



Critical Capital for African Agri-Food SMEs

A review of demand for and supply of risk capital
for agri-food SMEs in Sub-Saharan Africa.
Based on field studies in Kenya, Tanzania,
Zambia and Mali.

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Preface

Small and medium enterprises (SMEs) in the agri-food sector are making a vital contribution to food security and poverty alleviation in Sub-Saharan Africa. The agricultural sector is of immense importance to Africa: it is by far the largest source of family income and offers employment opportunities for the labour force.

SMEs are often family based and have particular characteristics. Their capitalisation is weak, and technology mostly simple. The production processes of these enterprises are typically more labour intensive than those in large corporate enterprises. Yet they contribute significantly to employment creation, income generation and national food security.

Due to their ownership structure and size, agri-food SMEs face challenges in their growth and development. They need capital for expansion and investments which cannot, or at least not entirely, be generated internally. Some banks and investment funds are willing to provide investment loans. But there are no set markets for external investors, especially equity investors that offer risk capital to these enterprises.

Rabobank Foundation, AgriProFocus and ICCO Cooperation offer support to agri-food SMEs in Sub-Saharan Africa in overcoming some of the most important hurdles to growth and development. We do this by linking them to relevant business and financial networks and offering access to knowledge, expertise and capital. We have learned that start-ups and early growth agri-food SMEs struggle to access risk capital. Private sector parties show great reluctance to extend critical capital to this segment. This limits not only their growth, but it is also a missed opportunity to contribute to achieving the 2030 Agenda for Sustainable Development, specifically SDGs 1, 2 and 8.

The study increases our understanding of the challenges faced by agri-food SMEs as well as those faced by investors and capital funds operating in Sub-Saharan Africa. We trust that this report challenges regulators, donors and potential investors to come up with novel approaches for making critical capital available to agri-food SMEs in Sub-Saharan Africa.

The recommendations in this paper are addressed not only to the Dutch government, but also to investment funds, technical service suppliers, philanthropists and other stakeholders, and they are based on the premise that the role of critical capital is to create sustainable social, environmental and economic impact.

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Utrecht, May 2018

Executive Summary

Agri-food SMEs in Africa, especially small and young companies, need better access to risk-taking investment capital. Agri-food SMEs occupy critical positions along the value chain and are conduits of technology and finance to farmers, in this way contributing to food security and family income. They also offer employment opportunities for the labour force. **Their lack of access to risk-taking capital, holds agri-food SMEs back in their development.**

There is a mismatch between the service offer of investment funds and demand expressed by agri-food SMEs. Investment funds essentially look for large deals, proven but scalable businesses with high growth rates and high return prospects. The majority of agri-food SMEs in Africa are small businesses that have modest financing needs and low return on capital. Moreover, they cannot meet the high standards of management and governance and extensive ESG and reporting requirements imposed by PE/VC funds, nor can they cover the costs of compliance. As a consequence, agri-food SMEs are being held back in their development and growth due to lack of access to risk-taking investment capital.

There is a need to develop a deliberate graduation strategy (see figure 4, page 33) so that agri-food SMEs can make use of an assortment of services that match their development stage. A study by AgriProFocus, Rabobank Foundation and ICCO Cooperation found that **subsidized funds like seed capital, grants, TA, training, BDS** clearly add value to companies and catalyse their development. Once companies meet the conditions, **mezzanine finance** can bridge the gap to market-based risk or debt financing instruments like venture and equity capital.

In order to realise a successful graduation strategy, we call upon:

- Governments and development agencies to recognize the need for philanthropic capital and **blending with substantially below market pricing** in order to reach out to the smaller SME ventures. Of course subsidy elements should be removed as soon as possible. **Governments and development agencies may need to revise the terms and conditions of their own investments** to avoid mission drift of investment funds. Lastly, **they can set up policy guidelines and conduct dialogue** in order to support investments that specifically target start-ups and pre-growth SMEs in the agri-food sector.
- Regulators, donors and investors to come up with **novel instruments** and approaches that better serve the needs of small and young agri-food SMEs and make this critical capital available. **NGOs, funds, development actors and governments should cooperate** to ensure that the different instruments they offer to support SMEs, such as incubation/acceleration programs, challenge funds, BDS and market-based investments are linked to each other to better service SMEs on the one hand, and create a pipeline with bankable clients for funds on the other.

Contents

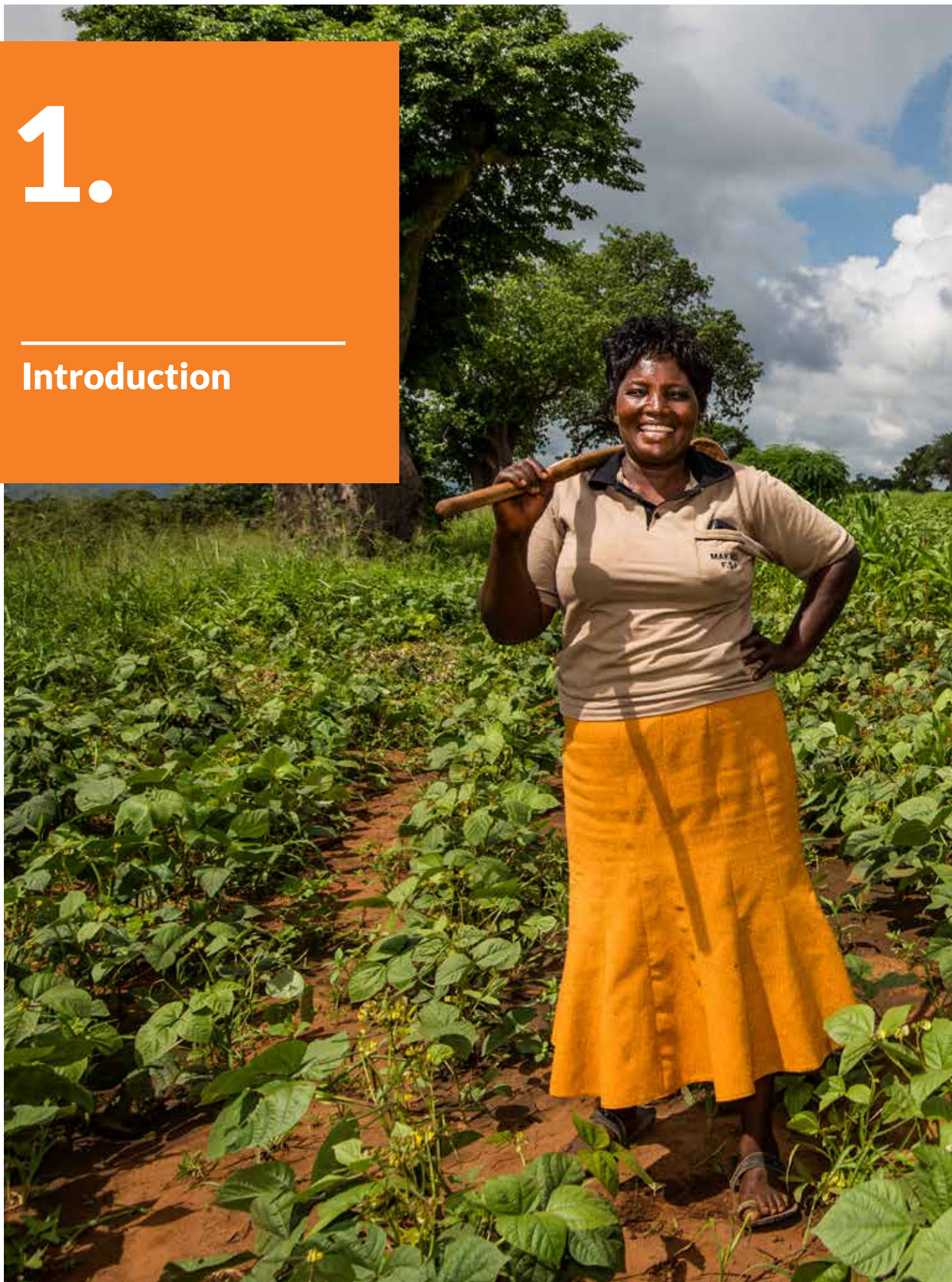
1. Introduction	6
1.1. Objectives	7
1.2. Definitions	7
1.3. Contents of this Paper	8
2. Supply of Risk Capital for Agri-Food SMEs in Africa	9
2.1. Private Equity in Africa	10
2.2. Investment Funds for Agri-Food SMEs in Africa	10
2.3. Fund Operations	12
2.4. Strengths and Weaknesses of Agrifinance Investment Funds	14
3. Demand for Risk Capital for Agri-Food SMEs in Africa	16
3.1. Narrow Market Segment	17
3.2. Low Ability and Willingness to Absorb PE/VC	19
3.3. Need W/C rather than Investment Capital	20
3.4. Political and Economic Environment	20
4. Are Demand and Supply for Agri-Food Investment Finance Matched?	21
5. Alternative Means to Finance SMEs	24
5.1. Using Venture Capital	25
5.2. Without Venture Capital	27
6. Key Results and Policy Recommendations	31
6.1. Key Results	32
6.2. What is Needed?	32
6.3. Recommendations	33
Appendices	35
Appendix A – Agri-Food SME Case Studies	36
Appendix B - About the Publishers	56
Appendix C - Acronyms and Abbreviations	57

Boxes and Figures

Box 1: Case Study Twiga Foods (Kenya)	13	Figure 1: Demand and supply discrepancies between investment funds and agri-food SMEs	22
Box 2: Reasons Funds Decline agri-food SMEs	13	Figure 2: Approximate capital position of the case studies	23
Box 3: Quote from the Fund Management Practice	14	Figure 3: Different types of mezzanine finance	26
Box 4: Case Study Sylva Foods (Zambia)	17	Box 10: Case Study Sochon (Kenya)	27
Box 5: Case Study Zambezi Pineapples (Zambia)	17	Box 11: Case Study Produits du Sud (Mali)	28
Box 6: Case Study Java Foods (Zambia)	18	Box 12: TanFeeds Ltd (Tanzania)	29
Box 7: Case Study Sofa Agri-business (Mali)	18	Box 13: Ten Senses Africa (TSA) (Kenya)	30
Box 8: Case Study Danaya Cereales (Mali)	19	Figure 4: Graduation services strategy for SMEs	33
Box 9: Case Study Faso Kaba (Mali)	20		

1.

Introduction



Introduction

1.1. OBJECTIVES

In spite of more than sufficient local potential, large portions of the population in Africa continue to be food insecure. These include the rural populations that produce food. Food supply is constrained by very low productivity, huge post-harvest losses, climatic factors that are not properly controlled through mitigation strategies, and generally poorly functioning value chains, including access to finance along the chain. Agri-food small and medium-sized enterprises (SMEs) occupy critical positions along the value chain: as input suppliers, off-takers, processors, distributors, service providers or otherwise. Agri-food SMEs are also conduits of technology and (harvest) finance to farmers, and also encourage the formation of farmer organizations. However, agri-food SMEs find it very difficult to access investment capital, probably even more so than non-agri SMEs due to their broad exposure to agriculture, which financiers deem to be risky. Agri-food SMEs' poor access to finance leads to reduced purchasing from farmers upstream and reduced food availability downstream.

This policy paper evaluates demand for and supply of risk capital in agri-food SMEs, and the extent to which these are matched, and it identifies bottlenecks in the provision of risk capital that might be taken away through development interventions. Apart from desk research, the study involved field research in four countries, namely Kenya, Tanzania, Zambia and Mali. Local researchers visited investment funds, agri-food SMEs, and relevant resource persons. This resulted in examples of agri-food SMEs that had raised capital, thereby boosting their development, and some SMEs that could not access such funds. Interviews with funds and resource persons shed light on the factors that impede more of this kind of investment activity taking place.

The ultimate objective of this study is to document the current situation in risk capital for agri-food businesses in Sub-Saharan Africa as evidence for related policy recommendations to governments, investment funds, technical service suppliers, philanthropists and other stakeholders.

1.2. DEFINITIONS

This study looks at agri-food SMEs that form the **'missing middle'**: too large for microfinance and too small for mainstream banks and private equity firms. Their financing needs are typically in the range of about USD 50,000 to USD 1 million, with a maximum of USD 2 million. However, most are below USD 250,000. The cost to financiers of serving the missing middle is high compared to client ability (or willingness) to pay interest or generate investment return. An additional barrier on the demand side is that many agri-food SMEs are not finance-ready (e.g. no track record concerning financial data, no collateral). Consequently, agri-food SMEs fail to realize their potential, purchasing less from farmers, producing less food for the market, and generating less employment than they might have with sufficient access to finance. This study does not cover the financing needs of primary producers (farmers), as different financing instruments are available for this group. However, access to finance for farmers is equally dire. They often rely on agri-food SMEs to access finance, e.g. harvest credit.

SMEs are usually classified based on their number of employees, turnover, or capital (e.g. < 10 staff is micro, < 50 is small, and < 300 is medium). However, one may also distinguish SMEs by other characteristics, such as whether they sell locally, regionally, or internationally, their legal status, or sophistication of management. Some small businesses operate globally and act like complex corporates. A special type of SME is cooperative societies, which are common in agriculture and may be sophisticated businesses including aggregation, processing and trading. Regrettably, because the ownership structure is based on 'members,' cooperative societies cannot easily be funded by a private equity/venture capital fund, although they can and do raise debt. None of the companies surveyed in this study is a cooperative, but many source from farmer cooperatives.

Following the Global Impact Investing Network (GIIN), the respective types of agri-food SMEs are defined as follows.

A **start-up** company is one where a business idea exists, but little has been established in terms of operations and little or no revenue is being generated. An **early stage** company is one where operations have started and the company is generating revenues, but has probably not yet achieved positive Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). Such companies are usually less than three years of age. A **growth** company is operational, has a proven product/market combination, and has positive EBITDA. However, the company still has plenty of scope to scale up and grow. A **mature** company has stabilized at scale, is operating profitably, and has only limited potential for further expansion.

Private equity (PE) is capital that is not noted on a public exchange, but directly invested in private companies, sometimes after a buyout and delisting of public companies. Private equity comes primarily from institutional investors, accredited investors and wealthy family trusts, which can dedicate substantial sums of money for extended time periods. Long holding periods are often required for private equity investments in order to create sufficient value for profitable exit. **Venture capital (VC)**, can be seen as a sub-class of private equity, and is money provided to build start-up firms or early stage initiatives that are considered to have high-growth potential yet high-risk of failure. Entrepreneurs turn to venture capitalists because their company is so new, unproven and risky that more traditional forms of financing, such as banks, are not readily available. A venture capitalist seeks a high rate of financial and/or social return to compensate for the high risk of failure and hence loss of capital.

Following these definitions, **PE funds** would normally be looking for scalable deals (growth companies and sometimes early stage initiatives), and the same is true for most funds providing debt financing. **VC funds** base their investment on the expectation of scalability, typically investing in early stage and sometimes start-up companies.

Seed capital consists of a direct capital contribution to start-ups and (very) early stage initiatives in the hope that some of them will achieve outstanding results. Seed capital can be used to purchase equipment, fund start-up costs, or to absorb initial losses. A **repayable grant** is a donation that is contingent on certain conditions, such as an investment programme being completed or the company failing, in which case repayment would be impossible. In **convertible equity** the contribution is converted into a percentage equity stake if and when the business takes off.

Impact investors' intention is to generate social and environmental impact alongside a financial return. Most impact funds use **blended finance**, which is the strategic use of public and/or philanthropic funding to catalyse private sector investment (make a transaction happen that would otherwise have had little chance of attracting private investor interest). They do this by mixing public and private monies, with some investors accepting higher risk or below market returns in order to leverage private capital (market priced) for their impact aims.^{1,2}

1.3. CONTENTS OF THIS PAPER

This paper starts with a summary of funds providing risk capital to agri-food SMEs in Africa, most of which are impact funds (chapter 2). This is followed by an analysis of demand for risk capital (chapter 3), based on the 15 case studies of agri-food SMEs in Kenya, Tanzania, Zambia and Mali that had obtained risk capital, or had failed to do so. The paper subsequently analyses the extent to which demand and supply are matched (chapter 4). Alternative means of financing agri-food SMEs are identified (chapter 5). The paper concludes with policy recommendations (chapter 6).

¹ Convergence, in "the state of blended finance", July 2017, distinguishes the following types of blended fund providers:
1) MDBs and DFIs (e.g. IFC, FMO), which also provide guarantees and risk insurance, 2) philanthropic investors (e.g. Gates Foundation, Stichting Doen), 3) private investors (e.g. JP Morgan, OikoCredit).

² Convergence, in "the state of blended finance", July 2017, makes a distinction between blended finance deals through 1) junior/subordinated debt (first loss to de-risk the investment of private investors and / or below market price), 2) grants for TA/BDS to enhance the project's chances of success, 3) guarantees and risk insurance, 4) design and preparation grants, 5) a combination of the above. The first two categories are most common.

