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Initial reflections on the establishment of a global coffee funding mechanism

Background

1. The ICA 2007 includes as objectives: (8) developing, evaluating and seeking finance for projects that benefit Members and the world coffee economy; and (13) facilitating the availability of information on financial tools and services that can assist coffee producers, including access to credit and approaches to managing risk.

2. The London Declaration "on price levels, price volatility and the long-term sustainability of the coffee sector" (2019) called on the International Coffee Organization (ICO), inter-alia, to "[explore] the set-up of a global multi-stakeholder funding mechanism with the goals of:

- leveraging investment in the coffee sector through blending of public & private sector funding
- incentivising environmental and social stewardship
- fostering development of sustainable coffee regions
- supporting transparency efforts and policy reform
- building additional capacity for relevant policy development and enforcement in producing countries, and
- reducing poverty",

and, "in accordance with the outcomes of the exploration, mobilise stronger political support and resources[1] towards the creation of such a global multi-stakeholder funding mechanism to address the short- and long-term sustainability of the coffee sector".

[1] From multilateral mechanisms such as G7, G20, and United Nations General Assembly, international organizations as well as multilateral and regional financial institutions, and the private sector.

3. At the 135th Session of the International Coffee Council in March 2023, the Executive Director, as per document ICC-135-6, indicated that the "creation of a coffee sustainability and resilience fund, as well as actions for the establishment of a centre focusing on the circular coffee economy were among the priorities identified and to be developed through partnerships" as part of the 2022/23 Programme of Activities.

4. **Annex I** therefore present a brief report[2] on the initial reflections regarding the need for sustainability and resilience investment in the coffee sector, as well as options to set up a coffee-focused financial vehicle.

Action

The Council is requested to note this report.

[2] Preliminary reflections of the engaged team of expert have been collated and are presented below as a reference for discussions to be held at the 136th Session of the International Coffee Council, at the 5th CEO and Global Leaders Forum and at the 5th World Coffee Conference. The document has not been edited.

Initial reflections on the establishment of a global coffee funding mechanism

1. Background

At the 134th International Coffee Council and the 4th CEOs and Global Leaders Forum, as well as within the Coffee Public-Private Task Force (CPPTF), in Bogotá, Colombia, from 3 to 7 October 2022, participants reiterated the need to explore options to increase access to finance for coffee farmers and additional funding for investing in the present/long-term sustainability and resilience of the coffee sector.

As a result, from October 2022 to September 2023, the ICO Secretariat and the CPPTF:

- Engaged many potential private and institutional development and financial partners. and held two informal meetings with some of the interested parties (IFAD, FAO, FAO Investment Centre, UNIDO, ITC, the World Bank, European Commission and CPPTF members);
- Capitalized on knowledge generated by the CPPTF (database of coffee sustainability projects, cost of production, living and prosperous income benchmarks, and resilient landscapes);
- Provided an update on progress since the 135th ICC and 2023 meetings of the CPPTF;
- Mobilized extra-budgetary in-cash and in-kind resources (seed money) from UNIDO, ITC and the CPPTF, and set up a high-level team of experts to carry out a prefeasibility assessment of the sustainability investment needs and financial mechanisms for a sustainable and resilient future for the coffee sector (July–December 2023).

2. Preliminary results

The process to identify challenges, opportunities, needs and solutions is currently underway, including the appraisal of the rationale for such interventions and the need to upscale current efforts by producing countries, industry and development partners to increase the coffee sector's access to finance. The analysis assessed how to expand/improve existing funding mechanisms[3] vs setting up new schemes/vehicles. The work of the ICO team and experts was guided by the need to think out of the box, identifying new, innovative options and sources of finance.

In addition, the ongoing analysis aims to determine the potential beneficiaries and partners for establishing a coffee-focused financial scheme or vehicle and whether it would be feasible to set up an ad-hoc scheme just for coffee or if it must also be expanded to include other commodities.

