

Business co-financing: an alternative approach to realise SDG1

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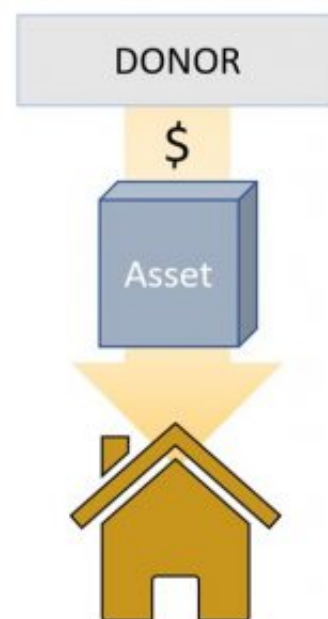
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Sustainable Development Goal One (SDG1) calls for over one billion people to begin earning more than \$1.90 a day by 2030. For a household of five, this equates to \$3,500 per annum.

There is significant interest in the donor community in using private sector partnerships to help realise SDG1. Such partnerships have typically focused on donors providing funds *to* a business. Businesses are asked to put forward a new business activity which will increase household incomes. A common activity is to source a product from poor families. However, by definition, the activity has a *negative business case*. The business and its competitors would not normally take part. Thus, the donor must choose from a range of negative business cases, which are only made worthwhile by the donor's contribution. This presents a number of challenges; principally, that donors are typically ill equipped to make such decisions.

This article sets out an alternative approach – in which businesses co-finance the cost of a largely donor-funded asset for households, rather than donors co-financing the cost of a private sector business activity.

Gifted assets to households



It is a traditional role of donors to give poor households an asset in order to lift their income. Common examples include a training course, a new tractor or repairing an income earner's sight. Assets are selected that will increase the household's income over the \$3,500pa benchmark.

If a household is currently earning half the SDG1 rate (\$1,750) they will require an asset worth thousands of dollars in order to double their income^[1]. It is evident that if a significantly cheaper asset could achieve the same outcome, an informed household would have purchased it already; a loan to purchase the item could easily be repaid from the income uplift. Donors who believe they can end poverty cheaply are assuming that they have discovered an asset the household themselves, money lenders and local businesses have missed.

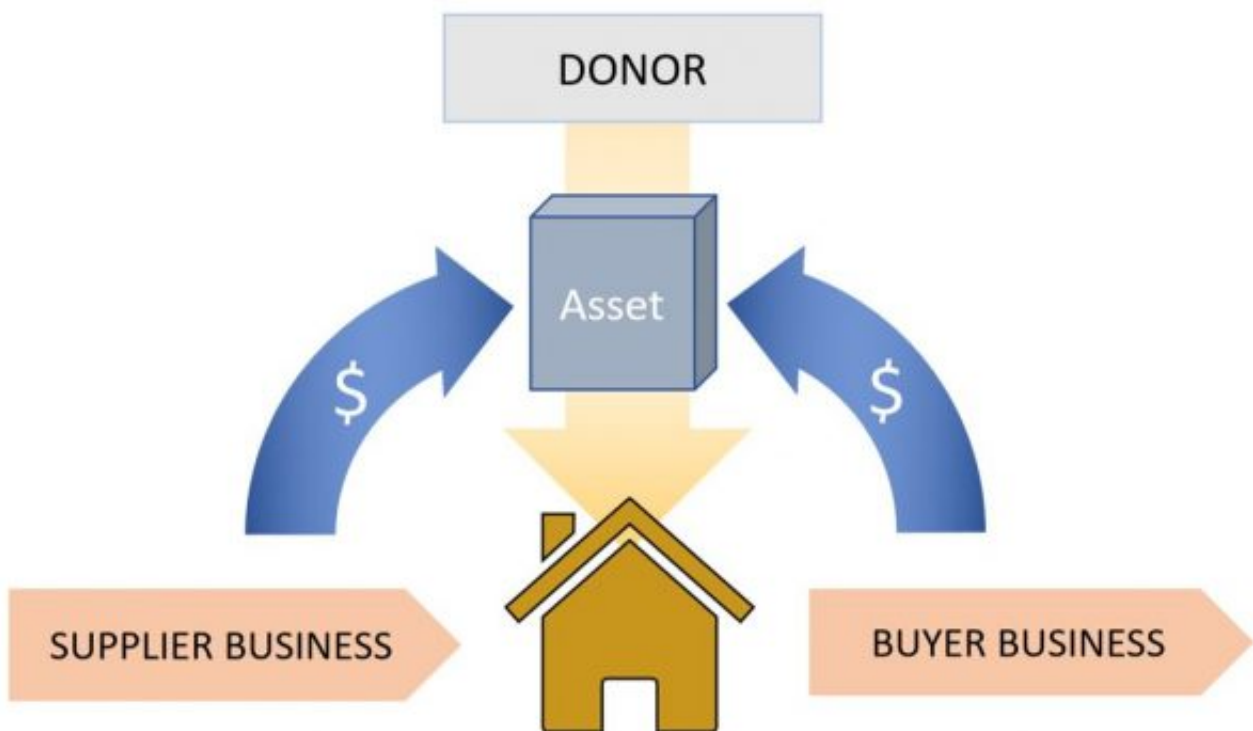
Securing a business' contribution to the asset

