BEST PRACTICES ON INVESTMENT READINESS OF SERVICE PROVIDERS IN THE AGRICULTURAL SECTOR

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FOREWORD

STRONG SERVICE PROVIDERS FOR A STRONG AGRICULTURAL SUPPLY CHAIN

Less than 5% of smallholder farmers' credit needs are currently being met. Creating **access to finance** for farmers and their direct business partners is one of the most pressing challenges of our times. It is likely to remain so in the decades to come if we do not find innovative ways to make up the shortfall.

Knowledge about capital supply and demand in the agricultural sector has primarily been concentrated in the direct-to-farmer (microfinance) segment of the market, and the larger project and corporate finance segment. Much less is known about the market **opportunities and risks** of financing agricultural small and growing businesses (SGBs), and the gap between microfinance and commercial lending to larger agriculture businesses.

In response to these challenges, Solidaridad's Impact Investment Task Force started building a pipeline of propositions for investors in 2017. By September 2019, our pipeline comprised 67 promising **small and growing businesses,** representing a potential investment volume of EUR 167 million. We provide ongoing support to the businesses we select to ensure they become investment ready, and connect them to likely investors in our network.

In this report, we share the lessons learnt as they relate to businesses and organizations providing services to smallholder farmers in the soya, cocoa and oil palm value chains in West Africa and Asia. Our aim is to give investors and donors a better understanding of the **investment opportunities** represented by service providers in the agricultural sector.

There is a clear need for more support of these service providers and it will only be realised if we work together. We hope that sharing these best practices will help to bring more service providers to investor readiness, and beyond – to turn them into **flourishing entities,** playing their part to strengthen local, regional and global agricultural supply chains.

Yours,

Hammond Mensah
Frederik Claasen

On behalf of Solidaridad's Impact Investment Task Force

EXECUTIVE SUMMARY

Smallholders are a crucial part of the food value chain as the majority of global agricultural service production comes from their fields. At the same time, smallholders are commonly caught in traditional farming methods and struggle to improve quality and productivity due to factors including the lack of access to market linkages, technical assistance, inputs and their associated costs. Agricultural service providers have the potential to support smallholder farmers as they overcome these key challenges, strengthening the agricultural supply chain. Supporting these organizations and businesses is thus an efficient way to improve farmers' livelihoods and stimulate economic growth driven by agriculture, because the entire value chain benefits.

Solidaridad has set up service delivery models for agricultural support in various value chains across the globe. To complement this work, it has developed a pipeline of investment opportunities in agricultural service providers which are at different stages of investment readiness. Solidaridad aims to attract investment capital and combine it with grants to support small and growing businesses in the agricultural service sector in order to scale its projects and make the initiatives sustainable.

Service providers in the agricultural sector are very diverse in terms of location, target group, commodity, delivery model to farmers, etc.. The objective of this report is to extract lessons and best practices from six case studies related to service delivery models, with a special focus on what makes them attractive to investors. These lessons will be used for other projects, to select investable business cases, and to improve business cases to increase their investment readiness. For this report, three categories of service providers (archetypes) have been identified, based on the entity providing the service: i) stand-alone company, ii) farmers' cooperative, and iii) value chain actor.

The research methodology includes desk review, a field visit and deep dives into six selected cases in four countries, with a mix of archetype to assess the main differences between them in terms of investment readiness. To determine the success of a service provider, characteristics around six themes are assessed including management and governance capacity, finance, market, support, sustainability & impact, culture and policy. The data was provided by Solidaridad staff based on a longlist of indicators.

This approach allows the report to capture and validate a list of good case practices that can increase service provider's profitability and the related likelihood of attracting investment. The extent to which a service model can become profitable varies, but our research distilled a set of eight crucial indicators. The value of these indicators in relationship to profitability and investment readiness is closely dependent on the organization's unique circumstances and the investor's requirements. As such, no exact values are assigned to them in this report. The eight indicators are presented in the table below.

TABLE 1:
EIGHT CRUCIAL INDICATORS FOR INVESTABILITY OF AGRICULTURAL SERVICE PROVIDERS

Indicator	Description
1. Availability of strong business plan	The business case has been tested and confirmed, and is clearly explained using realistic financial projections.
2. Quality of relationship management with farmers	Interaction with farmers, both proactive and reactive, is frequent, and the service provider cultivates personal and positive connections with its customers and potentially even the wider community.
3. Capitalization ratio	The service provider has a healthy capitalization ratio as its (requested) debt is a realistic share of the value of its shareholders' equity. This means the organization can potentially provide internal investment capacity.
4. Donor independence	The annual revenue stream is not heavily dependent on grants and subsidies, and donor dependence is decreasing.
5. Reasonable management salaries	The management team and board members earn salaries that are fair in comparison to the enterprise's turnover, and their own skill set and outputs.
6. Scale (hectares)	The service provider services a significant number of hectares and is able to achieve economies of scale.
7. Active customer retention rate and its trend	Irrespective of the number of customers, the service provider maintains a high (active) customer retention rate which improves over time.
8. Customers' productivity per hectare and its trend	Customers experience increased productivity per hectare which improves further over time, indicating a service's effectiveness.

Our deep-dive findings confirm that a wide range of business models, (crop-specific) services delivered and local modalities shape a business. Assessing the wider ecosystem and its impact on a business is an important part of due diligence. Nevertheless, archetypes of service models prove to be a reliable predictor of successful adherence to the eight crucial indicators and other best practices – and therefore of their investability. An archetype-based assessment can provide an early indication of the opportunities and challenges that may be encountered by a service provider and thus support investment decisions. The table below summarizes the main expectations per archetype:

TABLE 2:
ARCHETYPE-SPECIFIC CHARACTERISTICS OF SERVICE PROVIDERS

	Required investment	Likely opportunities	Likely challenges	Notes on support and subsidies required
Stand-alone service provider	Generally relatively small ticket size Often requires combination of equity and debt	Often has highly experienced technical staff High social impact if relationship with community is well managed Ownership and governance are usually transparent and structured	Tends to be small scale, resulting in start-up losses Needs to increase business capacity Limited capacity to capitalize the business Financial profitability may be low, resulting in reduced leverage	Support to strengthen organizational capacity as well as linkages Initial support for pilots to confirm the business case Advice on route to scale Subsidies for start-up costs High additionality of technical assistance (TA) and finance
Farmers' cooperative	Amount depends on size, track record and asset base of cooperative	High outreach and farmer loyalty countered by generally lower quality and sustainability of operations	Governance is an issue, with low management skills and lack of transparency	Advice on selecting key services that offer business opportunities while reflecting members' needs (focus)

	Required investment	Likely opportunities	Likely challenges	Notes on support and subsidies required
Farmers' cooperative	Mainly debt (both short- and long-term). Will need to create a separate entity allowing equity investment to improve investment readiness	Tends to prefer high-margin services such as marketing and inputs over technical assistance (TA) High potential for empowering farmers to become more influential	Tends to lack financial, and environmental and sustainability (E&S) reporting Low financial capacity and dependence on subsidies Tends to lack focus as it aims to address all the needs of its members Financial profitability can be low, resulting in reduced leverage	Subsidies to develop a clear business model and revenue stream Support to define a lucid strategy and engagement of members High additionality of TA and finance if aligned with other support
Value chain actor	May require larger scale financing Often carries debt	High probability of continued service demand due to value chain integration Often operates on a large scale, leading to broad social impact. However, impact per farmer is limited Often has greater need for capital than other archetypes Generally has high and stable income, usually profitable and with broad asset base Relatively professional organization with sophisticated business plan and credit or investment history Enables small income increase among large number of farmers	Company's interest comes before that of farmers Less comprehensive under-standing of farmers' needs Additionality can be a challenge	Risks of subsidies benefitting company rather than farmers Support will usually take the form of establishing relationships Grants should only be provided to invest in structures which ensure that farmers' interests are addressed consistently

1

INTRODUCTION

1.1 BACKGROUND

Service provision in the agricultural sector refers to technical assistance, inputs and finance provided to farmers in order to increase, directly or indirectly, the productivity and sustainability of their agricultural activities. Given the shortage of adequate public structures to facilitate these services to farmers in developing countries, different models to facilitate access have been developed. based, for example, on the entity providing the service or the entity financing the service. One of Solidaridad's activities in recent years has been to work on setting up service delivery models for agricultural support in various value chains across the globe. Solidaridad has identified four innovation themes, one of which is impact investment. Solidaridad's goal is to drive investments into agricultural transformation by developing a pipeline of investment-ready opportunities for impact investors. In this way, Solidaridad aims to scale and speed its projects, and increase the sustainability of initiatives, as well as meet increased interest of donors to leverage grants with semi-commercial funding.

