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Rapid appraisal of the financing landscape for the coffee sector in Africa
A business case for financing the "missing middle" and last mile borrowers in the African coffee value chains

Terms of Reference

Background

1. Following the submission of the Africa Coffee Facility proposal to the AFREXIMBANK as the main financial partner of the project, the need was felt to carry out a study to access the financial gaps and business opportunities in the coffee sector in Africa. The Afreximbank President expressed interest in the Bank's involvement as a partner in such a study. The proposed African Coffee Facility (ACF) has the vision of making financial resources available and affordable for the respective coffee value chain players in Africa, particularly Micro and Small to Medium Enterprises ("missing middle") and smallholder producers (last mile borrowers).

2. The proposed study, to be jointly conducted by CABI, IACO and ICO, aims to provide insight on how the lending models could be structured.

Action

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

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Background

3. Access to finance for production, in-country processing and marketing is one of the main challenges limiting the transformation of the African coffee sub-sector into a vibrant and resilient industry. Productivity, overall production and export of coffee from the continent is low due to inadequate application of improved agricultural practices. There are inadequate skills and knowledge of farmers arising from inadequate access to and use of extension services.

4. Inability of farmers to access and use modern and cost-saving technologies, such as improved varieties, efficient pest control approaches, labour-saving mechanisation options and diversification into complementary agri-businesses all conspire to reduce the productivity and quality of smallholder coffee, thereby compromising the income, food and nutrition security of the coffee-dependent smallholders. All these factors contribute to a weak global coffee value chain in Africa. Inadequate investment in coffee rehabilitation and expansion due to lack of finance occasioned by the perceived high risk in the production end of the value chain further jeopardises efforts to revamp the African coffee sector. Incorporation of Technical Assistance (TA), coupled with partnerships with institutions with facilities to absorb all or part of the perceived risk during the formative stages of banking relationships building between the borrower and the lending institution could overcome this bottleneck, thereby spurring improved coffee production and productivity in the continent.

5. The quality and quantity of coffee from African countries are below the biological potential of the farmed coffee varieties and, in many countries, decreasing. Processing equipment and associated practices are either obsolete or sub-optimal. Factory managers lack up-to-date skills and the knowledge-base in processing, thus the development and application of codes of good factory practices is scarce. Most countries lack incentive systems for the production and delivery of high-quality cherry, such as innovative cherry grading at the factory as well as payment based on the cherry quality delivered.

6. Where smallholders operate through cooperatives, a lot of value is lost due to the poor governance of primary cooperatives, low financial literacy of the cooperative management personnel as well as inadequate investment in efficient processing and storage facilities in addition to the limited knowledge in and use of **green power**. A crucial issue in processing in a number of countries, such as Ethiopia and Rwanda, where coffee farmers are paid upfront for the

cherry delivered is the lack of working capital, especially for buying cherry. Farmers' cooperatives often poorly equipped and lacking adequate organization, have low level of governance and inadequate financial literacy, all of which constrain the bankability of such farmers' organisations. Incorporating TA in the lending arrangement could fully overcome these challenges and make cooperatives bankable. Indeed, a project implemented in Ethiopia and Rwanda, which received funding from the Common Fund for Commodities and where CABI provided the TA and the International Coffee Organization provided supervision, proved that lending to smallholder farmers' cooperatives is viable and has a very high repayment rate.

7. Increasing the export of African coffees, while at the same time promoting intra-African trade and encouraging thriving domestic coffee markets therefore requires that actors along the value chain efficiently access the resources necessary to improve production, productivity, quality and marketing of coffee and the development of associated agri-enterprises. Access to finance and the associated TA is crucial in this respect, ensuring that the value chain actors have access to working capital and investment resources, thereby guaranteeing adequate volumes for both domestic, regional and export markets. In addition, financing is required to catalyse increased domestic coffee consumption by establishing expanded capacity of roasting facilities and café chains both in the producing countries and in non-producing African countries. The proposed African Coffee Facility (ACF) is designed with this in mind and has the vision of making financial resources available and affordable for the respective coffee value chain players in Africa, particularly the Micro and Small to Medium Enterprises ("missing middle") and the smallholder producers (last mile borrowers).

