***IMPACT INVESTING** TO*
REDUCE DEFORESATION

STRATEGIES FOR MOBILIZING FINANCE FOR SMALLHOLDER AGRICULTURE OPERATIONS

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GCF task force

Masters of the Environment

Strategies for Mobilizing Finances for Smallholder Agriculture Operations

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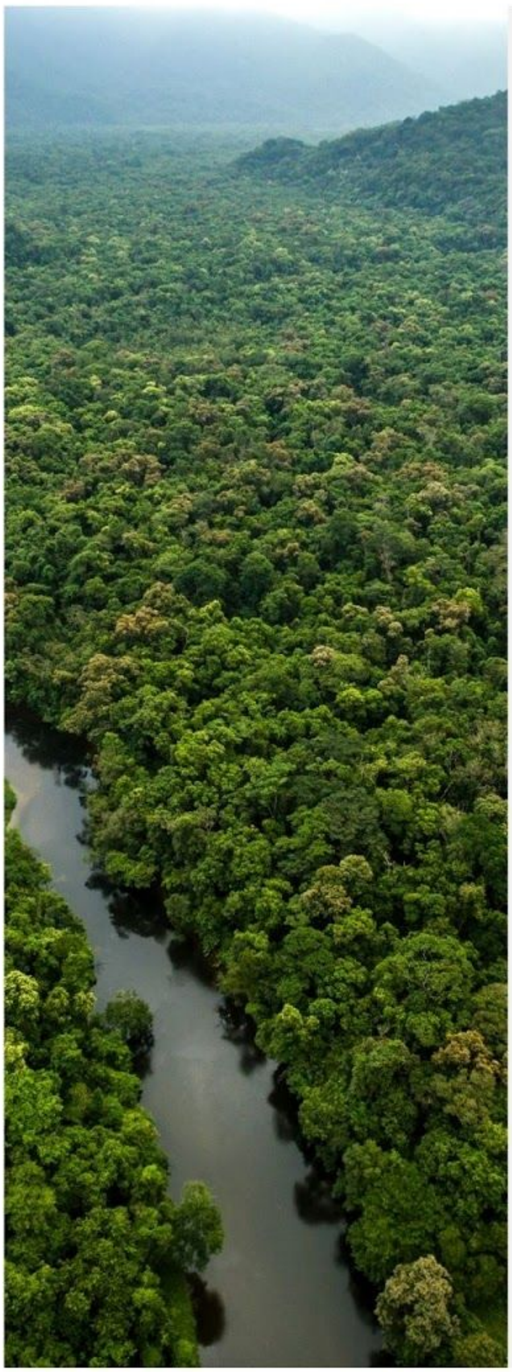


INTRODUCTION

Regional deforestation in the Peruvian Amazon is driven by smallholder farming, which is characterized by low productivity rates and unstable incomes.[1] To curb deforestation in the area, a transition to sustainable agriculture production that prioritizes soil regeneration in place of new land clearing is critical. One of the primary obstacles to this transition, despite regional and country commitments to reduced deforestation, is a lack of affordable financing for smallholders. The underdevelopment of the Amazon's financial and technical infrastructure, combined with a perception of high risk in lending to or investing in smallholder agriculture projects, has stymied smallholder access to the necessary credit to transition to more sustainable practices.

Encouragingly, there are many investment funds working specifically to increase funding opportunities for smallholder farmers through innovative financing strategies. Despite prioritizing environmental and social impact, these investment funds still must ensure financial performance and provide acceptable rates of return and data shows that larger cooperatives are better positioned for investment than individual farmers.

This report--which is primarily focused on the region of San Martin, Peru, but also details barriers to financing and provides insights that may be generalizable to other regions throughout the Amazon--provides a brief background of deforestation in the Amazon and the obstacles to affordable financing smallholders face; analyzes the key criteria that impact investors consider when making an investment in an agricultural project; presents an argument for smallholders forming co-operatives in order to attract transformative investment; explains the technical and financial assistance that will be required to help smallholders transition to co-operatives and shift production practices; and calls on the regional government of San Martin to take steps to facilitate private investment in agricultural co-ops in the region via blended finance and concessionary capital. The report concludes that by strengthening the associative relationships between smallholders through a legal structure (i.e. a co-operative), smallholder farmers will be better positioned to access affordable financing, technical assistance, and specialty markets.

[1] Szott, L.T., Ormeno, L.M., Suarez de Freitas, G., Galarreta, V., Edwards, R., Alcantara, I., Coronel, D., Saavedra, O., Leal, M. and Mendoza, E. (2017) *The Production-Protection Compact in the Peruvian Context* [online]. Available at: https://www.forest-trends.org/wp-content/uploads/2017/03/PPC-Report2-ENGLISH-WEB-17-0215-REV.pdf

STATEMENT OF METHODS/APPROACH

Investments can be broadly categorized as either equity-based or debt-based. An equity-based investment is made in exchange for ownership stake in an organization and the return on investment (ROI) takes the form of profits distributed to shareholders or the sale of the ownership stake for a higher value than the purchase price. Debt-based investments provide a lump sum of capital to the investee in exchange for a fixed repayment and agreed upon interest to the investor. Debt based investments include bonds, loans, mortgages, and lines of credit.

In alignment with the goals of the 2030 Concerted Regional Development Plan for San Martin--especially its objective of **increasing regional competitiveness through diversified public and/or private investment[2]--**this report explores financing opportunities *for cooperatives* to create a pipeline of sustainable, scalable, and verifiable projects for investment. As such, this report will primarily focus on debt-based investment strategies. Debt-based investment is appropriate given the nature of ownership in producer cooperatives. Because only members can be owners of such organizations, equity-based investments are not compatible with the cooperative organizational structure.

The appendix of this report includes profiles of organizations and impact investing funds that focus on supporting and increasing investment to smallholder farmers. The finance and technical assistance project partners featured were chosen from extensive research of innovative players already working in the Amazonian agricultural sector. The value chain partners were selected in a similar manner. The impact funds covered all work specifically to provide innovative, impact-driven financing to smallholder agricultural cooperatives through either direct loans or other forms of project development.

[2] Regional Government of San Martin (2018) *Regional Development Plan for San Martin by 2030* [online]. Available at: https://drive.google.com/file/d/1j9lgDqw2_EBcfZij8HM0XOIdWUYkiDJU/view

BACKGROUND

Deforestation is both a symptom and cause of extreme poverty among smallholder farmers. Historically, low productivity (relative to industrial agriculture) and low commodity prices have led to farm income stagnation. Further, because the Amazon lacks adequate infrastructure, such as roadways, irrigation, and financial services, market opportunities in remote areas pale in comparison to those in more urbanized regions. Financial and technical capital shortages both drive deforestation; farmers rely on the *natural* capital of the forest to maintain subsistence. This reliance manifests itself in a clear pattern: first, a farmer will clear an area of the forest - typically just a few hectares to begin; then, through the use of extractive farming practices, such as monocropping and chemical inputs, the soil is exhausted and rendered unproductive. While the soil could be revitalized through regenerative farming practices, such practices take time and resources - both of which are in short supply for the typical Amazon smallholder farmer. Instead of working to rebuild the soil, a farmer will clear a new patch of land, leaving the degraded land behind. The pattern repeats itself because, counterintuitively, clearing new land is a more affordable and accessible option. Clearing additional land is a relatively low cost option because land titling in the region is, at best, informal.

The regional government has taken meaningful steps to slow deforestation, including the construction of a conservation plan that included the implementation of the Economic Ecological Zoning Project (EEZ), which established enforceable zoning codes and designated areas of the forest well-suited for conservation. Further, a regional government fund--the Amazon Development fund of San Martin, or FONDESAM[3],--has been established to manage and distribute funds specifically for the purpose of financing low-emissions development throughout the region. And finally, the region has developed the Marca San Martin, or Regional Brand of San Martin, which is a designation of origin scheme that identifies local products that meet a set of sustainability criteria. In part, because of these efforts, San Martin was selected as one of Peru's Reducing Emissions from Deforestation and Forest Degradation (REDD+) pilot regions.

While San Martin has made marked progress in reducing deforestation that is worth praising, the region--and country--is still far from meeting its stated deforestation goals, in large part because of the underlying poverty that is driving deforestation, as well the lack of adequate financing for smallholder farmers. For example, when smallholders attempt to access credit for the purpose of making on-farm improvements, they are often penalized for their lack of business knowledge and assets, such as secure title to their land and other forms of collateral, which subjects them to higher interest rates - sometimes significantly over 20 percent. To put this into perspective, as of October 2020, the United States Department of Agriculture finances U.S.-based agriculture operating costs at an interest rate of 1.25 percent. While *private* agriculture operating loan interests rates in the United States are a little higher, they fall

[3] FONDESAM is the spanish acronym for the fund

well short of the rates in San Martin, typically characterized by variable rates that hover between 2.5 and 5 percent. The high interest rates encountered by smallholder farmers in the Amazon not only inhibit access to the requisite inputs and technical assistance needed to transition to more sustainable practices, but they also create a perception amongst the farmers that accessing credit is risky. This concern makes sense: the interest rates and repayment terms often do not align with farmers' income streams or production timelines. Again, this only exacerbates the vicious cycle of farmers continuing to encroach on virgin forests as their own farmland degrades and yields drop as a direct result of unsustainable farming practices.

In recent years, powerful public and private sector actors have recognized that the Amazon is a critical remaining line of defense in the climate crisis. Accordingly, they have made commitments to eliminate their reliance on products of agriculture that furthers deforestation. The Supply Change Project, which tracks companies with commitments to eliminate deforestation-associated commodities from their supply chains, found that out of the 718 companies included in their study, 447 have such commitments. Of the 447, 54 percent were publicly traded and 46 percent privately held, with combined annual revenues of $5.4 trillion.[4] The World Cocoa Foundation, whose members include organizations up and down the cocoa value chain, represents 80 percent of the world's cocoa market. Their 2025 vision includes goals of zero deforestation within their cocoa supply chains. This is representative of a paradigm shift in the cocoa industry, which now considers protecting forest cover as a priority sustainable development goal.[5] Such commitments impact the ability of San Martin farmers to compete in international markets for goods such as coffee, cocoa, and palm oil, among others.[6]

These well intentioned pledges and programs have the potential to exacerbate extreme poverty and drive further deforestation in Peru if they decrease demand for the products of smallholders and drive smallholders to increase output through the only means reasonably available - further land conversion.