Impact investment is a new focus for Solidaridad; it has hired a team of 15 financial experts in eight regions to manage the pipeline of opportunities. A global learning agenda has been set up to test assumptions, refine strategies, and share experience.
The main question for impact investments is: 'What are best practices among service providers in becoming investment ready, and what can we learn from these?'

1.2 OBJECTIVE

The objective of this report is to extract learnings and best practices from five case studies related to service delivery models, with a special focus on what makes them attractive for investors. These lessons can be used for other projects, to select investable business cases and to improve business cases to increase their investment readiness.

2

RESEARCH METHODOLOGY

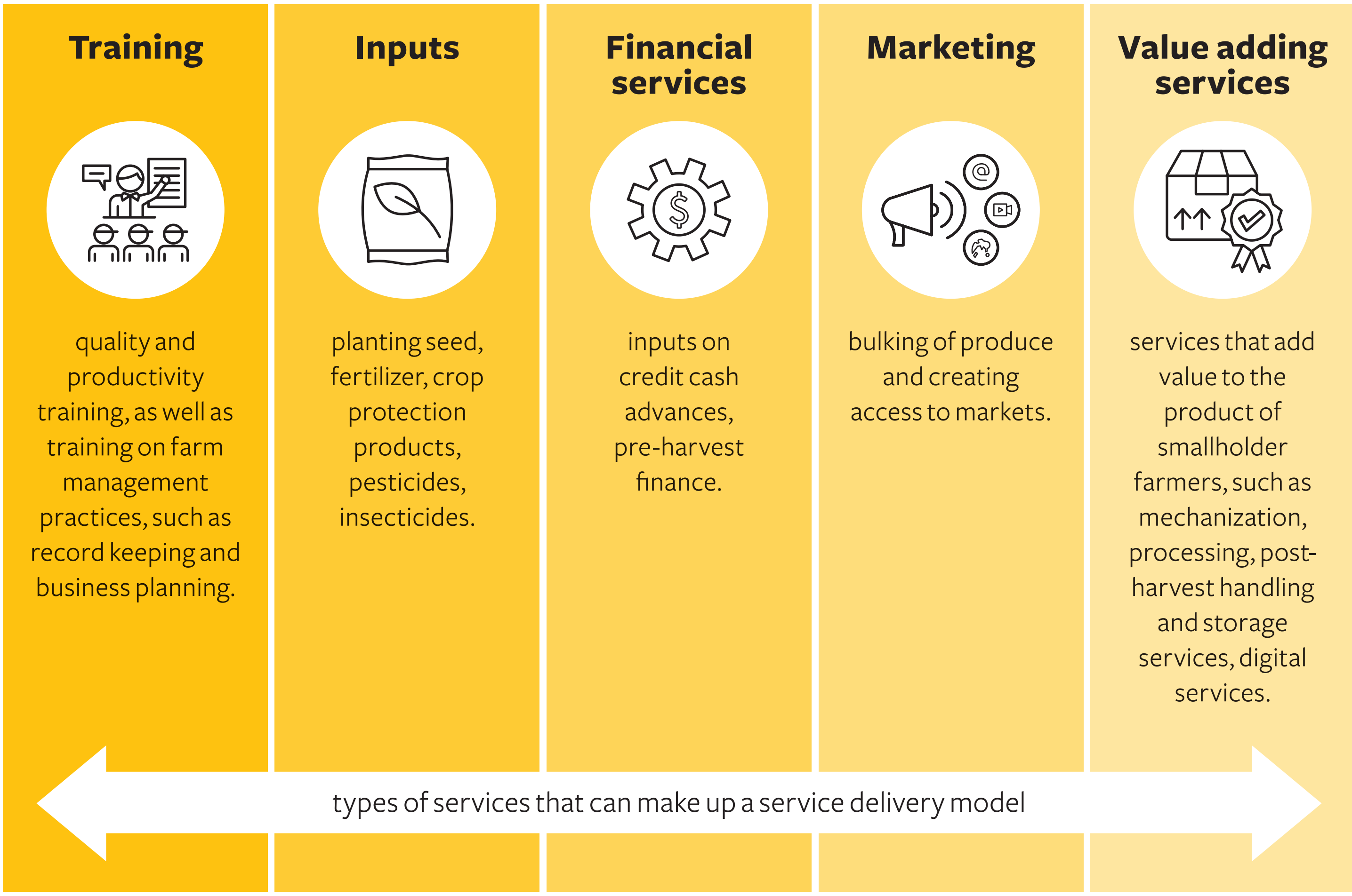
2.1 RESEARCH THEORY

This research is based on an earlier report, 'Applying the Investor's Lens' [1], which provides a framework to assess investment cases.

2.1.1 WHAT IS A SERVICE DELIVERY MODEL?

Service delivery models are supply chain structures which provide services to farmers. Efficient service delivery can improve farmers' performance, and ultimately their profitability and livelihoods. The various services range from training in agricultural management, to providing inputs, delivering financial services, marketing and value adding services as illustrated in Figure 1.

FIGURE 1:
SERVICES THAT CAN BE PROVIDED



Adapted from Smallholder to Small Business. Private sector insights on service delivery models that boost profitability and improve farmer livelihoods, IDH, 2015

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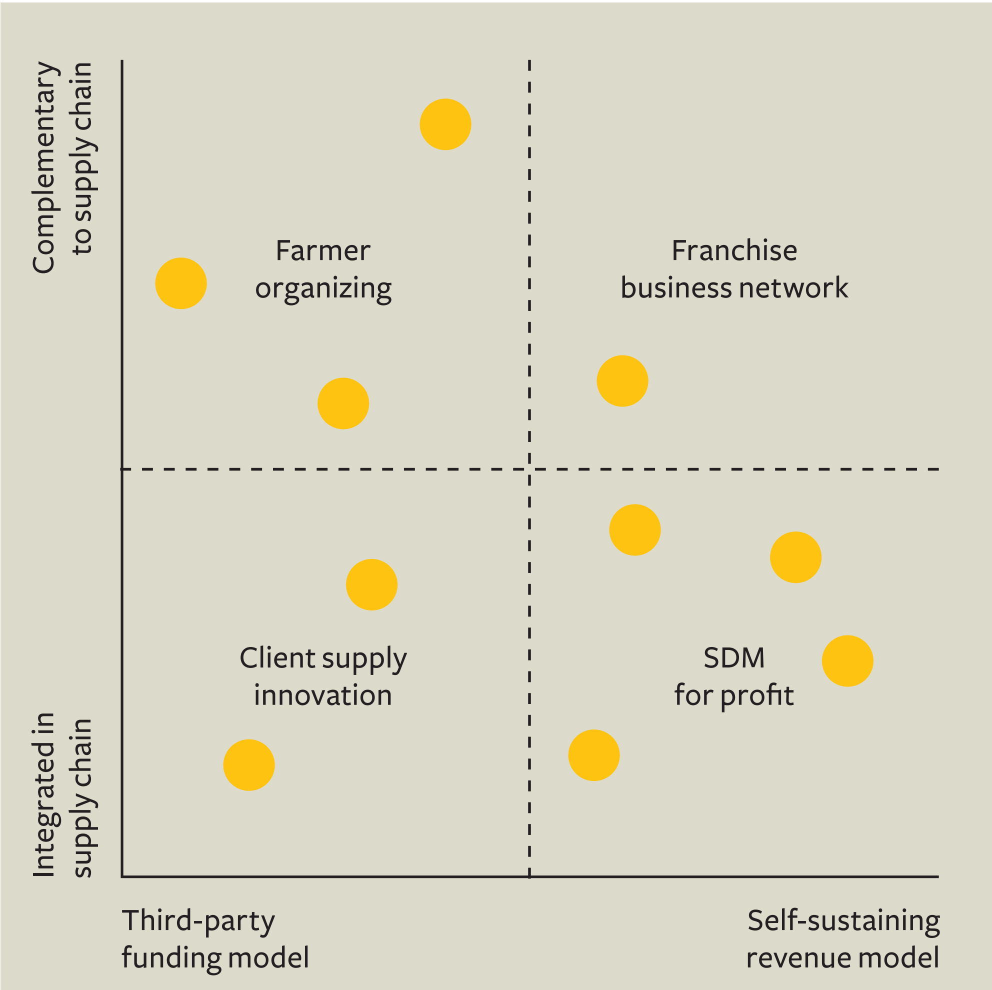
[1] Applying the Investor's Lens, Palladium, Carolijn Gommans, 2018.

