

CHALLENGE FUNDS AND INCLUSIVE BUSINESSES –KEY TO SOCIO-ECONOMIC DEVELOPMENT?

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ABSTRACT

This paper will introduce the concept of the challenge fund mechanism, and its role, from both a private sector development (PSD) perspective as well as from the sustainable social impact angle. The paper is informed by practical experience and reflections from the point of view of a manager who manages one of the world's largest challenge funds with a capitalisation of USD 250m and 200+ investments across 23 different markets. A challenge fund, which by nature, is a risk taking and risk-sharing PSD mechanism is used to support innovative, for-profit business ventures, which, by the virtue of being innovative, and therefore, more risky than other business ventures have restricted access to capital. A challenge fund, in a developing or frontier market context, will invest in innovative for-profit companies that exhibit strong intentionality on social impact, i.e. they will implement the inclusive business model concept. Essentially, inclusive businesses engage low income communities in a formal way either as suppliers of raw material, such as cocoa seeds, which the company then processes, or they engage low income communities as customers who buy and consume products and services which cater to them specifically. In this way, an inclusive business makes a profit and at the same time increases the income of low income communities. In this arrangement social impact remains sustainable because the business sees that it can make a profit by collaborating with low income communities. A challenge fund, by financing innovative and risky SMEs doesn't only support PSD and social impact, it also creates a tested and proven deal flow of companies for more commercial investors such as private equity funds or development finance institutions such as the International Finance Corporation. Therefore, the challenge fund mechanism serves a critical function in sustainable business and social development.

Keywords: Agribusiness, challenge fund, climate change, inclusive business, inclusive finance, private sector development, social impact, sustainable development