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MULTILATERAL INVESTMENT FUND – BID LAB

REGIONAL

Financing Agrobusiness and Cooperatives response to COVID-19 in Central America, Colombia, Mexico and Peru

(RG-G1035 – RG-T3772)

DONORS MEMORANDUM

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PROJECT SUMMARY

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Lack of access to timely, right-sized capital to weather the COVID-19 crisis, maintain operations, and fuel rural economies is an urgent existential threat—especially for Small and Growing Agricultural Businesses (agri-SGBs), and for the rural communities that rely on them. Agri-SGBs are typically small farmer cooperatives, associations that produce and market commodities and agribusinesses that process and distribute or export agricultural products. The ability of agri-SGBs to reach the most vulnerable in remote rural communities has never been more vital: they both support the livelihoods of employees and farmers, and can provide essential services to communities to mitigate the risks of the virus spreading and/or help manage its devastating effects.

In the face of the COVID-19 crisis and its expected "long tail" of recovery, the main problem this project seeks to address is the urgent financing gap faced by the highest-impact, least-served agri-SGBs across Latin America, and the threat this financing gap poses to their business continuity through this crisis. Even before the crisis, commercial markets were not serving early stage agricultural SGBs because of the inherent risks and unattractive returns; now, with rising market risks and uncertainty, even fewer lenders will be willing to serve this market segment. As a result, due to systemic market disruption from COVID-19, without sufficient access to capital, these rural SGBs faces liquidity crises that threaten their very survival, undermining the economic resilience and recovery of vulnerable smallholder farmers and their communities.

The project will address this urgent problem by building off the successes and learnings of an existing project, "Social Impact Incentives (SIINC) to Unlock Finance for Early Stage Agricultural Businesses in Latin America", a results-based investment grant financing initiative that applies the Social Impact Incentives (SIINC) approach to agricultural impact investing. Launched in 2018, the SIINC partnership brings together Root Capital, Roots of Impact, the Swiss Agency for Development and Cooperation (SDC), and IDB Lab to create a market-correcting incentive that compensates for early stage short-term unprofitability, high impact segment of the agri-SGB market. To date, this program has unlocked access to finance and built the credit-readiness of 42 early stage agri-SGBs in Latin America through a combination of access to catalytic financing and capacity-building training, strengthening the livelihoods of the more than 10,000 farm families reached by these enterprises, across Mexico, Peru, Nicaragua, Colombia, Guatemala, and Honduras.

Root Capital, the executing agency, is a social lender with a regional office in Costa Rica, and a demonstrated capacity to identify and serve innovative smallholder farmer organizations and enterprises in the agribusiness sector in Latin America. Specifically, over the next 24 months, as early-stage agri-SGBs withstand and recover from the COVID-19 crisis, the proposed project will help enterprises maintain liquidity, survive, and mitigate the effects of the virus on smallholder livelihoods. This will achieved through three instances: (i) by mobilizing critical financing needs; (ii) developing a Rapid Response Fund to help qualified enterprises' and their communities' urgent needs as they weather the pandemic; and (iii) providing technical assistance for qualified enterprises to build their crisis management capacity and position them successfully for recovery.

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ANNEX II	Detailed Budget
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Draft Resolution

AVAILABLE IN THE TECHNICAL DOCUMENTS SECTION OF MIF PROJECT INFORMATION SYSTEM

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ACRONYMS AND ABBREVIATIONS

CRF	Corporate Results Framework
CRG	Contingency Recovery Grant
DNA	Diagnostic of Executing Agency Needs
FAO	Food and Agriculture Organization of the United Nations
IDB	Inter-American Development Bank
IDBG	Inter-American Development Bank Group
IFC	The International Finance Corporation
IIC	Inter American Investment Corporation
LAC	Latin America and the Caribbean
MIF	Multilateral Investment Fund
RC	Root Capital
RoI	Roots of Impact
SDC	Swiss Development Corporation
SEP	Social Entrepreneurship Program
SIINC	Social Impact Incentives
SGB	Small and Growing Business

PROJECT INFORMATION

REGIONAL Financing Agrobusiness and Cooperatives response to COVID-19 in Central America, Colombia, Mexico and Peru

(RG-G1035-RG-T3772)

Country and Geographic Location:	Mexico, Costa Rica, Guatemala, Peru, Colombia, Honduras, Nicaragua[1]		
Executing Agency:	ROOT Capital (RC)		
Focus Area:	Climate Smart Agriculture		
Coordination with Other Donors/Bank Operations:	This project is part of the group of projects financed in collaboration with the Swiss Development Corporation (SDC) through the Bank's approved Funding "Mecanismo de Financiamiento de Impacto Catalizador en favor del Empresariado Social" - RG-X1261 (approval date October 27, 2015).		
Project Beneficiaries:	25 early stage (small and growing) agro enterprises (SGBs) and 5600 farmers indirectly (representing up to 22,000 household members)		
Financing:	Technical Cooperation IDB Lab:	US$ 150,000	8%
	Rapid Response Investment Grants:	US$ 200,000	11%
	Contingency Recovery Investment Grant (CR-IG) Financing:	US$ 500,000	28%
	TOTAL MIF FUNDING:	US$ 850,000	47%
	SEP Program Co-Financing RG-G1036[2] (To be approved separately according to SEP program procedures).	US$945,000	53%
	TOTAL PROJECT BUDGET:	US$ 1,795,000	100%
Execution, Disbursement, and Repayment Period:	24 months of execution,36 months of disbursement, and up to 60 for repayment.		
Special Contractual Conditions:	Special conditions precedent to first disbursement will be: (i) IDB Lab approval of the Annual Operating Plan for the first year; and (ii) contracting by the executing agency of a technical project KPI evaluation mechanism with Roots of Impact.		
Environmental and Social Impact Review	This operation was screened and classified as required by the IDB's safeguard policy (OP-703). Given the limited impacts and risks, the proposed category for the project is B.		
Unit responsible for disbursements	Country Office Costa Rica		

[1] Non-Objection has been granted for Costa Rica and will be sought from each of the countries before the project initiates.