A photograph of a woman in a coffee field. She is wearing a yellow headwrap and a blue and white floral shirt. She is smiling and holding a large woven basket filled with red coffee cherries. The background shows green coffee plants and a clear sky.

2.

**Supply of Risk Capital for
Agri-Food SMEs in Africa**

Supply of Risk Capital for Agri-Food SMEs in Africa

2.1. PRIVATE EQUITY IN AFRICA

When discussing risk capital, the role of private equity (PE) and venture capital (VC) funds comes to mind. Over the past decade, the use of PE and VC to fund capital investment in Africa has grown exponentially. In the early 1990s, a mere dozen Africa-based funds managed a combined USD 1 billion; today, more than 200 funds manage over USD 30 billion targeted to Africa.³ Private capital has funded large projects (± USD 100 million) in infrastructure, mining and energy in all four countries reviewed in this study. Industry has attracted private capital as well.

Agriculture, and primary production in particular, has attracted less capital, which is because agricultural investments are seen as risky and also logistically difficult to serve. Furthermore, private capital providers usually favour 'large' deals, much larger than the amounts a typical agri-food SME could absorb, let alone individual farmers. Nevertheless, investment capital for agriculture in Africa, including private equity, is strongly on the rise. In 2010, the study *Agricultural Investment Funds for Development* by Calvin Millar and Taskiani Ono (both FAO) listed 18 agri-Investment funds (worldwide). The team updated their study in 2016, and this time they found 63 such (specialized) funds. The total capital of the agri-investment funds identified by FAO in 2016 reached USD 7.1 billion.⁴ Briefing note 15 of the *Initiative for Smallholder Finance* (May 2017) listed more than 80 funds financing agriculture including agri-food SMEs (worldwide), totalling USD 19 billion, although on closer inspection many are multi-sector funds.⁵ The annual inventory prepared by GIIN (*Impact Investor Survey 2017*) found that out of 208 impact funds surveyed, 112 invested in Food and Agriculture, and this number is increasing. However, on average agriculture still does not exceed 6-7% of the impact portfolio. Traditional development-oriented investors, chiefly Multinational Development Banks (MDBs) and Development

Finance Institutions (DFIs), Foundations, Wealthy Family trusts, and religious institutions ("impact investors"), are being joined by global investors (not impact investors) that are far more focused on high returns. This includes pension and insurance companies, sovereign wealth funds, as well as professional fund managers on behalf of international capital providers. These investors capitalize on African companies that can absorb capital and generate high returns. Thus, an increasing volume of capital is directed to Africa, including agriculture, not just because of the wish to do good, but because it is good business. Some examples of funds that pursue financial rather than developmental goals are the various funds of Abraaj group, or funds such as AHL Ventures Partners and Inside Capital Partners.

2.2. INVESTMENT FUNDS FOR AGRIFOOD SMEs IN AFRICA

A survey of public sources, including an internet search, suggests that there are over 100 funds providing investment capital to agri-food SMEs in Africa.⁶ Funds can be categorized by the size of the investments (e.g. up to USD 1 million is small, up to USD 5 million is medium, and over USD 5 million is large), by geographical reach (e.g. national, regional, global), or a distinction can be made according to the instrument/investment policy (e.g. wholesale agriculture, niche fund, venture capital, local/regional fund, fund of funds, etc.).

A review of these 100-odd financing funds, purportedly reaching out to agriculture, shows that about ten are not active, either because fundraising has stalled, or because they have reached the end of their active life ('harvest'). Ten more only finance (other) funds, banks or micro finance institutions (MFIs), and a further ten are niche funds (e.g. climate change, soil conservation, renewable energy) that do not normally finance agri-food SMEs, although they are not excluded. Then

³ Source: African Private Equity and Venture Capital Association (AVCA)

⁴ Of these, there were 24 funds for Africa, 25 multi region (usually global), and 14 non-Africa.

⁵ Smallholder Finance briefing #15, "Moving the Needle on Inclusive Agribusiness Finance".

⁶ There are probably dozens of small local agri-funds that have escaped on our attention. There are also many wealthy family funds that keep a very low profile and are occasionally stumbled upon.

there are funds providing commodity trade loans (short-term), and some funds provide guarantees only. This still leaves about 70 investment funds that partly or exclusively finance investments in agribusiness (medium and long term) in Africa. Further analysis reveals that 53 funds offer private equity, 27 venture capital, and 41 loans (PE and VC funds often provide loans as well, but usually in the form of mezzanine finance).⁷ 23 funds exclusively finance agriculture (usually agribusiness only), four funds finance a sub-sector of agriculture (e.g. seeds, forestry), and 42 are multi-sector. Some multi-sector funds have a meaningful exposure to agriculture, but most are not of great interest to this study.

Of the 23 agriculture-only funds, 16 funds provide small (up to USD 1 million) and/or medium (up to USD 5 million) financing. The total capital of these funds is USD 252 million. However, after subtracting two funds that only or chiefly provide loans, the total amount available for capital investment is USD 231 million. While half of the funds target East Africa, their value amounts to less due to the large Fund for Agricultural Finance in Nigeria (FAFIN) (USD 66 million). The funds most relevant to this study are listed below.

Funds pursuing large deals in agriculture in Africa (> USD 5 million):

- Africa Agriculture and Trade Investment Fund (AATIF, only loans)
- African Agriculture Fund (AAF, Phatisa, PE and VC)
- Actis Africa Agri-business Fund (PE)
- Agri-Vie 1 and 2 (PE)
- Global Agricultural and Food Security Programme (GAFSP). This multi-donor fund, managed by IFC and blending donor funds with IFC capital, faces no size restrictions, but the fund has concluded large deals mainly (PE and loans). The above funds typically use blended finance streams. The developmental strategy is to grow the overall agricultural sector, indirectly reaching smallholders (e.g. as outgrowers) and related agri-food SMEs. However, all of the above funds tend to favour lending to (agricultural) banks and MFIs rather than to agribusiness companies directly. Banks and MFIs are then supposed to develop agrifinance products. Because of the deal size, none of these funds is directly relevant to the aim of this study. Nevertheless, they could have indirect effects on the stated target group.

Funds pursuing small and medium-sized deals in agriculture in Africa (< USD 5 million):

National funds:

- BAGC (Mozambique, loans)
- FAFIN (Nigeria, PE)
- Yield Uganda Investment Fund (PE)

Regional funds:

- AAC, AACF and ASIF, all covering East Africa and all managed by Pearl Capital (PE and loans)
- Voxtra East Africa Agri-business Fund (PE, debt)
- AgDevCo (all sizes, all instruments, seven countries)
- Injaro Agricultural Capital Holdings, West Africa (PE, debt)

These funds typically aim for the 'missing middle' segment, reaching smallholder farmers indirectly as outgrowers. Nearly all of these funds have an explicit developmental objective, which enters their appraisal process (e.g. create employment, reach out to smallholder farmers). Most but not all of these funds use blended finance streams, chiefly below market price or first loss capital. Nevertheless, these funds tend to be quite risk averse.

Funds serving early stage initiatives in agri-food:

- Truvalu (small deals in agribusiness)
- IncluVest (Woord en Daad, small deals in agribusiness)
- AgDevCo (all sizes, PE, VC and debt)
- AAF (Phatisa – large deals)
- Novastar in East Africa, a multi-sector fund that has a sizeable agricultural portfolio (small and medium sized deals, VC)
- DOB Equity, also multi-sector and in East Africa (PE, VC, medium-sized deals)
- Fanisi Venture Capital, in East Africa (PE/VC, medium sized deals)
- Acumen, East Africa (PE/VC, medium sized deals)
- Business Partners SME fund (Southern and East Africa, small deals)

The above-mentioned funds differ in strategies, sometimes focusing on the smaller ventures, sometimes reaching out to large companies, sometimes including start-ups, but mostly not. These funds typically accept relatively high investment risks, but only if they can rely on (implicitly) subsidized capital streams. VC funds are usually the first institutional investor in the SME. As the proprietors still have a lot to learn, hand-holding is embedded in the model.

⁷ As many funds provide more than one category of funding, the total adds up to more than the number of funds.

The above-mentioned funds rarely invest in primary production (agriculture). AgDevCo is the main exception. Grofin also invests in agriculture, but only in combination with post-harvest value addition, and it avoids seasonal crops.

Nearly all investment funds are stand-alone operations, not linked to any (other) development programme. Sometimes, however, funds collaborate with incubators, value chain or rural development programmes referring clients and helping build pipeline. This is the case, for example, in Truvalu as well as IncluVest. They pick up clients that have already been trained by somebody else (e.g. incubators/accelerators, development programmes, government, NGOs). However, overall such collaboration has been found to be quite rare.

In addition to the above, there are some local providers of capital, usually linked to banks, insurance companies, pension funds, MFIs or development projects. The fieldwork identified one such fund in Kenya and another in Zambia, but the volume of finance and individual deal size tends to be small. Generally speaking, access to finance – both loans and capital – for agri-food SMEs is more difficult in Zambia and Mali than in Kenya and Tanzania. Companies in Kenya looking for investors have the advantage that many funds have an office in Nairobi, not in Lusaka, Dar es Salaam or Bamako.

2.3. FUND OPERATIONS

PE/VC funds nearly always take an active interest in the **governance and management** of their investees. At the very least, they occupy one or two seats on the Board. Often, they fulfil an (informal) advisory role as well, for example through regular management meetings (ExCom). Truvalu states that it acts as ‘co-entrepreneur’, taking part in commercial and technical decisions along-side the project promoter. VC funds such as Novastar and Acumen also operate in close proximity to the business. Most PE funds limit themselves to minority positions. VC funds are more likely to take majority investments as early stage/start-up entrepreneurs typically have little capital of their own.

Apart from coaching by their own staff, PE and VC funds often use external consultants to provide **Business Development Services** (BDS) and training to their investees. This may be funded from within the fund (e.g. through the income generated) or through external donor support. All fund managers and resource persons interviewed for this study stated that this BDS is very important for the development of agri-food SMEs. This was confirmed by the SMEs visited. Benefits were obtained in management, governance, as well as operations and technical processes. It has nevertheless been observed that BDS needs to be relevant to the business (e.g. directly aimed at problems the company faces, not just general training) and that companies do not always partner the right staff to BDS and training efforts. The field research also revealed a lot of supply-driven BDS emanating from the investment funds.

PE and VC funds usually **exit** from their investment after five to eight years, whenever the PE/VC investor no longer adds value or a good divestment opportunity presents itself. The most common way of exit for the larger investments is through sale to another (strategic) investor including other PE funds. For smaller investments, sale to the co-shareholders or management buy-back are more common. Listing on the stock exchange is only open to the largest investments.⁸

As funds have little income from dividends or loan interest, all **fund management costs** must be recovered from the sale of shares at exit. This implies that a large chunk of the capital raised by PE/VC funds is never invested in companies. It is used for initial due diligence (e.g. legal and audit fees) and subsequent fund management costs instead. As investors in PE/VC funds typically expect a return on investment of at least 10% per annum, as the holding period is over five years, and as up to half of the capital is consumed by due diligence and management costs, it follows that the investments’ exit price must be at least 3-4x the initial price paid, not counting investment failures that must be compensated as well.^{9,10,11}

⁸ The annual inventory prepared by GIIN (Impact Investor Survey 2017) identifies four types of exit: 1) strategic buyer, usually another company in the same sector hoping to derive synergies from the acquisition or merger, 2) financial buyer, interested in the profit potential of the firm, 3) initial public offering, listing on the stock market and subsequent sale of shares, 4) management buy-out, by the current managers or current investors (which are often the same people).

⁹ We may cite the example of Voxtra East Africa, looking for investments with internal rate of return over 15%, or Silk Invest’s African Food Fund, which aims to deliver an internal rate of return in excess of 25%.

¹⁰ The Convergence study on Blended Finance noted that even blended finance operations require relatively high risk-adjusted returns; otherwise private investors would not be participating. For private investors to participate, the absolute risk must be acceptable, the risk-return profile of investments must reflect market conditions, and diversification through the pooling of assets across sectors or countries is required.

¹¹ The annual inventory prepared by GIIN (Impact Investor Survey 2017) found that 66% of (209) respondents (investment funds) target risk-adjusted market returns, 18% somewhat below market returns, and 16% aim for returns closer to capital preservation. The latter were chiefly funds operated by not-for-profit fund managers, foundations and NGOs, and invariably small funds.

The fact that few investment funds are revolving – they need to return the fund capital to investors after eight to ten years – also puts pressure on funds to generate return. AgDevCo is one of the few revolving funds.¹²

Consequently, PE and VC instruments can only be used for businesses that can generate rapid growth in turnover and profits. Indeed, PE and VC are most suitable for such high growth businesses because they would not be able to attract sufficient loan finance to fund growth. To maintain acceptable solvency ratios, bank financing would need to be accompanied by a rapid increase in equity capital, which probably cannot be generated through internally retained earnings.

Box 1: Case Study Twiga Foods (Kenya)

The case studies included several high-growth businesses, typical clients for PE/VC investment funds. Twiga Foods is one of them. The firm aggregates fruits and vegetables from producers and distributes to vendors with the help of an online portal. The technology platform and distribution method have been shown to be highly disruptive (to intermediary traders) and the company, which only started operations in January 2017, reached USD 300,000 monthly turnover by October of the same year. Sales are expected to grow by 15% month-on-month. Although Twiga Foods was essentially a start-up, it collected funds from a number of (international) PE/VC funds with remarkable ease. DOB Equity was one of them, AHL another. Over USD 6 million equity financing was received, and USD 4 million debt acquired.

Box 2: Reasons Funds Decline Agri-Food SMEs

It follows from the above that PE/VC funds must be highly selective. The most common reasons for declining applications are the following:

- Insufficient growth perspective in the market, lack of proven product-market combination, business model not scalable
- Linked to the previous, expected return (internal rate of return, IRR) too low - lack of ability to create shareholder value (e.g. 3-4x multiple on exit)
- Doubts about the entrepreneurs themselves (sometimes too old, not entrepreneurial, not technically qualified) or the management team in general. Often too dependent on one single person (key-man risk)
- Weaknesses beyond the direct control of the firm, such as low quality and productivity of its suppliers (outgrowers), which may jeopardize the business case
- Owner does not want to share control (let alone cede a majority stake)
- No shareholder structure or governance, may not even be legally established and registered
- Lack of viable exit strategy, in particular for the smaller ventures, or the owner/co-owner objects to the fund (eventually) selling its stake to an outsider
- Financing need too small, start-ups in particular
- Too little own investment by the entrepreneur ('skin in the game'). Sometimes the business is already heavily indebted or has a poor prior credit history
- Lack of proper accounting (let alone audited financial statements), management and reporting systems, hampering the due diligence and subsequent monitoring process
- Specific requirements relating to social impact or sustainable production are not met (e.g. no quantifiable social impact, use of ecologically unsustainable production methods)
- Financial, operational, tax, and legal due diligence reveal issues of non-compliance, involving a (reputation or financial) risk
- Politically exposed persons among the company's owners or managers

¹² In addition, DFID's return expectations are not much higher than capital preservation.

2.4. STRENGTHS AND WEAKNESSES OF AGRIFINANCE INVESTMENT FUNDS

The main **strength** of investment funds is their ability to provide access to finance where the regular banking and financial system cannot. Indeed, the case studies (Appendix A) include multiple examples of companies that obtained such funding, whereas they had previously been rebuffed by banks. Having obtained risk capital, many could subsequently obtain regular bank loans, but only in this order. Another strength of PE and VC funds in particular is their ability to bring companies to a higher level of performance. Due to their usually hands-on approach and insistence on best practices in management and governance, they keep management alert, which eventually pays off. Some of the more progressive entrepreneurs seek out PE/VC funds precisely for this role, not just the money.

Box 3: Quote from the Fund Management Practice

"It's all about having the right team, and the right management, whether you're a fund manager to come in and optimize agribusiness or do greenfield investments. If you can find the right management you can make a lot of money in anything, particularly in Zambia where the margins are slightly higher."

A **weakness** of many PE and in particular VC funds is their small size given high management and high deal generation costs. Funds such as the Pearl Capital funds (for agriculture) in East Africa, Truvalu, IncluVest, and Voxtra East Africa are all below USD 25 million, which makes it hard to cover due diligence and management expenses. This obviously becomes more difficult the smaller (hence more numerous) the individual investments. Another weakness of some funds is their desire to operate globally, adding yet more to the operating costs. Most funds, however, operate in a limited geographical space. Capital 4 Development, for example, has now decided to concentrate on East Asia.

The combination of the above-mentioned weaknesses, namely small fund size, relatively high management costs, and high return expectations by investors, means that many investment funds struggle to raise capital. Fund investors simply do not believe their return expectations will be met. It is not uncommon for funds to be announced but never to take off due to failed fundraising. Others start with a much smaller fund size than initially announced, just hoping that some more money will be collected once they have started.

