Aspen Network of Development Entrepreneurs

The Aspen Network of Development Entrepreneurs (ANDE) is a global network of organizations that provide critical financing and business support services to small and growing businesses (SGBs) in the developing world. ANDE members believe that support for SGBs will create jobs, stimulate long-term economic growth, produce environmental and social benefits, and ultimately help lift developing countries out of poverty. We also believe that in order to thrive, SGBs need an entire ecosystem that promotes their growth. This series of stories from the SGB sector highlights the power of collaboration among ecosystem actors.

Case Study: Honey Care Africa, Open Capital Advisors, Root Capital, Lundin Foundation, Grameen Foundation

About the Case:

ANDE Members:
Open Capital Advisors, Root Capital, Lundin Foundation, Grameen Foundation

Where:
Kenya

Supporting:
Honey Care Africa

What:
Investment Readiness and Patient Capital

About Honey Care Africa

In 2012, Honey Care Africa was one of many small and growing businesses that could be ready to scale its impact, if it had access to the support it needed. To address this challenge, Honey Care worked with several ANDE members to refine its business strategy and access financing. Open Capital Advisors supported management to become more sustainable and investment ready, and the Lundin Foundation, Root Capital, and Grameen Foundation provided the high-risk patient capital it needed. While each of these organizations is providing tremendous value to SGBs on its own, Honey Care's success demonstrates how collaborative efforts can have an amplified impact.

Alternative Income Streams

Agriculture is the strongest sector in Kenya's economy, accounting for nearly 30% of GDP. Smallholder farmers who grow crops on an average of 2.5 hectares are responsible for 75% of that production.[1] These farming families operate in a high-risk environment without a consistent monthly paycheck, and unpredictable harvests and market prices often lead to cash shortfalls. The extended time period between harvests makes it difficult for these farmers to re-invest their small margins into alternative income sources, which creates a vicious cycle of poverty. Given honey's high local demand, relatively stable price, low initial investment costs, and large positive externalities, beekeeping is one potential solution to more stable incomes.

"How does it work?"

On average, each household purchases 3 beehives (at an approximate price of $50/each) and can earn almost $150 annually from its hives. The hives last for 7 to 10 years, with each generating from $1,050 to $1,500 of supplemental income for the household. In addition natural pollination due to beekeeping has been proven to significantly increase crop yields.[2] For smallholder farmers, beekeeping can be an important secondary income source, helping to diversify income streams and increase total revenues.

Honey Care Africa was founded in 2000 with a vision to create more stable income opportunities for Kenya's smallholder farmers. The company sold hives to rural families who would produce honey, which Honey Care would then purchase and take to the market. This pioneering social enterprise model eventually reached 12,000 farmers across East Africa and garnered well-deserved international acclaim for its social impact. But by 2010 the company was in a precarious financial position. Despite its status as a social enterprise, Honey Care was largely reliant on donors to fund its operations, who often stipulated that Honey Care implement new projects or expand into specific geographic regions. This reliance on donor funds led to a dispersion of Honey Care's network all over Kenya and diluted the company's ability to carry out its operations effectively and efficiently. This dispersed network also forced Honey Care to rely on third party brokers to harvest honey from the hives. Given the large distance between operations, brokers would time their harvest to optimize convenience rather than honey production. Consequently, honey production was sub-optimal, and the business model had become unsustainable.

[1] Adeleke Salami, Abdul B. Kamara and Zuzana Brixiova. *Smallholder Agriculture in East Africa: Trends, Constraints, and Opportunities*. Working Paper No. 105, African Development Bank, 2010.

[2] Natural Resources Defense Council, *Why We Need Bees: Natures Tiny Workers Put Food on Our Tables*. NRDC Policy Paper. NRDC. 2011.

But the board wasn't ready to give up on Honey Care just yet. To jump-start a turn-around, they hired Madison Ayer to join as CEO. Madison was a serial entrepreneur looking for a way to direct his expertise towards positive social impact. The company was in no position to pay the salary they would need to recruit top talent, but Madison believed in the company and its mission and agreed to tie his own compensation to the company's performance.

When Madison moved his family from the Unites States to Kenya in 2010, his first goal was to immerse himself in the honey industry and to learn everything he could about Honey Care's suppliers, employees, and clients. He found that besides its unmanageable production network, Honey Care had been ignoring a fundamental problem: its beekeepers were scared of bees. With these insights, Madison recognized he would have to change Honey Care's entire production model. He knew that Honey Care would need some outside expertise to help them through this process, and he enlisted the help of Open Capital Advisors.

