Blended Finance for Agriculture

CASE STUDY

SOWING OPPORTUNITIES IN PARAGUAY

THE ROLE OF A SOCIAL TRUST FUND IN MOBILIZING INVESTMENT

Synopsis

Primary investors:

- Tomas Espiridión Davalos Fleita
- Alquimia S.A
- Fundación Paraguaya de Cooperación y Desarrollo
- Empresa de Comercio y de Desarrollos Inmobiliarios S.A
- Solfrio S.A
- Fundación Capital – Fundak

Value chain or sector: Chamomile

Country: Paraguay

Type of risk addressed: Investment in a new value chain

Type of blended finance instruments: Blended Trust Fund

Contributed by

José Gomez, Fundación Capital. Fundación Capital is a nonprofit social enterprise working in partnership with the public and private sector to improve the financial lives of people living in poverty around the world.

Executive summary

Chamomile tends to evoke soothing associations, but in Paraguay, it delivered a jolt to jump-start efforts designed to help people exit poverty. Through a government program called "Sowing Opportunities," private investors joined forces with smallholder farmers in a venture to grow chamomile as a new cash crop in some of the poorest parts of the country. As part of this innovative public-private effort, a Social Trust Fund was created to mobilize investment, cover initial production costs and provide farmers with access to markets.

This case study[i] aims to show how blended finance was applied to address the following challenges: (i) limited opportunities related to cash crops during the winter; (ii) lack of market access by smallholder producers; and (iii) financial exclusion faced by the target population. This experience was seen as a pilot to explore further opportunities with other crops and investment sources. Of the farmers who participated in the project, 85% said that they would like to continue to produce chamomile the following year.

The Social Trust Fund proved to be a beneficial tool for opening up new opportunities for smallholder farmers to grow crops that were linked to a specific market and met an important need for a cash crop that could be grown during the off-season. Farmers were also able to receive funds to cover production, along with technical assistance to cultivate and market the new crop.

Introduction

Over the past few decades, most countries around the world have made significant progress in reducing poverty. However, inequalities persist, and many of those who have recently overcome poverty or extreme poverty are just one unexpected event away from falling back into it. So-called "graduation" programs have proved to be an effective tool to enable people to become more productive, economically independent and resilient—in short, to graduate out of poverty.

Fundación Capital has been working with several governments to integrate graduation approaches into their public policy. However, a permanent exit from poverty requires the involvement of not only the public sector but the private sector as well. The public-private partnership established through this project suggests a compelling model for the global push to end poverty—the top priority of the Sustainable Development Goals—by mobilizing domestic capital and market opportunities.

This project took place in the context of a national program called Sowing Opportunities, which the government of Paraguay launched in 2013 to combat extreme poverty. In 2015, the program began integrating a graduation component called Sowing Opportunities Family by Family. In addition to the five classic aspects of such graduation programs, this one enabled families to connect with businesses to produce needed goods and sell them at a fair price.

The first step in this process was the creation, by presidential decree, of a Public-Private Council, under the leadership of Paraguay's Technical Secretariat for Planning (Secretaría Técnica de Planificación), the lead agency of the Sowing Opportunities program. The Public-Private Council was tasked with searching for practical solutions for poverty reduction, providing strategic advice and coordinating public investment for this effort. It identified a number of challenges faced by smallholder farmers (owning less than five hectares), including the practical business concerns of how to finance their investments, how to find a secure market for their products and how to obtain qualified technical assistance.

The Public-Private Council includes representatives of the business community, prestigious chambers of commerce and companies such as Alquimia S.A (an export firm), Grupo Pueblo (a supermarket chain) and Fundación Capital itself. These key actors created a Social Trust Fund to pool capital so that smallholder farmers participating in the graduation pilot project could engage in the production of the new crop. The next steps were to sign a contract with businesses that were committed to buying the product and identify families interested in cultivating chamomile.When it was considering potential business ideas, the Public-Private Council gave priority to those with identified market opportunity. Chamomile became the test case because it has great potential in both the domestic and the export market and is an alternative winter cash crop which is otherwise unavailable to small-scale producers. The chamomile project was geared toward 352 smallholder farmers in the districts of Capiibary, Choré and Carayaó, some of the poorest regions in Paraguay.