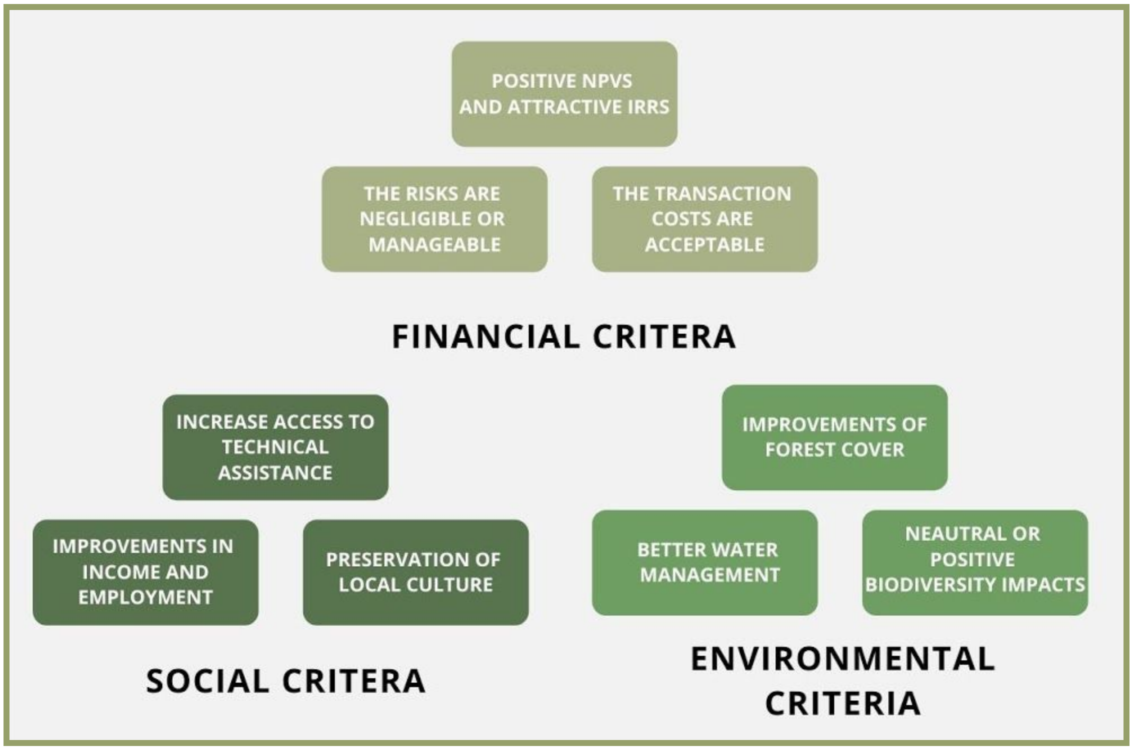
> To avoid this counterproductive outcome and unlock their potential as stewards of the forest and guardians of the climate, private actors and financial institutions should consider supporting San Martin stakeholders to 1) form producer cooperatives; 2) access transition financing to support adoption of more sustainable practices and development of robust monitoring practices; and 3) receive debt-based investment to sustainably scale operation and access markets. To enable private support, San Martin should 1) work to facilitate strategic partnerships that provide legal and business support to nascent cooperatives as well as continued professionalization of existing cooperatives; 2) employ blended finance principles to deploy affordable credit to cooperatives and their members; and 3) create a pipeline (pitch book) of organizations that are eligible for large-scale impact-oriented financing.

[4] Donofrio, S.,, Rothrock, P., and Leonard, J. (2017) 'Supply change: tracking corporate commitments to deforestation-free supply chains, 2017', *Forest Trends,* March [online]. Available at: https://www.forest-trends.org/wp-content/uploads/2018/04/2017SupplyChange_Trackin-Committments.pdf

[5] World Cocoa Foundation (n.d) *Vision and mission* [online]. Available at: https://www.worldcocoafoundation.org/about-wcf/vision-mission/

[6] Donofrio, S.,, Rothrock, P., and Leonard, J. (2017) 'Supply change: tracking corporate commitments to deforestation-free supply chains, 2017', *Forest Trends,* March [online]. Available at: https://www.forest-trends.org/wp-content/uploads/2018/04/2017SupplyChange_Trackin-Committments.pdf

WHAT IMPACT INVESTORS WANT



Impact investors with an eye toward investing in sustainable agriculture and/or deforestation-free supply chains look for projects that satisfy sustainability criteria, are scalable, and are verifiable. Additionally, investors are looking for specific rates of return and impact targets - a 2018 report published by the Global Impact Investing Network (GIIN) found that 76 percent of impact investors set impact targets for their investments.[7]

Sustainable production in this context refers to projects that allow for forests to be maintained at a certain level and the avoidance of the further depletion of forests (and other natural resources) in order to maintain ecological balance; additionally, *sustainability* is often also used by investors to refer to economic and social factors as well as environmental ones. The *Unlocking Forest Finance* project identifies the following sustainability criteria for portfolio selection:[8]

1. *Social criteria,* such as improvements in income and employment and preservation of local culture;

[7] Mudaliar, A., Bass, R., and Dithrich, H. (2018) ‘Annual impact investor survey’, *Global Impact Investing Network,* Eight Edition [online]. Available at: https://thegiin.org/assets/2018_GIIN_Annual_Impact_Investor_Survey_webfile.pdf

[8] Global Canopy Programme, Unlocking Forest Finance (2016) *Unlocking forest finance in San Martin: Leveraging private, public and climate finance to invest in sustainable land use* [online]. Available at: https://www.tropicalforestalliance.org/assets/Uploads/UFF_San_Martin_20_06.pdf

2. *Financial criteria,* including attractive internal rates of return[9] and negligible or manageable risks; and
3. *Environmental criteria,* such as improvement of forest cover and better water management.

Scale refers to creating projects that are large enough to garner large sums of investment. Some impact investment funds, such as **&GREEN**, do not invest in smallholders and instead require enterprises such as cooperatives and producer associations to be present for the consideration of funds.[10] An advisor to the project who works in the impact investing field suggested that the presence of a legal entity is a baseline requirement for structuring an investment deal.[11] Increasing the scale of smallholder projects also creates market advantages for producers. Producer association results in the capacity to aggregate supply and participate in larger, long-term contracts with private actors of the supply chain. Association can also spread the costs of third-party certifications, such as FairTrade or the Rainforest Alliance. By producing specialty or certified goods farmers can address the market risk discussed previously and access higher prices.

Verifiable projects are projects that can prove positive and sustainable environmental, social, and economic outcomes. Such outcomes are an integral element of impact investing and provide the foundation for the types of projects that can be included in an impact investing fund's portfolio. It is not enough to merely claim that a brand, product, or farmer is meeting sustainability criteria; an enterprise that is vying for investment must be able to demonstrate, with evidence, that it is not contributing to negative environmental outcomes, such as forest loss, that it is fostering social inclusion, and that the enterprise is financially stable and capable of producing investment-worthy returns. Most of the investment opportunities considered for this project require at least three years of accounting records, and prioritize organizations that have these records available upon request.[12] In the absence of proven financial returns, some investors will consider an organization's earnings before interest, taxes, depreciation, and amortization (EBITDA). EBITDA is seen as a more precise way of measuring profitability because it is not influenced by accounting and financial deductions. A company's EBITDA provides insight into its ability to meet debt obligations after accounting for operating costs.

The San Martin Case: Applying Impact Investment Criteria to Peruvian Amazon Smallholders

As stated, the region of San Martin has implemented numerous policies and programs to support deforestation-free development and spur investment in the region; however, the region (and the country) is still far from meeting its stated deforestation commitments. For example, San Martin committed to an 80 percent reduction in deforestation rates by 2020 under the Rio Branco Declaration. While San Martin is showing declining or at least constant rates of deforestation, it has not satisfied the goals of the Rio Branco Declaration.[13] To move from stated objectives to accomplished goals,

[9] Rates of return should be comparable to stock market rates. Market rates vary, and can be assessed by assessing current rates in the germane market.
[10] andgreen.fund (n.d) *Investment strategy* [online]. Available at: https://www.andgreen.fund/investment-strategy/
[11] Deriso, G. (2020) 'Impact investing', Interviewed by Ashley Lane and Mikkela Blanton for this report, 30 October.
[12] Deriso, G. (2020) 'Impact investing', Interviewed by Ashley Lane and Mikkela Blanton for this report, 30 October.
[13] Climate Focus (2018) 'Peru JECA Report', *andgreen.fund* [online]. Available at: https://www.andgreen.fund/wp-content/uploads/2018/07/Full-JECA-Report-Peru.pdf

ensuring that projects are well-positioned for investment will be critical; it is unlikely that goals will be achievable without financing from external parties. In order to attract necessary financing, projects must be sustainable, scalable, and verifiable - meeting these criteria will be a key step in securing investment in the region.

Consider the following barriers to each of these three criteria:

First, **farmers are concerned that, when transitioning to sustainable management practices, incomes are likely to fall before they rise**.[14] Farmers have also communicated that in order to be incentivized to transition to sustainable practices, they would require at least four years for repayment of any loan, and that this repayment must include grace periods, as well as interest rates that are closer to single digits, as opposed to the 20+ percent that is conventionally offered,[15] as discussed in the introduction of this report. Unfortunately, while it is estimated that regional yields for coffee and cacao--two of the primary cash crops in the region of San Martin--could be tripled over business-as-usual yields with sustainable management practices,[16] making a transition to more sustainable practices is impossible for most smallholder farmers without access to credit and, currently, fewer than 20 percent of small- and medium-sized farmers in the Peruvian Amazon use credit.[17] Access to the necessary low interest rates is hamstrung by perception of high risk in lending to such farmers. Major factors contributing to the perception of risk in lending to family farmers and smallholders include:

- inadequate land titling and collateral;
- instability of commodity pricing and exchange rates;
- scarcity of enabling goods and services;
- climate and weather unpredictability and associated risks; and
- limited credit history and financial education of farmers.