"I knew nothing about beekeeping when I took over. However, sometimes asking stupid questions can lead to valuable insights; in this case I found that hives weren't producing efficiently simply because the farmers were afraid of getting stung."

– Madison Ayer, CEO Honey Care Africa

Capacity Building

Open Capital Advisors is a financial services and strategy consulting firm based in Nairobi that supports high-impact businesses, investors, and innovative solutions throughout East Africa. Their work enables small and growing businesses to grow and attract investors, and supports investors to place capital. Between 2010 and 2012 their small team of consultants helped more than 39 SGBs to grow.

"Our primary objective is to help these SGBs change their strategies, understand their operations, look at their HR team, and really work underneath the hood to then successfully raise capital and use it to grow," said Annie Roberts, Partner of Open Capital Advisors. Open Capital Advisors also works closely with investors to help them support the broader SGB ecosystem. Consulting projects that Open Capital Advisors takes on address core business issues for SGBs or support investors to grow their portfolio companies. Part of Open Capital Advisors' philosophy is to work on what is called a "success-fee." They only charge SGBs for their strategy and fundraising services once they've successfully raised growth capital. This model allows businesses with high potential, but limited resources, to access their services. Honey Care is one example from Open Capital's portfolio. The team worked with Honey Care for six months to hone a new business strategy, after which point they began the fundraising process.

In 2011, Open Capital sat down with Honey Care's management team and developed a strategy incorporating a new business model called the Cluster. In this model, hives were still sold to farmers but professional hive technicians performed the actual hive management. This team of "SWARM" technicians coordinates hive maintenance and harvests to ensure optimal honey yields, minimal damage to the hive, and compliance with international quality standards. Professionally managed hives can produce significantly more honey than hives managed by "amateur" smallholders. The Cluster model creates more income for the farmers, mitigates supply risk, produces higher profit margins for Honey Care, and also generates employment for local SWARM technicians. Since this shift, Honey Care has exceeded production targets.

As Honey Care began to implement this new model, the company needed a way to better manage their supply chain. They were one of the first adopters of TaroWorks, a mobile data management tool developed by the Grameen Foundation. Honey Care uses TaroWorks to stay in touch with field staff and support reporting on hive locations and conditions. This real-time communication helped Honey Care optimize the timing of their field visits, improve the efficiency of harvests and reduce losses due to side selling. It also helped to ensure that any issues with the hive's health were promptly resolved. And by tracking hive performance, Honey Care was better able to estimate the amount of supply that it would market to both local and international honey buyers. Honey Care also utilizes TaroWorks to help it collect data about the social impact of its work, specifically tracking poverty levels of its suppliers with the Progress out of Poverty Index.

During their engagement, Open Capital Advisors conducted a market survey that showed that Honey Care was pricing honey at about half of what the customers would pay. Seeing this data, Honey Care doubled their retail price, which had an enormous impact on the company's profit margin. This change, in combination with a higher quality supply chain, prompted Open Capital Advisors to shift Honey Care to the fundraising.

Attracting Investment

"The major difficulty that funds face is identifying potential investments that align with their mission and values. When fundraising, Open Capital assesses each individual SGB to see 'who might be the right fit for this company?' Then we try to align an investor and SGB by looking at the impact profile, financial profile, the entrepreneur's vision, skills, and strengths as well as identifying areas where investors might be able to provide non-financial support."

– Annie Roberts, Open Capital Advisors

For many SGBs, the due diligence process is a challenging part of the fundraising process. Honey Care needed capital quickly – and waiting nearly a year for investors to complete the necessary due diligence represented a risk to their continued growth and ability to survive.

Root Capital, a nonprofit social investment fund that works to grow rural prosperity, was one of the first investors that connected with Honey Care. Root Capital had been interested in Honey Care for some time, but they are structured to only make debt, not equity, investments. "We liked Honey Care a lot because it had tremendous potential to have significant social impact as well as a high probability of achieving financial sustainability," said Fred Kitenge, Root Capital's Credit Manager for East and Southern Africa. "In addition when you're making these investments, you're not investing in the organization, you're investing in people, particularly the management. We were very impressed with Madison's team and had faith in their capabilities. However given Honey Care's financial condition at the time, we knew that debt investment would not be ideal, it needed patient capital and that's why we brought in our friends at The Lundin Foundation."

