The Need for Blended Financing in The Craft Sector

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EXECUTIVE SUMMARY

There are still 767 million people (10.7% of the world's population) living on less than $1.90 per day - 389 million of whom live in Sub-Saharan Africa.[1] In 2017, nearly three billion more people lived on less than $3.20 a day.[2] These World Bank statistics remind us of an alarming fact: despite recent progress, half of the world's population still lives on a few dollars a day or less. Notably, most of these people are craft producers or farmers.

In recent years, interest in agricultural investing has blossomed. But legacy private sector banking has generally failed to deliver financing for smallholder farmers, thus creating an opportunity for successful blended financing models that leverage private, public and philanthropic funding sources. These emerging players have successfully supported the expansion of fast-growing sectors, from ethical coffee to chocolate and spices.

At Far + Wide Collective, our ambition was to apply these new financing models to the craft industry so that we could become a catalyst for a new era of growth in the handmade economy – an important sector for many lower-income economies representing a sizeable percentage of GDP. We aimed to build a global lifestyle brand that tapped into a growing consumer demand for well-designed and ethically hand-crafted goods.

We successfully raised private social capital but never managed to attract public donors or philanthropists to our cause. Without a blend of capital with different risk/return expectations and impact objectives and targeted subsidies for accompanying technical assistance, we were unable to make significant headway in repairing the craft sector's fragmented and weak supply chains. As a result, we failed to have the desired large-scale impact on the lives of our artisan producers, most of whom are women.

For the craft sector to prosper, blended financing for targeted supply chain development is crucial. Public donors and philanthropists must invest in artisan business growth, while private impact capital must build market access. It will also be crucial to entice large buyers to be more involved in earlier stages of the supply chain by investing in the product development process, as well as agreeing to more favourable payment terms.

THE IMPORTANCE OF THE CRAFT SECTOR IN POVERTY ALLEVIATION

We strongly believe that economic empowerment is the only reliable way to build strong economies, equality, wealth, and greater well-being. When impoverished people have increased incomes, they typically send their children to school and can afford improved

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[1] "Poverty Overview," April 11, 2018, The World Bank, http://www.worldbank.org/en/topic/poverty/overview.

[2] "World Development Indicators," 2018, The World Bank, http://databank.worldbank.org/data/reports.aspx?source=2&country=LMC.

healthcare, leading to a better quality of life. As the second largest rural employment opportunity in most low-income countries, craft has enormous potential for economic empowerment. The opportunities afforded by the craft sector are especially significant for women, who dominate the sector and work mostly in the informal economy, which offers limited protection, income, and potential for growth.

"When the 2008 global financial crisis drove markets down, demand for artisan products kept growing — doubling in value from just six years before. Today, it's an estimated $32 billion a year industry."[3]

- *Willy Foote, Founder and CEO of Root Capital*

The global demand for well-designed and high-quality handmade products has grown significantly in the past decade. Despite this, weak supply chains and limited understanding of international markets have prevented this demand from translating into greater economic growth.

THE BEGINNING AND END OF FAR + WIDE COLLECTIVE

A lifestyle shot from our Spring 2017 Collection featuring Ethiopian cotton beach towels.

We launched Far + Wide Collective with an ambitious goal: to build a lifestyle brand that would help transform the global craft supply chain by selling well-designed and ethically hand-crafted goods. All of Far + Wide Collective's products were produced by artisan businesses or cooperatives in low-income countries. By growing local businesses in these communities, we fostered economic empowerment thereby reducing poverty.

Over the course of five years, Far + Wide Collective successfully raised impact investment and developed seasonal product lines that were sold directly to consumers online. We also developed more than 300 wholesale relationships with design-savvy buyers and forged partnerships with large brands and retailers such as Nordstrom, Indigo, Hudson's Bay, Wayfair and Holt Renfrew, demonstrating the demand for the high-quality and beautiful products our artisan partners produced.

[3] Willy Foote, "Tapping The Potential Of The Artisan Economy," September 29, 2015, Forbes, https://www.forbes.com/sites/willyfoote/2015/09/29/tapping-the-potential-of-the-worlds-fourth-largest-economy/#2d378ef71aa2.