Some of the same barriers listed above impact farmers' ability to join cooperatives and scale production. Most cooperatives require members to prove that they have a legal land title and business structure. The *Unlocking Forest Finance* project found that in the seven main sectors of San Martin agriculture, on average, 37 percent of smallholder families belong to producer associations.[18] Until farmers have greater capacity to aggregate supply, they will face barriers in accessing specialty markets and value chain partnerships; continuing to be susceptible to volatile commodity pricing and income instability.

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[14] Pinzon, A. (2019) 'Redefining finance for agriculture: green agricultural credit for smallholders in Peru', *Global Canopy* [online]. Available at: https://www.meda.org/innovate/innovate-resources/822-partner-publication-redefining-finance-for-agriculture-green-agricultural-credit-for-smallholders-in-peru-eng/file/

[15] Pinzon, A. (2019) 'Redefining finance for agriculture: green agricultural credit for smallholders in Peru', *Global Canopy* [online]. Available at: https://www.meda.org/innovate/innovate-resources/822-partner-publication-redefining-finance-for-agriculture-green-agricultural-credit-for-smallholders-in-peru-eng/file/

[16] Penaherrera, T., Rengifo, M., Sanchez, L., Pinzon, A., and Lima, G. (2016) 'FInancing sustainable landscapes: San Martin, Peru. Final Report.', *Global Canopy Programme and CEDISA, UK* [online]. Available at: https://financingsustainablelandscapes.org/sites/default/files/files/paragraphs/2017-02/FSL%20report%20on%20San%20Martin_full%20report_ENGLISH.pdf_0.pdf

[17] Szott, L., Suarez de Freitas, G., Gaalrreta, V., Coronel, D., Hicks, F., Edwards, R., and Gregory, J. (2017) 'A financial strategy for the production-protection compact in the Peruvian Amazon', *Forest Trends* [online]. Available at: https://financingsustainablelandscapes.org/sites/default/files/files/paragraphs/2017-02/FSL%20report%20on%20San%20Martin_full%20report_ENGLISH.pdf_0.pdf

[18] Szott, L., Suarez de Freitas, G., Gaalrreta, V., Coronel, D., Hicks, F., Edwards, R., and Gregory, J. (2017) 'A financial strategy for the production-protection compact in the Peruvian Amazon', *Forest Trends* [online]. Available at: https://financingsustainablelandscapes.org/sites/default/files/files/paragraphs/2017-02/FSL%20report%20on%20San%20Martin_full%20report_ENGLISH.pdf_0.pdf

Finally, projects must be verifiable to attract the attention of impact investors. San Martin is making progress on this front, but must implement more rigorous verification and certification schemes. As mentioned in the introduction of this report, San Martin has created a mechanism for regional branding and verification: the Regional Brand of San Martin (Marca San Martin); however, the criteria for participation and the means by which outcomes are monitored must be further developed and scaled before the designation will suffice as proof that branded products are not resulting in deforestation and ecosystem degradation.

Smallholders Must Cooperate With Each Other to Attract Transformative Investment

Developing and strengthening producer cooperatives is an approach to de-risk investments and enhance the attractiveness of investing in smallholder farmers. Cooperatives can be a critical tool for facilitating technical and financial assistance to smallholders, as well as increasing producers' access to specialty markets. Cooperatives are appealing both because they can create and manage projects at the scale required to attract investment, and also because regional partners have identified cooperatives as a preferred vehicle for deploying regional sustainability initiatives.

One reason that cooperatives, in contrast to individual smallholders, are well-positioned to receive funds is that cooperatives will not only operate at scale, but they also likely have internal or external partners who can identify investors in the space, design and share a growth model that illustrates the returns that investors might expect and how these returns will be distributed back to investors, and ensure that any producers within the coop meet certain ESG criteria. However, a cooperative *must* be a legal entity in order to attract investors; if it is not, it is unlikely to garner investment capital until such a legal platform is in place.

Forming producer cooperatives can help to manage and spread the risks faced by farmers,[19] thereby making investing in a cooperative a more attractive, less risky option. Under solid management, cooperatives can provide the opportunity to aggregate supply to meet specialized contracts, reducing the risks associated with commodity price volatility; and can serve as an intermediary between farmers and financial institutions, reducing the transaction costs associated with lending in the Amazon. Historically, family farmers have sold their harvests to intermediaries, leaving the farmers with little say over what price they must accept. *The proliferation of cooperatives expands competition for smallholder harvests and provides more negotiation power to the farmer when setting prices*. Cooperative enterprises also increase engagement with international buyers, which also allows farmers more options than just selling to in-country intermediaries. International buyers of specialty or high-quality commodities provide alternative market avenues for realizing the price premiums associated with differentiated and high-quality production.[20]

[19] Higuchi, A., Coq-Huelva, ., Arias-Gutierrez, R., and Alfalla-Luque, R. (2020) 'Farmer satisfaction and cocoa cooperative performance: evidence from Tocache, Peru', *International Food and Agribusiness Management Review,* 23(2) [online]. Available at: https://www.wageningenacademic.com/doi/epdf/10.22434/IFAMR2019.0166

[20] Higuchi, A., Coq-Huelva, ., Arias-Gutierrez, R., and Alfalla-Luque, R. (2020) 'Farmer satisfaction and cocoa cooperative performance: evidence from Tocache, Peru', *International Food and Agribusiness Management Review,* 23(2) [online]. Available at: https://www.wageningenacademic.com/doi/epdf/10.22434/IFAMR2019.0166

A study done on four emerging cocoa cooperatives in San Martin found that many initiatives to support cooperatives have focused solely on technical assistance and infrastructure development, but not transition financing. Further, the study found that interventions largely ignored the importance of developing business acumen, strong internal governance, relationship-building capacity, and sufficient working capital for operations.[21] **Strong relationships are key to successful value chain partnerships that create shared impact and benefits.**

Finally, before a cooperative will qualify for larger-scale investment, it must demonstrate sustainable production practices that yield positive social and economic outcomes without contributing to deforestation - remember, investors are looking for sustainability, scalability, and verifiability. In order for a cooperative to reach this stage of investment-readiness, it may require transitional financing and technical assistance to support producers as they adopt new practices, appropriately scale operations, and develop robust and transparent systems for monitoring and evaluating the impacts resulting from production.

[21] Donovan, J., Blare, T., and Poole, N. (2017) 'Stuck in a rut: emerging cocoa cooperatives in Peru and the factors that influence their performance', *International Journal of Agricultural Sustainability*, 15(2) [online]. Available at: https://www-tandfonline-com.colorado.idm.oclc.org/doi/full/10.1080/14735903.2017.1286831

TRANSITION FINANCING IS NEEDED TO SHIFT PRODUCTION PRACTICES

While cooperatives are viewed as an optimal vehicle for deploying financial and technical resources to its members, it is likely that most do not have the cash flow to make loans or provide technical assistance to members. To create value for members and incentivize adoption of sustainable practices, *cooperatives need access to transition financing.*

The Financing Gap

The Financial Strategy for the Production Protection Compact in the Peruvian Amazon and the *Unlocking Forest Finance Project* both point to the need for establishing public-private partnerships to address the financing gap that impedes the regional transition to sustainable low-emissions forest and agricultural development. Indeed, the unmet need for transition financing in San Martin is approximately $88 million.[22] While international agreements offer generous financial incentives for deforestation-reducing and climate-sensitive agriculture, these funds cannot be unlocked without upfront investment in developing and implementing measures to reduce deforestation, including the transition to sustainable, low-emissions agricultural production, and verifying the outcomes of these new approaches.

For example, Peru could receive around $250 million in results-based payments under the Joint Declaration of Intent with Norway and Germany when they can verify the intended outcomes of the agreement;[23]

1. to contribute to significant reductions in greenhouse gas emissions from deforestation and forest degradation in Peru;
2. to contribute to the achievement of the target of zero net emissions from land use change and forestry in Peru by 2021 and the national target of reducing deforestation by 50% by 2017 and additional reductions thereafter; and
3. in the context of 1. and 2. to contribute to the sustainable development of Peru's agricultural, forestry, and mining sectors.

The declaration provides Peru up to $50 million for project implementation, which is inadequate to cover the need in San Martin alone.

The financing available through international commitments and the Peruvian government is not enough to cover the transition and monitoring costs, which serve as gating measures.
Unlocking this "gate" requires private investment. In turn, to unlock private

[22] Pinzon, A. (2019) 'Redefining finance for agriculture: green agricultural credit for smallholders in Peru', *Global Canopy* [online]. Available at: https://www.meda.org/innovate/innovate-resources/822-partner-publication-redefining-finance-for-agriculture-green-agricultural-credit-for-smallholders-in-peru-eng/file/

[23] Government of the Kingdom of Norway, Government of the Republic of Peru, and Government of the Federal Republic of Germany (2014) *Joint declaration of intent between the Government of the Republic of Peru, the Government of the Kingdom of Norway, and the Government of the Federal Republic of Germany on "Cooperation on reducing greenhouse gas emissions from deforestation and forest degradation (REDD+[1]) and promote sustainable development in Peru"* [online]. Available at: https://www.regjeringen.no/contentassets/b324ccc0cf88419fab88f2f4c7101f20/declarationofintentperu.pdf

investment opportunities, smallholders in San Martin must be supported in developing projects that are sustainable, scalable, and verifiable.

