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Quality investment

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Inclusive agricultural investment: sharing lessons from experience

Policy pointers

- **Powerful policy and** commercial constraints prevent or discourage investors from supporting more inclusive agricultural investments.
- **But mounting experience** shows possible ways around some of these, including: aggregating smallholder suppliers; providing technical assistance; combining smallholder sourcing with nucleus estates; developing innovative links with retailers; reducing risk by targeting lower risk markets or segmenting risk profiles; and building multi-stakeholder partnerships.
- **Effective partnerships** between private, public and civil society organisations have real potential to help build inclusive investments, but also bring challenges of conflicting interests and higher transaction costs.
- **There is an appetite for** more experience sharing and multi-stakeholder dialogue. Establishing a community of practice to regularly share learning could help accelerate change.

The global surge in agricultural investments needs 'inclusive' alternatives to large-scale land acquisitions — alternatives that respond to local aspirations and share benefits with local stakeholders. But as yet there is little agreement on what inclusiveness might mean in practice, or how to overcome the considerable commercial and policy constraints opposing its implementation. In early 2013 IIED brought together asset management companies, global agri-food companies, agri-business consultancies, donor organisations, development agencies, international NGOs, southern governments and southern farmers' organisations to discuss these issues and to kick-start a longer-term multi-stakeholder dialogue. This briefing shares key learning and experience from the workshop, particularly focusing on practical insights that are most relevant to private sector stakeholders.

Reaching a shared understanding of at least the basic elements of inclusiveness proved relatively easy for workshop participants (see Box 1), but a greater challenge is to understand and then overcome the various structural constraints to inclusive investment. Many prevailing market conditions and government policies tend to favour large-scale land deals and discourage more inclusive investments (see Box 2), yet there is growing experience of investing in smallholder producers. This briefing particularly focuses on sharing participants' practical insights on overcoming the commercial constraints of such investments in smallholders.

Reducing risk, increasing returns

Aggregating smallholder suppliers can reduce the transaction costs of doing business. Such 'aggregators' may take various forms including local finance institutions, agri-businesses and farmers' cooperatives. For example, the Hivos-Triodos Fund,[3] a joint initiative of Triodos Investment Management and Hivos, which invests in sustainable agriculture and renewable energy, channels its finance through local micro-finance institutions (MFIs) and funds supporting rural SMEs. The Rural Fund for Africa (RFA), a fund developed by Madrid-based impact investment management company GAWA Capital[4] that aims to increase smallholders' access to capital, technical assistance and markets, is planning to channel its investments through local agri-businesses and farmers' cooperatives as well as local MFIs. Investing in cooperatives is a particularly promising option for promoting inclusiveness — but suitable organisations can be difficult to find.

Providing technical assistance can raise smallholders' productivity, minimise risk of crop failure and boost returns through improved quality. Technical assistance may be delivered and/or funded by external development organisations, but many agri-businesses sourcing from smallholders absorb technical assistance as an internal operational cost.[5] Technical assistance can also help smallholders if they transfer new skills to other farming activities,[6] increasing their income or food security.

Combining smallholder sourcing with a nucleus estate is a widely used strategy to diversify the production risks associated with smallholder sourcing, and it also means the investment can benefit from economies of scale at the packing or processing stage. One example is London-based investment management company Altima Partners, which has three commercial farms in

Zambia and supplements supply by outsourcing from local smallholders. The commercial viability of such mixed production models is now fairly well proven. But adopting this model does not necessarily guarantee inclusiveness.

Multi-stakeholder partnerships can add value to inclusive investments

Forming downstream linkages with retail companies can be an effective way both to secure markets and to reduce risk from loan default, without smallholders having to provide collateral. For example, loans provided to exporters and producer cooperatives under GAWA's RFA will be collateralised against purchase agreements with Co-op Italia (and potentially other retailers). Similarly, the Triodos Sustainable Trade Fund (in which Hivos also participates) forms tripartite agreements with producer organisations and global retail companies. The retailer pays the amount owed by the producer organisation directly to the fund, so the producer does not need to provide collateral.