8. Currently, AFREXIMBANK is the only significant commercial lender committing funds to the coffee value chain through the ACF. The bank's low presence in the producer and consumer countries in the continent makes it difficult to reach both the "missing middle" and the last mile borrowers. Models that facilitate effective reach to these categories of borrowers with the right products, while ensuring acceptable level of returns on investment, are necessary. The view that agricultural lending is more risky than other sectors emanates more from the lack of technical capacity for credit appraisal and structuring and lack of TA to accompany agricultural loans, than from business being riskier. The proposed project, to be jointly conducted by CABI, IACO and ICO, aims at providing insight on how such lending models could be structured and has the following objectives.

1. Undertake a scoping study to determine the financing needs and appetite of the various coffee value chain players in selected African countries;
2. Identify business opportunities and financial needs for women and youth entrepreneurship in the coffee value chain
3. Analyse the level of investment readiness of the various value chain players and the limitations that may hinder access to commercial lending;

4. Document the key risks associated with lending to the “missing middle” and last-mile borrowers and formulate workable mechanisms for de-risking this segment of the coffee value chain in Africa; and
5. Formulate mechanisms/models for rolling out targeted lending, at scale, to various players in the coffee value chain through the African Coffee Facility
6. Determine business cases for lending to respective actors in the Africa coffee value chain
7. Based on the results from objectives 1 and 2, convene two matchmaking events for the bank and potential borrowers to initiate relationship building between the bank and the borrowers.

Methodology

9. The study will be conducted using a combination of qualitative and quantitative approaches based on primary and secondary data. Primary data will be obtained through focussed field surveys covering the target beneficiaries whereas secondary data will be gathered through a desk study.

Desk study

10. The desk study will involve a document review to gather information on where **the gap** exists between the demand and supply of financial investment serving the large, medium and small enterprises involved in coffee value addition and those serving production and primary processing activities in the value chain. Existing information on the **types of loan products** necessary to fill the current gap will be collected as part of the desk study and analysed to give insight on the **loan sizes** suitable for the various categories of potential borrowers and to **establish the loan thresholds** at which the cost of lending can be recovered by AFREXIMBANK, while ensuring acceptable **levels of returns on the investment**. Information on the expected **annual turnover of loans** disbursed will be collected through the desk study and corroborated through information collected through field surveys.

11. The current sources of financing for the target beneficiaries will form an important part of the desk study. We propose to undertake an analysis of the current sources of finance, both formal and informal, for the value chain segments targeted by ACF, and to determine the existing gaps in financing services that needs to be filled through the ACF interventions. The analysis will further look at the cost of borrowing through such sources and what makes them attractive/non-attractive to the respective value chain players. An understanding of their design, including Safety Nets, to ensure the investors do not lose money, and how they optimise compliance with repayment schedules, will likewise be studied and any lessons learnt incorporated into the proposed design for lending through AFREXIMBANK. The viability of using the existing financial institutions as a bridge to access the “missing middle” and last-mile borrowers will be analysed and appropriate recommendations provided.

12. Part of the financing landscape analysis will concern matching the **types of loan products** available in the financing landscape with the requirements of the respective target segments of the value chain both for investment loans and working capital. This will include the process of accessing the products, the costs associated with the administration of the products and the **risk-return tradeoffs**.

13. The target beneficiaries will be **profiled** with respect to their **investment readiness** and the types and **nature of risks** inherent in their respective lending ecosystems. **Risk mitigation** options available in the respective ecosystems will be analysed and **models for incorporating** them into the proposed lending scheme through AFREXIMBANK formulated. Particular attention will be given to the suppliers of green coffee (**farmers through farmer organisations**), domestic coffee consumption actors (**café chain investors, vendors and local roaster**) and the service providers (input suppliers, insurance service providers, private sector extension service providers, etcetera).

14. With respect to **farmers**, the analysis will consider farmer cooperatives or associations as the smallest entity for consideration under financing by AFREXIMBANK. The analysis of the bankability status of this category of beneficiary will be pegged to a number of predetermined parameters, including the groups' **annual turnover** in terms of volume and value of coffee as well as their governance and **prudential standards**. The study will, based on the results of the ecosystem analysis, develop a checklist of minimum compliance criteria which the bank can use as the benchmark for determining borrower compliance for this category.