[2] Funds provided under Social Entrepreneurship Program RG-X1261, "Social Entrepreneurship Catalytic Impact Financing Facility 'LAC-IMPACT'" (MIF/PR-80). Project approvals under the SEP program are subject to a five-day distribution to the IDB Board of Executive Directors. See GP-75-11, par.4.1(f) (approved June 1, 2011).

I. The Problem

A. Problem Description

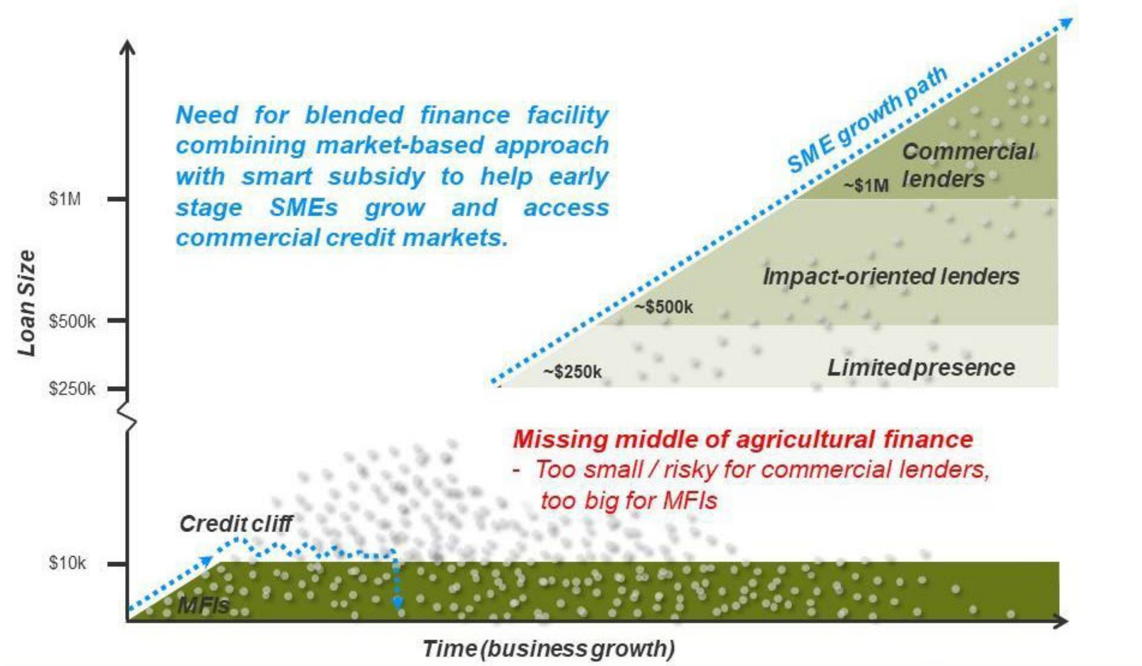
1.1. **The COVID-19 Crisis and Access to Finance for Agricultural SGBs.** As the COVID-19 crisis bears down on rural farming communities across Latin America, its economic and public health effects are intensified by the "force multipliers" of poverty, inadequate healthcare, and lack of infrastructure. Even in normal times, smallholder farmers across the region lack reliable access to inputs, credit, markets, technology, and knowledge of best agronomic practices to boost productivity, build resilience to climate change, and increase their incomes. Most live at or below the poverty line, suffer food insecurity, and are vulnerable to the shocks of volatile weather and markets.

1.2. Agricultural Small and Growing Businesses (SGBs) are critical conduits that have the potential to transform farmer livelihoods through improved access to markets and services. Agri-SGBs are typically small farmer cooperatives, associations that produce and market commodities and agribusinesses that process and distribute or export agricultural products. They are often located in rural areas, close to farms, and are governed by local farmers. In most cases they provide not only agricultural services but often also financial and educational services and are critical in the intermediation between small farmers and the markets. The ability of SGBs to reach the most vulnerable in remote rural communities has never been more vital: they both support the livelihoods of employees and farmers, and can provide essential services to communities to mitigate the risks of the virus spreading and/or help manage its devastating effects. Yet, these enterprises continue to face systemic barriers to accessing timely, right-sized capital—hampering their growth during normal times, and now posing an existential threat to their survival during the COVID-19 crisis, and to their ability to fulfill their potential for their communities.

1.3. The main problem this project seeks to address is this urgent financing gap faced by the highest-impact, least-served agri-SGBs across Latin America. As they confront the COVID-19 crisis and its expected "long tail" of recovery, agri-SGBs and their communities need access to timely, right-sized capital. This includes both access to credit to support basic liquidity and business continuity, as well as access to flexible emergency response funds to address needs related to the virus and its social and economic fallout.

1.4. **Access to Credit.** Most agricultural SGBs struggle to access financing to support their resilience and fuel growth: they fall in the "missing middle" of agricultural finance (see Diagram 1). This is the gap in the financial markets between microfinance to individuals and commercial finance to larger corporations and infrastructure projects. Even before the crisis, agricultural SGBs, especially early stage ones with small credit needs below USD$500,000, operated on thin margins and could not afford to pay the interest rates that would cover the operating costs and risks for financial institutions to make the type of seasonal working capital loans these businesses need. As a result, commercial markets do not serve early stage agricultural SGBs because of these inherent risks and unattractive returns, with commercial lenders focusing on highly collateralized lending above USD$500,000. Simultaneously, microfinance institutions find that their underwriting and risk management protocols are ill suited for SGB lending. Even social lenders active in agricultural markets rarely lend in amounts below USD$500,000 because of the difficult loan economics. Now, with rising market risks and uncertainty, even fewer lenders will be willing to serve this market segment.

Diagram 1. SGB Growth Path and the "Missing Middle". Source Root Capital.



