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

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JANUARY 2020
This report has been developed and published by FSG in partnership with the Bill & Melinda Gates Foundation and the UK’s Department for International Development (DFID).

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Foreword

At the Bill & Melinda Gates Foundation and the UK government’s Department for International Development (DFID), we are committed to using our resources to improve the lives of the most disadvantaged people.

Equality of opportunity is a core objective of our organisations. Inclusive markets hold the potential to expand incomes and opportunities for the poorest by making them part of the productive value chain as suppliers, distributors and consumers. While we have seen that individual inclusive businesses can make meaningful contributions towards the global Sustainable Development Goals (SDGs) while turning a profit, we have learned that this does not automatically catalyse change at the wider market level. We have also seen that in certain sectors, more traditionally donor-funded investments in public goods and enabling reforms continue to play a vital role in advancing market-level transformations and are an important part of the wider economic development package.

This new report marks an important step towards understanding the role that different forms of capital, from both donors and investors, can take to tilt agricultural markets towards becoming more inclusive. Building on case studies drawn from our own portfolios and those of ground-breaking investors and providers of concessional finance, the research looks at the role that private finance has played in advancing market-level transformations in the agriculture sector. Inclusive agribusinesses that increase the productivity and incomes of smallholder farmers can be effective in reducing poverty, particularly among women, and promoting economic development.

Informed by an analysis of five projects in different markets and geographies, alongside interviews with experts, business developers, investors and policymakers, this report explores how concessional capital in the form of grants and below-market rate financing can advance inclusive growth and poverty reduction, and also how its use has often been limited to supporting isolated, disruptive businesses rather than broader market transformation. Importantly, the analysis suggests that there are unexploited opportunities to ‘guide and shift’ agriculture markets towards greater inclusivity by using concessional capital as a lever for private sector financing. It also illustrates that the journey to scale, including graduation from concessional to commercial capital, isn’t always linear. If concessional capital is to catalyse significant changes across whole markets, then we will need to find new ways to better coordinate support between investments in different companies and between private capital and more traditional donor support. Experience tells us that this is hard, but we are excited by the innovative ideas presented here. As practitioners, we hope that they can enhance our impact in the coming years.

Although the report focuses on the agriculture sector across Sub-Saharan Africa, we hope that the lessons learned here can be applied to other sectors and geographies. The research adds to a grow-
ing body of work on the role of capital in helping inclusive enterprises reach scale and catalysing market transformation that works for all. The research has crystallised for us that ‘how’ capital is deployed—with attention to both scale and inclusion—is equally as important as ‘what’ it funds.

With the UK Government hosting the Africa Investment Summit in London in January, 2020 is shaping up to be an important year for increasing investment in the African private sector. We hope that this report can shed new light on how we can maximise the impact of this capital to bring the benefits of inclusive markets to more people currently living in poverty.

Bill & Melinda Gates Foundation

The UK’s Department for International Development
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.
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.
MOVING TOWARDS INCLUSION

MAKING MARKETS WORK FOR SMALLHOLDERS

Around the world, close to 500 million smallholder farmers rely on crops and livestock from their own small landholdings as their primary source of income. As well as being a huge population with needs of their own, these smallholders are important contributors to feeding others in both rural and urban areas.

However, markets do not operate in advantageous ways for the vast majority of smallholders. They tend to have poor quality inputs, and experience difficulty accessing credit to invest in better inputs or equipment. They also have limited access to channels through which to sell their output, and typically receive low prices from the intermediaries to which they sell. As a result, smallholder farming is too often linked to a cycle of poverty and food insecurity, especially in Africa. Poverty rates among smallholder farmers tend to be higher than national poverty levels. In Ethiopia, a country of more than 100 million people, close to half of smallholders live below the poverty line, compared with 30% for the country overall.

Against this backdrop, we see signs of innovation and progress towards more inclusive growth in the agriculture sector—through which smallholder farmers are supported to engage with the market in more beneficial ways, with significant positive gains for their livelihoods and living standards. One such innovative enterprise from Nigeria is Babban Gona, which is transforming the lives of thousands of smallholders by moving them from subsistence farming to profitable agriculture, and enhancing their resilience to agricultural shocks through crop diversification. In recent years, smallholders have also been brought directly into ownership and governance of Babban Gona, transforming power dynamics and providing even greater potential for economic uplift.

Beyond the successes of individual enterprises, we also see positive change at the level of entire sectors. In Burkina Faso, smallholders whose mangoes used to rot due to the absence of buyers, now sell their fruits to a cluster of small- and medium-sized enterprises (SMEs) that exports dried mangoes to the United States and Europe. Through this channel, farmers enjoy prices double that which they otherwise achieve in the local fresh mango market, and are able to have more stable income through the summer months when other crops are not harvested.
These cases, and others like them, are the result of innovative entrepreneurship, as well as the interplay of development initiatives and market dynamics. But they have also been critically enabled by a mix of different kinds of capital, from a variety of sources and with a range of risk-return expectations; they include grants and concessional development capital, but also nonconcessional capital from both development actors and mainstream commercial institutions.

THE ROLE OF CAPITAL

In this report, we examine how the combination of these different kinds of capital can help to promote inclusive growth in agriculture. This topic has gained a lot of interest over the past few years, and much has already been written. Past literature has looked into specific aspects of this question: enterprise or market-growth, the demand or supply-side of capital or specific instruments and types of capital. With this research, we paint a unified picture, connecting these different pieces and showing the interplay among them. As such, we hope to guide impact-driven investors in when and how to deploy their capital to support inclusive growth.

We define inclusive growth as the process through which enterprises and markets become more inclusive and generate impact at scale. Inclusive growth has two elements, the first of which is advancing inclusion. In the context of this study, advancing inclusion can materialise in different ways for smallholders, including greater participation in a value chain, improved power dynamics with traders, increased income or resilience and improved nutrition. The second element is advancing growth—specifically, the growth of more inclusive situations—to expand their benefits to larger numbers of smallholders. As such, to achieve inclusive growth and create inclusion impact at scale, both elements need to work hand in hand.

We are particularly interested in the role of grants and concessional development capital to promote inclusive growth because these funding sources can play pivotal roles in developing new models and markets, but are in much shorter supply than nonconcessional capital and also come with unique risks such as market distortion. However, used well, we believe that grants and concessional capital can serve to bend the arc of mainstream capital towards inclusive growth opportunities, and, at scale, bend the arc of development itself towards more inclusive and sustainable outcomes.

In doing this work, we have built on the work of many others. One example is ISF’s recent Pathways to Prosperity report which has helpfully shed light on existing gaps in agricultural finance, illustrating different ways greater inclusion takes shape for the lives of smallholders. In this report, ISF paints a dynamic view of smallholder inclusion, introducing a model to show how smallholders pursue greater resilience and agency through different trajectories: from farming for subsistence to farming through a business-oriented approach, and even transitioning outside of farming to pursue entrepreneurship opportunities within or beyond agriculture. This approach reminds us that fostering inclusion is not
about a single intervention, but rather about engaging with smallholders in a variety of ways to help create a diversity of opportunities that continuously improve their economic standing over their lifetimes.

Meanwhile, Tideline’s report on Catalytic Capital has helped the impact investment field to understand the various types of financial concessionality implicated in subcommercial investing: expecting a lower rate of return, taking a higher risk position in a capital structure to encourage follow-on investments and accepting lower liquidity through longer investment periods or due to uncertain exit options. Importantly, it has also helped explain why such capital can have a catalytic effect, by facilitating innovation, helping enterprises scale and supporting them in building their financial and impact track record.

**FIGURE 2 - OMIDYAR NETWORK’S THREE CATEGORIES OF CAPITAL, ADAPTED FROM “BEYOND TRADEOFFS” (2019) ON THE ECONOMIST DIGITAL HUB**

<table>
<thead>
<tr>
<th></th>
<th>Expected Financial Return</th>
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</thead>
<tbody>
<tr>
<td><strong>A. Commercial</strong></td>
<td></td>
</tr>
<tr>
<td>A1 Market Validated</td>
<td></td>
</tr>
<tr>
<td>A2 Not Validated</td>
<td></td>
</tr>
<tr>
<td><strong>B. Subcommercial</strong></td>
<td></td>
</tr>
<tr>
<td>B1 Positive Absolute Returns</td>
<td></td>
</tr>
<tr>
<td>B2 Capital Preservation</td>
<td></td>
</tr>
<tr>
<td><strong>C. Grants</strong></td>
<td></td>
</tr>
<tr>
<td>C No Expectation of Returns</td>
<td></td>
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</tbody>
</table>

In order to describe different kinds of capital across the risk-return continuum, we have drawn from the work of colleagues at Omidyar Network (ON) for categorising different types of capital:

- **Grant capital**: This can be provided to an inclusive enterprise to fund activities with high potential for impact with no expectation of financial return. In this report, we also consider grants that fund ecosystem interventions that support enterprises or smallholders, typically addressing barriers to scaling inclusive business models.

- **Subcommercial capital**: Capital that can also be referred to as concessional or catalytic, and accepts the expectation of lower risk-adjusted financial returns. This might be driven by lower expected absolute rates of return, or by higher risk for which the investor is not being compensated. In many cases, there might also be a greater level of effort and costs borne by investors across an investment’s lifecycle, from originating new opportunities that might be difficult to find, to becoming more involved in managing investments and supporting enterprises.
• **Commercial capital**: Capital through which investors seek risk-adjusted market-rate returns. This obviously encompasses capital from commercial private-sector sources, but also capital invested in opportunities that ON refers to as not *market-validated*, which can generate commercial returns but are not yet attracting commercial investors. This includes nonconcessional investments from impact-focused investors such as development finance institutions (DFIs).

Attracting stronger inflows of commercial capital is essential for the full promise of inclusive growth to be realised. For instance, the estimated $100 billion funding gap for agricultural SMEs in Sub-Saharan Africa requires three times more than the current available funding and can only be addressed if we are able to tap the capital of mainstream commercial investors. The problem is that this capital is largely flowing to opportunities that do not foster inclusive growth—fostering market conditions and structures that truly include and benefit smallholders and typically involve additional challenge, risk and cost, which most private-sector corporations and investors are not inclined to pay for.

While financial innovations such as blended finance are helping to close this gap, they have had limited success in directing capital from private investors where it is most needed: less than 4% of the private capital mobilised using blended finance tools flowed to low-income countries, between 2012 and 2015.

This is why we must consider how best to use grants and subcommercial capital to help bend the arc of commercial capital towards inclusive growth. We need more insight into the effective use of grant and subcommercial capital in crowding in commercial investment, so that we can increase the effectiveness that blended and concessional finance offers for promoting inclusion globally.

The need to achieve greater effectiveness in this endeavour is underscored by the scarcity of grant and subcommercial capital, relative to commercial capital. Grant funding, the scarcest of them all, plays a key role in supporting innovation into untested practices and models, particularly where the financial payoff is expected to be minimal, highly uncertain, or both.

Many inclusive growth success stories across diverse sectors can be traced back to the crucial enabler of grant funding. Perhaps the most well-known case is that of M-PESA, the mobile money platform developed by Vodafone that has kick-started a global revolution in digitally enabled financial inclusion, initially developed with grant funding from the UK Department for International Development (DFID). However, like any subsidy, grant funding has the potential to distort markets by changing the economics of business models and value chains, and continued reliance on grant funding can also compromise entrepreneurs’ focus on business fundamentals, weakening the ultimate potential for their models to serve populations at scale.
IN-DEPTH CASE STUDY ANALYSIS

The work of this report was based on an in-depth study of inclusive growth case studies in agriculture throughout Sub-Saharan Africa, where enterprises and sectors have effectively adopted and scaled inclusive approaches to address smallholder poverty. From an initial scan of 30 potential cases for exploration, we narrowed our focus to conduct forensic research into five case studies: three focused on individual enterprises, and two on entire sectors. We selected these cases based on the degree of scale achieved—with a minimum threshold of having engaged at least 10,000 smallholder farmers—as well as their level of inclusion impact and commercial success, and evidence of interaction with a variety of different types of capital in their development.

In making our final selection, we also sought diversity among different kinds of agricultural value chains—from livestock, to staple crops, to export-oriented crops—and a range of African countries. At the enterprise level, we also aimed for diversity in business models—both input providers and offtake—and enterprise profiles—from disruptive high-growth ventures to more traditional SMEs. The deep-dive case studies covered in this report are highlighted in the table below.

FIGURE 3 – SUMMARY OF DEEP-DIVE CASE STUDIES

<table>
<thead>
<tr>
<th>CASE STUDY</th>
<th>COUNTRY</th>
<th>MODEL</th>
<th>VALUE CHAIN</th>
</tr>
</thead>
<tbody>
<tr>
<td>EthioChicken</td>
<td>Ethiopia</td>
<td>Input provision</td>
<td>Poultry</td>
</tr>
<tr>
<td>Gulu Agricultural Development Company (GADC)</td>
<td>Uganda</td>
<td>Input provision &amp; offtake</td>
<td>Cotton, chili, sesame, maize</td>
</tr>
<tr>
<td>Babban Gona</td>
<td>Nigeria</td>
<td>Input provision &amp; offtake</td>
<td>Maize, soybean, cowpea, rice</td>
</tr>
<tr>
<td>Mango-drying cluster</td>
<td>Burkina Faso</td>
<td>Offtake</td>
<td>Mango</td>
</tr>
<tr>
<td>Dairy sector</td>
<td>Kenya</td>
<td>Offtake</td>
<td>Dairy</td>
</tr>
</tbody>
</table>

For each of the case studies, we sought to understand how different types of capital had supported their inclusive growth, drawing out patterns and lessons learnt wherever possible, in order to inform the conclusions and recommendations of this report.
Similar concerns relate to the use of subcommercial capital. Because this is available in considerably greater volume than grant funding, it also carries a significant risk of crowding out private investors, by offering cheaper capital when it is not necessary. DFIs have already been working to mitigate these risks, as reflected in the report from the DFI Working Group on Blended Concessional Finance for Private Sector Projects, which has elaborated upon a set of five principles to ensure effective use of their capital.¹⁸ ¹⁹

1. **Additionality:** DFI support for the private sector should make a contribution that is beyond what is available, or that is otherwise absent from the market, and should not crowd out the private sector. Blended concessional finance should address market failures.

2. **Crowding-in and Minimum Concessionality:** DFI support for the private sector should, to the extent possible, contribute to catalysing market development and the mobilization of private sector resources and minimise the use of concessional resources.

3. **Commercial Sustainability:** DFI support for the private sector and the impact achieved by each operation should aim to be sustainable. DFI support must contribute towards the commercial viability of their clients. The level of concessionality in a sector should be revisited over time.

4. **Reinforcing Markets:** DFI support for the private sector should be structured to effectively and efficiently address market failures, and minimise the risk of disrupting or unduly distorting markets or crowding out private finance, including new entrants.

