Transforming Food Systems

THE POWER OF INTEGRATING GRANT AND INVESTMENT CAPITAL

"Three colliding trends are impacting our global food system: the rise of the conscious consumer demanding healthy food, the social movement's claim on equity at the heart of transformation, and the certain impact of climate change on food production. To respond, our collective imagination must work in innovative ways."

~ meeting participant

AN INVITATION TO JOIN US IN INTEGRATING GRANT AND INVESTMENT CAPITAL

Dear Colleagues,

Farmers and food system businesses, including those utilizing small-scale, agroecological and regenerative practices, are undercapitalized and undervalued. As a result, poverty, poor nutrition and decreased biodiversity, among other ills, are making our global food economy more unhealthy.

At the same time, foundations are increasingly focusing their programs and grantmaking on lifting up healthy food systems. However, that's not enough. To maximize our collective impact, we must commit our endowment assets and investments to the places and issues we deeply care about while ensuring our endowments do not undermine our program work.

Until foundations creatively combine both their grant and investment capital into building more equitable and renewable food systems, we will not realize the transformations that we seek. We must also use advocacy, accountability, research and dialogue to address the perverse incentives and true costs of our current extractive agricultural system.

To tackle these issues, our Organizing Committee convened foundation representatives in early December 2018. This report draws from that meeting and is an exploration of current concepts, trends and challenges in impact investing for food system transformation. Importantly, it is also an invitation to join us as we move forward into this exciting and absolutely vital work.

Together we can unleash integrated capital and collective learning to truly transform the food systems we work in around the world.

Jennifer Astone
Executive Director, The Swift Foundation

Tim Crosby
Principal, The Thread Fund

Other members of the Organizing Committee:
Lauren Baker, Global Alliance for the Future of Food
Jane Maland Cady, McKnight Foundation
Daniel Moss, AgroEcology Fund
Y. Elaine Rasmussen, Social Impact Strategies Group

Front cover: Shoua and the Dahlias, Hmong-American Farmers Association (HAFA), Minnesota. Photo: Mike Hazard/HAFA FARM.

INTRODUCTION

Twenty foundation representatives, affiliated with the AgroEcology Fund and/or the Global Alliance for the Future of Food, responded to a call to explore the landscape of impact investing and integrated capital in transformative food systems. They were joined in Minneapolis by several issue experts and food system entrepreneurs.

The participants discussed the current state of the field to learn how foundations are directly investing in businesses, capitalizing funds and providing catalytic first loss capital. (See the glossary for financial terms in this report.) They learned from two Minnesota community organizations and other projects that use integrated capital for food systems work. The discussion was informed by Jen Astone's paper "Investing in Food Systems: Gaps in Capital, Analysis and Leadership."[1]

Central to the discussion was an ongoing tension between what it means to invest in transforming food systems in the United States, where industrial agriculture has a stronghold, and in other countries and regions around the world, where agriculture is still dominated by smallholder farmers.

This report highlights key resources, concepts and insights that caught our collective attention and provides a roadmap of the next steps we hope to take. Throughout this report we have quoted meeting participants anonymously so that they could speak freely in the meeting.

PRINCIPLES AND FRAMEWORKS

"Before we invest, we ask questions about financial return, but which questions should we be asking that address returns of social and environmental capital?"

~ meeting participant

The group discussed a variety of principles and frameworks that can guide impact investments, noting that existing tools are often inadequate or partial with respect to transforming food systems.

Environmental, Social and Governance (ESG) criteria, a set of standards that investors use to screen publicly traded companies, are among the best known. As one conference participant pointed out, there are limits to ESG. "ESG functions in the public equity markets, but it is hard to translate to early startups and private equity. We generally fund a lot of startups, such as a high-risk effort to organize small farmers into a food hub in Tanzania with organic products. In that situation, we spend less time evaluating formal ESG criteria and more time listening to the farmers on the ground."