However, we could not scale our model or grow fast enough in the end. The reason why is clear: private capital alone could not fix an entire sector. In the case of craft, it was insufficient to develop effective production systems in low-income communities given the investment risk. Without artisan suppliers who had the financial and technical support to efficiently scale production, our growth potential was limited as our resources went to capacity-building instead of sales and marketing.

In the craft sector, there is a very important segment of financing missing between micro-finance (typically a few hundred dollars) and larger commercial style loans requiring collateral (starting around $100,000).

When launching Far + Wide Collective, we recognized that blended financing – a combination of private, public and philanthropic funding – was needed to strengthen supply chains, to make the crafts more competitive with mass-produced, factory-made alternatives. After all, these layered financing solutions had driven the success of the ethical coffee, cocoa, and other agricultural commodity markets.

We assumed that by using our private sector investment to launch and demonstrate consumer demand for our products, we would be able to make the case to public sector and philanthropic donors to invest in our artisan partners. Despite submitting dozens of grant and partnership proposals on behalf of our many worthy artisan partners, we were unable to secure them the technical support and financing needed to scale production.

Some of the 800 Kasigau Weavers who handcraft sisal baskets in Kenya.

Instead, we tried to fill the financing gap ourselves by advancing payments to our partners. In the case of the Kasigau Weavers – a group of 800 women basket weavers in rural Kenya, we purchased bulk sisal, dyes, dying equipment and phones for them. We also hired staff to support and oversee production, manage the supply chain and ensure delivery. But even allocating such immense resources was not enough to sufficiently expand production. Our support helped grow their production capacity from 20 baskets per order to 400 per order, but this was still not enough to meet demand.

Higher production levels would have required structured financing, formalization and technical assistance on a significantly larger scale. Cash advances placed us in a challenging and precarious position with our cash flow. We paid for products early, often before they were made, and we were paid late (net 30-60 days post-delivery) by our larger retail clients. Successful retail typically maximizes cash flow by selling early and buying late. We found ourselves doing the exact opposite.

The more we grew, the larger this cash flow crisis became. We found ourselves spending most of our time and resources trying to maintain and improve a weak and fragmented supply chain, leaving us with less time and fewer resources to dedicate to our primary task: expanding the market for high quality and artisanal products.

Why did donors and philanthropists turn Far + Wide down? First, our lack of charitable status was a disadvantage. For many state-funded development agencies or large-scale foundations, there are still insuperable obstacles to working with private sector partners. Second, in a drive to achieve focused impact, most donors and philanthropists were unwilling to strike partnerships with smaller players in new sectors. Third, risk management for these organizations led to endemic emulation. In other words, a herd mentality prevented many philanthropic and state-funded organizations from breaking free of the assumptions and proven frameworks of established sectors. We found that there was little appetite for the disruption, leadership and risk-taking required to restructure the craft sector's supply chains in ways that would significantly impact impoverished producing regions and satisfy market demand.

The path to success for Far + Wide was clear. If we had succeeded in facilitating blended financing for the craft sector, and in doing so share the burden of funding a stronger supply chain with public donors and philanthropic investors, we are confident that Far + Wide Collective would still be operating today. After all, we share common objectives of economic empowerment and poverty reduction with these potential partners. We also share a conviction that the only way to deliver enduring success is by unlocking the power of markets to drive growth in sectors such as handmade craft.

IS THE CRAFT SECTOR AN ECONOMICALLY VIABLE INDUSTRY?

"According to research from the Inter-American Development Bank, if the creative economy, globally, were a country, it would already be equal to the fourth-largest economy in the world with the fourth-largest workforce."[4]

- *John Kerry, Former Secretary of State of the United States*

Statistics describing the craft sector are hard to come by. Craft often goes unrecognized as

[4] John Kerry, "Remarks at the Artisan Enterprise: The New Startup Economy" (speech, Washington, DC, September 10, 2015), United States Department of State, https://2009-2017.state.gov/secretary/remarks/2015/09/246795.htm.

a valuable economic opportunity and much of its workforce is still trapped in the informal economy where data is notoriously difficult to collect. There are, however, some strong examples that do illustrate the vast economic opportunity that craft represents.

