



CLIMATE SMART AGRICULTURE – CASE STUDIES SERIES

ECO AXIAL AND INSTITUTO ESTRELA: GUARANTEED PURCHASE AND SHORT-TERM MICRO-CREDIT FOR ECONOMIC DEVELOPMENT

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1. Local Context

In Brazil, two of the main challenges related to providing microcredit to smallholder farmers are connected to the borrowers' capacity to provide the required collateral to the lender – for instance, the proof of a land title or a constant family income flow – and proof of their repayment capacity, as this depends on their reliable access to consumer markets.

There are several attractive credit lines for family farming in Brazil which are offered by BNDES (Brazilian Development Bank) through multiple intermediaries – from state-owned banks to credit cooperatives. The average interest rate for these lines lies at 2% per year, which can be an attractive rate for a country with an official governmental interest rate of 6.4% per year.

Nevertheless, the number of smallholder producers accessing these credit lines is still few. The reasons are manifold and range from a lack of awareness, the inability to offer the needed collateral, to financial illiteracy and a consequent difficulty of understanding the lending contract terms.

Another challenge is linked to the capacity of making use of microcredit or credit for working capital purposes and of repaying it by having managed to sell the products in consumer markets.

In terms of agricultural activity, the northeastern region of Brazil is well-known for its semi-arid climate. There, the pressure on land use is not caused by large scale agricultural production and deforestation, but is rather related to the challenging access to water with predominant and historic subsistence agriculture. Hence, most of the food in this area, particularly vegetables and lettuce, are imported from other regions of Brazil.

However, one can find green oases in the middle of the semi-arid region, which are biome transition zones in higher altitude areas. The city of Bonito (which translates as 'beautiful') in the mainland of Pernambuco State is located in such an area.

Due to historic reasons, smallholder farmers in that region are not aware of the fact that they could be owners of their own plantations. A cultural and socioeconomic mindset shift is therefore what Eco Axial, a food company, and Instituto Estrela, a microcredit association, are promoting in the city of Bonito and its surrounding areas. The partnership between these two organizations, both of which are part of the portfolio of Axial Holdings, a private equity company, is providing the basis for an economic activity for local producers.

On one side, Instituto Estrela provides a short-cycle microcredit line for smallholder farmers who are then connected to guaranteed sales to Eco Axial on the other side.

2. The microcredit association Instituto Estrela

Instituto Estrela is a microcredit association that has been recognized by the Organization of the Civil Society in the Public Interest (OSCIP). It was created in 2005 with the mission to overcome the barriers that small businesses in the Brazilian semi-arid region face when trying to access working-capital credit. The microcredit association started with an initial grant of the Sandoz Foundation to begin their operations in the municipality of Sousa, in the State of Paraiba.

Since then, Instituto Estrela has shown a consistent track-record of successfully providing responsible credit to small-sized entrepreneurs. The key success factors, according to its management team, are based on three pillars. The first pillar relates to a deep understanding of the region's seasonal economic activity throughout the year. For example, the June Festivities, which are very traditional in the northeastern region, have a higher consumption level than the year-end parties, thus making this time of the year the high season for economic activity. Furthermore, due to their understanding of the farmers themselves, employees of the institution can explain the at times complex banking language and contracts to the borrowers so that misunderstandings can be avoided for both parties.

The second pillar builds on joint-debtor groups, which account for 90% of Instituto Estrela's lending. These groups are formed by an average of 3 to 6 participants, and all of them jointly guarantee the debt repayment. Interestingly, of the total number of borrowers, approximately 70% are female entrepreneurs.

Lastly, the third pillar builds on successful partnerships that the association has established with other credit organizations as well as on experience with the selected financing vehicle.

To date, Instituto Estrela has established a portfolio of 9,000 customers and has collected a committed capital of USD 5 million formed by the Institute's own financial assets and capital allocations by BNDES and Oikocredit. In connection to their capital allocation, BNDES performs monthly audits and offers support and assistance to the Institute.

With branches in four municipalities in the State of Paraiba, Instituto Estrela's main lines of credit focus on regional trade activities in both products and services. The average credit size ranges

between USD 280 and 6,000, which is the minimum and maximum credit size per person that has been defined by the Brazilian Government for OSCIP microcredit organizations.

Although Instituto Estrela is a non-profit organization, they charge a credit opening fee of 3% in order to pay for their operations. Repaid credits and interest are – in the manner of a revolving credit – used again for new loans.

In 2017, Instituto Estrela was rated a five-diamond microcredit organization by the Mix Market as a result of its transparency in reporting its activities and financial results. It also holds a $\beta+$ (Beta Plus) rating by Micro Rate, and is thus placed first among Brazilian microcredit organizations.

Based on the Institute's successful track record of providing responsible credit to micro-entrepreneurs in the field of trade and services, in the beginning of 2017, its advisory board challenged it to expand its activities to the agricultural sector by providing credit to smallholder farmers.

3. Eco Axial – a food production company partnering with smallholder farmers

Eco Axial is a food company with its own brand in the market, selling both organic and conventional vegetables and animal protein to grocery stores and retail shops as well as to fast food chains. The company was founded in 2015 and its key value is engagement with smallholder farmers.

In 2017, Eco Axial's product portfolio included goods ranging from organic tomatoes and different sorts of lettuce to cassava flour. Organic products account for 31% of their current product line, which is mainly sold to grocery stores (34% of the total volume) and food services (66% of the total volume).

Both Instituto Estrela and Eco Axial are portfolio companies of Axial Holdings, a private equity fund with an impact investing mindset. This ownership is certainly the key success factor of the Eco Axial–Instituto Estrela–smallholder farmers triad in the city of Bonito.

