



Understanding Root Capital's Blended Finance Model

ABOUT ROOT CAPITAL

Root Capital's mission is to grow rural prosperity and build the resilience of farming families around the world by investing in the growth of small and growing agricultural enterprises. These locally-rooted businesses create a stable link between smallholder farmers and global markets. They improve livelihoods in remote, economically vulnerable places, acting as engines of impact that can transform rural communities.

Yet these enterprises face numerous barriers. Many of them struggle to access the credit they need to fuel their growth. They are caught in the financial "missing middle;" their credit needs are too big for microfinance and too small or risky for commercial banks.

When agricultural enterprises gain access to the resources they need to grow, they can provide rural populations with jobs, training, higher incomes, and more resilient livelihoods. Through our "credit plus capacity" model, Root Capital helps enterprises fulfill their potential. Since 1999, Root Capital has financed more than 760 enterprises reaching 2.4 million farming families across Latin America, Africa, and Indonesia, and has provided tailored training to more than 1,800 enterprises. Because of this work, the fundamental bankability of smallholder enterprises is no longer a radical notion, but a proven concept.

ROOT CAPITAL'S BLENDED FINANCE MODEL

Our blended finance model includes a catalytic mix of investor capital and philanthropic funding that enables Root Capital—and our donors and investors—to be the strongest and most impactful partners possible for our clients and their communities.

This blended model includes distinct categories of capital: investment capital from our **senior and subordinated note holders**, philanthropic funding for our **net asset base, restricted loss support, and loan loss reserves** to fund our lending, advisory, and thought leadership activities

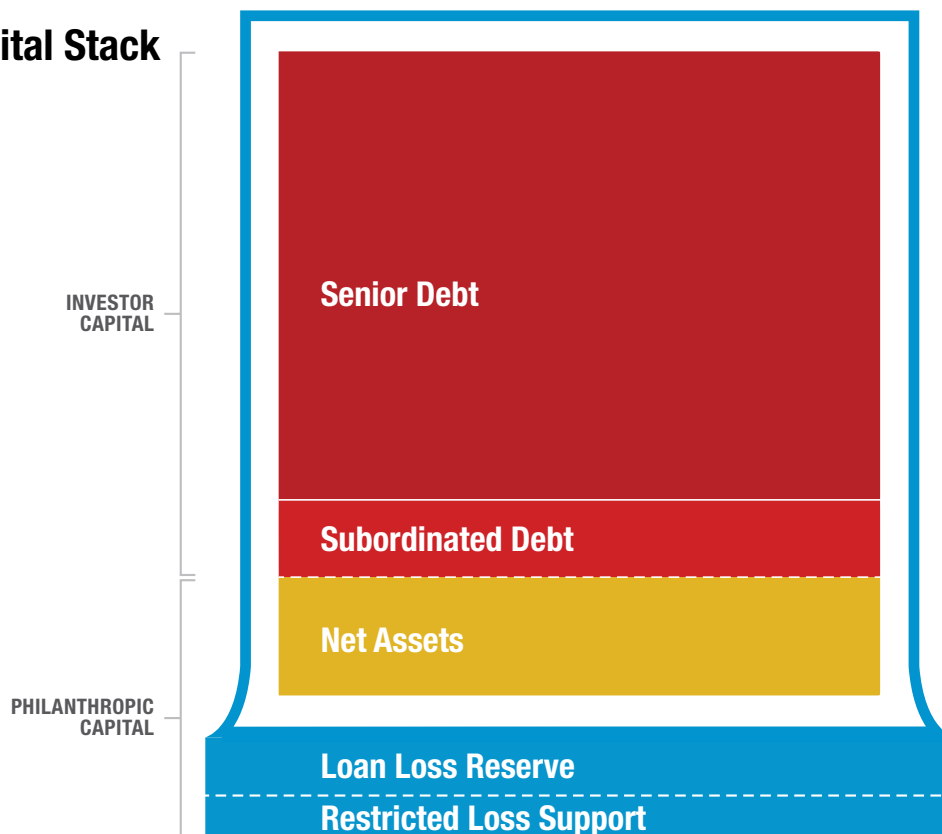
Investor Capital: Senior and Subordinated Debt

We raise senior and subordinated debt from impact investors ranging from individuals and family offices to foundations, corporations, multilaterals, and government agencies. Since our founding, Root Capital has made all interest and principal payments due to our investors.