2.1.2 CATEGORIZATION OF SERVICE DELIVERY MODELS (ARCHETYPES)

Different types and approaches for service delivery models have been studied by other organizations (Figure 2). The efficiency and impact on farmers' performance depend on several factors, including management and technical capacity, outreach and business model.

FIGURE 2A:
VARIOUS WAYS OF SERVICE DELIVERY MODEL CATEGORIZATION

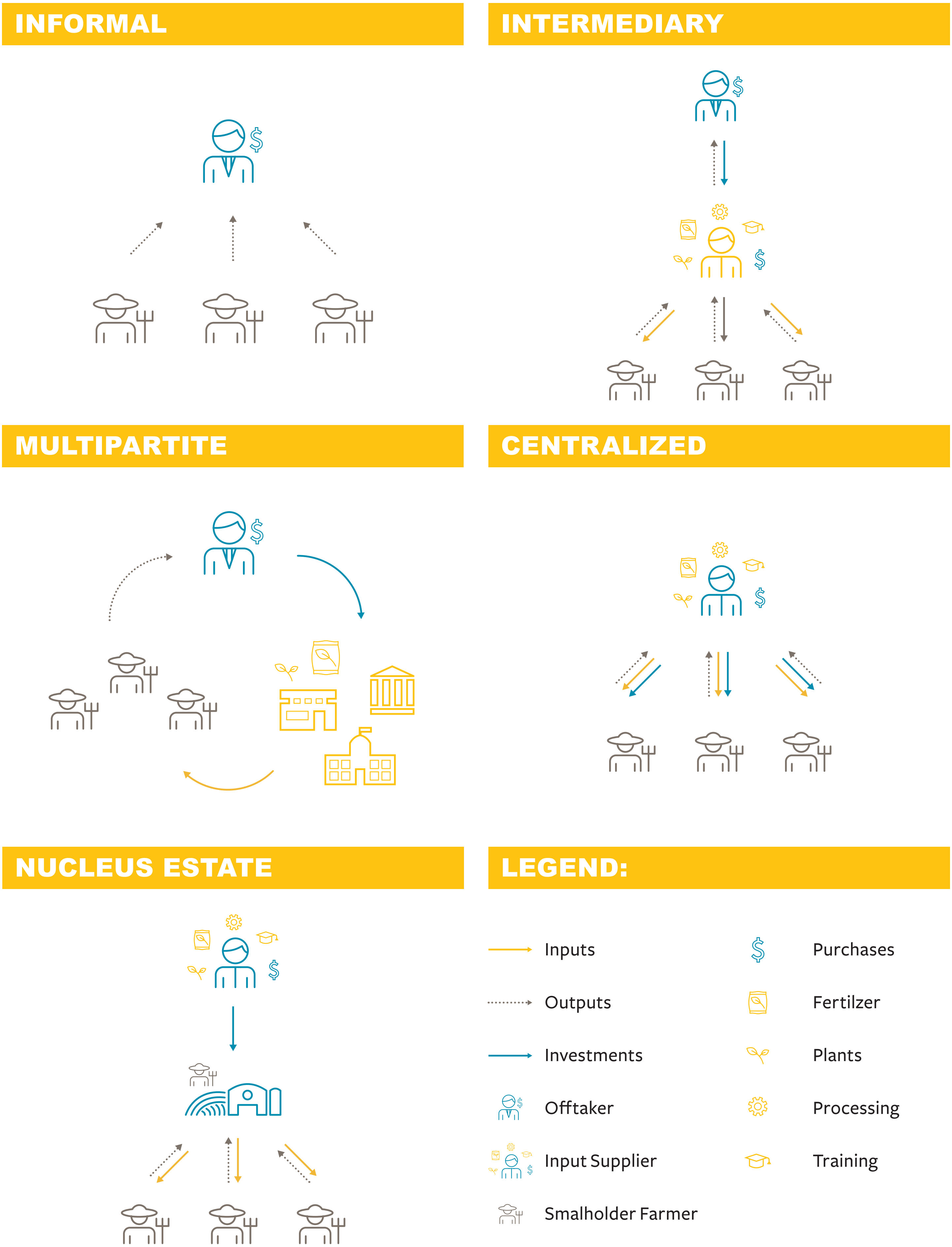


Source: IDH 2016, Service Delivery Models, Insights for continuous improvement and farm impact; IDH, 2015, From Smallholder to Small Business. Private sector insights on service delivery models that boost profitability and improve farmer livelihoods

For this report, the main service provider archetypes have been defined around the entity providing the service:

1. Stand-alone company (commercial)
2. Farmers' cooperative
3. Value chain actor (e.g. processing company)

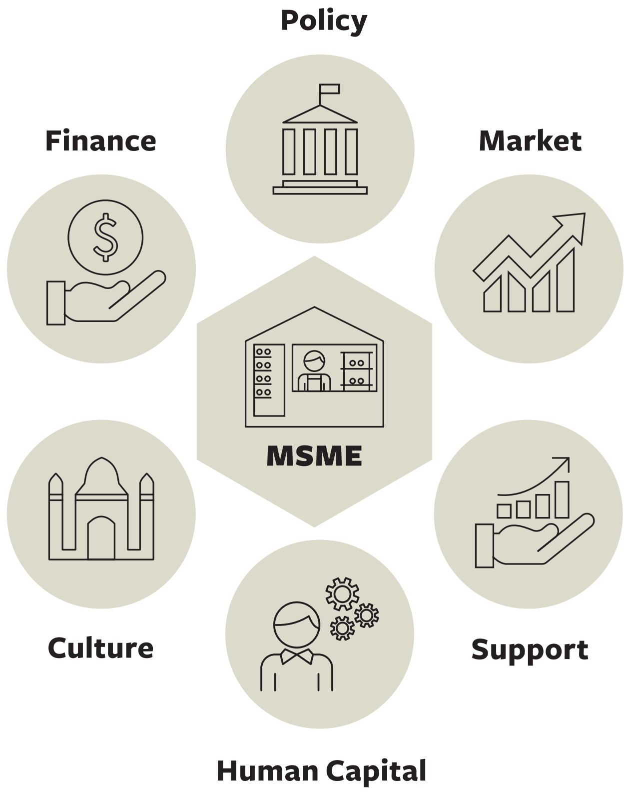
FIGURE 2B:
VARIOUS WAYS OF SERVICE DELIVERY MODEL CATEGORIZATION



2.1.3 FRAMEWORK TO ASSESS SERVICE PROVIDERS' PERFORMANCE

In order to identify the factors that make service provider archetypes successful, we referred to the six domains of the Babson model as a framework to assess the entrepreneurial activities and ecosystem in which service providers operate. The six domains or themes and how they are assessed per service provider are:

- **Finance:** business case per case study, financing need, instrument, investability and investor type
- **Policy:** policies that may hinder or accelerate commercial models
- **Markets:** targeted market. Market size in term of production volumes; linkages
- **Support:** the potential role that digital technology can play
- **Human Capital:** managing generations to remain in rural areas, gender aspects
- **Culture:** any cultural aspects that influence implementation



2.2 RESEARCH METHODOLOGY

The research required active collaboration with Solidaridad's regional offices through the impact investment manager and leads, especially for the collection of relevant information about the service providers in their pipeline. Four main steps were followed to identify best practices and conclusions on investment readiness, as illustrated below:

Desk review to identify common best practices in invest readiness ▸ **Field visit to understand service provider companies in pipeline** ▸ **Deep dives on 5 selected business cases to test hypothesis** ▸ **Conclusions on investment readiness and how to utilize these insights**

1. Desk review: review available literature on the investment proposition for investing in service providers and common best practices for investment readiness. Development of a template that includes indicators to identify critical success factors (based on Babson themes).

2. Field visit: visit to Ghana to collect information on seven projects on the ground, and to get an idea of the challenges and success factors on their road to becoming investment ready.