Costs that need to be covered

Agricultural systems and communities have unique needs that vary between crops and landscapes, but the following interventions and considerations were common amongst research:

- pest management
- organic waste management/ composting
- regeneration of degraded and previously deforested land
- cultivation of rapid-growth native species for planting
- livestock integration and agroforestry systems
- organic fertilizers
- agronomic assistance
- business assistance
- data tracking and reporting
- land titling

The case of cooperative CAC Pangoa provides a good example of leveraging partnerships in order to transition to sustainable, scalable, and verifiable production.

Helping farmers manage risk associated with transition stage losses in yield and early-income dips

One investment tool that is essential for enabling family farmers to bolster their competitiveness and productivity--factors which are both essential for long-term sustainable production--is affordable credit. The *Unlocking Forest Finance Project* proposed a green credit mechanism for San Martin. The mechanism would use donor funds (i.e. government, philanthropy, NGO) to provide a loan guarantee to an investor who would then provide a large loan, with favorable (green) terms, to a cooperative. The cooperative would act similarly to a microfinance institution and administer smaller loans to its members. The cooperative would then be responsible for managing repayment by members and servicing the debt owed to the

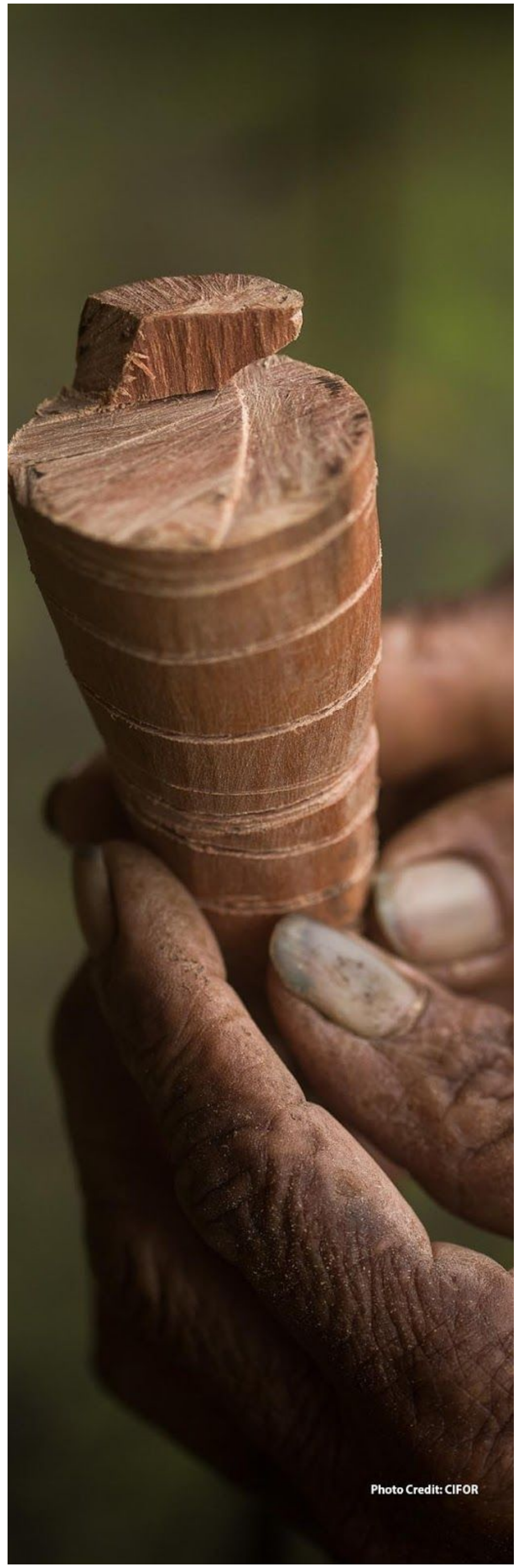
Case Study:
Rikolto, APPCACAO, and CAC. PANGOA

CAC Pangoa is a Peruvian coffee and cocoa cooperative that has partnered with Rikolto since 2011. CAC Pangoa has been recognized nationally as being a model for both profitability and social inclusion. Following the coffee rust crisis, CAC Pangoa made a strategic decision to focus on expanding their market share of fine cocoa. CAC Pangoa partnered with Rikolto and APPCACAO, the Peruvian association of cocoa producers, to increase their capacity to supply the fine cocoa market and to pilot programs to be scaled to all APPCACAO members. The project has adopted the following strategies to meet this objective:

- Professionalize cocoa producer organizations
    - Strengthen socio-business capacity of the cooperative though SCOPE methodology and an improvement plan
    - Establish clonal gardens of selected cocoa strains with the intention of scaling to all APPCACAO members
    - Strengthen leadership of women and youth development for succession
- Improve quality of fine aroma cocoa
    - Develop competency certification program for quality control
    - Strengthen tasting capacity
    - Create fine cocoa database
- Promote inclusive business relationships
- Create impact
    - Encourage multi stakeholder spaces to develop a national plan for the development of cocoa and chocolate

As a result of the partnership, CAC Pangoa has seen measurable increases in business and social capacity. The cooperative has seen a 20% increase in fine cocoa exports from 2017-2019. The cooperative has achieved a long-term agreement with Obolo Chocolates for sourcing their cocoa. The project was able to classify 42 native cocoa varietals and has proliferated 13 of them in their clonal garden. The garden will supply the trees needed to rehabilitate degraded plots. APPCACAO is expected to scale these interventions to its 26 member organizations. The leadership training school has impacted 60 women and youth leaders, and the certification program has yielded 80 post-harvest experts.

original investor. Congruent to this structure would be a mechanism that provides donor funds, or grants, to cover the costs of technical assistance. The final piece would be a partnership with an environmental organization that verifies results to donor organizations in exchange for results-based payments that will be passed to farmers upon the achievement of desired outcomes, such as the sustainability criteria discussed previously. Once again, this model illustrates the important role that cooperatives can plan in facilitating funds to smallholders. Making larger loans to cooperatives that then disperse these funds to smallholders is a strategy that can 1) reduce transaction costs for financial institutions by passing the burden of financial due diligence to cooperatives and consolidating loan paperwork into a single transaction; and 2) mitigate the challenges that are associated with limited rural financial and technical infrastructure.



FORMATION OF COOPERATIVES REQUIRES TECHNICAL ASSISTANCE

To form cooperatives, smallholders in San Martin need training on how to start and run a business. They need to understand basic accounting and finance principles to ensure adequate record keeping. A study of San Martin cooperatives found that the most successful cooperatives had leaders with exceptional capacity for relationship building and strong business acumen.[24] Cooperatives provide an interesting case because they are expected to run as a profitable business, but, especially in emerging markets, they also are expected to provide services to their members, similar to the roles of NGOs. In order to properly service their members, cooperatives need assistance in training specialists, that can in turn train members on sustainable practices and business professionalization. NGOs most commonly provide this type of assistance and it can be funded by grants, subsidies, as a part of an investment deal, or by value-chain partners. The following case study highlights how Root Capital, a financial and technical service provider, partnered with RAOS coffee cooperative to grow their business in size and capacity.

Case Study: Root Capital and RAOS coffee cooperative

In 1997, 19 farmers joined together to provide the coffee to fill a 5,000 lb. contract with an international buyer. The success of this contract resulted in the farmers creating the RAOS coffee cooperative. Since 1997, with the support of Root Capital, RAOS has grown to 300 member families who collectively export 4.5 million lbs of coffee annually. **How did Root Capital support this growth?** In 2007, Root Capital provided a small loan of $75,000 to RAOS. This loan helped RAOS to increase purchases from farmers and expand their exports, but without adequate financial knowledge the cooperative was unable to provide the necessary documentation to access further funding. Seeing this roadblock to the growth of RAOS, Root Capital joined with Keurig Dr. Pepper to launch their advisory services program.

One of the first projects was to help RAOS redesign their internal credit system, which aims to provide farmers advances on their harvests. Poorly designed credit systems can result in increased debt for the farmers and can weaken the finances of the cooperative. When successful, cooperatives can provide valuable credit that enables farmers to make necessary investments in the farm, while retaining working capital. Root Capital spent two years helping RAOS build a new system. They developed systems for determining the proper amount of credit given a farmer's individual circumstances and helped RAOS to hire and train an employee dedicated to managing member credit lines. This system led to stronger financials for the cooperative and resulted in access to larger loans.

In 2013, the coffee leaf rust crisis led to a furthering of the partnership. Recognizing the need for agronomic training to combat the crisis, Root Capital assisted RAOS in creating a full-time position for an agronomist that would provide advice to member farms. Root capital also continued to work on long-term financial planning with RAOS to build capacity, resulting in greater access to credit lines. RAOS now has the verifiable financials to qualify for favorable loans from larger commercial banks- a key indicator of a sustainable business model.

[24] Donovan, J., Blare, T., and Poole, N. (2017) 'Stuck in a rut: emerging cocoa cooperatives in Peru and the factors that influence their performance', *International Journal of Agricultural Sustainability*, 15(2) [online]. Available at: https://www-tandfonline-com.colorado.idm.oclc.org/doi/full/10.1080/14735903.2017.1286831

USING BLENDED FINANCING AND CONCESSIONARY CAPITAL TO FACILITATE PRIVATE INVESTMENT

To facilitate private investment in agricultural cooperatives, the government of San Martin should turn to blended finance and concessionary capital tools. Concessionary, or catalytic, capital is capital that will take outsized risk without commensurate return.[25] Calvert Impact Capital firm describes blending as, “mixing in concessionary capital that will reduce the difference between the perceived risk and the real risk of a deal, thereby incentivizing additional private investment.”[26] Blended finance is a strategy of impact investing to achieve scale.[27] Catalytic capital providers focus on garnering commercial private capital to develop new or unproven markets, prove the viability of those markets, and amplify impact by leveraging larger amounts of capital than what would otherwise be available for an investment with unacceptable risk.[28] As such, **blended finance seeks to manage the risk of lending to underdeveloped markets.**

In the context of San Martin, one strategic option is to turn to public partnerships that guarantee repayment of debt, such as through loan guarantees or subordinated debt. Loan guarantees reduce the risk of lending for private investors; a certain portion of the loan is guaranteed for repayment. Typically, development banks, government actors, or donor organizations, such as foreign governments and philanthropic foundations, will supply this type of guarantee as part of a larger project proposal, such as the green credit mechanism previously mentioned. Subordinated debt is a form of debt that is only repaid after senior debt obligations have been met. By taking a subordinated position, the lender assumes the default risk from the senior lender - the risk that’s associated with the likelihood of non-payment by the borrower. It is important to structure blended finance according to which risks you are trying to mediate.[29] For example, risks that exist due to an unproven business model or market vs. risks associated with a lack of credit-worthiness, etc.

