ISSUE BRIEF NO. 1

Social & Environmental Due Diligence

From the Impact Case to the Business Case

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IN THIS BRIEF

We would like to thank the Citi Foundation and the Skoll Foundation for their generous support of this Issue Brief series and more generally for their leadership in supporting the development of the smallholder agricultural finance sector.

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Synopsis

Root Capital is a non-profit agricultural lender that developed tools and methodologies for conducting due diligence on the social and environmental contexts and practices of the agricultural businesses that we lend to as a way to put our mission into practice, and to demonstrate our impact.

Like many financial institutions, we initially assumed that the costs of social and environmental due diligence were financial, and the benefits non-financial. We believed that our due diligence represented a cost burden that might make us less competitive or profitable than purely commercial lenders, but was necessary given our mission.

Years of lending led us to the realization that social and environmental due diligence brings financial benefits as well as costs. We have found the alignment between social, environmental, and financial interests to be strongest in five areas: (1) identifying and mitigating risk, (2) generating new business, (3) identifying businesses with growth potential, (4) strengthening client businesses by improving their relationships with suppliers, and (5) identifying opportunities to support more of our existing clients' unmet financial needs.

To be sure, there are often cases where financial interests run contrary to social and environmental ones, particularly in the short term. Our particular social and environmental standards preclude us from underwriting some potentially profitable loans that commercial lenders would underwrite—for instance, loans to businesses that do not benefit smallholder farmers, or that have potentially damaging long-term impacts on the environment. Other financial institutions might set different thresholds and still benefit from the risk mitigation and revenue generation benefits of social and environmental due diligence.

For financial institutions motivated by profit, by impact, or by both, social and environmental due diligence processes that strike a reasonable balance between efficiency and rigor can be introduced at modest incremental cost and with a potentially significant financial benefit that complements the intrinsic social and environmental benefits.

Along with this publication, we are releasing our social and environmental scorecards and an accompanying methodology guide. We hope that other financial institutions will share their approaches and that a community of practice emerges around these topics.

Our aspiration is that, over time, social and environmental due diligence tools become sufficiently accessible and standardized that an ever-broadening set of financial institutions can incorporate them into their processes to further their financial, social, and environmental goals.

Farmers, such as Juan Castro Lux, of Maya Ixil in Guatemala typically have less than $1 per day in cash income. They cite the the fact that the cooperative pays higher prices for coffee than other local buyers as the primary benefit that the cooperative brings.

Introduction

A Shifting Landscape

Distinctions between commercial interests and corporate social responsibility are blurring in the face of emerging resource scarcity, climate volatility, population growth, and consumer expectations of ethical and sustainable business practices. Milton Friedman's dictum that "the social responsibility of business is to increase its profits" remains widely accepted in many circles; but for a growing number of companies, social and environmental factors are integral to business strategy and profit generation.

Practices ranging from peat burning for palm plantations in Indonesia, child labor on cotton and cocoa farms in West Africa, and deforestation for beef and soy production in the Amazon have made the food and beverage sector among the first to recognize how social and environmental issues are shifting the business landscape. Environmental and human rights activists brought attention to the harm being done, and, along with niche trading companies and certification bodies, began to articulate the "impact case" for sustainability – that is, the potential for agribusiness to build livelihoods for impoverished farmers, and to avoid or remedy environmental harm.

Large food and beverage companies, particularly those that produce in or source from emerging economies, initially responded by participating in certification schemes or other audit-based approaches. Increasingly, leading multinationals such as General Mills, Green Mountain Coffee Roasters, Mars, Starbucks, and Unilever are going further, making strong internal and external commitments to build more resilient and sustainable supply chains. The large trading companies that supply them – ECOM and Olam, among others – are adapting their business practices to meet their customers' demands. For both consumer-facing brands and the trading firms that supply them, the impact case for sustainability increasingly aligns with the business case.