5. **Promoting High Standards:** DFI private sector operations should seek to promote adherence to high standards of conduct in their clients, including in the areas of corporate governance, environmental impact, social inclusion, transparency, integrity and disclosure.

In the work underpinning this report, we have taken these principles and existing contributions into consideration and sought to build on them.

**CAPITAL LEVERS TO PROMOTE INCLUSIVE GROWTH**

Appropriate investment can support inclusive growth in the agriculture sector, but it requires the intentional targeting of specific levers in relation to such development. Based on our research, we developed a framework that describes the key levers that typically advance inclusion and growth. All of these can be targeted at individual enterprises themselves, and two of them can also be addressed through the ecosystems around the enterprises. We describe the levers below (see Figure 4).

There are a number of levers that are primarily focused on advancing inclusion:
Develop & Refine Models, which can occur either at inception, when founders often have to test and refine their models through trial and error, or later on in an enterprise’s development, when expanding into new verticals or developing new products or services. These models are by nature inclusive or, when they are not inclusive, evolve to become inclusive.

Expand Participation by deploying capital to advance smallholder inclusion in value chains, whether directly through the enterprises or through ecosystem interventions. With respect to offtake models, this could involve training smallholders—improving their productivity and the quality of their produce—facilitating access to inputs and finance, or expanding sales channels for smallholders. With respect to input models, this could help develop new distribution channels or extend existing ones in order to reach more smallholders, as well as facilitate access to finance smallholders for the purchase of these inputs.

Entrench Inclusion by aligning the enterprise’s incentives and governance structures to prioritise inclusive practices. Capital targeting this lever can take the form of incentives for inclusion impact results, for example, linking interest rates with impact results to incentivise inclusion. It can also be done in a more radical way, such as bringing smallholders themselves into the ownership and governance of enterprises.

There are a number of levers that are primarily focused on advancing growth:

Fuel Growth of inclusive enterprises by supporting them as they take their business model to scale, either by reaching more smallholders in the same geography or by expanding to new geographies.
5 **Strengthen Capacities** by helping individual enterprises improve their ability to access additional capital. This can involve supporting enterprises as they build their asset base, establish management and financial tracking systems and develop operational and financial track records.

6 **Encourage Investment** from other providers through the structuring of individual transactions, including loans, or through vehicles that mobilise additional commercial capital. At the ecosystem level, this can also entail providing incentives for existing capital providers, or supporting the development of new financial institutions that challenge incumbent ones.

It is worth mentioning that we see that the aggregate effect of all of these levers is to promote inclusive growth, so the purpose of this framework is not to suggest that capital that mainly serves to advance growth is not also supportive of inclusion, but rather that its primary focus is not the advancement of inclusion practices beyond where they are at present. Ultimately, levers on both sides of this framework must be targeted in order to achieve inclusive growth.

Using this framework, we asked ourselves the question: do certain kinds of capital tend to address certain kinds of levers? The answer is yes, based on our analysis of the 97 transactions identified in our five in-depth case studies (see Figure 5), where we tagged each investment based on our assessment of the levers it targeted; where an investment addressed more than one lever, it was tagged with multiple levers.

Our analysis shows that grant funding focused on advancing inclusion. The use of grants for **Develop & Refine Models** shows the utility of such capital in highly uncertain, early-stage situations where inclusive business models and practices are as yet unproven, and therefore financial payoffs unclear. In **Expand Participation**, the use of grants reflects the fact that bringing more smallholders into participation in value chains has a strong element of public good creation; unsurprisingly, grants

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**FIGURE 5 – LEVERS TARGETED BY DIFFERENT TYPES OF CAPITAL**

- **Grant**: N=33
  - Entrench Inclusion
  - Fuel Growth
  - Financial Payoffs
  - Incentives for Inclusion

- **Subcommercial**: N=40
  - Strengthen Capabilities
  - Finance
  - Risk Management
  - Infrastructure

- **Commercial**: N=24
  - Economic Growth
  - Investment Returns
  - Market Expansion

*Advancing inclusion* | *Advancing growth*
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N = number of transactions identified in deep-dive case study research
here were applied to both ecosystem-level initiatives and direct activities through enterprises. To a lesser extent, grants were also used for the Strengthen Capacities lever, helping them build assets, capabilities and track record in the early stages of their development, before they are able to attract return-seeking capital.

The picture becomes more multi-faceted as we move to subcommercial capital, which played a strong role in advancing both growth and inclusion. We saw subcommercial capital often used to Strengthen Capacities in the earlier stages of an enterprise’s journey, demonstrating the importance of financial concessions to help enterprises build their financial and operational track records. In addition, we saw that most of these investments also targeted the Fuel Growth lever, given the ambition of this type of capital to generate returns. We also saw subcommercial capital advance inclusion by providing finance and inputs that Expand Participation of smallholders in improved value chains—this aligns with the motivations of most concessional investors to deploy capital in service of achieving greater inclusion. However, unlike grants, subcommercial capital was seldom used to Develop & Refine Models, given that the risk involved in doing so is far more significant than most concessional investors would be willing to take on.

Finally, commercial capital was almost entirely used for the advancing growth levers, chiefly Fuel Growth. This is entirely expected and consistent with our understanding of how and where commercial capital would naturally play, and underscores the complementarity of the different types of capital needed to enable inclusive growth.

Some of the levers from the framework were not targeted as frequently as those mentioned above. Only two grants and five subcommercial transactions worked to Entrench Inclusion; however, we believe that their impact has been transformative. Similarly, only a handful of grants and subcommercial investments Encouraged Investment but again, their impact was considerable.

It is also worth noting that many of these investments addressed multiple levers. The data revealed that subcommercial capital was most likely to target several levers simultaneously, with half of the transactions targeted on two or more levers, which echoes how this type of capital is best suited to advance growth in ways that also advance inclusion.

In the following chapters, we will go into our analysis of each of the in-depth case studies, in order to describe some further patterns in how different kinds of investment supported inclusive growth, as well as highlight examples of effective practice in deploying those investments and draw out some general lessons for practitioners going forward.

As we do this, we consider two different pathways for inclusive growth that we have observed across the case studies. One pathway is centred on highly disruptive, individual enterprises that are typically working to build new value chains and markets along smallholder-inclusive lines—we have called this the Disrupt and Grow pathway. The impact-driven enterprises that characterise this pathway typically
operate in underserved or untapped markets and, as they grow and consolidate their model, become a reference point for later entrants. 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 we will show, the inclusion impact is often limited to the enterprise and rarely spills over across an entire sector.

The other pathway we have observed involves a number of SMEs that gradually adopt smallholder-inclusive practices and contribute to shifting prevailing market norms, including those followed by larger enterprises and market leaders, over time—we have called this pathway Guide and Shift. This is, of course, a more complex course of action for development organisations and impact investors to adopt: it requires supporting a range of enterprises and other actors, and it also involves some amount of luck and serendipity. But the inclusion impact can be significantly greater and more durable, as we will see in the report. As a critical mass of enterprises, including market leaders, move toward greater inclusion, they can impact millions of smallholder farmers in positive ways through productivity gains, higher incomes and stronger market positions.

As we dive deeper into these pathways, we will explore both commonalities and differences in their journeys, and lay out the lessons they hold for where, when and how capital can support inclusive growth.
One of the pathways to change that we observed through our case study research involves a single enterprise that develops an inclusive business model. These single enterprises identify gaps in the market and offer a disruptive approach to serve smallholder needs. Given their disruptive model and the underserved markets they target, these enterprises often begin their operations without any direct competition. As they continue to develop, they validate their innovative business model, leading the way for new entrants to adopt, replicate or further refine inclusive models.

Enterprises leading the change in the *Disrupt and Grow* pathway fit what the Collaborative for Frontier Finance describes as ‘High-Growth Ventures’. These enterprises are dynamic and disruptive. They typically have inclusion built into their model from the outset and are often driven by scale-oriented entrepreneurs who have high levels of ambition, risk tolerance and desire to create outsized inclusion impact. As a result, High-Growth Ventures are able to embrace innovations that have not been market tested, embedding promising ones into their core business models.

Despite commonalities, the High-Growth Ventures described in the *Disrupt and Grow* pathway are not all the same. There are differences in the preconditions of the markets in which they operate, the nature of their business models, the background of their founding entrepreneurs and their routes to accessing capital. These differences account for slightly different approaches to driving inclusive growth. In this chapter, we explore the nuances of three enterprises: EthioChicken, the Gulu Agricultural Development Company and Babban Gona.
The scaling journey of EthioChicken, a poultry enterprise established in 2010 in Ethiopia, highlights the complexity of developing innovative, inclusive models. It also illustrates the many challenges that enterprises face as they grow, and underscores the importance of grants and subcommercial capital to refine unproven business models, create the conditions for inclusion and support enterprises in mobilizing commercial capital.

SNAPSHOT: ETHIOCHICKEN

<table>
<thead>
<tr>
<th>BUSINESS MODEL</th>
<th>INCLUSION IMPACT</th>
</tr>
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<tbody>
<tr>
<td>• EthioChicken produces improved day-old chicks, feed and vaccines that it supplies as a package to a network of farmer agents</td>
<td>• Has supported 3,500 micro-entrepreneurs to become farmer agents</td>
</tr>
<tr>
<td>• Farmer agents rear the chickens for 45 – 60 days and then supply them to smallholder farmers in their area</td>
<td>• Has sold 20 million chickens and reached more than 1.6 million households since inception</td>
</tr>
<tr>
<td>• The improved chicken breed offered by EthioChicken produces more eggs and meat enabling smallholders to increase their income from poultry farming</td>
<td>• Increases smallholder income from poultry farming by up to 5 times</td>
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EthioChicken was founded in 2010, after David Ellis, Trent Koutsoubos and Joseph Shields leased a failing government poultry farm in northern Ethiopia. Based on their agreement with the regional government, EthioChicken would operate the farm and produce chickens while government agents would distribute them to smallholders.
However, things did not proceed as planned. The contract with the government fell apart, with government agents failing to take on chicken distribution as initially agreed. Meanwhile, EthioChicken’s breed of chicken failed to gain widespread acceptance among smallholders and end consumers.

In response, EthioChicken reworked its model and distribution network. The cornerstone of this change was the recruitment and training of new farmer agents who would rear chicks for the first 45–60 days, and then sell them to smallholders—EthioChicken would provide day-old chicks, feed and vaccines to these agents, as well as veterinary support and monitoring services.

EthioChicken also had to find a new chicken breed that was favoured in Ethiopia. For four years, the enterprise imported different breeds and tested them with farmer agents and customers to find one that was adapted to the local needs. EthioChicken also engaged in promotional activities to build awareness of the benefits of the improved chicken breed among end customers, in an effort to stimulate greater demand.

Through these changes, EthioChicken was able to successfully refine its model and grow its operations. Today, the enterprise runs multiple farms, hatcheries and a feed mill. Its distribution network engages 3,500 farmer agents who sell chickens in nearly every district of Ethiopia. The founders also expanded operations to Rwanda and Uganda where they operate as Uzima Chicken Ltd.

EthioChicken’s model also generates inclusion impact at multiple levels. As of 2018, EthioChicken had sold more than 20 million chickens and reached more than 1.6 million households. The improved chicken breed produces more eggs and takes less time to reach market weight than local, traditional breeds. As a result, smallholders can grow their income from egg and chicken sales by up to 5 times. Poultry farming also helps farmers diversify their income beyond crop sales, therefore improving their resilience to droughts, which in Ethiopia are frequent and severe. In addition, EthioChicken’s model benefits women, who typically look after poultry, collecting eggs and bringing products to the market.

EthioChicken’s story shows that enterprises can succeed in driving inclusive growth. But, what enables them to do so? What role have grants and subcommercial capital played to support this? How has EthioChicken scaled its activities, and how has it financed its inclusive growth? We explore these questions and others in the sections that follow, and provide additional details (see Figure 6 – page 21).

**ADVANCING GROWTH: ACCESSING COMMERCIAL CAPITAL TO FUEL GROWTH**

When EthioChicken’s founders moved to Ethiopia in 2010, they had no prior experience in agribusinesses or livestock farming. They started the company on the back of their savings and capital from friends and family, and began to slowly build their business and their local network.
David, Trent and Joseph also wanted to raise commercial capital from the outset. They worried that accessing grants or subcommercial capital early on could raise doubts for follow-on investors. The founders leveraged their global social entrepreneurship and private equity networks to engage with commercial venture capital funds. In 2012, Arabica Investments invested in the business in exchange for a large minority stake. The fund’s investment was critical in setting up the initial team and the company’s governance structure. It also ingrained a commercial mindset into EthioChicken’s operations from the early days—while EthioChicken would focus on inclusion, it would need to do so in a resolutely profitable way.

**ADVANCING INCLUSION: RECOVERING FROM EARLY SETBACKS TO DEVELOP AND REFINE A MODEL**

Iterating EthioChicken’s model and building the company’s distribution network required significant investments in the first years of operation. This meant that the company quickly exhausted its initial funds. David Ellis describes, ‘We had six near bankruptcies, and there were a dozen times where we were late or barely made payroll’. With a promising model but growing losses, development actors had a role to play to support EthioChicken’s growth.

A zero-interest loan and a grant from the Africa Enterprise Challenge Fund (AECF), along with a subcommercial loan from Acumen helped EthioChicken recover from its early losses. Perhaps most significant, however, was a grant from the Bill & Melinda Gates Foundation in 2014. The $7 million Gates Foundation grant was larger than what any commercial investor would have been willing to provide at the time. These investments also gave the team breathing room to refine the company’s model without the pressure of generating immediate returns. They also helped EthioChicken grow its operations by investing in building its network of farmer agents, and through the acquisition of additional assets—farms, feed mills and hatcheries—that later served as collateral to secure bank loans.

The change in investor profile also meant that EthioChicken benefited from new kinds of support. Development-focused investors shared their experience in refining and scaling new business models, whilst reinforcing the company’s renewed focus on inclusion, sharing perspectives from other successful models as well as suggestions on potential modifications that could help the enterprise deepen inclusion and better serve its customers.

**ADVANCING GROWTH: ACCESSING COMMERCIAL CAPITAL BY STRENGTHENING CAPACITIES**

Since 2015, the business has focused on raising commercial capital from local banks and DFIs, as well as self-financing its growth as the business has built up its profitability. Securing grants and subcommercial capital has a high opportunity cost: it relies on building relationships with donors and investors, and typically involves additional post-investment activities, such as periodic impact evaluations.
Case study highlights

- High-growth ventures need to make significant investments to develop and refine their models in the early stages. Grants and subcommercial capital are well-placed to support this, particularly in situations where commercial capital does not offer sufficient flexibility for these model iterations.

- High-growth ventures often need to invest in building parts of their value chain to serve smallholders and expand their participation. Grants are most adapted to fund these activities as their financial returns are often unclear or longer term.