1.5. **Access to Emergency Resources.** In addition to lacking access to credit, early stage agri-SGBs are also facing the COVID-19 crisis with extremely limited access to safety net non-loan financial resources to meet emergency needs in their operations and communities. Indeed, in Q2 2020, Root Capital conducted a rapid response survey of 50% of clients globally, and found that 95% of enterprises interviewed across Latin America reported some level of disruption in their communities due to the COVID-19 pandemic, with approximately half reporting conditions contributing to increasing food scarcity. Yet, many communities lack the appropriate resources— from emergency food security relief, to funds to purchase soap, masks, and other sanitary equipment— to manage this emergency, due to a dearth of the publicly funded programs (e.g. insurance, disaster relief, and other supports) that are the foundation for the agricultural market and crisis response in North America and Europe. In this urgent time, agri-SGBs are positioned to fill this gap and serve as a crucial lifeline: with access to the appropriate non-loan resources, agri-SGBs can provide frontline response by mapping food shortages, filling short-term emergency cash needs for farmers, and sharing critical health information—even being the point of distribution for supplies. This project seeks to harness this potential through the proposed Rapid Response Fund.

1.6. **Root Capital's Experience**. For this project, Root Capital (RC) will leverage its sector-leading lending platform, technical assistance services, and small grants program for agri-SGBs. RC is a pioneering impact lender to agricultural businesses in the developing world, with over 20 years of experience innovating in frontier markets. RC seeks to improve farmer livelihoods by providing credit and capacity building to unlock the growth and impact potential of agricultural SGBs that would otherwise fall in the "missing middle". Since its founding in 1999, RC has lent $1.4 billion to more than 725 agricultural businesses aggregating over 1.5 million farm households and has provided critical

capacity-building training to more than 1500 agricultural enterprises. In addition, RC has previously partnered with multi-sector stakeholders, including IDB/MIF, to successfully deploy rapid response resources to agri-SGBs during prior crises, such as the coffee leaf rust (*la roya*) outbreak across Latin America[3].

1.7. **Root Capital's impact and additionality**. In recent years, RC developed a data-driven approach for integrating impact and financial considerations in investment decisions, known as the "Efficient Impact Frontier" (EIF) framework,[4] which was fully operationalized within their loan portfolio during 2017. Through this approach, RC strives to reach the highest-impact clients, given the constraints of their economic model. To do so, RC systematically assesses and tracks the "additionality" of each loan, sorting loans into "low", "medium", and "high" additionality brackets: "high" additionality if the recipient of the loan would not have received a loan in the same amount and under the same terms from any other lender, "medium" if the recipient would not have received such a loan from a commercial lender, and "low" additionality if the same loan would have been made by a commercial lender. Operationalizing this approach has allowed RC to systematically track the relative performance and cost to fully service the loans in each bracket (full costs to underwrite these loans).

1.8. **SIINC Model.** Many of the SGB recipients of medium and high additionality loans are unprofitable for RC to serve today, even if they play a critical role in anchoring their local economies and communities. Without a shift in the constraints of the economic model, serving these clients remains out of reach. Since 2018, RC, IDB Lab, and the Swiss Agency for Development and Cooperation (SDC) have tested an innovative Social Impact Incentives (SIINC) structure to shift these constraints[5]. This model creates a market-correcting payment to compensate for the risk and cost associated with serving early stage SGBs (see Diagram 2 below). This model has enabled RC to make 39 medium and high additionality loans to early stage SGBs that would otherwise have been highly unprofitable to serve, unlocking $12.15M in disbursements to date to fuel SGB growth and strengthen farmer livelihoods. Over time, as these enterprises grow due to this access to finance, they can be served sustainably, by RC or other lenders.

1.9. SDC has developed with the IDB Lab the SIINC model of funding, in order to structure adequate financing of innovative projects that have a high social impact. This project forms part of the overall LAC-Impact program financed by SDC, and managed by the IDB Lab, which was created to co-finance SIINC projects across the region. To date, this program has committed a total of US$1,794,500 in funding for six operations: (i) ME-G1013 for US$275,000; (ii) HO-G1246 for US$199,500; (iii) PE-G1006 for US$240,000; (iv) RG-G1018 for US$500,000; (v) EC-G1002 for US$280,000 and (vi) GU-G1010 for US$300,000. The IDB Board authorized up to $4.0MM in funding to be utilized by the Social Entrepreneurship Program of the IDB ("SEP") under this regional financing facility (MIF/PR-80, approved November 10, 2015), which the SDC has funded progressively in installments, recently increasing its resources sufficiently to fund this project, within that limit.

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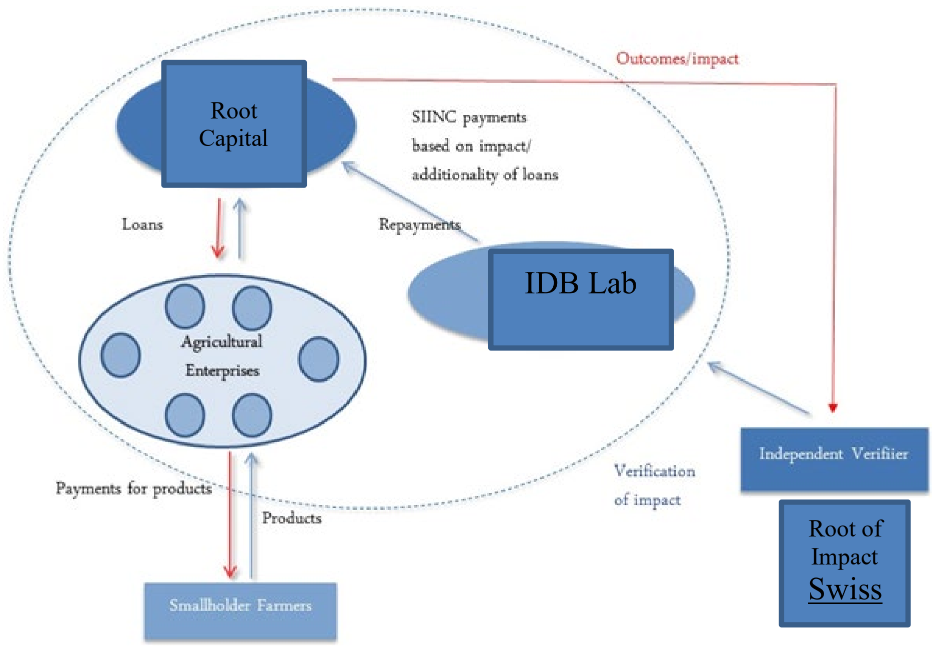
[3] Project RG-M1153 Financing for High-Value Agricultural Markets. December 4, 2013

[4] See November 2016 article in the Stanford Social Innovation Review (SSIR), "Towards the Efficient Impact Frontier".