Tools to Navigate

Just as sustainable sourcing began as a niche, a relatively small number of impact investors and social lenders are on the front lines of the nascent sector of smallholder agricultural finance. Mainstream financial institutions, however, are now beginning to engage. As food and beverage companies engage more deeply with their supply chains – often as far as the producers who grow raw agricultural products – they are exposed to unfamiliar risks and opportunities. Commercial lenders that compete to serve these large food and beverage companies, and that strive to understand the sustainability-related dynamics of crop production, aggregation, processing, and delivery have the opportunity to differentiate themselves by providing financial solutions – directly or via partners – throughout these global supply chains.

Root Capital is a nonprofit lender that specializes in working with smallholder farmers at the base of agricultural supply chains – the segment 'from farmgate to port.' We lend capital, deliver financial training, and strengthen market connections for small and growing agricultural businesses that aggregate hundreds or in some cases thousands of smallholder farmers but cannot access loans from local banks. Our goal is to grow rural prosperity in poor, environmentally vulnerable places in Africa and Latin America. We have developed tools and processes for conducting social and environmental due diligence on prospective borrowers as a way to put our mission into practice, and to help us build the Impact Case for providing credit and financial training to agricultural businesses. We articulate the Impact Case below.

Freshco's production of high-yielding hybrid seeds, to benefit smallholder maize farmers in Kenya, has increased 900% since their first Root Capital loan in 2010.

Financial Cost-Benefit of Social & Environmental Due Diligence

In the past, the default assumption at Root Capital – and at many financial institutions – was that the costs of social and environmental due diligence were financial, and the benefits non-financial. We believed that our due diligence represented a cost burden that might make us less competitive or profitable than purely commercial lenders, but was necessary given our mission.

While we focused on the Impact Case, the Business Case for social and environmental due diligence began to build itself. We have found that integrating social and environmental considerations into our borrower due diligence has improved our financial results in five primary ways:

- **Identifying credit risks:** We mitigate or avoid supply risk related to smallholder farmers side-selling their harvest to other local buyers rather than to the business we are financing, and the risk of product rejection associated with violation of certification or phytosanitary standards;
- **Generating new business:** A number of clients first approached us because we share their attention to long-term social and environmental considerations;
- **Identifying businesses with growth potential:** Businesses that struggle to present clear financial statements may nevertheless represent a strong base of producers with potential to supply larger or higher-value markets;
- **Strengthening our clients' business:** In the course of our due diligence process, businesses may identify opportunities to deepen engagement and improve relationships with their suppliers or to more efficiently manage their natural resources; and,
- **Growing our business with existing clients:** Identifying unmet client needs such as farm renovation, or a fund for small loans to suppliers that Root Capital can serve, helps build client loyalty and generates additional revenue.

We elaborate on each of these and provide examples in The Emerging Business Case. Qualitatively and anecdotally, we believe that the financial benefits of social and environmental due diligence to Root Capital are roughly balanced between risk mitigation and revenue generation. It is challenging to quantify those benefits, because it is impossible to know with certainty what the outcomes would have been (i.e. loan restructuring or, conversely, missed lending opportunities) had we not conducted social and environmental due diligence.

A growing body of literature suggests that companies listed in public equity markets with strong social, environmental, and governance practices create financial value for shareholders.[1] This Issue Brief begins to build a similar case in the much less-developed space of smallholder agricultural finance.

1 Indeed, asset owners and managers totaling $32 trillion in assets – or roughly 25% of the world's assets – have signed on to the U.N. Principles of Responsible Investment, according to the BSR Report "Trends in ESG Integration in Investments" of August 2012.

Cajou Espoir built the first cashew processing center in Togo, which now employs 500 people.

Early Findings

Exploratory analysis suggests that Root Capital's social and environmental due diligence likely covers its ongoing costs. Specifically, five percent of our Loan Officers' time is allocated to social and environmental due diligence. By comparison, Root Capital disbursed $120.8 million in loans to 205 enterprises in 2012. In reviewing our portfolio as well as prospective loans that advanced to a late stage but were ultimately rejected, our initial analysis suggests that our social and environmental due diligence helped us to avoid writeoffs and generate incremental revenue that covered or exceeded its ongoing costs. In the coming months, we will be quantifying these benefits as part of a deeper analysis testing our hypothesis that there is indeed a business case for social and environmental due diligence in smallholder agricultural lending.