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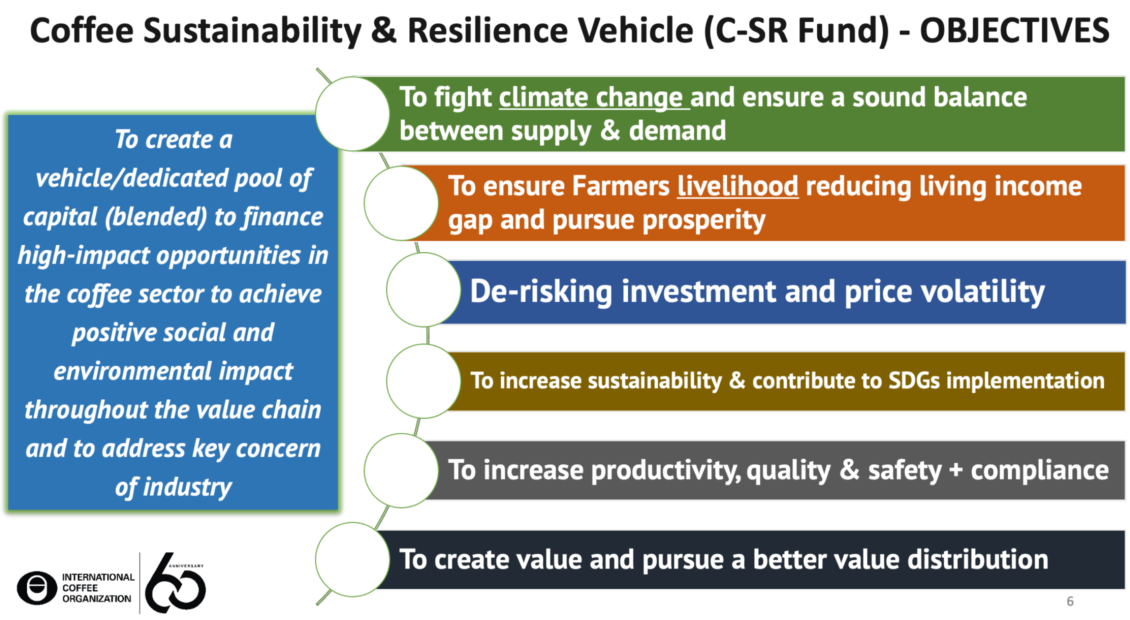
[3] Access to funding for the coffee sector has reduced due to the changing rules of the Common Fund for Commodities, even if new green funding like GEF and GCF have opened up new opportunities.

Regarding coffee farmers, increasing pressure towards efficiency, quality and sustainability is due mainly to:

- Aging plantations and farmers;
- Reduction in the average farm size;
- Stringent regulations on sustainability and on the use of agrochemicals;
- Increased cost of inputs;
- Price levels and volatility;
- Consumer demand for quality/affordability/sustainability; and
- Limited and structural access to finance and know-how.

With regard to the entire coffee global value chain, again structural issues such as the supply and demand balance, climate change, stringent regulations on sustainability and the use of agrochemicals, high transaction costs, the interest rate differential between exporting and importing countries, consumer demand and risk of concentration in a few origins, among others, require a large and consistent flow of capital to invest in the long-term sustainability of the sector.

The main preliminary reflections of the engaged team of expert have been collated and are presented here as a reference for discussions to be held at the 136th Session of the International Coffee Council, at the 5th CEO and Global Leaders Forum and at the 5th World Coffee Conference. The document has not been edited.