- Capital is most effective when it targets multiple levers simultaneously, sometimes advancing inclusion and growth at the same time. The grant and subcommercial capital received by EthioChicken helped the enterprise refine its business model and expand participation (relating to advancing inclusion), while strengthening its capacities (relating to advancing growth).
The different types of capital that have supported EthioChicken’s evolution show that progression to commercial capital does not always proceed in a clearly linear fashion. EthioChicken has accessed commercial capital at different points on its journey, including at the outset. At the same time, there have continued to be grants and subcommercial investments in the company from development actors. However, as shown in Figure 6, our analysis shows that these different kinds of capital targeted different levers for inclusive growth, with grants and subcommercial capital supporting essential activities related to advancing inclusion.
The Gulu Agricultural Development Company (GADC) started as a cotton ginner in Uganda in 2009 and has since diversified into other crops: sesame, chili and maize. The company's story highlights the role that grants and subcommercial capital can play in helping enterprises embrace inclusion by building out their supply chain. It also shows a different way for enterprises to build a financial and operational track record that can enable them to access commercial capital.

SNAPSHOT: GADC

<table>
<thead>
<tr>
<th>BUSINESS MODEL</th>
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</tr>
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<tbody>
<tr>
<td>• GADC provides a variety of products and services to smallholders through a network of field officers and lead farmers that head farmer groups</td>
<td>• Has rebuilt farmer livelihoods in post-conflict northern Uganda, and led the way for other ginners and traders to operate in the region</td>
</tr>
<tr>
<td>• This network allows GADC to provide ongoing training and support on agronomic best practices, access to financial services, quality agri-inputs and equipment to smallholder farmers as a way to improve farmer yields and produce quality</td>
<td>• Sources produce from more than 60,000 smallholders, of which 20% are certified organic, enabling them to receive price premiums</td>
</tr>
<tr>
<td>• The network enables GADC to source produce from smallholders, which it then processes and sells on domestic and international markets</td>
<td>• Increases the income of smallholders by enabling up to 30% increases in their yields</td>
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Between 1995 and 2007, the Lord’s Resistance Army (LRA) led a brutal insurgency across northern Uganda, driving families off their land. At its peak in 2005, close to two million northern Ugandans had been displaced. When the insurgency ended, northern Uganda had no significant economic activity, families had lost their homes and their land and farming practices had been forgotten.

It was in this context that Bruce Robertson founded GADC in 2009, and he describes it thus:

‘[The environment was] post-apocalyptic: the ginnery had been looted—[it had] bullet holes everywhere [and] it had not operated for 15 years. There were no skilled workers, and farmers had lost their cotton-growing skills. Anyone under the age of 30 did not know what work was as they had sat in [displacement] camps since childhood’.

Having made his career in multiple roles throughout Uganda’s cotton value chain, Bruce believed that cotton production could revive economic activity in the region. He leased a cotton ginnery in Gulu, formerly the epicentre of LRA activities, and started rebuilding the value chain through GADC. To do so, the enterprise set up a network of field officers and lead farmers that trained smallholders in the region on improved farming practices. Through this network, GADC also provided inputs on credit to smallholders, and sourced produce from farmers.

At inception, GADC focused its activities on cotton, which exposed the enterprise to significant risk. The focus on a single crop meant that its operations could be jeopardised by fluctuations in production, or by a drop in cotton prices. To mitigate these risks, GADC expanded into sesame, which now has become one of its main crops—in 2014, GADC purchased close to 10% more sesame than it did cotton. By 2019, GADC operated three cotton ginneries, and had diversified into sesame, chili and maize.

As it evolved, the enterprise also increased the breadth and the depth of its inclusion impact. GADC now works with approximately 60,000 smallholders. Almost 20% are certified organic—mainly producing organic sesame—which enables them to receive a price premium. The training GADC offers to smallholders has also helped boost farmer yields by up to 30%, thereby increasing their income. GADC’s diversification into crops beyond cotton has also reduced the risk shocks for smallholders, whose income is now spread across multiple crops throughout the year.

Over the last decade, GADC has rebuilt farmer livelihoods in a region that was destitute after years of violence. It has also led the way for other ginners and traders to operate in the region, building a more vibrant market. Grants and subcommercial capital again played a part in supporting this, as has commercial capital (see Figure 7 – page 27). In this section, we uncover the role that capital played in helping GADC deepen its inclusion impact and fuel its growth.
ADVANCING INCLUSION: REBUILDING THE SUPPLY CHAIN TO EXPAND PARTICIPATION

The capital that Bruce invested to start GADC’s operations was far from what the company needed to train farmers and rebuild the value chain. The business needed to provide extension services, but it did not make enough money to justify an upfront investment that would not have immediate returns.

Grants were key to overcoming this challenge. With no clarity on the potential for financial returns, GADC relied on grants to redevelop the broken value chain. An initial grant from the Danish International Development Agency, Danida, helped GADC build its network of field officers and lead farmers. The extension services funded by the Danida grant also resulted in a public good. Although GADC trained farmers, smallholders were not bound to sell their produce exclusively to the company. Better farming practices allowed for other ginners and traders to enter the value chain, increasing competition for farmer produce and strengthening the bargaining power of smallholders.

ADVANCING INCLUSION: PILOTING NEW VERTICALS TO DEVELOP AND REFINE A MODEL

Beyond using grants to rebuild the value chain, GADC also used grants to test new ways of expanding its model. As it grew, the thin margins the model operated on meant that GADC had limited capital to reinvest in testing and refining new verticals. Self-financing these activities also involved significant risk, as it was unclear whether the investments would actually pay off.

In 2015, GADC received a grant from TechnoServe’s Coalition for Smallholder Sourcing that subsidised the cost of running pilots for three initiatives aimed at refining its model: an innovative approach to increasing the inputs purchased by smallholders, a cash incentive for lead farmers aimed at securing greater volumes for GADC and the enterprise’s diversification into maize. The grant’s cost-sharing basis meant that GADC, which was also required to contribute its own funds, had ownership in the pilots and a keen interest in seeing them through.

Of the three pilots, only the diversification into maize generated results that were appealing enough for GADC to embed it in its core business. The fact that only one of three pilots proved successful reinforced the need for grant funding—had GADC financed these pilots fully from its own resources, or from those of commercial investors, it would have faced a severe cash crunch. More likely, though, the enterprise would not have taken the risk of refining its model, fearing the consequences of not succeeding. Grants eased the pressure to generate positive returns and they enabled GADC to explore alternatives without concerns about insolvency.
ADVANCING GROWTH: ACCESSING SUBCOMMERCIAL CAPITAL TO FUEL GROWTH

GADC provides inputs on credit to smallholders and prefinances field officers for the purchase of crops that the company sells weeks later. As a result, it requires significant amounts of working capital to run its operations. Despite this need, securing debt from private lenders was difficult for GADC at its outset. The company had no financial or operational track record. It also lacked assets that it could provide as collateral for bank loans—GADC had leased, not purchased, the ginneries it used until 2016. As a result, GADC turned to impact-driven investors to support the company's growth, helping it build its track record at the same time.

In 2010, GADC received a $1.4 million credit facility from Acumen and Root Capital. Structured along the lines of a factoring product, the facility provided GADC with ongoing credit proportional to the contract orders it secured from buyers, supplying a stream of capital to finance operations and its scale-up. Acumen and Root Capital provided capital at below-market rates relative to the risk profile of the investment. Though the cost of capital was similar to what commercial banks charge in Uganda, Acumen and Root Capital did not entirely price in the risk of the investment, which would not have been viable for GADC.

The working capital facility saw GADC scale over the six years during which Acumen and Root Capital remained invested. But, as the enterprise grew, so did its need for working capital. Indeed, by 2016 Acumen and Root Capital had reached their investment limit. GADC needed investors who could inject more capital to continue fuelling its growth. Responding to the enterprise's needs, AgDevCo and responsAbility took over the facility and mobilised more than three times the initial amount from Acumen and Root Capital. This second wave of investors enabled GADC to continue to grow its activities rapidly and with it, the capital it needed to operate. In just two years, the capital mobilised by AgDevCo and responsAbility nearly doubled.

ADVANCING GROWTH: BUILDING ASSETS AND SYSTEMS TO STRENGTHEN CAPACITIES

Beyond fuelling GADC’s growth, another explicit objective of AgDevCo and responsAbility’s investment was to help the enterprise access commercial capital. Rebecca Sankar from AgDevCo explains:

‘To attract market capital our investees need to meet three criteria. First, demonstrate consistent profitability. Second, have robust management systems. Third, have risk-mitigating policies in place, whether financial or non-financial. These also help reduce the cost of capital private players eventually charge’.

As such, AgDevCo helped GADC develop risk-mitigation strategies aimed at reducing the risk profile of GADC and attracting mainstream investors. Among others, these included policies regarding the use of pesticides in organic farming which, if done incorrectly, could jeopardise GADC’s activities.
FIGURE 7 – GADC’S CAPITAL JOURNEY AND LEVERS TARGETED BY TRANSACTIONS

Key levers pulled

- Develop & Refine Models
- Expand Participation
- Entrench Inclusion
- Fuel Growth
- Strengthen Capabilities

Case study highlights

- The evolution of high-growth ventures toward commercial capital is not linear. GADC has received grants throughout its journey which enabled it to invest in developing and refining its model, and expanding participation. These activities are too risky to self-finance or fund through subcommercial or commercial capital as financial returns from such investments are often unclear and long-term.

- By helping establish new models and building part of the value chain, high-growth ventures create public goods. As such, new entrants and other market actors can benefit from these, further making it challenging for high-growth ventures to recoup their investment.

- Subcommercial capital helps high-growth ventures strengthen capacities, preparing them to access commercial capital. As such, subcommercial capital helped GADC build its financial and operational track record, build an asset base that it could use as collateral to access commercial loans and develop risk-mitigation strategies.
GADC also strengthened its capacities by building an asset base that it could use as collateral to access future debt. Seven years after its founding, GADC was finally able to self-finance the purchase of its third cotton ginnery, which it then used as collateral to take out a loan from the Uganda Development Bank (UDB).

From UDB’s perspective, the investment was a great opportunity: by then GADC had a solid financial track record and had consistently generated profits. The enterprise had also shown its ability to deliver inclusion impact at scale, something that UDB sought out in its deals. Moreover, UDB had a good relationship with GADC’s founder, having worked with him previously during his tenure at the Western Uganda Cotton Company. Following this first loan, GADC received a second loan from UDB for the purchase of sesame processing equipment. As it continued to grow, GADC was on a clear trajectory toward commercial capital.
## BUSINESSES MODEL

- Babban Gona supports smallholders involved in maize, rice and soybean production to create farmer-owned franchises, to which it offers a variety of products and services.
- These products and services include low-cost, high-quality agricultural inputs provided on credit, as well as training to improve yields.
- Babban Gona also supports market access for these smallholder franchises by purchasing produce from them after the harvest, storing it and selling it when prices increase.

## INCLUSION IMPACT

- Has impacted more than 70,000 smallholders, including 20,000 farmers in the 2018 harvest season.
- Improves smallholder income, with affiliated farmers earning on average two and a half times more than the average Nigerian smallholder farmer.
- Has brought smallholders into the company’s ownership structure, changing the dynamics of power in the market.
Youth unemployment in Nigeria is currently estimated at 60%. It is attributed to be one of the main factors fuelling insurgencies in the country, because groups like Boko Haram have capitalised on it to recruit unemployed youth. The situation is likely to get worse. An estimated 80 million youth, equivalent to half of Nigeria's population, are expected to enter an already saturated job market in the next 20 years.\textsuperscript{22}

Seeking to address these issues, Kola Masha cofounded Babban Gona in 2012. His idea was to uplift smallholder livelihoods, turning farming into an attractive opportunity for young Nigerians. Smallholder farming is typically associated with poverty in Nigeria. Farmers operate on small plots of land, using farming methods that have been passed down for generations, leading to low yields. As a result, over two-thirds of smallholder farmers in Nigeria earn less than $1.90 a day.\textsuperscript{23}

With the ambitious goal of reaching one million farmers by 2025, Babban Gona’s model brings smallholders together into farmer-owned franchises that it supports. To do so, the company has developed a training programme for smallholder farmers focused on improving agricultural practices. The aggregation of its affiliated farmers strengthens the company's bargaining power in input and offtake markets. As a result, Babban Gona can purchase agricultural inputs in bulk, offering better prices to the farmers, who purchase these inputs on credit. It can also secure better deals on the sale of produce in commercial markets, given the volumes it is able to trade in.

Today, Babban Gona serves more than 20,000 smallholder farmers—40% of whom are youths—helping them move from subsistence to commercial farming.\textsuperscript{24} Smallholders affiliated with Babban Gona obtain crop yields that are generally two times higher than the national average.\textsuperscript{25} Farmers also command sale prices that are close to one-third higher when selling crops through Babban Gona, as compared to doing so directly to other intermediaries.\textsuperscript{26} As a result, the income of smallholders working with Babban Gona is, on average, two and a half times higher than that of the average Nigerian smallholder farmer.\textsuperscript{27}

Babban Gona’s model is also helping set inclusion as the norm in the market. It has led the way for other innovative inclusive agriculture enterprises, such as Thrive Agric and Farmcrowdy, to start operating in Nigeria. Though their model varies slightly to Babban Gona’s, especially as they seek financing for farmers through crowdfunding, they have retained the core extension services of the model.

The story of Babban Gona provides valuable lessons in how donors and concessional investors can deploy their capital to support inclusive growth (see Figure 8 – page 33). Actors that supported Babban Gona throughout its journey did so in unique ways, showing exceptional flexibility and developing innovative deal structures. In this section, we uncover how both of these factors were critical to enabling inclusive growth.
ADVANCING GROWTH: ESTABLISHING CREDITWORTHINESS TO STRENGTHEN CAPACITIES

Like GADC, Babban Gona has high working capital needs driven by the financing it provides to smallholders. However, with limited assets to offer as collateral and no credit history, the enterprise struggled to secure commercial bank loans early on. Seeking much-needed finance, the enterprise turned to DFID-funded programme Propcom Mai-karfi (PMk). There was strong alignment between Babban Gona’s work and the focus of PMk. PMk was particularly interested in the outsized impact it could have on smallholders by supporting Babban Gona, especially if it could help the company attract mainstream bank finance further down the line.

Yet, despite the alignment, PMk had been set up to engage in grant-making and lacked the ability to provide debt to enterprises. It took over a year and significant flexibility from both the PMk and DFID teams to adapt the programme and structure a debt instrument for the investment. In 2013, PMk finally invested $260,000 through a bond issued by Babban Gona. The cost of capital on this bond was below market rates, giving Babban Gona additional flexibility. PMk went on to invest in a second bond of $140,000 in 2014 and, reinvesting the capital and accrued interest from the first bond, in a third subcommercial bond in 2015.28

These bonds enabled Babban Gona to scale its model: during the two-year tenure of the 2013 bond, Babban Gona grew its smallholder base fivefold. More importantly, they did so without the excessive pressure for returns that commercial capital would have created. Beyond supporting Babban Gona’s growth, the PMk bonds helped the enterprise build its financial track record. Other lenders could now be comfortable in the knowledge that Babban Gona was indeed able to access and repay its lenders.