The costs of social and environmental due diligence are less than might be expected. On average, social and environmental due diligence takes our loan officers less than one day per client. Loan officers evaluate businesses' social and environmental practices primarily during on-site due diligence visits with each prospective and renewal client. Site visits offer an opportunity for the loan officer to get to know the management team, observe operations, meet producers, build rapport, and spot-check selected social and environmental issues. Based on the site visit and the information provided by each client in its loan application, loan officers complete a Credit Memo using our credit evaluation template, which includes our social and environmental scorecards. Root Capital's credit committees use this information to decide whether to grant the loan request.

By comparison, the financial benefits of social and environmental due diligence are greater than might be expected. For example, the callout box on page 4, "Using Social Due Diligence to Inform Credit Risk Evaluation," page 4), describes a representative event in which a loan officer identified an $80k disbursement that he declined to make based on his social due diligence. The officer correctly surmised that the client would have difficultly collecting sufficient coffee from its suppliers to fulfill its contracts. It is impossible to know whether the client would have defaulted, but it is likely that social due diligence saved Root Capital from a loan restructuring or write off.

Other loan officers have offered similar examples from their portfolios of disbursements avoided due to weak producer relations and other issues that surfaced in their review of social impact. Others cited instances where social due diligence helped them identify growth potential in a fledgling enterprise, or capture a greater share of clients' business.

This anecdotal review has considered only ongoing costs of social and environmental due diligence, not the fixed or sunk costs required to develop our approach. It is impossible to estimate the costs we incurred in iteratively developing our approach over the past years, and we do not propose that we will recoup those costs. On the contrary, our hope is that by releasing these materials, we may help other financial institutions to avoid some of those fixed costs of development.

Ultimately, the cost-effectiveness of social and environmental due diligence for each lender will depend on the form that their due diligence takes, and on the specifics of their cost structure. Our aim is not to demonstrate that a specific approach to social and environmental due diligence breaks even or turns a profit for a specific financial institution. Rather, we seek to demonstrate that a social and environmental due diligence process that strikes a reasonable balance between efficiency and rigor can be introduced at modest incremental cost and with a potentially significant financial benefit that complements the intrinsic social and environmental benefits.

The Impact Case

A Mutually Beneficial Cycle

Of the 2.6 billion people who survive on less than $2 per day, 75 percent live in rural areas and rely on agriculture for their livelihood. Too often, they are constrained by lack of access to markets, farm inputs, agricultural training and technology, and credit. They resort to survival measures such as illegal logging and slash-and-burn agriculture that degrade the environment and perpetuate a cycle of poverty.

Agricultural businesses that aggregate hundreds or thousands of smallholder farmers can overcome these barriers. Yet many are trapped in the missing middle, or the gap between microfinance and commercial banks. Root Capital lends and provides financial management training to these agricultural businesses. Whether cooperatives or private enterprises, they establish a mutually beneficial relationship with smallholder farmers and support their adoption of sustainable agronomic practices.

Specifically, agricultural businesses provide farmers higher and more stable incomes over the course of multiple harvest cycles by linking farmers to formal markets in efficient, stable value chains that pay farmers a higher share of the end price. For example, our study of Fruiteq, a mango processor in Burkina Faso, suggests that our loan enabled the business to purchase and export the highest-quality 10 percent of farmers' mangoes at three times the prevailing local price, ultimately increasing total income from the mango crop by 43 percent.

They also provide access to inputs such as seeds, agronomic training, and small loans that help farmers increase their productivity. For example, our study of COOPCAB, a coffee cooperative in Haiti, suggests that its technical assistance to farmers reduced the percentage of farms affected by scolytus (insect) plague from 65 percent to 15 percent.