15. The **café chain operators and vendors**, both start-ups and existing, is another category of potential borrowers for which the desk study will help bring more clarity to AFREXIMBANK on the conditions that would foster profitability and minimise unprofitability of lending to this segment of value chain players. For this category, the desk study will analyse the existing lending and borrowing tradition and use the results to formulate innovative lending standards for consideration by the bank. Lessons from the more successful lending schemes by mainstream providers will be collated to identify capacity building opportunities for the bank personnel, necessary for the bank to effectively serve this segment and to enable the café chain actors to develop robust and bankable business plans.

16. An important aspect of the desk study will involve **risk and risk mitigation options**. Key risks associated with lending to the "missing middle" and last-mile borrowers will be identified and quantified as part of the desk study. Workable options for designing appropriate intervention schemes, including financing and Technical Assistance, and products capable of de-risking the clientele in the "missing middle" and last mile borrowers, will be identified and synthesised into actionable options, taking into consideration the guiding principles of lending by AFREXIMBANK. To be considered in this regard will be risk-sharing mechanisms, including loan loss guarantee schemes and insurance products, which could be integrated in the initial period during which AFREXIMBANK would build and solidify relationships with the "missing middle" and last-mile borrowers. The period during which the loan loss guarantee schemes is in effect could be used

to **demonstrate the business case for lending to this category of value chain actors.** The success of this approach will rely on the nature of **partnerships** which can be established, and the resources leveraged through such partnerships.

17. Enterprise diversification is not only an important consideration in managing risk at production, but is also critically important in ensuring income, food and nutrition security of smallholder farmers. Financing of farmer-level activities in the coffee sub-sector therefore needs to encompass the associated high value crops for which agro-input use is a necessity. Where input finance is targeted to coffee alone, the tendency by the farmers is to divert part or all of the inputs to other farm enterprises crucial for their food security or in promoting a more balanced living income. The study will take this in mind and will take a more holistic approach when determining the financial requirement of smallholders.

18. Part of the assignment to be undertaken through the desk study will aim to determine the type of partnerships required for each category of the borrowers. The organisations with interest in the coffee value chain in the region with whom such partnerships could be established will be identified. Further, they will be clustered by category of borrowers and prioritised with regard to how they add value to AFREXIMBANK's engagement in lending to the respective borrower. Particular attention will be given to partnership arrangements which act as enablers in designing **blended financing opportunities** to increase private sector lending to the target segment of the coffee value chain.

19. An important category of partners is that of the Technical Assistance (TA) institutions. The desk study will assess the possible role of TA as an integral component of the loan products and models for its integration into the formulated loan schemes. We will be looking at the development partners who could support the two categories of borrowers through TA to build capacity as a means to increase skills and knowledge, hence reducing risk, and to ensure operational best-practice by the clients through provision of advisory services as well as monitoring of the use of borrowed resources. The TA to help the "missing middle" enterprises transition out of informality and grow into bankable, investable businesses will likewise be given prominence in the study.

20. Loan administration to the "missing middle" and last mile borrowers could present a challenge to AFREXIMBANK, given their diversity in size and geographical spread. The desk study will seek to determine viable options for AFREXIMBANK to effectively reach and serve these segments of the coffee value chain. This is critical, given that at the inception phase of the African Coffee Facility, AFREXIMBANK will most likely be the only significant commercial lender providing financing to the African coffee value chain through the scheme. The bank has a low density in the producing countries, with regional offices situated only in Abidjan, Abuja, Harare, and Kampala, in addition to the headquarters in Cairo. The low presence in producing and consuming countries makes administration of loans difficult, particularly to the medium to small-sized borrowers, such as SMEs and farmer organisations. Reaching these important value chain players may therefore require strategic partnerships to act as a bridge between AFREXIMBANK and the target borrowers. This possibility will be articulated through the study.

Field survey

21. To enrich the results of the desk study and to help better understand the factors impeding access to finance by the "missing middle" and last-mile borrower, focussed field surveys will be undertaken.

22. Semi-structured questionnaires and interview guides will be drafted, incorporating contributions from other relevant key experts, and used as the main tools to gather field data. The questionnaires will be pretested with relevant stakeholders from different segments of value chains. The key informant checklists will likewise be validated in similar format. The tools will be used to undertake field surveys and key informant interviews.

23. The field visits will be conducted in cooperation with relevant local government organs, research representatives and other institutions to be selected as appropriate. Data will be collected by contracted enumerators trained through the project.