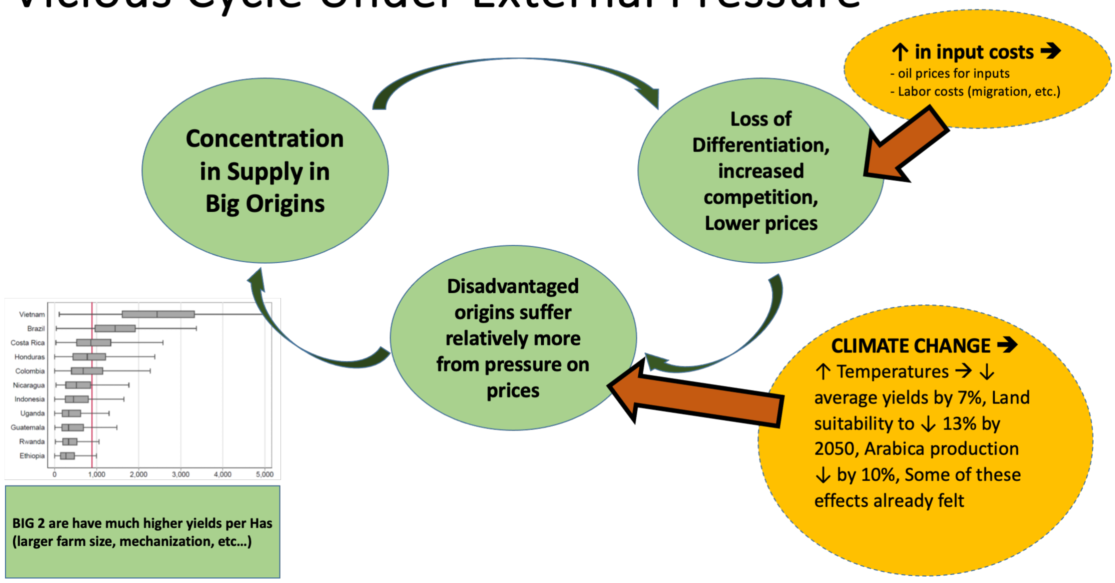
Demand

- Current: 3 billion cups daily
- Future: projected to grow over the next two decades

Challenges on the supply side:

- Climate Change
- New Regulatory Regimes
- Structural issues
- (Very) Smallholders in many origins
- Mechanization is difficult/impossible in many origins
- In the short-run, supply insensitive to prices → price volatility → challenges to long-term contracts/commercial relationships & to medium and long-term planning and investment
- Poor access to credit, insurance, etc.
- Price levels/volatility…

Vicious Cycle Under External Pressure



What to do or not to do?

- (Leaving aside estimates) Is there a case for intervention?
- Market concentrates supply in most efficient origins → no efficiency-based rationale
- “The cure for low prices is ... low prices”!
- Countries with market power have incentives to ↓ supply
- Sachs report: annual financing gap of $9bn to achieve SDG goals. Provisionally suggests $2.5bn contribution from private sector to be matched by donors.
- → Intervention should be limited to support public goods
  - Markets do not provide (enough) public goods
  - R&D is probably the main one
  - WCR estimates 250-450$ million needed for R&D
  - (still based on Sachs’s model)

Rational for some kind of intervention?

- “***On the other hand*** ...” markets yield efficient outcomes only under certain (idealized) conditions from which coffee sector deviates substantially ...
- (e.g., structure of supply, differentiation, diversification
- & resilience, externalities, market power, R&D)

- Macro/Aggregate models unlikely to provide accurate guidance:
  - Enormous heterogeneity *within* countries
  - Devil’s in the details: the problem is often not what to do,
- but ***how*** to do it effectively!
- We must be (very) **humble!**
- Conservative bottom-up estimates (**in progress**) suggest that **hundreds of millions** per year are needed to fill part of the investment gap globally.

What?

Any successful organization should know the answer to three questions:

1. What do we do?

2. Why we do it?
3. How we do it?

The "**what"** is the proposal to be discussed:

- Create a **new** **investment vehicle (IV)** dedicated to **coffee**, **blended** with direct engagement of the largest private companies to mobilize further investment
- **Must overcome competitive issues for a common goal**
- A clear rationale for coordinated action must be properly articulated (this afternoon)

WHY?

- Let's suppose we have agreed on the rationale. Why is a **new** **IV** dedicated to coffee, **blended** with direct engagement of the largest private companies needed?
- Why would *this* be better than the *alternatives*?

Alternative 1: **Continue with business as usual.**

- Private companies already support many sustainability programs at origin independently.
- Perhaps they can scale up their own programs as needed, leveraging detailed knowledge of their supply chains and their scale in key origins.

