



Projects Committee
17th Meeting
27 March 2019 (14:30)
Nairobi, Kenya

Project concept
**Improvement of small-scale farmers' access
to finance for building a sustainable coffee
sector in Vietnam**

Background

1. This document is based on a brief project concept submitted to the ICO by the Ministry of Agriculture and Rural Development (MARD) of Vietnam and aims at building a sustainable coffee sector in Vietnam through supporting small-scale coffee farmers' access to finance and the creation of value addition.
2. The Secretariat will be assisting Vietnam in drafting a fully-fledged project document and in helping to find sources of funding. When approved, the ICO will contribute by monitoring and evaluating the execution of the project.

Action

3. The Projects Committee is requested to consider this proposal and, if appropriate, to recommend its approval by the Council.

PROJECT CONCEPT
IMPROVEMENT OF SMALL-SCALE FARMERS' ACCESS TO FINANCE
FOR BUILDING A SUSTAINABLE COFFEE SECTOR IN VIETNAM

Project title:	Improvement of small-scale coffee farmers' access to credit for sustainable growth and value addition to contribute to the development of the coffee sector in Vietnam
Duration:	3 years (2019-2021)
Location:	Dak Lak and Lam Dong provinces (Vietnam)
Project Executing Agency:	VICOFA/MARD
Project Implementing Agency:	TBD
Monitoring and evaluation:	International Coffee Organization (ICO)
Total estimated project cost:	US\$0.5-2.0 million for the pilot phase
Financing from Donors:	N/A
Co-financing by the Government of Vietnam:	N/A

Project description:

The project aims to improve small-scale coffee farmers' access to short-, medium- and long-term credit to better manage their farms and achieve a profitable and sustainable coffee production. It will focus on the following objectives:

- Assessment of the current status of farmers' access to credit for sustainable coffee production
- Review of international experiences of credit to small-scale coffee farmers.
- Elaboration of appropriate and effective financial mechanisms to improve farmers' access to credit and to reduce risks arising from price and climate shocks;
- Piloting the credit model to farmers' groups involved in coffee plant rejuvenation and upgrading productivity, quality and environmental sustainability of production and commercialization;
- Review of the pilot programme and development of a roll-out plan for the dissemination of the model of small-scale farmers' credit at central and provincial level in Vietnam
- Identification of options for value addition and opportunities for greening the sector and for circular economy solutions to increase income opportunities for coffee farmers and to improve their livelihood and resilience.

Project background

Vietnam has emerged as the second-largest coffee producer in the world. From a tiny production of 1.3 million bags in 1990, representing 1.4% of world production, the country recorded a production level estimated at 29.5 million bags in 2017/18, accounting for 18.6% of the world total. Coffee has become one of the most important agricultural products and export items of Vietnam. The country is now the world-leading exporter of Robusta coffee. During the last five years average annual coffee exports generated an estimated total value of over US\$2.7 billion.

Coffee clearly represents a key factor in ensuring the livelihood of many rural households in the country, since it is the main source of income for more than 500,000 smallholders, many of who are ethnic minorities in the mountainous areas including the Central Highlands. However, after several decades of coffee booming and despite some significant achievements, the sector is facing many challenges on the way towards sustainable development. Coffee trees are getting old, with about 25% of coffee area in Vietnam (equivalent to about 140,000 ha) needing to be rejuvenated in the next five years to sustain current production levels. Coffee farming technology, including production and post-harvest methods, need to be adapted to environmentally friendly practices.

Table 1: Areas of coffee growing in Vietnam (by provinces and hectares)

