

INVESTING IN FOOD SYSTEMS: GAPS IN CAPITAL, ANALYSIS AND LEADERSHIP

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Introduction

Foundations are missing a critical opportunity in food systems funding. As they increasingly make grants in food and agriculture, few invest their endowment assets in farmers, cooperatives, businesses and entrepreneurs. This lack of capital investment reflects a big gap in analysis and leadership. Until foundations unleash their capital for equitable and renewable food systems, our efforts will be partial and ineffective.

While production from small, mixed agroecologic farms feeds 70% of the world's population², they remain undercapitalized and undervalued by markets, leaving most farmers in poverty and vulnerable to adopting industrial agricultural practices as a means of survival. Similarly, organic, regenerative, and sustainable agriculture enterprises are constrained by a lack of capital. The impact of this undercapitalization is poverty, poor soil fertility, increased global market dependence, and decreased biodiversity and ecological resilience.

Thus, while consumers across the globe are demanding healthy, diverse foods, farmers and food entrepreneurs are struggling to secure the investment needed to meet this demand, so essential to becoming competitive in a demanding market. Beyond consumer demand, other

constituents are recognizing the industrial food system's costs (e.g. water pollution, unsanitary working conditions, contaminants, soil degradation, etc.) and demanding change in how our economic models value the food produced within them.

Why should foundations go beyond their usual grantmaking, advocacy, and other leadership programs to activate their endowments through impact investing? In the first place, food system transformation requires more than grants, and foundations are uniquely positioned to invest their endowment capital in catalytic ways to make this transformation possible. Second, even early stage businesses operate within a market economy and financial investment tools (e.g. loans, equity, etc.) can help develop their business models.

This brief focuses on the rationale for such investments and the bottlenecks in thinking that prevent transformative investments. It does not analyze how foundations could make food system transformation investments, although some insights from Swift Foundation's investment portfolio are provided as illustrations.

Part I: Foundations need to incorporate investing as a critical framework for change and as a strategy for food system transformation.

- A. Smallholder farmers, cooperatives and entrepreneurs need values-aligned and blended investments.
- B. Current philanthropic investment in 'sustainable' agriculture and food systems is driving farmers and consumers primarily towards an industrial model.

Part II: Why is the field of transformative food system investments so constrained?

Part III: Opportunities to Reframe Food Systems Investing

Critical to this brief is the definition of two terms: food systems and values-aligned investing. Here please refer to the *Global Alliance for the Future of Food's* approach to food systems that identifies "a holistic systems approach that recognizes the food system's interrelationships" and incorporates "practices of transitions to more sustainable, secure and equitable food systems."³ For the values-aligned definition, please refer to the six Global Alliance principles

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2 Etc Group accessed 12/13/2018. www.etcgroup.org/content/who-will-feed-us-industrial-food-chain-vs-peasant-food-web

3 Global Alliance for the Future of Food, 2017, The Future of Food in a Climate Changing World" 2nd International Dialogue Summary Report, p. iv.

of: renewability, diversity, healthfulness, resilience, equity, and interconnectedness. Swift Foundation understands these principles as embodied in the practice of agroecology.

Part I: Why Invest?

A. *Smallholder farmers, cooperatives and entrepreneurs need our principled and blended investments*

Growing evidence exists that current financial institutions are not serving the demand among smallholder farmers, and small and medium sized businesses (SME) for capital.

A recent study by the *Initiative for Smallholder Finance* (ISF) estimates existing financial service providers meet only one-quarter of the estimated \$200 billion capital needed by smallholder farmers.

This study focusing on Latin America, sub-Saharan Africa, and South and Southeast Asia finds that “access to financial services can improve the lives of smallholder farmers and their families” yet the finance industry must “engage closely with customers to design and offer appropriate, desirable products through integrated and innovative partnerships supported by more and smarter subsidy.”⁴

The key barriers to the growth of financial services for agroecological, smallholder farmers include: low financial returns and high risk (e.g. weather, pest, price fluctuations, etc.) constrain investment, and available capital is extremely inflexible. While the ISF model to improve

agricultural production includes a broad range of opportunities such as more favorable terms of exchange in markets, credit to avoid unscrupulous loans during harvest, and low-input approaches to soil fertility, much of the investment is focused on high input production regimes dependent on purchased seeds, fertilizers, and pesticides that neither regenerate ecosystems nor foster resilient local economies in communities.