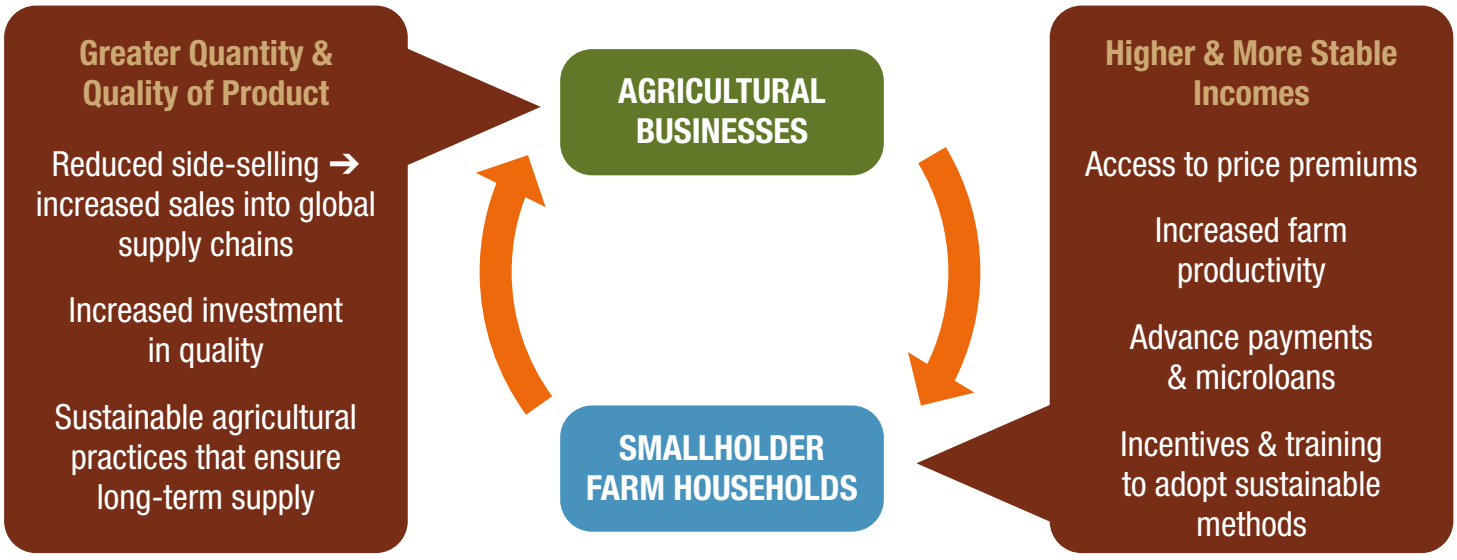
Beyond the impact on farmers and the environment, the businesses, as well as upstream exporters, processors, retailers, and consumers, also benefit, as farmers provide stable and secure supply of agricultural products. Over time, a cycle of mutually beneficial relationships can emerge throughout the value chain. Of course, the interests of the different players are not always aligned with one another, particularly over the short-term, and external factors such as commodity market volatility can disrupt these relationships. Nevertheless, to the extent that a cycle of mutually beneficial relationships can be achieved in a smallholder-based agricultural value chain, that value chain will be more secure, resilient and sustainable – and thus more creditworthy.

Where to Look

Due diligence on businesses' social practices can help financiers to look for indicators of a mutually beneficial relationship between the farmers and the business that will drive a successful upcoming harvest season and prove resilient to market shocks. Financiers with a longer-term view can also use environmental due diligence to evaluate in what ways, and to what extent, the practices of farmers and the business are renewing or degrading the local ecosystem, which in turn is necessary to support successful production – and rural livelihoods – through future harvests.

Agricultural businesses typically support producer livelihoods in one or more of the following ways, and each is measured in our social and environmental scorecards:

1. Increasing prices to producers and wages to employees
2. Increasing producer productivity
3. Increasing stability of producer income
4. Investing in or linking producers with public goods (e.g., health, education, water, transportation)
5. Creating the incentives and delivering the training required to sustain producers' ecosystems



With regards to the environment, the locus of impact is the relationship between Root Capital's clients and their farmer suppliers' agronomic practices on the one hand, and the environmental integrity of the supporting ecosystem on the other. To the degree that those businesses and their suppliers invest in practices that maintain biodiversity, build soil quality, and responsibly dispose of waste, their ecosystems will continue to provide the services – the climate regulation, nutrients, and clean water – required for long-term productive yields and healthy livelihoods. Unsustainable practices such as excessive agrochemical use or nutrient mining have the opposite effect, and the mutually beneficial cycle between producer and ecosystem will eventually break down.

