# FAO AGRINVEST

The initiative to link the need for investments in agriculture and food industries with the transformation of food systems in developing countries under existing challenges and new threats.

## 1. Food systems transformation and the COVID-19 pandemic: existing challenges and new threats.

People produce, buy and eat food, which is essential to live. The ways by which food is produced and delivered to our plates – the impact on our health, our economies and even where our leftovers go – are an integral part of the global economy, the human health, and the social life affecting every person on earth.

As a consequence, the way in which food is produced, transformed and consumed will be key in delivering the 2030 Agenda for Sustainable Development of the United Nations (UN). In this respect, the UN Secretary General will host a Food Systems Summit in 2021 to "to invest in diverse ways to make food systems inclusive, climate adapted and resilient, and supportive of sustainable peace". The concept of the Summit reflects the rapidly increasing concerns regarding diet-related health effects, the damage to ecosystem services, links to climate change and distress among millions of small-scale food producers and will raise food system transformation to the highest level, affirming its centrality to the achievement of the majority of the Sustainable Development Goals (SDGs). The issue of sustainability is key, as the world's current food systems are failing. In an age of unprecedented wealth and progress, while producing more than enough food for everyone, we still have over 820 million people hungry and 2 billion adults overweight.

For food systems to transform towards sustainability there is a need to put in place different kinds of incentives. On one side, policy incentives are needed, with interventions to facilitate the regulatory environment through adapted fiscal regulation, job creation facilities, employment upgrading and improved regulations, intervention on trade barriers, ease of financial limitations, etc. The incentives should be accompanied by a set of sustainability requirements for investments, which would be driven by increased opportunities to invest in a way that overcomes the traditional trade-off between profitability and social and environmental sustainability and instead generating both.

The position of the European Bank for Reconstruction and Development (EBRD) in this respect is emblematic. As stated by EBRD's climate change Managing Director, Mr Josué Tanaka, "(…) this is where the opportunities will lie. If coronavirus recovery packages do not support a green transition, within this 10-year timeframe, we will have missed the opportunity to remain within acceptable bounds of climate related risk. This investment will have to be part of the recovery packages designed as we emerge from the health crisis, and these packages offer the great opportunity to accelerate the green transition. We must not miss this opportunity" (EBRD, 2020).

The emergence of this evidence is not a coincidence: food systems as they currently operate at the global and local level are having negative effects on the climate, environment, human health, and social welfare. The financial impact of unsustainable and unbalanced food systems on public budget is a cause for concern, due to the increasing costs to address health and environmental related issues. This is becoming even more difficult with continued population growth in some parts of the world, changes in diets, and increasing challenges from climate change.

As the first unprecedented anti-recession and stimulus packages are unfolding, it is vital to ensure that these stimulus packages include targets on environmental performance. The first initiatives are already using a large injection of public spending to trigger better sustainability performance. For instance, in April 2020, amid the Covid-19 pandemic, the European Investment Bank (EIB) announced the launch of a new financing initiative that aims to unlock close to EUR 1.6 billion of investment in the agriculture and bio economy sector. The financing aims to support private companies operating throughout the value chains of production and processing of food, bio-based materials and bioenergy. It will be guaranteed by the budget of the European Union under the European Fund for Strategic Investments (EFSI), which forms the financial pillar of the "Investment Plan for Europe". The lending programme will enable direct lending for private sector investments ranging from EUR 15 million to EUR 200 million, with the EIB loan amount ranging from EUR 7.5 million to EUR 50 million. Targeted investments will support environmental protection and natural resource efficiency, renewable energy, innovation, competitiveness, and energy efficiency.

Like COVID-19, climate change, biodiversity loss, and financial collapse do not observe national or even physical borders. These problems can only be managed through collective action that builds resilience which prevents full-blown crises. They must be acted upon not only as singular threats with emergency response, but as a series of shocks with a long-term approach for improved food systems and more resilient societies. The economics of food systems must also change and must account for biodiversity loss and climate damage in clear monetary terms.

The good news is that solutions exist to change the unsustainable patterns of our food systems in a way that enhances inclusive economic growth and opportunity, while also safeguarding the global ecosystems that sustain life. Scientists have identified **food systems as one of the single strongest opportunity areas we have to achieve all of our goals for the planet and the people who inhabit it. Since food systems affect every aspect of human life**, actions to transform them can lead the way in showing us what sustainable development in all its dimensions ***can actually look like***. Better food systems will create a better future. The moment to transform our food systems is now and it must be central in our effort to achieve the SDGs.