Developing blended finance project proposals

A paper analyzing the *Unlocking Forest Finance* project, described above, suggests that developing blended finance project proposals requires simultaneously considering perspectives at a landscape (regional) level, farm level, and financial investor level.[30] In designing an investment, project partners need to build a joint vision and have a broad understanding of all three of these perspectives. Projects should begin by identifying viable transition activities based on

[25] Pryce, J. and Kumbuli, N. (2018) ‘Blended finance: what it is, what it isn’t and how to use it for maximum impact’, *Calvert Impact Capital*, 17 August [online]. Available at: https://www.calvertimpactcapital.org/blog/822-blended-finance-what-is-it-what-it-isnt-and-how-to-use-it-for-maximum-impact

[26] Ibid.

[27] Ibid.

[28] Ibid.

[29] Global Impact Investing Network (2018) *A resource for structuring blended finance vehicles: utilizing junior equity, subordinated debt, first-loss capital, guarantees, or technical assistance* [online]. Available at: https://thegiin.org/assets/upload/Blended%20Finance%20Resource%20-%20GIIN.pdf

[30] Rode, J., Pinzon, A., Stabile, M.C.C., Pirker, J., Bauch, S., Iribarrem, A., Sammon, P., LLerena, C., Alves, L.M., Orihuela, C., and Wittmer, H. (2019) ‘Why ‘blended finance’ could help transitions to sustainable landscapes: lessons from the Unlocking Forest Finance project’, *Ecosystem Services,* 37 [online]. Available at: https://www.sciencedirect.com/science/article/pii/S2212041618303176

selected economic, social, and environmental criteria. Projects should gauge the willingness of producers to change their practices, as well as identify producers' financial needs. After the activities are identified, specific locations with appropriate scale for each should be considered. This consideration should include the economic potential and risks of transition activities, as well as the expected social and environmental impacts. This analysis should then inform the selection of appropriate vehicles for delivering capital at the institutional level. An additional analysis should be conducted at the government level to assess an enabling policy structure, as well as estimate the needed financial, technical, and monitoring assistance.[31]

Garnering concessionary capital to employ blended finance

Outlined by the Organisation for Economic Co-Operation and Development (OECD), there are five principles for garnering concessionary capital to implement blended finance:[32]

1. *Anchor blended finance use to a development rationale.* In the case of San Martin and the scope of this project, the development rationale is to reduce deforestation of the Amazon. Project developers should make clear the connection between unsustainable agricultural practices and continued deforestation. It should also be clear how supporting the transition to sustainable agriculture will result in reduced GHG emissions from land-use change, as well as increased incomes and positive social outcomes for family farmers.

2. *Design blended finance to increase the mobilization of commercial finance.* Project proposals should show that concessionary capital is needed in order to mobilize commercial capital. For San Martin, this could be expressed by conveying the risks associated with directly investing in smallholder production. This could also look like showing how current levels of production and commodity pricing lead to unstable incomes which drive further deforestation. A successful proposal would show how the concessionary finance will lead to conditions that create market maturity and economic sustainability.

For example, "with the help of concessionary capital, this project will help x number of farmers acquire equipment to enact better coffee drying practices that will result in higher quality coffee, which will result in an increase $ y / lb. The project will also cover the certification costs of x certification scheme (i.e. Fairtrade or Rainforest Alliance) which will open access to y specialty markets, with a demand potential of z USD. This project will take x years to complete and at this time these producers will have agreements with y buyers that provide contracts of $z value."

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[31] Rode, J., Pinzon, A., Stabile, M.C.C., Pirker, J., Bauch, S., Iribarrem, A., Sammon, P., LLerena, C., Alves, L.M., Orihuela, C., and Wittmer, H. (2019) 'Why 'blended finance' could help transitions to sustainable landscapes: lessons from the Unlocking Forest Finance project', *Ecosystem Services,* 37 [online]. Available at: https://www.sciencedirect.com/science/article/pii/S2212041618303176

[32] Organisation for Economic Co-operation and Development (OECD) 'Blended finance - unlocking commercial finance for the Sustainable Development Goals', *Financing for Sustainable Development* [online]. Available at: http://www.oecd.org/development/financing-sustainable-development/blended-finance-principles/

3. *Tailor blended finance to local context.* Projects should provide clear connections between the use of concessionary finance and local development goals. For San Martin, this might include tying project outcomes to the desired outcomes of the 2030 Concerted Regional Development Plan.[33]

4. *Focus on effective partnering for blended finance.* All of the parties to a blended finance project need to have a stake in the success of the project. The OECD suggests, "The objective of blended finance is not to change the motivation of commercial or development actors, but to create opportunities for investments that yield both development and commercial returns, and thus that can be supported by commercial finance."[34] To this end, regional actors should develop proposals that outline how a project will contribute to the returns desired by the providers of the concessionary capital as well as the returns desired by private partners. Proposals should also identify the risks to each party and suggest how the risks will be shared and managed by the parties to any agreement.

5. *Monitor blended finance for transparency and results.* Projects should propose a mechanism for monitoring and evaluating the use of investment funds. Public and private parties should agree on the metrics and indicators for tracking the desired outcomes. There should be a system in place for tracking financial flows, returns on investment, and development results.

The suggestions outlined above provide a roadmap for preparing the public side of public-private partnerships. As described above, the strategy for preparing the private sector to receive investment funds is dependent on forming producer cooperatives.

[33] Organisation for Economic Co-operation and Development (OECD) 'OECD DAC Blended Finance Principles - Principle 3', *Blended Finance* [online]. Available at: http://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/principle-3/

[34] Ibid.

Once cooperatives have been formed, practices have been transitioned, monitoring systems have been established and private partnerships have been identified, producer cooperatives in San Martin will be attractive targets for impact investment.

The targets and criteria of the regional branding initiative in San Martin, Marca San Martin, align with impact-creating values but do *not* establish criteria and processes for ensuring that the targets are truly verifiable and will be acceptable to impact investors. The region of San Martin should consider scaling and further developing the branding initiative to ensure verifiable compliance with its impact targets; until that time, cooperatives might consider the use of third-party verification schemes, such as Rainforest Alliance or Fairtrade International. To this aim, the regional government could consider ways to subsidize the costs of securing these certifications, which would in turn help producers increase regional competitiveness and access differentiated markets for high-quality goods.

Yet another reason to consider third-party verification is the market risks that exist for producers of goods associated with deforestation, extractive farming methods, or unfair labor practices; buyers and sourcing companies are constantly looking for ways for removing these goods from their supply chains. Consider, for example, that the Consumer Good Forum, a global network of some of the world's largest retailers, manufacturers, and service providers, has committed to net-zero deforestation in member supply chains by 2020. This goal has not yet been reached, but is still actively being pursued with an updated deadline.[35]

Regardless of whether producers decide to pursue third-party certifications or certification through Marca San Martin (once the criteria and verification process of the initiative have been strengthened), technical and financial assistance will likely be necessary.

[35] Brack, D. (2019) 'Tackling deforestation and the trade in forest risk commodities: consumer-country measures and the 'legality approach", *Forest Trends* [online]. Available at: https://www.forest-trends.org/wp-content/uploads/2019/05/Consumer-Legality-Brief-FINAL-WEB.pdf

CONCLUSION

Values are shifting around agricultural production, reflected by the actions of governments and private-sector actors alike, both of which have moved to prioritize deforestation-free goods. However, small-scale farmers, such as smallholders in San Martin, Peru, have faced challenges both in transitioning to sustainable practices and in competing in international markets. Despite big commitments--as well as meaningful progress--San Martin is not currently on track to meet its stated deforestation goals, in large part because its farmers lack access to the capital they need to transition to sustainable practices. In addition to making a strong recommendation that smallholders form cooperatives in order to be better positioned to receive investments--an activity that should be supported by the regional government--this report concludes that accomplishing sustainable, low-emissions development hinges on the region's ability to facilitate the flow of financial resources to increase on-farm productivity, provide technical assistance, and create a portfolio of investable agricultural projects that are sustainable, scalable, and verifiable. begin facilitating private investment, the region of San Martin should turn to blended finance and concessionary capital. If the smallholders of San Martin are not supported in aligning their production practices with conservation-oriented procurement priorities, their fortunes will fall further and desperation may lead to further deforestation. However, if San Martin is able to stanch agriculturally driven deforestation, it will open new markets, unlock investment opportunities, and increase its competitiveness with other regions producing similar non-timber forest products.

APPENDICES

APPENDIX A

Fostering Sustainable Development of the Private Sector

The organizations highlighted in this appendix are working to develop projects and partnerships that rethink traditional agricultural finance and prioritize sustainable and inclusive development of the Amazon. Our research has highlighted working capital and financing for productive infrastructure as the main needs of San Martin cooperatives. The majority of regional cooperatives supply to the coffee and cacao markets, so partner organizations were selected based on their work in these markets. The selection of impact funds was not specific to these crops, but all prioritized working with producer organizations to impact smallholder farmer conditions.

