

# UNCDF

## LOCAL FINANCE INITIATIVE (LFI)

Case Study No.1: Mwenge Sunflower Oil Mills Ltd

Unlocking Private Finance

### INTRODUCTION

To realize inclusive growth, countries should have the capacity and resources to mobilize, allocate and account for capital flows to “last mile” pockets where poverty is entrenched, economic opportunities are limited, and development plans under-funded. Concurrently, local communities should have access to capital to fund their local development needs and respond to growing demands for better infrastructure, services, and jobs.

Yet, in many least developed countries (LDCs), local savings are not invested locally or limited investment is provided for local development because of lack of confidence from financiers and track record of successful transactions. Innovative financing mechanisms coupled with UNCDF risk mitigation instruments help reveal markets to a wider pool of investors; and thereby crowd-in non-traditional funders, public and private, into new areas.

In 2012, UNCDF launched the Local Finance Initiative (LFI), a “last mile” finance model aiming to unlock finance so that local development projects can get to “closure.” The purpose of LFI is to correct market failures and attract catalytic capital for the investments that are not being picked up by existing public or private investors. Therefore, LFI does not seek to crowd out the private sector and provide public subsidies for those investments that would be likely to attract investment without its support. This represents the foundation on which LFI investments are identified and how the selection process does not distort the market. UNCDF seeks to spark a demonstration effect where the public sector can replicate the blend, leveraging the private sector finance to take the business model to scale. The LFI approach and its risk mitigation strategies have

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Unlocking Public and Private  
Finance for the Poor





The UNCDF technical team in Tanzania, UNCDF LDC Investment Platform from New York and the project developer discussing the challenges of the old equipment and single refinery methods. The new investment will replace the old equipment/technology and other key components that will allow this company to scale up its production. © UNCDF

proven that local development investments can access additional funds from domestic capital markets, which is in line with the call for action in the Addis Ababa Action Agenda and Sustainable Development Goal 17 (the means of implementation) to mobilize resources from multiple sources to finance development.

As the LFI investment pipeline is expanding rapidly, UNCDF would like to document and capture the knowledge, information, and lessons learned in a systematic manner. This series of case studies aims to demonstrate how LFI approach contributes to unlocking domestic capital, public and private, and realizing transformational local impact.

Case study 1 covers LFI's facilitation of a blended finance structure for the Mwenge Sunflower Oil Mills in the Singida region of Tanzania.

## PROJECT SUMMARY

**Name:** Mwenge Sunflower Oil Mills Ltd

**Location:** Singida region, central Tanzania

**Sector:** Agri-business/food security

**Purpose:** Increase farmer productivity and strengthen local agro-processing capacity.

**Total project cost:** US\$ 1.6 million (Project developer's contribution + UNCDF seed capital grant + UNCDF concessional loan + commercial bank loan).

## MARKET CONTEXT

The United Republic of Tanzania has a large, national demand for edible oil. More than half of the demand is met by imported palm oil. The balance is covered by the local production of unrefined crude sunflower oil, which is primarily dominated by small producers and processors. The Rural Livelihood Development Company estimated the current demand for edible oil in Tanzania to be about 350,000 metric tons (MT) per annum, with an expected growth rate of 3% as consumption continues to increase. Currently more than half of the edible oil consumed is imported. Current data shows that local production of both factory and small-scale extracted oils contributes to about 40% of the domestic demand<sup>1</sup>.

National production of sunflower oil has been increasing over the years for three main reasons:

- The cost of producing sunflower oil in Tanzania is lower than for other oilseed crops (sesame, groundnuts).
- Sunflower oil is healthier than other types of oil, for example palm and groundnut oils, as it is low in saturated fat and high in polyunsaturated fat.
- There is an active local market demand for sunflower oil for domestic use as well as demand for the by-product: seed cake for livestock feeding.

Despite the increasing demand for locally-produced edible oil, small producers and processors lack the technical and financial capability to run their operations efficiently. The framework for agro-processors remains fairly underdeveloped and the government has provided little investment and policy support to enhance value addition.

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<sup>1</sup> United Republic of Tanzania Sunflower Sector Development Strategy 2016-2020



## DEVELOPMENT CHALLENGE

Singida is one of the poorest regions in Tanzania. Located in the central part of the country, agriculture is the mainstay economic activity in the region, providing employment to over 90% of the total working population in the region. There are about 1.1 million hectares suitable for growing various types of crops, but only 24.7% is currently utilized for crop production.