ADVANCING INCLUSION: STRUCTURING INVESTMENT TERMS TO ENTRENCH INCLUSION

Through their journey, enterprises can face tensions between their inclusion impact goals and the pressure to generate attractive returns for investors. These tensions can lead to impact trade-offs or mission drift; for example, it might be more profitable to serve more affluent customers or to reduce the prices paid to farmers for their produce.

As an impact-oriented enterprise moves from being funded by development-focused actors to having more mainstream investors in its shareholder base and on its board, one might expect these pressures to intensify.

One way of safeguarding an enterprise’s inclusion focus is to bring its intended beneficiaries directly into ownership and governance, and this is precisely what Kola Masha and the Gates Foundation did with an innovative $4 million grant in 2015.29 This grant funded an issue of Babban Gona shares that was transferred to smallholder farmer members. As a result, smallholders now own 30% of the com-
pany through a Farmer Trust, and a farmer representative now sits permanently on the company’s board with full voting rights. Farmers also have veto rights over changes to key aspects of Babban Gona’s business, including the pricing and margins on the inputs sold to them.

In addition to supporting Babban Gona’s continued development and growth, this grant has entrenched smallholder inclusion in the company’s core business model. Indeed, it has transformed the role of smallholders in the model from just being participants in the value chain, to being owners and stakeholders in the business itself. From the Gates Foundation’s perspective, this helps secure Babban Gona’s inclusion focus in a range of possible future scenarios, such as a change of leadership. Orin Hasson, from the Gates Foundation, explains, ‘The main risk we saw to Babban Gona’s impact was Kola having to leave. We therefore had farmers own part of the company, which underpinned its social goal’.

Babban Gona has also worked with another investor to embed inclusion outcomes within deal terms. In 2017, Babban Gona secured a $2.5 million mezzanine debt investment from the Global Innovation Fund (GIF) with impact incentives that provided a more favourable interest rate as the total farmer income increased.³⁰

ADVANCING GROWTH: MEETING THE REQUIREMENTS OF SENIOR LENDERS TO ENCOURAGE INVESTMENT

The Gates Foundation’s $4 million grant was also the first in a series of catalytic investments from development actors that helped Babban Gona build a capital structure with a strong equity base. This structure then facilitated later success at securing loans from more mainstream, commercial lenders. These investments included GIF’s $2.5 million mezzanine investment, and an additional $1.8 million in subordinated debt from Skoll Foundation and Fundación Netri, received between 2016 and 2018.³¹

At the time, both the Gates Foundation and GIF wanted to be strategic in how they deployed their capital. They wanted their investments to not only serve Babban Gona’s present capital needs, but also to help the enterprise meet the requirements of future investors. Investment officers at both organisations therefore engaged directly with potential follow-on lenders, including European DFIs.

Through these conversations, they understood how their grants and subcommercial capital could encourage investments from these potential follow-on investors. One key input surfaced in these conversations was the importance of building a strong equity base. Bram Thuysbaert, from FMO, explains that ‘one of the critical pieces we look at before investing is the [enterprise’s] balance sheet structure—in Babban Gona’s case, they had built a good level of buffer in equity and subordinated debt, which gave us confidence [that] we could come in’. With that in mind, the Gates Foundation’s grant funded an issue of common equity to smallholders, and GIF structured its investment as mezzanine debt—both of these had the effect of strengthening senior lenders’ assessments of Babban Gona’s equity base.
Case study highlights

- Grants and subcommercial capital can be used to entrench inclusion, helping mitigate the risk of impact trade-offs as enterprises grow and face pressures to generate attractive returns.

- Development-focused investors should seek to understand the investment requirements of potential follow-on mainstream investors, and help investee companies meet them. Some of Babban Gona’s investors were strategic in seeking inputs from potential follow-on lenders, which helped them structure their investments and provide targeted support accordingly.

- Development-focused investors should adjust the type of capital they provide based on the enterprise’s needs, even when such needs do not fit the instruments that they traditionally deploy. The ability of PMk to be flexible and provide debt to Babban Gona in lieu of grants significantly helped the enterprise strengthen its capacities and was catalytic to further attract capital down the line.
Interactions with commercial investors also surfaced additional requirements. One of these was a strong preference for financial audits prepared by a top-tier global accountancy firm rather than local firms; in response to this, GIF added a requirement for Babban Gona to engage such a firm. Babban Gona also developed policies to mitigate climate change and price fluctuation risks, which were critical to reduce the perceived investment risk for DFIs. The policies demonstrated that Babban Gona’s leadership was aware of potential issues that could affect its operations, and had a clear plan to mitigate them. Commercial investors also shared the estimated cost of capital on their loans, which validated strategic decisions that Babban Gona made in order to absorb these future costs.

Between 2016 and 2018, Babban Gona raised over $5.4 million in subordinated debt. This capital helped attract commercial capital. Since 2017, Babban Gona has tapped a total of $16 million of commercial capital, three times the amount of its subordinated debt over the same period. Senior loans provided by commercial investors include $4 million from FMO’s MASSIF Fund in 2017 and $5 million from the Nigeria Sovereign Investment Authority in 2018. Babban Gona also secured $2 million from the Belgian Investment Company (BIO) in 2019, for which actual disbursement is expected to occur in early 2020.

Both BIO and FMO lend to Babban Gona via local banks as a way to reduce the enterprise’s currency risk exposure. The DFIs use a back-to-back system whereby they make foreign currency loans that Babban Gona then uses as collateral to secure Naira-denominated loans from Nigerian banks. Beyond keeping the company’s finances in Naira, this structure enables Babban Gona to fuel its growth with debt at interest rates similar to those that local banks offer corporate clients.
LESSONS

Supporting a Disrupt and Grow pathway

The stories of these three enterprises illustrate key lessons on how development actors deploying grant and subcommercial capital can do so more effectively to support inclusive growth in the Disrupt and Grow pathway:

1 Use grants and subcommercial capital to advance inclusion

Different kinds of capital can target a range of levers relating to inclusive growth, and there are tendencies for certain kinds of capital to address certain levers, as explained in Chapter One.

The essential role of grants in advancing inclusion is clear in all of these cases, even in a situation where the business started out with a commercial investment, as was the case with EthioChicken. The ultimate flexibility provided by grant capital allowed companies to refine their pioneering business models through multiple cycles of trial and error, and also expand participation to more smallholders in situations with a weak or uncertain financial payoff.

Meanwhile, the critical role of subcommercial capital in strengthening capacities is notable, allowing young companies such as GADC and Babban Gona to gradually build out their operations and demonstrate a solid track record in servicing their debt, ultimately enabling them to access commercial senior debt later on as they seek to scale. Notably, in supporting Babban Gona, PMk recognised that its initial mandate to only provide grants would not help the company to build its track record as a borrower. PMk was able to adapt its structures and approach to provide debt instead, helping the company to move in time towards raising commercial finance.

Each enterprise studied here required a range of different kinds of capital over the course of their journeys, and often even had a combination of different kinds of capital coming in at a single point in time. Considerable time and energy from the entrepreneur is expended in pulling together the overall investment needed for the business, and there is always the risk
that the right capital does not present itself at the right time. As such, there is greater scope for investment platforms that deploy or coordinate various types of capital, through a range of different instruments, to help growing enterprises move more smoothly through their capital journey and be less reliant on serendipity in the process.

2 Plan for progression towards commercial capital to advance growth, but do not expect a linear path to graduation

One marker of success that is often used in the context of subcommercial capital supporting inclusive growth is the extent and pace at which enterprises access commercial capital over time. We see movement in that direction in the story of GADC, where its factoring facility grew from $1.4 million in 2010 to $8.5 million in 2018, with returns expectations gradually edging closer to those of commercial lenders. At the same time, the facility helped GADC demonstrate a consistent record of repayment that has been important in securing subsequent commercial loans.

However, complete ‘graduation’ (if defined as a complete transition to commercial capital) may not be achieved, and also may not be entirely desirable if the intent is to continue advancing inclusion where feasible. As such, progression to commercial capital is a more useful notion, with two caveats for practitioners to bear in mind.

The first is that it takes time to progress to commercial capital, and this time scale varies from enterprise to enterprise. It depends on a range of factors including the kind of business model being pursued—for instance, the offtake models that we looked at took longer to build and scale than the input provider models—and the degree of challenge faced by the enterprise in its context.

The second is that such progression mainly takes place on the advancing growth side of the capital levers framework. Given that commercial capital typically does not play a significant role on the advancing inclusion levers, we continue to see enterprises tap grants to advance inclusion, even as they receive commercial capital to fuel growth and scale. Successful later-stage grants require enterprises to leverage their own resources, aligning incentives for success and limiting the potential for enterprise and market distortion.

Having said that, progression towards commercial capital for advancing growth is important and there is a need for investors to be intentional in working towards this goal. Babban Gona’s journey demonstrates how grant and subcommercial capital can help an enterprise refine its model, scale inclusion impact and reach a stage where it can access commercial capital. As it evolved, Babban Gona developed its operational and financial track record, while expanding its inclusion impact.
One example is that of PMK’s adaptation to deploying debt instead of a grant, already mentioned above. Another is the way in which GIF approached its investment in Babban Gona based on input from senior lenders that it hoped ultimately to draw in. As a result, GIF structured its investment as mezzanine debt to improve the way in which potential senior lenders assessed the company’s capital base, whilst also building in additional requirements to reduce the perceived risk for commercial investors. Babban Gona had also reached a scale where its capital needs aligned with the larger loan sizes that DFIs could provide—FMO had previously considered investing in Babban Gona, but the company’s capital needs were too small for the DFI to get involved then.

These elements were critical for DFIs like FMO and BIO to invest in the business. At the same time, as it has moved toward commercial capital, the enterprise has continued to tap grant funding to refine its business model. The $77,000 grant from DFID-funded programme GEMS4 served to test the enterprise’s expansion into rice.\(^3\)\(^7\) Provided in 2017, it was smaller than previous grants and designed as an interest rate subsidy to cover the premium that local banks charged on the new crop. Accessing a grant enabled Babban Gona to reduce the pressure involved in testing a new vertical that had uncertain returns. At the same time, the size and conditions of this grant meant that Babban Gona would not lose the incentive to continue moving toward commercial capital.

**Entrench inclusion in incentive, governance and ownership structures**

In a context where the aim is for enterprises to scale their businesses profitably and progress to more mainstream sources of capital, it is wise to consider how inclusion will continue to be safeguarded within their models. In other words, how to entrench inclusion in models and enterprises. History suggests that inclusive enterprises can suffer from ‘impact drift’ as commercial pressures and investor return expectations increase. One salutary example is that of the microfinance sector in India, which overheated and suffered a devastating crisis just as it began to enjoy mainstream financial acceptability and success.\(^3\)\(^8\)

While we only saw two examples of investments in our research that targeted the *Entrench Inclusion* lever, both are worth highlighting here. One is GIF’s loan to Babban Gona, which built in incentives for inclusion impact results, providing a degree of balance in an environment where such strong incentives are provided for financial results alone. Another, more radical, example is the Gates Foundation’s grant to Babban Gona enabling smallholders to be brought into the ownership and governance of this disruptive business model. As owners, smallholders have board representation and voting rights, giving them influence over such key decisions as offtake prices, and they will also be able to participate in the financial upside of the Babban Gona model itself, opening up the potential for more transformative economic uplifts in the long run.
Engage with the local financial ecosystem to sustain inclusive growth

Given that these enterprises will continue to have ongoing (and growing) capital needs as they scale, there is considerable value in engaging the local financial ecosystem in seeking to meet these needs. This entails foreign concessional investors understanding the extent to which local financial institutions engage with inclusive enterprises, being cautious not to undermine them by inadvertently taking away the most promising pipeline of inclusive enterprises.

In addition to opening up new channels for finance, engaging local financial ecosystems can also enable enterprises to more easily receive investment in local currency. Beyond limiting market distortions, this also reduces the foreign currency exchange risk, which is particularly acute for African economies prone to currency fluctuations. In the case of Babban Gona, FMO’s senior loan was structured as a US dollar loan that the enterprise then used as collateral to take out a Naira-denominated loan from a Nigerian bank. In the next chapter, we will explore this further and consider ways to engage more systemically with local financial institutions.
In this chapter, we look at a different pathway to change, in which a number of smaller enterprises in existing markets gradually move into more inclusive practices, supported by development actors. When a critical mass of enterprises adopt these practices, and ecosystem conditions change to support them, prevailing norms in the market begin to shift. Ultimately, the rest of the market—including the largest players in the market—follows suit, setting inclusion as the new norm in the market. We call this pathway Guide and Shift.

We see a range of development actors with potential roles to play in guiding these market-level shifts. Governments can shape the rules of the market through policy change and regulatory frameworks that favour inclusive growth. They can also strengthen the infrastructure that enables markets to operate effectively—physical infrastructure, law-enforcement systems and access to critical resources like water and energy. Donors and international aid agencies can fund and support ecosystem interventions that enable enterprises to engage smallholders in meaningful ways. These interventions can involve training farmers and increasing their productivity, supporting knowledge exchange among market players and closing value chain gaps. There is also a role for investors to play in supporting individual enterprises as they refine their business models to adopt more inclusive practices and reach more smallholder farmers.

Enterprises leading the change in the Guide and Shift pathway fit what the Collaborative for Frontier Finance describes as ‘Dynamic Enterprises’, which resemble conventional SMEs. Compared with the High-Growth Ventures profiled in the previous chapter, these enterprises operate on established business models rather than trying to pioneer new ones, and grow more incrementally over time. These entrepreneurs are more risk averse and may lack formal business knowledge and skills; they are also typically unlikely to consider inclusion as a core priority. As a result, these enterprises have a weaker inherent orientation towards and capacity for innovation for inclusion, so there is a greater role played by external development actors in stimulating progress.

Development actors and impact investors can play a role in getting a critical mass of enterprises to move towards greater inclusion. They can highlight the success of early adopters to encourage other enterprises to adopt inclusive practices and models. However, that is often not enough to persuade a
significant number of enterprises. A complementary approach is therefore to put pressure on secondand third-mover enterprises by increasing the business risk of not being more inclusive. As we will see in the following sections, both of these approaches can be critical to support sector-level movement towards inclusive growth.

From our research, we have seen that a Guide and Shift approach has far greater potential for impact. It also involves broader changes that do not rely on any individual enterprise and, because they happen across a market, are harder to erode. However, it is not always the right approach. Not all markets will be ready for this type of change, and not at all points in their development. This approach is also more complex in execution: it involves a range of actors and actions in parallel, to bring about change across an entire market.

