Pomona Impact

Financing for the Missing Middle

Pomona Impact is an organization that works in Central America, Mexico, Ecuador, and Colombia with the purpose of financing profitable businesses that integrate social and/or environmental impact into their business model, in the agroprocessing, basic services/utilities, and the digital economy sectors. Financing is provided through innovative instruments structured through debt, with the possibility of acquiring equity. This organization is supported by the Pomona Impact Foundation as an accelerator of businesses that may eventually receive financing from the fund managed by Pomona Impact.

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LOCATION:
Central America and the Caribbean, Ecuador, and Colombia.

FOUNDING YEAR:
01
2011

INVESTOR TYPE/SILO:
Impact investment fund.

SECTORS:
- Agroprocessing.
- Basic services/utilities.
- Digital economy.

CONTINUUM OF CAPITAL:
Investing with impact.

FINAL BENEFICIARIES:
Social and environmental businesses.

MAIN PARTNERS:
Inter-American Development Bank, Capria Network, ISE, EY Seed, Pomona Impact Foundation, FONPRODE.

MOTIVATION OR PROBLEM TO SOLVE:
The population of Central American and Caribbean countries are falling behind in access to basic services. In addition, some of the businesses that provide these services in the region do not have access to financing that would allow them to scale their impact.

NON-FINANCIAL SUPPORT OFFERED:
- Strategic and operational strengthening.
- Corporate governance.
- Access to networks.

FINANCIAL INSTRUMENTS:
Mezzanine debt (75%) and equity (25%).

RESOURCES INVESTED OR DONATED:
- The pilot fund consisted of

USD 2 million.

- The second fund is expected to close in 2022 and reach

USD 30 million.

IMPACT:
- Job creation.
- CO^2 displacement.
- Access to basic services in vulnerable communities (particularly drinking water in rural communities).
- Gender lens.
- Standardized metrics.[1]

SDGS:

1 As the fund is in an early stage, there are no metrics to publicly report.

Overview

Currently, around 166 million people in Latin America and the Caribbean do not have access to safe drinking water,[2] and 443 million lack basic sanitation, which represents 69% of the population.[3] Furthermore, 19 million people do not have access to electricity, and 77 million do not have access to clean cooking fuels and technologies. Two of the main factors that explain the asymmetric and segmented access to basic services in the region have to do with the limited financing for public and private infrastructure projects that guarantee their provision and quality, as well as a narrowing fiscal space to increase such investment.[4]

Pomona Impact has emerged as a pioneering organization in Latin America and the Caribbean in financing enterprises and businesses that contribute to expanding access and quality in the provision of basic services such as health, education, housing, renewable energy, and drinking water. It also finances other initiatives in the agroprocessing and digital economy sectors, in areas such as e-commerce, fintech, and logistics.

Pomona Impact was founded as a non-governmental organization in charge of accelerating startups in agroprocessing. Then, it created a pilot fund aimed at providing capital to social businesses without access to financial resources and are in the *Death Valley* (i.e., enterprises that cannot find finance during their consolidation stage due to its high risk). Later, it consolidated a second fund with the purpose of financing larger amounts.

The first fund had an initial capital of USD 2 million, which was able to provide financing to 22 companies,

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2 That is, water available for consumption from an improved source located within the household. For more information, see: https://www.cepal.org/es/notas/inversion-universalizar-servicios-basicos-america-latina-caribe-2030

3 Economic Commission for Latin America and the Caribbean, ECLAC (2021). Inversión para universalizar servicios básicos en América Latina y el Caribe hacia 2030. Available at: https://www.cepal.org/es/notas/inversion-universalizar-servicios-basicos-america-latina-caribe-2030

4 Inter-American Development Bank, IDB (2020). De estructuras a servicios. El camino hacia una mejor infraestructura en América Latina y el Caribe, p. 58. Available at: https://publications.iadb.org/publications/spanish/document/De-estructuras-a-servicios-El-camino-a-una-mejor-infraestructura-en-America-Latina-y-el-Caribe.pdf

12 of which had exited the fund by April 2019.[5] Both funds use mezzanine debt, entailing the adoption of a higher investment risk, consistent with the expected level of return, adjusted to the market rate. The financing provided to the businesses from the first fund ranged from USD 50,000 to USD 100,000.[6]

Based on the lessons learned from the pilot fund, and with the purpose of offering flexible financing for impact businesses that are in the Death Valley, Pomona Impact advanced the capitalization of a second investment fund with a goal of USD 30 million. As of April 2022, the second fund had resources amounting to USD 10 million, and which the rest of the total projected resources is expected to be raised by the end of the year.