3. Deep dives: develop five case studies for in-depth understanding of the business and investable case of service providers in Solidaridad's portfolio.

4. Reporting: develop a final report emphasizing key factors and best practices for investment readiness of service providers, and providing recommendations for ways to create traction among relevant stakeholders.

2.3 RESEARCH LIMITATIONS

Most of the data collected is self-reported by the service providers and by Solidaridad's staff. This means data is not fully objective. Soundness of data has been analysed and the underlying assumptions tested to ensure accuracy.

Due to uneven geographic distribution of the service providers that were willing to participate, Latin America is not covered.

Furthermore, the geographic coverage (three cases in Ghana, one in Côte d'Ivoire, one in India and one in Indonesia) makes it difficult to extrapolate findings into general conclusions about the environment in which service providers operate. Therefore, each case has been analysed individually and best practices generated that can be useful for other service providers.

3

SERVICE PROVIDERS' BUSINESS CASE

Many smallholder farmers in developing countries are stuck in the so-called poverty trap. Smallholders in developing countries in Sub-Saharan Africa and Asia generally grow crops on very small plots of land, averaging less than two hectares (OECD, 2018). In general, the costs of agricultural production are very high, while output is low as the majority of smallholders cannot afford the costs associated with land-preparation, seeds, fertilisers, herbicides and pesticides. Many smallholder farmers' current farming practices do not provide their household with enough income to set aside any savings for investments in higher quality inputs, processing equipment or capacity building to improve the quality and quantity of their yields. Instead, they are stuck at a basic level of traditional farming methods using mediocre inputs. With smallholders providing the majority of global agricultural production, they are a crucial part of the food value chain and play a big role in feeding the world's population (FAO, 2014).

Why is a solid business case for service providers important?

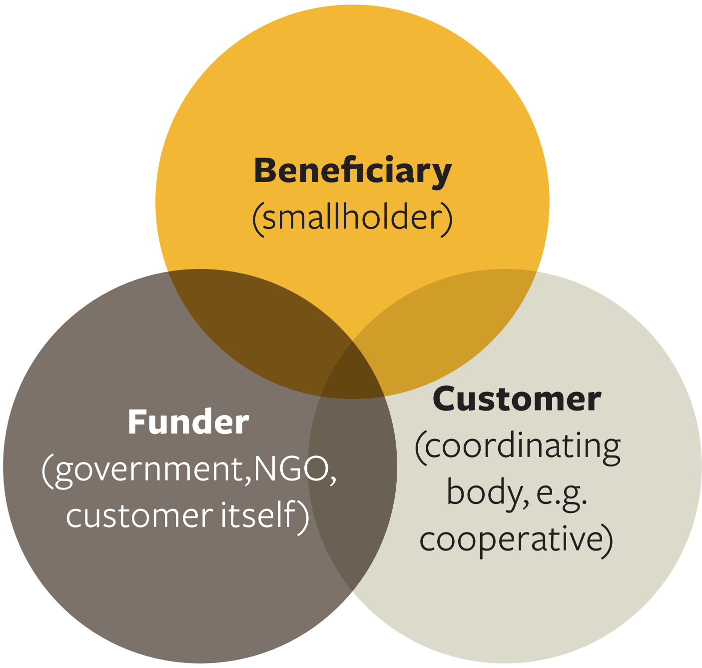
A commodity value chain consists of all value adding processes applied to a commodity from 'farm to fork'. The value chain actors responsible for these processes are closely linked and interdependent. Providing capacity and financial services to farmers, big or small, gives farmers the leverage to uplift their customers' performance. This in turn provides opportunities for input suppliers, as well as value chain actors active in post-harvest handling and processing raw materials to create additional value. Supporting and investing in agricultural service providers is therefore an efficient way to improve farmers' livelihoods and stimulate economic growth driven by agriculture, because the entire value chain benefits. There is a proven demand for agricultural service provision to farmers, although research is required to see which models serve this market best.

Definition of 'service delivery model': The mechanisms or structures in which support services are channeled through [or to, ed.] the supply chain to improve performance and value creation by value chain actors. (Based on IDH, 2015.)

Smallholders are the beneficiaries, but are rarely the paying customers

It is important to realize that while working with service providers will ultimately improve the profitability of smallholders, smallholders themselves are generally not the ones who cover the costs of services. There are differences between service model archetypes, but if you 'follow the money', it becomes clear that the actual customers of service providers are usually farmers' cooperatives, aggregators/traders and processing firms. Funding for services comes from their internal investment capacity and/or grant funding from international donors or governments. Understanding who the actual customer and/or funder is has an impact on service providers' value proposition. Each customer/funder has its own set of objectives for its beneficiaries, such as yield improvement, lower production costs, increased efficiency, improved quality of produce, access to markets, increased resilience to climate change and stimulating women and youths to start/remain in (agri) business. The 'mix-and-match' model of agricultural services is therefore unique to each customer.

[2] Solidaridad strategy note on agricultural service providers.



The key services offered by agricultural service providers generally include a combination of the following:

- **Training**, including quality and productivity training, as well as training on farm management practices, such as record keeping and business planning
- **Input provision** such as seeds, fertiliser and crop protection products
- **Financial services** such as inputs on credit, cash advances and pre-harvest finance
- **Marketing services** such as bulking of produce and facilitating access to markets
- **Value adding services** including any service that adds value to crops, such as processing and post-harvest handling
- **Information services** including (digital) information services on weather and market prices

An 'investable' business equals 'profitable' business

Being investable relates directly to successful service delivery models. The final verdict on being successful depends on the perspective of the beholder. The beholder's perspective in this report is that of potential investors – ranging from local commercial banks to impact investors. For local financial institutions providing short-term debt, success relates directly to profitability and the related ability to repay relatively limited loans. For impact investors providing (long-term) debt and equity, being successful usually means longer-term profitability allowing repayment of larger scale financing in combination with sustainable and impactful business operations. Either way, financial profitability is a firm requirement for accessing or providing any type of financing. We have extracted lessons learned related to becoming profitable as well as impactful from 27 service provider models mentioned in the literature listed in Section 6.

This report structures its finding using three key private service delivery archetypes. Their basic characteristics are introduced in Table 3 below.

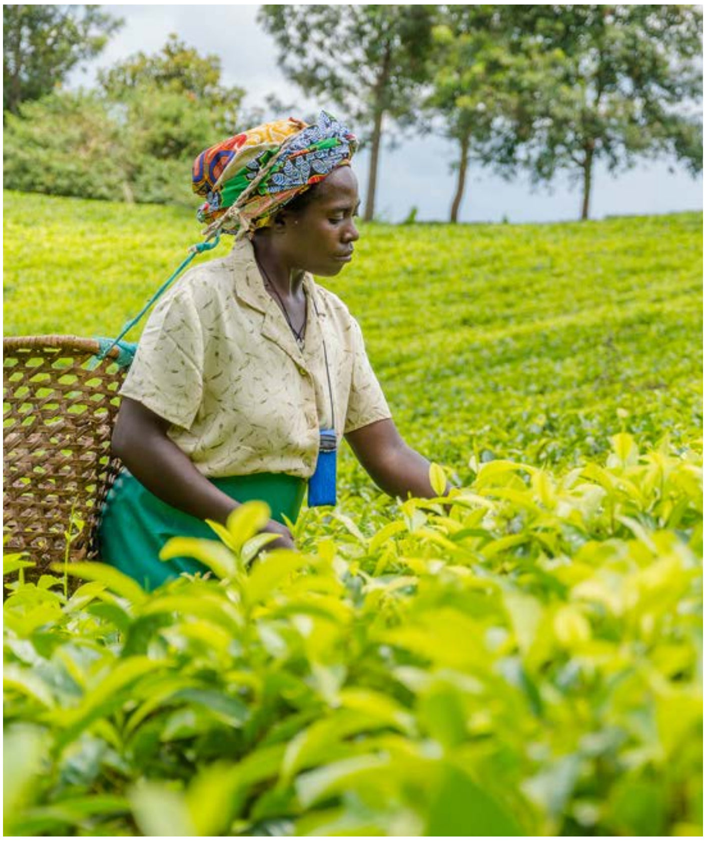
The main difference between these models is their service delivery mechanism, as this is the main determinant of their financial models (Who is paying? Who is benefitting?) and their potential outreach, and therefore ultimately, their financial profitability.