The challenge for lenders in identifying this positive cycle is that they typically interact only with the business. Lenders rarely survey farmers or measure ecosystem health, because to do so would be prohibitively costly and time-consuming.

Lenders can, however, look for a set of practices, of the business and of the farmers, which can reasonably be expected to lead to desired socio-economic and environmental outcomes. We call this approach 'practices as proxies.' For instance, our indicators include the price paid by the business to the farmers in the past season as compared to the local market price. We also record the types of technical assistance provided by the business, and the numbers of farmers that received the assistance. These indicators are not proof of impact. However, if the business is offering improved seeds and paying a higher price than other local buyers for farmers' harvests, we have reason to believe that those practices are improving farmers' incomes, all else equal.[2]

Evaluating prospective clients' social and environmental practices during due diligence enables financiers to direct their capital towards the borrowers and investees that are likely to generate the greatest impact. In addition, by aggregating and analyzing the data that we collect during social and environmental due diligence, and publishing that data as part of a broader approach that includes rigorous impact evaluations to verify our findings, we can build the evidence base for the impact of smallholder agricultural finance. In short, social and environmental due diligence can help lenders increase impact on a loan by loan basis, conduct portfolio analysis to identify trends and inform strategy, and demonstrate their impact to external stakeholders.

Using Social Due Diligence to Inform Credit Risk Evaluation

In 2012, one loan officer's social due diligence on a particular client – a small coffee cooperative in Peru – revealed that the business had experienced difficulties paying producers in the past due to weaknesses in its own financial management. This led our loan officer to doubt whether the producers would be willing to sell the volume of coffee to the business that the business projected, especially since the business could only afford to make a partial payment at time of sale, with the rest to come after the business was paid by its own buyers.

Therefore, the loan officer chose to structure the loan such that disbursements were dependent on targets for volume of coffee collected – a common structure for first-time clients. After the loan had been approved, the client requested and received a first disbursement to finance its first shipment, which it repaid successfully. However, the client was not able to secure enough export-quality coffee from producers to fill a second shipment because the producers sold their volumes to other local buyers.

Knowing that Root Capital would not approve the second loan disbursement (in the range of $70k to $80k), the client never asked for it. While it is impossible to know what would have happened had we made the second disbursement, it is likely that our social due diligence helped us to avoid a loan restructuring or possible write-off.

Later in 2012, that same loan officer was introduced to another small cooperative. This time, the social due diligence revealed a strong relationship between the producers and the business. Given the small size of the business and the fact that this was its first external financing, the loan officer structured the loan the same way. In contrast to the first client, this client requested and successfully repaid the full amount, and in 2013, was approved for a larger loan without conditions tied to volume of coffee collected.

For this business as for many others throughout Root Capital's portfolio, loyalty from the producers to the cooperative is an advance indicator of product delivery, and that loyalty is garnered by the economic and non-economic benefits that the cooperative provides to producers. Root Capital uses social due diligence to evaluate loyalty in order to inform whether to lend, and if so, whether to lend with or without conditions tied to the business' ability to secure product from smallholders.

2 Practices are not proof of impact. To the extent that individual lenders' mandate is to achieve certain social or environmental impacts, those lenders may implement deeper impact evaluations to demonstrate that impact. Root Capital conducts such evaluations. More generally, lenders must rely on professional researchers for experimental studies to connect the adoption of sustainable agronomic practices to desired social and environmental outcomes. In areas where researchers have generated a strong evidence base, lenders can leverage it to inform their choice of practices to look for.

With support from Root Capital, AgroMantaro now employs more than 600 plant workers, 90% women, who have received social and economic benefits from the company.