The project was designed to do the following: (i) involve the private sector in a project to diversify the sources of income available to low-income rural families; (ii) introduce a new business model based on blended finance to the market; (iii) provide poor families with an option to increase their income; and (iv) create sustainable linkages between the wealthiest 1% of the population and the rest of the country. One of the main challenges had to do with structuring the financial and organizational model to incorporate extremely poor smallholder farmers—participants in a government social protection program (Sowing Opportunities Family by Family)—into a value chain that involved private sector investment. While the potential was promising, there were also challenges in terms of coordinating the different players, setting up the business structure and engaging private investors with low-income families in a way that ensured balanced roles and bargaining power for all parties through a human-centered approach.

Fundación Capital helped on this front, as it was seen as a reliable partner for both sectors. It was also one of the investors in the Social Trust Fund and provided technical assistance to the Technical Secretariat for Planning on the graduation pilot program.

Blended Finance Approach

At the core of this project was the creation of the Social Trust Fund to mobilize capital from interested organizations and private investors. The bank-held fund was used to purchase the inputs needed to launch the project so that families did not have to use their own resources to participate. The project was designed in such a way that if there were losses, the private investors—not the small-scale producers—absorbed them. Risks were shared according to the size of each trustor's investment.

This is central to ensure success. As with any social impact investment project, the program works if organizations and businesses interested in doing blended finance absorb the risk from families living in extreme poverty, who are the least able to cope with potential shocks. Money was also advanced to participants to cover their labor costs, so that they didn't have to wait until harvest time to be paid. These payments were determined by an independent party (FECOPROD, the most important federation of farming and ranching cooperatives in Paraguay), which was contracted to monitor and audit the work. This oversight was financed by the Social Trust Fund. Payment to the participants was made through electronic transfers, which further advanced financial inclusion for rural and poor families.

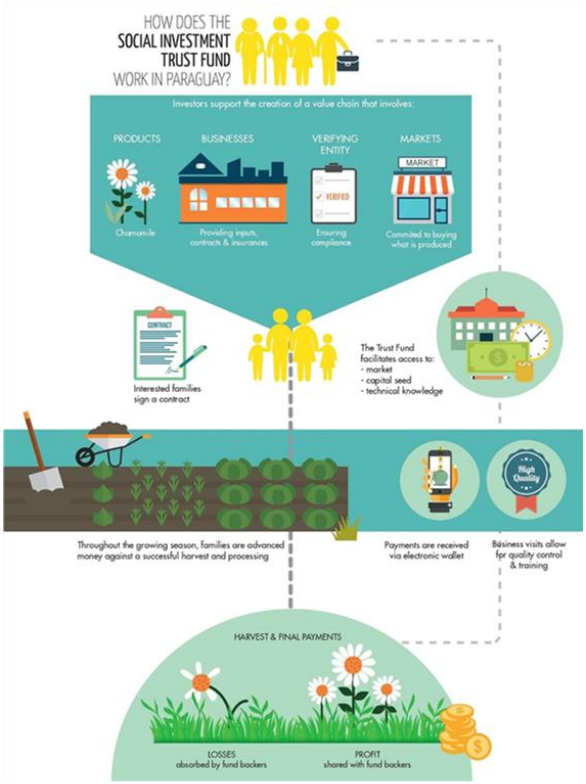
Figure 1. Investors in the Social Trust Fund

Trustors	Amount invested (U.S. Dollars)
Tomas Espiridión Davalos Fleitas	$ 85,000
Alquimia S.A	$ 30,000
Fundación Paraguaya de Cooperación y Desarrollo (part of UN Global Compact)	$ 25,000
Empresa de Comercio y de Desarrollos Inmobiliarios S.A.	$ 2,500
Solfrio S.A. (import/export company)	$ 2,500
Fundación Capital – Fundak	$ 30,000
TOTAL	**$ 175,000**

Source: Own elaboration, based on chamomile production administration and payment trust agreement.

