The Margarita Loan Guarantee Fund

Building a blended finance mechanism for small-scale dairy farmers in Mexico

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For millions of smallholder farmers around the world, limited access to finance represents a major obstacle to participating in formal supply chains and investing in regenerative practices. This was the case for many dairy farmers in the states of Jalisco, Aguascalientes and Zacatecas, Mexico, with negative consequences for the profitability and resilience of their farms.

To address this challenge, the Margarita program—a public-private partnership that has worked with more than 900 farmers with the aim of integrating small-scale dairy producers into an inclusive and stable supply chain—created an innovative and comprehensive solution. Margarita's mechanism for access to finance, known as ROSCA, helps producers to pursue and evaluate credit opportunities and government subsidies; enables farmers to access credit at affordable interest rates and manageable repayment terms; helps producers build a credit history; reduces the risk to financial institutions lending to small-scale farmers; and strengthens alliances with government and private entities. An investment of approximately 20 million pesos in the ROSCA mechanism has mobilized close to 150 million pesos in loans for milk producers over ten years.

Abel Gómez joined Margarita in 2012. He has used the guarantee mechanism 15 times since 2016 to access credit to buy silage corn for his cows and a tractor and solar panels for his barn. During the time he participated in Margarita, Abel increased the number of cows in production from 14 to 35, while his productivity has grown from 15 to 21 liters of milk per cow per day. The fresh milk Abel produces has a quality comparable to that of large producers: 3.3 g/lt in fat and 3.2 g/lt in protein.

"You pay the credit and the interest, all together, and it's not heavy burden at all. You can't raise the money on your own—it would be impossible to buy all the food."

CHALLENGES IN THE DEVELOPMENT OF INCLUSIVE SUPPLY CHAINS

For many years, Mexico has been the largest importer of skim milk powder in the world, with imports accounting for 30% of the country's consumption. 134,000 milk producers provide the remaining 70%, and family dairy farms or dual-purpose farms (with less than 50 cows) account for most of this (49% of the total). The Margarita project was launched in 2010 at the initiative of Danone to create an inclusive, sustainable milk supply chain, which today benefits small-scale producers in the states of Jalisco, Aguascalientes and Zacatecas (and was originally planned to include Guanajuato).

In the state of Jalisco, where most of the Margarita producers are located, 18,000 dairy farmers produce 21% of the total national volume. These producers largely operate small-scale, family farms and have limited access to milk buyers or face unstable sales relationships with intermediaries and highly volatile milk prices, with little capital available for investment in assets.

Stakeholers formed an exceptional public-private alliance to drive far-reaching economic and agricultural development in the sector. Danone Mexico, TechnoServe, the Universidad Nacional Autónoma de México (UNAM), the Fideicomisos Instituidos en Relación con la Agricultura (FIRA), Madero milking equipment, Posta el 4, and the Unión Ganadera Regional de Jalisco (UGRJ), with the support of philanthropic capital from Fonds Danone pour L'Ecosysteme, designed and implemented the Margarita project, which has worked with more than 900 dairy farmers to integrate small-scale producers into an inclusive and stable supply chain. This alliance has been joined by institutions such as the Inter-American Development Bank (IDB, through IDB Lab), Plataforma Nuup, Caja SMG, the Instituto Nacional de la Economía Social (INAES, formerly FONAES), and the Ministry of Agriculture and Rural Development of Jalisco (SADER Jalisco).

Including small-scale producers in a formal supply chain involves significant challenges: the low volumes and geographic dispersion of dairy farms result in high transportation costs; the lack of cooling tanks makes it difficult to establish a cold chain that complies with sanitation and food safety standards; and the low quality of milk due to poor production practices and limited access to quality feed for dairy cattle add additional difficulties at the processing strategy, among other obstacles.

FINANCIAL EXCLUSION OF SMALL-SCALE PRODUCERS

Financial exclusion is severe for the agricultural sector, especially at the primary production level. According to data from Banco de México mentioned in FIRA's institutional program, "...credit to the (primary) sector represents only 2.5% of total commercial bank financing to the non-financial private sector. In contrast, financing to the industrial sector and the service sector represent 25.7% and 31.9%, respectively (the rest of the financing corresponds to households)."