Provinces	2013	2014	2015	2016f	2017f
Total	623,900	641,300	645,200	662,200	662,200
Northwestern Mountain Region	13,800	15,300	15,900	17,500	17,500
Son La	9,900	11,200	11,700	12,000	12,000
Dien Bien	3,800	4,000	4,100	4,500	4,500
Central Coastal Region	8,800	9,200	9,200	10,000	10,000
Quang Tri	4,700	4,700	4,800	5,100	5,100
Phu Yen	1,400	1,400	1,400	1,400	1,400
Binh Thuan	1,800	1,800	1,800	1,800	1,800
Central Highlands	559,400	573,000	577,700	583,000	583,000
Dak Lak	199,900	203,700	204,400	209,000	190,000
Lam Dong	151,500	157,300	158,800	154,000	162,000
Dak Nong	116,900	118,800	119,500	126,000	135,000
Gia Lai	77,700	79,100	79,700	80,000	82,500
Kon Tum	13,400	14,100	15,300	14,000	13,500
Southeastern Region	42,100	43,800	42,400	51,700	51,700
Binh Phuoc	15,200	15,800	15,900	16,000	16,000
Dong Nai	19,400	20,400	19,700	21,000	21,000
Ba Ria - Vung Tau	6,600	6,700	6,500	7,000	7,000

Source: Country Coffee Profile – Vietnam. ICO, March 2019

An assessment of difficulties encountered in the sector

As reported in the Country Coffee Profile – Vietnam, ICO, March 2019, coffee production in Vietnam has developed as a major export-oriented industry over recent decades. The country is the world's second biggest producer and exporter of coffee. However, Vietnamese coffee is now facing several challenges, the main ones being:

Climate change has brought about several disasters for the coffee production of the country, especially a tropical storm in November 2007 and record heat and drought in 2013, which disrupted most of the coffee plantations in the Central Highlands. In early 2016, when El Niño conditions brought the worst drought in 20 years, rains from December 2015 to February 2016 were 40% below the previous year's level, and by mid-March reservoirs were 15 to 35% below average levels. According to the International Center for Tropical Agriculture (CIAT) Asia office in Hanoi, rising temperatures and shifting rainfall patterns may cost Vietnam 50% of its current Robusta coffee production areas by 2050. Environmental limitations are expected to significantly reduce the land suitable for coffee trees, as average temperatures increase and the dry season becomes longer and hotter, reducing water availability. Experts agree the situation looks dire, but there is hope that the country can cope by using smart agricultural practices.

About 50% of the coffee trees cultivated in Vietnam are between 10 - 15 years old. At this age coffee trees are at their peak and give the highest yield. In coming years, Vietnam's coffee production will depend mainly on these trees. For the rest, nearly 30% of trees are between 15 - 20 years old and about 20% are over 20 years old, beyond their most productive age, decreasing yields and outputs for farmers' season by season. If not timely re-cultivated in the next few years, ageing trees will directly affect the productivity and quality of the coffee beans in Vietnam.

The area of recently planted coffee trees has increased significantly, but the majority of these new areas are not in the planning regions, mostly grown on inadequate areas with shallow soil, steep slopes, lack of irrigation water etc. Therefore, although the newly planted area has increased, achieving high economic efficiency is difficult because of low productivity and high production cost due to being planted in unsuitable land.

Intensive cultivation, such as over-usage of chemicals, fertilizers and irrigation, done in order to achieve maximum yields not only made coffee trees quickly exhausted, but the soil is also severely polluted, causing many diseases and pests, especially fungal ones and root nematodes.

Due to the form of production, small size, dispersion and relative independence of the farming households, the product made is not only low quality but also unstable. The differences in investment for various stages of coffee harvesting and processing between coffee producers has affected the quality of the entire coffee industry. Moreover, it is recommended that there should be one large dry mill for every 100ha of coffee. This standard is still distant from reality, even in potential resource areas for coffee such as Dak Lak and Lam Dong. Standard storage locations for coffee beans after processing are still few in number. Branding and quality certification cannot be achieved.

While coffee is a plant that needs a lot of water, traditional but outdated irrigation is still the main method used in most of the coffee farms. In many localities, the drilling of wells for irrigation has led to the destruction of ground-water resources and pollution of the soil, which is wasteful and ineffective.

In fact, the custom of the farmers in the Central Highlands of harvesting by stripping from the trees of both unripe and overripe cherries is also recognized as one of the reasons for the declining quality of Vietnamese coffee.

The majority of the country's coffee crop is of the Robusta variety, which achieves lower prices than premium Arabica varieties grown mostly in South America, a factor that limits export earnings.

