Grupo FinTerra, S.A. de C.V., SOFOM, ENR (FinTerra)

COMPANY BACKGROUND

Grupo FinTerra, S.A. de C.V., SOFOM, ENR (FinTerra) is a specialized, non-deposit taking financial institution called a Sociedad Financiera de Objeto Multiple (sofom or non-bank financial institution) which specializes in lending to small, medium, and large farmers and agribusinesses in Mexico. FinTerra is one of several agribusiness non-bank financial institutions nationwide. Since its founding in 2004, the company has become the largest of the independent agribusiness non-bank financial institutions in terms of loan portfolio size and shareholders' equity. The company's senior management hails from top-tier international banks. At the end of 2011, FinTerra employed 70 staff in 11 branch offices in key agribusiness states in Mexico.

FINTERRA'S INCLUSIVE BUSINESS MODEL

FinTerra estimates there are approximately 4.9 million farmers in Mexico, of which approximately 90% may be considered micro or subsistence farmers. The company's target market consists of the remaining 10% of small, medium, and large farmers. FinTerra's service model for small farmer loans consists of grower financing, distributor financing, and specific crop financing programs. FinTerra offers its clients working capital and asset finance at reasonable interest rates. Working capital finance meets farmers' input needs from planting to harvest (a credit cycle of typically seven months to one year), while asset finance supports their investments in infrastructure and equipment (tenors of up to five years). FinTerra's key competitive advantages have been its fast response time in processing credit applications, which is particularly important in the agriculture sector, its agribusiness industry focus, experienced business origination team, and innovative financing solutions.

FinTerra finances the working capital needs of small farmers—mostly those with annual sales under US$50,000, as per FinTerra's definition—primarily through grower financing programs. Under these programs, FinTerra's borrowers are farmers who sign promissory notes with FinTerra, but who receive their loans via the companies to whom they sell their crops—mostly in the form of farm inputs such as fertilizers and seeds. FinTerra also enters into agreements with these companies, called off-takers. To repay FinTerra, farmers instruct their off-takers to deduct the equivalent loan and interest amounts from their payments at the end of harvest. The off-takers, in turn, benefit from having FinTerra finance their suppliers, whose numbers can reach several thousand farmers, rather than doing it themselves. Grower financing programs also enable small farmers to access inputs and financing at lower cost than if they were to seek financing from informal sources.

FinTerra's grower financing programs are structured to address the key constraints that financial institutions experience in lending to small farmers:

- First, as direct lending to small farmers creates high transaction costs, FinTerra works through agribusinesses that have off-taker agreements with small farmers. Each agribusiness assists FinTerra in selecting the farmers who will participate in the financing program based on pre-determined criteria; purchasing inputs for farmers using FinTerra financing; and in some cases providing technical assistance through the crop cycle. This structure reduces the transaction costs FinTerra would incur to reach, select, and provide loans to small farmers directly.
- Second, to mitigate credit risk, FinTerra asks the agribusiness to assume some part of the risk. This kind of structure enhancement permits FinTerra to avoid having to seek collateral from farmers for small loans which would be complex and costly or difficult to complete since approximately half the agricultural land in Mexico is not individually owned, leading to cumbersome and lengthy pledge, collateralization, registration, execution, and recovery procedures. Further, FinTerra reduces lending risk by working with agribusinesses that have built strong relationships with their suppliers over many years, making it less likely that farmers will break contracts. Moreover, farmers have additional incentives to maintain contracts such as ongoing access to lower-cost inputs and a guaranteed or above-market price from the off-takers in some cases. FinTerra also mitigates climate risk by requiring borrowers to contract crop insurance.
- Third, as small farmers may not have formal financial statements or credit histories, FinTerra has developed a simplified credit process taking into account a number of key factors such as production costs and yields, number of years of experience, and access to water.

FinTerra also finances small farmers indirectly through its distributor financing facilities and specific crop financing programs. Under distributor finance, FinTerra finances fertilizer and seed distributors that provide inputs on credit to farmers. Once farmers sell their produce, they repay the distributors for the cost of inputs, enabling the input distributors to repay FinTerra. Specific crop financing programs are originated through a credit scoring methodology which enables the farmer to receive a very fast response time with a financing product that is customized for a specific crop.