Singida is among the few regions in Tanzania with small scale industries using simple technology that have limited productive capacity to meet increasing local consumer demand. While these industries have succeeded in introducing new cash crops into the region, the commercialization and production of new crops has been constrained by poor farming methods, poor seed selection, and poor farm management. Often, the absence of a sustainable value chain for these crops provides little incentives for smallholder farmers to invest and increase production.

Mwenge Sunflower Oil Company Limited (“Mwenge”) is a privately-owned medium-sized oil mill that has been operating for over

nine years. The company’s main activities include the processing of sunflower seeds into oil, trading of sunflower seeds and by-products of the seed-oil process. Since 2012, the Company has been collaborating with the Singida District Council (local government), partnering with government extension officers in the field to identify and train farmers on proper agronomic activities and post-harvest treatment of sunflower seeds. To date, Mwenge has registered 7,500 registered farmers in 50 villages in Singida Rural and Ikungi Districts to supply sunflower seeds to the factory.

For more than five years, the founder and owner of the company, Mr. Salehe Hamis Hongoa, has been seeking financing to modernize and expand Mwenge’s sunflower oil processing plant. The plant expansion would result in monthly production of 53,000 liters of crude oil, 80,000 liters of double-refined oil and 280 MT of seed cake. Through the double refining process, Mwenge would also fortify the oil with vitamin A, which helps to increase the shelf-life of the oil product and to enhance the nutritional value of the products, thereby mitigating the malnutrition plight in the Singida region.



## PROJECT RATIONALE

The Mwenge project is a demonstration of how subsistence farming can be organized at the community level to assist over 7,500 small scale farmers to increase productivity by providing a stable market for their product, while concurrently providing a much-needed revitalization of the agro-processing subsector in the country.



*“Working with UNCDF has helped me realize my long-term vision for the company to become a significant player in the edible oil sector in Tanzania.*

*Because of UNCDF’s support and hand-holding through the entire process, we could have meaningful engagements/interactions with financial institutions and other stakeholders.*

*We look forward to having them by our side as we continue to implement this project for the benefit of the people of Singida.”*

Mr. Salehe Hamis Hongoa, Project Developer

It is a transformative investment in local economic development where productive agricultural value chains are developed with the specific intent to boost rural employment, promote value-addition in production, and ensure that the benefits and profits are retained within the local economy. Besides the economic benefits gained by players in the sunflower oil value chain, other positive externalities are also realized through improved nutrition from the Vitamin A fortified oil, empowerment of

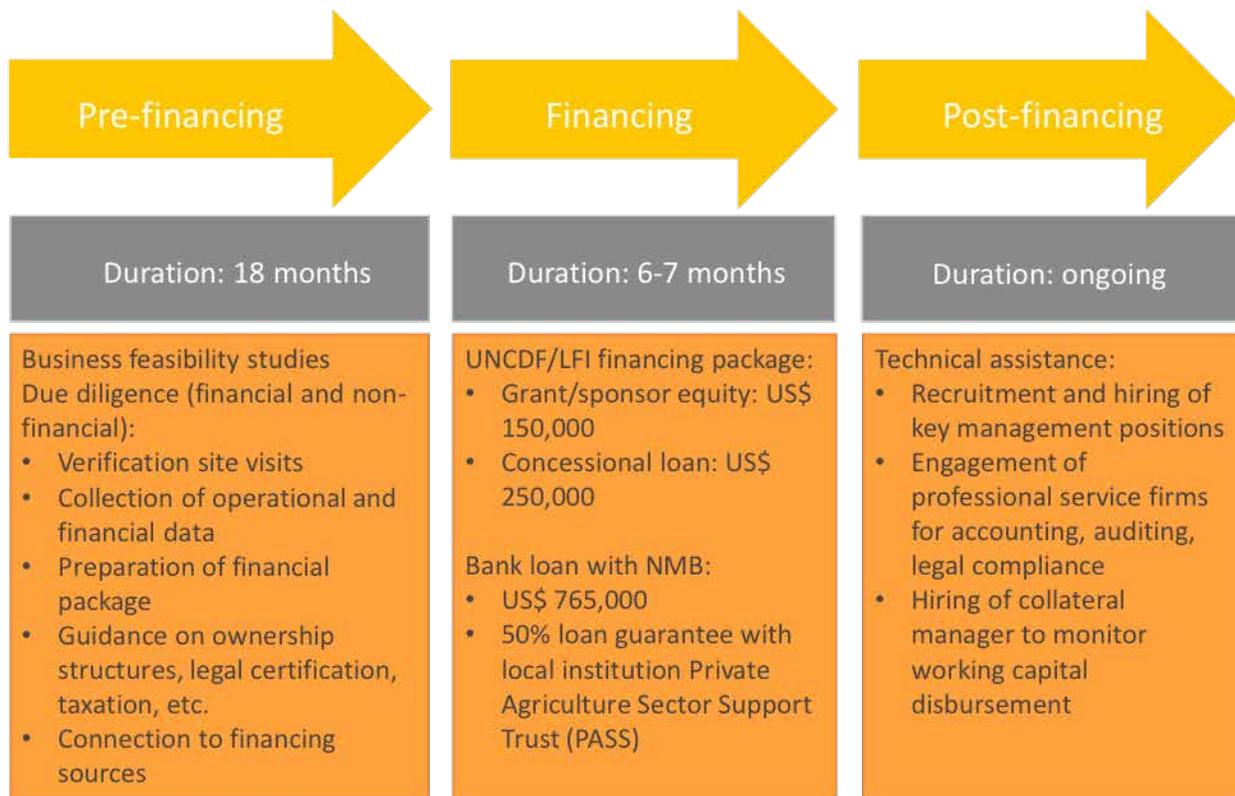
women sunflower seed producers within the value chain, and low environmental impact.