Food systems have been undergoing significant transformations over recent years driven by population growth (the global population is expected to quadruple to 4 billion people by 2050) and the dramatic expansion of urban areas, projected to double by 2030 (UNHABITAT, 2016). Agribusinesses, especially small and medium enterprises (SMEs), which represent the largest share of the industry in developing economies, need to adapt to these structural changes, without putting pressures on human health and environment, but instead introducing practices and technologies which comply and increase with sustainability and its goals. In order for this to happen, investments need to follow, but agribusinesses in fact continue to struggle to access funding and investments. According to the Initiative for Smallholder Finance

(ISF, 2012), the total financing need of the 270 million smallholder farmers, who represent the backbone of food production, is estimated to exceed USD 200 billion. Persistent gaps in the provision of finance to SMEs, including for trade of agricultural commodities, also remain. The World Trade Organization (WTO) estimates that the unmet trade finance demand in Africa is USD 120 billion and USD 700 billion in developing Asia (Byerlee *et al,* 2013). Furthermore, agricultural productivity must be increased concurrently with substantial investments in climate adaptation – estimates of adaptation costs are estimated at up to USD 7.3 billion (Nelson *et al*, 2010).

## 2. Underinvestment in agriculture, how to stimulate investment and the role of blended finance

For a long time, the agricultural sector has been suffering from underinvestment. In 2018, FAO estimated that an additional investment of USD 265 Billion per year will be needed to achieve the two key SDGs - zero hunger and poverty eradication.

The SDGs are underfinanced, with an annual financing gap of USD 2.5 trillion. The shocking effects on food systems may potentially turn investors away from investments in food production, processing, and marketing, as the COVID-19 will likely disrupt the demand and the supply of food, both cash and staple crops, in the medium term. In developing economies, the supply of finance and investments for agricultural related deals will be more and more precarious. The higher uncertainty will increase the risks (both perceived and actual), and the increased risk perception will unavoidably increase the cost of capital. Developing countries will have to address a range of challenges, including higher borrowing threatening inflationary spikes; international investors fleeing to the safety of developed government assets; and their traditional sources of foreign income (such as commodity exports, remittances, and tourism) likely declining, limiting their access to hard currency while the dollar strengthens, which makes debt servicing more challenging. Overall, these obstacles constrain the fiscal space developing economies need to manage the pandemic.

In this context, blended finance schemes (blending concessionary loans and grants to incentivize private non-developmental investments) becomes more and more crucial for its role in de-risking the agricultural sector (by creating public risk buffering mechanisms and thus distributing the risks among different actors) and by providing incentives to invest at a lower cost.
The demand for investments in agriculture can be met using a variety of instruments: grants, equity, loans, debt and risk mitigation products (guarantees and insurance products, including hedging), all of which can include a "blended" (concessionary) component. The concessionary element within agricultural blended finance transactions can be used to address different challenges. These may include the use of public funds to ensure adequate training through technical assistance, creating market facilitating infrastructure (e.g. collateral registries, warehouses), establishing public grant funds to match private investments (such as the challenge funds), and setting up subsidized guarantee programs and insurance schemes.

Blended financing schemes and mechanisms will ultimately represent the only instruments to keep investments flowing into food systems, enabling the transformation into more sustainable and efficient value chains. Therefore, addressing food systems bottlenecks and constraints will be hugely catalytic in getting abundant private sector capital back into circulation. Guarantees, first-loss protection, offtake commitments, advance market commitments; all of these will be increasingly more important.