Targeting lower risk markets, including local or regional markets, is a way to reduce market risks. Although many investments target high-value export markets, demand and/or price can be volatile, and the stringent quality standards can be difficult for smallholders to meet. For this reason, the Global Agri-Development Company (GADCO), a vertically integrated agri-food operator aiming to deliver social and environmental as well as financial returns, targets regional markets in West Africa, tapping into growing demand amongst urban elites. Altima Partners' businesses in Zambia are also targeting the domestic market.

Market segmentation is another way to cope with the risk-return profile of smallholder investments, as some investors will settle for lower returns and/or higher risk than others, letting managers 'average out' an acceptable overall risk-return profile. At the workshop, at least one fund said it was planning such a move.

Building multi-stakeholder partnerships is an increasingly popular strategy for raising additional capital and distributing risk associated with smallholder-based investments. Private investors partner with public-sector and civil society investors who are willing to shoulder higher risks, lower returns and/or a longer break-even period if certain social (or environmental) aims are addressed. And public and civil society stakeholders can help achieve some of the risk mitigation strategies outlined above. Such partnerships are discussed more below.

Finally, it is important to note that not all these strategies will be appropriate or effective in all situations. Nor do they, in themselves, guarantee an inclusive outcome. Other conditions need to be in place to ensure inclusiveness.[7] And most of the investment examples discussed at the workshop were still at early stages, so their overall impacts on local communities are as yet unknown.

Box 1. What is inclusiveness in agricultural investments?

There is no 'one-size-fits-all' model of inclusive investment. However, the diverse participants at the workshop this paper summarises identified several common elements underpinning all inclusive investments:

- **Inclusive investments respond to local aspirations about development pathways,** as well as to commercial considerations. So local people must have a voice in key business decisions, through free, prior and informed consent on decisions as the investment starts, and through opportunities to influence decisions once the project is up and running.
- **Inclusiveness principles must be incorporated into the core business model,** and not limited to one or two peripheral areas.
- **The legitimate focus on core business should not undermine efforts to minimise 'negative externalities'** — that is, the costs borne by those not benefiting from the investment (an example would be downstream shortages because of water extraction).
- **Local people must be enabled to have some degree of ownership** of the business and/or key business assets. Ensuring local land ownership is crucial, but there is also growing experience of enabling local groups to acquire a share of the business itself (for example, equity share).
- **Local people — both women and men — must receive a fair share of the economic benefits** generated by the business. Where land is leased out, local holders of land rights should receive a rental income that reflects true market value. Smallholder suppliers should receive fair terms and conditions of trade, including a fair price for their products. The business should provide decent employment opportunities for women and other land-poor groups. Disaggregation is key in assessing local outcomes. For example, to ensure women benefit, investors must take steps to promote equitable distribution of benefits within supplier households.
- **Local people should not be exposed to unacceptable risk.** Reward mechanisms should be structured to protect local people from excessive risk. For example, profit-sharing mechanisms work best if local people are entitled to some minimum income even if the business makes a loss one season.
- **Inclusiveness principles should be addressed in the design of investment funds (not just individual investments)**, as the overall fund structure can significantly limit how individual investments can tackle inclusiveness.

Building effective partnerships

It was clear from workshop discussions that multi-stakeholder partnerships can play an important role in making more inclusive investments possible. Governments, other public sector investors as well as NGOs and development organisations all have roles to play.

Governments. Governments can play a key role in multi-stakeholder partnerships, sometimes as business partners providing direct investment alongside the private sector if the investment promotes public policy goals. For example, the Mali government contributed land to the Markala Sugar Project, a public-private partnership producing and processing sugar (now discontinued).[8]

Governments can also facilitate information exchange and negotiations between investors and local communities as investments are set up. But this may need adjustments on all sides. For example, the workshop discussed an example where a parliamentarian in Togo was approached by local communities to help interpret a 1,000-page consultation document from a potential investor. Capacity building (for example, legal training) may be necessary if governments are to play this role effectively, but more appropriate consultations are also clearly needed.