Indeed, according to market observers, many agri-funds never reach the (high) return expectations they had presented at the time of fundraising. This is even more true for funds targeting small deals (below USD 1 million) – the due diligence and management costs just take too much of the fund's capital.¹³ It was also noted that many funds do not serve their (initially) stated target group. For example, they launch on the promise of reaching out to the smaller companies and early stage initiatives, but after starting work they gravitate toward the larger investment deals in more mature sectors. This was clearly visible during the field research. As many of such funds use blended or below market rate capital, initially meant to finance risky and unproven business propositions, these funds may end up distorting the market.

Given the cost of operations, small PE funds, and VC funds operating in the highest risk segment, need access to concessional capital. Indeed, even large funds such as AATIF and GAFSP rely on considerable amounts of blended finance, with donor agencies making available below-market rate capital. It is also common that blended finance includes grant elements for TA to fund managers and BDS to investees. In the segment investigated in this study, risk capital in small amounts for early stage agri-food SMEs, a substantial proportion of philanthropic funding would be required.¹⁴ AgDevCo does indeed receive some operational subsidies from DFID.¹⁵ 1776 Seed Fund can even make grants by way of seed capital. However, for most funds this is not available. Many of the

¹³ AgDevCo in Zambia recently raised its minimum investment size from USD 250,000 to USD 1 million because it found the small investments to be unviable (too high due diligence and management cost).

¹⁴ Truvalu just offers capital preservation to its investors.

¹⁵ AgDevCo provides 'patient capital', which it defines as long-term capital that seeks a social as well as a financial return, has a high tolerance for risk, and is willing to accept positive but less than fully commercial returns in exchange for greater development impact.

smaller VC funds appear stuck in a chicken and egg syndrome, too small to satisfy minimum risk/return requirements, yet unable to attract capital. They would need to operate at much larger scale to make a compelling business case to their (potential) investors and justify subsidy elements.

Another impediment to risk capital for agri-food SMEs relates to currency risk. Investment funds typically rely on funding sources denominated in USD or EUR, and need to repay their investors in the same currency. The investees, however, mostly operate in other currencies. A business may do well in local currency, but measured by the foreign currency value of capital returned at exit the result may disappoint. It does not matter in Mali due to the fixed value of the FCFA, but it does matter a lot in high-inflation Zambia. Where loans are provided, most investment funds opt to do so denominated in foreign currency. This, however, shifts the currency risk to the borrower. Again Zambia is an example of what could happen, and some funds have had to reschedule loans so that borrowers did not succumb to vastly increased repayment obligations (in local currency). Currency hedging by investment funds is not common, and the resulting hedging costs would be shifted to the investees anyway.

3.

Demand for Risk Capital by Agri-Food SMEs in Africa



Demand for Risk Capital by Agri-Food SMEs in Africa

The demand analysis is based on fifteen case studies of agri-food SMEs visited in the field, as well as feedback from investment funds and resource persons. The cases are summarized in Appendix A. Four out of fifteen companies are led by female entrepreneurs, all in Zambia and Mali.

The various investment funds interviewed by the research team, as well as various resource persons, indicate that there is strong *need* for risk capital for agri-food SMEs in Africa. Likewise, agri-food SMEs need assistance in strategy development, governance and management, as well as operations and marketing, which PE/VC usually supports as well. The case studies showed that many agri-food SMEs could benefit from a strategic co-investor, bringing both capital and management skills.

Box 4: Case Study Sylva Foods (Zambia)

This food processing company (which makes products including soups, porridge, tea) has been around since 2009 and has considerable growth potential. Sylva Foods has built solid supply networks with women's groups that produce and dry food ingredients. However, the company suffers from a lack of strategy, poor distribution, and lack of access to finance. Sylva would like to attract external investors, but it does not seem investment ready – certainly not for the PE/VC sort. The investment need of ± USD 100,000 is too low, annual sales are only around USD 350,000, and managerial weaknesses are plenty. For much of 2017 the company was inactive due to machinery problems. It might be a suitable client for seed capital (of which it already received some), angel investment, or perhaps some mezzanine finance. The company could certainly benefit from professional and strategic advice.

Nevertheless, many resource persons and fund managers in particular indicate that the volume of *investible demand* from agri-food SMEs is not all that large. Indeed, for investment

funds in Africa (PE, VC or loans) clients are pretty thin on the ground. Given their very restrictive requirements (proven but scalable business, impact aims), one of the VC funds indicated that only about 3% of the prospective clients that approach the fund eventually end up with a deal being closed. As to the other clients, while they apparently did wish to invest in agribusiness, they did not constitute investible 'demand' for the reasons indicated in the previous chapter. Fanisi Venture Capital in Kenya indicated that 80% of firms that present themselves are either start-ups (non-eligible) or too small (below USD 1 million) and dismissed right away. Pearl Capital reviewed 50 applications for the AACF and funded eight. All investment funds interviewed in this study indicated that they have to work hard to find the desirable deals. It is not uncommon for funds to be unable to place all their capital.

Box 5: Case Study Zambezi Pineapples (Zambia)

This company, essentially a start-up, processes pineapples and other fruits into snacks and juices. The company is still struggling to find its sustainable product/market combination. Challenges include high competition, high operational and logistics costs, and lack of working capital. The company was established through the owners' capital and external grants, of which the company hopes to tap more. The company has not yet reached the stage where it could tap debt markets, let alone risk capital. However, it might need managerial advice more urgently than capital.

The following issues were brought up to put the notion of high demand for risk capital into context.

3.1. NARROW MARKET SEGMENT

As mentioned in the previous chapter, PE and VC funds even more so can only be profitable if they invest in very *high growth* businesses. The business model must be proven to some extent, and be explicitly scalable. From the company's point of view, they would seek capital precisely because of

their high expansion, as they would be unable to finance such growth through bank loans (alone). In the absence of additional capital, solvency ratios would deteriorate – if banks were even willing to finance their ventures – and they might also not have sufficient collateral. Thus, more gradually growing businesses might get by on reinvesting retained earnings (e.g. Sochon farm) while leveraging bank loans, but fast growth companies cannot. This is precisely the bottleneck now felt by Java Foods – the company has hit the buffers of its borrowing capacity and needs to raise capital to realize its investment and expansion strategy.

Box 6: Case Study Java Foods (Zambia)

This is an early stage growth company, producing convenience food for the local market (noodles, cereals, snacks). The company plans to indigenize production, obtaining all raw materials locally. Investment is needed in equipment, quality control and certification. However, the company has been hit in its growth trajectory by its inability to raise more debt, for lack of eligible collateral and own capital (poor solvency). The company is negotiating with three PE funds, and has already made adjustments to its governance (e.g. Board). However, as the company never made much profit its valuation is quite low and any serious external capital might strongly dilute the owners' stake. A mezzanine finance structure is considered instead.

However, it is quite hard to generate the PE-type of rapid growth in established and competitive business sectors, and this includes many agricultural value chains. Sochon farm, for example, declares a net margin on sales of just 5%. Fasa Kabo just reaches 2%. Zambezi Pineapples barely breaks even (but this is also because it is a start-up). This pales compared to Twiga Foods, which claims to reach 15%, or Ten Senses Africa, which declares that it makes about 12%. It is no coincidence that many of the Novastar investments are in the (information and financial) technology sectors (FinTech). The Twiga Foods case study is an example of a “stellar growth” company, and this is precisely because of the use of innovative information technology and distribution models.

It was also noted that agri-food SMEs tend to be small operations – decent, but too small for a PE/VC fund. Sochon farm in Kenya is such an example. The business model is sound albeit not spectacular, and margins are below the usual PE fund expectations. At this stage in its development, financing of some USD

200-300,000 would do. About half of the case studies are in this situation. A problem related to the small size of agri-food SMEs is their small capital valuation, meaning that any serious PE investment would strongly dilute or crowd out the owner's equity. This nobody wants. Ten Senses Africa and Java Foods are examples of companies that are now reaching the scale that justifies the step toward PE-funding. But most of the case studies are not PE-ready, yet cannot get (bank) loans either.

Indeed, one PE fund in Zambia noted that it is aware of thousands of small firms growing and packaging tomatoes, but none are of any scale. It was estimated (by several resource persons) that virtually all agri-food SMEs in Zambia would have funding needs below USD 250,000 and hardly any above one million. Unsurprisingly, many of these firms do not have the basic reporting structures, management capacity, or business processes in place to meet PE fund demands either. There are simply very few Zambian SMEs in agri-food that would be appetizing to PE/VC providers, and the case studies confirm this. The lack of sufficiently sized businesses is even more acute in Mali. The overall number of PE investments (all types) in Mali is less than ten, with just a couple of investment deals in agri-food. Fund managers stated that they could not find any, as most of the economy operates on an artisanal and informal level. The Sofa Agri-business case study is a case in point. This company would probably need a total revamp of its business strategy and management to attract any serious investment capital. And the same applies to Sylva Foods in Zambia.

Box 7: Case Study Sofa Agri-business (Mali)

This company produces cosmetics and food products from shea nut butter for the local market. Shea nuts are obtained from local women's cooperatives, which is probably why some NGOs including SNV have provided investment grants. The company has been struggling to obtain finance. Root Capital has declined to finance, probably because of the lack of export operations. Local banks are sitting on their hands as well. The firm is not without potential, but its turnover is modest (± € 700,000 per annum), its strategy unclear and its management practices including accounting leave room for improvement.

The above size constraints (too small financing need) also hamper funds that provide debt financing, such as Grofin, or the many funds providing commodity trade finance. The transaction costs are too high, and all these funds struggle to break even.¹⁶

3.2. LOW ABILITY AND WILLINGNESS TO ABSORB PRIVATE EQUITY/VENTURE CAPITAL

PE and VC funds are typically more demanding than lenders, including impact lenders. Some of their demands include the following:

- To ensure their role in governance, investors insist on a proper **shareholder structure** including a Board (on which they take a seat). This is also required to allow for post-investment exit. Many (agri-food) SMEs being family or one-person firms do not have such governance, so need to restructure first. This takes time and is expensive.
- Investors insist on **management and reporting** practices (including impact reporting), legal and ethical standards, even demanding that certain types of personnel (e.g. CFO, internal audit) be put in place. Investors also bring extensive (often donor-inspired) requirements relating to Environmental and Social Governance (ESG) standards.
- Some funds, being 'impact' investors, often apply specific **selection criteria** related to developmental impacts that – strictly speaking – have little to do with the soundness of the business. For AgDevCo, employment creation, involvement of smallholder farmers (outgrowers), women's empowerment and food security are explicit selection criteria.¹⁷ Grofin looks at employment creation as well. Triodos bank is sensitive to sustainable cultivation practices (e.g. use of chemicals and pesticides). DOB Equity also looks for quantifiable social impacts, as do many other impact investors, the lack of which can be a reason to decline the deal. Nearly all impact funds now look for impacts on women and youth, either as entrepreneurs or as workers. Each fund has its own niche requirements, which can be confusing and bothersome to investees.
- At the **due diligence** stage, investors come with anti-money laundering, tax and legal compliance, labour rules, no child labour, IFC performance standards, and much more, all of which need to be reported on in detail.

As the case studies show, many agri-food SMEs are family-owned businesses, not always open to outside prying eyes, loth to cede control, or they may just not understand the

demands made. They may also actively resist the proposed management improvements, never mind establish a proper shareholder structure with governance, content to leave things as they were.¹⁸ The idea of the PE investor (eventually) selling its stake to another investor is particularly unappealing, as entrepreneurs fear being side-lined by newcomers. The case study companies Sochon, Danaya and Produits du Sud dismissed the possibility of PE investment out of hand.

Resistance to outside intervention is one of the reasons why SMEs tend to ask for loans instead of equity capital. The above is even more true for small SMEs, as these are less used to 'governance' and identify more closely with the 'owner' as a person. Start-ups and early stage companies may even feel that their ideas and inventions are being hijacked. TanFeeds in Tanzania received a proposal that amounted to a total takeover, just to prepare the company for profitable sale to a strategic investor. This did not appeal to the current owners. It was also mentioned, in Mali, that many SMEs expect to receive grants, as many indeed did.

Box 8: Case Study Danaya Cereales (Mali)

The company transforms cereals into (pre-cooked) djouka, couscous and other traditional Malian dishes. This allows the household to spend less time on the cooking process, while the food can be longer preserved. The firm obtained an investment grant from USAID (€ 114,000) as well as an investment loan (€ 90,000) from a bank. The company would like to upscale through exports, but it rejects the possibility of issuing shares to a strategic co-investor. This is probably slowing down its development.

Investment funds noted that few agri-food SMEs have the basic management and governance in place that a PE/VC fund would expect. There are simply not so many *investible deals* around that meet the minimum requirements. Other resource persons, however, pointed the finger at the investment funds, whose demands may be *excessive*. Many SMEs could not fulfil

¹⁶ Quote from The Council of Smallholder Agricultural Finance (CSAF), a body regrouping eleven impact investors, "Scaling Finance for Agricultural SMEs in Africa", Oct 2017: "We know from experience that it is possible to cover our costs of operations, capital, and risk for larger loans (more than USD 1 million) but that the economics are much more difficult for smaller loans to earlier stage businesses, as well as to businesses operating in less established value chains and lower-income countries with weaker infrastructure, institutions, and enabling environment. Nor can the cost and risk to serve enterprises in these segments be fully priced into the loans given the relatively thin margins in the agricultural sector and exposure to volatile markets and erratic weather, among other factors; interest rates that cover these costs and risks would be prohibitively high for these businesses".

¹⁷ AgDevCo has gone as far as providing unsecured loans for projects with exceptional social impact.

¹⁸ Pearl Capital identified unwillingness by its investees to adopt management change as a principal constraint to the performance of its portfolio. This concern is echoed by Kukula in Zambia, which for this reason has started to take majority positions. Kukula now forces through its own management choices.

the requirements even if they wanted, as they do not have the managerial, reporting, or environmental and governance systems in place. Much of this is already brought to the fore at the due diligence stage, and may lead to early rejection even if the business proposition as such seems juicy. One fund noted that they do management and governance restructuring post-investment, otherwise they would be unable to do any deal, but face resistance as mentioned above.

The due diligence process in a PE/VC deal can easily take six months, to which the actual deal structuring must be added. By that time the window of opportunity to invest may be lost, or the SME may have found another source of funding.

3.3. NEED WORKING CAPITAL RATHER THAN INVESTMENT CAPITAL

Many agri-food firms have a more immediate need for **working capital** than for long-term investment capital. This is particularly true for products with a seasonal pattern, both local food crops and export commodities (e.g. coffee, cocoa), as large quantities of produce must be procured from farmers immediately after harvest. Agri-food SMEs also pre-finance farmers to secure inputs (harvest credit) and play a central role in various forms of value chain finance. This is true for most of the case study companies, and nearly all declared that they had difficulties in securing sufficient and timely working capital.

Although export crops are reasonably well financed through local and international financiers, this is much less the case for local food crops. Indeed, lack of liquidity greatly holds back entire value chains, as does lack of cash downstream, which leads to cash strapped producers upstream as well. Agri-food SMEs operating in local value chains are also confronted with very poor payment behaviours of their partners, resulting in a constant struggle for working capital. Although it is useful to have some equity capital to fund seasonal procurement needs and provide basic working capital, it is generally more efficient and cheaper to fund these with short-term loans.

Some PE funds provide loans alongside their equity investment, but this is usually in limited amounts and typically in mezzanine finance (e.g. a convertible loan). Several of the case studies (Appendix A), such as Faso Kaba, Ten Senses Africa (TSA) and Sochon, combine investment with a considerable amount of working capital finance, invariably used to finance the value chain. Faso Kaba has obtained a particularly clever funding structure with mezzanine elements.

Box 9: Case Study Faso Kaba (Mali)

Faso Kaba, Mali, produces and sells certified seeds.¹⁹ The company has been in existence for over ten years, but still has a healthy although not stellar growth potential. In 2007, the company received an important sum of seed capital from AGRA, which launched the business. This was followed, in 2010, by a package of mezzanine finance from Injaro Agricultural Capital, consisting of redeemable equity, investment and working capital loans. Injaro has taken an equity participation with pre-agreed buy-back (essentially a put-option on the company) combined with much larger investment and working capital loans as junior debt. This in turn leveraged bank financing. These funding sources enabled the company to proceed on its development trajectory.

