KAMPANI
Investing in family farming

Project Concept Note

Project Title: Fighting extreme poverty amongst smallholder farmers by making proposals investment ready and de-risking investments

Grantee: Alterfin Guarantee Fund VZW

Social Impact Investor: Kampani NV

Funder: DGD Belgium

Expected disbursement date: 2021

Funding request: 900.000 EUR over three years

1. The challenge

As established by IFAD[1] and others, smallholder farmers and rural agriculture business the world over face challenges in attracting necessary capital to improve their productivity, livelihoods, and supply chain participation, particularly from financial institutions (FIs) and the private sector.

Despite growing interest in smallholder agriculture and rural finance, a wide gap remains between supply and demand for investment. It is estimated that the financing needs of the roughly 270 million smallholder farmers in Sub-Saharan Africa, Latin America, and South and Southeast Asia exceed US$200 billion[2].

Kampani has been designed to address a particular part of this gap – the part where the grant logic meets the investor logic. This gap is generally referred to as "the missing middle"[3].

2. The missing middle

[1] https://www.ifad.org/web/latest/speech/asset/40293533

[2] Initiative for Smallholder Finance, RAF Learning Lab, and Dalberg, "Inflection Point: Unlocking growth in the era of farmer finance." 2016

[3] The Missing Middle in Agricultural Finance, Oxfam GB Research Report, December 2009

More than 60 % of the poor worldwide are smallholder family farmers and although they are the world's main producers of food, they remain the most vulnerable part of the population in addressing their needs and those of their family members with regard to food security. This is particularly true for indigenous communities, women and youth.

Today, markets for agrofood products – even in the most remote areas in the South – are becoming increasingly modernized, resulting in requirements for farmers like high quality produce, food safety and traceability guarantees, high and constant supply quantities, and sustainability claims.

Some producer organisations in the rural South make impressive social and economic progress. Increasingly, these farmers no longer see themselves as poor –trying to survive– but as ambitious rural entrepreneurs.

But as these organisations grow and expand, they face a huge obstacle: access to capital. They have outgrown the microfinance market but are still too small and fragile to be eligible for the traditional investment market or even for most social investors. They are confronted with the so-called 'missing middle'.

The existence of the 'missing middle in agri-financing' is a well-known and a particularly hard nut to crack.

The reasons for this are pretty obvious: with a purely commercial perspective, these investments are a non-starter. Investing in such businesses implies a high transaction costs and a high risk. But the need is there, the flow of patient capital to agricultural SMEs and farmer cooperatives needs to be scaled up.

3. Kampani's answer

As established above, Kampani (bylaws and annual accounts are annexed) has been designed to address a particular part of this gap – the part where the grant logic meets the investor logic.

Kampani stands out from other social investors thanks to the following audacious combination of strategic choices:

- Putting the social impact central, focus on the most vulnerable
- Investing directly
- Strengthening the balance sheet of the investee through the use of equity or quasi-equity
- A long investment horizon of up to 10 years
- Only in the agro-food value chain
- Active involvement in the governance of the investee
- Small investment amounts (100k to 500k euros)

This pioneering combination of strategic choices constitutes Kampani's unique selling proposition. In doing so, Kampani's approach is substantially different, but complementary, to the investment strategy of other funds such as BIO-Invest and Alterfin.

BIO-Invest, for instance, makes similar investments but with far larger investment amounts. Even today, with the broadened scope under code 5, BIO-Invest invests only with amounts starting from 1.5 million euro. While important, this type of investments is not adequate to address the needs of the most vulnerable.

Alterfin on the other hand will at times make investments as small as Kampani, but always short term and collateralised, addressing working capital (OPEX) needs. These types of financing are also valuable, but there remains an investment need unanswered, namely for long-term hardware investments of relatively moderate size.

To summarise, the risk/return ratio acceptable to Kampani and its network is what makes Kampani unique. Doing so, Kampani acts as a bridge between traditional TA providing NGOs and investment funds interested in larger and more mature targets such as BIO-Invest. Indeed, Kampani counts for its exits for equity deals on funds like BIO-Invest. It is in part for this purpose that a BIO-Invest senior investment manager is a member of Kampani's Investment Committee.

4. Kampani's scope and nature of the investee

The description above of Kampani's contribution to fight the missing middle begs the question as to where Kampani carries out its mission and who can benefit (the nature of its targets). A detailed document describing the strategy is available.

It should be obvious to the reader that Kampani has a narrow sector focus: agrofood.

Geographically, its scope is limited to where its shareholders and close partners are operational, totalling some 20 countries. We have selected 11 focus countries[4], most of which are post-conflict countries and among the poorest in the world.

The investment targets can be cooperatives or businesses which produce, process, trade and/or market agro supply products, farming products or food. In other words, the investment target can both be in upstream (e.g. producers of seed or fertiliser) or downstream (e.g. processors) activities of the producer organisation as well as the farming activity of the producer organisation itself. Outside of scope are companies that provide services to the agrofood value chain (e.g. incubators, IT-solution providers, etc.)