[5] Project RG-G1018 New Models for Financing Early Stage Agribusinesses. November 2, 2018.



1.10. **Beneficiaries**: The project is designed to protect, and ultimately improve, the livelihoods of smallholder farmers supplying early stage agricultural SGBs in Latin America, many of which have not been reached by RC before[6]. The project focuses on countries where Root Capital has a strong lending presence, where it has sufficient operational capacity to manage the different components proposed by the project, and where it has seen that the need for support is most needed. These countries are Guatemala, Honduras, Costa Rica, Nicaragua, Colombia, Peru, and Mexico. In these countries, the early stage SGBs that RC serves are often farmer-directed cooperatives that purchase crops, usually corn, fruits, sugar, coffee or cocoa, from their supplying smallholder farmers. These cooperatives that RC serves through lending and advisory services tend to pay about 80-90% of their revenues to farmers, a proportion that stays constant as businesses grow. In Latin America, on average farmers earn 10 to 15% more selling to these cooperatives than they otherwise would by selling into local markets. These additional several hundred dollars per household allow families to cover more of their basic necessities, such as paying for children's education and healthcare.

1.11. **Summary Impact of Proposed Project.** Through this project, Root Capital will provide an estimated $6.25 Million in loans to SGBs, to provide critical financing during this time of crisis. These locally-rooted businesses which will receive the loans from Root Capital, have become ever-more critical for their communities—often remote rural areas with limited government services or other civil society entities. Agricultural SGBs are providing a critical safety net of support, continued market access, and even intervention to slow the spread of disease. RC thus seeks emergency support to enable continued access to

[6] In Mexico rural population represents two thirds of the extremely poor (National Council for the Evaluation of Social Development Policy); in Guatemala between 2000 and 2014, rural poverty increased from 74.5 to 76.1 per cent, while extreme rural poverty increased from 23.8 to 35.3 per cent (IFAD); in Honduras poverty rate is 66% with 45% living in rural areas (IFAD); in Nicaragua as of 2012 poverty stood at 42.5 per cent overall, with 14.6 per cent of the population living in extreme poverty. In rural areas, however, up to 63.3 per cent of the population is poor, and some 26.6 per cent is extremely poor (Central Bank of Nicaragua)

financing and targeted technical assistance for the most underserved and vulnerable segment of the agri-SGB market during this challenging time, as well as grant funds to deploy directly to agri-SGBs to fill their most urgent needs. This support will ensure that the gains achieved through the SIINC model to date are not lost and allow agri-SGBs to withstand the growing threat of COVID-19 to their business and communities. The proposed project will ensure these SGBs can continue to purchase farmers' crops, on time, and offer key services, from agronomic support to micro-credit to emergency food security measures. This support will enable these local "engines of impact" to persist through this crisis and emerge well-positioned for growth and successful long-term recovery in the coming years. With each early-stage SGB (estimated at 25 with the project) reaching on average 200-300 smallholder farmers, this project has the potential to provide timely support to an estimated 5000 to 7500 farm families across the target countries.

II. The Innovation Proposal

A. Project Description

2.1. In the face of the COVID-19 pandemic and its devastating social and economic impact, the expected result of the project is to apply the SIINC model to strengthen the livelihoods of smallholder farmers in Latin America, focusing on Guatemala, Honduras, Costa Rica, Nicaragua, Colombia, Peru, and Mexico, by closing the financing gap for high-impact early stage agricultural SGBs. With access to right-sized, risk tolerant credit, targeted capacity-building training, and emergency support, these early stage SGBs will have the liquidity and resilience to withstand the immediate crisis, and successfully anchor recovery in their communities. The innovation of the project lies precisely in providing adequate financing to a select group of early stage organizations, that either no other lender or no commercial lender would provide—for agricultural production, processing and marketing, and doing so within the framework of a social impact incentive mechanism, targeted at achieving high impact, and which, if successful, could be replicated by other donors and or impact investors.

2.2. In addition to Root Capital, the main lender to the SGBs, two other actors will participate in the project. Roots of Impact (RoI), an advisory firm specialized in impact lending will be operating as the key verifying agent to measure and verify results and impact. And secondly, the Swiss Development Corporation, which is the provider of the SEP resources to be used for this project as an" outcome payer" to benefit Root Capital, if certain project social impact targets are met. The SDC will contract directly RoI for the verification process.

2.3. In addition to its direct, emergency support to SGBs and farmers during this crisis, the project will also seek to demonstrate that the SIINC model can be applied to create a sustainable, cost-effective mechanism to close the financing gap for early stage SGBs and anchor post-COVID-19 recovery in rural communities. Specifically, the project will leverage US$6.25M in 25 high and medium additionality loans from Root Capital to fuel rural economies during the crisis and recovery period. Additionally, by including differential pricing for varied levels of impact (with four brackets determined by loan size and level of additionality; see details in following sections), as well as an innovative recoverable grant mechanism to cover the cost of elevated risk due to the COVID-19 disaster and a proactive, flexible debt relief and small grants program to help prevent enterprise default,

this project will continue to generate substantial learning for IDB Lab and RoI to apply in future SIINC and COVID-19 recovery projects.

2.4. The project has a strong emphasis on women and gender inclusiveness. Gender inclusion in the SGBs will be one of the key criteria for the outcome payment criteria described in Component 1. In 2019, close to 42% of the outstanding portfolio of RC (US$21M) was made to gender inclusive agricultural businesses. As a result, these loans supported close to 271,000 women farmers and 7000 women employees. RC launched its Women in Agriculture Initiative (WAI) in 2012 with a goal to unlock market opportunities for women working in agriculture to participate actively as farmers, workers, and leaders by working side-by-side with agricultural businesses to create a more gender inclusive industry. The same principles and strategies in RC's WAI for gender inclusiveness will be applicable to this project.