3.4. POLITICAL AND ECONOMIC ENVIRONMENT

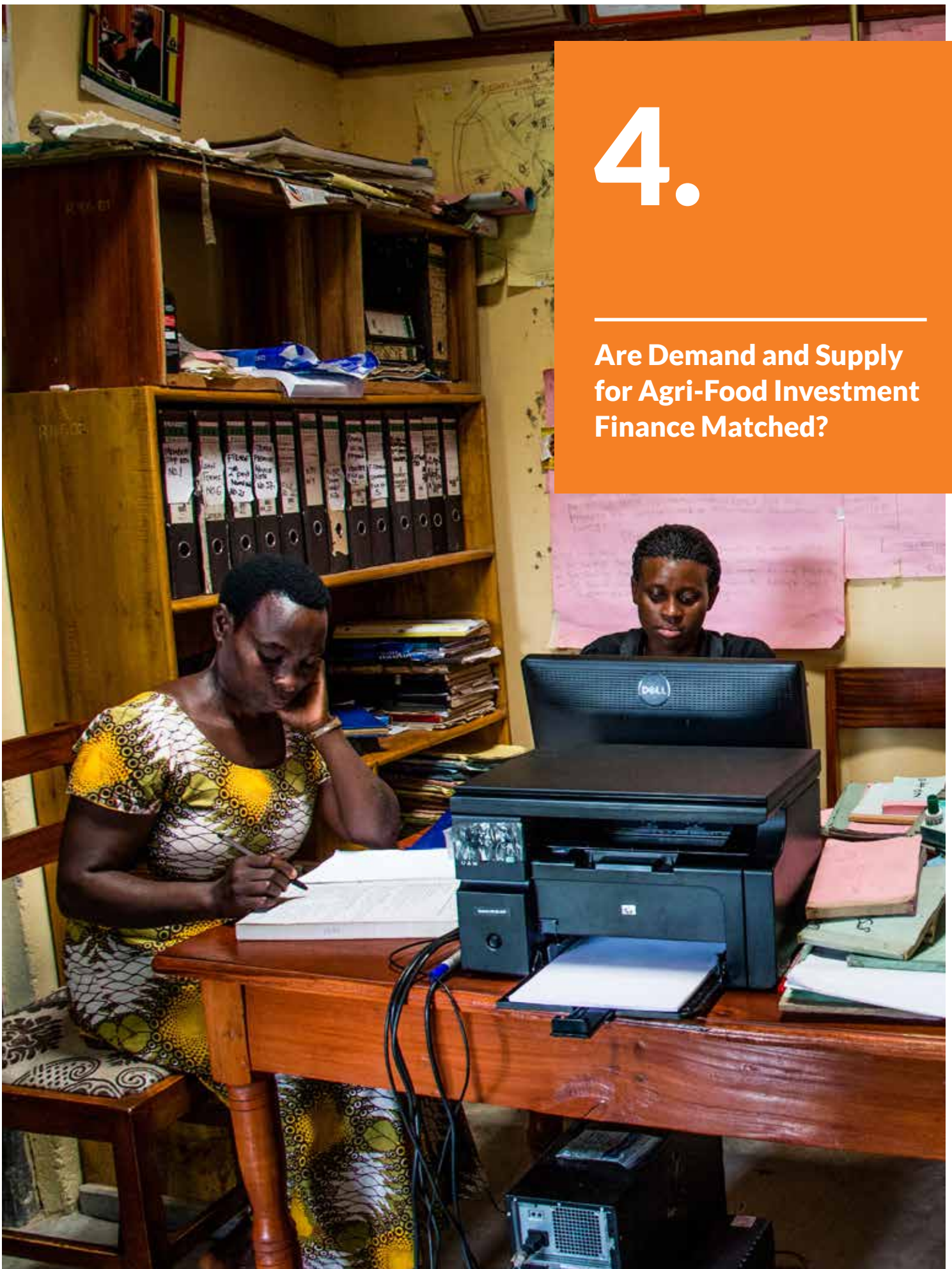
In some countries the political, economic and legal environment is not conducive to private equity investment. This is one of reasons that this research hardly found any PE activity in Mali – large parts of the country are still insecure and political stability is also in doubt. In Zambia government meddling in food crops has led to some funds shunning these value chains entirely, maize in particular. It is the same for sugar in Tanzania. In Kenya the government has capped interest rates and often interfered in agricultural prices, hampering agri-food SMEs in their development. Shareholder rights are not always well protected, or it takes ages to seek legal redress. Tanzania strongly limits the recruitment of expatriate managers and experts.

The above is reflected in the current supply of agricultural finance, as it naturally responds to demand. There is a lot of supply of harvest finance, at least in the more structured value chains (e.g. coffee, cocoa, cotton, tea, sugar), involving both local and international funders. There is much less supply of investment capital, both equity and debt, in particular from local institutions. Some of the established international funds financing commodity export trade are now trying to diversify to investment finance, including PE (Hivos Triodos Sustainable Trade Fund, Root Capital, ResponsAbility), but so far this proceeds only gradually.

¹⁹ The company has both its own production and sources from a network of tightly controlled outgrowers – all cooperatives.

4.

**Are Demand and Supply
for Agri-Food Investment
Finance Matched?**



Are Demand and Supply for Agri-Food Investment Finance Matched?

The fieldwork has shown that a rapidly increasing number of agri-investment funds are targeting Africa, which includes some that are open to financing early stage (younger than 3 years of age) initiatives, or even start-ups if there is a compelling business case. However, PE/VC funds are captive to their own self-imposed constraints – a reality check of which is due. Funds are nearly always obliged (by their investors) to seek risk-adjusted market returns, which translate into an IRR upward from 10%. This greatly narrows the selection of companies that could qualify. Furthermore, most agri-food SMEs are too small to enable a viable investment given the cost of closing a deal. In addition, PE/VC funds tend to impose many requirements (usually donor-imposed), some of which may not align with (immediate) business priorities and may be hard to comply with. The PE model is anyway not

designed to deal with a large volume of (small) deals and is selective by nature.

As to the SMEs, managerial weaknesses abound, and the amount of pre-deal BDS that would be needed to make a company invest-worthy stops many prospective deals from being formulated in the first place. Exit routes (which are analysed pre-deal) are often a big problem as well, and this gets worse the smaller the company. Often buy-back by the entrepreneur is the only feasible option, but it is far from certain that s/he has the money. There is also a general lack of understanding among small businesses of the role of PE/VC funds, including their participation in governance and active role in management processes. These findings are summarized below.

Figure 1: Demand and supply discrepancies between investment funds and agri-food SMEs

Investment Funds	Agri-Food SMEs
High return expectation Proven but scalable business, high growth	Few such cases Work in competitive, often mature, agricultural markets with low margins
High deal generation cost, hence need for large deals	Small companies, small financing need
Standards of management and governance	Incomprehension Reluctance and inability to change the way the business is run
Impact, ESG requirements Reporting requirements	Incomprehension Cost of compliance
Offer of equity capital	Demand for credit, working capital in particular
Exit to the market or buy-out	Few realistic buyers Reluctance to allow strangers to buy Entrepreneur may lack the capacity to buy

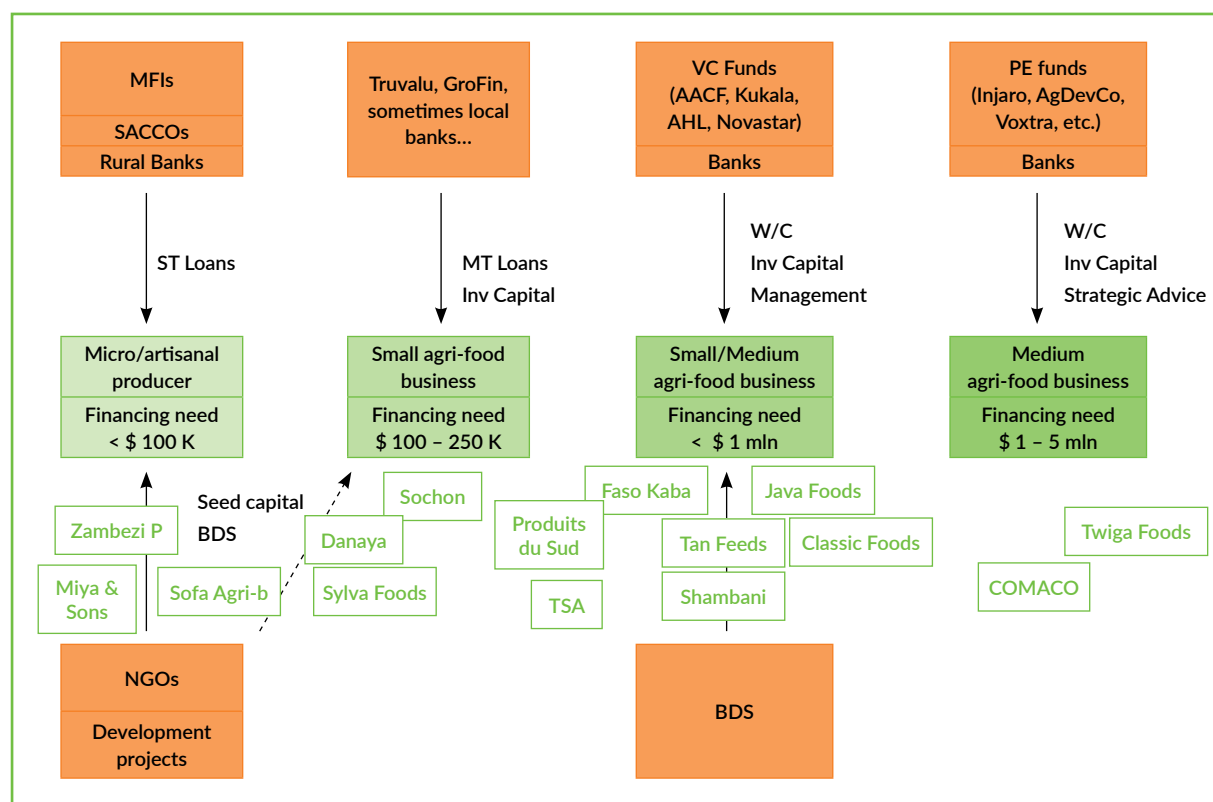
Although not all agri-food SMEs need risk capital, they may need working capital more urgently, and there is undeniably a group that could use risk capital to launch a faster growth trajectory. This not only includes the limited number of high-growth businesses (e.g. Twiga Foods), but also many more mature businesses that still generate healthy although not stellar growth and need capital to propel them along. The Faso Kaba case study in Mali is an example of a company that did not realize Twiga-like growth, but still had sufficient growth potential to justify the Injaro participation. The mezzanine finance structure was particularly appropriate in this case (see below remarks on mezzanine finance). The case studies revealed several examples of companies that could be candidates for (modest amounts of) risk capital.

However, the picture that emerges from the fieldwork is that a limited number of 'investor darlings' collect capital from multiple funds. A case in point is Twiga Foods in Kenya (eight investors) and Mtanga Foods in Tanzania (seven investors), both of which have attracted this mainly from international impact investors. Impact funds are also selling to other impact funds (e.g. Western Seeds and Countryside Dairy, both in Kenya). This raises the question to what extent the funds'

work is still additional in the market. The vast majority of agri-food SMEs, however, have investment needs of USD 100-250,000, which the established (donor-funded) agri funds do not provide. The Sofa Agri-business in Mali cannot find finance anywhere (but this may also be because of lack of clear strategy and cash flow). Sylva Food Solutions and Zambezi Pineapples (both in Zambia) are in a similar situation. Very few funds are structured to serve this segment. Miya & Sons (case study in Tanzania) is essentially a micro business.

The above findings are depicted in the graph below. Micro enterprises can, to some extent, benefit from the services of microfinance, savings and credit cooperative organizations (SACCOs), rural banks, and various development initiatives. SMEs with investment needs of about USD 1 million or higher can call on a plethora of investment funds and local banks. The smaller SMEs, however, with investment needs in the ranges of USD 100-250,000 have very few support options available. Examples are the Sofa Agri-business (Mali), Danaya Cereales (Mali), Sylva Food Solutions (Zambia), and Zambezi Pineapples (Zambia) case studies. This segment is far larger than the section of firms deemed investible by investment funds.

Figure 2: Approximate capital position of the case studies



5.

Alternative Means to Finance SMEs



Alternative Means to Finance SMEs

5.1. USING VENTURE CAPITAL

5.1.1. Local Capital

Among the solutions to make it easier for agri-food SMEs to obtain risk capital through investment funds, it was suggested that funds need to be more **locally embedded**, making better use of local (product) knowledge in appraising clients rather than complex, intrusive and costly (external) due diligence processes. Locally established funds could raise capital locally from pension funds and insurance companies for example, thus being less reliant on international DFIs.

The fieldwork revealed the existence of some local institutional investors, but the amounts at their disposal are still very modest. In Kenya, Umati Capital co-financed Ten Senses Africa. Zambia created the legal framework to allow pension funds to invest in risk capital. Thus, Kukula capital raised funds from two pension funds as well as from some individuals, but not in the amounts the fund would have wanted. There may be a role for the development community to encourage and guide this process, starting from local banks, MFIs, pension funds and insurance companies.

It was also mentioned that local banks are often the best placed to identify potential investment clients, as they can see which ones have good cash flows but are undercapitalized when it comes to achieving their full potential. So far, there is little collaboration between banks and capital providers.

5.1.2. Educate SMEs

There is also a need to **'educate'** local SMEs on the role of PE/VC, as most do not even know such finance exists. Entrepreneurs do not understand the role of equity compared to debt, which explains their resistance to certain demands made. Entrepreneurs usually expect PE providers to act like lenders, just asking for collateral and proposing an interest rate. There is also some suspicion toward external investors. A company such as Danaya Cereales has a growth strategy which a competent external partner could help translate into practice – but the owners do not wish to take that route. Lack of general understanding of the PE/VC instrument is one of the reasons why none of the PE/VC funds interviewed during the fieldwork undertake active promotion – they fear

being flooded with unfeasible financing requests. Rather, they use informal channels, networking and external references (e.g. conferences, business advisors, banks and other funds) to seek out the good entrepreneurs and deals.²⁰ However, by taking a low profile approach, funds probably miss out on lots of potentially interesting cases. Indeed, as many SMEs are totally unaware of what funds can offer (according to entrepreneurs interviewed in the research), there is undoubtedly (potential) demand that is missing out on contact with suppliers of financial services.

More generally, agri-food SMEs lack knowledge of the wide palette of financing opportunities consisting of local banks, local and international investment funds, and debt and equity providers. There is no natural and efficient market where demand and supply meet. There are still entrepreneurs that lack viable internet access or are not conversant with using such media to seek information.

5.1.3. Prepare Investment Application and Pre-Deal BDS

SME proprietors may also need help in preparing their **investment application**. They need education before they meet the PE/VC fund or bank, thus helping them be more convincing from the start. This is what BID Network is doing in Uganda. In Zambia, this role is played by Open Capital Advisors and Kukula Finance, funded through Private Enterprise Programme Zambia (PEPZ). The service includes the production of investor documents, such as an investor pitch (e.g. case of Java Foods).

More generally, SMEs can do with capacity building to better qualify for access to finance. CSAF notes that the vast majority (90%+) of businesses that CSAF members screen do not meet basic requirements for financial management and accounting to qualify for credit.²¹ Although most agri-food SMEs in the case studies had received some BDS, assistance is often constrained by specific parameters (e.g. geography, crop) that restrict access. BDS offered may not align with the requirements of prospective financiers. A stronger range of pre-deal BDS would help agri-food SMEs gain access to finance. CSAF has proposed offering vouchers to financial institutions that they can hand over to SMEs they would like to finance depending on the outcome of pre-deal BDS.

²⁰ Faso Kaba was introduced to Injaro by AGRA. One of the promoters of Twiga Foods had previously worked at DOB Equity. Sochon got backing of Technoserve.

²¹ Source: CSAF, "Scaling Finance for Agricultural SMEs in Africa", October 2017.

5.1.4. Flexible Investment Size

Some funds use their **size constraints** flexibly, starting with a participation below their minimum threshold in the expectation that further investment will be made as the company advances. Such examples were found with AHL, Injaro, AgDevCo and Grofin. Sometimes funds start with a loan or mezzanine finance, followed up by a full equity participation later on. Thus, graduation could be a deliberate strategy, and could enhance the scope of the existing investment funds.

5.1.5. Mezzanine Finance

Resource persons and fund managers have mentioned that the use of **mezzanine finance** (quasi equity) could help increase agri-food SMEs' access to capital. Mezzanine is a generic term for financing that incorporates elements of debt and equity. It is typically ranked above equity and below senior debt. A summary of different types of mezzanine finance is shown below.

Figure 3: Different types of mezzanine finance

	Instrument	Description
Debt-like	Partially unsecured / Junior loans	Loans that are typically subordinated to other debt, and with flexible collateral requirements. The loan may include long grace periods or take account of seasonality in loan and interest payments.
	Royalty based lending	Provides the investor with a base interest plus royalties, which are payments that are dependent on the performance of the company, usually a percentage of revenue or EBIT(DA).
	Convertible loans	Typically a loan with a maturity date and a regular repayment schedule, and an option to convert the loan into shares of the company. This works as a put option and captures upside potential.
	Redeemable equity	Mostly similar to ordinary shares, but with a right to sell the shares back to the entrepreneur (put option), typically using a predetermined price or a formula.

Source: Adapted from *New Perspectives on Financing Small Cap SMEs in Emerging Markets*, DGGF, May 2016

Faso Kaba in Mali has received a package of mezzanine finance from Injaro Agricultural Capital consisting of redeemable equity and junior investment and working capital loans, the latter to buy seeds from suppliers. The finance includes a pre-determined exit through loan repayment and share buy-back. Substantial bank loans were leveraged as well. The Injaro finance greatly helped the company in its expansion trajectory. The (redeemable) shares issued to Injaro take the place of collateral: if the entrepreneur fails to repay the loans she will not get her company back. Shambani Milk in Tanzania received a convertible loan, probably to allow the investment fund to harvest any upward potential if applicable. Java Foods in Zambia is also conducting discussions for a package of mezzanine finance, in order to avoid diluting the owners' equity too much.