Daw Myint Myint Win, client of Proximity Finance, a microfinance institution in MCE's portfolio in Myanmar. A duck farmer and mother of three, she lives in a small village outside of Pyapon, Myanmar. Photo: Harrison Pharamond | MCE Social Capital

1 www.swiftfoundation.org/investing-in-food-systems-gaps-in-capital-analysis-and-leadership/

In the report "Impact Investing in Sustainable Food and Agriculture Across Asset Classes", the Croatan Institute provides a framework for how foundations can use Total Portfolio Activation to fund sustainable agriculture and food investments in all of their asset classes. Croatan includes examples of investments in public and private equities, fixed income, venture capital and real assets.[2]

A representative from the Global Alliance for the Future of Food offered the group's principles as an innovative framework applicable to impact investing in transformative food systems:

Renewability: Respect the integrity of natural and social resources;

Diversity: Value our rich and diverse agricultural, ecological and cultural heritage;

Healthfulness: Advance the health and well-being of people, animals and the environment and the societies that depend on all three;

Resilience: Support regenerative, durable and economic adaptive systems;

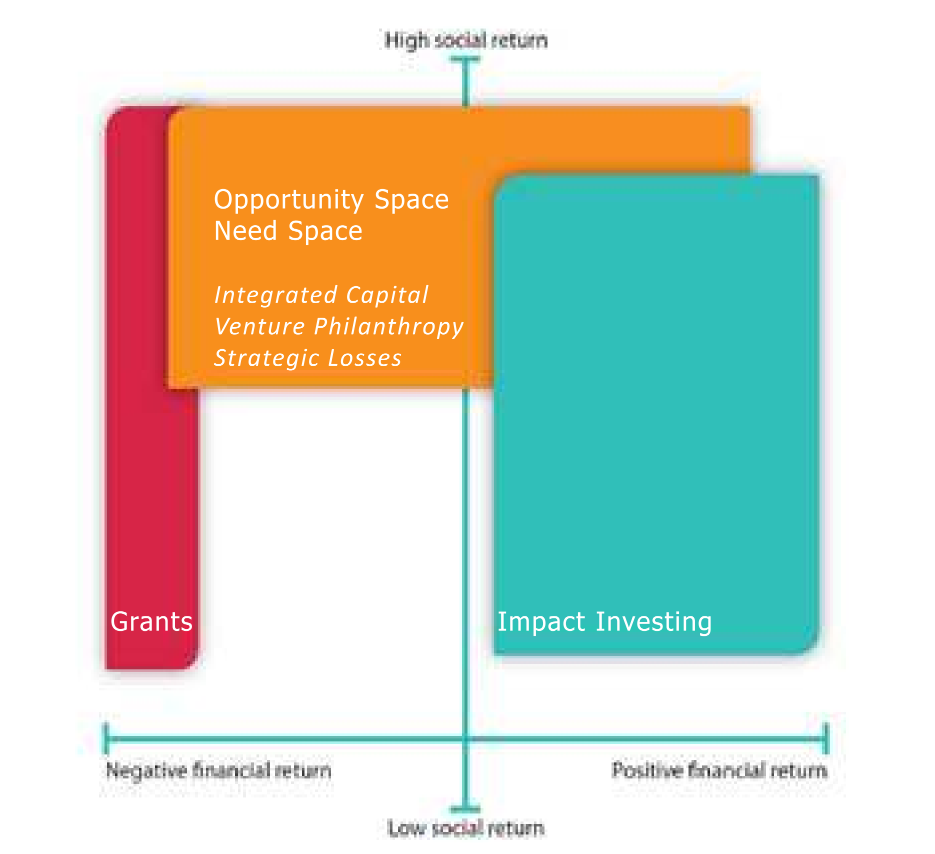
Equity: Promote sustainable livelihoods and access to nutritious and just food systems;

Interconnectedness: Understand the implications of the interdependence of food, people and the planet.[3]

Other participants suggested foundations may wish to consider frameworks and principles such as Wealthworks[4], Permaculture Design Principles[5] and the Just Transition framework.[6] Participants noted that the United Nations Sustainable Development Goals[7] have had traction this past year, with even private investors highlighting them.

One participant offered TEEB: The Economics of Ecosystems and Biodiversity[8] as a model for evaluating the effectiveness of investments. TEEB, an initiative hosted by the United Nations Environment Program, lays out a holistic approach for evaluating food chains (ecological, economic, social and human considerations), rather than the more common approach of using an individual indicators approach focused on production only (such as productivity per hectare).

Participants expressed confusion about the plethora of approaches for evaluating investments. Others wondered how complete and effective those approaches are. "Most of the screens are incomplete and results will be inconclusive or related back to broader frameworks," one participant said.