I will explore here the potential benefit to donors of asking a business to shoulder part of the cost of the gifted asset.

To find a business partner willing to contribute to an asset the donor should map out two types of businesses:

- *Supplier Businesses* who sell the household a product, such as farm supplies; or
- *Buyer Businesses* who purchase products from the household, such as agricultural commodities.

The donor is interested in finding businesses who stand to benefit as the household's income rises. As the household's income grows they will buy more from suppliers and sell more to buyers, driving business growth. For *some* businesses, this will drive up profits. Of particular interest are those businesses where the household is somewhat "bound" to the business, those for whom as the household's income grows the business can be fairly confident they will continue to buy from (or sell) to the household^[2].



Having mapped the supplier and buyer businesses who stand to profit from the household's income growing, the donor is now positioned to negotiate with each business a contribution to the asset. Thus, for example, we can imagine the household's seed supplier making a contribution (alongside the donor) to their new tractor.

The business' contribution will be small

What is immediately evident is just how little these businesses stand to gain. Should a household double their income to \$3,500pa they *might* double their seed purchase from \$200 to \$400pa, but this may result in just \$30pa in profit to the supplier. This hardly provides grounds for a significant contribution to an asset costing thousands of dollars.

The private sector is thus seriously constrained in the resources which it is incentivised to provide to poverty alleviating assets, as each business stands to benefit only marginally when compared to the cost. The bulk

of the cost must be met by the donor.

The greatest value from the business is information and ideas

Given the limited funds available from the businesses, it may be considered a waste of effort to pursue the contribution from the business. However, the benefits of a private sector partnership fortunately extend beyond the financial contribution. A significant avenue of benefit from eliciting the business' contribution is *information and ideas* ^[3].

A donor who proceeds on their own must select the right asset and ensure its effective use. It is easy for donors who are often remote from the household's context to make poor decisions.

The businesses which have been mapped above not only have an interest aligned with the donor (to see the household's income rise) but they possess a rich array of information and ideas the donor doesn't have access to. This information might include an accurate knowledge of local costs, risks and household behaviour which are all critical to asset selection.

I submit that the best means of accessing this information is to elicit a small amount of funding for the asset from the business. The business will provide the funding only if they believe the asset will indeed lead to the projected uplift in income. If the business (based on its private information) believes that the investment will not be successful, they will not want to invest, because they won't recoup their investment.

This is the ideal means for a donor to test the effectiveness of a proposed asset together with a knowledgeable and informed partner. If the business invests, the donor can be more confident the asset is going to have its desired impact.

For example, in 2013 a donor consortium in Africa elicited \$US35.1m in contributions from 21 cotton buyers to support smallholder farmer training and marketing, under the [Competitive African Cotton Initiative](#) Phase 2. This funding provided an endorsement of the project's design from 21 actors who are intimately involved in the cotton supply chain. The companies' contribution bought not just funding but "inside information" to inform the program's planning and governance.

In my experience, the traders and businesses who buy from and sell to poor families have an array of relevant knowledge often learned over years and sometime decades of experience. While their financial interest in the household's success may be small, this interest can be leveraged to provide access to a rich source of information and ideas which can be used in asset selection, allocation and delivery whether donors are providing training, seed drills or eye surgery.

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Notes:

^[1] *The Net-Present-Value of the \$1,750 increase in income is \$4,163 based on a cost of capital of 40%. The 40% rate is an estimate of the risk adjusted cost in a typical impoverished community.*

^[2] *Donor should however avoid those businesses whom have a monopolistic relationship with the household.*

^[3] *The value of this "private information" held by businesses is addressed in the work of [Friedrich Hayek](#) who challenged the efficacy of centrally planned economic activities.*