In the long term, building more inclusive food systems can reduce the impact of such shocks in the future, and bring a wide range of economic and development benefits to all people, especially the poor and disadvantaged. The organization of food supply chains will be strongly affected by the level of economic development and factors such as urbanization and globalization. COVID-19 will thus have different impacts on food systems in poor versus rich countries. Rich countries have introduced massive health and public spending programs to counter the economic effects of the COVID-19 pandemic; for poorer countries, the options for fiscal and monetary responses are more limited, and therefore the role that international organizations can play in helping them will be more important.
Blending in agriculture has been far slower than in energy/infrastructure or even micro, small and medium enterprises (MSMEs), reflecting the greater perceived risk of the sector/risk aversion, higher transactions costs, as well as the more limited experience of DFIs in this domain. In Africa such blending schemes remain at the initial stages of activity: they are in the set-up phase in Senegal and Kenya, while the YIELD Fund in Uganda has recently started investing[1]. Of the EU's total upcoming pipeline for blending projects, only a small share is agricultural (4% of total blending in Africa). There are several agri-blending initiatives launched by the drive of the European Commission on blended finance in the period 2013-2017 which culminated with the External Investment Plan of the EU, including a contribution to the first-loss shares of the Africa Agriculture and Trade Investment Fund, establishing the AgriFi investment facility, a contribution to the HURUMA Fund, and the first-loss shares for the Agribusiness Capital Fund Fund of the International Fund for Agricultural Development[2]. Besides these examples, there are cases of donor funded initiatives which managed to blend public developmental financing with private commercial non-developmental investments, through the combination of investment products, risk sharing facilities and technical assistance. Some of them have been analyzed in a recent report produced by the he Smallholder and Agri-SME Finance and Investment Network (SAFIN, 2019). Among them, it is worth mentioning the PROFIT programme in Kenya, which was designed and implemented by African Green Revolution Alliance to facilitate the transformation of smallholder agricultural sector and rural enterprises into profitable areas capable of attracting private investment from the commercial sector. Through the use of two blended finance instruments (a risk sharing facility and a credit line) coupled with technical assistance, PROFIT has been providing incentives to existing commercial banks (Agricultural Finance Corporation and Barclays) to increase the volume of their agricultural lending, diversify their services and products to rural areas, focus on innovation to reduce the cost of services and technical assistance for business services to producer groups, for a total of almost USD 30M lending, with a leverage ratio of 1:4,75.

Another interesting project is the US Agency for International Development (USAID) funded FinGAP project, which managed to leverage USD 169M in agricultural finance in Ghana for 2995 SMEs, combining business advisory services, pay-for-performance grants and risk mitigation tools.
A third successful case that is worth mentioning is the PASS Trust in Tanzania, which in 2018 alone guaranteed loans for a value of USD 83M to 196,000 agri-enterprises. The Credit Guarantee Fund provided by the governments of Denmark and Sweden has grown by 15% through capitalization of surpluses combining guarantee funds, TA for youth business incubator centers and quasi-equity and mezzanine finance.

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[1] The Yield fund was established by the EU Delegation in Uganda in 2012 which entrusted IFAD and a local Fund manager to create a unique vehicle with mezzanine funding from EU to assist small business in agriculture and agroprocessing (see interviews and articles in newspaper).
[2] This initiative was modelled over the example of Yield in Uganda by the EU

## 3. FAO AGRINVEST – fostering investment to protect food supply chains in the era of COVID 19 and beyond

Today, in the context of a global pandemic like COVID 19, where the disruption of supply chains and their food systems are a major concern, initiatives such as the FAO-led AgrInvest have become key, as they bring together development impact and risk reduction for investors, and support to food supply chains, creating sustainable and resilient mechanisms to support food systems transformation.

The AgrInvest initiative was established by FAO in 2018, with the objective of leveraging private investment in agrifood systems to achieve SDGs, ensuring sustainable economic, social and environmental impact. AgrInvest provides a combination of investment support options in terms of (i) promoting enabling policies and policy dialogue; (ii) de-risking mechanisms and financial services; (iv) leveraging critical public investments; (v) capacity development; and (vi) innovative investment options.

Since its establishment, the AgrInvest initiative has been introduced and promoted to several countries, and it has been welcomed both at government level and among private sector stakeholders. Since 2018, funds have already been allocated through trust funds in 6 countries, namely Burkina Faso, Ethiopia, Kenya and Niger (funded by the Italian government), Uganda (funded by the EU) and Zimbabwe (funded through the FAO technical cooperation programme), and 14 countries are included in the pipeline.

The initial proposal was built on FAO's vast experience in supporting public interventions aimed at improving agricultural sectors, as well as on FAO's unique understanding of the technical, socio-economical and policy dimensions of food and agriculture systems, in particular on FAO's solid knowledge of sustainability and social inclusion.

For example, the AgrInvest initiative supports significant de-risking agricultural investment by addressing the root causes of market and policy failures affecting the countries as a whole and more specifically, their agriculture sector. De-risking options are numerous, but they are typically of "public good" nature meaning that a large number of persons can enjoy their benefits. By their very nature, these corrective interventions will typically be undertaken by public entities and will represent pre-conditions for private investment. These interventions can take the form of interventions addressing market failures (main ones include information asymmetries, imperfect competition, high transaction costs, thin markets, ill-defined property rights and externalities) as well as policy failures (by either correcting inadequate policies or filling a gap where a policy is missing).