2.5. **Component I: Social Impact Incentives (SIINC) Payments (IDB Lab: $0; Counterpart (SEP): US$750,000)**. This is the component that includes the SIINC payment mechanism through which the project executing agency (RC) will be compensated up to US$750,000 based on individual loan results for an estimated 25 medium or high additionality loans of up to US$500,000 each to be made to early stage SGBs in the project countries, with loan sizes and additionality/results independently verified by RoI. These loans provided by RC are typically for short term working capital needs, terms that go from 6 to 18 months, interest rates between 10% to 18% and often used for post-harvest financing, production and marketing, and for on-lending to small farmers. RC has an established credit and loan policy, which allows for the adequate analysis and risk management of its credit operations. The differentiated per-loan payments proposed by impact bracket are summarized in the table below:

Impact Criteria	Per-Loan Payment
Medium additionality loans between $300k-$500k	$22,000
Medium additionality loans <$300k	$24,000
High additionality loans between $300k-$500k	$26,000
High additionality loans <$300k	$28,000
Gender inclusivity (*) per loan	+$1,000

(*) For each additional loan that is gender inclusive as defined in the criteria of the incentive scheme, a bonus will be added of $1,000, in addition to other incentives.

2.6. The expected results of this component will be total amount of lending from Root Capital, that these payments are expected to incentivize to these SGBs, which are estimated at US$6.25 Million. The exact number of loans and the amount of the payment per loan will depend on their level of impact; higher impact loans will trigger higher per-loan payments, resulting in fewer loans overall. The payments will be made after the verification process

of RoI has concluded and the resulting report has been sent to the IDB Lab's officials who will supervise the operation.

2.7. **<u>Component II: Contingent Recovery Investment Grant Financing (IDB Lab: US$500,000, Counterpart: $0)</u>**. This innovative mechanism is intended to provide Root Capital with an element of loss support to encourage it to take on the additional risk associated with SIINC-qualified lending to early stage businesses potentially impacted by COVID-19. Under this mechanism, IDB Lab's contingent recovery investment grant (CR-IG) will provide resources to Root Capital to cover losses related to SIINC-eligible loans to borrowers in Costa Rica, Mexico, Nicaragua and Guatemala. The CR-IG financing must be repaid by RC to IDB Lab at the termination of the agreement (repayment period); provided that the amount of repayment shall be calculated by incentive factors and loss factors as set forth below. RC will present its calculations to IDB Lab, who will verify prior to confirming the repayment amounts. The repayment amount shall bear no interest and payments will be made semi-annually.

Number of loans closed: To calculate the CR-IG repayment amount, Root Capital shall determine the number of SIINC-eligible loans submitted for compensation as provided in the agreement during the execution term of the agreement. The loans in this analysis will be in the same category as the loans analyzed for payments under Component I. To incentivize RC to continue to make the highest possible number of high impact loans with measurable risk, the greater the number of SIINC-eligible loans submitted for compensation, the lesser the repayment amount related to the CR-IG financing, which incentivizes Root Capital to make a greater number of SIINC-eligible loans. Specifically, baseline repayment amounts are as follows:

SIINC-Eligible Loans Closed	RC Required Repayment Amount
1 - 3 Loans	$500,000
4 - 6 Loans	$250,000
7+ Loans	$0

Loss rates[7]: Following the calculation set forth above, Root Capital shall calculate the loss rate with respect to the SIINC-Eligible loans submitted for compensation during the term of the Agreement. If the loss rate with respect to such loans is equal to or less than 2.5%[8], the baseline repayment amount shall be unchanged. If the loss rate with respect to such loans is equal to or greater than 2.6% and less than or equal to 7.5%, the baseline required repayment amount shall be reduced by fifty percent (50%). If the loss rate with respect to such loans is greater than 7.5%, the baseline repayment amount shall be $0. The following table summarizes this concept:

[7] Loss rate is defined as the aggregate amount of principal written off on qualifying loans net of recoveries on qualifying loans as of the calculation date, divided by the aggregate origination amount of qualifying loans. Calculation date is defined as two years after the financial close date of the last qualifying SIINC-eligible loans on which a SIINC payment may be claimed.

[8] Average level of loss rate on loan portfolio is less than 2.5% as a reference from the most recent audited financial statements of RC.

Loss Rates	RC Repayment Amounts
0 - 2.5%	100% of amount calculated as set forth in Section 2.7 (1)
2.6% - 7.5%	50% of amount calculated as set forth in Section 2.7 (1)
>7.6%	0% or $0

The overall CR-IG repayment structure combining these two factors is as follows:

# of SIINC-eligible loans closed	**Loss rate**	**Retained by RC**	**Root Capital Repayment Amount**
1-3	0-2.5%	$0	$500,000
	2.6-7.5%	$0	$500,000
	>7.6%	$0	$500,000
4-6	0-2.5%	$0	$500,000
	2.6-7.5%	$125,000	$375,000
	>7.6%	$250,000	$250,000
7+	0-2.5%	$0	$500,000
	2.6-7.5%	$250,000	$250,000
	>7.6%	$500,000	$0

2.8. **Component III: Business Advisory Services (IDB Lab: US$150,000; Counterpart: US$ 0).** As many early-stage SGBs lack crisis management capacity, as well as the financial management skills and experience to successfully access and manage credit, the loans incentivized by Components I & II will be complemented by targeted business advisory services delivered by RC to 15 early stage SGBs in the project countries (Guatemala, Honduras, Colombia, Peru, Nicaragua, Costa Rica, and Mexico). Most of the clients receiving training will also be recipients of medium and high additionality loans, but a portion may be earlier stage "pipeline" clients who require crisis management support and catalytic training in financial management in order to accelerate their progress towards basic credit-readiness. Some clients will receive digital business intelligence advisory services and/or agronomic advisory services (including ag-tech) through the cooperatives[9]; these clients will likely be more advanced early stage clients on the cusp of "graduating out" into larger, more financially sustainable lending brackets, and for whom these extra services could accelerate their growth trajectory. The exact package of services delivered per business will depend on the business's needs and capacities and may include crisis management training and other COVID-19-related support. The trainings administered through this project will be delivered either on-site at the businesses' premises or, if necessary due to COVID-19 travel restrictions, online via

[9] These advisory services will also cover topics and techniques to adapt to climate change.

remote training, and will last approximately ten days on average, with some businesses receiving between ten and twenty days depending on their individualized training package.