Morocco, for one, considers its craft industry vital to the economy and job creation. The share of Morocco's labour force working in the craft sector today exceeds 20% and crafts account for 9% of its GDP.[5]

In his opening remarks at the Trade + Impact Conference in 2016, Younes Lahrichi of Morocco's Agency Invest noted that Morocco's population growth has outpaced job creation by 150,000 each year since 2010. He believes that the craft sector is opportunity to create these missing jobs, if adequately supported.[6]

In Kenya – a significantly less prosperous country with 46 % of the population living below the poverty line, the creative industry accounts for 5% of GDP – the same percentage as the mining sector.[7]

Valued at USD $65.2 billion in 2007, the international market for gifts and decorative home accessories is significant.[8] Exports of handicrafts alone grew by over 100% between 2002 and 2010 to USD 29.8 billion, despite artisans' very limited access to developed markets.[9]

ETHICAL COFFEE AND THE SUCCESS OF THE BLENDED FINANCING APPROACH

To date, the success of blended financing has been best exemplified by the ethical coffee industry. Smallholder coffee farmers, like artisans, mostly live in impoverished rural areas and have limited access to education. They also face unstable coffee prices and many lack access to the appropriate financing tools to invest in sustainable production practices. The latter is a particularly significant challenge, as outbreaks of coffee leaf rust in Latin America frequently devastate crops.

To produce high-quality, ethically grown coffee, it is crucial to provide smallholder coffee

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[5] Moroccan Ministry of Tourism, Air Transport, Crafts and Social Economy, www.artisanat.gov.ma/fr.

[6] Younes Lahrichi, "Ouverture de la Journée Trade + Investment" (speech, Ifrane, Morocco, September 21, 2016).

[7] Heva Fund, Trade + Impact Conference (Ifrane, Morocco September 21, 2016).

[8] "Consumer Market Gifts," March 11, 2018, MarketWired, http://www.marketwired.com/press-release/consumer-market-gifts-home-decorative-accents-has-enjoyed-vibrant-growth-past-five-years-830807.htm.

[9] "Creative Economy Report 2010," United Nations and UNCTAD, http://unctad.org/en/Docs/ditctab20103_en.pdf

farmers with the financing, training, and other forms of support required to combat coffee leaf rust and other production challenges. This is exactly what a number of private, public and philanthropic investors have set out to do. As the ethical coffee sector grew, these investors remained committed in the face of significant challenges. By way of example, when a particularly aggressive outbreak of coffee leaf rust occurred in 2014, Root Capital – a non-profit that invests in agricultural enterprises to improve the lives of rural farmers – worked with various stakeholders to establish the Coffee Farmer Resilience Initiative (CFRI). The CFRI leveraged financing from the private sector (Keurig Green Mountain, Starbucks, Equal Exchange, Coop Coffees), the public sector (Multilateral Investment Fund, USAID), and philanthropic and investment advisors (Ford Foundation, Skoll Foundation, Open Road Alliance, DOEN Foundation, Svenska Postkod Lotteriet) to prevent future coffee leaf rust crises by making targeted supply chain investments.[10]

While a crisis response, the CFRI demonstrates the ongoing commitment of the many financiers who have been working to empower smallholder coffee farmers for decades.

Given the inherent risks in agriculture and the limited availability of adequate insurance and hedging products in these markets, commercial capital is simply too expensive for most smallholder farmers. Root Capital has therefore concluded it is "unrealistic to expect that smallholder [investments in sustainable production] can be financed on purely commercial terms and deliver risk-adjusted returns to investors."[11]

For investment to occur at scale in coffee or other value chains, Root Capital asserts that "what is required is a blend of capital with different risk/return expectations and impact objectives, as well as targeted subsidies for accompanying technical assistance. When designed and implemented in ways that align incentives, mechanisms such as partial loan guarantees, risk-sharing facilities, reserves for first-loss capital, and technical assistance funds can mitigate risk and expand impact. These types of blended financing structures, if further scaled, can also help lower barriers to entry for other lenders and mobilize capital from a range of sources."[12]

APPLYING BLENDED FINANCING TO THE CRAFT SECTOR

This blend of capital is what the craft sector requires and exactly what Far + Wide Collective was intent on cultivating. Similar examples can be drawn from renewable energy or even