As we will see in this chapter, windows of opportunity are crucial to determining if and when a Guide and Shift approach can catalyse change. We characterise windows of opportunity as significant, sudden disruptions in a market that provide an opening for a number of simultaneous changes. Structural policy reforms, political upheavals, financial crises and rapid changes in consumer demand can all lead to windows of opportunity for change. In this chapter, we tell the inclusive growth story of two sectors in different parts of Africa: the export-focused mango cluster in Burkina Faso, and the domestic-oriented dairy market in Kenya. Both of these case studies have seen change happen across entire markets. In the sections that follow we highlight lessons for how capital can play a role in supporting this type of change.
The inclusive growth journey of the mango-drying sector in Burkina Faso highlights how market facilitation can play a role in supporting a collection of existing SMEs to adopt a new model and grow their inclusion impact. It also shows how changes in global demand can lead to important windows of opportunity for change where external actors can facilitate the link between new demand and existing supply channels.

**SNAPSHOT: MANGO DRYING IN BURKINA FASO**

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<tr>
<th>SECTOR HIGHLIGHTS</th>
<th>INCLUSION IMPACT</th>
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<tr>
<td>- As a crop, mango requires manual selection and picking to avoid bruising, thereby giving smallholders an advantage over mechanised alternatives</td>
<td>- Has impacted more than 10,000 smallholders and employs more than 7,000 people</td>
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<td>- Mango-drying enterprises that adopt modern tunnel dryers can process significantly higher volumes of mango</td>
<td>- Dried mango represents a new sales channel for smallholders</td>
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<td>- The sector relies on exports to global markets, in particular the US and Europe</td>
<td>- Improves smallholders income, with farmers earning three times as much for sales in the drying value chain versus the local market</td>
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This journey can be described as a progression through three different phases of market change:

**1. An emerging window of opportunity**

The early 2000s saw a rise in global demand for dried mangoes. Alongside it was the growth of the export market. At the same time, local fresh mango production did not meet international standards, and smallholders in Burkina Faso saw up to half of their harvest go to waste.⁴⁰
The industry was stagnating and local players could not benefit from the growing demand for dried mangoes in Europe and the United States. They lacked the capacity and the technology to meet consumer preferences, and did not have sufficient knowledge of what was needed to meet this demand.

2. Market building

In this context, the World Bank launched the Agriculture Diversification and Market Development Project (PAFASP) in 2006. The project aimed to enhance farmer livelihoods by improving the efficiency of a number of existing value chains, including mango.

PAFASP introduced new technologies that enabled local SMEs to compete globally, grow their local activities and source more mangoes from smallholders. The programme introduced a more efficient technology into the market, the tunnel dryer, which also produced better quality dried mangoes. SMEs could now sell their products to export buyers in different parts of the world.

3. Model proliferation

Over the past decade, the mango-drying sector has experienced a wave of modernisation and growth. A cluster of more than 70 mango-drying SMEs has emerged, now employing more than 7,000 people. Most of these enterprises use the modern tunnel drying technology and sell their products on international markets. With close to 2,000 metric tons of dried mangoes exported in 2016, the channel now absorbs more than one-third of total mango production in Burkina Faso.

As it has grown, the mango-drying sector has also become more inclusive of smallholder farmers. Through mango sales, smallholders can generate income during the summer months, when other crops are not harvested. Dried mango also represents a new sales channel for produce that was previously going to waste. In addition, farmers earn $30 per tonne of mango sold in the drying value chain, double what they can earn for fresh mango sales on the local market.

The mango sector’s journey toward inclusive growth has been supported by different types of capital deployed by a range of actors to address the needs of different enterprises over time (see Figure 9 – page 43). In the sections below, we explain how ecosystem facilitation efforts have played an important role, alongside direct investments into mango-drying enterprises.
FIGURE 9 – BURKINA FASO MANGO SECTOR JOURNEY

Window of opportunity:
- Rise in global demand for dried mangoes
- Existing mango production in BF

Market building:
- Introduction of modern Tunnel dryer technology to leading SMEs
- Local manufacturing of Tunnel dryers in West Africa (Mali)

Model proliferation:
- Adoption of Tunnel dryer technology by other SMEs

Ecosystem interventions
- CEAS
- COLEACP
- PAFASP (World Bank)

Dynamic enterprises
- COOPAKE
- Tensya Guampri
- Santé Sechage Export
- Fruiteq
- Groupe Waka
- SINTE

Degree of enterprise inclusion (darker = greater inclusion)

Sector-level mobilisation of commercial capital

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| Grants | Subcommercial capital | Commercial capital |

Note: Charts not exhaustive; recording only known transactions
MARKET BUILDING: ENABLING ENTERPRISES TO ADVANCE INCLUSION

Preparing a market for inclusion can be a wide-ranging endeavour. It could require building local capacity of enterprises and farmers, as well as creating public goods that benefit multiple market players. Achieving this typically involves intervening across different parts of the ecosystem, often without the possibility of direct financial returns. Development actors will then need to grant-fund ecosystem interventions to set the foundations for inclusion that market players can then build on.

In the early 2000s, mango SMEs in Burkina Faso had low productivity, used obsolete technology and produced mangoes that were too dry for the taste of consumers in export markets. These enterprises also lacked the resources and the capabilities to invest in better drying equipment.

The World Bank’s PAFASP intervention sought to address these challenges. It provided grants that subsidised the purchase of modern tunnel dryers for three Burkinabé SMEs—Fruiteq, Tensya Guampri and Sanlé Séchage Export—that were among the first adopters of this new technology. PAFASP also engaged South African multinational MPAK, who made commitments to purchase these enterprises’ products. The programme also provided technical assistance on business management to these three SMEs, with a view to strengthening the enterprises’ ability to compete and grow beyond the terms of the agreement with MPAK.

The grant subsidy reduced the risk borne by local enterprises when refining their model to meet global consumer requirements. At the same time, the enterprises matched these grants with their own resources, which helped ensure that they had a sufficient incentive to work towards making the project a success. By supporting multiple enterprises, PAFASP was also able to demonstrate the advantages of the new technology across a number of players, with the intention of then using the successful results to encourage other enterprises to adopt modern drying technologies and practices.

PAFASP went beyond working to demonstrate the business benefits of this new technology, and created the conditions for other enterprises to adopt it. The programme worked with a Mali-based manufacturer to start the local production of tunnel dryers. This enabled the adaptation of these dryers to local operating constraints. It also facilitated access to modern drying technology by reducing the costs for market players in Burkina Faso and beyond. As a result, multiple organisations migrated to tunnel dryers, which helped grow exports from 300 metric tonnes in 2010 to close to 2,000 metric tonnes in 2016, a 30% increase per annum.

MODEL PROLIFERATION: ADVANCING THE GROWTH OF MORE INCLUSIVE MODELS

Once the foundations for inclusion have been laid and first-mover enterprises have adopted more inclusive practices, advancing the growth of these inclusive models requires proliferating them amongst a wider range of enterprises. In Burkina Faso, as more enterprises saw the benefits of the
modern tunnel dryers, the perceived risk of purchasing them decreased. However, access to capital for financing these new assets continued to be a major barrier to wider market change.

Early acquisition of assets

High up-front cost was one of the primary barriers to adoption of modern mango drying. Most enterprises could not self-finance the required investment into drying equipment, and struggled to access bank loans, given their limited financial track record and their lack assets to use as collateral.

When Georges Ido started the Société Industrielle de Transformation des Fruits (SINTF) in 2014, he faced these exact challenges. Despite his experience managing a mango-drying unit for multiple years, Georges was unable to secure a loan from a local bank. Without sufficient savings to build the initial facilities, Georges applied for a government grant that he received in 2016. The $40,000 government grant covered the construction of drying facilities, and required SINTF to self-finance the dryers, worth $120,000. As the enterprise scaled, the equipment also served as collateral with which the enterprise obtained a $100,000 bank loan to purchase additional tunnel dryers.

Alternative routes to financing

Accessing bank finance remained a challenge for many enterprises as they grew. Banks charged high interest rates and required collateral that could sometimes be twice the value of a loan. Banks also had other complex requirements—one entrepreneur had to engage a solicitor, purchase health insurance and go through multiple health exams before taking out a loan. Together, this resulted in significant costs for enterprises and major time investments for entrepreneurs.

Instead of going to the banks, some of these enterprises sought subcommercial debt finance from impact investors. One of these is the Coopérative Agricole du Kénédougou (COOPAKE). In 2016, after completing several loan cycles with local banks, COOPAKE turned to UK-based impact investor Shared Interest and secured a loan to prefinance the purchase of fresh mangoes from smallholders. The loan had a simpler application process, and lower collateral requirements. It also had interest rates that were 2 to 4 percentage points lower than those offered by commercial banks, resulting in an appealing proposition for the Cooperative. Other enterprises secured loans from their buyers. Sanlé Séchage Export obtained an equipment loan from OTC Holland and Tradin Organics. The loan, worth $630,000, was part of a $1.2 million investment the enterprise made to purchase mango-drying and packaging equipment to fuel its growth.

Securing subcommercial capital from buyers and impact investors involves significant relationship and trust building. These subcommercial investors typically offer shorter-term, smaller loans in the early stages of their relationship with an enterprise. As the relationship evolves over multiple loan cycles and seasons, investors grow their exposure, sometimes extending loans for enterprises to invest in assets. Sanlé Séchage Export’s loan from its buyers only materialised after six years of working with
them. Although the cost of capital ends up being lower for enterprises, the opportunity cost is high: building these relationships takes time and can constrain the growth of mango dryers who want to expand rapidly.

As enterprises became increasingly able to meet mainstream borrowing requirements, they were able to secure bank loans. Groupe Waka, for example, obtained loans from local banks in 2017 and 2018 to purchase additional mango-drying equipment, after self-financing their initial purchase of dryers in the early 2010s.
The journey of Kenya’s dairy sector highlights how individual enterprises can be important contributors to shifting market norms towards greater inclusion. It also reinforces the role of market facilitation in preparing the foundation on which enterprises can later adopt more inclusive practices. Further, this case study underlines the importance of coordinating different types of support, including donor programmes and individual investments, to achieve inclusion impact at scale.

**SNAPSHOT: DAIRY IN KENYA**

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<tr>
<th>SECTOR HIGHLIGHTS</th>
<th>INCLUSION IMPACT</th>
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<tr>
<td>Dairy processors buy raw milk from small-holder farmers, including those that produce their own milk</td>
<td>Has impacted more than 1.8 million smallholders, a 260% increase since 1990</td>
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<tr>
<td>Milk production has increased, with 4.1 million litres produced in 2016</td>
<td>Improves smallholders income, with higher farm gate prices and more sales channels</td>
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<tr>
<td>The sector focuses on domestic sales, with steady increases in consumer demand since the 1990s</td>
<td>Productivity has increased by over 40% since 1992</td>
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<td>Results in nutrition and health benefits for consumers, especially given recent improvements in milk quality</td>
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As with the mango sector in Burkina Faso, the transformation of the Kenyan dairy sector has been the result of a number of different phases of change, and has gone further: it has not only achieved much larger scale, but also has shifted market-wide norms towards greater inclusion, which was not observed in the case of mango production.
1. Capitalising on a window of opportunity

In the early 1990s, a wave of macroeconomic reforms reshaped the Kenyan economy. As part of these reforms, the Dairy Development Policy was implemented in 1993, liberalizing the milk industry. The Kenya Dairy Board stopped regulating milk prices. It also abolished the monopoly on urban milk markets that had been held by the Kenya Cooperative Creameries (KCC) for the past 60 years, opening up the market to new entrants.

In the wake of these changes, new dairy processing enterprises sprang up across the country, eager to win a slice of a market that had long been closed off. Some of these were commercial dairy farms, like Brookside, Delamere and Illara, moving into processing and marketing. Others, such as Happy Cow Dairy and Eldoville Dairies, were smaller enterprises set up specifically to tap this new market opportunity. These smaller enterprises initially sourced raw milk from their own dairy farms but, as domestic demand for dairy grew through the 1990s, many of them saw the need to purchase milk from other producers, the vast majority of whom were smallholders.

2. Market building

However, low productivity constrained smallholder production and the growth of the overall domestic market. In response, a series of donor interventions were launched from the late 1990s to address these value chain issues. Executed with the support of the Kenyan government and a range of NGOs, the programmes tackled the lack of technical and managerial capacity among smallholders, the poor access to quality farm inputs and the limited financing avenues for smallholders.

On the back of increased supplies of raw milk, dairy processors expanded into new product lines through the early 2000s. Eldoville started producing yoghurt, and Happy Cow expanded to cheese, yoghurt, fresh cream and ghee. Despite this movement towards value addition, smallholders continued to focus on selling raw milk, lacking the technical knowledge and managerial capacities to expand their operations.

3. Model proliferation

The Githunguri Dairy Farmers Co-operative Society was one of the first farmer-owned enterprises that moved into value addition, marketing processed milk and other dairy products to consumers. By doing so, the Cooperative captured value across a greater portion of the dairy value chain. And, while it was initially hard to compete against market leaders like Brookside Dairy and the New KCC, Githunguri Cooperative has controlled the third-largest share of the market since 2008.

As the domestic demand for dairy products continued to grow, so did the pressure for higher-quality standards. This increased the need to source better quality raw milk. However, many dairy processors could not discern which farmers offered higher or lower quality. Differentiating the milk’s quality required engaging with smallholders in new ways.
Smaller enterprises like Eldoville and Happy Cow began paying price premiums to smallholders whose milk met the requisite quality standards. They gained the loyalty of smallholder farmers to whom they paid better prices, helping set fairer prices as the market norm.

4. Norms shift

From an inefficient monopoly in the early 1990s, the dairy sector grew significantly over the years. Cow milk production in Kenya exceeded 4.1 billion litres a year in 2016, a 64% increase since 2001.\(^{51}\) In the same period, the proportion of milk production sold through formal channels rose from 6% to 16%.\(^{52}\) This meant that end consumers received better-quality milk, as formal sector processors had to comply with national standards, unlike informal sellers.

The sector’s growth and formalization also brought about a higher level of smallholder participation in the market. More than 1.8 million smallholders were engaged in milk production in 2016, a near threefold increase since 1990.\(^{53, 54}\) Smallholders also had more channels through which to sell their milk, and commanded a higher price for it. In 2008, they received $0.30 per litre of milk, close to double than what they did in 1996.\(^{55}\)

An increasing number of dairy processors saw the benefits of including smallholders in their business model, and did so. As this happened, pressure grew for market leaders who saw their supply of raw milk threatened. These other players soon began to match the practices that first-mover enterprises had adopted: they guaranteed the purchase of milk to smallholders, provided inputs and credit to farmers and paid them fairer prices. Market leader Brookside Dairy, for example, saw a significant increase in the number of farmers it could purchase raw milk from after it increased farm-gate prices by 42% in 2018.\(^{56}\) With a critical mass of players adopting inclusive practices, the prevailing norms in the market effectively shifted—deep engagement with smallholders had become a key to success.