Most mezzanine finance has a loan as the basic structure, so if the entrepreneur performs well, the loan will simply expire and be repaid. This solves the exit route, which is one of the biggest problems in risk capital for small business. Also, investors in quasi equity do not usually sit on the Board, so this takes care of the reluctance of the entrepreneurs to let in outsiders – not to mention the fact that they may not have a shareholder structure to start with. Some fund managers prefer starting with a loan or mezzanine finance, only to engage later in a full equity participation (see above). Indeed, given the constraints listed in chapter 3, loans and quasi equity are probably much more appropriate for the target segment of small agri-food SMEs than straight equity.²²

²² This also solves the constraint that many early stage SMEs tend to have low equity valuations. They lack a profit track record. PE would quickly dilute the owners' capital to the point of a minority position.

5.1.6. Seed Capital

On the other side of the spectrum, there could be more opportunities for **'seed capital'**. Seed capital consists of a direct capital contribution to start-ups and (very) early stage initiatives, in the hope that some of them will achieve outstanding results. The Dutch Good Growth Fund (DGGF) has the Seed Capital fund, which can co-finance projects with other funds (loans, equity), this way reducing the overall risk profile. Some funds have a seed capital option (e.g. 1776 Seed Capital).

Faso Kaba in Mali has received an important sum of seed capital, from AGRA. This launched the business. The same is the case for TanFeeds, which received an important matching grant from AECF. Community Markets for Conservation (COMACO) in Zambia funded all investments through grant funding. Danaya (Mali), Classic Foods (Kenya), and Zambezi Pineapples (Zambia) also received a limited amount of seed capital. Java Foods (Zambia), Sylva Foods (Mali), and Sofa Agri-business (Mali) also received several grants, but this had more to do with their social impact through purchasing from women's cooperatives and is not strictly speaking seed capital.²³

It can be concluded from the case studies that 'free money', whether seed capital or more developmental grants, is common. Indeed, for the specific segment of start-ups and early stage initiatives, funders with a lot of risk appetite and modest (average) return expectations are needed. All impact funds use blended finance to some extent, meaning some level of implied subsidy, but for the VC segment focusing on agri-food SMEs some level of **philanthropic support** is probably hard to avoid. In all the cases included in this study this kind of support had a demonstrable developmental impact on both the SME and their suppliers, usually farmer groups.

5.1.7. Risk Sharing

Other than risk sharing through blended finance, the availability of **guarantee/risk-sharing** facilities to de-risk investment operations has also been mentioned. However, the truth is that many guarantee funds worldwide have been left unused. Often, the conditions were not sufficiently attractive to participating banks. Nevertheless, in 2016 the guarantee fund in operation in Mali issued 978 guarantees, of which about 15% in the agricultural sector.

5.2. WITHOUT VENTURE CAPITAL

From the above it can be seen that the requirements of PE/VC funds combined with economic logic mean that the role of such funds in financing agri-food SMEs is limited to a specific set of scalable SMEs that can generate high growth, have the ability and willingness to comply with the ample conditions imposed, offer an exit route, and are large enough to enable a cost-effective deal. Few SMEs fit the description. However, they have found other ways of funding their investment projects.

5.2.1. Investment Loans

To start with, local banks, SACCOs, MFIs and other local and international finance providers do offer **loan products** that to some extent can be used for agribusiness investment. Sochon farm in Kenya invested in hay stores, offices and various equipment using long-term and short-term loans from Root Capital and Equity bank, complemented by TA from Technoserve.²⁴ Produits du Sud, in Mali, was launched through an export loan from Root Capital. The company had previously been rejected by local banks. As this has become an annually recurrent export finance facility, the Root Capital loan has become a predictable part of the financing structure and permitted stable growth of the company. Classic Foods in Kenya obtained several investment loans, the largest of which was from Rabo Rural Fund and Capital 4 Development.

Box 10: Case Study Sochon (Kenya)

Sochon is a solid company having grown in a steady pace. The farm produces hay bales for surrounding dairy farmers. Over the years, the company has gradually increased its production area and sales (now some USD 225,000 per annum), attracting an investment loan from Root Capital and working capital from Equity bank (USD 120,000 in total). The firm still has potential for growth, but the relatively small size and low profit margin (5%) do not make it a suitable client for private equity. The company intends to pursue its steady expansion through reinvestment of profits and debt finance.

²³ It has been observed in the field that some funders use SMEs as a conduit through which money moves to smallholder farmers as the main beneficiary. Support focusses on capacity building of the farmers, which may distract the company from its core business and focus more on NGO work.

²⁴ This technical assistance was probably seen as a risk mitigator by the financiers.

Box 11: Case Study Produits du Sud (Mali)

This company is a good example of the impact of export finance. Produits du Sud exports forestry products, chiefly gum arabic. Since 2008, Root Capital has been providing annual export loans, covered through an export contract with a European importer. This client ensures loan reimbursement when the products are received. The partnership with Root Capital, whose finance has become a recurrent and permanent fixture, has enabled Produits du Sud to invest, expand and leverage local bank loans as well. Over 400 villages in the arid south-western zones of Mali are now involved in harvesting raw materials. The owners have declined PE investment, wishing to maintain their independence from outsiders.

Although most investment funds reviewed in this study provide risk capital, Grofin chiefly provides loans to support investment – in amounts as low as USD 100,000. AgDevCo also makes active use of the debt instrument. The Dutch public-private development bank FMO provides loans (directly) to agricultural companies, although it usually favours large deals (e.g. KDTA). Smaller loans go through funds and banks. There are many such examples and debt finance continues to play an important role in funding the agri-food SMEs' investments.

The advantages to the SME, compared to equity finance, are the following:

- Does not need to cede control, other than regular reporting.
- Does not need to share profits with external investors.
- Usually fairly swift approval – less intrusive than PE/VC.²⁵ Loan processes can be more easily standardized than equity deals.
- Exit is automatic as the loan reaches maturity.

The disadvantages are the following:

- Often expensive (high interest rate) and must be paid irrespective of business performance.²⁶ To this must be added loan application and processing costs. Due to the perceived risk, loans in the agricultural sector tend to be more expensive than in other sectors.

- Need for collateral, which is often an obstacle to credit – for young businesses in particular (e.g. operate from rented premises) – and one of the reasons SMEs may need capital instead (mezzanine structures may partly solve this). Java Foods in Zambia started with investment loans, but has outgrown its borrowing capacity (too little collateral), hence its decision to talk to PE investors now.
- As exit (repayment) is inflexible, the company may be faced with liquidity constraints if the business performs less than planned.
- Due to solvency requirements, the amount of debt finance is limited in proportion to own capital invested (e.g. case of Java Foods).
- Risk of becoming debt dependent.
- Often currency risk, as many development loans are made in foreign currencies.

Banks across Africa are gradually discovering agriculture, developing products specifically for agribusiness. Successful operations by international impact investors fulfil a demonstration function, inducing others to follow. There are differences by geographical area, however. Whereas in East Africa many banks have developed a range of services for agri-food SMEs, this is much less the case in Southern or Western Africa. It can also be stated that lack of reliable financial records hampers agri-food SMEs' access to credit finance, and this is most severe for young and small companies.

5.2.2. Public Programmes

Most countries operate programmes to encourage SME development, such as Uwezo fund, Women Enterprise Fund and Youth Enterprise Development Fund in Kenya, or Citizens Economic Empowerment Fund and Youth Employment Fund in Zambia. Usually, these funds, which provide either grants or loans, are poorly resourced and impose all sorts of conditions. The research found no companies that had recently benefitted. However, previously public grants have played a role in Mali.

5.2.3. Challenge Funds

There are several challenge funds in operation in Africa, the most well-known of which is the Africa Enterprise Challenge Fund (AECF).²⁷ Related to this are Business

²⁵ As the fund provider does not become (co-)owner, there is less need for intrusive due diligence. The extent to which the funder is exposed to the behaviour of the core entrepreneur is less in case of debt financing.

²⁶ In Zambia, interest rates have reached a level (>40%) where investment is nearly impossible. In Mali, due to their inclusion in the FCFA zone, interest rates remain in the single digits or a little above.

Plan Competitions, such as the Nyamuka BPC in Zambia. Such funds operate on a competitive basis, offering funding to whoever presents a winning proposal. Challenge funds typically provide (matching) grants, 'repayable' grants, and loans to start-ups and early stage initiatives, which otherwise would not be able to obtain capital in the market. Thus, challenge funds operate in the highest risk segment – which is what justifies their explicit (seed capital grant) and implicit (fund management cost) subsidy elements.

As challenge funds provide seed capital, these are very suitable for start-ups and early stage agri-food SMEs that would otherwise struggle to access capital – even from VC investors. Shambani Milk in Tanzania won both the BID Network business plan competition and the Google 'Believe, Begin, Become' competition. The contribution of challenge funds also leverages other sources of funding, such as bank loans.

Box 12: TanFeeds Ltd (Tanzania)

TanFeeds produces, packages and distributes animal feed, chiefly chicken feed, but also fish feed and dog food. Most products are sold to smallholder livestock breeders in Morogoro region, where the factory is located, and where inputs are sourced as well. The company has achieved a turnover of USD 1 million, which it expects to double over the next two years due to machinery investment. The company obtained a USD 300,000 matching grant from the Africa Enterprise Challenge Fund (AECF), along with grants from ADB and Canada. Matching funds were contributed by the four shareholders.

TanFeeds still has a lot of investment needs. Bottlenecks are lack of own capital (e.g. to match grants) and lack of collateral for loans. A PE investor has offered to take part, but insisted on a majority share – to be able to sell to a strategic investor in five years-time, so maximizing upward potential. This offer was rejected.

5.2.4. Angel Investors

Angel investors increasingly have a role to play.²⁸

Crowdfunding combines the efforts of multiple angel investors, possibly through very small individual contributions. Although most angel investors have social motives, they may also be enticed by financial gains.

BID Network has a network of private investors, often private persons with philanthropic aims, who are willing to co-invest in developing countries. They may be business people themselves, and often seek out leads in the same sector as their own. This means that they can provide business coaching along with finance. Or they may simply want to put their (surplus) capital to good use.

The key challenge is to bring together the angel/crowdfund investor and the entrepreneur. An intermediary organization is needed that matches demand and supply, after having prepared the entrepreneur for investment. Lendahand advertises the financing needs of the ventures it has scouted, and investors can contribute the full amount or part of it (crowdfunding). Lendahand also collaborates with PE funds, complementing their capital with loans, meanwhile sharing due diligence costs between the two.

It happens that a business starts with a small angel investment, and later scales up through a PE or VC fund. One of the case study companies, Ten Senses Africa, started with a loan from Lendahand (EUR 100,000 at 7%) and a local loan from Umati Capital, both since repaid. The company is now in negotiation with DOB Equity and Novastar Ventures to obtain a (larger) PE investment. Thus, the (quite small) loan from Lendahand has probably set off an expansion process that is bringing the company into the remit of institutional equity investors.

²⁷ The AECF covers 24 African countries, and provides between USD 250,000 and USD 1.5 million in funding to businesses allocated through business competitions in priority sectors in Africa. The winning proposals are selected on the basis of their commercial viability, innovation and potential development impact on the rural poor. Grantees co-finance a minimum of 50% of the total cost of the project. AECF has agriculture and agribusiness among its key sectors, to which it has now committed USD 183 million. It did finance, for example, a chicken hatchery in South Sudan – a project as risky as it gets (now closed).

²⁸ Definition from Wikipedia: An angel investor is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. A small but increasing number of angel investors invest online through equity crowd-funding or organize themselves into angel networks to share research and pool their investment capital, as well as to provide advice to their portfolio companies.

Box 13: Ten Senses Africa (TSA) (Kenya)

TSA deals in fair trade certified macadamia and cashew nuts, implying a close collaboration with fair tradecertified producer groups that receive training and support, along with fair trade prices and premiums. Turnover expanded more than 20-fold over the past few years, and further growth is expected. Interestingly, TSA owes its recent development to an investment loan of Lendahand (EUR 100,000) combined with a working capital loan from Umati Capital (a local fund). The company is now ready to solicit private equity for its next growth steps. Negotiations with fund providers have started.

Local investors exist as well, but other than family and friends these may have entirely commercial objectives, and are therefore not 'angels'. Local entrepreneurs tend to be wary of such investors, as they fear losing control. Rapacious local capitalists may grab the firm if and when it reaches scale.

The research did not reveal diaspora funding, although it is reportedly quite common in the Indian community in South and East Africa. However, much is directed toward property funding.

5.2.5. Other Financial Innovations

An invoice discounting/factoring practice is emerging, specific to working capital, which is a key problem for all agri-food SMEs. Financial Access has set up factoring services in Kenya and Uganda, under the brand name FACTS, specifically for agribusinesses selling to supermarkets. In Kenya invoice discounting is also on the rise. Umati Capital has a specific service for farmers, agri-food SMEs and retailers. Likewise, in Zambia agri-food SMEs including producers and agri-processors are increasingly relying on invoice discounting to ensure business continuity. Specialized factoring companies provide this service.²⁹ Banks are joining in as well. Invoice financing, however, is extremely expensive in Zambia (about 10% per month incorporating all costs).

The impact of invoice discounting/order finance/factoring on agri-food SMEs can be quite large, however. Supermarkets tend to take over 30 days to complete payment. Combined with typically poor or absent credit terms from suppliers, this means that the agri-food SMEs' liquidity is squeezed from two sides. This prevents SMEs from maximizing order fulfillment. An invoice discounting or order financing service frees up their working capital to do productive business. These products are now rapidly being introduced, chiefly through local capital.

²⁹ The leading companies in Zambia offering these services are Focus Financial Services and Better Now Finance. They compete on a very fast turnaround time – much faster than banks could offer.

6.

Key Results & Policy Recommendations



Key Results & Policy Recommendations

6.1. KEY RESULTS

6.1.1 The mismatch

The study has demonstrated that agri-food SMEs in Africa, especially small and young companies, have very limited access to investment capital. SMEs primarily look for credit facilities, working capital in particular, rather than for equity capital, but banks mostly decline to serve agri-food SMEs. At some point in their development agri-food SMEs may need risk bearing capital, but international and local investment funds are generally not focussed on the agri-food SME market, in particular the smaller ventures, so capital is out of bounds. Indeed, the case studies include several companies that are clearly being held back in their development due to lack of access to risk-taking investment capital.

The study found a mismatch between the service offer of investment funds, what they need and require, and the demand expressed by agri-food SMEs. Investment funds have relatively high deal generation costs, therefore look for large deals and proven but scalable businesses that are set for high rates of growth and offering high return prospects. In practice, there are very few such cases in Africa, even fewer in agri-food. Agri-food SMEs generally operate in competitive agricultural markets, with low margins and incremental growth prospects only. The majority of companies are small, with modest financing needs and low return on capital. Moreover, PE/VC funds usually impose high standards of management and governance, while they have extensive ESG and reporting requirements. SMEs are often reluctant or unable to change their business practices and cannot or will not comply with the demands made. Furthermore, they cannot cover the cost of compliance. Lastly, PE/VC funds usually wish to exit from their investments after five to eight years, through sale to another (strategic) investor or to co-shareholders or by management buy-back which is more common in the case of smaller investments. Sale to strangers might meet with resistance of the entrepreneur, while he or she may lack the capacity to buy back the shares in the company. Lack of a viable exit mechanism is often a deal-breaker in PE/VC investment.

6.1.2. Mission drift

Somewhat paradoxically, the study finds that many investment funds, whether for equity or debt, find it hard to identify clients

that meet the expected return requirements, fit the funds' risk appetite, and, thirdly, also satisfy the conditions relating to environmental and social performance. It is not uncommon for funds to fail to invest all capital entrusted to them. As a consequence, funds tend to suffer from mission drift, not serving the type of clientele they had initially identified during fundraising. A case in point is GAFSP, which obtained a very large contribution from the Netherlands to reach out to smallholder farmers, but has instead ended up favouring financial institutions and big business.