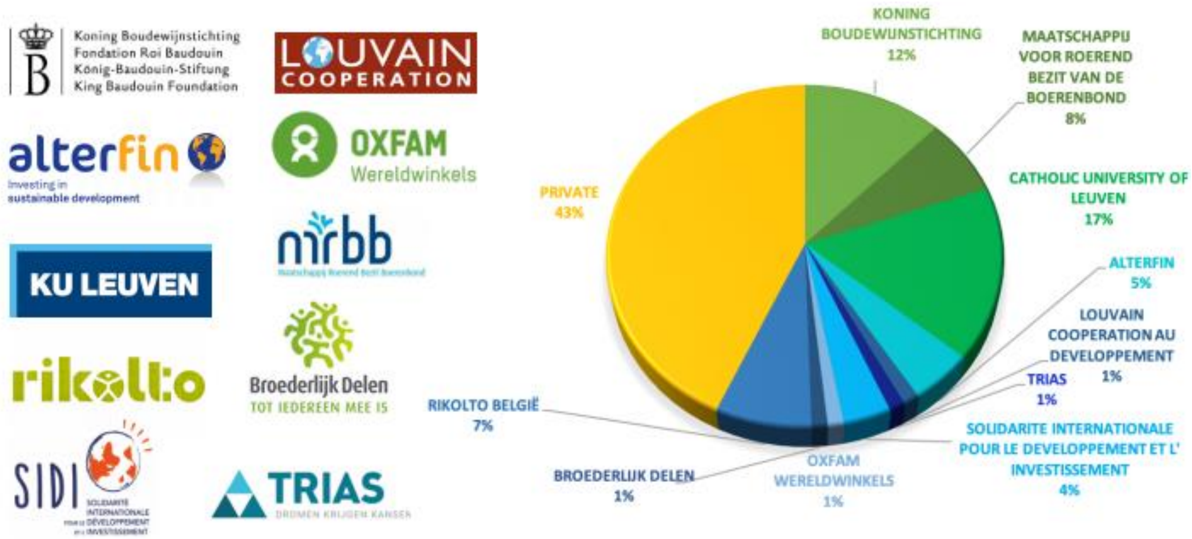
While Kampani prefers to invest in farmer cooperatives, it can also invest in privately owned SMEs as long as there is a close link with - and lasting benefit for - smallholder farmers. In the case of an SME, the IC pays particular attention to the social impact generated by the investment on smallholder farmers.

[4] Indonesia, Burundi, Kenya, Tanzania, Guatemala, Benin, Guinee Conakry, Uganda, Philippines, Honduras, Nicaragua

5. Kampani's ecosystem

Kampani's shareholdership lies at the heart of its success in that it is an emanation of the ambition to cooperate beyond the usual suspects. Kampani is an initiative supported by the private sector, the social impact sector and the NGO sector. The fact that the Belgian NGO-sector is organised around Kampani is itself a strength.

Kampani's shareholders are:



In other words, the know-how, network, and expertise of the private sector is combined with that of the participating NGOs. It is in the first place the NGOs and social investors that via their extensive network on the ground generate the fund's deal flow. The private investors inject the discipline of the market, ensure proper and qualitative due diligence, risk management, and business acumen. The King Baudouin Foundation offers in particular its unparalleled convening power.

6. The social impact

As described above, it is the specificity of the type of investment Kampani makes that unlocks growth amongst smallholder farmers. It is a type of money that is inherently impossible to provide with a purely commercial logic and without a sophisticated risk mitigation strategy.

Kampani's investment in a coffee cooperative in Burundi, COCOCA, is well-suited to illustrate the social impact. COCOCA, a Fairtrade certified coffee exporter and a union of smallholder cooperatives, represents almost 30.000 smallholder coffee farmers. Kampani helped finance the acquisition of a coffee hulling plant. Consequently, COCOCA could offer its members a much-improved service, and traceability and quality control for its clients. This investment has contributed towards the growth of the cooperative. In terms of volume, the hulling factory is now the largest in

Burundi. COCOCA remains the only cooperative in Burundi with its own export capacity. In part thanks to Kampani's investment the extreme vulnerability of thousands smallholder producers is dramatically reduced.

To gain further insight in the deals Kampani has in portfolio and their current status, we refer to the annex which describes each deal individually.

7. Leveraging public money

From the above, the specificity of Kampani and its social impact should be clear. And we have a proof of concept. Kampani is 6 years old. We have 9 deals in implementation. Remarkably, especially given our investment strategy, we have no failures. We target capital preservation, net for investor, and are on track to meet that target.

The question is now one of scaling. This is where the use of public money can generate a tremendous leverage.

In order to scale, Kampani needs:

a) A healthy pipeline
b) Additional shareholders

In terms of identifying deal potential and making deals investment-ready, Kampani and its partners need to invest a lot of time and effort. At a certain point, this is a cost that cannot be reasonably borne by Kampani's shareholders alone. This is why we seek grant funding from DGD.

In terms of the fundraising, it is also clear that investors willing to accept Kampani's risk/return ratio are rare. In order to scale and attract more investors, Kampani's value proposition needs to be de-risked further. This is why we want to allocate part of the grant to establish a first-loss tranche and make a first step towards our scale-up. To implement the scale-up we are looking to partner with organisations such as ENABEL.