ISF calls for more farmer-centric financial services, stronger partnerships among financial actors to de-risk the cost of capital needed to serve smallholder farmers, and smart subsidies that include blended capital. These recommendations ring true regardless of the type of investment. In addition, they note “capital deployed through blended financial transactions can often attract one to five times the initial amount in private investment.” (Ibid. p.10)

Another recent report by the *Council on Smallholder Agricultural Finance* (CSAF) draws similar and more nuanced conclusions. CSAF is a collective of nine organizations (including Root Capital, Global Partnerships, Alterfin, and Shared Interest, among others⁵) that collectively have lent \$682 million dollars to 765 businesses in 65 countries in the global south. These businesses generated \$7.6 billion in annual revenue for 2.3 million smallholder producers, 29%

of whom are women. They provide capital in what is termed the “missing middle” of loans between \$100,000 to \$2 million. Coffee, cocoa and specialty nuts dominate their investment portfolios. As these are all export crops, these are not well poised to promote the kinds of domestic and local food crops local consumers need and want.

Importantly, CSAF’s recent state of the sector report addresses climate change, gender equity, and orphan crops such as sorghum, critical issues for values aligned foundations interested in food system transformation. CSAF’s recommendations parallel those by ISF and include: a smart subsidy program⁶, technical assistance vouchers, creation of a distressed debt facility and a foreign currency facility, loan guarantees, scholarships, and relevant policy reforms to unlock public investments.

While these reports mention issues such as consistent tax policies, subsidies, and the issues of weather and market volatility, other issues such as women’s access to land, agroforestry as a sustainable land use system, and resilient local economic systems for decreased dependence on export crops are not referenced. In other words, these reports highlight certain types of food systems that need to be supported and developed. Also neglected is the value of biodiversity, water quality and fertile soils, even

4 Dalberg Global Development Advisors, 2017, *Inflection Point: Unlocking growth in the era of farmer finance*, Executive Summary, p. 1.

5 Note: Swift Foundation is an active investor in several of these funds including: Root Capital, Global Partnerships, and Shared Interest, among others. See our website at swiftfoundation.org for a full list under the Transitional Investment Portfolio.

6 A smart subsidy is one that achieves public policy goals efficiently and effectively. www.bostonfed.org/-/media/documents/commdev/smart-subsidy/4-introduction.pdf

though Swift knows that many of the involved organizations prioritize these issues. These critical dimensions we seek to support cannot be monetized within a traditional financial model. Another weakness of these reports is their focus on farmers and not on the food system as a whole, limiting their transformative potential.

Indeed, Swift Foundation believes that philanthropy can be a creative driver in the field of food system investing, by employing holistic approaches to understanding systems and their solutions and proactively employing integrated capital. Philanthropy can align financial capital with different outcomes and other types of wealth such as traditional knowledge, community capital, and natural resources.

B: Current philanthropic investment in 'sustainable' agriculture and food systems is driving farmers and consumers primarily towards an industrial model

Currently, the most visible philanthropic support to address the food system crisis in the global south is directed towards maximizing yields to address global hunger and a growing global population. This support takes the form of farmer adoption of expensive seeds, fertilizers, pesticides, and in some cases irrigation and machinery. The proponents of this model use a variety of strategies combining subsidies, technical assistance and loans in coordination with governments and global industrial agricultural companies often

described as public-private partnerships.

Not only do capital and input intensive strategies undermine smallholder farmers' complex systems of cultivation, they affect the economic wellbeing of smallholder farmers. Many powerful industrial stakeholders see smallholder farmers as a key target for growing their markets. Fortunately, many smallholder farmers have remained beyond the reach of industrial agriculture. To counter this approach, interested actors and foundations must engage in strategies, beyond grantmaking to support the economic viability of smallholder farmers and catalyze public and private investment in agriculture and food systems that support local wealth generation not extractive models. Strategies may include investing in appropriate green manures, fertilizers and low-cost technologies, and public policies that address the health costs of industrial food, such as diabetes rates due to highly processed industrialized food, by procuring locally produced food for schools and hospitals to promote healthier fresh food diets resulting in more regular demand for local agricultural production.

Farmers who steward the land for sustainability *and* have strong incomes are more resilient to malnutrition and hunger. Investing in higher farm incomes and better, healthier practices can stem youth migration to urban areas. In fact, youth migration out of rural areas undermines the adoption of more labor-intensive agroecological practices. Investment in sustainable agricultural practices

can spur higher yields, better prices and more favorable living conditions in rural areas.