2.9. **Component IV: Rapid Response Investment Grants (IDB Lab: US$200,000; Counterpart: US$0)** To further support early stage SGBs as they and their communities manage the ongoing social and economic impacts of the COVID-19 crisis, RC will complement this project's high-impact lending and tailored advisory services with Rapid Response Grants to an estimated 12 SIINC-qualifying enterprises. These one-time, non-repayable emergency grants will be quickly deployed to address needs that clients identify either within their own operations or in their communities, including those relating to food security, health and sanitation (such as purchasing personal protective equipment), or mitigating the effects of lost income for employees and/or farmers. Results from a global survey of Root Capital's clients showed that a majority (75%) foresee a setback or delay in harvesting, processing, shipping, or sale of their product, with a median delay of 30 days. For certain businesses, especially the particularly cash-poor early stage SGBs served by this project, this will mean that their cash flows will go negative for a prolonged period of time and they will be forced to operate below their break-even point and beyond their cash reserves unless drastic action is taken to help facilitate additional liquidity. As an example, due to delays in contracts, clients might need help making payroll or capitalizing their internal credit systems to provide liquidity to farmers and employees to purchase food or other essential items.

2.10. This investment grant mechanism will help RC provide for these urgent cash flow needs of its clients. Clients will be selected by RC according to a systematic prioritization process that will take into account their local context, community needs, and business situation. Client proposals for grants must include consideration for gender inclusion and will be reviewed and approved by Root Capital staff. Funds will then be quickly deployed through existing systems and mechanisms, as Root Capital has an established program to partner with select clients to use small grants for investments in other areas such as to increase gender equity, youth engagement, or climate resilience. Root Capital will disburse an estimated 12 grants over the project period[10].

2.11. **Component V: Debt Relief Fund (IDB Lab: US$0, SEP: $195,000)** According to a client survey conducted in Q2 2020, 23% of Root Capital clients globally foresee needing loan restructuring, and this number is likely to increase as delays in returning to the pre-COVID levels of production and sales continue and the possibility of economic recession looms. As agricultural value chains remain active during COVID-19, agri-SGBs require the working capital to operate their businesses, continue to participate in value chains, and support livelihoods. To support the continued flow of goods and services, Root Capital is prepared to use the counterpart support provided as an investment grant from the SEP (funded by SDC) to cover losses to continue serving clients facing COVID-19-related delays and setbacks.

2.12. This SEP component of the project, supported by SDC, will enable RC to provide proactive relief to SIINC-qualified businesses impacted by COVID-19. It will be used on a needs assessment basis to provide businesses with SGB debt relief when needed, as assessed by loan officers. Loan officers will be closely monitoring clients, and, as per normal RC internal protocol, flagging increased risks to the loan that arise. At times of increased risk,

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[10] RC has an in-house Guideline for the grants that will be used for the decision making on these grants.

the RC credit committee will make a determination of whether, what, and how much debt relief to provide, based on the needs of the client and credit risk analysis. This relief may be provided as interest rate relief if the client needs to extend repayment to account for shipping delays, for example, or payment forgiveness, if the sales face a long-term decline. This facility will be used proactively to help cover for clients who face defaults and costly workouts or collections to help their businesses to better weather the COVID-19 crisis.

B. Project Results, Measurement, Monitoring and Evaluation

2.13. At the end of the implementation period, the project is expected to have accomplished the following: (i) 25 new (medium or high additionality) loans made to early stage agribusinesses ; (ii) 15 agribusiness SGBs receive technical assistance to build their crisis management capacity and position them for successful recovery form the COVID-19 pandemic; and (iii) the total amount of credit extended to early stage enterprises via the project reaches US$6 Million.

2.14. The project has incorporated within its operating plan structure a mechanism to monitor and verify project results, the details of which are described in Annex VI. In the performance plan, Key Performance Indicators (KPI) have been defined by agreement between all relevant project parties: SDC, RoI, Root Capital and the IDB Lab. These indicators, which reflect some of the focused project incentives for RC in the target countries, include: (i) the number of additional loans (with medium or high additionality) of $500,000 or less closed and funded in the target countries; (ii) number of additional loans of $500,000 or less closed with gender inclusive businesses in the target countries; (iii) total amount of credit invested in early stage enterprises that commercial lenders would not have provided; (iv) number of Rapid Response Grants provided to SIINC-qualified businesses to help address the urgent needs of businesses and their communities as they weather the pandemic; (v) number of enterprises receiving technical assistance to build their crisis management capacity and position them successfully for recovery. The same performance plan establishes the following key processes for verification of the above KPIs (i) and (ii), necessary for project Component I: Social Impact Incentives (SIINC) Payments: (a) verification of loan officer training and knowledge on the impact framework; (b) a review of the qualifying loan; and (c) spot checking. Finally the performance plan details the monitoring tools to be used throughout the project life which include the borrower's capital structure report and revenue figures, the report describing the additionality determination, the organizational metrics, a key stakeholder interview guide, and a borrower interview guide.

III. Alignment with IDB Group, Scalability, and Risks

A. Alignment with IDB Group

3.1 **Alignment with Institutional Strategy**. The project is aligned with the IDB institutional strategy by supporting the insertion of small-scale farms into value chains and by addressing cross cutting issues such as climate change and environmental sustainability. It is aligned with the Bank's strategy of improving agricultural productivity and competitiveness and expanding access to financial services for agricultural producers.

The project also aligns with other Bank operations in the region which to seek to strengthen and support the agricultural sector of small farmers.