24. Field visits will be implemented through face-to-face interviews. Key Informant Interviews and focus group discussions will be done as far as practicable. Arrangements to use ICT-enabled interviews will be organised as a contingency. Each category of value chain players will be covered during the field surveys. The categories will have been profiled through the desk study and will include farmers and farmer organisations (individual farmer interviews and focus group discussions), traders/aggregators, millers, local roasters, café chain operators, exporters, financing institutions, service providers/support organisations and Regulatory organisations all reached through Key Informant Interviews. Efforts will be made to have adequate proportional representation of different gender categories.

25. Data collected will be analysed using descriptive statistics, inferential statistics, content and thematic analysis.

Selected countries of the study

26. The following countries will be considered for the study:

- **Coffee-producing countries:** Angola, Burundi, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, Ethiopia, Gabon, Ghana, Guinea, Kenya, Nigeria, Rwanda, Sierra-Leone, Togo and Uganda

- **Non-coffee producing countries:** Algeria, Sudan, Morocco, South Africa, Egypt, Tunisia. In coffee year 2018/19 the selected non-coffee producing countries consume 5.5 million 60-kg bags of coffee, representing 47% of the total consumption of Africa estimated at 11.7 million bags.

Quality control measures

27. CAB International will take responsibility for the quality control under this project. CABI runs its projects in a PRINCE2 project management environment. Projects are managed within a rigorous structure, with performance monitored against deliverables and milestones by the

Project Board, constituted of senior staff involved in oversight and monitoring, and representing the interests of the suppliers and users (clients) of the work. The PRINCE2 project management environment enables CABI to implement established and proven best practices and governance for project management. CABI has managed and led many collaborative projects and programmes, ranging from short consultancies to major global programmes.

28. Under the PRINCE2 system of project management, CABI will establish a Project Board that ensures that targets are met, that the quality of the work is assured and the project outputs are delivered on time and within budget. A robust system of monitoring and evaluation is in place with regular reporting at the end of each stage. The Project Executive leads the Board, and is a senior member of staff with oversight of the work at the highest level, and would be responsible for dealing with any complaints. In the case of a complaint, the issue is elevated to the Project Executive, who would convene a meeting of the Project Board, and any other necessary people, and carefully scrutinise the issue with the project manager and other members of the project team. CABI processes ensure that external customers are represented on the Project Board, so that any concerns can be raised before they become major issues. This is done via the Senior User, who is the Project Board member representing the user/client, and the Project Assurance, who provides advice throughout the project.

29. The quality of performance is ensured by careful project monitoring and by close work with the clients. The work of projects is benchmarked against the acceptance criteria defined at the outset of the work, and usually stated in the contract. The Project Manager and Project Board ensure, through regular monitoring, that quality issues are addressed as they arise. Continuous monitoring against milestones and acceptance criteria ensure that any issues can be resolved at an early stage; delays or issues beyond a set level of tolerance (e.g. 1 day, 1 month, 5%, $x) are automatically escalated via an exception report, which could trigger the above actions.

Logical Framework

Logic of Intervention	Objectively Verifiable Indicators	Sources of verification	Assumptions
Overall Objective Value chain financing for smallholder coffee system in Africa enhanced		ICO reports IACO reports IACO member country reports AFREXIMBANK reports	
Specific Objective: Options for sustainable coffee value chain finance in Africa formulated	Investment readiness status of value chain actors determined Demand for financial investment by the key value chain actors established Key lending risks identified and risk mitigation measures formulated and made available Models for lending to respective value chain actors designed and made available Modalities for establishing effective partnership for blended financing formulated	ICO reports IACO reports IACO member country reports AFREXIMBANK reports	- Target beneficiaries organised in stable legal units - Partner institutions willing to invest in de-risking the coffee value chain - All value chain players and key informants will be willing to provide information - Available key secondary data information will be accessible - Countries will be willing to validate the project and project results - Enable policy and security environment to allow carrying out the study prevails - Timely availability of financial resources
Expected results			
Profiles of the “missing middle” and last-mile borrowers compiled and their investment readiness documented	i. Criteria for characterising the “missing middle” and last-mile borrowers developed ii. The two groups of borrowers clustered based on their similarities with respect to the designed criteria iii. Bankable /near bankable clusters		