Impact Investing in Sustainable Food and Agriculture Across Asset Classes: Financing Resilient Value Chains through Total Portfolio Activation (May 2017) addresses foundations who wish to invest in this sector. While the report's main points and examples draw on much of the best investment work in sustainable food and agriculture today, the report is oriented towards a classic investment portfolio approach.

A few highlights from the paper illustrate this point. Opening with the gap between the interest from impact investors (63% say they want to invest in food and agriculture) compared to actual assets invested in agriculture (7%), the report lays out opportunities to fill this gap. The authors describe the changing context in terms of global finance and commoditized food systems which have entered a period of instability and have wreaked havoc upon consumers, producers and the planet globally.

As we know, the food system is incredibly diverse and resilient due to the assets and knowledge of smallholder farmers. Industrial agriculture has created a chain of wasted calories, industrial crops, and poor nutritional values that cannot be changed through the same financial systems that created it. In addition, if farming is separated from food systems, the contribution of total global agricultural and food systems activities shifts considerably from the 10% of global greenhouse

gasses cited to ranges of 33 to 56%.⁷

They identify ways to invest throughout the value chain from smallholder farmers to large corporate entities and present total portfolio activation as an exercise to effect change. The concept of total portfolio activation is “the idea that endowment and foundation investors have an opportunity and responsibility to leverage impact across all asset classes in alignment with their programmatic focus.”⁸

Swift Foundation has invested in many of the funds and opportunities outlined in the report. But the question remains: are existing investment opportunities transforming our food system or engaging in incremental change? It depends on the investments considered within the report, some of which are transformational. They recognize many opportunities are not paying market rate returns in their asset classes and they emphasize the critical importance of blended capital opportunities to overcoming constraints.

In total portfolio activation, investments in different sectors are seen as complementary in creating a risk averse portfolio but if we stay within a modern portfolio theory paradigm, will we be able to value other impacts equally as financial returns? Many believe a more radical rethink of capital deployment in food systems is required to shift the system. Currently, Swift follows this incremental approach to investing through our investments in the six identified areas of total portfolio activation:

1. Community Development Finance Institutions
2. Private debt through microfinance
3. Public bond markets
4. Private equity investments
5. Public equity managers
6. Real assets, acquisition of farmland, ranchland and forests

Swift agrees that some of the investments are transformational; however, overall we recognize that

- 1) there is a dearth of opportunities,
- 2) the existing opportunities could be stronger in their transformational aspects, and
- 3) an approach to deploying capital that relies upon current financial investing models of risk management and aversion will not get us the kind of change we need in food systems. In fact, as described in the report, a more visionary approach to investing with blended or integrated capital that integrates values-aligned principles of mission-driven foundations is critical.

The question is whether the existing investing opportunities in agriculture and food systems are sufficiently transformative as a whole. In addition, are existing financial institutions and policies up to the task of transforming food systems? Without going into the specific details of these investment

areas, traditional debt and equity structures don't meet most farmers' and entrepreneurs' needs.

Other opportunities for investing exist and some foundations are experimenting with models to integrate capital business assistance and other kinds of profit and value creation through cooperative structures and innovative models of exchange and return such as the Buen Vivir Fund at Thousand Currents and models wherein workers and entrepreneurs do not envision market exits but instead create employee wealth and provide royalty payments to investors in relationship to overall profits. Both the Slow Money and Slow Food movements provide good examples of alternative approaches to transforming investors' relationship to food systems.

Despite the innovation and hope these models present, they do not attract significant resources and are not widely shared as relevant and/or feasible for foundations uncomfortable with new ways of working. These models are constrained by a lack of visionary capital, thus unable to show the necessary momentum. Foundations need to consider that these kinds of investments may demonstrate how to challenge our financial thinking into new directions that will create the food systems future that we want.

7 See figure of 33% in Meridian Institute (2017) *Climate Change & Food Systems: Assessing Impacts and Opportunities* and 43–56% according to UNCTAD and GRAIN as reported in “How much of the world's greenhouse gas emissions come from agriculture?” www.grain.org/article/entries/5272-how-much-of-world-s-greenhouse-gas-emissions-come-from-agriculture. In another perspective, reducing greenhouse gas emissions requires diverse interventions in food among other sectors like energy, building and land use. In *Drawdown* (2017) by Paul Hawken the range of investments span a food systems perspective and highlight areas as diverse as: plant-based diet, farmland restoration, reduced food waste, agroforestry, improved rice cultivation, regenerative agriculture, and composting.