Under the AgrInvest initiative and related projects, relevant value chains, business models, market systems, and other relevant elements of the food systems are analyzed starting from the enabling – and conducive - environment for investments which is given by multiple factors, including: (i) the existence of a market and of the demand for commodities and their specific value chains; (ii) the structure of the food system (including elements such as urbanization, population growth, climate change), and forces such as technological change and innovation, policy change, etc; (iii) the overall performance of the food system (measured in terms of sustainability of firms, farms, consumers).

Furthermore, the financing needs for each group or type of SME is mapped against the available supply. This allows an initial assessment of where funding needs are already met,

and where gaps exist. The latter may represent opportunities for investors which can be described in the proposal.

The selection of the value chains is based on their opportunities for growth and employment creation. With this regard, the purpose of the investment proposal is to focus the sector stakeholders on investments/programs in an aligned manner around strategic gaps between investment opportunities and what the financial sector is currently able to offer. Thus, the proposal is expected to guide the mobilization and targeting of investment and financing resources and other solutions (including technical assistance) to enhance the efficiency of the value chain, specifically targeting smallholder farmers and agri-SMEs that engage in this sector. The investment proposal is also of value to policy makers for guiding or informing the development of policies and strategies that aim at promoting the growth of the sector, as well as to private business development and service providers in the design and provision of interventions that aim to enhance the flow of investments and financing in the industry/sub-sector.

AgrInvest is ultimately meant to foster investments aligned to the SDGs that contribute to economic growth, generate employment in rural economies – in particular, for women and youth - improve livelihoods, promote gender equality and reduce poverty. It is a practical example of linking investments, SDG-programme implementation and policy dialogue. Through this initiative, FAO promotes well-structured multi-stakeholder platforms for policy dialogue. Aiming, inter alia, at removing obstacles for investments, providing a framework for collective action on practical issues facing stakeholders, and supporting development of a conducive regulatory framework, FAO could promote, in a proactive way, these dialogues, organized on a value chain or territorial basis, with family farmers, fishers, pastoralists and foresters and their rural partners at the centre. This can sustain advancement on necessary policy reforms, key services and public goods, and appropriate means of implementation, including finance and investment, research and development, and market access.

Reaching out to the private sector and supporting it via SDG compliance in their investments could be activated by the Agrinvest initiative through DFIs and other financial sector players, such as:

- Development financial institutions: the need for complementary and/or additional direct investment in agrifood SMEs is often significant and this funding requirement can generate significant private sector pipeline. These blending operations also represent a strong de-risking factor for private investment.
- Impact Investment financiers: FAO is committed to assist investors by providing quantitative and qualitative information on the impacts and outcomes of its investment activities, so that shareholders, as well as donors, civil society and investors can be confident that the impact investor’s investment portfolio will be delivering real social and environmental benefits.
- Commercial banks, private equity funds etc.: FAO can efficiently support commercial financial institutions through (i) capacity development of their staff on improved management, product development for funding of agricultural SMEs and safeguards implementation linked to compliance with SDG and other standards; (ii) technical assistance to the clients/borrowers for improved technical performance; and (iii) monitoring of the portfolio performance on technical ground.

## 4. CONCLUSION Investments in sustainable agri-food systems will be more attractive and profitable in the future: sustainability can work for better financial returns

Since the adoption of UN SDGs, there has been increasing recognition of the unique role that private investments can play in building a sustainable future. Food and agriculture offer an opportunity for inclusive economic growth, particularly in developing countries. With sufficient financing in sustainable food systems, the sector can unlock enormous economic potential while achieving several of the SDGs.

As a specialized UN agency, FAO has an essential role to play in in catalyzing actions for sustainable investment in agriculture and innovative agribusiness partnerships.

To this end, FAO provides technical assistance, in the form of analyses, strategy, and programme design, articulated along the following main lines:

- Identify partner/investor's needs in terms of support, type of technical assistance, as well as capacity development and learning
- Customize FAO-developed guidelines and knowledge material to accompany the investor's agricultural activities.
- Practical due diligence tools that could be applied at the project level
- A blend of e-learning materials accompanied by certification possibilities.