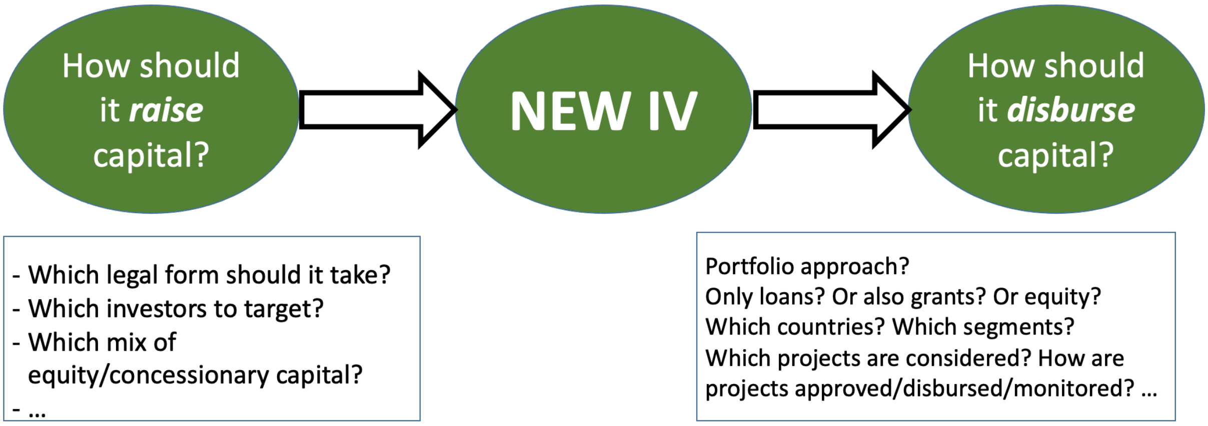
Alternative 2: **Scaling up investment in [other] existing facilities.**

- Setting up a new IV is costly.
- There is no shortage of existing initiatives that could be used to focus on specific investments.

How exactly would a **new IV create value** for the industry (farmers, consumers and anyone in between)? We need to discuss *value capture* separately.

HOW?

- Let's suppose we have agreed that the investment gap and the need for intervention are clear
- And we have also agreed that the **new IV** has the potential to ***create value***. Then, how should it work?



What to look into in order to defining Investment Vehicle options

- Coffee farming **major source of livelihood** for millions of people in developing countries
- **Access to finance persistent challenges, as investment in smallholder production is seen as increasingly risky, with returns not able to compensate commercial investors for this perceived risk.**
- Many farmers, especially smallholders, are at risk of abandoning coffee cultivation due to **low income, climate change, and market volatility**.
- This shift away from coffee could **jeopardize future production** and income for the entire coffee industry
- Need for a **dedicated global tool** involving all key stakeholders to be part of the solution.

Mapping of Initiatives

Initiative	☑	✗
Global Coffee Fund (Columbia University)	**Focus on coffee, linkages with local National Sustainability Plans**	**Governance, too political, too ambitious. Never took off**
Farm Fit Fund (IDH)	**Global, Involvement of multinationals as investor and pipeline generation, adaptable funding strategies**	**Limited focus on coffee,**
ABC Fund (IFAD)	**Global, Well-designed blended finance structure, integration of Technical Assistance, Funding through local banks**	**Public sector driven governance, limited focus on coffee**
Aceli (CSAF)	**Incentive mechanism to commercial lenders, Innovation Facility, Industry led**	**Limited country coverage, limited focus on coffee, No direct investments**
Coffee Resilience Fund (Root Capital)	**Coffee focus, Linkages with other initiatives notably TA**	**Focused on Latin America only, direct lending only**
Aroma Program (Conservation International)	**Evidence based grant, Technical Assistance. Linkage with ecosystem players**	**Limited country coverage, Limited to direct funding, Grant focus (phase 1)**
Inspire (KCL)	**Impact focused Corporate Structure attracting large PE, Diversified**	**Caribbean focus only, Limited focus on coffee. Limited track record**