The initial idea to start operations in order to provide fresh vegetables to the northeastern region's market originated from Eco Axial's management team. The location of the operations was defined

in 2016, with respective establishment of a processing industry and the engagement of a group of smallholder farmers in 2017.

4. Short-term-cycle working capital credit associated to guaranteed purchase

Together with Instituto Estrela, Eco Axial organized two credit lines for smallholder farmers as part of their fresh vegetables supply chain program.

The first one is designed for the initial infrastructure setup and encompasses a 10-month credit with a grace period of 100 days. The second credit line is used for working capital, which is aligned with the crop plantation cycle and associated with the product deliveries to Eco Axial.

The loan size for both the infrastructure setup and the working capital credit equals USD 2,800 each and the borrowers can only apply for the next round of working capital credit once one of these two has been repaid.

The agreed guaranteed purchase by Eco Axial equals 200 boxes of lettuce per week. Overproduction is purchased by the company as well, providing producers with a real entrepreneurial experience: if they invest in infrastructure and technical support, the produce volume will be higher, and the purchase of that overproduction is guaranteed.

I have been able to produce 270 boxes of lettuce per week. The extra 70 ones are my profit. (José Erivelton, producer)

This connects to one of the intended positive impacts of Instituto Estrela, which is to encourage a financial discipline culture associated with an entrepreneurial mind-set, leading to producers being free of the traditional socioeconomic structures of the sugar cane lords in the region.

Another important social impact is related to a rural exodus reduction. Furthermore, from an environmental perspective, the program supports the farmers' consciousness about the sustainable use of water resources and river basin maintenance.

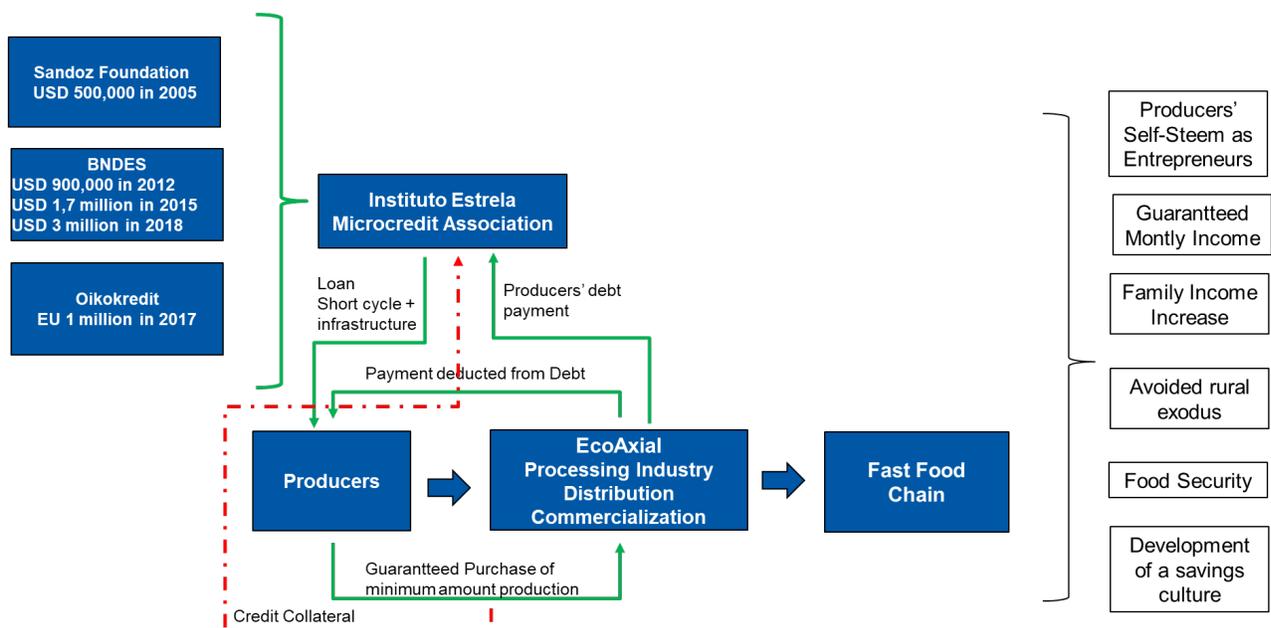
Guaranteed purchase is a risk mitigation strategy in providing microcredit to smallholder farmers. (Edinalda Lima, director of Instituto Estrela)

For Eco Axial, working in collaboration with Instituto Estrela was a key element for engaging smallholder farmers in the region of Bonito. The access to credit connected to guarantee purchase offers the possibility for smallholder farmers to break free from a cyclic situation in which no credit means no production, and no production means no market. Now, producers with one hectare, besides being owners of their own business, have also developed a sense of production expansion. (Manuel Hing, Eco Axial Director)

Why Bonito?

The city of Bonito and its surrounding rural area offer several advantages that make up the reasons why the joint initiative was started there. The ideal climatic conditions and the availability of water of this biome transition zone are both rare in the northeastern region of Brazil and essential for growing lettuce. These optimal external conditions are also why the quality of the produce is particularly high and, furthermore, why there were already farmers with experience in lettuce farming in this region, so that Eco Axial did not have to introduce a new farming approach. Lastly, Bonito is strategically well-located, as it lies close to the main logistic operator of Eco Axial's customers and to the large consumption centers to which the food is delivered.

5. Eco Axial and Instituto Estrela Framework



6. Future Plans

The next steps in both the medium and the long term future involve expanding and introducing the model to a larger number of farmers. First, if the demand continues to grow, about seven new conventional farmers are expected to enter the cooperation, so that in the next 12 months, a total number of 15 conventional farmers will be working with Eco Axial and Instituto Estrela. Secondly, Eco Axial is planning to apply the approach to the organic farmers of the Bonito region as well in order to extend the organization's product portfolio.