In response to these challenges, Vietnamese policy-makers have been introducing long-term reforms of the country's industry. In 2014, the Government mapped out the Sustainable Coffee Development Plan till 2020 and the Vision to 2030, an overall agenda aimed at sustainably managing economic and environmental resources for the coffee sector, increasing export earnings and ensuring stable production. The plan includes concrete economic goals for the industry's performance, such as increasing intensive processing for added value to achieve US\$6 billion in export revenue in the coming decade. It also sets out environmental directives, including a cap on nationwide coffee cultivation at 600,000 hectares, replacement of old coffee trees with low yields by new varieties with higher yields and better pest and disease resistance, rezoning of coffee areas and exploration of water-saving irrigation methods, as well as environmentally friendly fertilizer and pesticide inputs.

As coffee exports are still dominated by green beans, with low value addition and limited access to bank credit, smallholder farmers must rely on micro-credit from informal moneylenders or small traders who are also input providers. Small traders will advance inputs or cash funds to farmers for investment in production, from the start of the season. At harvest time, farmers are required to pay back the loans with coffee beans. The advantage of this

model is the flexibility in timing, amount and no requirements for collateral. However, the interest rate is very high compared to formal market rates, and there is a large gap between the price paid by traders to farmers and the market price. This difference is considered as the interest rate paid by the farmer for the loans. In addition, these loans are also mainly for short-term investment, making it hard for farmers to finance long-term investment, such as rejuvenation or improvement of environmentally friendly production practices. More specifically, the proposed project will address the following challenges:

- Lack of variable investment to cover production costs from the early season.
- Lack of investment for rejuvenation, seedling change, application of new technology, infrastructure (drying yard, warehouses etc.), and other farming equipment.
- Shortage of funds to cope with risks, such as natural disasters, price fluctuations, coffee pests and diseases.
- Poor capacity of cooperatives/associations.
- Inadequate and inconsistent coffee quality.
- Groundwater depletion that threatens the long-term sustainability of coffee production.
- Lost opportunities and income through minimization and usage of waste from coffee production.

Project rationale and objectives

Project objective: To ensure the sustainability of smallholder coffee farmers by developing and piloting a scheme for improving access to finance for sustainability and value addition.

The project seeks to build an “integrated credit scheme” that establishes direct links between coffee farmers and financial institutions. In order to enhance the technical capacity of the smallholder farmers and their cooperatives, the project will incorporate agricultural extension and strengthening of their management skills and also look into ways to greening the sector and opportunities for circular economy. The main thrust is to enhance the confidence of financial institutions in coffee farmers, and so to enhance the capacity of the financial institutions in credit appraisal and loan monitoring. The key to the success of the programme is the ability of these financial institutions to monitor and facilitate the movement of cash and coffee during the production, processing and marketing cycle. The project will also build the capacity of the institutions involved to access the needs of farmers and extend loans and provide extension services.

The project should also look into providing a facility to address both climate change resilience and vulnerability to price shocks, while implementing solutions created by value addition opportunities.

Project components and activities

Outcome 1: Farmers' access to credit for sustainable coffee production assessed

- 1.1 Assessment of current related policies/strategies/programs in Vietnam, and analysis of the policy gaps/inconsistencies that need to be revised and filled.
- 1.2 Assessment of research/reports conducted on farmers' accessibility to finance in Vietnam by national and international organizations.
- 1.3 Review of current loans/credit programs provided by formal financial organizations in Vietnam applicable to coffee farmers/cooperatives, reflect detail requirements, designs, difficulties of providing for farmers including subsidies, government, banks, guarantee schemes, hedging, etc.
- 1.5 Assess appropriate conditions for formal financial organizations to provide loans/credits for farmers.
- 1.6 Look into hedging and risk-management schemes applicable to coffee sector in Vietnam, including the new IFAD scheme CACHET¹.

Outcome 2: Assessment of the needs and potential of participating farmers

- 2.1 Develop and conduct field surveys in selected provinces (Dak Lak and Lam Dong) of key coffee farmers' groups and cooperatives to assess their cost and revenue structure, as well as financial, legislation and economical issues facing small-scale farmers in accessing formal loans and other funding and insurance schemes
- 2.2 Identify local sources of information and any existing databases that can form the basis of reliable information on farmers
- 2.3 Organize consultative meetings with selected farmers and other stakeholders and with international experts with a view of formulating and consolidating feedback and any other relevant information for the benefit of the PEA and institutions involved in project follow-up (expansion).