Source: The Thread Fund modified from original graphic in report "Venture Philanthropists & Impact Investors" Toniic Institute, June 2016. www.toniic.com/venture-philanthropists-and-impact-investors/

2 www.croataninstitute.org/croatan-publications

3 www.futureoffood.org/about-us/how-we-work

4 www.wealthworks.org

5 www.permacultureprinciples.com

6 For an overview of Just Transitions: www.climatejusticealliance.org. Find good links on approaches and strategies at: www.croataninstitute.org/croatan-programs/just-transitions

7 https://sustainabledevelopment.un.org/sdgs

8 www.teebweb.org/agrifood/home/evaluation-framework/

Another concern was about how onerous data collection can be. One participant expressed, “You can collect data on pretty much anything, but it is very expensive to do. How much data do you really need to evaluate investments?”

SMASHING SILOS BETWEEN GRANTMAKING AND INVESTING

“Grant making is the purest area for most foundations. Traditionally an endowment is less pure. Is our impact investing portfolio a less perfect reflection of our values? Yes, but we always ask ourselves ‘What is the next wise action?’ Rather than trying to figure out the solution for everything.”

~ meeting participant

Achieving transformative results involves working on social, economic and environmental goals at the same time. “What is real wealth? What will build intergenerational and community wealth? We don’t see financing in silos,” said a participant. “We can’t think about only one area like land. We need markets, capital, training and research as well. You have to have a whole foods model.”

Yet foundations are too often focused on one issue, according to some of the participants, which colors the way they invest as well. Said one: “There are agriculture funds for water quality, for example, but some are now looking for more holistic approaches. Very few foundations are making grants in a holistic manner, but it is coming.”

The McKnight Foundation described its decision to work within the U.S.A. with its direct investment in Midwestern BioAg, a farmer-centric business to help producers grow yields, increase profits and improve soil health.[9] The Foundation’s $5 million direct equity investment in Midwestern BioAg allowed it to build a facility that turns animal waste into energy and then soil-enhancing fertilizer. McKnight was attracted to the company’s ability to work with both organic and large-scale conventional farmers.

Many participants remarked on the silos that often exist between the grant and investment sides of foundations. A few reported that the two sides of their foundations were working and talking together, but communication can be difficult. Grant officers reported program illiteracy on the investment side of their foundations, as investments are commonly misaligned from the foundation’s mission and goals. Grant officers admitted a degree of financial illiteracy on their part. They do not understand key strategies in the impact investment toolbox, such as primary debt, subordinated debt, public and private equity — even the phrase “integrated capital.”

“Grant officers don’t understand financial flows. These are challenges we have to figure out and overcome. How do we bridge those understanding and knowledge gaps?” one participant asked.

The Thread Fund discussed a recent experience from the Cascadia Foodshed Financing Project[10] that illustrates the divide. The Project hired Ecotrust to identify market drivers and investment opportunities in the Pacific Northwest for six sustainably produced products. When presented with the report, grant makers and investors—based in the same region and presented with the same information—had different conclusions about how to proceed. “Foundations tend to fund for transformational system change, while for-profit investors seek to ‘pick winners’ based on

Chef of community-owned business in tribal area of Northeast India that works with the North East Slow Food and Agrobiodiversity Society (NESFAS). Photo: AgroEcology Fund.

9 www.mcknight.org/impact-investing/
10 www.cascadiafoodshed.org

transactional financial success," the Thread Fund representative said.

Despite efforts at some foundations to bring investment and program staff together to align their work, the assembled group acknowledged that they bring deeply seated professional practices and biases that work against their ability to engage with one another productively. Strong board leadership is required to overcome such challenges and create an environment for creative thinking.

RISK AND RETURN

"You have to take the risk. At the intersection of risk is innovation. There is no transformation without!"

~ meeting participant

Most participants agreed that a focus on achieving the highest possible financial returns based on maximizing yields has caused much harm for food systems around the globe.

"You can't fix a broken food system with a broken finance system. So much of what we are calling market rate is based on extractive principles. Understanding what that means for communities is still behind the curtain."

~ meeting participant

Said another participant: "The endowment model of investing went early in on natural resources and brought capital to land grabs abroad. We changed the world with these blue-chip endowments."

One key path for transformative change is the flow of integrated capital to farming and food efforts that finance-first investors consider high risk and provide lower returns. For example, the Swift Foundation's position is that "we are aiming to preserve capital and not make a profit from food system investments overall."

One participant referred to a recent *Stanford Social Innovation Review* piece, which found troublesome barriers between projects' piloting phase and scaling phase.[11] "Pilot phases require a lot more friendly risk capital than a scaling phase, where the model is more proven. It is like the difference between venture capital and other forms of investment where there are actual historical numbers on sales, costs and profits," said the participant.