Unique valued proposition

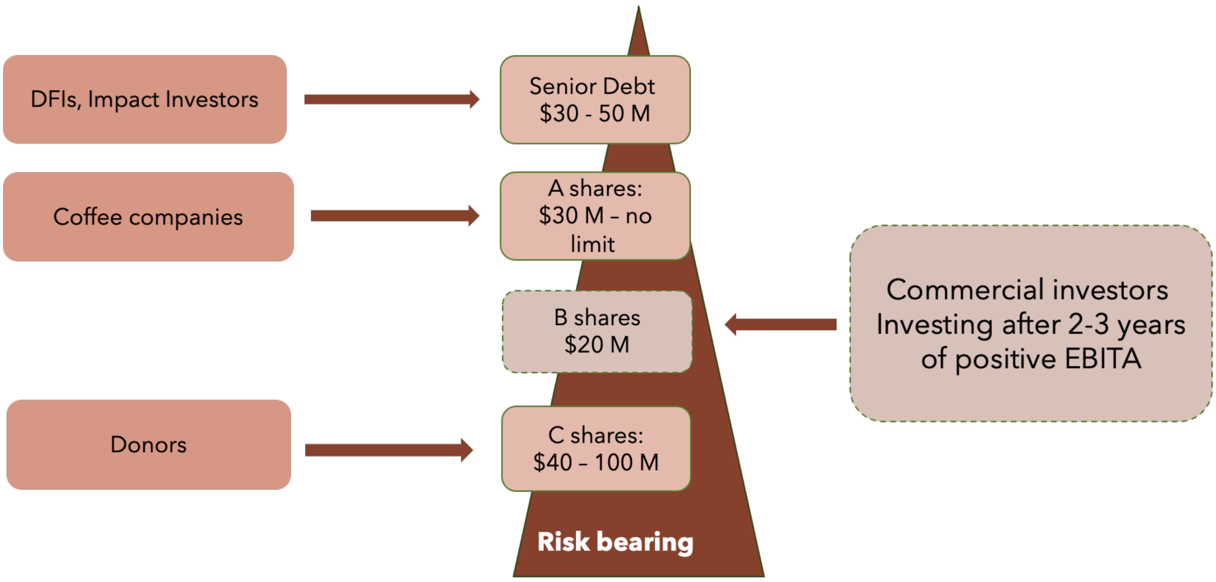
- Global initiative focused on coffee, with local subsidiaries
- Built around leadership of private actors shared responsibility of public and private actors
- Leveraging and catalyzing public and private resources, with a multiplier effect
- Realistic with a phased approach with unlimited potential for growth

- Private sector focused governance structure geared towards autonomy and attractive to investors
- Leveraging coffee companies for pipeline generation as a de-risking and business alignment tool
- Built upon learning and demonstration of value of collecting action.

Key Parameters for investing in the Sustainability and Livelihoods of Smallholder Coffee Farmers:
- Improving productivity of coffee farms and viability of coffee farming
- Mitigate price volatility
- Financing resilience to climate change
- Broaden access to finance for rejuvenation and new plantations.

Components
- Direct catalytic funding to cooperatives, farmer organizations and SMEs in underfinanced yet profitable segments of agricultural and agribusiness value chains.
- Preference given to producers working in the value chain of coffee rosters investors in the fund
- Indirect funding through financial intermediaries to further improve access to financial services for smallholders, cooperatives and farmer organizations, as well as agribusiness SMEs
- Technical assistance facility providing advisory services to cooperatives and farmer organizations, SMEs and financial intermediaries.

A Blended finance vehicle?
For example, it could be capitalized as a Fund or Holding Company (HoldCo).