Perhaps most importantly, governments should play a strategic role in creating an enabling policy environment for more inclusive agricultural investments, not least by establishing a clear vision of agricultural development and of the role of investment within that. Box 1 briefly addresses some of these issues, but broader policy questions are beyond the scope of this paper.[9]

Other public sector investors. Other public sector investors, such as development banks, are increasingly being sought at both the fund and individual investment level to provide additional capital and absorb some of the risk associated with investing in smallholders. For example, the RFA is seeking public investors that will accept higher risks in investments that help achieve social or environmental priorities, thus letting GAWA offer mainstream private investors more secure investments. In the case of the Markala Sugar Project, the African Development Bank agreed to provide additional investment on the condition that the project design was adjusted to ensure greater involvement of, and benefits for, local communities.[8]

NGOs and development organisations. Development organisations and NGOs play at least three distinct roles in multi-stakeholder partnership models. The first is providing technical assistance and links to smallholders. For example, in Zambia Altima Partners works with the Conservation Farming Unit, a local NGO that provides agricultural extension services to Altima's smallholder suppliers. Similarly the RFA is partnering with Technoserve[10] (a global NGO that focuses on developing business solutions to poverty by linking people to information, capital and markets) to oversee technical assistance to its investments.

The second role is initial screening, followed by impact monitoring and assessment. For example, the World Bank recently signed a three-year memorandum of understanding to independently monitor and assess the development impacts of GADCO and to recommend improvements where needed. Although not directly linked to commercial risk/return, independent impact monitoring is often a pre-condition for securing buy-in from public-sector investors, and hence is important for attracting diversified investment. And HIVOS's role in the HIVOS-Triodos Fund includes screening all potential investments against developmental impact criteria, helping to ensure that inclusiveness principles are met.

Thirdly, development organisations can provide a financial guarantee for investments and loans. For example, HIVOS guarantees investments made under the HIVOS-Triodos Fund, thus allowing the fund to take on more risk than would otherwise have been possible.

Clearly, multi-stakeholder partnerships can deliver significant added value to inclusive investments. But such partnerships also bring additional challenges. Workshop participants particularly highlighted higher transaction costs and greater risk of internal conflicts of interest, which can in turn increase the risk of project failure.

Box 2. What is constraining more inclusive investments?

Commercial (market) constraints

- **The low but rising price of land** in many lower income countries, combined with volatile financial markets, means that investors are increasingly speculating by buying land.
- **An upward price trend for agricultural commodities, combined with volatility,** encourages agri-business companies to invest in primary production to secure supply and increase profit margins.
- **The agronomic characteristics** of many commercially important crops, including sugarcane, palm oil and certain cereals, lend themselves to large-scale production.[1]
- **Involving small-scale producers is typically associated with high risk and low returns,** due to factors including high set-up and transaction costs; the risk of side-selling; and difficulties with meeting quality, traceability and other market requirements.

Policy constraints

- **Investment policies often favour large-scale land deals,** for example governments may offer 'one stop shops' that help streamline the investment approval process, or various tax incentives. And screening for social or environmental impacts is often poor, creating little incentive for investors to adopt more inclusive models.
- **Land policies often undermine local land rights.** Few countries legally require investors to obtain local free prior informed consent, and compensation requirements for loss of access to land are typically inadequate. Many national laws only recognise customary land rights for 'productive use', meaning that rights to land used for grazing, hunting and gathering are generally not protected. Even where local land rights have been strengthened, implementation has generally been weak.
- **Governments often fail to develop and maintain the basic infrastructure needed for efficient trade,** such as adequate transport, communications and storage infrastructure, and this may only be commercially viable for investors to supply at large scale.[2]

Grounds for cautious optimism

Although this briefing, and the workshop it draws on, have focused largely on the risks and constraints associated with inclusive agricultural investments, there are grounds for cautious optimism: recognising several opportunities as well as the risks.

First, despite remaining a niche market, the impact investment sector (which aims for social and

Box 3. A discussion agenda

Participants raised important questions that went beyond the scope of the initial workshop, but might be the basis for further discussions. These included:

How can inclusiveness principles be incorporated into project design? What new models are emerging, and what are the lessons for designing future investments? In particular, what types of business models are most inclusive of women and other land-poor farmers?

How to ensure effective implementation? How do you turn well-intended project designs into well-implemented investments that deliver substantial and sustained benefits, and give meaningful voice, to local people?