Much of the research to date has focused on demonstrating the link between a company's overall environmental, social and governance performance (ESG) and its financial performance.

Studies conducted by Boston Consulting Group (BGC, 2019) and McKenzie (McKenzie, 2020), between 2009 and 2020 present some evidence that:

- Investors rewarded the top performers in specific ESG topics with valuation multiples that were 3% to 19% higher, all else being equal, than those of the median performers in those topics.
- Top performers in certain ESG topics had margins that were up to 12.4 percentage points higher, all else being equal, than those of the median performers in those topics.

Application of the SDG lens allows companies to spot completely new opportunities:

- **Opening up new markets.** Business strategy integrating profit and societal impact can open up access to new geographic or demographic market opportunities, and to underserved customer segments in existing markets. Although these new markets may not be immediate money makers, entering them is often a strategic move that leads to long-term, profitable growth opportunities.
- ENFAŞ, the energy arm of Turkey's largest dairy firm, Sütaş Group, is one example of such possibilities. Founded in 2011, it has become one of the leading bioenergy-companies in Turkey. Enfas has been introducing an innovative biomass supply chain model, based on the transformation of organic wastes from dairy farms, agro-processing industries and municipalities into bioenergy and organic fertilizers.
- **Innovation.** Companies that adopt the SDG lens will often identify new products that can provide societal benefits while boosting the appeal of those products, or develop entirely new lower-cost products, services, or a new business model for an underserved community or a product that addresses a specific environmental

issue, can often be successful in existing markets. For instance, food retail, is a vibrant sector undergoing unprecedented changes and challenges, including the introduction and impact of new technologies, changing consumer demands and attitudes and the rapid development of new products thanks to innovation. These challenges also highlight the growing interdependence between producer and consumer who increasingly recognize the need for action. These challenges represent a risk, but they are also a blessing in disguise as they offers new opportunities.

- **Reducing cost and risk in supply chains.** The development of more inclusive supply chains can make those networks more resilient and cost effective being less dependent on a few suppliers and distributors, and raw materials can be sourced closer to the end market.

  As an example, development of inclusive supply chains to ensure sustainability from "farm to table", through inclusion of producers and SMEs in modern food value chains and adjustment of these SMEs to higher food quality and safety standards. Being able to successfully target higher end markets means creation of added value and higher returns.
  Development "Geographical Indications" – an origin-based official labelling system protecting the reputation of traditional agrifood products, and helping them to stand out in the competition thanks to high quality standards.

- **Strengthening the brand and supporting premium pricing.** Companies known for products with positive environmental or social impact can inspire customers' loyalty and trust. That can translate into increased sales and even premium pricing on certain products for certain market segments, a powerful benefit, in particular for the consumer goods industry. Emmanuel Faber, chief executive of Danone: "Consumers are looking to 'pierce the corporate veil' in our industry and to look at what's behind the brand. The guys responsible for this are the millennials. Millennials have a completely new set of values. They want committed brands with authentic products. Natural, simpler, more local and if possible small, as small as you can."

- **Gaining an advantage in attracting and retaining talent.** A strong track record in contributing to society can energize the workforce – especially the millenniums - and give a company an advantage to attract, engage, and retain talent.

- **Becoming an integral part of the economic and social fabric.** Companies that explicitly work to support a country's economic and social development goals can strengthen relationships with governments, regulators, and other influential parties.

Companies that are able to seize opportunities offered by SDG alignment while addressing the key development issues, increase the likelihood that they will grow and thrive over the long term.

**AgrInvest - a platform for an action-based approach to foster investment and sustainable food systems transformation and SDG compliance**

Today, many countries recognize an increasingly urgent need to foster investment in agriculture with the idea of transformation of food systems so that they can sustainably nourish a growing population while providing economic opportunities and livelihoods to urban and rural communities.

The FAO-led AgrInvest approach is the attempt to not just deliver commitments, but to present and implement an action plan that can be monitored and reported against the 2030 SDGs. It is not a one-size-fits-all approach for enabling investment and incentivizing food systems transformation. Given the complexity of food systems as well as the multi-country and multi-issue overlaps involving health, food, land use, rural economic development, migration, conflict and investment, each country and region may therefore adopt a bespoke approach.

While there is an increasing number of successful partnerships and alliances evolving to address geography-specific, as well as consumer and producer-specific issues, AgrInvest will be joining its efforts with existing initiatives providing a global action-based platform that encompasses different efforts.

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