Once the goods were ready—once the chamomile was harvested, cleaned, sorted and prepared—the company that had signed a contract committing to buy it collected the product from farmers and paid the proceeds directly into the bank-held investment fund. Payments were then made to the smallholder farmers, and any profits were shared equally between the fund investors and the producers, proportionate to the amount of product delivered. If there were losses, those same backers were the ones who absorbed them, not the families themselves, with losses distributed according to the size of their investment. Figure 2 gives an overview of how the blending approach worked.

Figure 2. Blending approach in the chamomile production Social Trust Fund



Source: Fundación Capital

One factor that contributed to success was the high level of importance the public sector gave to the program. The Technical Secretariat for Planning led the Public-Private Council, with the cabinet minister himself chairing each session and his top-level team providing support. The priority given to this initiative convinced the private entrepreneurs to engage with the low-income families who were part of the public program. Another factor of success was the auditing process by the independent auditor, FECOPROD, which brought transparency and was also key to tracking results. For example, whenever a service or an input was delivered to producers, or a product to buyers, the auditing was carried out by FECOPROD. This process was financed by the Social Trust Fund.

Furthermore, the use of technology gave confidence to the investors. A platform called Apptitude helped provide training to participants and track the work of the fieldworkers via its reporting system. Other applications were used to monitor the coaches who visited families every two weeks, and to keep a record of crop conditions. The technical assistance offered by the coaches was financed by the government's Sowing Opportunities program, as this blended finance component was an add-on to the services rendered through this graduation-style program.

Impact

This pilot project produced significant positive impacts. First, because the project created a guaranteed market, it was able to bring much-needed certainty for participating families, both in terms of a secure contract and prices—something that is rather unusual in the local context. Companies also provided a guarantee of the basic inputs the farmers needed to meet their production commitments, such as seeds and organic fertilizers. Second, whenever possible, families were part of the value-adding process. In the case of chamomile, besides the seeding, harvesting, cleaning, sorting and preparation, families were in charge of separating the chamomile flowers (more value) from the chamomile leaves and stems (less value) for delivery to the processing plant.

In terms of social impact and inclusion, the Social Trust Fund helped to connect some of the very poorest families in Paraguay with some of the wealthiest in a joint venture with the potential to both increase income for smallholder farmers and secure returns for private investors. Moreover, the crop was planted and cared for mostly by women, empowering them and putting knowledge and cash into their hands. Among all producers who participated in the program, 41% earned $191 during the three-month period of chamomile production.

Most of the producers involved were able to increase their income during the winter season, and 85% stated in a survey that they would like to continue producing chamomile under the same arrangement. One of the most important reasons is that they were not forced to go into debt to participate, since the Social Trust Fund did not give them a loan per se, but instead provided the inputs directly. Another reason is that the risks and potential losses were assumed by the social investors, not the producers. Furthermore, since chamomile is a winter crop, it brings potential income during the lean season when there is no other crop alternative for small-scale producers.

One of the main barriers was a lack of knowledge about the crop. Chamomile was introduced to producers for the first time, requiring more technical assistance and labor than expected. However, these barriers were overcome with the support and commitment of the coaches who visited the families every two weeks. They were able to quickly flag complications and issues, which facilitated prompt decision-making within the Social Trust Fund.