How can multi-stakeholder partnerships be made more effective? How can the risks and challenges associated with such partnerships be best managed? What types of institutions are best placed to facilitate these partnerships and mediate between stakeholders? How scalable and sustainable is such an approach?

How can the policy environment be improved? What can be done by different stakeholders to address the policy constraints outlined in Box 2? What additional policies are needed to proactively encourage more inclusive deals, and how can these best be promoted?

environmental benefits as well as financial return) is growing steadily, demonstrating rising investor interest in more inclusive approaches.[11]

Second, there is increasing recognition of the commercial risks associated with not being inclusive, in particular reputational risks. Media exposure, local community opposition and/or wider campaigning against the damaging social impacts of specific investments have already led to numerous investors withdrawing from controversial agricultural investments in Africa.[12] These developments can only strengthen the business case for investing in more inclusive models.

Third, history provides a cause for optimism. In the early days, microfinance was seen as a model that could only function effectively with support from public donors. Yet many MFIs now operate purely commercially, a situation made possible by the development of soft infrastructure such as efficient credit rating agencies and improved know-how. Workshop participants — including those with first-hand experience of microfinance — believed that impact investment in the agricultural sector could also become fully commercially sustainable over time, if the right developments in soft infrastructure are made.

Finally, many participants believed that continued multi-stakeholder dialogue and practical lesson sharing could help accelerate the development and application of effective approaches to inclusive agricultural investment. Specifically, there was a strong appetite for establishing a 'community of practice' where practitioners could continue to share their practical experiences of how to design and implement inclusive agricultural investments, and how to overcome key constraints. IIED hopes to help make this a reality, and Box 3 suggests a potential agenda for discussions.

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This briefing summarises perspectives shared at the workshop 'Making agricultural investments more inclusive: building a framework for action.' 28 February 2013, London. Inclusion of business experiences does not constitute an endorsement of those experiences by IIED or by the other institutions involved.

Notes

■ [1] Cotula, L. forthcoming. *The Great African land grab? Agricultural investments and the global food system.* Zed Books, London, New York ■ [2] Vorley, B., Cotula, L., Chan, M. 2012. *Tipping the balance: Policies to shape agricultural investments and markets in favour of small-scale farmers.* Oxfam GB, Oxford. ■ [3] www.triodos.com/en/investment-management/our-funds/overview-all-products/hivos-triodos-fund/ ■ [4] www.gawacapital.com ■ [5] For examples, see Natural Resources Institute. 2003. *Smallholders in export horticulture: A guide to good practice.* CD-Rom. ■ [6] Armah, J., Plotnick, R. 2010. *Smallholder contract farming in Sub-Saharan Africa and South Asia.* Evans School of Public Affairs, University of Washington. ■ [7] See Vermeulen, S., Cotula, L. 2010. *Making the most of agricultural investment: A survey of business models that provide opportunities for smallholders.* FAO/IFAD /IIED/SDC, Rome/London/Bern. http://pubs.iied.org/12566IIED; and Cotula, L., Leonard, R. (eds). 2010. *Alternatives to land acquisitions: Agricultural investments and collaborative business models.* FAO/IFAD/IIED/SDC, Rome/London/Bern. http://pubs.iied.org/12567IIED ■ [8] Djiré, M., Keita, A., Diawara, A. 2012. *Agricultural investments and land acquisitions in Mali: Context, trends and case studies.* IIED/GERSDA, London/ Bamako ■ [9] For a detailed analysis of government policies that enable more inclusive investments see reference 2 ■ [10] www.technoserve.org ■ [11] GIIN 2012. *Perspectives on progress.* Report by J.P. Morgan for the Global Impact Investing Network (GIIN). www.thegiin.org/cgi-bin/iowa/resources/research/489.html ■ [12] Litovsky, A., Villalpando, P. 2012. *The land security agenda: How investor risks in farmland create opportunities for sustainability.* Earth Security Initiative, London.

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About the series

A commercial investment's 'quality' determines whether it promotes or undermines inclusive sustainable development in low-income countries. This briefing is part of an IIED series that investigates the notion of quality investment across different sectors and themes. Individual briefings do not start from a specific definition of quality investment. Rather, a final briefing will review the series and discuss implications for such a definition.

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