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[10] Willy Foote, "Coffee and the Press of Migration," August 16, 2014, Forbes, https://www.forbes.com/sites/willyfoote/2014/08/16/coffee-and-the-press-of-migration/#20f231a68dd1

[11] "Financing Farm Renovation," 2016, Root Capital, https://rootcapital.org/wp-content/uploads/2018/01/Root-Capital-CFRI-Learning-Report-Full-Report.pdf

[12] Ibid.

certain sectors of the pharmaceutical industry. In these areas, public policy and consumer demand have driven new financial models to tackle challenges such as climate change and the high cost of health care. If we are serious about promoting ethical production, alleviating chronic and extreme poverty, and supporting women's economic empowerment, these models should be adapted to, tested, and deployed more broadly in the craft sector.

There are, of course, very obvious differences between coffee and crafts, the latter of which includes home décor and fashion items. The demand for ethical coffee is strong and constantly growing in a market with established buyers. And as a commodity, coffee is relatively easy to produce and distribute as it has fewer variables of design and quality as compared to home décor and fashion items. Furthermore, the ethical premium for a cup of coffee is far lower than for an item of clothing, given its relatively low price. For consumers, it's easier to afford.

That being said, it is equally important to recognize that craft and coffee are often produced by similar demographics – rural populations with low levels of education. Before the ethical coffee movement with its focus on financing and supply chain development, coffee farmers were stuck in a vicious circle of poverty with inefficient supply chains, inconsistent product quality, and very limited access to markets.

There is, however, one notable difference between coffee and crafts' producer demographics: gender. Men dominate the ethical coffee industry and other agricultural commodities, whereas women heavily dominate the craft sector. At a time when there is such overwhelming rhetorical commitment and recognition of the importance of empowering women, it is disappointing that potential partners did not see the value of deploying blended financing tools to support the handmade sector, which employs such a vast number of women living in extreme poverty.

A Turquoise Mountain artisan soldering jewellery in Kabul, Afghanistan.

Eighty per cent of the approximately 5000 artisan partners Far + Wide Collective worked with over the past five years are women; very few of whom received loans, grants, training or support in any other form despite producing increasingly large orders. We had hoped to help these women improve their production capacity and provide a strong sales channel so that they could become economically empowered.

Given the growing demand for handmade and ethical products, artisans' vast and varied skillsets, and the opportunity that the craft sector holds for low-income economies (and particularly women), we are convinced that investing in the craft sector is both important and timely.

MOVING FORWARD

The underlying challenge that inspired us to create Far + Wide Collective remains unresolved. For the handmade revolution to reach its full potential in achieving large-scale poverty alleviation and market expansion, the sector needs champions who will make blended financing available and forge the necessary partnerships to share the risks and rewards of scaling production.

To develop an effective and robust supply chain for the craft industry we need to:

1. Find new ways to engage development or philanthropic partners for capacity building and technical assistance;
2. Engage more impact investors for loan capital;
3. Convince partners involved in the ethical coffee or similar sectors to expand their focus to include administering loans and technical assistance for the craft sector (i.e. Root Capital and others) or encourage new players to get involved; and
4. Entice buyers to be more involved in earlier stages of the supply chain (such as for example Starbucks and Nestlé are for coffee and chocolate) by directing investment or CSR dollars to the supply chain and/or agreeing to more favourable payment terms such as forward contracting or payment upon shipping.

Forging this type of risk-sharing coalition where each partner invests in activities that align with their respective goals and capital is the key to success in the craft sector, as it has been for the ethical coffee industry.

Artists Martynka Wawrzyniak and Zoe Buckman in pieces from our Fall 2016 collaboration with Jenny Bird.

No matter who seizes this opportunity, it will be vital to ensure genuine collaboration amongst all players who care about poverty reduction, beautiful and ethical products, and unlocking the potential of entrepreneurship in low-income economies. In today’s marketplace, all products – even ethically and sustainably produced ones – have to be well-designed, beautifully-packaged and presented to customers through a strong brand offering and with all the conveniences other major brands and online platform provide. Sharing the burden of investing in artisan communities will free enterprises such as Far + Wide Collective and other retailers to use their revenues and private funds raised to invest properly in building their brands, marketing their products and establishing strong sales channels.