Project Partner Profiles

Partner Profile: Oikocredit[36]

Oikocredit is a worldwide cooperative that promotes sustainable development by providing loans, investment, and capacity building. Agriculture is one of their key focus areas. They aim to work with organizations that contribute to inclusive development and improved rural livelihoods. They seek to provide loans of between €500,000 and €10 million that typically mature in 3-4 years. Their criteria for partnership includes organizations that:[37]

- Create jobs and income for disadvantaged groups
- Are cooperatives, financial institutions or small to medium sized enterprises
- Have women in influential positions such as management
- Are environmentally sustainable and respect animal welfare
- Have a suitable management in place and are (or can soon become) financially sustainable
- Have a clear need for foreign investment

Oikocredit also offers capacity building services to strengthen governance and management in financial and social performance. Their capacity building program focuses on the following themes:[38]

- Financial Inclusion- promoting ethical, responsible access to finance in a digitising world.
- Agriculture- supporting sustainable agriculture for smallholder farmers.
- Social performance management- using Client Protection Principles and Universal Standards on Social Performance Management to strengthen social performance.

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[36] Oiko Credit (n.d.) *Home page* [online]. Available at: https://www.oikocredit.coop/en/
[37] Oiko Credit (n.d) 'Loans', *Products and services* [online]. Available at: https://www.oikocredit.coop/en/products-services/loans/loans
[38] Oiko Credit (n.d.) 'Capacity building', *Products and services* [online]. Available at: https://www.oikocredit.coop/en/products-services/capacity-building

Contact Oikocredit Peru:
Regional office
Av.Aramburu 166. Office 5A. Centro Empresarial Suizo
Miraflores, Lima
Lima 18- Peru
T: +511 222 4644 / +511 422 9329

Partner Profile: Alterfin

Alterfin is a cooperative society that has been operating since 1994 to raise capital in developed countries that is then ethically invested in developing economies. Alterfin raises capital by selling shares to entities or individuals, and the proceeds are then invested in organizations that offer loans to smallholder producers and small businesses. As of 2019 Alterfin had 6,077 shareholders with €65 million in assets under management (AUM). Alterfin ties their work to the achievement of the SDGs. Alterfin has the following criteria for lending to smallholder farmer organizations:[39]

Loan Conditions

- Principal amount between $150,000 and $1,500,000
- Currency: Euro, USD, or local currency
- Short-term trade loans from 3-18 months, used to finance harvest and processing and given against purchase orders
- Long-term loans of up to 5 year to finance capital infrastructure, physical collateral required
- Near market-rate interest

Loan Eligibility Criteria

- 2 or more years in operation
- Demonstrable benefits to farmers (e.g. fairtrade certification)
- Benefit at least 150 farmers
- Minimum annual revenues of $500,000
- 90% or better operational self sufficiency (OSS) note: OSS is a ratio which determines if an organization is earning sufficient revenues to cover their total costs. Costs include financial, operational, and the costs of asset depreciation. An OSS of 100% indicates operations at a break-even level. A 90% OSS would mean that the company is not operating at more than a 10% profit loss.

Alterfin accepts Application for Loan by email. The contact email for Peru is latam@alterfin.be. After an application is deemed eligible, an Alterfin agent will arrange an on-site visit and prepare a report to be reviewed for approval.

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[39] Alterfin (2020) *Request finance from AlterFin* [online]. Available at: https://www.alterfin.be/en/request-finance-alterfin

Partner Profile: Root Capital[40]

Root Capital is a non-profit lender that specializes in lending to organizations that are in between microfinance and traditional commercial lending. Root Capital targets enterprises that support smallholder farmers, such as producer cooperatives. Root Capital provides loans in the range of $200,000 to $2 million that are tailored to harvest and income cycles. They pair their loans with business, technical, and financial training. They monitor the impacts of investments through sustainability due diligence and extensive impact studies and surveys. They share impact data with farmers and organizations. Root capital provides advisory services that increase capacity for inventory management, accounting procedures, strong governance, and integrating technology. Clients may select to receive advisory services through either centralized workshops or customized training. Eligibility criteria for loans include:[41]

- Years in operation: 3 years of business operations
- Minimum annual revenue: $250,000
- Documentation: audited or management prepared financial statements from at least 3 years
- Products & Services: must be active in one or more focus industries: coffee, cocoa, honey, tree nuts, grains, oilseeds
- Commercial Relationships: must have established relationships with buyers and at least 2 professional references

To apply to Root Capital, you must first visit their website and complete a short eligibility form. Root Capital partners with ACCDER of Peru.

Contact ACCDER:
ACCDER
Torre El Pilar, Oficina 901
Av. Camino Real 348
San Isidro Lima 27, Perú
Phone: (51) 1 203.6700

Partner Profile: Shared Interest Society[42]

Shared Interest Society is an ethical investment cooperative that lends to Fairtrade organizations. Currently, a majority of their lending is going to the cocoa and coffee markets with Peru being their largest lending country. In 2019, Peru received 424 payments totaling £23.8 million. Shared Interest recognizes that supplying export markets can put a strain on businesses, due to long time cycles that are exacerbated by international shipping, even under excellent financial planning. They offer export credit that finances working capital against orders or trade contracts. This allows producers and cooperatives the chance to free working capital in the periods between payments for goods. Shared Interest also offers loans that can be used for capacity building such as purchasing essential equipment. These loans range from 1-5 years, with a 7-year product offered for coffee plantation renewal. ‘

[40] Root Capital (2020) *Home page* [online]. Available at: https://rootcapital.org/
[41] Root Capital (2020) *Request a loan* [online]. Available at: https://rootcapital.org/request-a-loan/
[42] Shared Interest (2020) *Home page* [online]. Available at: https://www.shared-interest.com/en

Shared Interest has a loan inquiry form on their website or can be contacted at:
PAUL SABLICH, SOUTH AMERICA
Av. Pardo 601 Of. 1101, Miraflores, Lima 18, Peru
Telephone: +511 447 7038
Fax: +511 422 3379
Mobile: +51 9450 57650
Email: paul.sablich@shared-interest.com
Skype: paulsablich

Partner Profile: Rikolto[43]

Rikolto is an international NGO, with over 40 years of experience, that works with farmer organizations to increase productive and technical capacity and to help create relationships between producer organizations, wholesalers, banks, and other stakeholders. Two of Rikolto's key areas of work are inclusive business and sustainable cocoa and coffee production. Rikolto's main expertise lies in supporting producer organizations to become stronger businesses and to help them build capacity for nurturing long-term relationships with value chain stakeholders. Rikolto invites producer organizations to connect with them for a tailored plan to address the specific needs of a cooperative in the local and international context.

Services offered by Rikolto include:

Professionalising of farmer organizations through strengthening business skills and improving market access

- Rikolto uses the SCOPE assessment tool to assess the performance and current level of professionalism of an organization. The SCOPE analysis informs a tailored capacity building plan for the organization. SCOPE profiles can be used by the organization but also by financial institutions to identify bankable investment opportunities.
- Rikolto provides unique training programs based on the needs of the organization. Training support can cover quality control, financial management, strategic planning, technical assistance and marketing and communication. For financial institutions, the training programs can help to mitigate lending risk.
- Rikolto uses the LINK methodology, created by the International Centre for Tropical Agriculture, to foster inclusive commercial relationships. The LINK methodology brings together actors in the value chain and helps businesses to develop inclusive strategies and evaluate how their strategies impact

6 principles that define inclusive and sustainable value chains

1. Cooperation between all actors in the chain with a common goal;
2. Close relations between all chain actors, leading to a stable market and constant supply;
3. Fair and transparent agreements and policies (labour conditions, fair prices, good working conditions)
4. Fair access to services, such as credit, technical support in the field, market information, etc.
5. Inclusive innovation and co-creation: innovation driven by multi-actor collaboration
6. Measuring results and outcomes; ongoing monitoring to optimise the value chain and follow up.

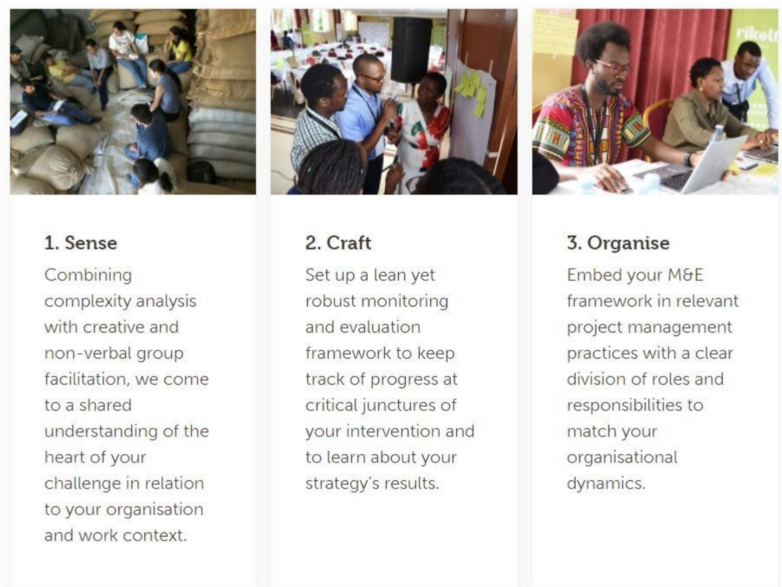
Source: LINK methodology (CIAT)

[43] Rikoloto (n.d) *Home page* [online]. Available at: https://www.rikolto.org/en

smallholder farmers. A questionnaire and consultation guide the analysis of value chain members for bottlenecks and strengths of commercial relationships.
- Rikolto has developed the innovative Inclusive Business Scan to capture the voices of producers, organizations, and value chain actors to provide timely and relevant feedback from key stakeholders. The tool relies on the collection of micro narratives from stakeholders to uncover relationships amongst actors.

Sustainable supply chain development

- Rikolto offers extensive assistance in developing innovative pilot projects coupled with ongoing financial and technical support. They help facilitate deals with key stakeholders and facilitate the collaboration and implementation of the project.
- Monitoring and evaluation- The infographic (right) shows Rikolto's approach to setting up monitoring and evaluation systems for clients



Rikolto can be contacted at info@rikolto.org. Fausto Rodriguez is the Latin America director and can be reached at fausto.rodriguez@rikolto.org.

