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DCA LOAN GUARANTEE ROOT CAPITAL

IMPACT BRIEF

On the Cover: Sorting coffee cherries in Ethiopia

BACKGROUND

Rural, small and medium enterprises (SMEs) struggle to obtain the capital they need to operate and expand their businesses. Yet, SMEs have the potential to provide much-needed employment for rural inhabitants, increase food security, and enhance a country's export revenues. The financial sector has historically viewed agriculture as a risky investment, subject to the vagaries of weather, seasons, and sometimes widely fluctuating prices. In addition, rural producers typically lack acceptable guarantees or collateral, an existing credit history, and bank-required paperwork.

The non-profit organization Root Capital provides credit to village-based producer businesses to enhance community economic development in Latin America. Its innovative model uses Fair Trade/Organic Certified businesses' purchase orders with international buyers as collateral. It also provides technical assistance in financial management.

Recognizing a synergy in vision and goals, USAID's Bureau of Economic Growth, Agriculture and Trade, Office of Development Credit (EGAT/DC) decided in 2003 to support Root Capital's lending to qualified producer/cooperative groups in Latin America with a loan portfolio guarantee.

In early 2005, EGAT/DC decided to further support Root Capital with another guarantee to help the organization expand its model into East Africa.

ABOUT DCA

USAID's Development Credit Authority (DCA) was created in 1999 to mobilize local private capital through the establishment of real risk sharing relationships with private financial institutions in USAID countries. The tool is available to all USAID overseas missions and can be used as a vehicle for providing much needed credit to an array of enterprises and underserved sectors. The Root Capital evaluation is part of a set of evaluations that EGAT/DC is undertaking in different countries, to test a series of developmental hypotheses related to the DCA guarantees.

EVALUATION OBJECTIVES

EGAT/DC, which administers the DCA guarantees, commissioned an evaluation of the Root Capital guarantees in 2010. This evaluation assesses the performance of the guarantees relative to their objectives as defined in the Action Packages developed by USAID, i.e., increasing access to credit for SME agribusinesses in Latin America and East Africa. The evaluation assesses the outputs, outcomes, and impacts of the guarantees.

The evaluation covers Root Capital's lending behavior and potential demonstration effects in the financial sector. It does not examine EGAT/DC's or USAID's administration of the guarantees, nor does it examine the guarantees' contribution to USAID Mission strategic objectives.

EVALUATION METHODOLOGY

This evaluation used a mixed methods approach, including statistical analysis of loan data, key informant and group interviews, and document review. It began with a review of background documents on Root Capital and its DCA guarantees, and continued in Cambridge, Massachusetts (Root Capital's headquarters) from July 12 to 16 with semi-structured interviews with Root Capital staff and review of the organization's portfolio data. The evaluator used comparative analysis, statistical analysis, and content pattern analysis to draw findings from the collected data, from which she drew conclusions.

ROOT CAPITAL LOAN GUARANTEES

Starting Year	Ending Year	Ceiling Amount ($)	Number of Loans	Aggregate Amount ($)	Utilization Rate	Average Loan Size ($)	Average Loan Tenor (days)
2003	2008	2 million	22	3,982,250	99.56 %	181,011	425
2005	2008	1 million	15	1,602,000	80.1 %	106,800	161




KEY FINDINGS AND CONCLUSIONS

OUTPUTS

Conclusions Root Capital entered into the guarantees to enable it to expand lending to riskier borrowers and markets. The first guarantee allowed Root Capital to extend lending to needier clients, while the second guarantee helped Root Capital expand its operations to East Africa. In both cases, Green Mountain Coffee Roasters' (GMCR's) partnership with USAID was instrumental in both Root Capital's expansion and its link to the DCA guarantees.

Findings in support of these conclusions include:

- Senior Root Capital officers said one of Root Capital's main partners, GMCR, had a partnership with USAID and learned of the DCA opportunity. With the DCA guarantee, Root Capital could expand through bringing loans to its credit committee which were too risky to approve in the absence of the guarantee.
- Root Capital's Regional Director for Latin America said Root Capital used the first DCA guarantee to provide loans to riskier businesses than those to which Root Capital normally lends.
- According to senior Root Capital officers, Root Capital's Memorandum of Understanding (MOU) with GMCR included the intention to expand lending to Africa.
- Africa was very risky for Root Capital because of its unfamiliar languages and cultures, fewer Fair Trade-Certified businesses, lower education levels, and more fraud and corruption than in Latin America. The DCA guarantee, Root Capital's officers said, made the board and investors comfortable with lending to Africa.
- Fifteen of the 31 (48 percent) borrowers under both guarantees were new borrowers to Root Capital.

OUTCOMES

Conclusions The Latin America guarantee helped triple Root Capital's nonguaranteed Latin American portfolio from $3.3 million pre-guarantee to $10.9 million. The second guarantee contributed to nearly tripling Root Capital's Africa portfolio from $1 to $2.9 million. Root Capital intends to sustain lending to small and medium Fair Trade and/or Organic Certified producers and processors in Latin America and Africa, thereby sustaining the DCA guarantees' outcomes.