[3] Adapted from Smallholder to Small Business. Private sector insights on service delivery models that boost profitability and improve livelihoods, IDH, 2015.

TABLE 3:
TYPOLOGY OF THREE SERVICE PROVIDER ARCHETYPES

Archetype	Average size	Description of delivery mechanism	Type of services provided	Start-up costs required	Pricing mechanism	Who is paying?	Systems in place
Stand-alone service provider (commercially owned: for profit)	Small SGB	An independent commercial entity with technical employees that provides services directly to its customer base	Mostly training, financial services, value adding services (e.g. digital services). Less frequently, marketing and inputs	Full start-up costs of independent service structure (staffing, marketing, transport, curriculum development)	Concrete, fixed price services that are either paid directly by beneficiary or in lump sum by development partners	Mostly affordable for larger farmers. (Small) cooperatives and smallholders are less likely to pay directly for these services	Sustainability and impact tend to be important, but no specific systems in place to monitor effectiveness
Service provision through farmers' cooperative (farmer-owned)	Up to 10,000 members	The cooperative is used as a service hub and the cooperative's staff reach out to farmers	Mostly training, inputs and marketing. Relatively developed cooperatives also offer financial services and value adding services	Expansion of (limited) existing service structure. Additional skilled staff, training/services development or investments in assets like equipment	Integrated services the costs of which are integrated in payments to members for crops	The cooperative's members, through fees subtracted from payments for their crops, or (partly) subsidized by governments or NGOs	Sustainability and impact tend to be important, but no specific systems in place to monitor effectiveness
Value chain actor (commercially owned: for profit)	Large corporate, sometimes active nationally or internationally	Agri-services linked to existing commercial value chain activities like seed sales and processing	Training, inputs or marketing, some finance or value adding services (but the latter is usually incorporated in VC actor's operations)	Expansion of existing office, network & marketing efforts. Additional staff, training development, service costs (transport, communication)	Integrated services the costs of which are integrated in the prices charged to customers	Individual farmers, with costs being subtracted from payments for raw materials or included in price of inputs charged to customer	Tends to be a market requirement. Systems in place are centrally designed and might not be tailored to local situations

The service providers assessed demonstrate that the extent to which a service model can become profitable varies, with its main determinant being the range of services offered. Service providers tend to struggle with the right mixture of services to offer. The fact that beneficiaries, customers and funders tend to be separate entities increases the complexity of their business model. It results in different opinions on what the 'right' services to offer are and can therefore result in inefficiencies and lack of appropriate incentives.



Most service providers offer a combination of fully or partly subsidized and fully paid service options to diversify income sources, maximize profitability and manage income risk. In many cases, the main share of service providers' income stems from donor funding (FAO, 2013; IDH, 2014 & 2015; Aidenvironment, New Foresight and IIED, 2015). As such, their service offer is dominated by the funders' priorities. There are little to no long-term economically viable service delivery models that survive solely on direct payments from individual smallholders (the beneficiaries). This relates directly to the extent to which providers currently offer services that the target group is willing and able to pay for. Choosing the right services to offer, designing suitable content and offering a feasible cost structure determines the likelihood of a profitable business model for service providers. Whoever is covering the costs of service – donors or farmers – has significant power over the service outputs and the financial success of a service provider.

> "Donor funding allows for development of solutions for more sustainable outreach of service providers and sustainable production. Impact investment can bring these solutions to speed and scale" (Solidaridad, strategy note, undated)

Specific services or business models of a service provider that are profitable can be eligible for (semi-) commercial financing, while other components require blended finance or subsidies to continue to deliver services (IDH, 2016: Aidenvironment, New Foresight and IIED, 2015). Full or partial dependence on public and private donor funding is a risk for lenders, and this needs to be carefully managed.

Next to the service offer, the business development stage of service providers is a very important factor for financial profitability. Modelling the timelines of specific services and the point at which they reach sustainability can help define 'tipping points' for different types of finance solutions. Initial investments for

[4] A mix of public and private funding.

setting up service infrastructures (including staffing, training, marketing and facility/transport costs) are high and occur at a moment the organization is not yet profitable.
A constraining factor in accessing commercial financing is the fact that service providers tend not to own (sufficient) assets for collateral purposes, where entities such as processing companies do. Without access to funding in the start-up phase, it is very difficult for service providers to scale up to the next level in their business life cycle – irrespective of the type of services they offer. The majority of the assessed service models were established or scaled up using donor funding rather than commercial financing (FAO, 2013; IDH, 2014, 2015).

When a service provider matures, it generally breaks even or becomes (more) profitable and is more likely to access commercial funding as a result. This is not a given for all service providers and depends on several performance indicators. The deep dives analysed, and Solidaridad's impact investment team point to the same conclusions on the impor

tance of 1) reaching scale (farmer outreach potential), 2) service adoption (farmer level impact) and 3) customer loyalty (likely continuation of demand) for service providers to progress from unprofitable start-up to mature, profitable organization.

TABLE 4:
SERVICE DELIVERY ARCHETYPES AND ELEMENTS INFLUENCING PROFITABILITY

Archetype	Scale/outreach	Adoption of services	Customer loyalty
Stand-alone service provider (commercial)	Depends on level of organization of customers. SPs servicing farmers under processors or input suppliers can scale up more easily then SPs working directly with 'paying' farmers	This type of SP usually has to juggle the interests of beneficiary and customer/funder. In some cases, this results in a sub-optimal service offering leading to low uptake or adoption. Deep understanding of all needs and interests is required for high service adoption rates in the longer-term.	There is usually no 'natural' sense of loyalty involved in these transactions, as the beneficiary is generally not dependent on the SP. Commercial competition (value for money) in the market and availability of donor-support strongly affects loyalty to an SP
Service provision through farmers' cooperative	Outreach to all cooperative members. Usually limited outreach to non-cooperative members. Geographical region and (cash) crop focus is a major determinant of the average size/outreach potential of cooperatives	This model has relatively high chances of success as it allows for long-term service provision and facilitates easy response to follow-up questions or issues without (high) costs to the beneficiary. Cooperatives' understanding of local reality and wide network of farmers can increase the suitability of service design and continued integration of services in farmers' daily lives	Services provided to group members, with whom it has usually built up an ongoing relationship. This triggers farmers' loyalty but also poses a risk as cooperative management and organization of marketing (including payment timeline) and crop prices can easily influence farmers' willingness to make use of a cooperative's services
Value chain actor	Limited to suppliers and customers, but these networks can be very extensive	Services offered by value chain actors are usually adopted relatively well because of their formal links or integration with basic needs of farmers like inputs supplied to or raw materials purchased by farmers. In some cases, continued usage of SP's services is a formal requirement for doing business with a beneficiary, for example processors offering certification support to farmers	Loyalty is generally high due to dependence on these value chain actors. However, this is strongly mitigated by the level of competition in the market as well as availability of additional support options of (international) donors. Many of the cooperative model's loyalty challenges apply here too

WHAT MAKES A BUSINESS CASE WORK?

In addition to the general typology of the three service provider archetypes, we have formulated a selection of universal good case practices (GCPs) based on the literature listed in Section 6. When properly applied, each of these increases the chances of service providers becoming profitable and they are closely aligned to the three elements for profitability introduced in the previous section: scale, adoption and loyalty. They are also applicable to all three types of service providers.

Each service provider is unique in the ease with which it can adhere to these good case practices. This depends on multiple factors including service model archetype, combination of services offered, geographical location and enabling environment. For example, cooperative service providers will have more difficulty diversifying their income source (GCP 5) as they mainly service members based on informal (day-to-day) service requests. Their geographical location will inform the extent to which the local government interferes in value chain management and service provision (GCP 2). As these factors are unique to each business case, they must be assessed individually.

The table below introduces the GCP scores for the three service archetypes on their potential ability to adhere to this practice using a low/neutral/high rating.

The main conclusion we can draw from this table is that each service archetype has its own unique set of risks, constraints and opportunities. It confirms the need for case-specific assessments that take into account the individual organization's characteristics as well as the wider ecosystem.