Throughout the sector’s inclusive growth journey (see Figure 10 – page 50), different types of capital played different roles. Ecosystem interventions addressed market-level challenges to enable the inclusion of smallholders into the dairy value chain. Grants and subcommercial capital helped enterprises adopt and retain inclusive practices, while remaining financially sustainable. As the sector evolved, commercial capital also played a key role in advancing the growth of inclusive models. In the following sections, we take a closer look at the role that different kinds of capital played in bringing about these changes.
MARKET BUILDING: INCREASING SMALLHOLDER PRODUCTIVITY TO ADVANCE INCLUSION

Events like major policy reforms can open significant windows of opportunity for change. However, events alone do not guarantee that a market will move towards inclusive growth. Achieving this requires a concerted effort to lay the groundwork for inclusion, which often involves a range of different actors.

In Kenya, smallholder farmers only produced 56% of Kenya’s raw milk, despite owning over 80% of dairy cattle. They struggled to improve their cattle breeds after government-run artificial insemination programmes had stopped in the late 1980s. They lacked the knowledge and the resources to adopt better feeding practices, and struggled to sell milk beyond informal traders.

Tackling this challenge required a high level of investment that individual dairy processors could not bear on their own. Moreover, market players had little incentive to address value chain gaps, as this would benefit their competitors. Commercial investors also had low incentives to support the development of the value chain, given that these efforts would not yield direct returns. In the absence of action from market players, external facilitators had an important role to play in including smallholders in the dairy value chain.

A range of ecosystem interventions funded by USAID and other donors supported the aggregation of smallholders in dairy farming regions. Initial interventions focused on strengthening smallholders’ management capacity and improving their ability to collect, store, market and distribute raw milk. Later interventions also provided credit and technical assistance that enabled farmers to access better breeding technologies and superior feed and fodder. Within six years of the first USAID intervention, milk yields had increased by 36%. Farmers could sell more milk, and dairy processors could buy it in a more consistent way.

MODEL PROLIFERATION: SUPPORTING THE DEVELOPMENT OF INCLUSIVE MODELS

Increasing farmer productivity laid the foundation for inclusion by enabling enterprises to include smallholders into their value chain. After an initial wave of enterprises adopted more inclusive practices, the challenge was deepening inclusion, while still advancing growth. In Kenya, this first happened when smallholders captured greater portions of the dairy value chain, and later when they increased the price they received for better-quality raw milk.

Moves into value addition

When the Githunguri Cooperative first tried to move into milk processing and distribution, it struggled to secure commercial bank loans—lending to a cooperative that had been affected by cor-
ruption and mismanagement in the past was too risky for the banks. In 2003, impact-focused lender Oiko Credit stepped in with over $2 million in loans for the acquisition of dairy processing facilities. While its loans charged prevailing market rates of interest, Oiko Credit took on a higher level of risk than mainstream lenders were willing to accept. Beyond entrenching inclusion, these loans also strengthened the Cooperative’s capacities by building its asset base and its financial management capabilities. Oiko Credit also offered a more flexible application process and capacity-building support alongside the loan. As a result, the Cooperative was able to move into milk processing and distribution, creating a business that today has the third-largest share of the dairy market.

Oiko Credit also provided a grant to train smallholders in collecting and converting cow dung into biogas, reducing both environmental impacts and energy costs. Oiko Credit’s grant only partially funded the extension services and only for one year, but the success of the initial efforts then led the Githunguri Cooperative to sustain these services from its own funds.

**Price premiums for high-quality raw milk**

Although Happy Cow purchased raw milk from smallholders at the outset, the need to source better-quality raw milk became apparent as demand grew. To do so, the enterprise wanted to implement a payment system that rewarded farmers for better-quality milk. However, investing in quality-testing equipment was expensive, and working directly with smallholders was new for the business.

In 2014, Happy Cow received a $385,000 grant from the Netherlands development agency, SNV, to offset the cost of setting up a quality-testing laboratory. In addition to the grant, SNV required that Happy Cow contribute its own funds to cover a portion of the cost, which the enterprise did through a $185,000 commercial bank loan. Equipped with this new technology, Happy Cow was able to identify high-quality suppliers and purchase milk with higher fat content.

SNV’s support also required Happy Cow to work closely with two dairy cooperatives. SNV grants provided technical assistance in dairy husbandry and facilitated the purchase of better cooling facilities for these cooperatives. At the same time, Happy Cow implemented a quality-based milk payment system for the farmers. Smallholders now had both the tools to improve milk quality and an incentive to do so.

Around the same time, the Rabo Foundation was exploring new ways to extend credit to smallholder farmers. It started channelling low-interest rate loans via Happy Cow, who discounted loan instalments from farmers as it bought their milk. This complementary system further deepened the ways in which Happy Cow was inclusive of smallholders, and strengthened the relationship between the enterprise and its supplier base. Smallholders used the loans to finance the purchase of better inputs, and Happy Cow benefitted from sourcing higher-quality raw milk.
Inclusion in the face of unforeseen shocks

Beyond advancing inclusion and supporting the growth of enterprises as they became more inclusive, subcommercial capital also helped small enterprises absorb unexpected shocks in remaining inclusive. In 2017, Nakumatt, one of Kenya’s largest supermarket chains, filed for bankruptcy and halted payments to its suppliers. Nakumatt was one of Happy Cow’s main customers, and its demise resulted in a working capital crunch for the enterprise.

Happy Cow’s relationship with Rabobank came in handy when the Rabo Rural Fund stepped in to help bridge this gap with subcommercial capital. The Rabo Rural Fund provided working capital loans that had a 10% interest rate, lower than the 13-14% offered by most commercial banks. It also offered an easier application process and a longer repayment period, enabled by the existing relationship between the bank and the enterprise. This flexibility helped Happy Cow navigate an unforeseen shock while remaining financially solvent. By early 2019, the enterprise had repaid these loans in full, having returned to a healthy financial position.

NORMS SHIFT: SUSTAINING THE GROWTH OF INCLUSIVE MODELS

The positive results of ecosystem interventions encouraged larger players to source raw milk from smallholders. As productivity increased, market leaders like Brookside Dairy found it easier to complement their own production with raw milk sourced externally.

Capital deployed to help individual enterprises engage with smallholders in more inclusive ways also played a role in shifting market norms. The success of smaller enterprises demonstrated the value of investing in smallholders. Simultaneously, the increasing ability of SMEs to build a loyal supplier base placed pressure on larger processors who risked losing their suppliers. Brookside today provides farm inputs on credit, and has supported smallholder groups to set up cooling centres in a number of counties. It also invests in the Livelihoods Fund, an investment fund set up to improve sustainable farming practices and improve milk productivity among smallholder farmers. Similarly, the New KCC, who holds the second-largest share of the dairy processing market, now also provides smallholders with credit and additional support.

As a critical mass of market players have moved towards inclusive growth, they have increasingly done so financed by commercial capital. Many dairy processors now self-finance inclusive practices, which have become central to their business model. Others are now able to access commercial bank loans. Large corporations and market leaders also mobilise mainstream capital towards inclusion, as their shareholders support their move toward inclusion as a key driver for growth. Over the last few years, the dairy sector has continued to mobilise significant amounts of commercial capital without any erosion to inclusive practices, indicating that prevailing market norms have indeed shifted towards inclusion in a way that is likely to be sustained into the future.
FULL MARKET TRANSFORMATION TOWARDS INCLUSION

Mango drying in Burkina Faso and dairy in Kenya are two sectors currently undergoing a transition towards inclusive growth. As such, they demonstrate some elements of market-level transformation, but do not reveal the full extent to which markets can achieve inclusive growth. Around the globe there are other agricultural markets that have moved further in this direction, shifting prevailing market norms and cementing inclusion as the baseline for market players. In our 2017 report *Shaping Inclusive Markets*, we studied a number of these, two of which we highlight below:

Dairy in Gujarat (India)

In Gujarat, smallholder dairy farmers who were once exploited by milk traders now control India’s largest milk processor, the Gujarat Cooperative Milk Marketing Federation Limited (GCMMFL) which markets a wide range of dairy and related products under the *Amul* brand. GCMMFL has revenues in excess of $4 billion, and its profits flow entirely to the 3.6 million dairy farmers who own it.62

The roots of the market transformation can be traced back to India’s independence movement, a major social and political event that opened a window of opportunity for change. Capitalizing on this aperture, dairy farmers in Gujarat approached prominent independence leaders who helped them organise into a cooperative and supported their move into dairy processing. The model was rapidly adopted across the state, leading to the creation of the GCMMFL, a federation of district cooperative unions. These cooperatives helped farmers rebalance their relationship with local milk traders—they paid fair prices for raw milk, guaranteed the purchase of their milk and increased the share of value captured by smallholders.

When the market was liberalised in the 1990s, new private companies had to model the inclusive practices—including prices and terms—that had been set by the GCMMFL in order to buy raw milk. The cooperatives had successfully changed market norms, embedding inclusion at the heart of the market.

Tea in Kenya

Another example of inclusive market transformation is the tea sector in Kenya, which has turned into a smallholder-inclusive market. Owned by 560,000 smallholder tea growers, the Kenya Tea Development Agency (KTDA) is one of the largest exporters of tea in the world, and consistently achieves premium prices for quality.63

As a result, Kenyan tea smallholders receive much higher prices for their green leaf than their counterparts in neighbouring countries, as well as dividends paid out from the profits of the company itself.

The Kenyan smallholder tea industry was started in the mid-1950s, in the context of widespread discontent over colonial policies whereby native Kenyans were excluded from most commercial activity, including agriculture. To ease mounting tensions, the colonial administration implemented the Swynnerton Plan in 1954, redistributing land and repealing the ban on tea farming for ethnic Africans. This opened up a window of opportunity for the creation of a whole new smallholder tea industry, backed by the Kenyan government, the World Bank and CDC, the UK’s official development finance institution.
The Kenya Tea Development Agency (KTDA) was established to build this new industry: it set up tea plant nurseries and factories closer to smallholders, supplied tea bushes to growers and sourced and sold tea leaves at the weekly Mombasa auction. While commercial tea estate operators were involved in managing KTDA in its first decade of operations, they were displaced by the mid-1970s by native Kenyan managers that had risen through the ranks of the company.

As the sector has grown, KTDA has been instrumental in shifting market norms, moving smallholders from being wage labourers to engaging in independent tea production. In 2000, KTDA brought smallholders into the ownership and governance of the company, entrenching inclusion into the market. The dominance of KTDA in Kenya has also spurred commercial tea estates to develop smallholder outgrower schemes paying attractive green leaf prices, and invest in other inclusive practices such as extension services. It appears that smallholder inclusion has become, and looks set to continue to be, the market norm.
ENCOURAGING INVESTMENT: THE FINANCIAL SECTOR IN KENYA

Running parallel to the development of the dairy sector has been the evolution of Kenya’s financial ecosystem. Since the early 2000s, new types of financial institutions began entering the market with innovative models—from microfinance to mobile money—that challenged incumbent banks. Equity Bank was one of these, which in 1995 began catering to under-banked and underserved populations as part of its competitive strategy. To support this shift, a host of development actors provided loans, technical assistance and staff training for the development of new microfinance products, alongside commercial capital from investors like Helios Investment Partners, an African private equity fund. The EU-funded Equity Bank’s computerization, reducing transaction times and improving customer experience. Microsave and Swisscontact helped the bank redesign its products and services to meet the specific needs of these new customer segments. As it grew, Equity Bank also expanded into other sectors and began extending credit to agribusinesses, smallholder farmers and input suppliers.

Despite some movement, the financing channels for players in the agriculture sector were still limited in the early 2000s. Dairy enterprises struggled to access capital, particularly when they required financing for models that deviated from the status quo in favour of more inclusive practices. To encourage investments into inclusive agribusiness models, USAID’s Development Credit Authority (DCA) program began providing partial-credit guarantees to commercial banks in Kenya. DCA guarantees provided between 2006 and 2017 exceeded $6 million and mobilised $13.5 million in close to 2,000 commercial loans. They also included technical assistance components for both borrowers and lenders. DCA support helped borrowers build financial management systems that could enable them to raise future capital. Technical assistance for lenders helped train bank staff and adapt internal systems to increase the likelihood of future agribusiness lending in the absence of DCA guarantees.

More commercial banks have slowly moved into agriculture sector lending, incentivised by enhancements or encouraged by the success of competitors. However, financial institutions like Equity Bank remain ahead of the curve. In 2017, Arise—an Africa-focused investment venture backed by Norfund, Rabobank and FMO—invested in Equity Bank’s parent company, Equity Group Holdings, to become its single-largest shareholder. Investing at commercial rates, Arise focuses on financial institutions that serve SMEs and engage with the agriculture sector. Through Rabo Partnerships, Arise has also supported Equity Bank in refining its financial products to meet the needs of agriculture enterprises, thereby expanding the options through which they can access capital. With a 12% stake in Equity Group, Arise has direct access to data and decision-making at Equity Bank. As a result, it can play a critical role in ensuring that, as it grows, the bank continues to meet the needs of the customer base that Arise prioritises.
LESSONS

Supporting the Guide and Shift pathway

Bending the arc of whole market development towards inclusive growth can have far-reaching impacts, but it requires consideration of a wider range of aspects than when assessing a single enterprise. Nevertheless, there continue to be some parallels with the lessons from the previous chapter, while some new ones emerge in relation to market change dynamics and the need to facilitate ecosystem change.

1 Support ecosystem facilitation alongside investment in enterprises

Both of our case studies here reflect the interplay between the enterprise and the ecosystem levels in terms of investment and supports needed to enable market change. While a call for ecosystem facilitation is hardly new, we would add that this need is particularly acute in the Guide and Shift pathway in order to move existing Dynamic Enterprises (which are typically SMEs) towards greater inclusion. Compared with High-Growth Ventures, these enterprises are typically less oriented towards innovation, and have lower capacity to be anchor players in reshaping business ecosystems. For example, while investments to expand participation in Disrupt and Grow could be delivered through enterprises such as Babban Gona or GADC, the equivalent lever in this pathway would need to be targeted through ecosystem facilitation programmes that would then seek to engage and support the enterprises involved.

These ecosystem initiatives work best when they build on each other, and when they are reinforced by investments in individual enterprises. Although this was critical to the success of market-level change, the reality is that these efforts tend to be siloed in most markets, and their successful interplay is often as much the result of serendipity as of the efforts of the various actors involved. Being intentional about a Guide and Shift approach calls for different actors to coordinate their efforts in order to provide mutually reinforcing support, both in terms of ecosystem interventions and investments in individual enterprises. One promising avenue is the creation of platforms that can help to coordinate a range of different support to accelerate the pace of change. We return to this idea in the next chapter.
Sense and respond to market change dynamics, including windows of opportunity

Both of the case studies in this chapter show market change progressing through a number of stages: they begin with the opening of a *window of opportunity*, move through *market building* and accelerate through *model proliferation*. In the Kenya dairy case, we also see a fourth stage of market norms shift, leading to widespread transformation across the entire market.