¹ *The Climate and Commodity Hedging to Enable Transformation (CACHET) is a financial solution designed to ensure revenue protection for smallholder farmers against climate-related disasters and price shocks. It aims to address two key challenges that are limiting the use of risk transfer mechanisms by smallholders: the lack of access and the limited sustainability of the existing schemes. To address these challenges, CACHET relies on market-based instruments (derivatives), which are substantially used by large private sector operators but have remained unexplored by small-scale producers. The ICO is working with IFAD to pilot the scheme in the coffee sector.*

Outcome 3: Appropriate and effective financial mechanisms for improving accessibility to credit for farmers, farmer groups and cooperatives and to minimize risk to price and climate shocks

- 3.1. Based on deliverables 1 and 2, design appropriate and effective financial mechanism for improving accessibility to credit of farmers, especially focussing on:
 - The design of direct credit accessibility mechanisms from financial organizations to farmers, farmer groups and cooperatives in coffee rejuvenation and sustainable production.
 - The design of indirect credit accessibility mechanisms from financial organizations to farmers, farmer groups and cooperatives through providing credit to input and output companies.
 - The design of risk management schemes to address price and climate shocks.
- 3.2. Hold consultation and validation events to get comments and communicate with policy makers and financial organizations in Vietnam on the proposed mechanisms.
- 3.3. Identify options for networking, clustering and grouping into cooperatives of the participating farmers to increase the feasibility of identified schemes
- 3.4. Assessment of the creditworthiness/ability to repay loans and of available individual and mutual guarantee schemes, collaterals and schemes for individual farmers and groups/networks/clusters/cooperatives. Existing repayment schemes for coffee-centred loans will be put to use.
- 3.5. Define modalities and specification of the terms and conditions of lending to farmers so as to improve access to finance for:
 - Inputs
 - Good Agricultural Practices
 - Business development services and market access
 - Value addition options and greening (post-harvest handling, processing and consumption), including certification and Geographical Indications/typical products, branding

Outcome 4: Model of the mechanism piloted to cooperatives and farmer groups who are involved in coffee rejuvenation and sustainable production.

- 4.1. Identify and select key farmers/cooperatives in Dak Lak or Lam Dong provinces with the greatest potential for growth
- 4.2. Consult with local banks, international banks, donors and other public/private funds on the model piloted in the selected provinces
- 4.3. Pilot the model for at least one group in the selected provinces

- 4.4 Conduct baseline assessment, monitoring the progress and impact evaluation of the model implemented
- 4.5 Communicate the results to other provinces, stakeholders, banks and central level
- 4.6 Develop a plan for the institutionalization and dissemination of the model at central and provincial level in Vietnam

Outcome 5: Efficient Project management

- 5.1 Identification of project stakeholder and governance
- 5.2 Design the project management scheme and the appropriate project committee
- 5.3 Select entity for implementation of the pilot phase
- 5.4 Project supervision by VICOFA
- 5.5 Project monitoring and evaluation by ICO

Project coordination and management

Coordination organization:

Partnership for Sustainable Agriculture in Vietnam (PSAV) is a multi-stakeholder board with the main function of providing coffee-related policy advice to MARD, and coordination and monitoring of resources/programs related to coffee at the national level. VCCB is in a good position to coordinate the implementation program at the national level, connecting with provinces and other programs, especially the agri-finance PPP taskforce within MARD. Based on the source of funding, the specific project management scheme and the appropriate project committee will be defined.

Implementation organizations:

- Coffee provinces institutions
- State Bank of Vietnam, commercial banks of Vietnam
- International banks, funds, donor organizations

Monitoring and evaluation Framework: An M & S system will be established in liaison with the ongoing Delta project in Vietnam aiming to develop a commonly agreed sustainability performance measurement and reporting framework through setting of indicators.

Timeframe: The project is planned for the period 2019 - 2021

Budget: To be determined.