Unfortunately, Mwenge has not been able to obtain capital from lenders due to the owner’s lack of experience in access to finance, insufficient collateral, and the lack of credit history. Despite the fact that the company is fully funded by owner’s equity and has been profitable for over three years, the company was perceived as high risk with insufficient track record, and the expansion plan requires a significantly larger loan than most domestic private commercial banks were willing to take on.

The requisite cost, skills and knowledge to prepare the necessary financing package – business plan, risk assessment, financial model, project information memorandum etc.—was another significant barrier due to the fact that the Mwenge project developer, while having strong business acumen, lacks formal school education. UNCDF through LFI channeled its financial and non-financial resources in a strategic and targeted way to support Mwenge meet the last-mile transaction costs associated with the preparation of its bankable investment package and ultimately, to unlock the flow of private capital towards the realization of its expansion plan.

## PROJECT IMPLEMENTATION

LFI's key activities under this project consists of three distinct phases (see Figure 1 below) spanning over a period of 24 months. LFI used a mix of technical assistance and financial assistance in this project intervention, with the bulk of technical assistance taking place during the pre-financing and post-financing phase.



### Pre-financing

Of the three phases, the pre-financing stage represents the more labor-intensive and time-consuming technical support aspect of the project. During this stage, LFI investment officers worked closely with the Mwenge project developer to conduct due diligence and structuring of the project financing and governance – ensuring the accuracy, validity, timeliness, and completeness of all relevant operational, financial, and legal information. Key tasks comprise project preparation, technical assistance on governance, regulatory and tax laws, and designing the financing options.

### Project Preparation

- Validated the project's feasibility, revised the business plan, reworked financial projections and prepared a project information memorandum for potential investors.
- Determined the optimal size of the project and structuring of the proposed investment to expand the factory.

## Technical and Advisory Support

- Advised the project developer on simplifying the company's shareholding structure by buying out minority shareholders.
- Assisted the developer to obtain a certificate of incentives from the Tanzania Investment Centre (TIC) to receive exemption on import duties for equipment.
- Advised the project developer to delay investment in anticipation of new legislation (Financial Act of 2017/2018) which expunged value-added tax on importation of oil processing equipment, generating a 18% savings that can be used by the developer towards its loan payment.

## Designing Financing Options

- Prepared LFI's internal investment documents to support a recommendation of financing investment.
- Prepared investment package for submission to third parties including potential lenders and equity investors.
- Connected the developer to local commercial banks and a guarantee institution (UNCDF's strategic partners).
- Supported project developers in the presentation of the investment and negotiation of the initial term sheets from potential private sector financiers.