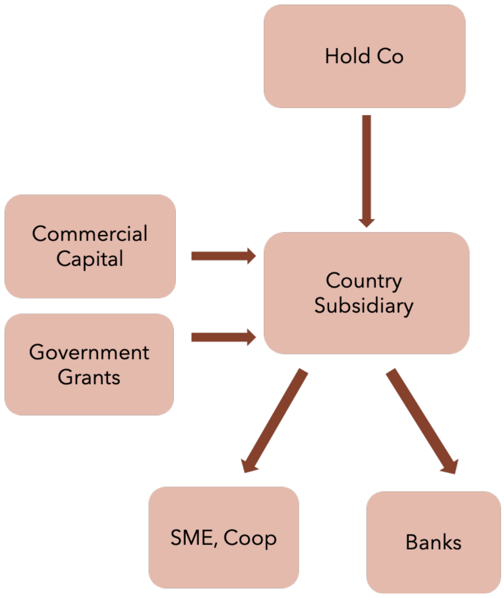


Holding Co option
- HoldCo to capitalise subsidiaries in countries of interest or countries expressing interest
- Subsidiaries to be geared with domestically sourced commercial capital co-invested with public finance from those countries
- Subsidiary level debt secured against local collateral (receivables etc.) and subsidised where possible with public funds remains senior to HoldCo debt to mitigate risks associated with structural subordination.

Key advantages:

☑ Unlimited potential for growth

☑ Higher capacity to attract investors



Governance?

- Investment Vehicle to be managed by professional staff with full P&L responsibility and incentivised to deliver clearly defined C-SR results as identified in Phase I
- Investment Vehicle to be governed by an elected Board of Directors comprising representatives of LPs (fund) or A and B Shareholders (HoldCo) under an Independent Chair in accordance with the terms of the original SPA or Investment Agreements
- All investment decisions pertaining to instrument, C-GVC segment and investment amounts to be made at country level subject to ratification by a centralised Risk Committee to ensure portfolio balance and avoid mission drift
- In-country boards to comprise elected local representatives

Phase 1: Grant Facility

- Repayable Grants to known suppliers in the global coffee value chain in order to quantify outcomes which constitute success.
- Target: $50 million of public money.
- Duration 1 – 3 years. Outcome: detailed investment strategy

Phase 2: Holding Company

- Holding Company or 5-year closed end SME debt fund.
- Target : Initial capitalisation $30 million of Industry & DFI commitments plus $40 million of public finance including reflows from Phase 1 (assuming 20% loss of principal). Total c. $70 million.
- Expected single digit net financial return.
- Important to demonstrate successful investment track record.
- Anchor investors ideally an industrial coffee company foundation with DFIs

Phase 3: Listed Hold Co

- Listed HoldCo or 10-year closed end fund investing variety of instruments throughout the value chain.
- Target first close $150 million; final close $300 million. Expected to attract commercial and institutional capital.
- Expected net financial returns exceeding 15%

Subsequent phases:
- to grow AUM to $1+ billion.
- No fixed timeline

Additional Remarks on feasibility for a coffee-focused vehicle
- There is a significant SDG financing gap for developing countries. Private capital is crucial to closing this gap; however, less than 5% of global private assets are invested in developing countries. Public and private investments in developing economies are often fragmented, crowding out instead of reinforcing.
- Deeper collaboration among all stakeholders is crucial to ensure success — recognizing the limits of public investment and the increasing appetite among private investors and corporates to engage in interesting opportunities in fast-growing emerging markets, especially in impact investing, blended finance, ESG, and other purpose-driven investing sectors.
- ESG does not guarantee impact; impact requires a level of investment often unavailable to agri-SMEs and smallholder farmers. Bridging this gap requires public-private investment and collaboration.
- The time is NOW! The climate is ripe for this type of intervention, given increased regulation worldwide, particularly in Europe, rising corporate ESG/Sustainability initiatives, and increasing interest in impact investing. Planet, People, and Profit!
- Producer country and farmer requirements should be a starting point for building any new investment solution.
- The coffee industry's financial participation in an innovative investment mechanism (s) is vital to encouraging impact investment from the private sector. Key 'cornerstone commitments" from the industry would increase the chances significantly for successful fundraising of any investment vehicle (s).