Pomona Impact has a geographic focus in Central America, Mexico, Ecuador, and Colombia and its team is based in Guatemala. As a result, the organization has a broad and diverse network of partners, as well as detailed knowledge of a considerable number of allies, as well as a deep knowledge of the organizations working in the three sectors in which it invests. This knowledge has been accumulated mainly thanks to the implementation of the first pilot fund—which had a considerably vast pipeline of organizations—and has been further developed as a result of the configuration of the second fund. These organizations are the focus of Pomona's impact goals, which include the creation of 3,700 jobs by directly financed entities,[7] 450,000 direct beneficiaries,[8] and a target of USD 120 million in income generated by the financed entities.[9]

Pomona Impact does not directly provide technical assistance to the enterprises that it finances. It has, however, worked with the Pomona Impact Foundation—especially within the framework of the pilot fund—in the development of acceleration programs and bootcamps, particularly through the PomonaAgTech and PomonaGreenTech Costa Rica initiatives. The purpose of the PomonaAgTech

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5 Lavca Ventures Investors (2019). Pomona Impact raises US$35M to invest in Central American companies. Available at: https://lavca.org/2019/04/08/pomona-impact-raises-us35m-to-invest-in-central-american-companies/

6 Mezzanine debt is defined as a hybrid instrument that combines subordinated debt and equity. It usually takes the form of a medium-term bond with some option or security on leveraged or bonus shares. It is used to cover finance needs as the business grows and evolves.

7 IRIS, 2019. Jobs Created at Directly Supported/Financed Enterprises: Total (PI3687). v5.0.

8 IRIS, 2021. Client Individuals: Total (PI4060). v5.2.; IRIS, 2021. Supplier Individuals: Total (PI5350). v5.2.

9 RIS, 2021. Revenue Generated at Directly Supported/Financed Enterprises (PI3180). v5.2.

has been to catalyze innovation and entrepreneurship in the agricultural sector in Central America through capacity building, community building, and access to investment. To this end, the possibility of accessing to financing was established since the formation of the pilot fund so that the businesses in their early stages were supported to reach the maturity they needed to access investment.

PomonaGreenTech Costa Rica was created as an accelerator program for green technology startups with high export or internationalization potential in the country. The program includes three months of intensive acceleration, after which the startup has the possibility to access to the investment opportunities then provided by the pilot fund, and currently provided by the second fund. In both cases, the Pomona Impact Foundation acts as an independent entity to select the businesses that will be part of the training and acceleration processes. This has the purpose of limiting the joint work with the fund on selecting the finance opportunities offered to those that graduate from the program.

Innovative factors

Pomona Impact has implemented an innovative financial instrument that aligns with its investment decisions ever since the pilot fund was created. Mezzanine debt has given the fund enough flexibility to make higher-risk investments, with a return equivalent to the magnitude of the risk assumed. Based on the fund's structure, up to 25% of its total capital can be allocated to equity investments.

Likewise, thanks to the flexibility that the fund pursues in its investments, it has devised other financing instruments, such as venture debt credit (non-convertible debt[10]) or revenue-based financing instruments. The former works as a credit at a competitive market rate (8% to 10%). A portion of the credit is taken in options to allow a greater risk-taking in the financing. This is done through debt repayment with the acquisition of the business's shares as a form of guarantee. In addition, Pomona Impact does not seek to maintain its shareholding for a long time under this scheme, but rather it seeks to offer the company flexible repayment possibilities so that it can repurchase the shares held by the fund.

10 Aimed at companies that have received finance via equity from venture capital firms.

Additionally, Pomona Impact provide revenue-based financing when businesses require CAPEX[11] to scale their business model more quickly. The maturity of the debt can vary from 5 to 7 years and may include a grace period, depending on the needs of the business. During this period, the fund takes a percentage of the revenue generated by the business as debt repayment. This scheme is based on the premise that a large number of social businesses financed by Pomona Impact may have a high potential for scaling their business model or impact but do not have the possibility of accessing conventional financing, despite having a proven level of sales.

