

# Bending The Arc

## How The Full Spectrum Of Capital Can Enable Inclusive Growth In Agriculture

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### EXECUTIVE SUMMARY

**While the world has made huge economic gains over the past 50 years, this progress has been highly uneven. It is increasingly and widely acknowledged that economic growth must become more inclusive and equitable, and wealth and prosperity should be more widely shared, with a particular focus on those groups who have so far been left behind.**

Agricultural smallholder households are one such group, numbering nearly 2 billion people globally; Africa alone is home to more than 300 million of them. Many of these smallholders live on meagre incomes and face high levels of economic insecurity, with limited access to economic opportunities in the rural areas where they live.

In recent years, there have been some innovations and advances in delivering smallholder inclusion through businesses that significantly boost incomes, resilience and living standards. These advances are the result of dynamic entrepreneurship and smart investment, and a range of facilitation efforts by development actors. However, they have typically generated limited benefits in terms of the number of smallholders reached, and there have been few cases where truly widespread, market-level transformative change towards inclusion has been achieved.

This report seeks to add to our understanding of how we can work effectively to bend the arc of agricultural market development in Africa towards inclusive growth, and of the role of different kinds of capital in enabling such changes. Within that we focused on how to most effectively deploy capital that is most flexible in terms of risk-return expectations—subcommercial investment capital and grant funding—because it is key to the achievement of inclusive growth within many different contexts. Flexible capital is also relatively scarce, compared with commercial investment capital, so it is important that we understand how best to maximise its use. By identifying related best practices, we hope to inform and strengthen the work of development actors—philanthropies, aid agencies, development finance institutions, impact investors—providing flexible capital in order to drive inclusive growth.

In our in-depth research of five case studies across Sub-Saharan Africa, we observed two pathways for inclusive growth:



One pathway, which we have called **Disrupt and Grow**, is centred on highly disruptive, individual enterprises that are typically working to build new value chains and markets along smallholder-inclusive lines. Successful enterprises in this pathway can impact tens of hundreds of farmers, while remaining financially viable. This pathway has been the approach of many development actors and impact investors in recent years but, as this report shows, the inclusion impact is often limited to the enterprise and rarely affects an entire sector.



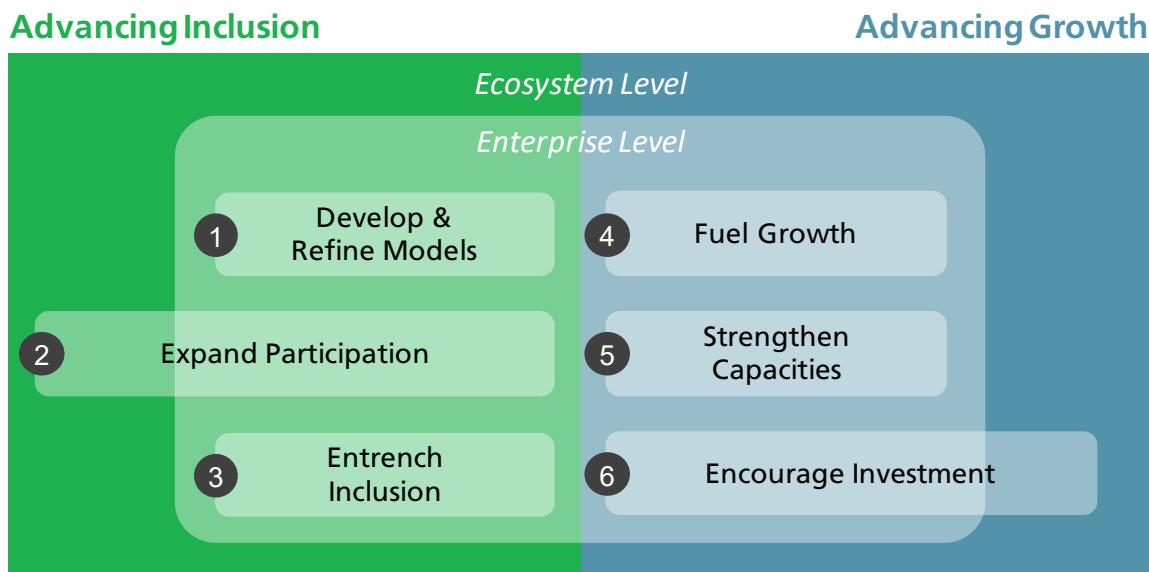
The other pathway, which we term **Guide and Shift**, involves a number of small- and medium-sized enterprises (SMEs) that gradually adopt more inclusive practices and contribute to shifting prevailing market norms, including those followed by larger enterprises and market leaders. Adopting this approach requires supporting a range of enterprises and other actors, as well as some amount of luck and serendipity. However, the inclusion impact can be significantly greater and more durable, impacting millions of smallholder farmers in positive ways through productivity gains, higher incomes and stronger market positions.

## EFFECTIVELY DEPLOYING CAPITAL FOR INCLUSIVE GROWTH

Based on our exploration of these pathways, we have identified a number of lessons for investors and development practitioners. These lessons address the types of capital that can be deployed in different situations to catalyse change towards greater inclusion, and identify ways to do so effectively:

- 1. Capital can target a range of levers relating to inclusive growth, and different kinds of capital tend to pull different levers (See Figure 1).** Grant and subcommercial capital are particularly powerful at moving the needle on inclusion, addressing levers that commercial capital tends not to focus on, such as *expanding participation* to more smallholders, and entrenching inclusion in business models and structures. This is highly complementary to what commercial capital does best, which is to *fuel growth*. Across all of these levers, it is important to consider the needs of different enterprises, starting with the problem and providing support accordingly, and trying to avoid force-fitting instruments to enterprises.
- 2. The work of advancing inclusion is not a one-off effort, but rather a journey.** We see that enterprises advance inclusion over time in multiple ways—expanding participation to previously unreached smallholders and enhancing the benefits to farmers—with this work continuing even as they begin to scale. This means that we can still ensure appropriate and effective use of grants and subcommercial capital to advance aspects of inclusion, even as the enterprise taps into commercial capital to advance growth. A key implication of this approach is that the concept of ‘graduation’ to commercial capital needs to be addressed with care, and not applied in simple and absolute ways.