3.2 The project will contribute to the IDBG's institutional strategy goals of reducing poverty, increasing sustainable growth, and fostering development through the private sector by: (i) providing key financing services to underserved SGBs; (ii) promoting the adoption and dissemination of farm management tools, training and quality control systems; and, (iii) creating new opportunities in farm- related activities, particularly for women and youth who are more vulnerable to unemployment and migration. In addition, the project will introduce technologies that constitute an innovation in region's agricultural finance sector.

3.3 The project is aligned with IDB Lab's efforts in different countries to pilot test and foster initiatives that address constraints and bottlenecks in agriculture and agricultural value chains. This project falls within the Thematic area of Climate Smart Agriculture. The project will provide critical financing in the forms of loans and technical assistance to last mile and excluded populations, most of them farmers and their families who have been hard hit by the pandemic.

B. Scalability

3.4 Scaling of the project will be achieved by replication, expansion, and collaboration. It is expected that local Banks, other social impact investors and anchor companies, will enter this space as they see and assess the capacity of Root Capital to lend to this market segment. It is estimated that at least five other actors aside from the executing agency start lending to the SGBs as a result of the intervention. In addition, through the project, SGBs reached during the project term will be positioned to grow and access more commercial sources of financing over time from Root Capital and other sources. Finally, scale will be accomplished by the systematization of the experience and the sharing of the experience in networks such as CSAF (Council of Small Holder Agricultural Finance) of which Root Capital is a member and leader. CSAF is made up of 15 social impact investors focused on agricultural lending and has developed a platform for the collaboration among the members where these types of pilots can be tested. The IDB Lab also runs and participates in a number of financial inclusion networks and platforms where the results achieved by the project will be shared.

C. Project and Institutional Risks

3.5 **Environmental and Social Risk Classification**. The proposed transaction is classified as B, as Root's Capital existing or proposed portfolio is comprised of, or is expected to be comprised of, business activities that have potential limited adverse environmental or social risk impacts that are few in number, largely reversible and readily addressed through mitigation measures. RC has developed and operates an Environmental and Social Management System (ESMS) that is commensurate with the level of environmental and social risks in its portfolio and prospective.

3.6 The project team has identified the following risks and corresponding mitigation strategies which have been embedded in the project design:

3.7 **Risk 1: Credit/Default risk**: Although SIINC payments will mitigate the cost to serve for the high-risk, high-impact lending clients reached through this project, it will not eliminate

the elevated risk of default for these early-stage businesses, especially due to the effects of the COVID-19 crisis. The small rural enterprises served by this project tend to lack cash reserves, can have limited management capacity, and often have less robust buyer relationships. Together, these factors make them especially vulnerable to delays, shifts in buyer demand, and other disruptions. **Mitigating factor**: The project is specifically designed to help mitigate this risk, by the following three mechanisms:

3.8 **Proactively supporting clients to prevent default:** The project's Advisory Services will help build the internal capacity of clients, so they can plan for, respond to, and recover from crises and disruptions. In addition, the proposed Rapid Response Grants and Debt Relief fund will enable Root Capital proactively and with flexibility to work to address clients' urgent needs during the crisis; ultimately, this support will help preserve clients' liquidity and ensure their business continuity during the acute phases of the crisis.

3.9 **Ameliorating the effects of client default:** If clients do default at elevated rates, the project's Contingent Recovery Grant will help ameliorate some of the impact on Root Capital's balance sheet, encouraging Root Capital to continue offering high-impact, high-risk loans even during this period of extremely elevated market risk.

3.10 **Complementing RC existing risk management systems:** Although SIINC payments will incentivize RC to make relatively unprofitable loans, they will not override RC's existing Risk Management infrastructure, which includes the RC Finance & Credit Risk Committee that sets RC's risk appetite and reviews credit performance and quality, and the Risk Oversight Committee which closely monitors the particulars of RC's lending performance and decision-making on a monthly basis. These committees will only allow RC to lend to businesses that meet basic parameters for credit-worthiness, and while SIINC payments can shift the overall risk calculus, they will do so to a limited extent. Ultimately RC will continue to try to mitigate default risk to the extent possible. RC's Risk and Lending teams are closely monitoring the evolving conditions due to COVID-19 in the project's countries and value chains.

3.11 **Risk 2: Prioritization and use of Rapid Response Grants**: RC will need to efficiently and effectively assess the needs of project agri-SGBs to select recipients of small grants, and ensure small grants resources are directed to where they will have the most impact. The early stage agri-SGBs receiving grant are often located in remote areas and can lack internal management capacity. There is a risk of small grants funding released to agri-SGBs being directed towards purposes other than the original intention or otherwise mismanaged. **Mitigating factor:** RC will apply its robust monitoring and oversight protocols established for its existing small grant program for client agri-SGBs. Since 2014, RC has executed and monitored more than $2.5M in small grants to agri-SGBs across its global reach. Relevant procedures include application of a rigorous prioritization and assessment tool to identify top-priority clients to receive grants; active facilitation and guidance for SGBs during grant proposal origination; thorough internal review of proposals by members of RC Lending, Advisory, and Impact teams.

3.12 **Risk 3: Market volatility**: RC's existing Risk Management policies and procedures cannot entirely correct for the inherent volatility and unpredictability of smallholder agriculture; clients and loans that appear creditworthy at time of loan application approval may not be entirely resilient to sudden shifts in external circumstances, due to regional/global factors including the COVID-19 pandemic. **Mitigating factor**: RC mitigates market risk by lending against forward contracts where possible, reviewing country-specific lending regulations

and currency controls, and performing ongoing market assessments. RC is maintaining close contact with clients' buyers, other industry partners, and its teams on the ground, in order to track shifting market conditions and anticipate potential problems.

3.13 **Risk 4: Effects of climate change and other weather-related shocks**: Many of the early stage SGBs which RC seeks to serve through this project will be small-scale coffee cooperatives in Latin America, where the effects of climate change on coffee yields and harvest timing are acutely felt. These effects may hinder the impact of the project with these clients. **Mitigating factor**: The services RC will be able to extend to these clients through this project, namely affordable financing and targeted management, agronomic and digital technology capacity building, will increase the resilience capacities of these SGBs, rendering them better-positioned to weather the effects of climate change. With access to credit and growth, SGBs are able to implement key initiatives such as income diversification programs, crop renovation and rehabilitation, and agronomic training for supplying farmers.