Foundations' integrated capital relies upon creative financing strategies (such as loan loss reserves, longer loan periods and lower financial return expectations) and the ability to adapt when times are tough for the farmers and food system efforts. "Patient capital can mean modifying terms and working out loans in collaboration with the farmer (rather than foreclosing)," said a participant.

Julie Ristau of Main Street Project[12] spoke to the group, illustrating the risk-return dilemma. Main Street Project has developed a poultry-centered regenerative agriculture system that the Minnesota-based nonprofit is spreading throughout the Americas (including Native communities in South Dakota and Nebraska). The nonprofit needed friendly capital to help build chicken coops and other perennial infrastructure on its Minnesota farm.

Main Street Project needs friendly capital — for example, loans of 2 percent or less — to successfully expand its poultry-centered regenerative agriculture system.

11 "Why Proven Solutions Struggle to Scale Up" by Kriss Deiglmeier and Amanda Grego (Aug. 10, 2018): www.ssir.org

12 www.mainstreetproject.org

"When I went looking for loans, I received offers of 7 percent for five years — terms that will take Main Street Project down," Julie said. "Then a Foundation came out and asked: 'What do you need?' I said 2 percent or less interest, five years of interest only. And their Board went along with that. We simply have to have real patient money."

WHERE TO INVEST?

"Don't use concessionary forms of capital to invest, if it doesn't further transformative food systems."

~ meeting participant

Many at the meeting were hungry for specific information—on due diligence questions and procedures, potential investments to make, terms and type of capital, and potential opportunities for foundations to invest together.

"Many foundations want to invest in this space but don't know how. Is there a website that tells you where to invest and offers definitions of financial terminology? Not all of us can or will bring on a consultant to advise," a participant said.

Participants provided several case studies of impact investments they had made. The Thread Fund,[13] for example, invested in Thundering Hooves, "an organic grass-fed cattle company of fourth-generation ranchers who sold to farmers' markets and restaurants. They wanted to scale up and get into supermarkets. Banks wouldn't lend them money because they had no contracts; they had no contracts because they didn't have cattle."

Chef Sean Sherman: Looking for an Indigenous (R)evolution

It was fitting that Chef Sean Sherman, Oglala Lakota and founder and CEO of the company The Sioux Chef, came to talk with the group, as the meeting was held on the banks of the Mississippi River — land that was stolen from the Dakota in the 1800s. Sherman has become a celebrity for his award-winning food and cookbook and his efforts to use "Native American foods to become an anchor for a new food system based on indigenous culture and foods that can also serve as an engine for Native economic development, address the health crises facing Native communities, and preserve and hand down millennia-old Native food traditions."

"I could find food from all over the world in Minneapolis but couldn't find food from the land we were standing on, the Dakota land. There are zero Native American restaurants in Chicago, LA and New York," Sherman says. "Food should be the center of all of our lives. And yet many Indigenous peoples are eating commodity program food or stuff from gas stations."

Sherman is "looking for an Indigenous (R)evolution" through his nonprofit organization, NATIFS (North American Traditional Indigenous Food Systems).[14] "Our plan is to first create an Indigenous Food Hub in the Twin Cities that will house an Indigenous Restaurant, alongside a training center called The Indigenous Food Lab. The food hub will offer education and live skill training focused on Indigenous food systems and techniques." In the future, satellite labs and restaurants will be built in population centers with large Native American populations.

Sean Sherman, CEO, The Sioux Chef

13 www.threadfund.org

14 www.natifs.org

The Thread Fund purchased the cattle for the company, which helped them secure supermarket contracts and a distributor. The business more than doubled in a year, but in the end the company went bankrupt. As the company was failing, the distributor offered the contracts to other ranchers. “Transformation can mean failure — and willingness to learn from that failure is key,” says the Thread Fund. “In this space between philanthropy and investment, we opened up a market in about a year’s time and for a net $90,000 loss. How many years and how much money would it take a grant-funded project to achieve that outcome?”

The Swift Foundation offered up another example: Its investment in MCE Social Capital[15], which makes loans to organizations committed to improving the lives of women and families throughout the developing world. “This is a nonprofit impact investing firm to which we have made two $1 million loan guarantees. The guarantees have been successful with only a 2 percent delinquency rate. Three years ago, they asked us to invest in their Small and Growing Business (SGB) portfolio. We made a $400,000 investment at 3.2 percent return for seven years. We did it because they have long-standing relationships across the developing world.”