The Margarita project has contributed to reducing this financing gap by:

1) Ensuring that producers' productivity and income grow at a level that allows reinvestment in assets and the consolidation of financing flows for working capital—especially sufficient livestock feed throughout the production cycle;

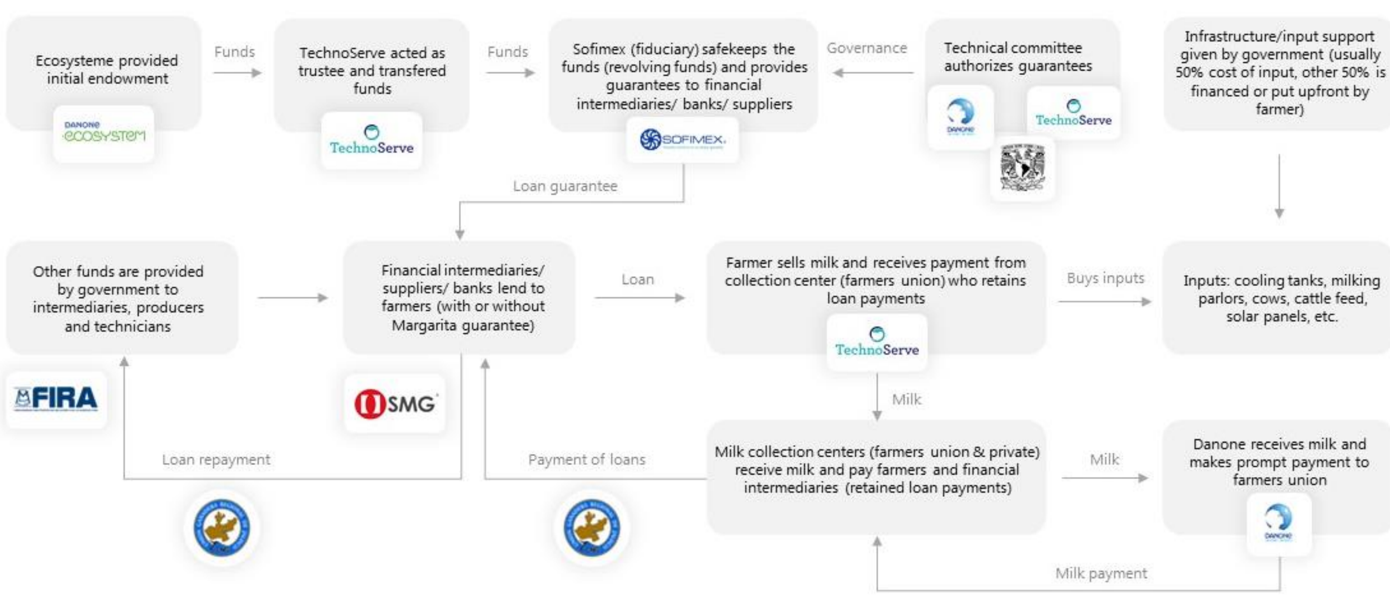
2) Creating a financial mechanism that lowers the risk for lenders, working side by side with loan officers and regional branches; and

3) Providing the support of a field team that accompanies each producer in the creation of credit files and throughout the process of credit management and the Margarita guarantee.

THE MARGARITA FUNDING MECHANISM

Through agreements with equipment suppliers that granted installment payment facilities to Margarita producers, between 2011 and 2013 the project provided support mainly for the purchase of cooling tanks and milking machines—both key assets to make supplying milk to Danone viable. In 2013, with a grant from Fonds Danone pour L'Ecosysteme, the leadership of Danone's milk purchasing area, the financial advice of Cosme Almada, the strategic advice of Dr. José Luis Dávalos representing the Universidad Nacional Autónoma de México, and the technical support of TechnoServe, a guarantee trust was created to help small-scale Margarita producers invest in assets or working capital for their

The ROSCA Model



farms. The fund was established in a Mexican trust that provides guarantees to producers interested in acquiring credit, with a multi-sector governance body that includes Danone de México, TechnoServe, and UNAM.

