CHAPTER 7. Conclusion

The underlying value proposition of the enquiry was echoed at the World Economic Forum's annual meeting in January 2024. Economists Esther Duflo, Thomas Piketty and Ann Pettifor argued that global challenges from poverty and climate change cannot be addressed without reducing economic inequality (Nuttall, 2024). The missing middle is at the core of this challenge.

Reducing inequality requires that small enterprises receive not only affordable financing but also accompanying services to help them upskill and reskill as innovation and technology advance. In addition, the world is predicted to breach the 1.5° C threshold in 2024, which will push an additional 68 million to 135 million people into poverty and expose 245 million people to new and aggravated water shortages. These numbers will more than double if temperatures reach the 2° C threshold (Milman, 2024). It therefore becomes even more urgent to address the missing middle as they are the first in line to be affected.

The enquiry also finds that the political mood for risk-taking and blended finance is ripe. This was demonstrated at COP28 through the following.

- DFI and donor government commitments to include climate-resilient debt clauses in their sovereign lending to developing countries. Under these clauses, countries have the option to pause debt servicing during times of climate stress and catastrophe (AfDB, 2023).
- Several donor countries agreeing to channel unused special drawing rights through MDBs, which, in turn, would use them to issue bonds and crowd in private financing for sustainable development (IDB, 2023).
- The World Bank committing to use its callable capital to take more risk and expand lending (Christie, 2023). Callable capital is the commitment from the World Bank's shareholders to provide fresh financing under extreme circumstances. The World Bank is working to expand the conditions and clarify the procedures under which it can 'call' on its shareholders and, in doing so, increase additionality in making more high-risk investments.
- The announcement that the 2009 commitment made by developed countries to provide US$100 billion a year in climate finance was reached. As reported by the OECD, approximately US$89.6 billion in climate finance was availed of in 2021 and contributions were expected to have exceeded US$100 billion in 2022 (OECD, 2023c).

These are all significant milestones. The reality is, however, that difficult geopolitics, wars, climate change and supply chain disruptions are likely to maintain high food prices and that global food crises are likely to continue in the medium term.

Therefore, donor dollars will probably become an extremely sought after and rare commodity. Donors must not be shy. As providers of a rare commodity, they must raise the bar and demand more financial and development additionality for each dollar deployed. This includes demands for greater participation from and risk sharing with beneficiary governments and sovereign wealth funds. The recommendations from the enquiry chart the immediate steps in this direction.

The fundamental challenge is, however, that agriculture and food are difficult businesses and agrifood SMEs are often barely profitable. The experience of donors and blended funds that participated in this enquiry show that, when lending to the missing middle, the risks and costs of lending are so high that the "returns" are around US$0.88 to US$0.91 per dollar invested (Acumen, 2022). This indicates losses of US$0.12 to US$0.09 per dollar. Profitability increases when investments are larger and enterprises are more mature.

The objective of the agrifood development finance agenda must hence strike the difficult balance between providing concessional financing for marginalized SMEs and supporting those with better business models to reach a stage of maturity to work with blended and private financiers. In practice, however, a large cross section of SMEs will fall short of fully embracing commercial financing (ISF Advisors, 2022). The reality is that most SMEs will always remain SMEs. This underscores the continuous need for and the high additionality of concessional financing, guarantees and incentives. Together, they provide the basis for increasing resilience and access and lowering the cost of capital for the missing middle.

The enquiry shows that donors are already rising to the challenge and experimenting by placing concessional financing in mezzanine, junior debt and equity positions and increasing performance-based financing. Donors are also working on incentives such as payments to banks to cover the additional costs and risks of lending to first-time borrowers.

Bold donor decisions are paramount to making agrifood development finance more affordable and accessible. The catalytic power and the demonstrated effect of donor money must not be underestimated.