8. The use of the grant

Well-targeted public money can leverage substantial private capital. In the case of Kampani, for every euro financed with public money, approximately 4 euro from private investors is mobilised.

DGD financing would be used for the following purposes:

A) Enable agricultural SMEs or producer organizations to be investment ready:

- Provide training in financial literacy to the management

- Organize exchanges so that learnings from other geographies or sectors are captured when developing an investment proposal
- Install capacity (or provide ad hoc support) to develop the business plan, financial forecasting, sensitivity analyses
- Financial feasibility studies, market studies, due diligence reports
- Other business development services

B) Help de-risk deals:

- Hedging of the FX-risk with local currencies
- Taking out a political risk via an insurance
- Giving access to different certifications schemes, targeting sustainability (including but not limited to organic and Fairtrade), and food safety and traceability.
- Management training in terms of governance issues, financial management, HR management, strategic planning, setting up of information management systems, etc.

C) Establish a first loss tranche:

Kampani's founders put the social impact front and centre. Kampani wants to address a specific section of the missing middle – the hardest part – and has reverse-engineered a solution. Organisations that are serious about addressing the most difficult segments of the missing middle, require some form of compromise from their shareholders. Indeed, the social ill which Kampani addresses, inherently and unavoidably implies a high risk and a low financial return. Not a particularly attractive proposition for the shareholder.

Kampani's shareholders accept this compromise because of the societal benefit Kampani generates. But, in order to substantially grow we need to be able to attract investors that are less prepared to accept such a compromise. There are just too few actors that accept the compromise. This is where the logic of the first loss tranche comes in with its highly catalytic effect.

Kampani – when we do well – will be able to deliver on its ambition to have a financial return, net for investors of capital preservation. (We are on track to do so). The financial return is a function of our investment strategy. In order to improve the financial return, we would have to change the investment strategy, precisely what we do not wish to do as it would move us away from our social focus.

With the financial return fixed, the only way to improve the risk/return ratio for Kampani's shareholders is to reduce the risk. At deal level, we have a good track record (no failures to date). But at portfolio level, a real game changer would be the creation of two separate shareholder classes, i.e. creating a first loss tranche. Using such a tranche would *systemically* improve the risk/return ratio for Kampani's shareholders.

The holders of the first loss tranche are the first to absorb any losses. This has an incredible catalytic effect. Leveraging this first loss tranche will help Kampani to reach its target fund size of 20M euro. It is important to know that this money will be put to work immediately – invested in deals – but it will not constitute an expense except if Kampani does not meet its target of capital preservation.

Practically speaking, we propose to organise the first loss tranche via AGF VZW (see below). It would be AGF VZW that would become a shareholder of Kampani. In other words, the proposed grant request will be used partly to improve the risk/return ratio for Kampani's shareholders and therefore used as leverage to attract new and more risk-averse shareholders – needed in order to scale.

This innovative mechanism would internationally put Belgium further on the map in the impact investment sector as a pioneer.

9. The structure

The recipient of the DGD grant money would be the Alterfin Guarantee Fund VZW (Bylaws and annual accounts 2020 and 2019 are enclosed). Already in 2017, Kampani signed a cooperation agreement with AGF. Kampani had put this in place precisely to start attracting grant money.

Per this cooperation agreement (also enclosed as an annex), Kampani has unimpeded access to all money collected by AGF that are earmarked specifically for the use of Kampani. It is Kampani alone that determines how the money earmarked for Kampani is used.

The cooperation agreement between AGF and Kampani can accommodate the DGD funding without the need for amendment.

In section 8 above, we described the use of the grant. For subsections A and B, the eligible expenses would be borne by the AGF instead of by Kampani. For subsection C, the first loss tranche, the proposal is for AGF to become a shareholder of Kampani.

To avoid confusion, it is important to explain both how Kampani and Alterfin CVBA are related as well as Kampani and AGF VZW. Alterfin CVBA is a shareholder of Kampani. Alterfin CVBA is not in any way involved in or affected by this grant request. As described above, the work of Alterfin, a social lender, is valuable and complementary to the work of Kampani. Their investment strategy allows them to issue dividends to their shareholders year after year. This, Kampani will never be able to do.

Simply to avoid duplication of work, Kampani and Alterfin have agreed to share the AGF VZW. The name, AGF or Alterfin Guarantee Fund, no longer fits the bill but it is a practical way for Kampani to be able to raise grant money. This is even tax incentivized via Kampani's agreement with the King Baudouin Foundation.

10. Monitoring

Kampani would welcome DGD to monitor the envisaged cooperation.

Success will be measured by two over-arching variables:
1) The number of deals made bankable and sufficiently de-risked
2) Kampani's ability to scale up by attracting new shareholders (and the stability of the shareholdership).

Output indicators will start showing results early on. However, the more interesting outcome indicators will only start showing results after some time. Making deals bankable takes time. Kampani only provides grant financing to potential investees that can reasonably be expected to be investment ready within an 18-month period, however.

We propose to have regular update meetings with DGD.