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DRIVERS FOR FINTERRA'S INCLUSIVE BUSINESS MODEL

- Significant demand for formal agribusiness finance in an underserved market creates a business opportunity
- FinTerra's mission to provide finance to farmers and agribusiness-related industries and services

Farming involves a number of risks, including local and foreign weather conditions, tariff and subsidy regimes, freight costs, and pest infestations. It is particularly hard for small-scale producers to obtain the financing they need because—in addition to the risk factors above—they tend to have limited credit history and collateral, and the transaction costs of servicing small loans are high. Most banks have traditionally prioritized consumer, housing, and corporate lending over agricultural production and other agribusiness-related sectors. As a result, in Mexico, lending from the banking sector in primary agriculture production is lower than in most other sectors (as a percentage of financing to the sector's respective GDP).

Most of the funding for lending to agricultural producers and other rural enterprises in Mexico comes from trust funds set up by the central bank in 1954, called Fideicomisos Instituidos en Relación con la Agricultura (FIRA). In addition to funding, the Mexican government also provides guarantees and subsidies to banks and non-bank financial institutions targeting this segment. Subsidies are available for all loans made to small producers borrowing for the first and second times. As per FIRA's definition, these are producers with annual incomes of up to 1,000 times the minimum daily wage, which is currently approximately US$5. Although FIRA subsidies are declining, the availability of these subsidies has helped financial institutions like FinTerra in their initial lending to small farmers.

Demand for formal agribusiness finance in rural areas is expected to grow as the credit culture spreads in Mexico and replaces informal sources of finance. The expected growth in demand for agribusiness finance has created a business opportunity for banks and non-bank financial institutions like FinTerra whose mission drives its ongoing product development in small farmer financing. FinTerra has gained significant experience in financing small farmers over the past seven years, and continues to refine its business model and products to enable small farmers to gain access to financing in an efficient and cost-effective manner.

RESULTS OF FINTERRA'S INCLUSIVE BUSINESS MODEL

- Loan portfolio CAGR of 27% between 2005 and 2011
- Loan portfolio of approximately US$100 million in 2011
- Reached over 2,000 small farmers per year through grower financing programs since 2004

FinTerra financing has benefited farmers in over 20 states in Mexico, as well as a range of subsectors such as grains, fruits and vegetables, dairy, and livestock. The company has demonstrated strong growth with a loan portfolio compound annual growth rate of 27% between 2005 and 2011. At the end of 2011, FinTerra's loan portfolio was approximately US$100 million with total assets of US$115 million. Approximately 80% of the loan portfolio was primary agriculture production and 20% was agriculture-related industry and services such as farm input distributors, grain commercialization, water management, and food processing. FinTerra's grower financing programs to small farmers represented approximately 15% of its loan portfolio and approximately 85% of its number of clients.

Since it launched operations in 2004, FinTerra has worked with several companies through grower financing programs to provide loans to meet the working capital needs of over 2,000 small farmers per year in various subsectors including grains, sugarcane, and milk production. FinTerra has also reached approximately 500 to 1,000 farmers per year through distributor financing facilities, primarily in grain production.

IFC'S ROLE AND VALUE-ADD

Specialized non-bank financial institutions in Mexico may access funding from FIRA, but are expected to tap financial markets directly within three years of their inception. IFC has a strong role to play to support agribusiness non-bank financial institutions in this transition. In 2008, IFC provided a MXN 15 million (US$1.1 million) credit line to FinTerra with a 7-year tenor.

IFC financing has enhanced FinTerra's credibility, and supported its efforts to raise money from private financial markets. Further, as the non-bank financial institution sector is loosely regulated, IFC is playing a key role in providing prudential guidance through its financial covenants.

In addition, IFC is helping FinTerra to develop advanced credit risk management tools through IFC's Small and Medium Enterprises Finance Program in Latin America and the Caribbean. These tools will help FinTerra to expand its reach to small and medium enterprises in Mexico's rural areas.

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IFC's Investment:

$1.1 million in long-term debt financing