Partner Profile: Sustainable Harvest, Relationship Coffee[44]

Sustainable Harvest is a coffee importer that works to create impact within the communities of its coffee producing partners. They focus on disrupting commodity supply chains and instead prioritizing the relationships that are embedded within the value chain. The pillars to their approach are traceability, transparency, the MVP program, and investing in origin. The MVP program is of particular interest to coffee producers because it is Sustainable Harvest's preferred supplier program. As part of the program Sustainable Harvest offers training events to its producers that focus on:

- Quality control
- Best agronomic practices
- Processing Techniques
- Warehousing
- Financial Risk Management
- Compliance

[44] Sustainable Harvest Coffee Importers (n.d.) *Home page* [online]. Available at: https://www.sustainableharvest.com/

- Environmental process improvements
- Market updates
- Developing organizational excellence

Sustainable Harvest held their most recent MVP training event in Peru in 2019. Sustainable Harvest also offers the opportunity for their purchasing partners to develop more extensive projects to positively impact the communities in which they are sourcing their coffee. Sustainable Harvest's

Peru office can be contacted at:
Lima, Peru
Calle Pedro Benvenutto 126, San Miguel,
Lima, Peru
peru@sustainableharvest.com
(51+) 1 637 5372

Partner profile: ECOTIERRA[45]

ECOTIERRA is a sustainable agroforestry project developer that works to address deforestation caused by unsustainable land use. ECOTIERRA partners with producer cooperatives to deliver resources for a transition to sustainable land use such as:

- Funding
- Project implementation
- Technical Assistance
- Certifications
- Crop valorization equipment
- Market access

ECOTIERRA also works to certify projects that can provide carbon offsets as a diversified stream of income. Their key performance indicators for project partnership are:

They have a sourcing program called ElevaFinca that highlights key producers and connects them with specialty markets. Currently ElevaFinca offers coffees from the group Cafe Selva Norte.

ECOTIERRA's Peru office can be contacted at:

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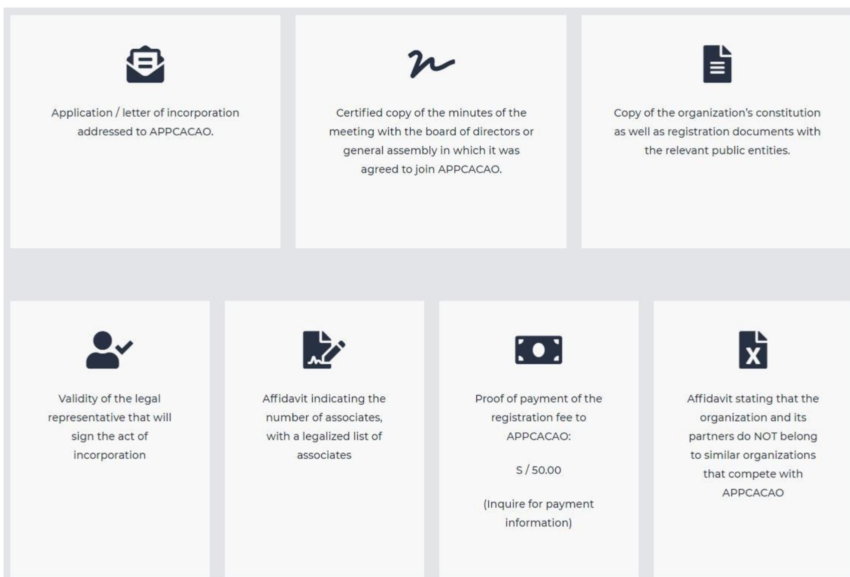
[45]Ecotierra (n.d.) *Home page* [online]. Available at: https://www.ecotierra.co/

Peru
Calle los Rosale N° 109,
interior 4,
Urbanización las Flores
Jaén, Cajamarca, Peru
T +51-076-784-998

Partner Profile: APPCACAO[46]

APPCACAO is the national trade association for Peruvian cocoa producers. It comprises over 30,000 producers coming from over 25 cooperatives. APPCACAO serves as a market channel for cocoa producers as well as a project development partner. They facilitate alliances with public institutions that promote producer interests and offer training and certification opportunities. The requirements for membership are:



APPCACAO can be contacted at:
T +51 1 566 6067
imagen@appcacao.org
Jr. Sáenz Peña N° 525 - Int. 605,
Magdalena del Mar

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[46] Appcacao (n.d.) *Home page* [online]. Available at: http://appcacao.org/en/home/

Appendix B

Impact Investment Fund Profiles

Investment Fund Profile: &GREEN[47]

The &GREEN fund was developed by IdH, the sustainable trade initiative, in partnership with Norway's International Climate and Forest Initiative (NICFI). NICFI is the anchor investor to the fund, contributing $100 million as a grant. Other contributors to the fund include bi- and multilateral donors, development finance institutions, development banks, private sector companies, and foundations. The fund was structured as an evergreen fund which means there is no termination date for the fund and contributions can constantly evolve. The mission of the fund is to invest in agricultural projects that protect and restore tropical forests and peatlands while promoting sustainable and inclusive development.[48] &GREEN provides loans or guarantees to finance commodity supply chain projects. The fund has the capacity to provide loan tenors of up to 15 years and they cap their participation in a project at 25% of total risk, often taking a subordinated debt position to encourage additional investment. They aim to support projects with investment needs of $5-15 million. They only invest in commercial projects and the project must have a direct impact on land-use. While &GREEN will invest in any commodity that impacts tropical forests, they specifically focus on soy, livestock, palm oil, rubber, and timber. The fund does not invest in smallholder farmers directly, making the cooperative level the most appropriate for engagement in this context.

&GREEN assesses all projects on their potential to generate desired environmental returns and social inclusion, and this assessment has a direct impact on the expected return on investment. Key performance targets for a project include:[49]

Another key strategy to the fund is the safeguarding of environmental, social, and governance (ESG) standards. Project requirements to assure this are:[50]

- Investments must follow the [IFC Performance Standards]
- Investees must implement an Environmental and Social Action plan to address gaps in the IFC standards
- Investees must commit to No Deforestation, No Development of Peatlands, and No Exploitation at the organizational level

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[47] andgreen.fund (n.d.) *Home page* [online]. Available at: https://www.andgreen.fund/
[48] andgreen.fund (n.d.) *The fund* [online]. Available at https://www.andgreen.fund/#the-fund
[49] andgreen.fund (n.d.) *Investment strategy* [online]. Available at: https://www.andgreen.fund/investment-strategy/
[50] Ibid.

- The project area and any adjacent high carbon stock or high conservation value lands must be covered by a long-term Landscape Protection Plan
- Investees must obtain Free, Prior, and Informed consent of all local communities impacted by the project area.

&GREEN focuses on a jurisdictional approach and conducts extensive eligibility studies to determine which regions have the appropriate governance and policy structures for effective engagement and investment. Peru has been selected by the fund as an eligible country for investment. The eligibility report for Peru found that the national level may be the most appropriate for engagement.[51] While some regions, including San Martin, have defined their strategies and objectives through regional development plans, the report found that most of these strategies lack clear implementation plans and are in the initial stages of design and development.[52] One major barrier to regional engagement with the fund is the inability of regional governments to access donor and development funds without national level engagement. This limits the ability of regional governments (GOREs) to act independently and in the best interest of the local context. Despite legislative efforts to decentralize the government of Peru, resources are still dispensed through the national government and are expected to align with national goals and priorities.[53] It is recommended that as San Martin progresses in the implementation of the regional concerted development plan, they re-engage &GREEN for consideration of investment at the jurisdictional level.

The contact for &GREEN is info@andgreen.fund

Investment Fund Profile: Livelihoods Fund for Family Farming[54]

The Livelihoods Fund for Family Farming (L3F) was created to support smallholder farmers in transitioning to sustainable farming practices in order to combat climate change, poverty, and land degradation. The fund was launched in partnership with Danone and Mars. The intention of the fund is to design, structure, and implement sourcing projects for partner brands of the fund. L3F provides upfront financing to project implementers, such as large producer organizations, that deploy large-scale sustainable agriculture projects. Smallholders are provided training, equipment, and technical assistance for successful implementation of the interventions. Public and private off-takers pay fees to access the goods and benefits of the project, and those fees serve as the financial return for the fund. L3F currently works in Peru.

To contact L3F, send a message through their online contact form.

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[51] Climate Focus (2018) 'Peru JECA report', *andgreen.fund* [online]. Available at: https://www.andgreen.fund/wp-content/uploads/2018/07/Full-JECA-Report-Peru.pdf
[52] Ibid.
[53] Ibid.
[54] Livelihoods Fund (n.d) *Livelihoods fund for family farming* [online]. Available at: https://livelihoods.eu/l3f/

Investment Fund Profile: IDH Farmfit Fund[55]

IDH's Farmfit Fund is a public-private impact investment fund that seeks to support smallholder farmers. The major contributor to the fund is the Dutch Ministry of Foreign Affairs, and the US Agency for International Development (USAID) provides guarantees. The fund takes the highest risk position in the deal, or 1st loss, reducing the risk to farmers and lenders. USAID also provides 2nd loss protection, covering up to 50% of losses for senior lenders. By taking a loss position, Farmfit and USAID decrease the risk for commercial lenders, catalysing commercial capital. The fund offers working capital as well as asset financing with a maximum loan tenor of 10 years. The contribution of the fund will not exceed 30% of the cost of the project, and the fund contributes between $700,000 to $5 million per investment.[56] Farmfit integrates business support and data modeling to complement the fund.[57]

Farmfit can be contacted at office@idhtrade.org]

Investment Fund Profile: URAPI Sustainable Land Use[58]

URAPI is an investment fund created by ECOTIERRA to address climate change through deforestation and land degradation. The fund invests directly into community-based sustainable agroforestry projects in Latin America. The fund aims to deliver market rate returns typical for private equity investment as well as significant environmental and social impacts. The fund provides long-term debt financing to cooperatives and focuses on farmers of cocoa and coffee. The fund expects project proposals to contribute to the SDGs and has an internal monitoring and reporting solution. ECOTIERRA serves as the project developer and operator.