Under this premise, Pomona Impact has financed initiatives such as *Tunart* in Guatemala—a company that owns a processing plant for artisanal and sustainable tuna fishing. Its business model delivers an outstanding performance, although below the financing requirements laid down by traditional sectors. Pomona Impact saw an opportunity to scale up this company's impact, particularly after identifying inefficient practices in its value chain, such as not having refrigerating systems to keep the tuna in optimal conditions in fishing boats. With the financing from Pomona Impact, the company was able to increase its efficiency and productivity, which made it possible to streamline the fishing process and integrate women into the value chain in an area where their employability is low.

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Another important aspect of Pomona Impact's operation is related to the non-financial support offered to the enterprises that it finances. In addition to the upfront support provided by the Pomona Impact Foundation, when investments are made in the businesses, a seat on the main governing body is usually requested, with strategic but not decision-making responsibilities. As an observer, Pomona Impact can have a close look at business's operations and the decisions made with regard to the financing provided.

Non-financial support is mainly aimed at assessing the company's administrative and financial policies, tools, and instruments. This support is established as part of the action plan designed for the first 100 days after the first disbursement, where a comprehensive due diligence of the company is carried out, identifying its adherence to policies that include the Sustainable Development Goals

11 CAPEX (capital expenditure) refers to the investment made with the purpose of acquiring fixed assets necessary to operate.

(SDGs), compliance with local legislation in administrative, financial, and accounting matters, and the integration of anti-corruption practices, among other aspects. This assessment results in a plan that is shared with the business's main governing body and identifies those areas where Pomona Impact's support could be most effective, including recommendations for structuring a balanced, equal, and transparent corporate governance model.

Finally, another aspect of Pomona Impact's innovative operation is its impact management. The organization has made an effort to standardize the impact metrics it establishes for its different portfolio enterprises. The impact criteria are defined at the time the financing is provided and are adapted to the sector in which the company operates, assessing their impact on various aspects, such as job creation, carbon dioxide displacement, access to basic services, and gender equality. Moreover, Pomona Impact seeks to provide financing to businesses that have incorporated impact criteria into their own business model and as an integral part of their own operation—a part of the core of the company itself and not only a by-product.

Lessons

The transition that Pomona Impact has undergone since its foundation as an NGO strictly in charge of accelerating startups in the region, then from a pilot fund to the capitalization of a second fund fifteen times larger than the first one, has been only possible by leveraging experience and learnings. Instead of establishing dispersed relationships with a large number of businesses under its portfolio, Pomona Impact has increased its capacity to closely support each one of the businesses. In addition, the experience of its pilot fund was critical to the construction of a pipeline of businesses and set the portfolio ready well before the configuration of the second fund.

> *"We already have momentum, we know the ecosystem, we have partners, and we have capital to deploy."* Miguel Sanz-Agero, Investment Associate, Pomona Impact.

Pomona Impact faces the challenge of altering the paradigm placed on the trade-off between financial return and achieving social and/or environmental impact. For this organization, both options can be reconciled within the same operation. As financed enterprises and businesses scale, the cumulative impact will be proportionally greater, reflecting a close alignment between the interests of investors and those of entrepreneurs.

Finally, Pomona Impact considers the flexibility that debt offers as a gentler instrument, in that it requires less administrative overhead compared to an equity agreement, for example. This is because debt allows the financed organization to go into default[12] in the event of non-compliance with the clauses[13] that are defined and agreed with the businesses.

Finally, when Pomona Impact provides finance through equity instruments, its purpose is to take a greater risk, which requires more oversight and control from the organization. In any case, Pomona Impact prefers to sell back the shares to the financed business rather than to keep the equity options.

12 An organization financed by Pomona Impact defaults when it has failed to meet the established payments. Pomona Impact makes every effort to help the enterprise pull through, including possible refinancing, although this is not proposed in all cases. If total insolvency occurs, legal action is taken.

13 Some of these clauses are defined around compliance with anti-corruption practices, appointment of key people within the organization, debt ratios, or access to information. They are generally defined before signing the contract, into which they are integrated.