6.2. WHAT IS NEEDED?

6.2.1. Free money

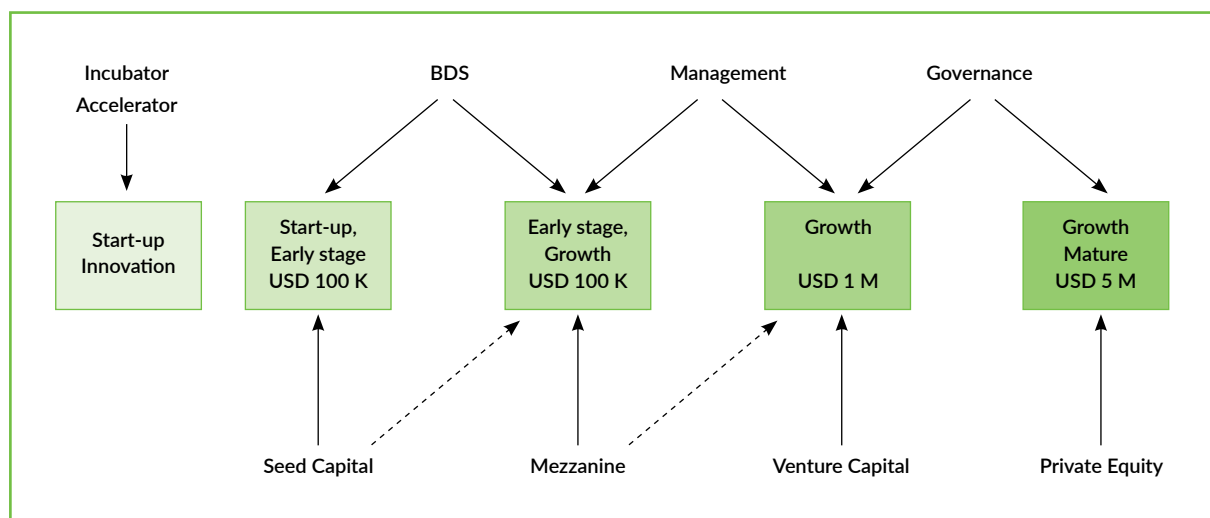
Notwithstanding the above mentioned issues, the case studies include a number of companies that did manage to obtain risk bearing investment finance.

Two of the cases received PE/VC funding, with or without mezzanine elements. One company received a convertible loan. Three companies were fully funded through loans; others were partly funded. A surprising finding of the study, however, is the prevalence of 'free money'. Nine companies obtained seed capital, an investment in the business proper, while four received grants chiefly motivated by their development impact on farmer groups. In addition, nearly all companies received important contributions by way of TA, training and BDS. These forms of subsidised funds clearly aid companies, catalysing their development. The cases also highlight the use of mezzanine finance as an alternative or intermediary step to equity capital. Once a company has received seed capital, mezzanine finance or equity capital, it usually succeeds in obtaining bank loans as well.

6.2.2. A more elaborate toolbox

The fundamental issue is that investment funds have too few instruments in their toolbox. Companies such as Danaya, Miya & Sons and Sylva Foods appear to have good potential, but they do not fit the funds' desired investment profile. However, these companies cannot obtain support elsewhere either. Their needs – limited investment capital, working capital loans, and lots of BDS and strategy advice – are not met by investment funds. A more complete toolbox could help investment funds reach out to their not-yet PE/VC-ready clients, growing them up to the level where market-based risk or debt financing can take over.

Figure 4: Graduation services strategy for SMEs



6.3. RECOMMENDATIONS

6.3.1 A graduation strategy

The resulting recommendation is to develop a deliberate graduation strategy, so that agri-food SMEs can make use of an assortment of services that match their development stage. This is indicated in the figure below. The graduation strategy implies that agri-food SMEs are served differently at various stages of their development, thereby creating a tailored pipeline for investment funds. In contrast to the current situation, companies could be picked up as soon as they exit from incubation/acceleration programmes, and supported with limited seed capital and BDS. This could be followed up with appropriate mezzanine finance, VC and eventually PE instruments as they progress through their development.

The graduation model can be realized by involving the PE/VC providers at a much earlier stage than is currently the case. For many investment funds, that would require a re-appraisal of their investment conditions, some of which may need a reality check (too many conditions). The graduation strategy does not necessarily mean that a single financial institution or investment fund should offer all graduation steps. Instead, it may also imply stronger collaboration between various development operators (e.g. incubators and accelerators, microfinance, banks, business angels, venture capital and private investors, BDS providers, public bodies), each of which will fill in certain steps in the graduation process.

Presently, nearly all investment funds are stand-alone operations, not structurally linked to any development program. The study, however, found examples of funds that tend to pick up

clients that have been trained by for example incubators/accelerators, development programs or NGOs in agri-value chain and rural development programmes. Stronger collaboration with other actors would help fill the gap that habitually arises when start-up entrepreneurs exit their incubation, but cannot yet access venture capital. Such links would result in better serviced SMEs on the one hand, and in a pipeline with bankable clients for the funds on the other. Policy makers and development organizations can help structure such collaboration, and through their funding fill in the missing links in the graduation chain. For the lower end of agri-food SMEs, local funds and MFIs can play a role. Development assistance can support them through capital and technical assistance.

6.3.2. Aggressive blending

To put in place such graduation strategy, however, investment funds and their partners would need access to some form of philanthropic grant capital. The current situation in (Dutch and international) development cooperation is a dichotomy of subsidised funding (e.g. NGOs, public-private partnerships) on the one hand, and investment funds that operate on or near market conditions, even if funded by donor agencies (e.g. Netherlands government). DGGF is a case in point. However, when targeting the smaller ventures (including early-stage initiatives and start-ups), and agri-businesses in particular, market-based finance leads to non-access. Only aggressive blending with substantially below-market pricing would remove this bottleneck.

Most funds currently have a budget for BDS at their disposal, partly funded from donor-resources, as well as some

below-market rate capital or first loss guarantees. However, this is by far insufficient to reach the small and young ventures in agri-food. In our proposal a (modest) budget for seed capital should be on offer to kick-start the smaller ventures with innovative business ideas, followed by substantial concessional funding directly after. The lead time allowed to the fund manager should be sufficient to permit these early stage initiatives to reach sufficient maturity to enable a VC or PE participation to eventually take place.

It is also suggested that the process leading to a deal being concluded, involving extensive legal, financial and environmental due diligence, would be considered eligible for a BDS budget. The hiring of external experts (e.g. legal, financial and tax advisors) is presently charged directly to fund capital, while in fact pre-deal business development is taking place.

To reduce the 'give-away' factor, any seed capital and even the cost of BDS could take the form of 'convertible equity', meaning that the contribution will be converted into a percentage equity stake if and when the business takes off. In order not to discourage the project promoter, this should probably be limited to a minority stake.

6.3.3 Targeting the intended market segment

As a consequence, serving the smaller agri-food SMEs requires various forms of blended finance. In order to avoid mission drift, concessionary funding must be carefully directed to the intended market segment. The level of implicit or explicit subsidisation is reduced as the company passes through the various stages of graduation. While seed capital implies a considerable amount of subsidisation, even if the 'convertible equity' form is chosen, companies that have reached the stage of private equity should be expected to generate market-related rates of return.

Policy makers (e.g. the Netherlands government, international development agencies) can contribute to the above by restructuring existing investment funds (e.g. granting them a wider mandate and access to the corresponding – low cost – financial resources for the deserving segments), but also by formulating clearer policy guidelines and conducting open dialogue with all stakeholders. DGGF already has the Seed Capital and Development Fund at its disposal, but this Fund is used in a far more restrictive manner than the above graduation strategy requires.

6.3.4 Call to action

In order to reap the full potential of contributions that young and small agri-food SMEs in Sub-Saharan Africa can make to local economic development, rural incomes and food security, there is a need for

- regulators, donors and investors to come up with novel instruments and approaches in making critical capital available. NGOs, funds, development actors and governments should cooperate to design and implement a deliberate graduation strategy tailored to the needs of the sector;
- philanthropic capital and aggressive blending with (substantially) below market pricing in order to reach out to the smaller SME ventures, while removing subsidy elements as soon as possible. Both governments and development agencies can play an important role by revising the terms and conditions of their own investments and by setting policy guidelines and conducting dialogue in order to support investments that specifically target start-ups and pre-growth SMEs in the agri-food sector.

A close-up photograph of a person's hands holding several large, thick stacks of banknotes. The person is wearing a blue and white plaid shirt. The banknotes are green and yellow, and are tied together with small rubber bands. The background is slightly blurred, showing other people's legs and feet in a dusty outdoor setting.

A

Appendix

Agri-Food SME Case Studies

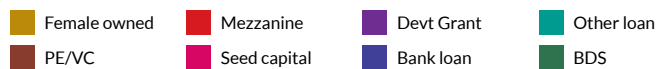
APPENDIX A

Agri-Food SME Case Studies

Number	Company name	Country	Female owned	PE/VC	Mezzanine	Seed capital	Dev't Grant	Bank loan	Other loan	BDS
1	Twiga Foods	Kenya		X	X					X
2	Ten Senses Africa	Kenya							X	X
3	Sochon	Kenya						X	X	X
4	Classic Foods	Kenya				X	X	X	X	X
5	Produits de Sud	Mali						X	X	
6	Sofa Agri-business	Mali				X		X		
7	Danaya Cereales	Mali	X			X		X		
8	Faso Kaba	Mali	X	X	X	X		X	X	X
9	TanFeeds	Tanzania				X		X		X
10	Miya & Sons	Tanzania							X	X
11	Shambani Milk	Tanzania			X	X				X
12	COMACO	Zambia				X	X	X		X
13	Zambezi Pineapples	Zambia				X			X	X
14	Sylva Foods Solutions	Zambia	X			X	X			X
15	Java Foods	Zambia	X				X	X		X
	TOTAL		4	2	3	9	4	9	7	12



KENYA



Case Study 1	Twiga Foods – Kenya
Description	<p>Twiga Foods is a mobile-based supply platform for Africa's retail outlets, kiosks, and market stalls. The company trades fresh fruits and vegetables.</p> <p>The business model is mobile-based, cashless, business-to-business (B2B) supply. Twiga has established 25 collection points across Kenya, sourcing from 20,000 farmers and SMEs. On collection the farm produce is aggregated and transported to a warehouse in Nairobi for sorting and grading. From there products are delivered to vendors. "A vendor orders stock from Twiga, and we reliably show up the next day at their shop with a low-cost, better quality, product than informal markets can provide."</p> <p>Twiga claims to offer suppliers higher prices while discounting to vendors, all made possible by superior logistics and essentially cutting out (seven layers of) middlemen. For now, the company only sells in Nairobi. However, expansion to other cities will start shortly.</p>
History	Operations only started in January 2017, initially with bananas and subsequently various fruits and vegetables. Currently the turnover is USD 300,000 per month, growing at 15% month on month.
Finance received	<p>Capital was collected from multiple PE/VC funds, namely 1) DOB Equity, 2) Wamda Capital (Dubai), 3) Omidyar Network (technology), 4) Uqalo (consumer products), 5) 1776 Seed Capital, 6) Blue Haven Initiative (family fund), 7) Alpha Mundi (Switzerland), 8) AHL.</p> <p>In total, Twiga Foods raised USD 6.3 million in capital and USD 4.0 million in debt. The funds were used to invest in collection centres, warehouses and transport equipment. This was only possible through personal contacts and a convincing proposal by the project promoters.</p>
BDS received	BDS were received in operations and IT infrastructure. These were very helpful for launching the pilot project and subsequently scaling up. Advice was also received on governance and management structures.
Impacts	<ul style="list-style-type: none"> • Sales went from 0 to USD 300,000 per month in less than a year, and are expected to hit USD 1 million per month in two years. • Employment went from 2 to 160, expected to reach 500 in two years. 60% are women and 70% youth (< 35 y). • Farmers use their contracts with Twiga Foods to guarantee loans from MFIs and SACCOs. • Farmers receive advice on production technology, are paid on time, and more than they get from traditional middlemen.

Case Study 2	Ten Senses Africa (TSA) – Kenya
Description	Ten Senses Africa (TSA) is dedicated to organic, fair trade and ethical business practices. In accordance with its fair trade seal, TSA acquires macadamia nuts at a price that enables the producers to improve their living standards and develop their businesses. An additional development premium goes towards infrastructure development and community improvement. TSA currently purchases fair trade certified macadamia nuts from 30,000 farmers in Taita Hills, Meru and central regions in Kenya. TSA processes roughly one hundred tons of macadamia nuts annually. In addition, TSA also purchases cashew nuts under the same fair trade guidelines, primarily in Lamu area, which is north of Mombasa.
History	The company was founded in 2006, and has grown gradually. Since 2008, TSA has been working with smallholder farmers in Kenya to grow organic macadamia and cashew for export. Local farmers groups are trained by qualified agronomists and fair trade certified to produce quality macadamia and cashew nuts.
Finance received	<p>TSA received an investment loan of EUR 100,000 (at 7%) from Lendahand and working capital from Umati Capital, all since repaid. At the time, no other sources of finance were available.</p> <p>Investments were made in drying, production, grading and packaging equipment, as well as storage capacity and washrooms for staff.</p> <p>The company is now conducting negotiations with PE funds, including DOB Equity and Novastar, to enable it to scale up operations.</p>
BDS received	TSA has received TA from the Fair Trade Labelling Organisation as well as USAID, which it has chiefly used to train its producer groups. Subjects included group dynamics, leadership and governance, record keeping, and production technology. Other training topics (for producers) were Principles of fair trade, Labelling/Producer Standards, Farm Hygiene and Sanitation, Crop Management and Nutrition, and Waste and Pollution Management
Impacts	<ul style="list-style-type: none"> • Annual turnover has reached USD 2.9 million, up from just USD 100,000 two years ago. TSA hopes to double again over the next two years. • Employment increased from 40 to 160 persons in two years. 70% are women, 75% youth. Up to 640 seasonal workers are hired. • The investment helped TSA to enter new export markets. • More farmers were enrolled in the purchasing network. • Training of farmers has resulted in a decrease of rejection rates, increased yield, and the ability to manage their association for the benefit of the members. • Environmental impacts include waste, pollution and water management.

Case Study 3	Sochon Ltd – Kenya
Description	Sochon Ltd is one of the few large-scale commercial hay producers in Nakuru County. Hay bales are sold to dairy farmers. Estimated market share in the county is 36%. Sochon has about 4,000 clients. Good hay helps farmers improve milk production, and hence their cash flow. Orders are received through a mobile platform. The company enjoys a net margin of 5%.
History	Sochon farm started in 2010, and has grown gradually. Sochon currently has 400 acres under hay production. The company is in the process of increasing the amount of land under hay production to 1,200 acres. This will require an increase in staff and outsourcing some of the technical services including soil analysis, quality control and agronomy and veterinary services. There is abundant demand for hay in the Rift Valley, Central and Western regions of Kenya.
Finance received	<p>Sochon has received a long-term loan from Root Capital (7%) and a short-term loan from Equity Bank (14%). The total of loans received was USD 120,000. This was sufficient. The farm did not find it easy to obtain these loans as it lacked proper records of accounts as well as eligible collateral.</p> <p>Investments were made in hay stores, offices and various production and transport equipment, as well as the IT platform. Further investment is planned in farm equipment and irrigation systems.</p> <p>Sochon is not planning to grow through external capital (PE), but wants to raise debt instead.</p>
BDS received	Sochon has received technical training (hay production) from various sources, including TechnoServe. Consultants trained the staff in organization, bookkeeping, business plan development, quality seed production, quality hay production and extension services.
Impacts	<ul style="list-style-type: none"> • Over the past two years annual sales went from about USD 60,000 to over USD 220,000, and are expected to exceed USD 335,000 over the next two years. • Employment has increased from 15 to 26 persons over the past two years, 70% women, 80% youth. To this can be added 32 seasonal workers. Further growth is expected. • Farmers benefit from improved hay availability, which boosts their milk production.

Case Study 4	Classic Foods Ltd – Kenya
Description	Classic Foods is a processor of a wide range of products, including pasteurized and UHT milk, yogurt, fruit juices, maize flour milling and animal feed making. The products are sold in supermarkets in the greater Nairobi area. Over the next months, a new plant will be opened in Isiolo to process camel and goat milk in the largely pastoralist and semi-arid North Eastern parts of the country.
History	Classic Foods was established in 2007, by taking a mortgage on the family home, and has since gradually expanded. The camel milk factory in Isiolo will be unique in the country.
Finance received	<p>The company was established through own capital.</p> <p>Matching grants were received from DFID (GBP 480,000) and USAID (USD 250,000), including seed capital for the Isiolo plant and grants for various developmental and training activities.</p> <p>Loans were received from Rabo Rural Fund/Capital 4 Development (USD 1 million), FACTS Africa, Root Capital, Hivos, and NIC Bank Kenya. The loan from Rabo Rural Fund/Capital 4 Development has been used to refinance old debts and to invest in the Isiolo plant.</p>
BDS received	Various BDS have been received, notably from DFID, in governance, accounting, marketing, tax training, branding, administration, logistics and certification.
Impacts	<ul style="list-style-type: none"> • Current turnover is USD 1.3 million, up from USD 1 million two years ago, expected to reach USD 4.5 million with the new plant in Isiolo. • The company has 26 production staff, up from 18 two years ago, and expected to grow to 41 with the new plant in Isiolo. Most staff are women, and most are youth. • The company sources products from 17,000 dairy and fruit farmers. With the plant in Isiolo, about 10,000 camel and goat herders will be added, whose milk will no longer go to waste. • The company employs 15 field workers to provide extension services.