- The majority of commercial service providers assessed are challenged by low levels of (farmer) awareness and demand for non-subsidized services, impacting their long-term profitability. They are usually well positioned to meet Monitoring and Evaluation (M&E) requirements and introduce digital innovations, which are valuable factors in accessing finance.
- Cooperatives tend to have difficulty meeting these practices due to the level of education and skill set of their management, and are challenged by fragmented service demand and high dependence on (partial) subsidies.
- Value chain actors can benefit from their strong value chain linkages whereby offering services correlates strongly to the financial or operational performance of their other business activities. Their service offer is usually relevant and targeted, yet limited by their own interests and the homogenous nature of their group of customers.

High potential for this GCP	
Low potential to meet this GCP	
Neutral	

Good practice	Description	Stand-alone	Cooperative	Value chain actor
Business case confirmation at outset	– Confirmed presence of a (partly) underserved market segment – Profitable for the beneficiary and SP, supported by market analysis	Market analysis & pilot crucial but seldom implemented before investment. Tendency to start new activities without prior experience	Usually based on members' feedback, rather than formal market analysis or pilot. Activities are often aligned with prior experience	Usually no formal market analysis, but cost calculations are made and needs estimated based on prior experience
Insights in (financial) governance structure to ensure capitalization	– A transparent and logical management structure in place to confirm the archetype and business model, followed by financial management to ensure ownership of assets – Provides insights into financial feasibility of investment – Willingness (and capacity) to provide in-house co-investment is a plus	Usually strong governance, but limited in size and related financial capacity	Tend to have unclear governance structure, and limited financial transparency and resources	Clear governance structure and high in financial capacity
Skilled communication	– Strong communication skills in interaction with a potential investor or alternative supporter, e.g. quick replies to messages, willingness to put effort into responding to information requests	Usually very strong	May be limited by skill set and experience of management team	Usually very strong
Level playing field	– Limited market distortion by competition from international NGOs or governments that offer similar services at (partly) subsidized rates. Some governments control key functions in the supply chain of staple foods and cash crops they regard as strategic – A specific country-level policy framework for business services creates a basis for coordination among the players and can prevent market distortion by governments	Very sensitive to market distortion	Applicable but less relevant due to position and connection to farmers	Limited sensitivity as there is usually a complementary commercial relationship
Facilitation of competitive landscape for SPs	– Regional presence of other private SPs helps to ensure some familiarity with the potential benefits amongst customers, but supply should not outstrip demand	Very relevant, awareness raising needed	Less relevant, relationship with members is key	Relevant
External (financial) support to create initial demand for services	– Optional donor assistance or government support to create awareness and/or encourage customers to purchase services is beneficial early in the process, followed by a gradual weaning off external funding	Relevant for non-(fully) subsidized services only	Majority is at least partly subsidized so less relevant	Relevant for non-(fully) subsidized services only

Good practice	Description	Stand-alone	Cooperative	Value chain actor
Not fully dependent on subsidies; careful phasing out of donor funding	– Preferred use of multiple revenue streams to manage financial risks. Income should consist of a mixture of fully or partly subsidized services and fully paid services. If the service business model is partly subsidized, the financial sustainability of the service provision is embedded in the project's or donor's exit strategy, which should be firmly in place	Initial high subsidy dependence due to low direct demand from beneficiaries; in later stages very relevant	High risk due to frequent high dependency on subsidies for non-basic cooperative services paired with low internal investment capacity. Less risky for large cooperatives in cash crops such as coffee	Low dependence on subsidies or direct profitability as services facilitate income from other activities
Broad customer base and mix of short- and long-term contracts	– In addition to a sustainable and varied income model, it is important to maintain a broad customer base (private companies, government and development partners and/or farmers) and a mix of short- and long-term contracts to allow for flexibility, ensure cash flow and reduce dependence on a single customer	High potential for diversifying contracts	Low potential, as it mainly services members based on informal (day-to-day) service requests	Low potential for diversifying customer base as it is limited to (usually rather uniform) customers or suppliers
Ensured sources of income to cover at least part of operating costs	– Ensuring coverage of a large proportion of costs by a selection of longer-term contract(s) for the first years to reduce risk and allow for innovation such as developing new lines of work	High potential, although long-term contracts are usually limited to large farms (perennial cash crops) or linked to donor funding. Also depends on crop type (perennial versus annual)	Low potential, see above. But long-term commitments (especially for perennial cash crops like palm oil) are usually possible	Possible when service off-take is a requirement for doing business with the SP
Offer diversity in skill set and services, but outsource where needed	– SPs should offer a variety of services rather than just one category to be able to cater to a variety of customers and manage financial risk (e.g. combination of inputs, finance, marketing, training and value addition activities) – In some cases, it is more cost-effective to outsource part of the services to a specialized partner	High potential, thanks in part to extensive outreach possibilities	High potential, but strongly dependent on member demand	Low potential due to strong dependence on VC actor's own (limited) interests

Good practice	Description	Stand-alone	Cooperative	Value chain actor
Focus on high-value crops	– Most successful service models focus on cash crops and international value chains, such as coffee, cocoa, horticulture, palm oil and tea	Paying farmers or VC actors commissioning services usually grow high-value crops; donors or governments also work with staple crops	Members tend to grow a mixture of high-value and staple crops	High potential; VC actors usually already focus on specific crops
Standardized services to ensure quality and cost-efficiency (possible accreditation)	– Standardization of services (in particular of training) ensures quality and can support the likelihood of continued demand from the market for these services – Presence of formal quality accreditation or willingness to obtain it is a quality assurance for investors (e.g. BASIS accredited training courses)	High potential	Usually too challenging for the service & business skill set of cooperative management	High potential
Ensure service provision that reflects both customer/ funder's and beneficiaries' needs	– SPs should perform frequent needs assessments among customers as well as funders and design training programmes and other initiatives to respond to the needs identified – SPs must take into account a potential discrepancy between their own (short-term) needs and those of beneficiaries	Potential, but high risk of distorting effect of donor/ government's wishes when funding services	Limited potential for subsidized services, high potential for fully paid services as there is no middleman funder influencing service design	High potential, though there is a risk of VC actor using his power position to enforce service use
Using technology as a driver for innovative delivery mechanisms	– Innovative distribution channels like digital platforms and other non-traditional outreach methods enable wider outreach and scaling impact at modest costs to SPs – Big data and transformative knowledge allow for targeted services with optimal results	High potential	Low potential, as cooperatives are not usually equipped to deal with such innovative technology	High potential

Good practice	Description	Stand-alone	Cooperative	Value chain actor
Ensure capable management that is willing to learn and invest in learning	– Adequate organizational management (management skills) are a key requirement for business performance. Well-performing models usually have skilled managers – A proven willingness to keep learning (both technical skills and innovations for business operations) is important and is confirmed by SPs investing their own resources in courses and education to research new ways of farmer outreach or to create new services	High potential; independent entrepreneur(s) with appetite for business	High risk due to generally low management skills of cooperative management team	High potential as SP can tap into overall management resources of value chain player
Have a well thought-out M&E framework and preferably a digital management system in place	– An M&E framework provides strong guidance for organizations for translating their business strategy and goals into operational targets and a methodology to keep track of financial and non-financial performance. This is a key requirement for SPs and their lenders. Preferably, the M&E framework also has a farmer feedback system in place. Some service models are observed to benefit greatly from having a digital knowledge management system that reports on the services it delivers, results obtained and level of customer satisfaction	High potential	Low potential (see above)	High potential
Maintain a good image and network	– Successful service models require a good reputation resulting from customer satisfaction combined with a well-established network of potential customers. Both are the result of staff skills and commitment – Local knowledge, understanding of and connection to farmers is another key determinant of success. Farmers prefer working with an organization with boots on the ground, a familiar face with strong understanding of their situation. In some cases, this does not fit well with digital outreach technologies as farmers generally have little formal education and prefer traditional (personal) interaction when investing in services or products	No specific constraints, though network usually needs to be established	No specific constraints; opportunity of existing network & local experience	No specific constraints; opportunity of existing network & local experience

4

CASE STUDIES

The research identified a longlist of 15 providers as potential case studies. Key data around the Babson themes was requested for each one. Solidaridad staff assisted with the collection of data for each indicator. The selection criteria used to choose the case studies was based on:

- Availability of data
- Reliability of data (score between 1 and 5; score above 3 shortlisted)
- Balanced mix of archetypes (at least one of each archetype)
- Maturity of the business
- Outreach/scale (number of beneficiaries)
- Investment readiness (as assessed by Solidaridad's impact investment team; score between 1 and 10; score above 6 shortlisted)
- Engagement of the company (ease of contact, willingness to cooperate and share sensitive data)

Once as much information as possible was collected, the six case studies analysed below were selected for deep dives.