Approximately 70 percent of MCE’s SGB portfolio is in the agricultural value chain sector, including investments in shea nut and cashew processing enterprises in Ghana and Côte d’Ivoire respectively. “There was no cashew processing in Côte d’Ivoire before this. They created 100 jobs for women in a rural community from an enterprise that adds local value to a local product.”

Swift pointed out that MCE’s ability to invest in these enterprises depended on decades of charitably-funded work by local technical assistance providers, building up markets in shea butter and cashew processing. “There has been a lot of donated time, local expertise, and community building work that created the opportunity for those businesses to exist. Market rate return is untenable without investment in technical assistance, community support,

15 www.mcesocap.org

Hmong-American Farmers Association. Investors have helped the HAFA provide the full set of services its farmers need to succeed, including training, technical expertise, farmland and infrastructure. Photo: Mike Hazard/HAFA FARM.

and infrastructure development," said Swift.

According to Swift, foundations derive benefits from investing in funds that aggregate investments in numerous enterprises over direct investments in individual enterprises. "Funds diversify risk by investing in many enterprises, they provide us with insights into a place and issue through expert staff, and they create opportunity for leverage through growth."

Participants encouraged others to learn from the agroecology movement about emerging enterprises that seek investments. "Open dialogue with key actors in the agroecology movement to understand how advocacy for a healthy food system can work hand-in-hand with emerging just and sustainable enterprises," one participant said.

The McKnight Foundation and the Swift Foundation share their investments publicly for others to learn from.[16] One participant noted the Russell Family Foundation's journey from 7 percent to almost 75 percent mission-aligned investments.[17] Many agreed that foundations need to be more transparent about their investments and appreciated McKnight and Swift for their efforts.

The foundation representatives sharing their journeys agreed that they had to engage in imperfect existing investing opportunities to learn, while remembering their ultimate goal: "The perfect is the enemy of the good. Where do we start and how?"

CREATING EQUITABLE RELATIONSHIPS

"We need to make sure that our work is a conversation between investors and investees. Right now, those who are needing the financing make the pitch, and everything only flows one way."

~ meeting participant

Insights from the Meeting

- Every foundation present is already investing their foundation corpus in food systems through public equities and other instruments, many of which are unexamined by their board and staff members.
- Foundations need to think holistically to transform food systems, blending grant and endowment resources in integrated capital strategies, employ total portfolio activation approaches—and consider how patient capital, loan loss reserves and guarantees can be gamechangers.
- Tools and frameworks for measuring impact need to respond to a broader and more integrated set of principles and needs, such as those of the Global Alliance for the Future of Food and the Just Transition Framework that address the interests of both investors and investees.
- Case studies of actual investments, both successes and failures, document what is possible and advance the field. We applaud foundations that share individual investments and their portfolios for public review.
- Great opportunity arises when program and investment staff are empowered to work together with a strong mission-based mandate and clear financial goals. Many foundations are motivated to learn and employ strategies to get capital to farmers and entrepreneurs who are transforming our food system towards a healthier, more equitable, biodiverse and resilient future.

Farmer engaged with CEDICAM (Centro de Desarollo Integral Campesino de la Mixteca), Oaxaca, Mexico. Photo: Lauren Baker, Global Alliance for the Future of Food

16 www.mcknight.org/impact-investing/
www.swiftfoundation.org/tag/social-impact-investing/

17 www.trff.org/impact-investing/

The group highlighted the importance of open conversation between investors — including foundations — and investees. Similar to how many foundations increasingly seek honest dialogue with grantees about their needs, the same should be the case with entrepreneurs.

Pakou Hang of the Hmong-American Farmers Association[18] spoke to the group about her nonprofit's work to provide training, technical expertise, farmland and infrastructure. "Early on, we spent a lot of time presenting to investors for money. Finally, an elderly Hmong woman said, 'We have to stop waiting for someone to save us. We have to save ourselves.'"

Hang urged funders to examine who is in decision-making positions in nonprofit organizations. "When you see a website full of people of color, look to see if there are people of color being paid. Are there people of color on the Board making the decisions?" She also discussed structural equity issues such as corporate farming laws.