MALI



Case Study 5	Produits du Sud – Mali
Description	<p>Produits du Sud exports agricultural and forestry products, chiefly gum arabic, cashews and sesame, to Europe and India. Gum resins are used to produce pharmaceuticals, cosmetics, and food ingredients.</p> <p>Raw materials are obtained from over 400 villages, which collect or produce the products. The firm maintains very strong relations with these villages, and does not use intermediaries. A processing factory (cleaning, conditioning, packaging) is based in Sandaré, 130 km from Kayes.</p>
History	<p>Produits du Sud was established in 2007 by 4 Malian entrepreneurs. The company has grown steadily. It operates in the Malian Sahel, a region of harsh drylands, desperate poverty and extreme drought that stretches across central and southwestern Mali. Since 2008, Produits du Sud has obtained export finance from Root Capital. In contrast to banks, Root Capital went with the company to visit the villages and understand the business. With access to reliable finance and reliable export clients, the company has been training villagers to tap the gum arabic and gum karaya trees for their high-value resins, rather than clear them for cattle land or firewood, which exacerbates the region's harsh conditions.</p>
Finance received	<p>The company was founded using the capital of the four owners. Regular short-term (up to one year) loans have been received from local banks. In the past season, two local banks provided 400 million FCFA.</p> <p>However, most important is the recurrent export loan from Root Capital, received since 2008. This annual loan, EUR 500,000 at 9% in the current season, is covered through an export contract with a European client, which reimburses the loan on the company's behalf directly to Root Capital (triangular loan contract). The Root Capital loan, being for a full year, offers flexibility to do business, encourages the owners to invest more of their own, and helps leverage bank loans as well.³⁰</p> <p>Without Root Capital, the company would not have been able to develop. All local banks insisted on physical collateral, which the company did not have. Root Capital, in contrast, only takes the export transaction (signed contract with repayment directly from the sales proceeds) as loan surety.</p> <p>The company has been approached by I&P (Investisseurs et Partenaires) for an equity stake, but the owners have rejected this as they wish to remain the sole owners.</p>
BDS received	<p>Root Capital has offered BDS to the company's management, but this has not yet been taken up.</p>
Impacts	<ul style="list-style-type: none"> • Sales have increased from USD 17,000 in 2008 to more than USD 1 million now. • Employment has grown from 5 persons in 2007 to over 90 now, half of which permanent and half seasonal (mainly women). • 4,500 villagers in 400 villages provide raw materials, with further indirect impacts in those villages. Most work on the trees is done by young men, who otherwise might have fallen in the hands of criminal and terrorist bands. • Produits du Sud has supported social infrastructures in those villages (e.g. school, swimming pool). • Understanding the value of the gum arabic and gum karaya trees, farmers do not cut them down for firewood, saving the precarious environment.

³⁰ www.rootcapital.org/portfolio/stories/tapping-gum-trees-drives-economic-growth-mali

Case Study 6	Sofa Agri-business – Mali
Description	Sofa Agri-business undertakes several activities, the most important of which is processing of shea nuts into (17) cosmetics and food products for the local market. The company obtains the shea nuts from 72 cooperatives, chiefly groups of poor women. Other than the press, much of the production process is manual.
History	The company was established in 2007, and has one single owner. The company has slowly grown, mainly through the owner's efforts.
Finance received	<p>The company received investment grants from SNV (FCFA 75 million) and a Canadian NGO (FCFA 25 million).</p> <p>A small bank loan has been received for FCFA 6 million.</p> <p>Initial contacts were established with Root Capital, but they have never followed-up. One may suppose that this is chiefly because of the lack of export operations. Also, the management systems of the company are not the best, lacking up to date accounting practices and transparency.</p> <p>At this point, the company would need working capital rather than investment capital. This is very hard to find.</p>
BDS received	No
Impacts	<ul style="list-style-type: none"> • Over the past two years, employment has grown from 8 to 12 persons, of which 8 women and 10 youth. To this can be added some 60 seasonal workers. • Sales have grown from about FCFA 250 million to 400-500 million. • The company sources from 72 cooperatives, chiefly women.

Case Study 7	Danaya Cereales – Mali
Description	<p>Danaya Cereales, female-owned, transforms cereals, fonio and millet chiefly, into pre-cooked djouka and other traditional Malian dishes. The prepared (pre-cooked) consumption products allow the household to spend less time on the cooking process. Furthermore, the processed products can be preserved for much longer than the traditional food. The raw materials are purchased from local cooperatives. The final products are sold through local supermarkets. A small portion is exported, which the company hopes to increase. The aim is to raise production from 3 to 10 tons per day. Productivity and quality need to be increased to allow for such export performance. Quality certification is in process.</p>
History	<p>The company was created in 1992, and remains in the hands of the founder and her children. In 2012 the company adopted the Ltd status. The company had a slow start as women were not supposed to use pre-cooked food products – they were expected to labor in the kitchen instead. However, with changing social attitudes the market for ready-made cereals products has increased.</p>
Finance received	<p>The company was established with own capital only.</p> <p>In 2015, the company received a grant of FCFA 75 million from USAID, which was used to invest in processing equipment.</p> <p>A five-year investment loan of FCFA 60 million at 11% interest was received from a bank, and used to construct a factory building.</p> <p>A working capital loan of FCFA 15 million has been obtained as well.</p> <p>A PE investor from Lomé approached the company, but this was rejected.</p> <p>For the future, the company needs working capital above all. The company is not open to inviting a co-owner.</p>
BDS received	No
Impacts	<ul style="list-style-type: none"> • Danaya's turnover is about 100 million FCFA per annum, up from some 80 million two years ago. The company hopes to raise sales to FCFA 500 million. • The company makes about 10 million FCFA profit annually, up from 8 million two years ago. • The company employs 23 people, of which 19 women and 5 youth. There are some flex workers as well. • Cereals are sourced from local cooperatives.

Case Study 8	Faso Kaba – Mali
Description	<p>Faso Kaba, female-owned, produces improved and certified seeds, chiefly maize, rice, sorghum and other crops that yield 2-4x the amount that traditional breeds yield. The company produces seeds on its own fields, as well as through a network of outgrowers – mainly cooperatives. Outgrowers receive their breeder seeds through Faso Kaba. Seeds are certified by a local seed laboratory. Faso Kaba cleans and packs the seeds in bags of 500 g to 50 kg. Faso Kaba sells through a network of distributors. Most seeds are sold to farmers locally, but some are exported as well.</p>
History	<p>Faso Kaba was established in 2005. Initially, the company found it hard to sell seeds as farmers were relying on fertilizers rather than good seeds. However, as the results of the company's seeds gradually became known, demand increased. In 2007, a grant was received from AGRA, and then the business really took off. In 2010, Injaro Agricultural Capital Holdings obtained a 49% stake in the company, complemented by subordinated loans, which allowed for considerable capital investment.</p>
Finance received	<p>The company started in 2005 with EUR 15,000 own capital and a bank loan guaranteed by a Japanese NGO.</p> <p>In 2007 AGRA granted USD 141,000 by way of seed capital.</p> <p>Faso Kaba subsequently received working capital loans from local banks, including an agricultural and development bank.</p> <p>In 2010, Injaro took a 49% equity stake, valued at just FCFA 2 million. This is actually mezzanine finance as the company is expected to buy back the capital in 8 years with 25% premium (redeemable shares).</p> <p>Simultaneously, Injaro provided a (subordinated) investment loan of FCFA 208 million for 8 years at 10.25%.</p> <p>This was later followed by another junior debt of FCFA 250 million, this time for working capital (the use of this credit line is conditional on signed sales contracts). So the full Injaro finance consists of mezzanine finance structures.</p> <p>Faso Kaba has subsequently been able to attract harvest credits from local banks.</p>
BDS received	<p>Injaro provided BDS in production technology, accounting and stock management.</p>
Impacts	<ul style="list-style-type: none"> • The Injaro capital injection helped raise production from about 350 to 1,200 tonnes per annum (2010 to 2016). • Turnover went from about FCFA 300 million to FCFA 850 million per annum. • Profit went from about FCFA 7-8 million to FCFA 30-35 million per annum. • Employment went from 6 to 15 direct, and 5 to about 20 seasonal workers. • The company has over 30 outgrowers (coops) and 150 resellers.



TANZANIA



Case Study 9	TanFeeds – Tanzania
Description	<p>International TanFeeds Ltd produces, packages and distributes animal feed, chiefly chicken feed, but also fish feed and dog food. It produces pelleted feed for fish, poultry and rabbits. Although poultry feed is still the main market, fish feed is expanding. Oil seeds processing takes place as well. About 80% of production is purchased by local smallholder livestock keepers in Morogoro, where the factory is located. Most inputs are sourced locally, from smallholders. The company installed a soya extruder to replace fishmeal in chicken feed.</p>
History	<p>The company was established in 2008, and now has four shareholders (one of whom a woman). The company founder is a university professor, specialized in animal science and production.</p>
Finance received	<p>The company mainly developed through own equity, grants and loans:</p> <ul style="list-style-type: none"> • Matching grant – 320 million TZS (approximately USD 140,000) provided by African Development Bank (ADB) • Matching grant – USD 300,000 provided by Africa Enterprise Challenge Fund (AECF) • Grant – CAD 60,000 provided by Mennonite Economic Development Associates (MEDA) • Every year the company receives loans from CRDB Bank for operational activities. This is expensive, however, and often late. <p>Finding own funds for <i>matching</i> the grants was not always easy.</p> <p>PE investors have shown interest, but set a condition that they would become the majority shareholder and after 5 years sell the company to a strategic investor to maximize upside potential. This offer was declined.</p> <p>With PE funds usually located in Nairobi, not Tanzania, getting in contact with PE funds is not easy.</p>
BDS received	<p>Catholic relief services and PUM Netherlands senior experts trained workers on operations, marketing, branding, and governance.</p> <p>Some of the funds provided training on record keeping, marketing, financial management, general operation. This was part of the grant package, not demand driven.</p>
Impacts	<ul style="list-style-type: none"> • The company employs 40 people, up from 15 two years ago and further growth is expected due to the investment in new machinery. • Turnover reached USD 1 million in 2016, expected to exceed USD 2 million in 2018. • Production was 2,500 tons, expected to grow to 4,000 tons by 2018. • The company sources inputs from over 1,000 local smallholders. • Most clients are women. Clients report that good poultry feed makes the birds grow more rapidly, and improves egg production as well (more constant output).

Case Study 10	Miya & Sons Co. Ltd – Tanzania
Description	Miya & Sons Co. Ltd is a newly created company active in coffee processing and marketing. The company uses a flexible business model, producing a variety of coffees based on client demand. Most of the coffee is sold as a branded upmarket product, but there is a product offer for the lower-end market as well. To raise awareness of coffee types and support marketing, 'know coffee' workshops are conducted.
History	Miya & Sons Co. Ltd was established in October 2015 as a company limited by shares.
Finance received	<p>The company was financed with the capital of the owners, which was used to purchase roasting and packaging equipment. Some friends and family provided loans to the value of USD 9,000 at 12% interest.</p> <p>The company has applied for bank loans, but was rejected as it is considered a start-up. In addition, being located in a rented building, the company lacks collateral.</p> <p>Lack of access to finance is holding back the development of the company, reducing the quantities of coffee beans that can be bought from producers.</p>
BDS received	The company management has taken part in training on management, marketing, finance and branding.
Impacts	<ul style="list-style-type: none"> • Miya & Sons has 4 permanent workers, expected to increase to 8 over the next two years. The number of flex workers, currently 6, is expected to double as well. • Turnover is USD 18,000 now, projected to reach USD 45,000 over the next two years. • Coffee is bought from 18 farmers, expected to rise to 50 within two years.

Case Study 11	Shambani Graduates Enterprises Ltd - Tanzania
Description	Shambani Milk is engaged in the collection, processing and marketing of milk and milk products in Morogoro and Dar es Salaam. The company produces pasteurized cultured milk, pasteurized fresh milk and pasteurized flavoured milk. Raw milk is collected in Morogoro, through collection centres with appropriate quality and hygiene control.
History	Shambani Milk was founded in 2003 by three entrepreneurial agribusiness graduates from Sokoine University of Agriculture, who saw an opportunity for small-scale farmers in the region to market their milk. In 2007, Shambani won the BID business plan competition nationally and internationally. At the same time the company participated in the Google “Believe, Begin, Become” competition and was awarded USD 15,000.
Finance received	<p>The company was established with own capital, and received seed capital through the BID and Google competitions as mentioned above.</p> <p>MTI Investment, a PE fund, provided a convertible loan of USD 500,000 at 19% interest. It is expected that the loan will be converted into equity over the next two years. This will realize the upward potential of the MTI Investment in Shambani. The MTI loan was used to purchase pasteurizer systems, milk holding tanks, instant chillers and a generator. MTI has a Board seat, and is actively involved in managing the business and supporting the business management.</p> <p>Further PE funding is being sought for expansion. However, PE funds are not generally represented in Tanzania and are therefore quite hard to contact.</p>
BDS received	MTI has provided BDS services, as have various external programs. Training was received on governance, financial management, marketing, and general operations. Specific milk training was received as well.
Impacts	<ul style="list-style-type: none"> • Turnover in 2016 was USD 240,000, up from USD 162,000 in 2014, and expected to grow to USD 350,000 by 2018. • The company has 38 employees, up from 26 two years ago, and expected to grow to 55 over the next two years. There are also a dozen flex workers. • About 30% of workers are women, and 60% youth. • Initially, the plant had the capacity to process 30 litres of milk per day. Capacity is now 750 litres daily and is expected to double over the next two years. • The company sources milk from 200 farmers, providing them with a reliable outlet for their milk. Many dairy farmers struggle, having to sell raw milk on the market or to intermediary traders at poor prices. • The company has created wealth for dairy farmers, employment within the plant, and provided milk to consumers for which there is still strong demand.



ZAMBIA

Female owned	Mezzanine	Dev't Grant	Other loan
PE/VC	Seed capital	Bank loan	BDS

Case Study 12	COMACO – Zambia
Description	COMACO is a social enterprise, incentivizing better ways to farm and care for the land while sustaining household food and income security across an entire ecosystem. COMACO promotes conservation and wildlife preservation by discouraging poaching and unsustainable farming. COMACO provides extension services to farmers and it also processes and markets their produce. The main products are groundnuts and peanut butter, rice, soya, beans and honey. Products are sold under the 'It's Wild' brand.
History	COMACO was founded in 2003, and has grown chiefly through development grants and concessionary loans.
Finance received	<p>Being a company limited by guarantees, there are no shareholders and no shares can be issued (e.g. to PE funds). The company is owned by a separate non-profit legal entity.</p> <p>All capital investment has been made through grants. Some of the important contributions were:</p> <p>USD 740,000 from Norway USD 814,000 from The World Bank by way of carbon credits USD 600,000 from USAID USD 125,000 from Musika</p> <p>Working capital is mostly obtained through loans, such as:</p> <ul style="list-style-type: none"> • USD 4.5 million revolving inventory finance loan, by AHL Venture Partners and World We Want Foundation, to purchase farm products • USD 500,000 from IFAD for a farmer revolving fund • ZANACO loan, quickly repaid because too expensive
BDS received	<p>Technoserve has provided technical training to both the company and farmers.</p> <p>TA related to management of the food business and to finance has been received from GIZ and Cornell University.</p>
Impacts	<ul style="list-style-type: none"> • Sales have grown from USD 10 million in 2014 to over USD 12 million in 2016, and expected to reach USD 15 million by 2019. • The company has reached the scale where it can explore export opportunities for peanut butter. Certification remains a challenge. • Currently, a total of 167,400 farmers from 70 cooperatives in the 67 chiefdoms that surround the Luangwa Valley and adjacent areas supply COMACO. • The opportunity given to farmers to grow and sell crops dissuades them from poaching and woodcutting. • COMACO also contributes to the environment by distributing efficient cooking stoves, and by briquette manufacturing based on groundnut shells (reduces woodcutting and air pollution).

Case Study 13	Zambezi Pineapples – Zambia
Description	<p>Zambezi Pineapples, based in NW Zambia, processes pineapples into dried snacks and juices. Pineapples are abundant in the NW province – some 3,000 smallholders grow them. However, the company has found the snacks market quite competitive and struggles to obtain its place. There are many imports from South Africa in particular. Furthermore, pineapples have been shown to be a relatively uneconomic snack ingredient, consisting of lots of water and little dry matter. The development strategy is to broaden the assortment by including more types of fruits, mixing them with pineapples. This will also bring the cost down. Fresh fruits will be sold as well. However, it was clear from the interview that the company – essentially still a start-up – has not yet found its winning commercial strategy.</p>
History	<p>Zambezi Pineapples was established in 2013, and started operations in 2015. The company has four shareholders, one of whom holds 70%.</p>
Finance received	<p>Apart from the investors, the company has received some seed capital from Musika (co-funded juicing machine, a pasteurizing machine and a bottling machine). Some friends and family provided support as well.</p> <p>At this point, the company is hoping for further grants. The option of convertible debt has been discussed with some NGOs, but without result so far.</p> <p>The biggest problem right now is working capital. The company has debts outstanding with suppliers, while clients are slow to pay. There is less immediate need for investment capital as the machinery capacity is sufficient for now.</p>
BDS received	<p>The company has received BDS from Peace Corps and PUM. The latter helped the management open its eyes to many managerial and commercial weaknesses.</p>
Impacts	<ul style="list-style-type: none"> • Having started in 2015, the company now employs 24 people and some flex workers, chiefly women and all youth. • Turnover in the first half year of 2017 was just ZMW 200,000. • In terms of profitability, the company is breaking even.