The Emerging Business Case

Social and financial due diligence are sometimes two sides of the same coin. Whether social or commercial, any lender to agricultural businesses that source from smallholder suppliers would be negligent not to evaluate the strength of those businesses' relationships with suppliers. What we call 'social impact,' in the form of timely and ideally higher payments to producers, is simply good supplier relations to the agricultural businesses to which we lend. What we call "environmental impact," in the form of training in sustainable agricultural practices, often translates to long-term productivity and supply security.

The alignment of financial and social and environmental interests, however, is not always so clear. There are cases where financial interests run contrary to social and environmental ones, particularly in the short term. To take an extreme example, an agro-food company and its financiers might turn a quick and potentially large profit by clear-cutting tropical rainforest and replacing it with monocrop agriculture with intensive chemical use (though they would incur substantial reputational risk by doing so). Root Capital's social and environmental due diligence causes us to forgo many potentially short-term profitable lending opportunities that would have longer term environmental consequences.

Yet at the same time, there are the ways in which social and environmental due diligence has improved our business results. We have found the alignment between social, environmental, and financial interests to be strongest in five areas: risk management, generating new business, identifying businesses with growth potential, strengthening client businesses, and identifying opportunities to support more of our existing clients' unmet financial needs.

Risk Management

With agricultural enterprises aggregating hundreds and even of thousands of smallholder producers, the process of identifying, evaluating and mitigating risks is a difficult but critical exercise. For instance, environmental due diligence can alert us when a group of producers that has been certified (for instance, as organic or by Rainforest Alliance) is employing practices that could place at risk the certification and access to high-value export markets of the larger business that we finance. Or, it can also help us to avoid financing shipments of agricultural products that will be rejected due to violations of phytosanitary standards by smallholder farmers looking to save on input costs.

Using Environmental Due Diligence to Inform Credit Risk Evaluation

In 2010, a Kenyan fresh vegetable exporter and first-time Root Capital client received a trade credit facility of EUR 44,600 to support purchase of vegetables from contracted smallholder farmers. At the time, the company allowed its contracted outgrower farmers to purchase and apply pesticides from a list of approved agrochemicals.

In the course of environmental due diligence, we looked at the business' plan to train its outgrowers in responsible agrochemical application. We did not, however, fully evaluate whether the client's extension team would be able to monitor the producers' adoption of such techniques during the growing season.

Despite having received training, multiple outgrowers bought cheap but non-approved pesticides and applied them in excessive doses. Unaware of the environmental and business risk introduced by their producers, our client collected, packaged, and exported the vegetables only to have its first shipment to Europe rejected due to pesticide residue levels that violated the requirements stipulated by its buyers. Over the next two and a half months, the company was forced to sell most of the harvest at or below cost due to excessive pesticide residues, and defaulted on its loan to Root Capital

In the case of a large-scale, sophisticated horticulture operation, Root Capital would be able to ask the enterprise for its professional environmental management plan. In the case of smaller agricultural businesses sourcing from smallholder farmers, a loan officer must dig deeper. Dozens or hundreds of smallholders are agreeing to follow certain environmental standards, which means that our due diligence must focus heavily on the business' strategy for engaging with and monitoring these individual suppliers.

In this particular example, the company responded by hiring a team, supervised by its own agronomists, to perform pesticide application on behalf of its growers. Root Capital responded by strengthening our environmental due diligence. While our approach still requires a review of agrochemicals used in production (when applicable the majority of our clients are certified organic), we now go a step further by evaluating the way our clients monitor smallholders' environmental practices, including conducting a limited number of farm visits to get a sense of producers' awareness of environmental risks. While this can be a complex and time-consuming exercise, we have learned that it is necessary.

Generating New Business

Our social and environmental standards preclude lending to many otherwise creditworthy businesses, such as enterprises that do not benefit smallholder farmers, farm workers, or the local ecosystem. However, this reduction in market opportunity is partially offset by the agricultural businesses we attract based on our reputation for strong social and environmental due diligence.