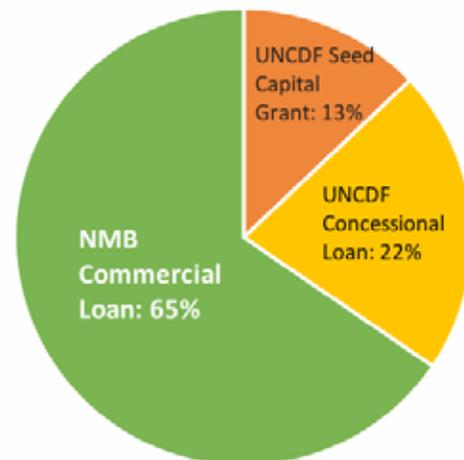
## Financing

Based on the feedback from initial engagement with financiers and given the significant size of the additional funding required to complete the project (costed at US\$ 1.16 million), UNCDF recognized that it would be necessary to de-risk the transaction in order to attract private bank financing. This would entail co-financing of the investment by LFI and a risk-sharing arrangement with a third-party to increase the bank's comfort level in underwriting a loan. Thus, a decision was made to structure a multi-layered blended financing solution consisting of the following:

- **UNCDF instruments:**

(i) a catalytic seed capital grant to help the owner meet the equity contribution required by an external lender, (ii) a concessional loan with an interest rate of 11.5% in local currency instead of the 20% - 24% prevailing rate charged by commercial banks. The difference between market interest rate and UNCDF interest rate is a risk that is absorbed by UNCDF to ensure that the deal is completed.

Percentage of financing unlocked by LFI



- **Bank loan:**

The concessional loan from UNCDF LFI was key in getting the National Microfinance Bank (NMB) to agree to finance the bulk of the funding required to complete the project (65%). Since the LFI loan is subordinated to the bank loan, this means that the bank would have first priority for repayment, and UNCDF as an institution would assume second priority on the transaction security.

- **Partial loan guarantee:**

A partial loan guarantee was issued by a local institution, Private Agriculture Sector Support (PASS), where 50% of the loan principal would be covered in case of default.

The grant and the loan guarantee were the crucial pieces needed to ensure the project developer's compliance with the bank's lending requirements. While the owner was able to contribute US\$ 422,000 of his own equity into the project, this was still not sufficient for a bank loan so LFI supplemented the equity contribution with its grant funding. The loan guarantee enabled the owner to meet the collateral requirement of the bank (125% of the loan amount).

- **Post-financing:**

LFI's assistance does not end with the loan approval from NMB. On the contrary, the bank designed the loan contract so that loan disbursement is predicated on the hiring of a robust management team at Mwenge to strengthen the operational and technical capacity of the factory. LFI staff provided technical assistance and advisory support in the recruitment process of these key management positions.

LFI also ensured that Mwenge engaged new professional service providers such as a corporate lawyer and accounting and audit firm to increase accountability and transparency. The company also hired a collateral manager to monitor working capital disbursement, a measure meant to mitigate credit risk (for UNCDF and the bank) and ensure proper utilization of loan proceeds.





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## RESULTS AND IMPACT

The Mwenge case demonstrated that limited development finance from UNCDF effectively **unlocked 65% of total financing gap from private sector bank, with a leverage ratio of 1:2, and enabled the implementation of a US\$ 1.6m local development project in rural Tanzania.** With appropriate risk mitigation options, local development projects such as Mwenge can access private sector capital, and domestic capital can be used to finance sustainable development and create opportunities for economic growth, employment generation, agricultural productivity, empowerment of women, and general improvement of people's lives.

While it remains early in the implementation process to gauge the full impact of LFI's interventions, Mwenge's expansion project is expected to generate multi-dimensional and transformative change in the following ways:



### Nurturing Local Economic Development

The project will stimulate sunflower farming activities and other formal economic activities such as banking, micro finance, transport and logistics, as well as informal economic activities such as food entrepreneurship. The can enhance farmers' purchasing power and allow them easy access to food.



### Reducing Rural-urban Migration

The expansion of Mwenge will develop a regional sunflower value chain that integrates vulnerable households, offering economic opportunities at home, and providing a stable source of income.



### Enhancing Women's Economic Empowerment

Women are usually key actors in the sunflower farming activities. The Mwenge project will further facilitate the increased engagement of women and therefore their full presence in the value chain.



### Expanding Access to Markets and Geographic Footprints

With improved productive capacity and consistent quality control over production and distribution, Mwenge will enhance its brand and reputation, especially in the market for double refined oil. Eventually, Mwenge will be able to expand to regions outside of Singida—to other major cities within Tanzania and potentially more lucrative export markets.



### Deepening Financial Sector

The use of the blended finance model to spark private financing will contribute positively to financial market development in Tanzania. While this is only one transaction, there is strong potential for a demonstration effect that will incentivize NMB and other local banks to learn more about a sector previously viewed as risky and not bankable.