Other equity issues surfaced as well. "Simply operating in another country using U.S. dollars can be extractive unless you address currency fluctuation issues. When we asked our Peruvian partners, 'Why don't you invest in local businesses that sell to national markets?' They responded that the profit margins were too low, and businesses needed products to sell globally where the payment would be in U.S. dollars or other foreign currency to repay loans," said one participant. "It is hard for them to operate with currency exchange rates risk. We foundations need to think beyond our limitations: Would a revolving evergreen fund in local currency provide for local economic development that would be less extractive?"

Principles Captured in the Room

- Be clear about your intentions.
- Ensure your investments align with your mission.
- Empower the groups you work with (let them do the work they do).
- Approach your work with a spirit of inquiry and learning.
- Wrestle with the bigger questions.
- Recognize the interconnectedness of your actions and activities.
- Commit to constant improvement.
- Look for opportunities for "value-add" within the country of origin.
- Don't let the perfect be the enemy of the good.

18 www.hmongfarmers.com

Glossary of Financial Terms

Catalytic first loss capital
Socially- and environmentally-driven credit provided by investors who agree to bear first losses in an investment in order to catalyze the participation of co-investors that otherwise would not have entered the deal.

Concessionary capital
Investments that are “below-market” and made primarily for program-related purposes and not for maximum financial return.

Evergreen fund
An investment fund that has an indefinite fund life, meaning that investors can come and go throughout the life of the fund.

Integrated capital
The coordinated use of diverse forms of financial — both investment and philanthropic — and human capital to support enterprises and strategies that address complex social and environmental problems.

Loan guarantee
A pledge (a promise) to cover the payment of debt or to perform some obligation if the borrower defaults.

Loan loss reserves
Cash or cash equivalents set aside to cover estimated potential losses in a loan portfolio.

Patient capital
Investments that are aligned with a longer timeline than average investments, in order to increase the investments’ chance for success.

Primary debt
Loans that are paid first in case of borrower default.

Private equity
Investments directly into private companies through the acquisition of their shares.

Public equity
Investments in securities listed on an organized exchange and sold publicly.

Subordinated debt
Loans that are paid after all other corporate debts and loans are repaid, in the case of borrower default.

Total Portfolio Activation
A framework and set of analytical tools to help mission-driven investors understand the specific impact opportunity set that can be pursued across every asset class in their portfolios.

Adapted from Transform Finance’s (www.transformfinance.org) Glossary of Terms.

Prior page: Chickens in paddock feed on seeds and sprouts. Photo: Main Street Project

Right: Wang Ger with tomatoes, Hmong-American Farmers Association. Photo: Mike Hazard/HAFA FARM

NEXT STEPS

By the end of the meeting, the group had developed the following action steps:

Formalize a Community of Practice

Participants are establishing a "Community of Practice" for foundations to work together to explore and solve collective issues. The Community of Practice will review specific investments, share resources and hold workshops on financial literacy and investment strategies for transformative food investing.

Share Foundations' Protocols and Investments

Participants agreed to encourage foundations to document and share their learning. Which "due diligence" questions do foundations ask before making an investment? Where have they invested — and not invested — and why? What "aha" moments can foundations share about this nascent world of integrated capital in transforming food systems?

Explore the Establishment of a Fund

Several in the group were interested in establishing a fund that would invest in agroecological practices that transform food systems and align with the principles of the Global Alliance for the Future of Food.

Develop Investment Case Studies Using True Cost Accounting

A few foundations plan to apply the TEEB principles (see footnote 8) to specific investments in order to better track their impacts, both negative and positive. These evaluations will be shared publicly.

HOW YOU CAN GET INVOLVED

The participants left the meeting with a shared commitment to transform food systems by integrating grant and investment capital. The AgroEcology Fund and the Global Alliance for the Future of Food will be moving this work forward. Please join us for this important work.

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Representatives of the following organizations attended part or all of this meeting:

AgroEcology Fund
Breakthrough Strategies and Solutions
Casey Family Programs
Croatan Institute
Delta Institute
11th Hour Project
Global Alliance for the Future of Food
Helvetas Swiss Intercooperation
Manchester Capital
McConnell Foundation
McKnight Foundation
New Field Foundation
Packard Foundation
Swift Foundation
A Team Foundation
Thread Fund
University of Minnesota
Wallace Global Fund

The facilitator for this meeting was Y. Elaine Rasmussen. The report was written by Teresa Opheim with Jennifer Astone and designed by Marianne Wyllie.

Gratitude to:

All of the farmers who grew and cooks who prepared the food for the meeting: The Sioux Chef, Afro Deli, D. Brians and Bachelor Farmer Restaurant.