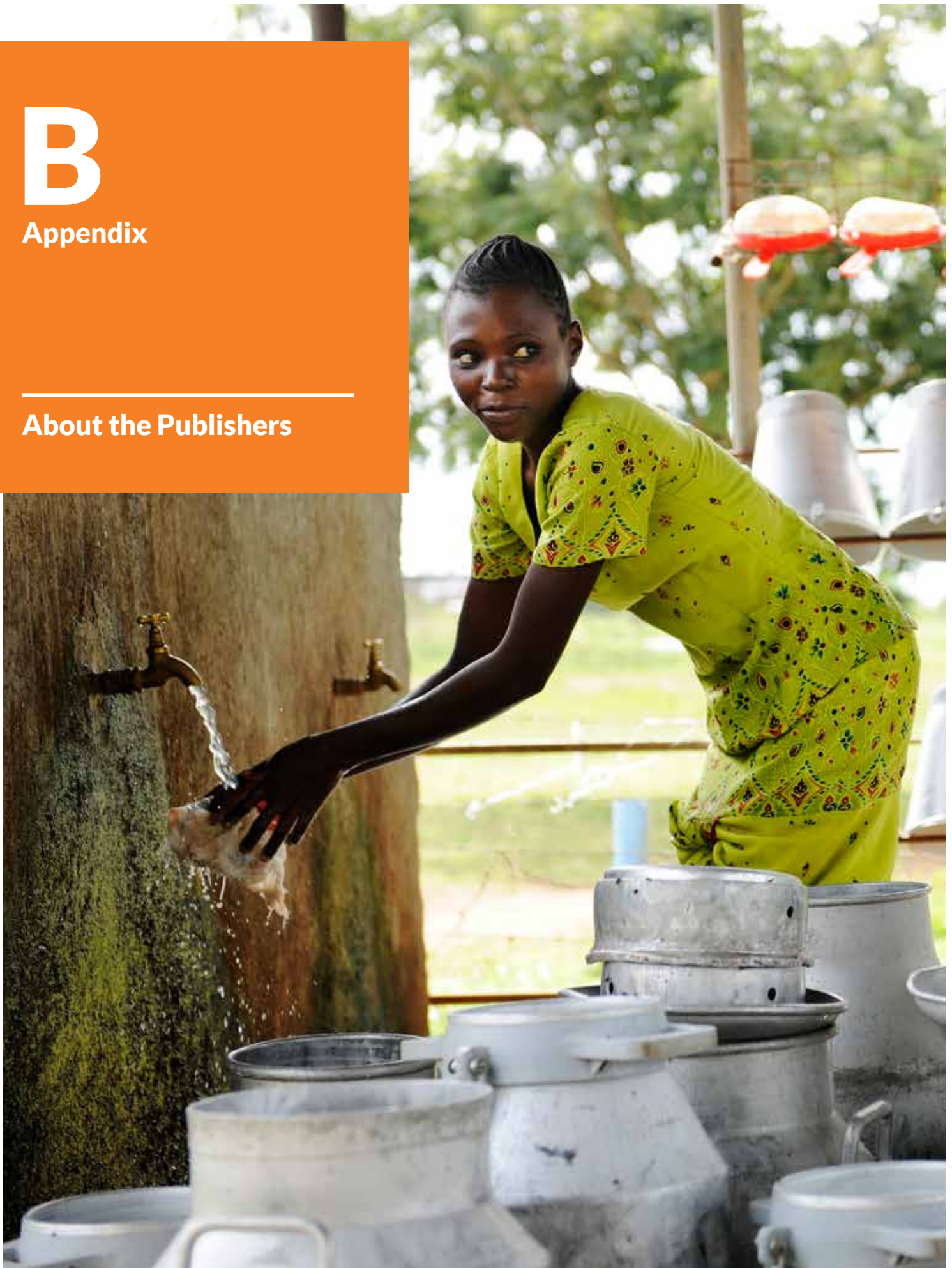
Case Study 14	Sylva Food Solutions (SFS) – Zambia
Description	<p>Sylva Food Solutions, female-owned, produces processed soups, porridge, Moringa tea, and dried traditional vegetables. SFS works with women's groups to produce and dry the products. These are located in all ten provinces of Zambia, as well as two provinces in Tanzania and five districts in Mozambique. Processing and packaging takes place in Lusaka.</p> <p>So far, SFS has mostly been selling off-factory. Demand is said to be strong, but the company lacks a sound distribution strategy, which would help it to better capitalize on its potential.</p>
History	<p>The company started in 2009. To date, Sylva Food Solutions has trained over 20,700 farmers and off-takes for most of them. Most of the farmers are women. Over the years, production has gradually expanded. However, in 2017, the factory was confronted with production stoppage due to the slow commissioning and installation of new equipment.</p> <p>As the current facility is not of viable size and unable to meet demand, capital expenditure is planned.</p>
Finance received	<p>Apart from the investment by the owners, SFS received grants from The World Bank (equipment), Musika, AFE and Care International (for farmer training).</p> <p>The company has never received any bank loans, partly due to lack of eligible collateral. So far, the company has grown through reinvesting profits and some grants (see above).</p> <p>SFS seeks USD100,000 to fund working capital and investment. With the help of Open Capital Advisors (PEPZ funding), SFS is preparing to seek out PE investors. An investment proposal has been made. It is doubtful, however, whether the company is PE ready. It seems too small and has managerial and strategic weaknesses. Perhaps an investment loan or mezzanine capital could be obtained. SFS certainly could do with professional advice.</p>
BDS received	<p>SFS has received BDS from Musika (smallholder relations), Care International, PEPZ (investor relations), Business Innovation Facility (marketing), PUM, and Concern Worldwide (business operations).</p>
Impacts	<ul style="list-style-type: none"> • The company employs 39 people, down from over 100 two years ago (half women). The reason was factory stoppage due to problems with installing the new equipment. To this can be added about 100 flex workers. • In 2015 and 2016 sales were over ZMW 3 million. The 2017 season was lost due to problems with equipment. • The company sources from women's groups all over Zambia. These women are trained in (hygienic) production practices as well as business management. Groups have been introduced to the solar dryer. • SFS provides a ready market, and women's incomes have increased.

Case Study 15	Java Foods – Zambia
Description	<p>Java Foods, female-owned, was set up to produce nutritious food items, notably noodles, cereals, snacks, and other convenience food. The items are fortified with micronutrients, cheap and intended to reduce (child) malnutrition which is prevalent in towns. For now, most ingredients are imported, but the company is preparing to source up to 90% of raw materials locally.</p>
History	<p>Java Foods was established in 2012 as a one-woman firm. Since then, two other shareholders have joined.</p> <p>Java Foods started by packaging imported noodles. The product assortment has gradually expanded and diversified. The company has started to organize smallholder farmers to grow products like soya, maize, wheat and sorghum, and become their exclusive off-taker, meanwhile reducing the cost of ingredients through the creation of an efficient supply chain. The company is now restructuring, including the formation of a Board, to allow for the participation of PE investors. Their capital must make it possible to fully indigenize production.</p>
Finance received	<p>Java Foods has obtained capital from three shareholders.</p> <p>In 2014, the company received USD 100,000 in long-term bank credit. This facility still exists, but cannot be increased due to lack of additional collateral.</p> <p>The company also has an overdraft and import loan facility from banks.</p> <p>Several small grants were received from various development organizations. One of the three investors has provided an investment loan.</p> <p>However, to allow for serious expansion, investment, certification and quality control, the company needs to raise capital. Java Foods is now in discussion with three PE funds. The fact that the company has not been all that profitable in the recent past does not help in raising capital and depresses the company valuation. One of the potential investors appears to be considering a convertible debt instrument.</p>
BDS received	<p>The company has received various BDS from PEPZ, Technoserve and Care International. Subjects covered were production technology, marketing, costing and accounting. PEPZ also helped the company become more investor-ready – governance was revised and an investor pitch was prepared.</p>
Impacts	<ul style="list-style-type: none"> • Revenue went from ZMW 3.9 million in 2015 to 6.4 million in 2016, and will probably double again in 2017. • Gross margin has been 25-30%, but the company has not yet made any serious (after tax) profits. • Employment went from 15 in 2015 to 25 in 2017, 30% women and 80% youth, planning further growth. There are also some flex workers. • Eventually, the company will be sourcing nearly all inputs locally from smallholder farmers (e.g. grains, soya, leaving only flavouring to be imported).

B

Appendix

About the Publishers



About the Publishers

Rabobank Foundation

Rabobank Foundation, Rabobank's social fund, has been improving the lives of underprivileged and disadvantaged groups of people for over forty years by promoting self-sufficiency. Respecting the co-operative roots of Rabobank, Rabobank Foundation focuses on establishing and promoting co-operative savings and loan systems and agricultural producers' organizations to stimulate economic development, thus helping small-scale farmers obtain access to financing, knowledge and markets. We are active in 22 countries in Africa, Asia and Latin America. In 2017 we supported 288 projects abroad and reached 4,886,869 smallholder farmers. Rabobank Foundation is also active in the Netherlands, where we work to enhance the self-reliance of vulnerable people.

www.rabobankfoundation.com

ICCO Cooperation

ICCO Cooperation is a non-governmental organization whose mission is to build resilient local communities in developing countries by stimulating entrepreneurship and realizing food security and sustainable economic development. We embrace a push and pull strategy. On the 'push' side, ICCO enables smallholder farmers to increase their production and quality and enhance their income. On the 'pull' side, SME agribusinesses that source from farmers are connected to markets with networking and business development services. We offer finance through our investment companies Capital 4 Development Partners and Truvalu. ICCO is rooted in the Netherlands and has 6 regional and 22 country offices in Latin America, Africa and Asia.

www.icco-cooperation.org / www.c4dpartners.com / www.truvalu-group.com

AgriProFocus

Few of the challenges humanity faces are as urgent and complex as food security. The AgriProFocus network brings together businesses, civil society, knowledge institutes and governments to meet this challenge collaboratively. United in diversity, our members share the conviction that business and development are not mutually exclusive. AgriProFocus supports innovative 'agripreneurs' in finding new, sustainable ways of doing business. Exchanging perspectives and expecting the unexpected are ways to accomplish more in a culture of collaboration. Navigating the network, AgriProFocus staff helps members find the right partners and the right information. Rooted in the Netherlands, AgriProFocus is active in 13 countries in Africa and South-East Asia.

www.agriprofocus.com

Food & Business Knowledge Platform

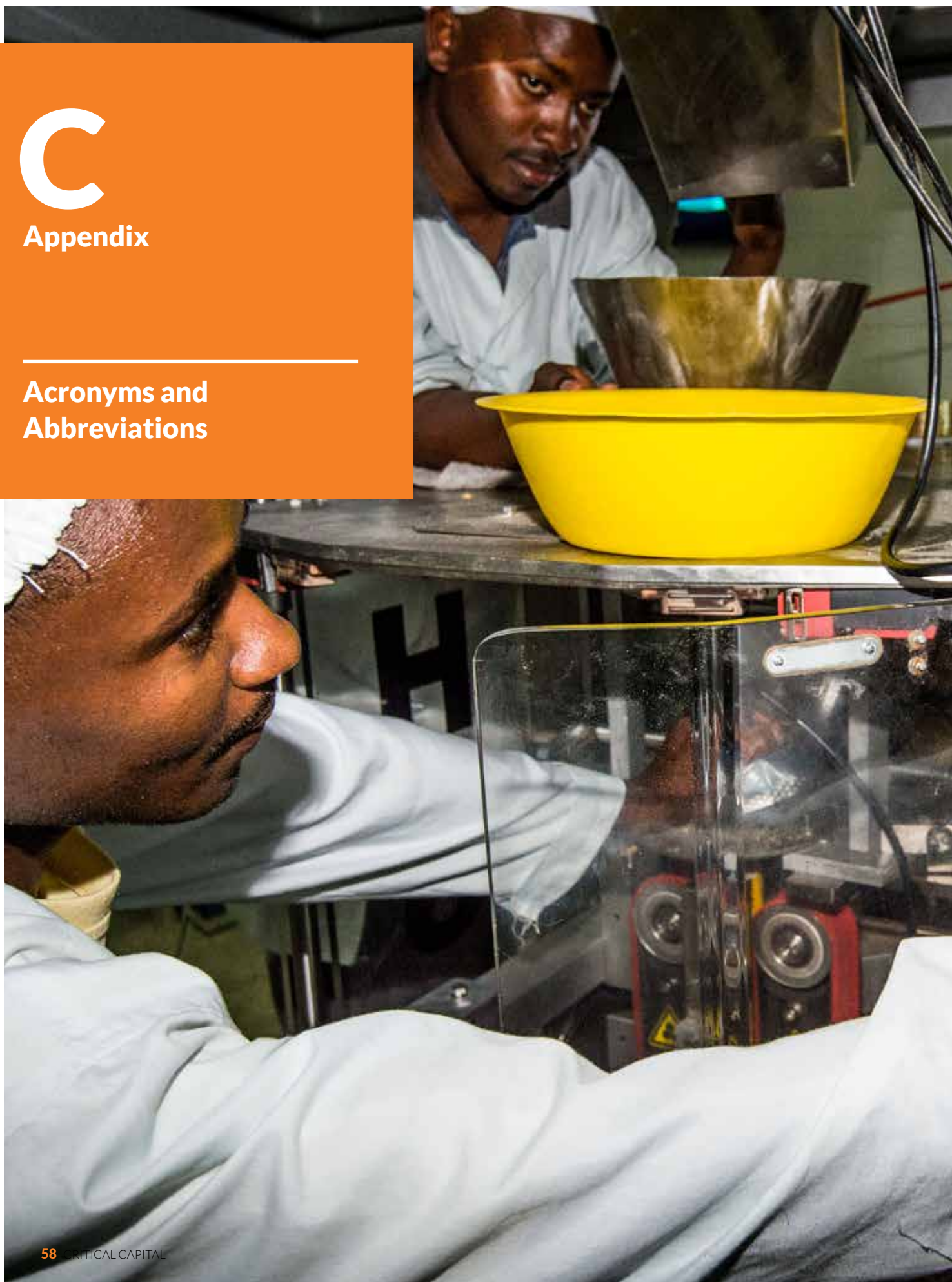
The Food & Business Knowledge Platform (F&BKP) is the gateway to knowledge for food and nutrition security. Nearly one-eighth of the world's population suffers from chronic hunger. And the world's population is projected to reach ten billion in 2050. Thus, the demands on land, water and climate are growing significantly, as is the demand for affordable and good quality food. The F&BKP aims to foster food and nutrition security by sharing and generating knowledge in collaboration with business, science, civil society and government. Knowledge leverages coherent policy development and increased investments from the Dutch agri-food sector in emerging economies.

www.knowledge4food.net

C

Appendix

Acronyms and Abbreviations



Acronyms and Abbreviations

AAC	African Agricultural Capital (East Africa)
AACF	African Agricultural Capital Fund
AAF	African Agriculture Fund
AATIF	Africa Agriculture and Trade Investment Fund
ADB	African Development Bank
AECF	Africa Enterprise Challenge Fund
AGRA	Alliance for a Green Revolution in Africa
AHL	AHL Venture Partners
ASIF	African Seed Investment Fund
AVCA	African Private Equity and Venture Capital Association
BAGC	Beira Agricultural Growth Corridor
BDS	Business Development Services
COMACO	Community Markets for Conservation (Zambia)
CSAF	Council on Smallholder Agricultural Finance
DFI	Development Finance Institution
DGGF	Dutch Good Growth Fund
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
ESG	Environmental and Social Governance
EUR	Euro
FAFIN	Fund for Agricultural Finance in Nigeria
FCFA	West African CFA franc
FMO	Dutch public-private development bank
GIIN	Global Impact Investing Network
GAFSP	Global Agriculture and Food Security Program
ICCO	Interchurch organization for development cooperation
IFC	International Finance Corporation
MDB	Multinational Development Bank
MEDA	Mennonite Economic Development Associates
MFI	Micro Finance Institution
PE	Private equity
PEPZ	Private Enterprise Programme-Zambia
PUM	Netherlands senior experts
SACCO	Savings and credit cooperative organization
SFS	Sylva Food Solutions
SME	Small and medium-sized enterprise
SNV	Netherlands Development Organisation
TA	Technical Assistance
TSA	Ten Senses Africa
USD	US dollar
VC	Venture capital

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