BRIEF DESCRIPTION AND ANALYSIS OF CASE STUDIES

Agro Quorum Enterprise

Agro Quorum Enterprise is a start-up company in Ghana serving smallholder farmers in the palm oil sector. The founder started selling seedlings to farmers and over time they demanded additional services to enhance their yields and profitability. The company began providing farm management services in 2018, and these now provide the primary revenue

stream. Agro Quorum also sells (harvesting and pruning) tools and seedlings, and provides fresh fruit bunches (FFB) aggregation services. All services are still in development phase as the company has not completed a full year of operations.

Current outreach of farm management services extends to 202 smallholder farmers with total landholding of 560 ha. At the time of going to press, the business model remained to be proven. Financial analysis indicates the business model is profitable with an aggregate area of 250 ha of farms under management, i.e. the company has already passed the breakeven point with current outreach. The investability of the company is currently classified as low. Although the business has quickly gained areas under management and demonstrated strong ability to tap into the market, it is still very small and will require time to get the business model working and build a track record. And while it shows early signs of profitability, Agro Quorum's cashflows could not currently support debt repayments. However, the investability of the company should improve in the medium term

thanks to the combination of palm oil experience and the technical capacity of the team, together with the entrepreneurial mindset of the founder and the expansion opportunities for farm management services and tools provision in the operational area.

COOPTOSA

COOPTOSA is a cooperative society providing marketing services and inputs to its 2,100 oil palm farmer members – which are also its owners. Daily operations are overseen by a management team. Main revenue streams are marketing of members' FFBs and some training and fertiliser sales. It only purchases 10% of its members' crops due to lack of capital and timeliness of crop marketing. COOPTOSA is looking for an investment of USD 1,079,621 split into a renewable trade finance line for commodity procurement (USD 141,509), a five-year investment loan for an oil palm mill (USD 849,056) and working capital for a fertiliser hub (USD 89,056). Potential investors could be local commercial banks in the case of confirmed collateral requirements or sub-commercial institutions. Based on the financial performance and profitability of the cooperative, the latter would be the most sustainable and feasible option for both short- and long-term financing needs.

The overall business case is not currently investable and the investment potential is rated low to medium. COOPTOSA benefits from experienced (field) staff in terms of technical skills and understanding of the local community. Over the years it has received support from a variety of development partners, including Solidaridad, FIRCA and AIPH, to optimize its business model, integrate sustainable management and palm management good practices, etc.. Yet potential investors including GroFin and Oikocredit are delaying potential involvement as financial systems are not yet in order, and a strong and transparent governance structure is lacking. These opportunities and challenges are quite common for the cooperative archetype. With Solidaridad's help, COOPTOSA should be able to optimize its financial systems, but the governance issue needs to be explored.

Credit Union Keling Kuman (CUKK)

Incorporated in 1994, the CUKK palm oil cooperative has 172,353 members. It would like to finance additional oil palm planting and replanting, and may want to operate its own mill. The managing director is very important to the cooperative, but has very recently been elected to a political position. The investability of this business is medium. The fact that CUKK does not have palm oil processing experience does not need to be a hindering factor for investments, as

5 Grofin is interested in investing in the mill and has therefore asked that a business and investment case for the mill be submitted to it for consideration. However, this interest is tempered by the poor governance structure of the cooperative which must be addressed as part of investment readiness support to COOPTOSA.

experienced managers can be appointed. The cooperative is mature and has had previous loans. However, it is now looking to raise USD 10 million and this requires commercial thinking in terms of repayment and loan conditions, so it will need some more support in terms of financial know-how. Quasi-commercial investors could fit the bill, but none of the financial investors will accept a loan period of more than ten years.

EMFED

EMFED is a Ghanaian commercial service provider of cocoa farm management services to smallholders from one central delivery point. EMFED currently has 250 contracts with farmers. Active service will start once farm mapping is completed. With additional financing, EMFED's ambition is to roll out to 1,200 farmers through five service centres.

EMFED's cashflows may not support debt repayments and an equity investment could work best at this stage. Current financial data indicates that all of EMFED's activities (input sales, farm services and cocoa purchasing) are profitable but small scale. The company needs to ramp up its input and farm management business within the next 12 to 18 months to be attractive to potential investors. Fortunately, scale-up potential is high.

EMFED has high investment potential. It is technologically strong and well-connected to the farming community, and its business case after scale up is financially feasible. This is tempered by moderate market, policy and price risks. EMFED is seeking USD 677,702 in year 1 to be deployed as working capital (USD 593,419) and capex (USD 84,283). EMFED is looking for a mix of equity (from a strategic investor) and debt. The key challenge will be to find an investor who is willing to invest in a relatively young local company with few assets that needs further guidance. EMFED has resumed talks with Wangara Capital, a local missing-middle agribusiness fund.

PBC- Input & Certification Unit (ICU)

With a market share of 31%, PBC Limited is Ghana's leading licensed buying company, authorised to buy cocoa beans by the Ghana Cocoa Board (Cocobod). In 2015, PBC created the ICU to implement the company's sustainability programmes. This unit is currently transitioning to a separate legal entity (limited liability company) to enhance its investability.

The ICU provides physical inputs and input credit, certification training and labour services to smallholder farmers who sell their cocoa beans to PBC. The ICU's key interest is to increase the amount of beans handled by PBC by increasing the number of farmers supplying PBC and increasing farmers' capacity. Current outreach extends to 24,000 farmers representing an aggregate area of 40,200 ha. With additional financing the ICU can almost triple its outreach to farmers within five years using PBC's existing rural service centres to roll out the input credit scheme and certification training.

The investability of the ICU as a service provider is high for debt financing and medium for equity financing. Although the ICU's purpose is not necessarily driven by profit (but rather by a strategy to increase outreach and secure sources of good quality cocoa beans for PBC), the company is able to generate adequate cashflow to repay debt financing. The fact that PBC is a well-established company and can provide some guarantees or use receivables as collateral could make financing the ICU more attractive for investors.

External equity, however, may be hindered by the current ownership of the ICU. It is impossible to end government participation as PBC is currently the main shareholder in the ICU and this might discourage equity investors. This lack of investment could limit the numbers of farmers it reaches.

Samarth

Samarth is a legal entity with 6,552 members who are also its shareholders. An elected board of directors is the main decision maker, responsible for decisions related to business, finance, farmer relations and administration. Soy seed production and marketing are Samarth's core businesses. It buys high-quality seeds from about 500 farmers and sells them to its farmer base. Its 35 trained service providers provide (free) extension services. Samarth also purchases soy and sells soy products processed by its small processing unit (450 metric tonnes). It would like to double its processing capacity and expand the number of farmers it works with. It is looking for working capital to expand its seed trading business, and for a long-term formal loan to set up a new processing unit.

The investability of this business is high. It turns a solid profit, has been operating for several years, and it has already taken several loans from local commercial lenders that it has repaid on time. The assumptions underlying the financial model seem reasonable, the risk is mainly related to price volatility. Samarth itself would prefer a credit facility for working capital, not equity investment, at rates lower than those offered by local commercial suppliers. The business model looks sound and replicable, and therefore scalable. Modular growth is possible.

5

SERVICE PROVIDERS' INVESTMENT CASE

5.1 MAIN LESSONS LEARNED

The previous sections have provided a set of relevant insights in establishing and maintaining successful agricultural service models – stemming from Solidaridad or the wider ecosystem. This section presents our core findings.

Is there a single formula for the investability of service providers?

– No there isn't, as there is no such thing as a generic service provider: there are a wide range of business models, (crop-specific) services delivered, and country- or even area-specific modalities that shape a business. A main but unsurprising observation is that each country has different policies, culture, markets, human capital and finance specifics promoting or hindering an enabling landscape for service provision. Assessing this wider ecosystem and its impact on a business should be and often is part of the due diligence, and is covered by Solidaridad's supported business plans. Our research distilled a set of eight crucial indicators from a broad set of good case practices. We recommend taking these into account as a first step in assessing an agricultural service provider. However, the value of these indicators in relationship to profitability and investment readiness is heavily dependent on the organization's unique circumstances as well as the investor's requirements. As such, no exact values are assigned in this report.

