, and farmers to avoid the brunt of currency fluctuations. If deployed well, philanthropic capital can help address market failures and support financial inclusion for agricultural clients. We suggest the following series of interventions:

- **Subsidize the provision of advisory services and/or create a shared-service back-office for FX risk-management:** Managing FX risk is difficult, but there are specialized advisory service providers that can help. As these services can be expensive, one option to support smaller agricultural lenders on a bi-lateral basis would be for donors to subsidize the cost of services. More ambitiously, a group of agricultural lenders with similar FX management challenges could establish a “shared service entity” in order to benefit from economies of scale in addressing FX management challenges together. Key challenges of this approach would be identifying a host, establishing and building a team, and detailing the specifics of the service offerings. The shared service entity could generate some revenue through fees, but may also require donor grant funding to cover operational costs. For donors, a shared service approach would leverage resources in support of multiple lenders rather than focusing on bi-lateral support.

- **Subsidize costs associated with executing foreign exchange hedges:** Hedging is often an expensive and complicated option to manage foreign exchange risk, which deters agriculture-focused actors from adequately covering their exposure. A subsidy on the cost of hedging from donors could incentivize demand side actors to use hedging options (e.g., via MFX) by making it more economically feasible. Over time, depending on the region and currency, the subsidy could decrease or be phased out as participants gain comfort with the process and see a clear financial benefit.

- **Establish individual currency reserve funds:** Currency reserve funds can protect individual agricultural lenders from currency losses. The advantage of this intervention is ease of implementation, as it is quite straightforward to establish a donor-funded reserve. However, by tying up capital in reserves, less capital is available for lending into the market. Such an intervention requires donors with a significant tolerance for losses, as it is likely that lenders will draw down reserves over time and may not be able to replenish. Further, given the volatility of FX markets, there may be scenarios where lenders have to draw very large amounts all at once rather than drawing down smaller tranches over a longer period of time.

- **Provide currency-focused risk guarantees sponsored by one or more development finance institutions or foundations:** The use of credit guarantees in agriculture is not new, but most only cover operational defaults. If guarantees were extended to cover defaults caused by currency depreciation, they could significantly lower the risks (and therefore the costs) of local currency lending. A single entity, preferably a large development finance institution with significant capital and experience managing guarantees, would have to take the lead in establishing the concept and organizational structure, and leading fundraising. This would also require targeted outreach and marketing to ensure that lenders understand the product and are able to take advantage, as well as careful collaboration with banks to ensure a useful design.

- **Create local currency notes and adapt other currency solutions in the microfinance industry to**
the agricultural finance industry: Agricultural lenders require support to test and scale innovative solutions to currency hedging, which other industries have already deployed. For example, FINCA has demonstrated success with the use of local currency notes in microfinance (see Box 5 below), but agricultural lenders have been unable to gain traction on the concept. In supporting the adaptation of such solutions, initially, impact would be limited to support for an individual institution. However, once proven, other institutions could replicate and the impact could spread across the industry. An initial push will require financial backers willing to take on the risk of working with innovators to test and refine the model.

In the long-term, deeper and more liquid currency markets will enable greater lending and hedging of local currencies and reduce the current reliance on international markets for such operations. An easing of country-level constraints to local lending operations could lead to a lowering of FX risks and the accompanying risk premiums they cost smallholders. The effects of regulatory reform may take a while to realize, but would lead to an increase in the number of lenders in the smallholder agriculture industry, greater volumes of capital available, and a reduction in the cost of capital. A broad strengthening of capital market infrastructure should include more robust credit assessment mechanisms, as well as the development of increasingly sophisticated derivative instruments by local commercial banks for supporting FX risk management. Specific reforms would need to be investigated in each country, as context varies widely.

Conclusion

The challenges of managing currency exchange risks for agricultural financiers have a severe negative impact on the growth of smallholder finance. Without affordable access to FX risk management mechanisms, lenders either limit their exposure or they adopt internal strategies that pass on FX risks or high costs to borrowers. Existing hedging solutions are expensive and difficult to access. In the near term, philanthropic and socially oriented organizations should support lenders to mitigate these risks. We have identified a range of interventions with significant potential to support agricultural lenders. Some of these interventions are bilateral, requiring simple partnerships and funding structures, while others will need industry-wide collaboration. The latter will be more difficult to implement, but could have greater effects and reach. In the long term, the deepening and strengthening of local currency markets, combined with diversification and scaling by local lenders, will reduce much of this FX risk. In the meantime, continued donor support for innovation will enable adaptation of successful models in other industries to agriculture, as well as experimentation of entirely new products and services that could meet this crucial market need.

Box 5: Example from the microfinance industry – local currency notes

FINCA International partnered with an international bank to structure and place a series of three notes denominated in multiple local currencies.

Note I, launched in 2011 for $10 million USD; Note II in 2013 for $25.5 million USD; and Note III in June of 2014 for $30 million USD. The simultaneous issuance of multiple local currencies reduces foreign currency exposure on the part of participating FINCA subsidiaries while also reducing FX risks and costs for FINCA clients.

This innovative product helps meet the demand for local currency financing and risk hedging; the portfolio diversification also offers investors exposure to multiple emerging-market currencies in a way that minimizes devaluation risk.

Agricultural lenders have been considering such notes as a mechanism to reduce their FX exposure, but have struggled to structure notes so that they gain traction with funders – FINCA’s success could serve as a useful case study for agricultural lenders.


NOTES

1 Dalberg, "Catalyzing Smallholder Agricultural Finance," 2012
2 For example, the World Bank, IFC, and GuarantCo provide guarantees to encourage large infrastructure investments. In agriculture, guarantors may be banks, governments, or other partners—e.g. USAID’s Development Credit Authority (DCA), Rabobank’s Sustainable Agriculture Guarantee Fund, AGRA schemes with FSD-T and Kilimo
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ABOUT THE INITIATIVE FOR SMALLHOLDER FINANCE

The Initiative for Smallholder Finance (ISF) is a multi-donor and investor platform for the development of financial services for the smallholder farmer market. It was launched in May 2013 with the intention of making marked progress toward closing the gap between the $450 billion in smallholder financing demand and the current $10-20 billion supply. The ISF’s primary role is to act as a "design catalyst." The emphasis is on mobilizing additional financing for smallholders and seeding replication of innovative models in new markets.

The ISF is housed in the Global Development Incubator (GDI), a non-profit, public charity designed to support innovative organizations and initiatives that have the opportunity to create large-scale social change.

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