Contact URAPI at info@urapi.co

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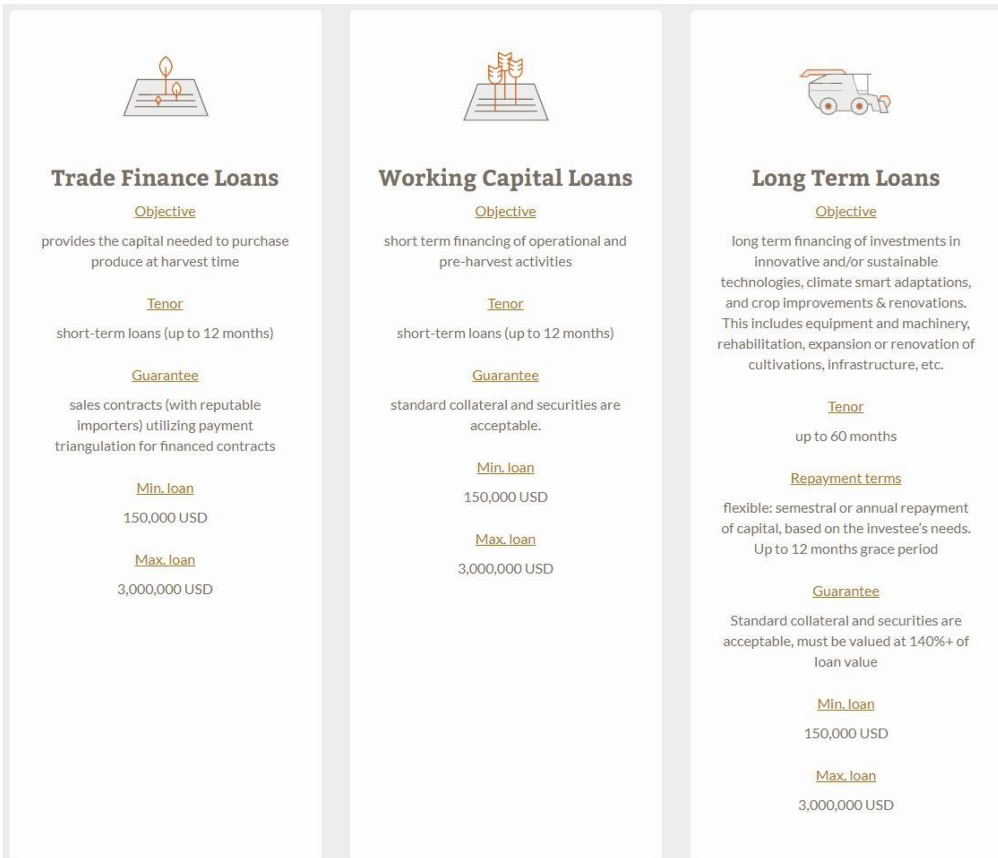
[55] The Sustainable Trade Initiative (n.d) *IDH Farmfit: investing in inclusive agribusiness* [online]. Available at: https://www.idhsustainabletrade.com/farmfit/
[56] IDH Investment Management (n.d) *IDH Farmfit Fund* [online]. Available at: https://www.inclusivefinanceplatform.nl/wp-content/uploads/2020/07/Farmfit-Fund-presentation_short.pdf
[57] Ibid.
[58] URAPI Sustainable Land Use (2020) *Home page* [online]. Available at: https://www.urapi.co/

Investment Fund Profile: Fairtrade Access Fund[59]

The Fairtrade Access Fund (FAF) invests in Fairtrade or sustainable certified organisations, such as producer cooperatives, providing trade finance, working capital, and long term loans. The FAF also has a technical assistance facility that works to improve business capacity, on-farm productivity, and to help meet certification requirements. The FAF has developed its impact indicators in alignment with the SDGs. They measure impact by the number of farmers served, increases in productivity, hectares of sustainable land cultivation, and increases in farmer income. Products offered are:[60]



Trade Finance Loans

Objective

provides the capital needed to purchase produce at harvest time

Tenor

short-term loans (up to 12 months)

Guarantee

sales contracts (with reputable importers) utilizing payment triangulation for financed contracts

Min. loan

150,000 USD

Max. loan

3,000,000 USD

Working Capital Loans

Objective

short term financing of operational and pre-harvest activities

Tenor

short-term loans (up to 12 months)

Guarantee

standard collateral and securities are acceptable.

Min. loan

150,000 USD

Max. loan

3,000,000 USD

Long Term Loans

Objective

long term financing of investments in innovative and/or sustainable technologies, climate smart adaptations, and crop improvements & renovations. This includes equipment and machinery, rehabilitation, expansion or renovation of cultivations, infrastructure, etc.

Tenor

up to 60 months

Repayment terms

flexible: semestral or annual repayment of capital, based on the investee's needs. Up to 12 months grace period

Guarantee

Standard collateral and securities are acceptable, must be valued at 140%+ of loan value

Min. loan

150,000 USD

Max. loan

3,000,000 USD

Eligibility criteria for producer organizations includes:[61]

- Fairtrade or other approved sustainability certification; can either be certified or in the process of receiving certification
- Legally registered as a producer organization
- Focus on smallholder farmers
- 3 or more years in operation
- Positive EBITDA for 3 or more years on average; note: EBITDA is earnings before interest, taxes, depreciation, and amortization. EBITDA is seen as a more precise way of measuring profitability because it is not influenced by accounting and financial deductions. It is likely required in this context because a company's EBITDA provides insight into their ability to meet debt obligations after accounting for operating costs.
- Financial projections for a positive EBITDA over the next year

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[59] Incofin Investment Management (n.d.) *Fairtrade Access Fund* [online]. Available at: http://incofinfaf.com/#mission
[60] Ibid.
[61] Incofin Investment Management (n.d.) 'Products', *Fairtrade Access Fund* [online]. Available at: http://incofinfaf.com/products/

- Audited financial statements or a commitment to auditing

FAF can be contacted through their website. FAF uses this application for financing requests.

Appendix C

Innovative Projects and Partnerships

Case Study: Root Capital and RAOS Coffee Cooperative[62]

In 1997, 19 farmers joined together to provide the coffee to fill a 5,000 lb. contract with an international buyer. The success of this contract resulted in the farmers creating the RAOS coffee cooperative. Since 1997, with the support of Root Capital, RAOS has grown to 300 member families who collectively export 4.5 million lbs of coffee annually. **How did Root Capitol support this growth?** In 2007, Root Capital provided a small loan of $75,000 to RAOS. This loan helped RAOS to increase purchases from farmers and expand their exports, but without adequate financial knowledge the cooperative was unable to provide the necessary documentation to access further funding. Seeing this roadblock to the growth of RAOS, Root Capital joined with Keurig Dr. Pepper to launch their advisory services program.

One of the first projects was to help RAOS redesign their internal credit system, which aims to provide farmers advances on their harvests. Poorly designed credit systems can result in increased debt for the farmers and can weaken the finances of the cooperative. When successful, cooperatives can provide valuable credit that enables farmers to make necessary investments in the farm, while retaining working capital. Root Capital spent two years helping RAOS build a new system. They developed systems for determining the proper amount of credit given a farmer's individual circumstances and helped RAOS to hire and train an employee dedicated to managing member credit lines. This system led to stronger financials for the cooperative and resulted in access to larger loans.

In 2013, the coffee leaf rust crisis led to a furthering of the partnership. Recognizing the need for agronomic training to combat the crisis, Root Capital assisted RAOS in creating a full-time position for an agronomist that would provide advice to member farms. Root capital also continued to work on long-term financial planning with RAOS to build capacity, resulting in greater access to credit lines. RAOS now has the verifiable financials to qualify for favorable loans from larger commercial banks- a key indicator of a sustainable business model.

Case Study: Rikolto, APPCACAO, and CAC. PANGOA[63]

CAC Pangoa is a Peruvian coffee and cocoa cooperative that has partnered with Rikolto since 2011. CAC Pangoa has been recognized nationally as being a model for both profitability and social inclusion. Following the coffee rust crisis, CAC Pangoa made a strategic decision to focus on expanding their market share of fine cocoa. CAC Pangoa partnered with Rikolto and APPCACAO, the Peruvian association of cocoa producers, to increase their capacity to supply the fine cocoa market

[62] Root Capital (2020) 'RAOS: Training for a more resilient future in Honduras', *Meet our clients* [online]. Available at: https://rootcapital.org/meet-our-clients/stories/raos-training-for-a-more-resilient-future-in-honduras/
[63] Rikolto (n.d.) 'High quality Peruvian cocoa for fine chocolates', *Discover & invest* [online]. Available at: https://www.rikolto.org/en/project/high-quality-peruvian-cocoa-fine-chocolates

and to pilot programs to be scaled to all APPCACAO members. The project has adopted the following strategies to meet this objective:

- Professionalize cocoa producer organizations
    - Strengthen socio-business capacity of the cooperative though SCOPE methodology and an improvement plan
    - Establish clonal gardens of selected cocoa strains with the intention of scaling to all APPCACAO members
    - Strengthen leadership of women and youth development for succession
- Improve quality of fine aroma cocoa
    - Develop competency certification program for quality control
    - Strengthen tasting capacity
    - Create fine cocoa database
- Promote inclusive business relationships
- Create impact
    - Encourage multi stakeholder spaces to develop a national plan for the development of cocoa and chocolate

As a result of the partnership, CAC Pangoa has seen measurable increases in business and social capacity. The cooperative has seen a 20% increase in fine cocoa exports from 2017-2019. The cooperative has achieved a long-term agreement with Obolo Chocolates for sourcing their cocoa. The project was able to classify 42 native cocoa varietals and has proliferated 13 of them in their clonal garden. The garden will supply the trees needed to rehabilitate degraded plots. APPCACAO is expected to scale these interventions to its 26 member organizations. The leadership training school has impacted 60 women and youth leaders, and the certification program has yielded 80 post-harvest experts.