8 Reference: <https://www.tides.org/accelerating-social-change/philanthropy/total-portfolio-activation-a-framework-for-creating-social-and-environmental-impact-across-asset-classes/>

Part II: Why is the field of transformative food investments so constrained?

The current state of investing in regenerative, agroecological, or organic smallholder farmers and entrepreneurial businesses can be characterized at best as fragmented and at worst disorganized. This discourages values-aligned investors. The reasons are multiple and require our attention as the field of investing is complex, place-based and country specific, and overgeneralization can reduce our ability to converse persuasively.

The main challenges include:

- 1) impact investing work involves a large tent of actors with sometimes oppositional goals (e.g. returns vs. outcomes), resulting in a lack of definitional clarity which threatens meaningful investment;
- 2) foundation stakeholders have little reason to be visionary, work with colleagues in new ways, and/or learn new skills because of entrenched roles and relationships; and 3) most of the infrastructure for creating and sharing investment opportunities is dominated by large foundations which are structurally unable to support small, locally based investment opportunities. Yet, these limitations are mostly self-imposed and result from the current conventional financial infrastructure that is archaic, inflexible and structured in such a way to prevent these kinds of businesses and producers to thrive. Few financial intermediaries are positioned to place capital in a flexible and customized way to address the true need of a place

or community. Most tend to focus on scale and replication that is not tailored to the local environment.

Linked to this field building effort, there is a need to “make the case” that agroecological and small locally based farming is indeed a viable alternative in ways that resonate with more actors in agricultural investment. As evident throughout the studies cited in this brief, even progressive actors in agricultural investment still tend to assume that such approaches can only exist at the fringes, at best. There is an implicit assumption in their investment approaches that industrial approaches to agriculture need to be expanded, rather than investing for expansion of successful agroecological practices to replace industrial ones.

Frameworks for Thinking & Value-Aligned Investing

Investing in food systems for transformation requires development as a field, including analytic tools, case studies of integrated capital and deeper study of investment strategies as they relate to different ecological, political and cultural contexts.

Much of the impact investing work that passes for ‘sustainable’ actually promotes high input agricultural regimes that do not support diversity and equity. Their focus is on maximizing yields and increasing farmer incomes without considering other principles such as resiliency, renewability, and healthfulness.

Within foundations both staff and leadership responsible for investment and those that are

responsible for programmatic decisions often reinforce silos that complicate our ability to move into both impact investing and integrated capital in a dynamic and transformative way that would support social change and justice in food systems. In nearly every foundation the roles of investment and program staff are separate. Foundations recruit for specialized experience that does not promote cross-pollination of knowledge. Without strong mission leadership, these groups do not work together well. Mostly, these silos exist because of foundation-created limitations and the fact that hired consultants and financial advisers rarely focus on the mission of the foundation.

No foundation networks exist to invest in food systems that reflect transformative values-aligned investments. The result is that foundations look exclusively to their grant and advocacy portfolios to meet their missions. This is a missed opportunity. Other barriers to investment involve the nature of the opportunities available. Swift Foundation has experience to illustrate how food investments are unlike other investments as they require a different kind of patience and set of values.

Barriers to Investing in Sustainable Agriculture and Food in the United States

Financial Returns are Low (0 – 4%) and Terms are Long

Few investors and businesses in food systems transformation expect profits greater than 5%. Most investments require a 7 to 10 year time horizon.

Access to Loans and Financing is limited

Most innovative farmers and entrepreneurs subsidize their food enterprises with their own time, money and talent because they cannot qualify for formal loans.

Sustainable Agriculture and Healthy Food Businesses Are Small

Much of the success and quality of sustainable farming and healthy food businesses is characterized by local knowledge. Aggregation of investment in these activities is challenging.

Growth Beyond Family Enterprises Requires Know-How and Significant Capital

Once a farmer/entrepreneur starts an agriculture and food system business their growth is often limited by their knowledge of business development and the cost of capital to secure needed infrastructure.