IV. Instrument and Budget Proposal

4.1 The project has a total cost of US$ 1,795,000 of which US$850,000 (47%) will be provided by the IDB Lab, and US$ 945,000 (53%) by the financing source SDC. Counterpart resources provided by the executing agency (RC) include an estimated $6.25M in investment capital mobilized for the project's SIINC-qualified loans; this capital is sourced from RC's existing pool of assets. The execution period will be of 24 months and the disbursement period will be 36 months.

4.2 IDB Lab financing will be split between a non-reimbursable grant and a Contingent Recovery Grant (CRG). The project budget is summarized in the following table:

	IDB Lab	**Counterpart (SDC)**	**Total**
Project Components			
Component 1: Outcomes Payments	0	750,000	750,000
Component 2: Contingency Investment Grant Finance	500,000	0	500,000
Component 3: Business Advisory Services	150,000	0	150,000
Component 4: Rapid Response Investment Grants	200,000	0	200,000
Component 5: Debt Relief Fund	0	195,000	195,000
Grand Total	850,000	945,000	1,795,000
% of Financing	**47%**	**53%**	

V. Executing Agency (EA) and Implementation Structure

A. Executing Agency(s) Description

5.1 Root Capital (RC) is a pioneering lender and technical assistance provider to agricultural businesses in the developing world, with 18 years of experience innovating in frontier markets. Founded in 1999 and first incubated as Ecologic Finance, RC was incorporated as a 501(c)(3) in 2006. RC seeks to improve farmer livelihoods by providing credit and capacity building to unlock the growth and impact potential of agricultural SGBs. Since its founding, RC has lent $1.4 billion to over 725 agricultural businesses aggregating 1.5 million farm households (impacting 6.9 million people). Much of RC's lending has targeted earlier stage SGBs requiring $100-500K but lacking credit history or formal collateral.

5.2 In 2019, Root Capital worldwide disbursed $121 million to 201 small agricultural businesses reaching 667,000 producers. The organization's average loan portfolio balance was $50 million for the year. RC ended the year with assets of $88.3 million, liabilities of $70 million, and net earnings of $3.6 million, thanks to disciplined underwriting, targeted expense management, and a successful fundraising campaign to build the organization's philanthropic equity base to strengthen resilience and ensure RC can continue to reach overlooked businesses for years to come. In 2019, RC complemented its fundraising efforts by working diligently to improve portfolio quality. The organization reduced the number of clients in Portfolio-at-Risk (PAR) by half, to 8 clients, in the process writing off $3.2M of past due loans, recovering $1.8M of previously written-off principal, and yielding a trailing 12-month net write-off ratio of 2.3%. With the support of partners like IDB Lab, RC was able to achieve these risk management results while also deepening the impact of its portfolio, with 73% of loans showing medium or high additionality— the highest-ever proportion in the history of RC.

5.3 In 2020 YTD, due to RC's strong financial position coming out of 2019 as well as global operations able to easily transition to remote working, Root Capital has been able to successfully manage the disruptions due to the COVID-19 crisis. Since the crisis intensified in March, RC has undertaken two global client surveys to understand clients' evolving circumstances, urgent needs, and the crisis' impact on their communities. Building off those survey results, RC has launched emergency programming across its global reach, including emergency grants to clients and remote Advisory Services to help enterprises weather the crisis. Despite continued travel restrictions, RC has continued servicing clients' loans, issuing disbursements, and closing new loans for clients for whom we were able to complete in-person due diligence prior to the suspension of travel due to the crisis. Through the first two quarters of 2020, while RC has seen rising risk ratings across their portfolio— as enterprises across value chains and geographies manage through delays, shifting buyer demand, and deep uncertainty— RC has yet to experience elevated rates of client default.

5.4 Root Capital's global headquarters is in Cambridge, MA and it has several regional offices in Latin America, sub-Saharan Africa, and Indonesia. Of the 115 employees, the majority are based in the regional offices where they are hired locally, facilitate a close relationship with clients, and are responsive to clients' evolving needs. Furthermore, RC indicates that its senior and middle management teams have a demonstrated commitment to rigorous screening of potential clients, crop policies, and environmental and social impacts.

B. Implementation Structure and Mechanism

5.5 The project will be executed by Root Capital from its regional office in Costa Rica. RC will establish its core project execution unit in San Jose, staffed by a team of 5 professional and technical officers. This team will receive administrative and technical support and leadership from the RC team in headquarters.

5.6 The project will be implemented with close collaboration from Roots of Impact. Roots of Impact (RoI) is a specialized advisory firm and market builder based in Germany, which supports impact investing and development finance. RoI creates innovative financing solutions for scaling social enterprises, and advises impact investors, public funders, and philanthropists in implementing them. RoI has pioneered the SIINC concept and is currently piloting it in partnership with the IDB Lab and Swiss Development Corporation in Latin America. RoI will act as the external agent to measure compliance and adherence to the impact and results targets of the project. The costs related to the participation of RoI in this project will be covered by the SDC under a direct contract with RoI, which contracting will be a condition precedent to disbursing part of the project resources.

VI. Compliance with Milestones and Special Fiduciary Arrangements

6.1 **Disbursement by Results, Fiduciary Arrangements.** The Executing Agency will adhere to the standard IDB Lab disbursement by results, Bank procurement policy[11] and financial management[12] arrangements.

VII. Information Disclosure

7.1 **Access to Information:** Project information is not considered confidential under the IDB Access to Information Policy. This document is therefore public in accordance with said policy.

7.2 **Intellectual Property.** The IDB will own relevant intellectual property rights related to any of the products that are produced as part of the project

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11 Link to the Policy: Procurement of Works and Goods Policy

12 Link to the document Operational Guidelines for Management of Milestones and Financial Supervision for MIF and SEP Technical Cooperation Projects