### Supporting Environmentally-sustainable Agriculture

The sunflower production system avoids future land degradation and reduce current land spoiling because small farmers will be provided with agricultural inputs that can improve the cropping system and reduce/rehabilitate degraded land in the Singida region. Moreover, sunflower residue contains major plant nutrients so recycling them in the soil may be one of the best alternative practices for replenishing the depleted soil fertility and improving the physical, chemical, and biological properties of the soil. Thus, the Mwenge project is expected to result in improve soil productivity, thereby contributing to food security and resilience of the populations dependent on the land.



### Contributing to Global Development Agendas and Government of Tanzania National Development Strategies

The Mwenge Sunflower Oil Mills is contributing to Sustainable Development Goal #2, “End hunger, achieve food security and improved nutrition, and promote sustainable agriculture” by enabling access to safe and nutritious oil for vulnerable peoples, help to end all forms of malnutrition for children under 5 years and pregnant women of Singida region and across Tanzania. The project contributes to attain the objectives of the Addis Ababa Action Agenda (AAAA) by increasing private investments and focusing on smallholders including women farmers, improving access to markets and enabling domestic environments.

## LESSONS LEARNED

### **LFI's targeted technical support is critical in jumpstarting the development of projects and improve their bankability.**

The most critical bottleneck to accessing finance is the lack of projects that are ready to be assessed by a formal financial institution. Often finance is not available because requests for finance tend to be just "concepts" or "wish lists," lacking business plans, feasibility studies, market assessments, engineering and legal inputs, etc. Even when feasibility studies do exist, they lack finance fundamentals that would enable sponsors to reach the last mile. The skills and capital required to develop bankable projects and businesses are lacking in many developing countries. Additionally, the equity investment requirements imposed by commercial lenders and the high cost of accessing legal and financial advice to structure projects and business deals make it almost impossible for small investors to successfully develop projects.

### **A blended financing solution is needed to address the complexity and risks of local investments.**

The Mwenge case illustrated that multiple financing instruments were needed to unlock private capital and bring the credit risk to an acceptable level for the commercial lender. In this case, Mwenge did not have sufficient equity to meet NMB's lending criteria and prudential guidelines requiring collateral totaling 125% of the loan amount requested. The provision of the UNCDF grant, combined with the loan guarantee from PASS, helped to boost the project developer's assets to meet the collateral requirement without

having to adjust the growth objectives and size of the project.

### **UNCDF's willingness to take on more risk – credit risk, foreign currency risk – lends credibility to the project and paves the way for the entrance of other external players.**

By offering a concessionary loan that is subordinated to the commercial bank loan, UNCDF essentially demonstrated its commitment to the project and reinforced the financial viability of the project in the view of the lender. This case showed that leading with public funding can effectively lower barriers to access to finance and unlock private financing for local enterprises.

### **Technical support should aim to strengthen the project developer's financial and non-financial capabilities.**

LFI's capacity building efforts helped Mwenge to transition from a family business to a professional company with greater transparency, accountability, and governance. As a result of UNCDF business advisory support, Mwenge's owner simplified the company's shareholder and ownership structure which helped the developer to move forward with project development expeditiously. This not only improved the bankability of the project in the short term but also lays the foundation for a more sustainable enterprise in the long run.

# UNCDF & SUSTAINABLE DEVELOPMENT GOALS

**1** NO POVERTY 

**17** PARTNERSHIPS FOR THE GOALS 

LFI with impact on



## ABOUT UNCDF

The UN Capital Development Fund makes public and private finance work for the poor in the world's 47 least developed countries (LDCs).

With its capital mandate and instruments, UNCDF offers “last mile” finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development.

UNCDF's financing models work through two channels: financial inclusion that expands the opportunities for individuals, households, and small businesses to participate in the local economy, providing them with the tools they need to climb out of poverty and manage their financial lives; and by showing how localized investments—through fiscal decentralization, innovative municipal finance, and structured project finance—can drive public and private funding that underpins local economic expansion and sustainable development.

By strengthening how finance works for poor people at the household, small enterprise, and local infrastructure levels, UNCDF contributes to SDG 1 on eradicating poverty and SDG 17 on the means of implementation. By identifying those market segments where innovative financing models can have transformational impact in helping to reach the last mile and address exclusion and inequalities of access, UNCDF contributes to a number of different SDGs.



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