- **Senior debt:** Root Capital holds more than \$45 million in senior debt from investors who lend to us at concessionary rates due to the high social and environmental impact of our lending. This mission-driven debt is “on-lent” or lent onward to small and growing agricultural businesses.
- **Subordinated debt:** We hold almost \$7 million in subordinated debt from investors. Subordinated debt functions in a similar way as our senior debt, and is on-lent to our clients; the difference is that this debt is subordinated to our senior notes in order of repayment. In return for their modestly riskier position, subordinated debt investors generally receive a premium rate.

Many impact investment funds stop here—they raise investment capital from supporters to advance their mission. Root Capital’s unique model takes this one step further. Complementary philanthropic support gives us the opportunity to go beyond serving the most established enterprises, allowing us to extend our advisory and lending programs to smaller, less mature, and higher-risk agricultural enterprises.

Capital Stack





Philanthropic Capital

Root Capital partners with philanthropic funders to maximize the impact of our investor capital. Our blended finance model leverages philanthropic support in three distinct ways:

- To build our net asset base;
- To reinforce our risk appetite through loss support; and
- To fund our lending, advisory, and impact measurement operations, so we can direct our “credit plus capacity” model where it is most needed.

Unrestricted Net Assets: Like any lender, Root Capital requires equity to underpin our leveraged investment funds and protect them in case of losses. Because of the elevated risk inherent to agricultural lending, Root Capital maintains low levels of financial leverage. With a robust base of net assets, we can deploy our investment funds to their full potential.

To help build and maintain net assets, philanthropic partners contribute funds that enable our high-impact programs. These net assets give us the ability to expand our risk appetite; we have been able to continue operating in volatile environments such as Nicaragua and the Democratic Republic of the Congo. With systemic crises from climate change to public health emergencies bearing

down on rural communities across the world, net assets allow Root Capital to stay the course and accompany our client enterprises through these challenges.

Put simply, net assets are the critical foundation that stabilizes the structure of Root Capital’s portfolio. They allow us to direct our work to where it will have the greatest impact.

Protecting Our Capital Stack through Loss Support:

Root Capital deploys specialized loss support to buffer our net assets—and ultimately our senior and subordinated debt investors—from potential erosion due to the elevated credit risk inherent in our lending. This loss support comes in two categories: a loan loss reserve that we maintain through our lending activities, and restricted loss support that we raise from philanthropic partners. Together, these pools of capital are the first to absorb credit losses in the lending portfolio.

- **Loan loss reserve:** Root Capital regularly allocates funds to maintain a **loan loss reserve**, just as commercial banks do. This loan loss reserve is sized to cover expected credit losses from our lending portfolio. Due to the elevated risk profile of our lending, Root Capital invests deeply in maintaining this reserve to protect our net assets and debt investors.



- Restricted loss support:** To further expand our capacity to serve higher-risk clients, while protecting our net asset base from potential losses, Root Capital seeks out additional, loss protection instruments from philanthropic partners. These instruments may be general, protecting the portfolio from large-scale force majeure events, or targeted to enhance the risk-return profile of particularly high-risk/high-impact loan types (i.e.; in a particularly high-risk country/region or value chain, in times of global economic instability, or for higher-risk loan structures such as longer-term loans). Restricted loss support can take the form of:
 - Restricted grants:** A grant that sits in reserve to absorb losses on a particular lending segment.
 - Guarantees:** Instruments that cover a portion of a loan portfolio's loss, and are only deployed when losses occur—if no loss is incurred then we do not draw down on the guarantee.