	identified for each segment of the value chain		
Financing gap for the "missing middle" and last mile borrowers documented and options for bridging the gap formulated	i. Model for estimating the financial requirements per value chain player per activity domain developed ii. Estimates of financial requirements per activity domain compiled iii. Current sources of financial services per stakeholder segment per activity domain compiled and their respective capacities compiled		
Models for de-risking lending to the "missing middle" and last-mile borrowers formulated	i. Lending risk register for respective category of borrowers compiled ii. Available options for lending risk mitigation in agricultural commodities evaluated for applicability in coffee value chains iii. Recommendations on best-bet risk mitigation for respective segments of the coffee value chain made available.		
Best-bet lending models for the "missing middle" and last-mile borrowers formulated and made available to AFREXIMBANK	i. Main lending models prevalent in agricultural value chains compiled and analysed for their relevance to coffee ii. Main features of lending to agricultural value chains identified and assessed for their relevance to coffee value chain		

	iii. Lending models that take account of the peculiarities of coffee value chains formulated and validated		
Partnership arrangements to facilitate lending to the “missing middle” and last-mile borrowers formulated	i. Aspects of lending to the target segments of the coffee value chain requiring partnership arrangements identified ii. Potential partners in lending to the target segments of the coffee value chain identified iii. Partnership frameworks for each segments of the value chain developed iv. Models for operationalising the partnerships agreed upon		
Activities			
Develop and pre-test tools for field data collection and analysis			
Undertake gap analysis, profile the potential clientele, quantify the demand and supply of financial services			
Document the current sources of finance, and their adequacy in servicing the requirements of the value chain segments			
Document the existing loan products, their size thresholds and target beneficiaries			
Match the types of loan products available in the market with the needs of the respective target segments of the value chain and determine the risk-return Trade-offs			
Document the key lending risks to target segment of the coffee value chain and formulate risk mitigation measures			

Assess the partnership arrangements necessary to develop and implement blended financing schemes for coffee value chains in Africa			
Formulate modalities to increase the reach of AFREXIMBANK to the "missing middle" and last mile borrowers in the coffee value chain in Africa			
Convene two matchmaking events for the bank and potential borrowers			
Identify capacity building needs for both the bank and the borrowers to effectively progress lending to the segment of the value chain			
Compile research results			
Validate report with key stakeholders			

Timeframe for implementation

Activity	Month of implementation								
Develop and pre-test tools for field data collection and analysis	1	2	3	4	5	6	7	8	9
Undertake gap analysis, profile the potential clientele, quantify the demand and supply of financial services									
Document the current sources of finance and their adequacy in servicing the requirements of the value chain									
Document the existing loan products, their size thresholds and target beneficiaries									
Match the loan products available in the market with the value chain needs, determine the risk-return Trade-offs									
Document the key risks associated with lending to target value chain actors, formulate risk mitigation measures									
Assess the partnership arrangements necessary to implement blended financing schemes for coffee									
Formulate modalities to increase AFREXIMBANK reach to the "missing middle" and last mile borrowers									
Identify capacity building needs for both the bank and the borrowers to effectively progress lending to the value chain									
Organise two matchmaking events between AFREXIMBANK, the borrowers, TA institutions and development partners									
Compile research results									
Validate report with key stakeholders									

Budget estimates

Activity	**Estimated cost (USD)**
Develop and pre-test tools for field data collection and analysis	2,860
Undertake gap analysis, profile the potential clientele, quantify the demand and supply of financial services	27,000
Document the current sources of finance and their adequacy in servicing the requirements of the value chain	2,470
Document the existing loan products, their size thresholds and target beneficiaries	2,340
Match the loan products available in the market with the value chain needs, determine the risk-return Trade-offs	2,340
Document the key risks associated with lending to target value chain actors, formulate risk mitigation measures	2,340
Assess the partnership arrangements necessary to implement blended financing schemes for coffee	1,820
Formulate modalities to increase AFREXIMBANK reach to the “missing middle” and last mile borrowers	1,300
Identify capacity building needs for both the bank and the borrowers to effectively progress lending to the value chain	1,170
Organise two matchmaking events between AFREXIMBANK, the borrowers, TA institutions and development partners	4,160
Compile research results	2,340
Validate report with key stakeholders	2,500
Total budget*	**52,640**

** The proposed budget depends on the total countries covered and can be adjusted with a reduction in the number of countries.*