Since Root Capital's officers asserted that the organization would not have lent to these borrowers in the absence of the DCA guarantees, the guarantees contributed to these outcomes. Other contributing factors to Root Capital's continued lending to these customers and markets are likely (a) increased trust between Root Capital and its clients as they got to know each other; (b) Root Capital's rising knowledge of the East African market; (c) Root Capital's desire to expand; and (d) increased investor interest in Root Capital's target markets.

The primary, exogenous factors responsible for Root Capital's growth are: (a) large, unmet need among its target market; and (b) increased capital base. Fueling both has been the increased interest among consumers, buyers, and investors in Fair Trade and Organic Certified products from SMEs in developing countries.

Findings to support these conclusions include:

- Of the 19 borrowers which the Latin America DCA guarantee supported, 14 received subsequent, non-DCA-guaranteed loans, at an average value of $480,000. Six were new Root Capital clients when they received their DCA guaranteed loans.
- Root Capital's subsequent, nonguaranteed loans to these six new clients accounted for a $7.6 million increase in Root Capital's Latin American portfolio over 1999-2002 levels.
- Eight of the 12 borrowers under the Africa DCA guarantee received subsequent, non-DCA-guaranteed loans, at an average value of $228,479. Five of the eight borrowers were new clients.
- Subsequent, nonguaranteed lending to these five new clients accounted for a $1.6 million increase in Root Capital's Africa portfolio over 2004 to 2005 levels.

- Root Capital's senior officers said the organization's objective is eventually to "graduate" their clients to accessing finance from locally-available, commercial sources of financing.
- Root Capital's nonguaranteed lending portfolio increased from $9 million to $53 million between 2004 and 2009. Asked to what they attribute this growth, all Root Capital staff interviewed cited the large demand among targeted clients for Root Capital credit.
- By the end of 2009, Root Capital counted 20 major philanthropic and corporate investors in its operations, thanks to increased interest in social investing and the attractiveness of Root Capital's 100 percent repayment rate in an unstable financial environment.
- Buyers have become increasingly interested in Organic and Fair Trade Certified products.

IMPACTS

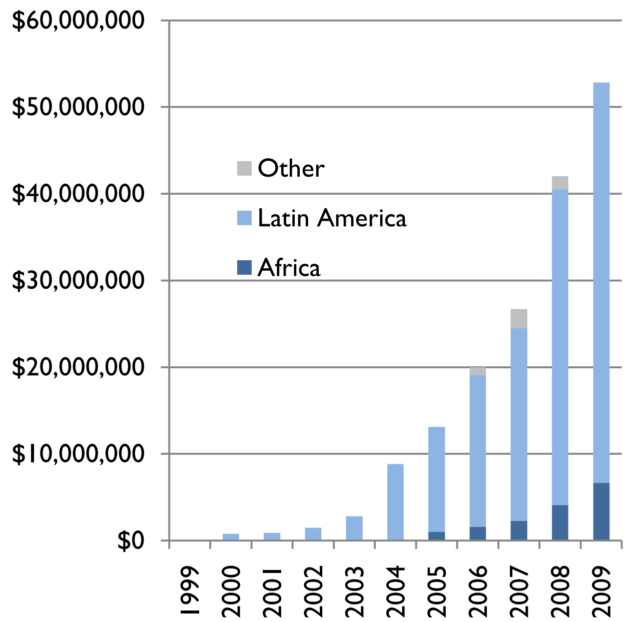
Conclusions Root Capital has increased access to finance for its own clients. There are specific cases of producer groups that have gained access to finance through Root Capital and gone on to access other sources of finance. The DCA guarantees contributed to this by allowing Root Capital to provide loans to otherwise too risky borrowers.

As organizations gain lending experience and additional lenders enter the market, borrowers have increased the amounts they borrow, although not necessarily their loan tenors. More government programs, international donors, NGOs, and social investors lend to this sector, and collateral requirements have become less stringent for some producer groups. Root Capital is making a positive difference in its clients' businesses and the DCA guarantees supported that assistance.

Findings to support these conclusions include:

- The training that Root Capital and others provide increases investor confidence in both the trained and untrained organizations because people see overall a higher level of financial management in the sector, said Root Capital's Latin America Regional Director.

ROOT CAPITAL'S NONGUARANTEED LENDING



- 14 of 15 respondents to the Latin America borrower survey realized an increase in loan amounts. 67 percent of respondents currently have credit valued at more than $500,000. 65 percent of respondents reported their first loan amounts at less than $100,000.
- Eight of 11 East African borrower survey respondents reported higher current loan amounts than their first loan amount, including six DCA beneficiaries. 35 percent of respondents currently have credit valued at more than $500,000. 57 percent of respondents reported first loan amounts at less than $100,000.
- 29 percent of Latin American respondents realized a longer loan tenor for their current loans. One African DCA beneficiary reported a longer current loan tenor.
- 4 of 12 Latin American respondents, and 3 of 12 Africa respondents reported a decrease in collateral requirements (no collateral requirement).
- 80 percent of Latin American respondents and 79 percent of African respondents said that access to credit has improved over the last 7 years.

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