Lessons learned

This project showed that working with producers on nontraditional crops is a good practice because it brings new opportunities that can be replicated both for the participating producers and for the whole community. One factor to take into account is that working with producers who live in extreme poverty means accessing remote farms, making logistics (delivery of inputs, collection of produce) more complicated. An option for the future could be to work with the whole community rather than focusing only on extremely poor smallholder farmers, so that the model can take advantage of economies of scale. It is important, however, to have clearly differentiated strategies that favor those farmers classified as living in extreme poverty over those who are more well-off.

In terms of human resources, the coaches who participated in the graduation program served as a critical link between the Social Trust Fund, the private companies and participating families. They provided the confidence factor that was essential to keeping families informed about and engaged with the initiative, and their frequent visits raised timely alerts that facilitated the decision-making process. No less important is the need for a clear understanding of the role of different actors: producers, companies, auditing staff, investors, government and the financial institution. Good communication is key so that everyone understands their responsibilities and supports the success of the model.

Some challenges were also identified. For instance, frequent personnel changes in the government agency in charge of the initiative was a potential pitfall. A key success factor was the commitment of the people involved in the process; therefore, one of the biggest challenges is how to make this initiative permanent and "immune" to staff changes. Another challenge identified is how to optimize the model and make the decision-making process more efficient, especially within the Social Trust Fund. In Paraguay, only banks can operate these types of funds, which results in a rather bureaucratic process that requires a signed agreement each time the fund makes a payment. The business model therefore requires a manager who can handle day-to-day decision-making.

This blended finance initiative has the potential to mobilize capital from small investors; crowdfunding mechanisms could allow citizens to participate in social impact investments by contributing as little as $100 into this financial mechanism. More opportunities need to be tested to include small-scale investors, not just large companies, when seeking seed capital to fund productive activities of small-scale producers living in poverty. Another important issue is the need for insurance to cover key risks such as climate conditions. In Paraguay, no insurance products are available for small-scale producers. This problem needs to be addressed in future rollouts of the model, as during the pilot almost 33% of producers faced drought conditions that damaged their crops.

A government transition in 2018 made the scaling up of the graduation initiative difficult, thus discouraging the expansion of further blended finance initiatives. In July 2018, the government asked Fundación Capital for its help in implementing its vision of transforming the country into a reference point for poverty reduction, citing the organization's track record in supporting Paraguay's social development agenda in recent years. Meanwhile, in December 2018, Fundación Capital was selected to join an ambitious initiative established through Co-Impact to improve the lives of 9 million people around the world. Over a five-year period (2019–2024), Fundación Capital will focus on supporting the government of Paraguay in lifting up to 75,000 families out of poverty.

Given the challenges and opportunities, it is clear that these results cannot be secured only by addressing the core components of any graduation-out-of-poverty program. Fundación Capital passionately believes that the private sector (whether companies or individual investors, large and small) can play a key role in helping to alleviate poverty while ensuring a decent return on investment. The main challenge remains finding the right business model and financial product that can adequately leverage transparent and agile procedures, while ensuring simple instruments for decision-making and accountability. Surprisingly, mobilizing domestic capital from corporate and philanthropic investors was not an issue in this case, as more capital than necessary was easily raised for the pilot project.

Notes

i. The study used both quantitative and qualitative methodologies, relying on interviews with key stakeholders, a final survey with all producers and verification reports provided by the independent auditor, FECOPROD, as well as secondary sources of information, mainly the "Evaluation of the Chamomile Production Project" carried out by Fundación Capital. The analysis aims to determine the profitability of the project for producers and investors, the main lessons of the blended finance initiative and the necessary conditions for implementing the Social Trust Fund.

About

This case study is part of an effort by the Smallholder and Agri-SME Finance and Investment Network (SAFIN), the Inter-American Development Bank (IDB) and the Organization for Economic Co-operation and Development (OECD) to document the use of blended finance to strengthen agri-SME finance supply.

Contact details

Bettina Prato
Senior Coordinator, SAFIN
b.prato@ifad.org

Yuri Soares Dillon
Unit Chief, IDB Lab
yuris@iadb.org