**Growing interest in agricultural investment funds**

Recently, interest in agricultural investments in developing countries has been growing in response to increased global food demand owing to population growth, longer life expectancies, increasing urbanization rates and changing diets associated with increases in purchasing power. Together with increased bio-fuel consumption, this has driven up food prices thereby increasing the attractiveness of investments in agriculture. Moreover, the 2007–08 food crisis revived public sector interest in agricultural investments to address food security concerns.

While agricultural investments can take several forms, there has been special interest in agricultural investments funds (AIFs). Thirty-one AIFs primarily focusing on developing countries were analyzed according to their capital base, shareholder and management structure, target group served, investment process and expected and actual financial performance. Drawing from this analysis this brief assesses some lessons relevant for development agencies, governments and investors on setting up AIFs and creating a policy and regulatory environment that stimulates agricultural investments. The brief summarizes the results from a FAO study analyzing the performance of 31 agricultural investment funds in developing countries.
Characterization of Agricultural Investment Funds

AIFs channel resources from investors into financial portfolios with a focus on investments in agriculture, agribusinesses and other areas linked to agriculture. They are attractive for investors because they help diversify their existing portfolios and reduce risk. However, AIFs require highly specialized fund management, and operational arrangements that build on partnerships in order to achieve cost efficiency.

AIFs are commonly categorized based on a) geographical focus; b) investment theme (financial instrument used); and c) fund duration (closed- versus open-ended). The funds studied targeted Sub-Saharan Africa (32 percent), global (32 percent), South Asia (6 percent), with Latin America and the Caribbean (LAC), the Middle East and North Africa (MENA) and Eastern Europe and Central Asia (EECA), each constituting 10 percent.

The financial instruments AIFs commonly use include:

Private equity funds which invest in companies to gain part or full ownership (equity) in listed and/or unlisted agricultural businesses. As securities of unlisted enterprises are not traded in stock exchanges and have a limited number of shareholders, AIFs tend to invest in those as they can potentially influence strategic business decisions such as restructuring and sale of these companies.

Debt funds which issue loans to companies. In this case investors are creditors rather than (part) owners of the company and they receive a contractually fixed return on their loans. Loans are provided either directly to agricultural producers, or to microfinance institutions (MFIs) which provide loans to selected small-scale farmers and micro-, small- and medium-sized agricultural enterprises (MSMEs).

Combined equity/debt funds in which investment funds provide equity and loans (debt capital) to the target group.

Microfinance investment funds (MIFs) which extend loans for repayment of existing debts (refinancing), mainly on a global scale, and target other economic sectors in addition to agriculture. MIFs targeting agriculture either provide capital via MFIs or invest in agricultural cooperatives and enterprises, smallholder and/or fair trade producer organizations.

Guarantee funds which are risk-sharing mechanisms in which the guarantor organization promises to repay the investor’s principal in part or in full should the investment fall below the initial sum invested. This reduces the investor’s exposure to risk and leverages additional funds from local financial intermediaries.

AIFs often acquire start-up equity from public organizations in order to leverage additional equity from private investors and obtain loans when needed. In addition, they tend to have a “double” or “triple bottom line” with social development and ecological impact as part of their return analysis, and a long-term perspective needed to obtain competitive returns in agriculture. This requires greater focus on managing risks inherent to the agricultural sector such as production risks, price volatility, and susceptibility to policy interference.

By and large, the scale of AIFs remains low compared to funds focused in the manufacturing and services sectors with about USD 7 billion currently under management by the 31 AIFs studied. This limits their developmental impacts. However, the growing interest in AIFs presents significant opportunities for expansion, particularly in the ability to harness investments from private equity funds, pension funds, sovereign wealth funds and MIFs.

Local participation, be it financial or in terms of project management, is critical for the sustainability and overall success of AIFs. Given the rise in the number of local entrepreneurs in developing countries demanding investment capital for projects in agriculture, governments are encouraged to initiate policy reforms to ease investments for both local and foreign investors.

Management models

Specialized fund management companies or institutions generally manage AIFs. Although AIFs may be stand-alone funds, they often are part of a family of funds managed by one specialized management company, or a second-tier fund of funds can manage investments in a portfolio of funds. Although this can raise overall administration costs, such strategies can clarify management responsibilities and serve to both expand the investment portfolio and reduce risk by co-investing with other funds that are not in the same line of business.