For instance, the manager of a cooperative sourcing beans, onions, and chia from smallholder farmers in Nicaragua found that current and potential future buyers viewed financing from Root Capital as a 'stamp of approval' of their social and environmental practices, as well as their good management more generally. Several other recently acquired clients have cited our focus on social and environmental factors in their decision to borrow from Root Capital. As demand grows for products produced using socially and environmentally sustainable methods, a focus on and familiarity with these issues positions lenders to capture a share of this market segment.

Agricultural (and, we suspect, most other) businesses are more likely to seek financing from lenders whose values and missions are aligned with their own. As long-term social and environmental considerations move from the niche to the mainstream of agricultural value chains, so will the reputational benefits accruing to financiers that understand and value these considerations.

Identifying Businesses with Growth Potential

Businesses operating deep in rural areas of Africa and Latin America often lack clear business plans and audited financial statements. The businesses may be stronger – or weaker – than they appear on paper. All financiers must look beyond borrowers' financial statements, but lenders to early-stage agricultural businesses sometimes must look a little further than most.

Sometimes, what we find alerts us to risks to avoid. But in other cases, our social and environmental due diligence reveals unexpected strength in a business' supplier base, or in its potential to serve new markets. By becoming the first provider of external financing to these early-stage businesses, we position ourselves to grow with them over a long-term and often profitable client relationship.

Using Social and Environmental Due Diligence to Evaluate Client Growth Potential

Ankole Coffee Producers' Cooperative Union (ACPCU) is a federation that purchases and markets the coffee of smaller primary cooperatives in Uganda. At the time of Root Capital's first loan in 2008, ACPCU had just started operations, and it had unsuccessfully approached several commercial lenders before Root Capital.

ACPCU's credit application was weak due to limited financial management capacity, but our social and environmental due diligence suggested the federation had potential for future growth. The ten primary cooperatives that ACPCU sourced from were all Fair Trade Certified, ensuring price premiums for the producers. They also distributed all profits to the farmer members each year to ensure their loyalty and commitment to sell to ACPCU in the following year.

ACPCU was also a member of the National Organic Movement of Uganda (NOGAMU). The cooperative had provided training to its members to adopt organic farming practices and was in the process of becoming organic certified. The coop would soon be able to earn additional price premiums by selling into the organic certified market, while avoiding the volatility of the conventional (non-certified) market.

ACPCU successfully repaid its first Root Capital loan of $112,560 in 2008. The next year, based on this credit history, a foundation gave the cooperative a capacity-building grant of 250,000 Euros and another offered an interest-free loan. ACPCU did not solicit another loan from Root Capital until 2012, when its financial needs exceeded the limits of those foundations. Root Capital lent ACPCU $500,000 in 2012, a loan which it repaid and renewed in July 2013. ACPCU now has external financing totaling $1.2M and projected sales of over $3M for the 2013/14 season – an impressive achievement for a business that is only five years old.

Strengthening Client Businesses

In some cases, the very act of conducting due diligence on an agricultural business identifies opportunities to improve social and environmental practices in ways that strengthen the business. For instance, in 2012, we began lending to a private business that sources soy beans from smallholder farmers in Ghana and processes the beans into vegetable oil and animal feed.

Prior to our loan, the company had no direct contact with its farmer suppliers, as it relied on one prominent local farmer to aggregate and deliver the harvests of many other farmers. Our social and environmental due diligence, which requires us to visit a subset of farmers, prompted the company managers to visit their farmer-suppliers for the first time.

The farmers were encouraged by the company managers' visits, and used the opportunity to raise issues to improve the relationship (for instance, requesting that the company provide inputs and services like ploughing and threshing). Since then, managers have continued to visit the farmers and this has significantly increased the loyalty of the farmers to the business and enhanced the supply security of raw materials.

Growing our Business with Existing Clients

Once we have established a lending relationship with an agricultural business, social and environmental due diligence forms part of our ongoing client relationship management and helps to surface additional lending opportunities.

