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IMPACT INVESTMENT CHALLENGES IN THE AFRICAN OIL PALM SECTOR

October 2021

Oil Palm In Africa

The African oil palm tree (Elaeis Guineensis) which is native to West Africa, is an important crop with high global demand across industrial, retail, and consumer markets. Although the crop is grown vastly in West and Central Africa, Africa contributes to less than 10% of the global output. The continent remains a net importer of palm oil, with most countries having a significant trade deficit. Palm oil is increasingly seen as a key development sector by most national governments and remains the subject of interest from international development organisations. Developing a cost effective and sustainable oil palm sector that is inclusive of independent producers is a key challenge. With edible oil consumption across Africa expected to continue an upward trajectory as well as growing international demand, there is a clear opportunity to develop the sector in a way that benefits both local and international actors. This is especially critical as the sector is dominated by smallholder production who continue to face pervasive poverty in the oil palm growing communities.

Little Engagement By Impact Investors Compared To Other Cash Crops

While the oil palm sector in Africa may not be officially precluded from general impact investor interest, several challenges often constrain its inclusion in investor portfolios in comparison to other cash crops. Fundamentally, the sustainability risks that characterize production within the sector restrict investor interest and action as a precautionary measure. These risks include:

Environmental Social and Governance (ESG) Risks. Impact investors can suffer significant reputational damage when associated with ESG related harm like deforestation, human rights abuse, biodiversity loss, and so on. The IFC Environmental and Social Performance Standards are the most common tool used by investors to determine the level of environmental and social risks of a potential investment. This means that for the oil palm sector which has high ESG risks, investors expend considerable time and financial resources in the conduct of due diligence as well as building trust relations with investment prospects. Such risk mitigating measures result in increased investment costs without commensurate guarantee that all ESG risks are adequately managed due to the complexity of the sector and contexts. To navigate these cost barriers, blended finance through partnerships with donor agencies are sometimes adopted but these are not yet as common as needed.

Country and Currency Risks. The position of countries in the African continent has been persistently low on various ease of investment indexes. This is of course precisely why impact investment is needed in these regions. Nonetheless, when political instability and violence couples with the complexity of the oil palm sector, most investors become risk averse and avoidant, leading to investment exclusion. This is particularly the case for some countries in Central Africa which have conducive agroecological conditions for oil palm production, however, face challenges with political stability and regulatory weakness. In addition, currency risk is highly relevant for international investors whose investments require expensive mitigating strategies to prevent loss. This challenge is, however, less pronounced in Francophone countries that have currencies linked to the Euro.

Highly Capital Intensive. Key investment needs for oil palm producers usually comprise of farm replanting financing and capital to support the development of outgrower schemes. To be economically feasible such schemes often have to be on large scale which also translates into large investment requirements. In the face of high risks in the sector, investors are hesitant to sink too much capital upfront into projects. Additionally, in replanting schemes, oil palm presents long investment horizons for investors with limited income generation. Thus, such investments are often only attractive when involving highly capitalized organizations as partners who can facilitate loan repayments during the gestation period.

Weak Land Regulatory Environment. In general, most African countries have weak legal and regulatory environment which makes investment challenging. A critical area is that of property ownership rights and land tenure systems, which tend to be complex across the region. Enterprises looking to acquire vast and contiguous lands for the development of plantations risk accusations of land grabbing and forceful removal of indigenes with claims to the land. Greenfield investments are therefore less likely to be invested in by impact investors as a risk mitigating strategy.

Smallholder Risks. Although the presence of smallholders in the oil palm sector presents opportunities for impact investors to make contributions to key objectives such as poverty reduction and inclusive development, smallholder dominance also impedes investor action due to several reasons. For one thing, any investment in the sector would likely be plagued by the challenges associated with smallholder production such as sparse distribution, limited technical expertise, difficulties with traceability, among others. Indeed, dealing with smallholders further elevates the likelihood of ESG breeches as monitoring and reporting of unsustainable activities like deforestation become difficult to implement. For investors seeking to support sustainably produced palm oil, tracing producer adherence to sustainability standards like Roundtable on Sustainable Palm Oil (RSPO) is highly complicated when sourcing of oil palm fruits involves smallholders as against industrial plantations.

The Way Forward

Blended Finance and Multi-Stakeholder Approaches. The multi-faceted nature of oil palm production makes it prime for the use of blended finance vehicles as various social, economic, and environmental interests typically overlap in this sector. As such, different types of capital can be attracted to the sector as a means of addressing different forms of risk.

What is essential but often difficult in this process of blending finance is ensuring a commensurate level of financial structuring and sector expertise. To develop the appropriate financing models for any intervention, there is need for a clear understanding of how the local value chains work and what is the right balance of stakeholders needed for successful investment. This may involve the adoption of a systems approach to conceptualizing financing and could require intermediary actors who understand both the local value chain context, private capital, and impact investors as well as the needs of international donor bodies.

Promotion of More Integrated Value Chains. The palm oil market, like most agricultural commodities, faces volatility and intrinsic market risks. Since investment ticket sizes in the sector are often sizable, investors are more attracted to oil palm companies that are relatively well integrated. This would mean companies that have fair control over sourcing, processing, and product distribution, restricting the likelihood of shocks to its production and supply process.

For the smallholder dominated value chains in Africa to be less excluded from the benefits of impact investments, more attention needs to be paid to the development of more structured and sustainable outgrower schemes that link smallholders to such preferred agribusinesses and plantations. This approach may however imply additional cost drivers to these companies for monitoring, service provision, and harvesting.

Information Systems for Smallholder Inclusive Financing. In relation to developing more integrated value chains, the use of farmer, supply chain and landscape data, and the adoption of digital tools and information systems would play a critical role in enabling impact investors and industrial oil palm plantations to better engage with smallholder producers. In particular, the use of data analytics and risk scoring tools tailored to facilitate agri-lending offer a means of cost-effectively assessing smallholder credit worthiness, exposure to climate risk, and other critical insights into smallholders that may be involved in an outgrower investment scheme. Such analytics can enhance investor understanding and confidence to go beyond the lead supply chain actor to invest in its smallholder suppliers through input, replanting, and other types of financing.

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