Performance

A comprehensive assessment of the performance of AIFs is difficult given that many of them have been set up only recently. In addition, their performance is influenced by the mix of interests of investors participating in the fund and their attitudes towards certain investments. Notwithstanding these challenges, an in-depth review...
of the selected AIFs indicates that the performance of investment fund management companies, measured by capital base, depends on:

- Geographic spread, particularly having a network of offices located in several countries. This helps build local capacity, geographically diversify risks and affords the fund manager the ability to monitor investments and provide hands-on operational support. It also enables investee firms to acquire global connections that accelerate their growth and profitability.
- The prevailing financial instruments used and investor types. Equity prevailing over debt tends to be associated with a larger capital base for the fund and a larger value of average investments.
- Committing resources to improve the profitability and operational efficiency of investment funds. Post-investment support, in particular technical assistance funds and/or grants combined with an investment fund almost always enhance the success of enterprises, through effective management.
- The use of information and communication technology to monitor operations in a timely manner (e.g. accounting, information sharing and valuation services).
- Manager experience that helps build institutional and sector knowledge and makes it possible to easily identify and implement best practices worldwide.
- Ability to access local knowledge, which allows fund managers to invest more efficiently and avoid intermediary fees and conditions.
- Ability to tailor finance to the needs of SMEs in the agribusiness sector.
- Ability to leverage investments with developmental initiatives.

These observations lead to some recommendations to enable the growth of AIFs:

- Appointment of a qualified fund manager with the correct skills mix for the specific agricultural investments. In general, the manager should have extensive knowledge of agriculture and agribusiness issues in addition to private equity management.
- A clear mandate to the fund manager and board, along with clarity of investment goals and guidelines is essential. It is important, however, that these are not too prescriptive especially in terms of investment structuring parameters and eligibility standards of companies. Such discretion enables the fund manager and board to react and take advantage of opportunities that may arise in agricultural markets.
- Provision of a bonus incentive for the fund manager possibly tied to investor goals including non-financial developmental impact.
- Due consideration of risks specific to the agricultural sector. In particular, investors need to be sensitive to socio-cultural land related issues in order to minimize socio-political risks.
- A local partner is important to identify investment projects suited to local conditions that maximize impact, and thus attract additional investors.
- A hybrid fund model with multiple share class structure and offering a variety of financial instruments according to target groups is important to provide investors with different risk and return investment options.

**Impact**

The experience of the AIFs studied suggests that the most developmental impact is realized through using a parallel technical assistance facility. This enables SMEs to increase productivity and profitability through access to finance, by receiving equity from investors, or by supplying goods and services to investee firms. This type of support to SMEs benefits the poorer sectors of the population involved in them through improvements in their skills and wage increases.

Developmental impact is also achieved by not only financing acquisition of equipment and technology to improve quality and competitiveness and overcome market barriers, but also by facilitating investees’ access to networks with international service providers and customers. Other developmental impacts arise through operational benefits to investee SMEs which range from tax benefits, social security contributions to employees and philanthropic subsidies that may spill over to their suppliers, customers, employees, and even competitors. In addition, AIFs can address investment gaps in the supply chain, thereby benefiting all segments of the chain.

In general, broader developmental impacts are maximized through close links with local communities and emphasis on generating jobs for the poor.

**Lessons on setting up agricultural investment funds**

Coordinate different investors through well-structured public-private partnerships (PPPs). The major role of the public sector in setting up PPPs is to absorb part of the investment risk.
thereby attracting private capital into the agricultural sector, where there is often little experience from major investors.

**Appoint a fund manager with local agribusiness expertise** and an understanding of the risks specific to the agricultural sector.

**Conduct careful risk assessment and portfolio diversification** that strike a balance between ensuring in-depth knowledge of a specific market and regional risk diversification.

**Sensitize potential investors on the long-term nature of agricultural investments** as this has an impact on their liquidity but can yield significant future returns.

**Integrate market-based risk management tools** such as insurance mechanisms into the process of setting up AIFs to mitigate related risks and attract investors. If and when AIFs operate in multiple countries, special attention must be paid to the role of foreign exchange risks.

**Develop tailor-made financial products** to meet the needs of agricultural stakeholders while managing the inherent volatility and risks in agriculture.

**Integrate impact assessment into the structuring of AIFs** to allow for continual assessment of the qualitative and quantitative developmental impacts of AIFs.

**Stimulating investments in agriculture in developing countries**

Governments and donors can facilitate the expansion of AIFs by considering the following aspects:

**Promoting market-based approaches** to agricultural production and marketing without distorting the market.

**A proper enabling environment for investments** in the agricultural sector is a precondition for successful investment funds. This refers to ensuring security of property rights as well as favoring contract enforcement and execution rights which are particularly pertinent for land markets. This needs to be complemented by employment regulation.

**A clear legal framework for capital repatriation** is needed so that investors are aware of policies that limit their ability to repatriate capital gains in hard currency.

Enabling policies may include **carefully targeted tax incentives for foreign direct investment (FDI)** based on the potential of FDI to contribute to sustainable local development; **investments in infrastructure** to support agricultural production and marketing; and **investments in information technology and education**. These parallel public sector interventions require **coordinated efforts from the relevant public and private sector entities** in order to avoid costly duplication.

**RECOMMENDED READINGS**