For instance, our social and environmental due diligence of a coffee cooperative in Nicaragua, revealed a well-run internal credit program that makes small loans to farmer members and other social programs such as construction and repair of dirt roads that link farmers' plots to the community. Based on these strengths, in 2012 Root Capital made a small initial loan of $21k to finance the installation of solar panels in the homes of 49 farmers that are entirely off-grid and lack other access to electricity. In 2013, we issued a larger loan to finance solar panels for the remaining 106 farmers in the cooperative.

Jose and his wife Dinora, members of the SOPPEXCCA, are farming land purchased through a loans for land program.

SOPPEXCCA: using social and environmental due diligence to identify additional lending opportunities

SOPPEXCCA (Asociación de Desarrollo Integral Productivo Cocolense – Productive Development Association of Cocolá) is a fair trade- and organic-certified coffee cooperative located in the jungles of Jinotega, Nicaragua, a major center of coffee production. The coffee cooperative is well known in Nicaragua for its emphasis on gender inclusion and the empowerment of women farmers; 45 percent of its members are women.

Root Capital first started working with SOPPEXCCA in 2003, when we provided the cooperative with a $70,000 short-term trade credit loan – its first commercial loan – to support the collection and marketing of its members' coffee. At that time, SOPPEXCCA had 450 members cultivating coffee on around 825 hectares, and exported around 600,000 pounds of coffee a year.

Since 2003, Root Capital has approved 12 trade credit loans to the cooperative. In addition, our social and environmental due diligence for these loans surfaced conversations with the cooperative around its desired impact on the community, and how Root Capital, as a financier, could support the growth of that impact through investments in new or expanded service offerings. Specifically, we learned that the cooperative manages an internal credit fund, through which it provides its members with small loans for the purchase of new coffee land or for the renovation (replanting) of aging or diseased coffee trees.

These due diligence conversations increased lending opportunities for Root Capital, while increasing impact for both organizations. Root Capital has since made six long-term loans to support SOPPEXCCA's internal credit fund, most recently a $2 million facility to support the scaling of its renovation program. Together, these loans account for over $3.5 million in incremental lending for Root Capital.

With Root Capital's support over the last ten years, SOPPEXCCA has grown significantly, to 650 members farming on 1,900 hectares – an almost 50 percent increase in farmers reached – with exports of over 2.2 million pounds of coffee in 2012.

Since Root Capital's first loan to Sunshine Agro Products in Uganda, the business has increased its payments to producers by 660%; it now sources chili peppers from more than 900 farmers and provides seasonal employment to 70 local women.

Conclusion

The financial costs of social and environmental due diligence are smaller than might be expected, and the financial benefits larger. We have sought to demonstrate this in the context of our own sector, which is smallholder agriculture in Africa and Latin America, but we believe that our argument is relevant across sectors and geographies.

Impact investors and social lenders have a critical role to play in not only creating a direct impact through the businesses they finance, but in creating cost-effective tools that can be adopted more widely by financial institutions to drive systemic change.

WE INVITE IMPACT INVESTORS AND SOCIAL LENDERS:

- To apply social and environmental due diligence to guide their capital towards greatest impact;
- To share tools and methodologies that they develop, so that those tools can be incorporated by others, including commercial financial institutions; and
- To use these methodologies and tools to advance society's understanding of the ways or circumstances in which social and environmental sustainability do and do not align with financial returns for the investor, or business success of the investee

We invite commercial financial institutions to consider how social and environmental factors might impact the success of their borrowers and investees in the short- and long-term, and to incorporate those factors into their financial due diligence.

WE INVITE FOOD COMPANIES:

- To further explore – and share as appropriate– the ways in which social and environmental performance impacts the agricultural value chain and the bottom line;
- To develop or deepen their business strategies that respond to these social and environmental considerations and mainstream them into core business processes and evaluations;
- To build relationships with financial institutions that understand and are well-positioned to support decision-making that incorporates social and environmental risks and opportunities

Financiers and food companies alike need tools to incorporate social and environmental issues into their decision-making: to build the impact case and accomplish the greatest good; to build the business case and achieve risk-adjusted returns; or to pursue an integrated strategy to compete effectively in a market that increasingly rewards long-term social and environmental sustainability.

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