One key implication of this is that it is important to identify and respond to windows of opportunity—or disruptions in market rules or dynamics—that create the space for deeper change to take place. These can result from major policy reforms, social or political upheavals, financial crises, or changes in supply and demand patterns. Therefore, sensing the past and current movements of a market is important to identify if and when it may be ripe for this kind of intervention. Building local knowledge, either through in-country presence or via partnerships, can be helpful in understanding these dynamics and responding appropriately when the opportunity arises.

The kind of support and investment provided also needs to respond to where the market is on its journey of change, and address its needs at that point. These needs evolve as the market develops, changing the nature of gaps and barriers that must be addressed for inclusive models to thrive. In the Kenyan dairy sector, earlier ecosystem interventions in the market-building phase supported farmer aggregation, while more recent efforts in the model-proliferation phase have focused on increasing financing options for dairy SMEs.

Deploy capital based on enterprise needs to advance inclusion and growth

As the market becomes ready for enterprises to adopt inclusive practices, capital can be deployed to individual enterprises as grants or subcommercial investments to facilitate the proliferation of inclusive models.

Grants help enterprises advance inclusion by adopting new practices for which the financial payoffs are unclear. This can occur even when enterprises have operated successfully for a number of years. In Burkina Faso, PAFASP grants helped mango-drying enterprises purchase new equipment when they lacked sufficient resources and incentives to do so on their own. These grants required enterprises to contribute their own resources, aligning the incentives of the companies with those of the programme.

Subcommercial capital plays a strong role in strengthening capacities as enterprises move towards accessing commercial capital. In the previous chapter, we saw how subcommercial capital can and often does target levers that advance both inclusion and growth. In the *Guide and Shift* pathway, however, we see something slightly different: as dynamic enterprises are less focused on innovating towards greater inclusion, subcommercial capital
targets some of the growth levers by strengthening enterprise capacities. Through these concessional investments, enterprises can build their asset base and their financial track record, both of which are critical to helping them access commercial loans in the future.

The provision of technical assistance alongside subcommercial capital has supported dynamic enterprises to achieve this progression. In the Kenyan dairy sector, subcommercial capital helped SMEs build their financial management capabilities and accounting systems, and demonstrate a track record of repayment. This can be particularly important when entrepreneurs or teams do not have a business background or are not experienced at seeking finance: the very process of applying for, obtaining and repaying a loan strengthens the capacity of enterprises by exposing them to the requirements and procedures of lenders. Some investors, such as Root Capital, intentionally align their application processes with those used by banks, to help build the financial acumen of their borrowers. Root Capital also provides additional capacity-building support to enterprises to help them strengthen financial management systems and staff skills.

Finally, and unsurprisingly, we see that commercial capital tends to primarily target the levers that advance growth; in these cases, most enterprises use commercial loans to continue building their asset base and expand operations in the later stages of their development.

Across all of these kinds of capital, a key requirement is to tailor investment to align with enterprise characteristics, needs and preferences. Many of these enterprises will not be seeking equity investment, nor would it be appropriate in any case given their likely growth trajectory. While loans are likely to be a critical instrument with which to finance growth, enterprises may also benefit from other types of facilities, such as trade finance from buyers. We also see opportunities for donors and investors to provide mutually reinforcing support through their investments: for example, the Rabo Foundation channelled smallholder credit through Happy Cow to complement SNV’s grants in support of quality-based payments.

At the sector level, achieving wider change requires a mix of different kinds of capital, delivered through a variety of instruments and initiatives, and led by an array of different players. We see the potential for more coordinated, longer-term, flexible intervention and investment platforms to support change along the Guide and Shift pathway, a thought that we will return to in the next chapter.

**Entrench inclusion at the enterprise level, and work towards shifting norms at the market level**

As in the Disrupt and Grow pathway, entrenching inclusion in the Guide and Shift pathway could entail transferring ownership of enterprises to smallholders. However, this is less likely to have a transformational effect given the lower-scale potential and trajectory of the dynamic enterprises’ characteristic of this pathway.
We see the potential for capital to support entrenching inclusion in a different way: helping existing smallholder groups (such as cooperatives) move into one or more stages of value addition, thereby capturing a greater share of total value in the sector value chain. In the case of dairy in Kenya, subcommercial capital supported smallholder cooperatives to extend downstream: Oiko Credit loans helped the Githunguri Cooperative capture a greater proportion of value by financing the setup of facilities to process dairy products. Today, Githunguri is the third-largest player in the Kenyan dairy market, positioning its farmer members not only as input suppliers but also as business owners, fundamentally changing the power dynamics in the market in favour of smallholders.

Beyond the enterprise level, the case studies in this pathway also illustrate the potential for more far-reaching change once a critical mass of market players adopts inclusive models and practices, such that they shift prevailing norms in the market. In the Kenyan dairy sector, the success of players like Eldoville and Happy Cow contributed to changing market norms around smallholder participation and fairer farm gate prices, while ecosystem facilitation initiatives helped to build conducive conditions relating to smallholder productivity and readiness for participation in improved value chains. All of this proved to be compelling in encouraging corporate market leaders to eventually follow the lead of the early adopters in smallholder inclusion, resulting in much greater scale impact: Brookside Dairy now reaches 200,000 smallholders, far more than any of the smaller players could engage.64

Develop local financial ecosystems to sustain inclusive growth

As with the Disrupt and Grow pathway, we see the progression of enterprises to commercial capital as something that applies to the advancing growth levers, but not necessarily to the advancing inclusion levers. Indeed, we see that even longstanding commercial enterprises can benefit from grants or grant-funded programmes to advance greater inclusion, as exemplified by the way in which Brookside Dairy, the market leader in the Kenyan dairy sector, was supported in adopting smallholder-inclusive practices.

At a market level, however, inclusive growth relies on the mobilisation of commercial capital across multiple enterprises, big and small. Contributing to that is the ability of these enterprises to access commercial capital in their local context. However, often these local players do not have the right incentives to support inclusive growth, as they deem it either too risky or too expensive. Development actors can therefore play an important role in engaging with local financial ecosystems to catalyse market-level change.

We see this clearly in Kenya, where development actors have provided enhancements to incentivise existing banks to engage in agriculture financing—the DCA guarantees are one example of this. These enhancements have had a limited duration and have been attached to technical assistance, building the capacity of local banks to engage with new customer segments even in the absence of guarantees.
Another approach has been the support for challenger financial institutions that are more willing than incumbent players to serve new market segments in new ways. In Kenya, the rise of Equity Bank has been vital in making finance more accessible to the agriculture sector, and a key enabler of market transformation in the smallholder-inclusive tea and dairy sectors. In the early days, Equity Bank was supported by development actors including the EU and UNDP, who provided loans and grants to help the bank develop and launch financial products tailored to the needs of new customer segments, including agribusinesses and smallholder farmers. More recently, Equity Bank has received investment from Arise—a commercial investor with a strong focus on SMEs and agriculture—strengthening its inclusive growth orientation and expanding its possibilities for the future.

Allow for realistic time horizons to see a sector achieve inclusive growth

The promise of the Guide and Shift pathway is that it can achieve more durable change at a greater scale than the Disrupt and Grow pathway: for instance, the dairy sector in Kenya has reached over ten times the number of smallholders than have many of the High-Growth Ventures we looked at, while increasing productivity and doubling farm gate prices.

However, it must be noted that this kind of change takes even longer to come about when focusing on individual enterprises, such as in the case of the Disrupt and Grow pathway. The inclusive growth story of dairy in Kenya, which has impacted close to two million smallholder farmers, has spanned more than two decades. Similarly, the Burkina Faso mango sector has moved toward inclusive growth during a period of over 15 years.

Donors and investors that take a Guide and Shift approach will benefit from understanding and committing to long-term market transformations. This has implications for the type of support that they deploy at different points along the inclusive growth journey, as well as the way in which they provide such support. It may, for instance, call for different types of investments vehicles designed to support returns over a longer period of time—permanent capital vehicles are one example that we discuss further in Chapter 4.
In the previous two chapters, we laid out the findings from our case studies, and a number of key lessons and implications for practice that emerged from them.

We discussed the need for different types of capital to target a range of levers relating to inclusive growth at different points over the course of evolution of an enterprise or a market. Within that, we saw that structures or investments to entrench inclusion into models and markets could be a key part of sustaining inclusive growth. We also found that the concept of ‘graduation’ is not absolute, and that enterprises and markets continue to need different types of capital as they evolve.

We highlighted that the time horizons for developing inclusive agriculture models and markets tend to be longer than for typical commercial investments, which means that most mainstream investment structures often cannot accommodate these needs. Related to that, we underscored the need to engage and develop local financial ecosystems, which can be critical to mobilising commercial capital in the long term.

Finally, when thinking about shifting entire markets towards inclusive growth, we called out the need for initiatives that focus on ecosystem facilitation to be deployed alongside support for individual enterprises. This, we found, can be most effective when interventions respond to ‘windows of opportunity’ in a market; discontinuities that can be critical to catalysing broader market-level change.

Some of these insights are already well-recognised and practised widely, such as the use of subcommercial debt to help enterprises build track record and capacities so that they are able to progress to commercial finance later on. Others point to practices that are not yet established, such as specific measures to entrench inclusion in models and markets in anticipation of the challenges and risks that could be faced at scale.

1. INCLUSION-FOCUSED PERMANENT CAPITAL VEHICLES FOR PATIENT AND HIGHLY ENGAGED INVESTING

The time horizons to achieving inclusive growth are significantly longer than most investors, and even some development actors, have experienced. This is particularly acute in the case of agriculture
where a number of elements should be in place in terms of input provision and offtake. We believe that it is time that development actors acknowledge this, and recognise that the agricultural context requires tailored, specialised vehicles that allow for these longer time horizons while supporting enterprises as they advance along their journey.

We see the potential for new types of investment vehicles that better align with the realities and needs of inclusive agricultural enterprises. Key features of such vehicles would include:

- **Permanent capital structure** to better match likely enterprise time to scale, such as an open-ended fund or a holding company;
- **Intentionality across levers to advance both inclusion and growth**, including measures to entrench inclusion through conditions, incentives and governance, as well as a focus on progression towards commercial capital;
- **Highly engaged, cross-disciplinary investment team** with a strong operational orientation and expertise in agribusiness, and the ability to engage with commercial capital providers to understand their requirements and design towards them; and
- **Addition of, or coordination with, a grant facility** to support very-high-risk needs or target critical inclusion levers.

While we do not currently see any examples of vehicles that have all of these features, we do see examples of some of these features in the current landscape. For instance, Maris Africa is a commercial venture investor structured as a permanent capital vehicle with a strong operational focus. It operates in nine African countries and a number of sectors including agriculture.

In the impact investing sector beyond Africa, SONG/Aspada is an example of an investor that set up an evergreen fund in order to achieve the flexibility and patience required to nurture early-stage, high-impact models across a range of sectors. Following its acquisition by LGT, the Lichtenstein banking group, Lightstone-Aspada (as it is now known) will seek to invest more strongly in scaling models in a range of sectors (including agriculture), building linkages between clusters of portfolio companies within specific sectors and value chains, and providing additional support to investees in management, governance, strategy and human capital.

**2. FOCUSED INVESTMENT AND INTERVENTION PLATFORMS FOR MARKET-LEVEL CHANGE**

In the *Guide and Shift* pathway, there is a need for a range of different interventions and investments, at both the enterprise and ecosystem levels, to support market-level change. In the absence of explicit coordination of these efforts, there is a high degree of reliance on serendipity as well as the informal efforts of various actors in making sure that these initiatives align and are mutually rein-
forcing. In addition, not all actors involved will be actively sensing and responding to market change dynamics, which could limit their effectiveness.

To better address this need, we see the potential for new specialised platforms that can effectively spot and respond to evolving needs across whole markets, in an effort to shift them towards more inclusive models and practices. Key features would include:

- **Assessment and ongoing tracking of the market**, including needs, gaps, opportunities, players and resources as they evolve;
- **Coordination of enterprise finance and investment as well as ecosystem facilitation efforts**, across DFIs, donors, banks, private investors, buyers and government;
- **Investment capabilities focusing on specific capital gaps** identified within the landscape, addressing specific inclusive growth levers, using an appropriate range of investment instruments; and
- **Building of a critical mass of smallholder-inclusive practices and models** that mobilise commercial capital throughout an entire market, with the aim of shifting market norms towards inclusion.

This approach has the potential to engage with markets in a way that could accelerate movement toward inclusive growth, but it is not without its challenges. The skillsets and systems required to do this well are not easy to build, and it is difficult for any one investment vehicle to be fully flexible in terms of financial instruments given their mandates and limitations. Moreover, there are considerable challenges in meaningfully engaging, while also coordinating a wide range of market actors.

Again, while we do not see any current examples of platforms with all of these features, we have observed signs of movement in the right direction. For instance, the Gatsby Charitable Foundation and Wood Family Trust have established East African Tea Investments (EATI) to invest in two Rwandan tea factories in order to demonstrate a smallholder-inclusive model. This effort runs in parallel to their Imbarutso programme, which builds capacities in farmer cooperatives across a range of areas including agronomic services, production logistics and stakeholder representation. Interestingly, this approach has shown better results in Rwanda than in Tanzania, where it has also been implemented, reinforcing the importance of platforms that are market-specific. This requires tailoring support for a specific country or region, the type of crops and the point in the market’s development.

Meanwhile, the ongoing evolution of the World Bank’s Global Agriculture and Food Security Program (GAFSP) intends to pursue greater coordination between its Public Sector Window that invests in infrastructure and enables environment for agriculture, and its Private Sector Window that provides affordable capital to enterprises. By doing so, GAFSP aims to respond more effectively to situations of market failure where there is an opportunity for inclusive growth. Despite these early movements, however, some room does exist for practitioners and investors to reflect this thinking more intentionally in their work to reach the needs of the agriculture sector.
A more seasoned example of work along these lines is that of Fundacion Chile, a public-private entity that has combined business incubation and venture capital investing with ecosystem building and technology development, to promote sustainable development in Chile. Its most striking success has been the development of the Chilean salmon farming industry that brought the country to its current status as the world’s second-largest producer of salmon. Fundacion Chile’s approach reflects a worldview that multiple market failures often need to be overcome in order to build and shape new patterns of market development, and that a range of different investment and ecosystem facilitation tools are needed to address them.