One example of a fund that tries to fill this gap on a national level is the RSF Food System Transformation Fund that provides loans between \$50,000 and \$450,000 to food entrepreneurs (food production, food access, value-added processing, distribution, retail and waste management). Swift has invested \$800,000 in the fund for more than 7 years (1% return, 3 year term) and made several small grants (\$25,000 range) to support the administration of these funds. The businesses themselves are highly compelling: such as Eastern Carolina Organics (ECO), a growers' supply hub connecting organic farmers to markets, and D.C. Central Kitchen that

has a variety of social ventures supporting culinary job training, healthy school food, etc.

While these businesses are leading the way in transforming our food system, the RSF fund itself has had trouble attracting capital from foundations and investors, and challenges in covering its overhead at its current size. This reflects less on RSF and more on the challenges of investors' mindset and unwillingness to invest in food system businesses characterized by high risk and low financial return.

Swift has also made direct investments in several food companies based in the United States including: Guayaki Yerba Mate, Native American Natural Foods, and Heavenly Organics. The story behind each of these businesses differs, however, their missions are incorporated into their business models, a positive indicator. However, direct investment requires specialized financial and market knowledge as well as a tolerance for risk beyond which most foundations are willing to engage. Foundations are generally more interested in funding a diversified investment fund such as Renewal Funds. Like many impact funds, Renewal selects only some food businesses in a broader portfolio of sustainable companies.

Barriers to Investing in Sustainable Agriculture and Food in the Global South

Microfinance supports rural farmers

Most farmers and food systems entrepreneurs access capital primarily through microfinance

institutions, both for-profit and non-profit. These institutions also provide credit for needs beyond food systems making this a mixed opportunity, a challenging profile for "pure" food investors.

Most investment is focused on a few export crops

Coffee and cacao followed by cashews and quinoa tend to dominate agricultural lending in the global south due to the value of these crops in providing a return to lenders in foreign currency.

Returns are Low (0 - 5%)

Similar to U.S. based investments returns tend to be below 5%.

Risks include Exchange Rate Fluctuation, Changing Policy Environment

Since most financial institutions focus on export crops, they avoid the issue of exchange rate fluctuations, a key risk for foreign investors. While solving the currency question, it limits the scope of agriculture that investors will consider and does nothing to enhance local consumption. Instability in policies can also greatly affect the investment environment.

Like RSF in the U.S., similar institutions exist to serve the global south with loans between \$25,000 and \$400,000. Root Capital has a 20-year history of investing in cooperative and other farmer owned businesses. Similar funds to Root in this space provide technical assistance and capacity building alongside capital, essential for successfully reaching ESG goals.

A dominant feature of global south lending is the microfinance institution. Funds such as MCE Social Capital and Global Partnerships extend support to non-profit organizations and banks providing small loans, services, and technical assistance to farmers and entrepreneurs in the global south. Loans range from \$50 to \$1,500 and reach the unbanked populations of women, Indigenous Peoples and smallholder farmers. Swift has invested in Global Partnerships (5% return, 10 year note), MCE Social Capital (no return, \$2 million loan guarantee), and Microvest (2 – 3% return, \$1.5 million, 3 month note).

Interestingly, Microvest – a microfinance backer – is in Swift’s market rate portfolio as this investment is favorably benchmarked in its asset class with a track record to back it up. Notably, these funds are not exclusive to food systems and provide loans for food production, renewable energy, health, artisanal crafts, and small business development.

Part III: Opportunities to Reframe Food Systems Investing

Globally, the capital needs of farmers and food system entrepreneurs are unmet. While this field is extremely complex and geographically and location-specific, it is clear that current financing solutions and analysis are not aligned with transformational food systems work.

This means that foundations can no longer ignore the role of investment in transforming our food systems by focusing only on grantmaking, advocacy and leadership. It is time to overcome this division in our work.

Due to our holistic perspective on food systems and our commitment to values-aligned principles of renewability, resilience, equity, diversity, healthfulness, and interconnectedness, food systems-oriented foundations bring a unique lens to the conversation. We have the capital and leadership to catalyze a reframing of the food systems impact investing conversation.

To rise to this urgent challenge, we can:

1. Provide leadership to break down program–investment silos within philanthropy that limit our ability to address food system transformation;
2. Understand and engage with innovative approaches to financing that help transform food systems (e.g. integrated capital);
3. Identify and share food system investments that are transformative; and
4. Develop better criteria to evaluate transformative food system investing.