FIGURE 1 – SIX CAPITAL LEVERS TO PROMOTE INCLUSIVE GROWTH



### **3. One lever that deserves more attention is that of entrenching inclusion in enterprise models and structures.**

Just as growth can both advance and recede, inclusion can be developed but also eroded over time. In deploying grant and subcommercial capital, we should consider implementing features that entrench inclusion to prevent movement away from inclusive growth in a range of future scenarios, such as the diversification of the investor base to more commercial investors and changes of leadership beyond the original founders. We have seen examples of incentives for inclusion impact where there is more of a balance of incentives across financial return and inclusion impact, as well as more radical approaches of bringing smallholders into ownership and governance. There is also potential in helping smallholder-owned enterprises capture greater value, for example, by moving into agriprocessing where it makes business sense. This not only enables them to capture more of the value, ensuring a more transformative impact on their livelihoods, but can also reduce earnings volatility.

### **4. Commercial capital is well-placed to fuel growth, and targeted subcommercial investments can help bring in commercial capital.**

Our research has shown that subcommercial capital plays a strong role in mobilizing commercial capital, and in helping enterprises access it. This could be at the level of an individual enterprise, or throughout an entire industry or sector. The critical success factor is to understand the requirements of the commercial capital we seek to mobilise, then work to tailor our investment approach and design. We should also be realistic about the time horizon over which new inclusive enterprise models will be able to progress to commercial capital. In our research, it took between five and eight years for enterprises to achieve this goal, which could be a longer process in different markets or for different types of crops.

**5. When working to effect whole-market or sector shifts towards inclusion, ecosystem initiatives are needed alongside investment** and support to individual enterprises. Many existing enterprises in a market are typically less oriented towards innovation for inclusion, and have lower capacity or incentives to be anchor players in reshaping business ecosystems. Guiding these enterprises toward greater inclusion requires support from a series of initiatives focused on ecosystem facilitation, reinforced by investments in individual enterprises. Despite this need, we have observed that ecosystem facilitation and investment moves can be highly fragmented even in a single market or sub-sector, and there is high reliance on serendipity and entrepreneurs to stitch various elements together. We therefore see an opportunity to develop market-specific investment platforms to help coordinate and connect these otherwise disparate ingredients for change.

**6. We should focus on ‘windows of opportunity’ in the market, and deploy our investments accordingly.** For instance, not all enterprises will move at the same time or speed: inclusive innovations may first be adopted by the smaller actors, but over time they build a track record and modify market norms to the extent that the larger players adopt these inclusive practices smoothly and with confidence. It is also important to consider where and when there might be discontinuities in market rules (such as changes to government policy, laws or regulations) or dynamics (such as major economic events) that open up ‘windows of opportunity’ for accelerating change).

**7. Mobilising commercial capital also relies on engaging local financial players and their ecosystem.** Beyond considering ways to engage these players, actively supporting the development of local ecosystems can play a significant role to sustain inclusive growth. This can happen through credit guarantees, direct investment into new financial institutions and technical assistance in the development of new products and services.

## POTENTIAL FOR FURTHER INNOVATION

Beyond the lessons outlined above, we have also seen strong potential for further innovation in the investment and facilitation vehicles deployed by development actors. These include:

- **Structuring inclusion-focused permanent capital vehicles for highly engaged investing to support longer time horizons than those commercial investors would tolerate.** The time horizons to achieving inclusive growth—especially in agriculture—are significantly longer than most investors, and even some development actors, are used to. Permanent capital structures better match the time enterprises take to scale, and an intentional focus on inclusive growth levers would help entrench inclusion through conditions, incentives and governance. This type of investment vehicle, accompanied by supplementary grants, could be an effective way to deploy subcommercial capital to the point where more commercial capital can be engaged.

- **Creating focused investment and intervention platforms for market-level change that are able to coordinate investment strategies with ecosystem facilitation.** These dedicated platforms would help reduce the reliance on serendipity, ensuring that different efforts to move various parts of the market towards greater inclusion are mutually reinforcing. Assessing and tracking the market on an ongoing basis would also ensure that capital is deployed to address specific bottlenecks on the journey towards inclusive growth. In addition, the focus on a specific sector would allow for building a critical mass of smallholder-inclusive practices and models that mobilise commercial capital across an entire market, ultimately shifting market norms towards inclusion.
- **Increasing smallholder power and ownership through innovative investment strategies and structures.** A strong focus on not only supporting smallholders as beneficiaries, but also empowering market players, can lead to deeper, more durable inclusion impact. When implemented appropriately, deploying capital to increase the smallholder share of enterprise ownership or to support greater value creation by smallholders can be transformational. It can result in smallholders participating economically in the value chain to a greater extent, improving their resilience to market price volatility and transforming power dynamics more broadly.
- **Providing enhancements and support for local financial institutions to increase agriculture sector lending in the long term.** Although enterprise growth benefits from access to local finance, mainstream banks are often reticent about lending to the agriculture sector when there are less risky or more lucrative opportunities in other sectors. Enhancements like first-loss guarantees, coupled with technical assistance, can incentivise existing players to move into underserved sectors. Investment, grants and technical assistance can also play a role in supporting the development of local financial institutions that challenge the incumbents. These financial instruments can also create new players in the market and pressure traditional banks to shift their practices.

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