Another example can be found in the work of the SIDBI Foundation for Micro Credit (SFMC) in accelerating the development of the microfinance institution (MFI) industry in India from 1998. Supported by grant funding from SIDBI and DFID, and concessional debt from IFAD, SFMC played a crucial role in supporting MFIs and moving them towards scale, while strengthening infrastructure and influencing public policy development.

3. INVESTMENT STRATEGIES AND STRUCTURES TO GIVE SMALLHOLDERS GREATER POWER AND OWNERSHIP

We believe there is strong potential in seeking ways to entrench inclusion of smallholder farmers more deeply and powerfully, by bringing them into ownership of agribusiness enterprises, or by enabling existing smallholder groups to move into value addition. These transitions give smallholders the opportunity to participate economically in the value chain to a greater extent, and to improve resilience to market price volatility while transforming power dynamics more broadly.

The Kenya tea sector model is one of the clearest success stories along these lines, where approximately 560,000 smallholder tea growers own KTDA, a thriving tea processing and marketing company that sells over $800M of tea annually, making it one of the country’s top foreign exchange earners.65 Because smallholders own the company, three-quarters of the final export value of the tea flows directly into their pockets, and this has enabled further asset building and investment in other economic activities across rural Kenya.

We see the potential to further develop, test and refine investment strategies that foster more smallholder ownership across value chains. The Gates Foundation grant to Babban Gona that provided its smallholder suppliers 30% ownership of the enterprise is one example.66 Another is the East African Tea Investments (EATI), where the intention is to transfer the entire ownership of its two tea factories into the hands of smallholders. Of course, these transitions need to be carefully designed and properly supported. In the case of Babban Gona, smallholders receive their shares through a trust, which allows for more streamlined and effective participation in governance. The ownership has also been transferred gradually over time, enabling both the enterprise and the smallholders to ease into the new ownership model as they learn how to work together. KTDA has been engaged as the manag-
ing agent in EATI’s tea factories to help build capacities and support the progression towards 100% smallholder ownership and control over a period of time.

There is also potential to invest in ways that enable existing cooperatives and other smallholder-owned structures to extend into greater value addition, as shown by the example of Oiko Credit’s loan to the Githunguri Cooperative. Another, more recent example comes from Colombia where Acumen invested in a wet mill to support a farmer cooperative’s move into processing by creating a self-liquidating structure with a combination of equity and debt, paired with an equity buy-back plan. Acumen intends to eventually transfer full ownership of the wet mill to the cooperative.

The Phata Cooperative in Malawi is another successful enterprise that has taken this approach a step further. By pooling their small holdings into Phata, cooperative members now enjoy improved incomes thanks to a healthy stream of dividends from the business; many also receive wages as Phata employees. Combined landholdings mean that it has been possible to implement systems for reliable irrigation, leading to more consistent yields in an area plagued by unpredictable weather and frequent droughts. Similarly, Phata has engaged Agricane, a professional management company, to manage the cooperative and build local capacities.

4. ENHANCEMENTS AND SUPPORT FOR LOCAL FINANCIAL INSTITUTIONS TO INCREASE AGRICULTURE SECTOR LENDING

As discussed in previous chapters, enterprise growth benefits from access to local finance especially in local currency terms. However, mainstream banks are often reticent about lending to the agriculture sector when there are less risky or more lucrative opportunities in other sectors.

Guarantee programmes, such as USAID’s Development Credit Authority, have been successful at unlocking bank finance for agribusiness SMEs in countries like Kenya. While these programmes have helped to mitigate downside risks for lenders, they do not offer any additional incentives for local banks to expand lending in the sector.

A new initiative, Aceli Africa, is now proposing to take this a step further, by offering a financial incentive to local financial institutions to encourage greater lending to agricultural SMEs, coupled with technical assistance to enterprises to help them access this finance. The initiative also relies on data analytics for individual loans to track how they are used and to, eventually, move subsidy thresholds in response to market dynamics. Aceli Africa expects each dollar of donor funding to generate $12 of private sector lending and $3 in incremental farmer income, with capital leverage doubling as the market becomes more competitive. The initiative is due to launch in 2020.

While the success of Aceli Africa remains to be proven, the Private Agriculture sector Support Trust (PASS) in Tanzania has been doing this effectively for a number of years. In addition to
building the capacity of SME entrepreneurs to access commercial finance, it works with financial service providers to provide credit guarantees and help them tailor their products to the needs of agribusiness entrepreneurs.

A different—and potentially complementary—approach is to invest in emerging financial institutions that challenge the incumbents. This involves capital support and should be paired with technical assistance to help financial institutions develop appropriate financial products for the agriculture sector. One recent and promising example is that of Arise, a commercial venture backed by Norfund, Rabobank and FMO that focuses on challenger financial institutions throughout Africa. Instead of providing enhancements, Arise invests for a minority shareholding position that enables it to guide newer banks toward inclusion, and provides ample visibility into the impact of its support. Arise also provides technical assistance to help its investees develop and tailor products to the specific needs of the agriculture sector.
ENDNOTES


8. The Working Group consists of the African Development Bank, the Asian Development Bank, the Asian Infrastructure Investment Bank, the European Bank for Reconstruction and Development, the European Development Finance Institutions, the European Investment Bank, the Inter-American Development Bank Group, the International Finance Corporation and the Islamic Corporation for the Development of the Private Sector.


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For their invaluable contributions to our research, we would like to thank:

Nathaniel Makoni  
*Australian Breeders Services Total Cattle Management Ltd (ABS TCM)*

George Wamae  
*ACDI/VOCA*

Jean-Frederic Beauchesne  
*ACDI/VOCA*

Venny Mayaka  
*ACDI/VOCA*

Brian Milder  
*Aceli Africa*

Alberto Gómez-Obregón  
*Acumen*

Esha Mufti  
*Acumen*

Patrick Oketa  
*Acumen*

Emmanuel Keya  
*Africa Enterprise Challenge Fund (AECF)*

George Njuguna  
*Africa Enterprise Challenge Fund (AECF)*

Angelous Kamande  
*AECF Connect*

Ivan Ssenyonjo  
*AgDevCo*

Mollie Liesner  
*AgDevCo*

Rebecca Sankar  
*AgDevCo*

Hans-Willem van der Waal  
*AgroFair*

Jean Bosco Dibouloni  
*Agrodev Services*

Aïssata Ouedraogo  
*Association Burkinabé Action Solidarité Femmes et Enfants*

Désiré Kayal Sombié  
*Association Wouol*

Adaeze Usah  
*Babban Gona*

Kola Masha  
*Babban Gona*
Lola Masha  
*Babban Gona*

Dana Boggess  
*Bill & Melinda Gates Foundation*

Orin Hasson  
*Bill & Melinda Gates Foundation*

Maximilien D’Harcourt  
*Belgian Investment Company for Developing Countries (BIO)*

Anthony Pile  
*Blue Skies*

David Joiner  
*Coffey, a TetraTech company*

Roger Bird  
*CoolCap Fund*

Souleymane Konate  
*Coopérative Agricole du Kénédougou (COOPAKE)*

Jean Francois Guay  
*Cultivating New Frontiers in Agriculture (CNFA)*

Fred Ogana  
*East Africa Market Development Associates Ltd*

Michiel Arnoldus  
*Economic Sense*

Lucy Karuga  
*Eldoville Dairies Ltd*

Esther Muiruri  
*Equity Bank*

Joseph Shields  
*EthioChicken*

Patrick Hanemann  
*Farm2Market Agribusiness Consulting*

Bram Thuysbaert  
*FMO – Dutch Development Bank*

Jeroen Harteveld  
*FMO – Dutch Development Bank*

Thelma Brenez Muñoz  
*FMO – Dutch Development Bank*

Bruce Robertson  
*Gulu Agricultural Development Company (GADC)*

Gerard Sands  
*Gulu Agricultural Development Company (GADC)*

Jurie Hayes  
*Gulu Agricultural Development Company (GADC)*

Fredrick Mureithi  
*Githunguri Dairy Farmers Co-operative Society*

Olivier Van Lieshout  
*Global Facts*

Simeon Bridgewater  
*Global Innovation Fund (GIF)*

Fogué Koudouhou  
*Groupe Waka*

Catherine Oosterwijk  
*Happy Cow Ltd*

Gerard Oosterwijk  
*Happy Cow Ltd*

Douglas Masika  
*Heifer International*
Hanspeter Werder
HPW AG

Steven Humphreys
Identiv

Peter Kirimi
International Fertilizer Development Center (IFDC)

David Ferrand
Independent

Dominic Menjo
Independent

Geoff Tyler
Independent

John Stanley
Independent

Julian Velez
Independent

Beatrice Githinji
ISF Advisors

David Harvey
Land O'Lakes

Mark Mitchell
Land O'Lakes

Fabian Chessell
Larry Ellison Foundation

Guillaume Bouculat
Livelihoods Venture

Kerman Wildberger
Livelihoods Venture

Gerald Muthomi
Meru Greens

Caroline Mulwa
OikoCredit

Yves Komacllo
OikoCredit

Andrew Youn
One Acre Fund

Núria Vlonk-Cunha Soares
OTC-Organics

Edward Isingoma
Pearl Capital Partners

Abdullahi Umar
Propcom Mai-karfi

Sonali Ruparelia
Rabobank Foundation

Franck Jouve
Ranch du Koba

Adityendra Kumar
responsAbility Investments AG

Jerome Poulin
responsAbility Investments AG

Richard Rogers
Rogers MacJohn

Robbie Witkop
Root Capital

Steve Nocka
Root Capital

Henning Høy Nygaard
Royal Danish Embassy (Nairobi)

Joseph Kimotho
RTI International
Yaya Koné  
Sanlé Sechage Export

Cosmas Muchina  
SNV

Georges Ido  
Société Industrielle de Transformation des Fruits (SINTF)

Justine Maytraud  
SIDI (Solidarité Internationale pour le Développement et l’Investissement)

John Logan  
TechnoServe

Juliana Kariuki  
TechnoServe

Kindra Halvorson  
TechnoServe

Nupur Parikh  
TechnoServe

Kevin Gager  
The Palladium Group

Ogheneovo Ugbebor  
The Palladium Group

John Emoi  
Uganda Development Bank (UDB)

Etienne Christian Dioma  
Upromabio

Benson Kimithi  
United States Agency for International Development (USAID)

Brook Adam  
United States Agency for International Development (USAID)

Moses Sitati  
United States Agency for International Development (USAID)
Recommended Reading

**Beyond Trade-offs**

*Matt Bannick, Mike Kubzansky, Robynn Steffen*  
*(Omidyar Network, 2018)*

This series, published on The Economist’s digital platform, features voices from a range of leading impact investors operating across the returns continuum. It leans on Omidyar Network’s investment framework, laid out in *Across the Returns Continuum* (2017) to share the perspectives of investors ranging from the Bill & Melinda Gates Foundation to Goldman Sachs.

**Catalytic Capital: Unlocking More Investment and Impact**

*Christina Leijonhufvud, Bryan Locascio*  
*(Tideline, March 2019)*

This report, supported by the MacArthur Foundation, explores the concept of catalytic capital, aimed at filling financing gaps for impact enterprises that conventional capital cannot. It highlights how a range of investors have used catalytic capital to support inclusive business models, crowd-in private sector investment, and achieve inclusion impact.

**Shaping Inclusive Markets**

*Harvey Koh, Samantha King, Ahmed Irfan, Rishi Agarwal, Ashvin Dayal, Anna Brown*  
*(FSG and Rockefeller Foundation, July 2017)*

This report provides an assessment of how transformations of entire market systems towards greater inclusion take place, and the role that a range of cross-sector actors play to bring about systems-level change. It is the result of a year-long research process into seven case studies across five continents, as well as consultations with program teams at the Rockefeller Foundation and leading experts in the field.
**Blended Finance in the Poorest Countries: The need for a better approach**  
*Samantha Attridge, Lars Engen*  
*(Overseas Development Institute – ODI, April 2019)*

The authors of this report underscore the need to mobilise private finance to finance the Sustainable Development Goals (SDGs), given the estimated $2.5 trillion SDG financing gap in developing countries. The report focuses on the role of blended finance in reducing this gap, and calls for a range of actions that development actors can take to target this challenge.

**Pathways to Prosperity: Rural and agricultural finance state of the sector**  
*Matt Shakhovskoy, Clara Colina, Mikael Clason Höök*  
*(ISF Advisors and MasterCard Foundation, November 2019)*

In this report, the authors share their latest findings on the size and scope of the rural agricultural finance market. The report notes that only 30% of the global demand for smallholder finance is currently met, leaving a gap of approximately $170 billion. It also highlights the significant gap in lending for SMEs in the agriculture sector, and suggests ways to address it.

**Development Finance: How it can enable the growth and transformation of agriculture**  
*Michael Shaw, Michael Obanubi, Geoff Tyler*  
*(Gatsby Africa, December 2019)*

This report looks at the role of finance in five sectors that have successfully transformed around the world. It also explore the extent to which finance is currently available in the agriculture sector, and presents ideas on how to increase different types of finance to support agricultural transformations in developing countries.

**Agricultural Investment Funds for Development**  
*Calvin Miller, Toshiaki Ono, Milica Petruljeskov*  
*(Food and Agriculture Organization of the United Nations – FAO, 2018)*

This publication considers the role of investment funds in meeting the needs of agricultural financing. It looks at 63 funds focusing on the agriculture sector, and classifies them according to a range of criteria including geography, investment instruments, and financial performance, among others.
THE AUTHORS WISH TO EXPRESS THEIR GRATITUDE TO:

The Bill & Melinda Gates Foundation and the UK’s Department for International Development (DFID) for funding and supporting this work

Charles Bleehen, Katherine Tan, Marcella McClatchey, Rodrigo Salvado, and Tom Kehoe from the Bill & Melinda Gates Foundation, as well as Simon Calvert and Iris Krebber from DFID, for significant contributions including reviewing our draft manuscript

Craig Courtney, Dan Zook, Daudi Lelijveld, Martin Webber, and Michael Shaw for giving time to attend Advisory Panel meetings, contributing their knowledge, reviewing our draft manuscript, and connecting us to their networks

Geoff Tyler for generously granting us access to the database used for his 2012 report, co-authored with Grahame Dixie, *Investments in Agribusiness: A Retrospective View of a Development Bank’s Investments in Agribusiness in Africa and East Asia*

Teams at the Bill & Melinda Gates Foundation and DFID for their inputs and support

The many other expert practitioners, funders, investors, entrepreneurs and advisors who contributed valuable observations, opinions and suggestions

The key actors implicated in our case studies, for their boldness and thoughtfulness, and their candour in sharing their stories and perspective with us

The core FSG team of Kerry Rodriguez and Victor Tavarez, who supported the project at different stages

Mark Russell, Stephanie Cubell, and Tarun Pandey for their support in producing this report
This report is based on research and analysis conducted with the support of Kerry Rodriguez and Victor Tavarez.

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