TABLE 5:
EIGHT CRUCIAL INDICATORS FOR INVESTABILITY OF SERVICE PROVIDERS

Indicator	Description
1. Availability of strong business plan	The business case has been tested and confirmed, and is clearly explained using realistic financial projections.
2. Quality of relationship management with farmers	Interaction with farmers is frequent, both proactive and reactive, and the SP cultivates personal and positive connections with its customers and potentially the wider community.
3. Capitalization ratio	The enterprise has a sound capitalization ratio as its (requested) debt is a healthy share of the value of its shareholders' equity. The organization can therefore potentially provide internal investment capacity.
4. Donor independence	The organization's annual revenue stream is not heavily dependent on grants and subsidies, and donor dependence is decreasing.
5. Reasonable management salaries	The management team and board members earn salaries that are fair in comparison to the organization's turnover, and their own skill sets and outputs.
6. Scale (hectares)	The organization services a significant number of hectares and is able to achieve economies of scale.
7. Active customer retention rate and its trend	Irrespective of the number of customers, the organization maintains a high customer retention rate of (active) customers which improves over time.
8. Customers' productivity per hectare and its trend	Customers experience increased productivity per hectare which improves further over time, indicating a service's effectiveness.

How can the service provider's financing needs and archetype help match it with a suitable investor?

– Previous research by Palladium provided insights into the interests and criteria of different investors. The table below details a core typology of financial institutions based on the type of investments offered, and the characteristics and requirements related to their financial offer. It was used to make potential investor matches in the deep dives presented in Appendix 7.1, and can serve as an assessment tool for Solidaridad to check if one of its potential investees matches the investors it has in mind. Though every case needs to be assessed individually, each archetype has its own most logical type of investor as highlighted in Table 6.

TABLE 6:
FINANCING NEEDS & INVESTOR TYPOLOGY

Type of investor	Local commercial	Sub-commercial		Quasi-commercial		Commercial	
Type of investment	Debt	Debt	Equity	Debt	Equity	Debt	Equity
Investment size	Up to 1m	50,000 to 2.5m		1-10m		2-20m	
Risk tolerance	Medium	High		Medium		Low	
Return expectations	Medium	Low	Medium	Medium	High	Medium	High
Reporting requirements	Low	High		High		Medium	
Social return expectations	Low	High		Medium		High	
Financing term (debt)	1-7 years	3-10 years		3-10 years		3-10 years	
Collateral requirements	Strict	Flexible	n/a	Flexible	n/a	Strict	n/a
Examples	Local banks, regional banks	Root Capital, LafCo, responsAbility, Rabobank Foundation, GroFin		DGGF, Triodos Bank, FMO, MASSIF, AgDevCo		DFIs (IFC, AfDB, FMO, CDC, Proparco), Rabobank	
Typical archetype match	Stand-alone, cooperative, value chain actor	Stand-alone, cooperative		Cooperative, value chain actor		Value chain actor	

Are service provider archetypes useful in predicting investability?'

- Service model archetypes have proven to be a reliable predictor of investability. To put it more precisely, an archetype can predict the likely opportunities and challenges that a business might encounter on the road to becoming investable. Therefore, each individual service provider has a mix of likely opportunities and challenges that should be carefully assessed before onboarding them, as these can influence the investment's impact. The insights summarized below can help investors adjust their expectations as they explore the service provider landscape and select the right organizations for their pipeline.

TABLE 7:

ARCHETYPE-SPECIFIC SOCIAL AND FINANCIAL OPPORTUNITIES AND CHALLENGES

	Required investment	Likely opportunities	Likely challenges	Notes on support and subsidies required
Stand-alone service provider	Generally relatively small ticket size Tends to require combination of equity and debt	Often has highly experienced technical staff High social impact if relationship with community is well managed Ownership and governance are usually transparent and structured	Tends to be small scale, resulting in start-up losses Needs to increase business capacity Limited capacity for capitalizing the business Financial profitability may be low, resulting in reduced leverage	Support to strengthen organizational capacity as well as linkages Initial support for pilots confirming business case Advice on route to scale Subsidies for start-up costs High additionality of technical assistance (TA) and finance
Farmers' cooperative	Amount depends on size, track record and asset base Mainly debt (both short- and long-term). Will need to create a separate entity allowing equity investment to improve investment readiness	Good outreach and farmer loyalty generally countered by relatively low quality and sustainability of operations Tends to prefer high-margin services such as marketing and inputs over TA services High potential for empowering farmers to become more influential	Governance is an issue because of low management skills and lack of transparency Often lacks financial and E&S reporting Low financial capacity and dependence on subsidies Often lacks focus as it aims to address all the needs of its members Financial profitability may be low, resulting in reduced leverage	Advice on selecting key services that offer business opportunities and reflect members' needs Subsidies to develop a strong business model and revenue stream Support to define a lucid strategy and engagement of members High additionality of TA and finance if aligned with other support

	Required investment	Likely opportunities	Likely challenges	Notes on support and subsidies required
Value chain actor	May be seeking large-scale financing Often debt	High probability of continued service demand due to VC integration Tends to be large scale, with associated high impact potential Tends to have pressing need for capital Tends to be profitable, with relatively high and stable income, and a broad asset base Tends to be professional organization with existing credit or investment history May enable small increase in income for large number of farmers, though impact per farmer is often relatively low	Company's interest comes before that of farmers Less comprehensive understanding of farmers' needs Additionality can be challenge	Risk of subsidies benefitting company rather than farmers Support will tend to be in the form of establishing relationships Grants should only be provided to invest in structures which ensure that farmers' interests are addressed consistently

5.2 BEST PRACTICES

- Almost all service providers gravitate naturally towards a business model consisting of **multiple revenue streams**, especially in well-organized and closely connected value chains. A varied service offer is nearly always aligned with the farmers' needs, including solutions for times when markets, prices or production fluctuate. However, diversification should take place in a phased approach to avoid losing focus. Broadening the service offer too fast can result in unnecessary inefficiencies and may lead to inadequate service delivery.

- **A proven business model is key.** The EMFED case study is a good example of Solidaridad helping a service provider by providing subsidies to develop a proof of concept.

- Business plans which specify the business model's subcategories are more likely to attract investors as this makes it easier to match the service provider with the right investor type. **Phased business plan preparation and matchmaking can speed up the investment process and increase the chances of successfully matching investors and investees.** A mix-and-match package of short- and long-term financing or debt and equity is less likely to be successful.

- A sound financial business case remains any lender's number-one priority. Current profitability does not directly determine whether an organization's business case is a solid investment. **The core consideration is the post-investment profit potential** based on the allocation of resources and intrinsic capacity of the service provider.

Agro Quorum is an example of a service provider which has identified many opportunities (including farm management, inputs and planting material, FFB and CPO aggregation). However, only farm management services currently seem to be efficient and profitable.
In cases like this, it is better to prove this model first before trying to deliver a broader range of products and services.

COOPTOSA in Côte d'Ivoire is looking for local (renewable) trade finance, working capital for a nursery (one year) and a capital investment loan for a mill (five years). This case consists of three interlinked business cases with different selection criteria applied by its potential lenders.

– However, **current profitability** is almost always a requirement for working capital, as local lenders tend to be more risk averse than their international counterparts; the short-term nature of the loans they supply does not allow for delayed repayment.

– All agricultural service providers with audited accounts for the past three years or more, and a feasible operational and financial roadmap detailing the likely impact of investment inputs, are technically 'investable'. Yet many service providers struggle to provide a sensible business model, valid business plan and audited books. **A realistic business plan built on demonstrably strong foundations is an important USP and should be a key focal point for service providers seeking investment.**

– The business model needs to be proven in terms of both **market penetration** and **customer retention.** Solidaridad builds on this practice by providing subsidies to start-ups who have not yet proven their business concept, to help them substantiate it and build up a loyal customer base. Information on retained customer base and newly acquired customer base is relevant for proving the investment case.

– **Digital innovations** such as digital marketing platforms or weather data apps may reduce costs while increasing the quality of training and farmer-relationships. Although not a game changer for becoming investable, having these innovations in place is often of interest to impact investors and can be beneficial to the service provider's operational and therefore financial performance.

APPENDIX: REFERENCES

APPENDIX:
REFERENCES

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