The Lundin Foundation is a private Canadian Foundation that invests in innovative small and growing businesses in the areas of agriculture, financial services, and access to energy. "Lundin had actually considered investing in the old model of Honey Care back in 2009," said Ka-Hay Law, Portfolio Manager at the Lundin Foundation, "but we had seen a lot of proposals for honey businesses and knew the difficultly they would have scaling and remaining profitable. However, when Root Capital brought the investment to us in 2011, we were very impressed. We liked that Honey Care demonstrated knowledge of the farmer constraints such as low productivity due to sub-optimal hive management and lack of access to markets. We liked the innovative hive management model which ensured rural farmers realized greater benefits. Management was offering a high level of inclusion and participation for the farmers in combination with the high level of skill and expertise of the management team. We know that working with rural markets is risky, but one thing that is critically important to us in evaluating investment opportunities is the management's ability to handle challenges as they arise and their ability to quickly roll out operational improvements to overcome those snags. We saw all of these qualities in Honey Care."

"What is a bridge loan? "

As the term implies, these loans "bridge the gap" between periods when financing is needed. They are used by both corporations and individuals and are used until permanent or the next stage of financing can be obtained. This type of interim financing allows the user to meet current obligations by providing immediate cash flow. The loans are short-term – usually up to one year – with relatively high interest rates and are backed by some form of collateral such as real estate or inventory.

The Lundin Foundation signed on to provide a convertible bridge loan to Honey Care. This convertible note allowed financing to transition from debt to a much needed equity investment. This allowed Root Capital to follow along with a patient debt investment that delayed principal payments for 12 months. This injection of patient capital allowed Honey Care to test its new model in the field and gave it time to reorganize its internal management structure.

The Grameen Foundation was also interested in supporting Honey Care's mission. The Grameen Foundation's Pioneer Fund invests in early stage social enterprises that generate economic opportunity for the poor and poorest in rural and hard to reach markets. Matthew Speh, the Director of Capital Markets for the Grameen Foundation, said "lots of investors look primarily at a venture's intentions, but as much as possible we want to be positioned to assess verifiable impact with respect to improved livelihoods." In addition to looking at standard financial performance metrics at the company level, the Pioneer Fund takes an in-depth look into the return on investment case of the end customers, in this case the farmers. "It is essential for us to understand the value proposition from the perspective of the poor entrepreneur. If a venture does not produce value for the customer we are not interested. With Honey Care, we could apply the traditional investment analysis of a business plan to a bee hive...With this information we can estimate the expected horizon to break-even on the farmer's investment as well as the long-term internal rate of return on the investment over the life of the asset. For Honey Care, we saw a reasonable entry price for an investment. While we considered the time to break even to be a little extended, we believed the economic return potential for the farmer was tremendous relative to moderate risk."

What is convertible debt?

A convertible loan starts as a straight forward loan of money that has to be paid back with interest. However convertible loans have a "conversion feature" built in which gives the lender an option to convert all or a portion of the outstanding principal into an equity share of the borrower's company. Typically, the borrower is willing to provide this conversion feature in exchange for favorable loan terms that may include lower interest rates and payment grace periods. Convertible loans have the potential to create win-win situations for both the borrower and the lender, especially for early-stage, high-risk businesses. Borrowers benefit from both the favorable loan terms and the possibility of eliminating debt upon conversation, while lenders benefit from the potential later stage appreciation in value with lower risk fixed payments on the front end. Convertible loans have been particularly effective in funding early stage ventures in untested markets and are thus a critical tool to supporting SGBs in the developing world.

Even though Grameen Foundation was impressed with the potential social impact of Honey Care and its business model, the company itself was “essentially insolvent and was a very high risk investment,” said Matthew. “We decided to provide a $350,000 investment in the form of convertible debt with structured incentives to bring on a new investor in the near future.” In light of the high risk, the Pioneer Fund and other investors were essentially taking on the lower return of debt with the higher risk of equity. For these investors, it was the potential social upside that allowed for this shift of the typical risk-return calculation.

This combination of investments has allowed Honey Care to make a dramatic turn around. While Honey Care is not yet profitable, it is far exceeding growth targets. The Grameen Foundation and Lundin Foundation both intend to convert their loans and take an equity stake in Honey Care once the second round investor comes in--a significant indication that Honey Care is on the right track to achieving sustainability and profitability. Honey Care’s success is an example of how a strong and collaborative ecosystem of support can help propel the growth of SGBs in the developing world in ways that individual efforts alone cannot.