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Spent shells
could power
cocoa processing

Venezuela
could be hit
by coffee shortages

Decaf companies
claim organic decaf
is the future

**Peru's
coffee farmers
held back by
lack of credit**



Prior to founding the social investment fund Root Capital Willy Foote worked for Lehman Brothers, the investment bank – work which took him regularly to Brazil, Colombia and other countries in The Americas – and as a financial journalist in Mexico

Whilst in Mexico, Foote witnessed first hand the effects of what he calls "the missing middle" - the credit gap between microfinance and traditional banking – on small and growing businesses in developing countries and rural communities.

He could also see that, although Micro-Finance Institutions (MFIs) were having a positive effect in other parts of the economies in developing nations, MFIs rarely reach rural communities. As he explained to C&CI, he also saw clearly that, in addition to holding back farmers, lack of access to credit had an adverse effect on the environment, because it led to environmentally destructive practices by economically-challenged farmers.

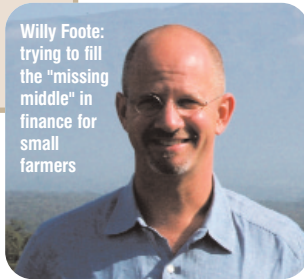
New class of capital

"This set me thinking 'how might we create a new class of capital' that would enable producers to gain access to the credit they need, at the time they need it?" Mr Foote explained. The result was EcoLogic Finance, nowadays known as Root Capital.

"Our aim was to help farmers whose businesses were too small and risky for mainstream banks and too large for microfinance. These grassroots businesses are caught in the 'missing middle'; they cannot access the capital they need to grow and sustain their operations," Mr Foote told C&CI.

"Root Capital addresses this market failure through an innovative lending model that serves the needs of these remote grassroots businesses. We have created a new class of capital, sitting between micro-credit and commercial lending, enabling rural communities to unlock wealth and build sustainable livelihoods."

Willy Foote: trying to fill the "missing middle" in finance for small farmers



Social investor aims to "fill the missing middle"

Describing his concept to a partner in the new venture, Mr Foote was once told that "naiveté is a strategic advantage" – and it certainly seems to have been just that in Root Capital's case.

Then came the coffee crisis, with historically low prices for green coffee and many thousands of farmers either driven out of coffee farming or so badly affected that whole communities suffered.

Credit worthiness

The need for another form of financing for farmers who were stuck 'in the middle' had never been greater. "Historically, these people had never been regarded as creditworthy in the conventional sense, but when you apply a new model to them, as we have, many of them obviously are," Mr Foote explained.

"We lend to small grassroots businesses that are locked out of the local banking system, and provide financing for both short-term working capital loans and longer-term investments," he explained.

For the majority of its loans, Root Capital uses future sales contracts from companies like Green Mountain Coffee Roasters, Starbucks, and Equal Exchange as a form of collateral. When products are shipped, the buyer pays Root Capital directly for interest and principal payments. Using this factoring model, Root Capital can be confident that a loan will be repaid – in fact its repayment rate is over 99 per cent.

"By moving beyond traditional approaches to collateral, we are proving the business case for lending to the rural unbankable," Mr Foote explained. Since its formation, Root Capital has provided credit to grassroots businesses in 30 countries including Guatemala, Mexico, Peru, Tanzania and Rwanda, often providing straight working capital for harvest finance; in this way, farmers are not forced to sell prematurely to middlemen.

Since then, however, the range and type of financial products it has assisted farmers with has expanded significantly, and Root Capital is also providing farmer organisations with access to finance for infrastructure and capital goods that enables them to process the coffee that they grow. More recently still Root Capital provided US\$300,000 in finance to enable a group of farmers in the Cusco region of Peru to turn surplus grain they produced into a product that they could begin to trade themselves.

"Nowadays," said Mr Foote, "we aren't just providing finance for the harvest or helping farmers during the lean months; we provide capital that also helps farmers add value to what they are growing, and helps them process what they grow; we also help build internal credit management capacity at co-ops and other farmer groups."

Financial literacy

Many small farmers have never held a bank account and have no concept of cash flow or basic cost accounting, so a lot of what Root Capital now delivers is financial literacy training along with access to credit. That is essential, said Foote, if the rural poor are ever to become customers of traditional banking services.

Creating this new class of capital to fill the 'missing middle' between microfinance and commercial lending has, said Foote, required him and his colleagues to be "pathologically collaborative" with other non-profit organisations; and despite the current economic climate, he predicts that investors will be attracted to the small business sector by the very characteristics that have made Root Capital successful – these are, notes, "transparency, strong relationships, and measurable results that are good for people and the planet."

"Ultimately, I guess our exit strategy from this business would be to have convinced the mainstream banks that they have been mispricing the risk they see in lending to grassroots businesses. If they could see that these small and growing businesses can actually be very creditworthy, and if the banks can start to lend successfully in rural areas where it's needed most, there would no longer be a need for Root Capital." ■ C&CI