Catalytic Operating Support: No matter how robust our capital stack and regardless of how much loss protection we have in place, Root Capital cannot activate the impact potential of these resources without philanthropic operating support. **Operating support** from philanthropic partners funds our business operations, our innovative Advisory Services program, and sector-leading impact measurement programs. Critically, it also fuels Root Capital's lending activities: the business development, due diligence, and loan servicing activities without which we cannot disburse a single dollar to drive impact in rural communities.

The standalone economics of our higher-impact loans do not generate sufficient revenue to cover their costs. The “contribution margin”—the extent to which interest paid on the loan covers the costs of making that loan—on most of our loans is negative, with the gap covered through support from philanthropic partners.

A “typical” Root Capital loan might yield the following contribution margin:

ILLUSTRATIVE PER LOAN ECONOMICS FOR A \$1M LOAN (yields and costs as % of average loan balance)		
REVENUE YIELD	Yield from interest and fees	11%
COSTS	Cost of debt: (interest paid to the investors who lend us capital)	2%
	Cost of provisioning for potential loan losses	5%
	Operating costs (direct costs for due diligence, loan servicing, etc.)	9%
TOTAL DIRECT COSTS		16%
NET OPERATING MARGIN	Total operating gap, net expenses	-5%



Most of Root Capital's loans are unprofitable; [we select the enterprises we serve based on their capacity for high impact and need for capital, rather than according to the estimated financial return on their loan](#). On a per loan basis, it costs Root Capital the same (or more) to identify, assess, and service a small, early-stage client in a risky geography as it does a more mature client with larger credit needs. Without operating support from philanthropic partners, these loan economics would force Root Capital to concentrate our lending on less risky, upmarket clients whose loans both yield more interest as a function of their size, and incur lower provisioning costs. To expand our reach and impact, however, Root Capital must have the freedom and flexibility to serve businesses that others will not, across every stage of growth and development—even if doing so means that many of our loans require subsidies.

Leveraging Philanthropic Support for the Greatest Impact

Philanthropic partners' support for our lending operations generates cascading impact in rural communities. Specifically, philanthropic operating support enables Root Capital to:

- **Reach high potential, early stage clients.** Philanthropic support changes the day-to-day decision making of our lending team, as loan officers and business development team members know they have a mandate to recruit high impact, high potential clients, even if those clients may exhibit a negative expected contribution margin in the short term. Among peers, Root Capital's lending regularly

achieves the highest levels of financial additionality, reaching clients no other lenders—commercial or socially-minded—will serve.

- **Grow the smallholder finance market.** With our donors' philanthropic support, we push the boundaries of smallholder finance, catalyzing the growth of underserved enterprises so they can become an addressable market for other more upmarket, commercial lenders. Furthermore, by successfully lending where others see only risk, Root Capital demonstrates the bankability of earlier stage, underserved enterprises, crowding in other financiers to follow our lead. As a leader among smallholder financiers, we've helped build [a sector disbursing \\$750M+ per year](#) to fuel growth and prosperity in rural communities around the world.
- **Transform farmer livelihoods.** Root Capital's ability to reach marginalized enterprises has a transformative impact on farmer livelihoods. Our rigorous deep dive impact assessments have demonstrated that **every \$1 of philanthropic support for Root Capital's lending operations translates into \$3, on average, in incremental income gained by smallholder farmers whose livelihoods are supported by our most underserved clients.**

Partners providing philanthropic operating support thus empower our entire global portfolio to reach its full potential for impact, touching every loan decision and improving the livelihoods of hundreds of thousands of farming families.

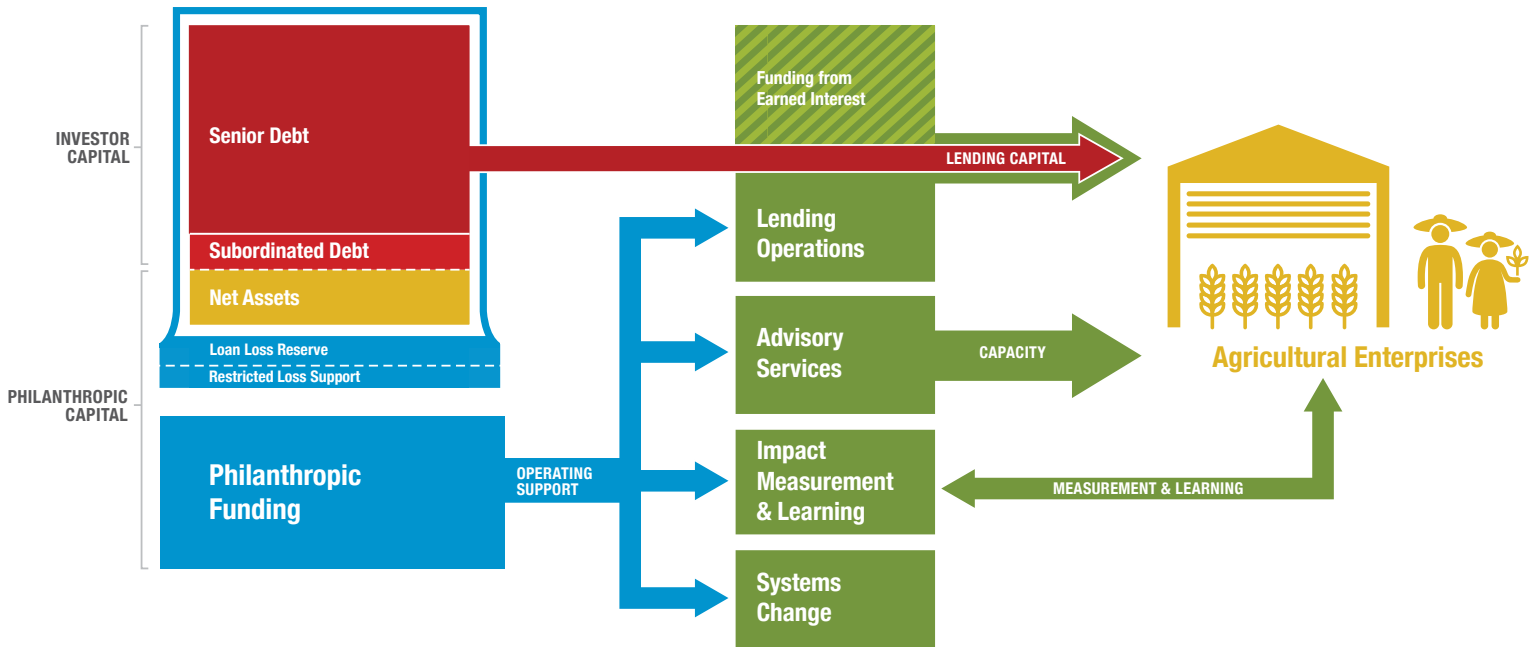
JOIN US

Despite Root Capital's nearly 25 years of progress, our work is far from over. Financing agricultural enterprises in vulnerable rural communities remains a risky proposition, keeping the vast majority of lenders out of the market. Meanwhile, smallholder farmers and their communities continue to face intractable problems and rising risks, including the increasingly urgent threat of climate change.

More than ever, farmers and agricultural enterprises require allies who are willing to share the burden of these risks, stay the course, and invest in the future of their communities. In order to continue to expand our impact and reach, Root Capital needs steadfast partners to stand with us.

We welcome opportunities to co-develop innovative blended finance structures with philanthropic partners to support our programs in specific market segments. The blended capital could be a combination of grants, investments, and/or restricted loss support. To date, we have pursued these partnerships with USAID, the Inter-American Development Bank, the Swiss Agency for Development and Cooperation, and Visa Foundation.

Blended Finance Model



Your partnership and support are more valuable than ever. Contact us at info@rootcapital.org to learn how we can work together to grow rural prosperity and build the resilience of farming families around the world.