Guarantees are freely available to all producers in the Margarita project who pass a financial evaluation of their milk business. In some cases, the producers' finances are not healthy enough for a guarantee to be granted; however, they still receive the benefit of the collection mechanism, i.e. withholding payment.

With this guarantee, the dairy producer obtains important benefits when accessing a loan, starting with the interest rate, which has remained between 10% and 12% (and in some cases as low as 6.5%) per year since the mechanism was initiated, compared to rates of around 20% in the domestic financial market for primary agricultural production. Meanwhile, loan repayment terms range from one year for working capital (used to purchase livestock feed) to five years for asset purchases.

Margarita also created a credit collection mechanism that provides significant benefits to the participating financial institutions, since the URGJ (the administrative manager) deducts a pre-agreed amount from each producer's milk sales each week. Weekly credit payments automatically deducted from the milk sales substantially improve the rate of repayment: the default rate for loans obtained with Margarita's guarantee and is exceptionally low, with only three of 828 loans being classified as in default. The combination of the financial mechanism, the strong commercial cannel, and field accompaniment has succeeded in aligning the benefits for producers, financial intermediaries, and the anchor firm.

In addition to adopting good production practices, producers that have joined the Margarita project are operating formally in legal, tax and accounting terms and have obtained the proper registration with livestock associations and government institutions. This has not only allowed them to access private financing but also

Lilia García is a producer who joined Margarita in 2014. Since then, she has used the program's loan guarantee 15 times to acquire credit on beneficial terms. Lilia has used the credit for assets and working capital, acquiring heifers and a tractor, as well as installing a roof for the cows and a feeder corridor. To feed her animals, every year Lilia buys corn silage, one of the best foods for dairy cattle. Between 2014 and 2022, Lilia increased the number of cows in productionfrom 40 to 88; her productivity grew from 21 to 29 liters of milk per cow per day; and the quality of the milk in fat and protein is substantially higher than when she entered the program.

"Part of my growth has been due to the credit: as the saying goes, "He who owes nothing, has nothing." The guarantee is very useful because many of us don't have enough for the project and even less to put up the guarantee. Besides, nowhere else will they give you the interest rate they give you here."

activities. Finally, Margarita's producers have access to the formal financial system and have a credit history, which opens up their possibilities for further financing within and outside the dairy business.

IMPACT

Throughout its ten years of operation, the guarantee fund has had a very positive and significant impact, **mobilizing close to 150 million pesos in loans, which represents a 7.5:1 ratio with respect to the resources invested.** The guarantee fund has backed 828 loan guarantees for an average amount of 170,000 pesos. **Through this mechanism, Margarita's producers have been able to improve their infrastructure and equipment and acquire 127,000 tons of corn silage and other fodder, a key element in maintaining stable, high-quality milk production.**

Through high-level agreements, the financing mechanism has also resulted in the delivery of more than 44 million pesos in government subsidies (382 cases), mainly from the federal and state SADER. In 92% of cases, the government subsidy has been accompanied by a private loan that the producer acquires to co-finance his or her investment. In 66% of cases, the producer has also contributed his or her own resources as co-financing.

The Margarita project has had a ripple effect on the local economy, as it has enabled small producers to invest in their businesses and improve their quality of life. The funds have provided key resources to improve the quality and quantity of their production. In turn, the partnership with the technical team has also provided valuable support and guidance, enabling producers to operate more efficiently.

LESSONS LEARNED

Through the implementation of the project, several lessons have been learned that can inform future efforts to support small-scale Mexican dairy farmers in different regions.

First, philanthropic capital has enormous potential to mobilize private capital and support regional development. Second, the process of integrating primary producers into the formal financial system has very positive effects over the long-term, as the farmers have built a credit history that allows them to access agricultural and personal financial products. This, in turn, can help them maintain and grow their businesses over time.

Thirdly, the support model that Margarita has created—which integrates milk sales, technical assistance, support with paperwork and procedures, and access to finance—has resulted in a default rate close to zero. This is because the relationship with producers is continuous and covers key points of interest in the development of their businesses.

Finally, it is clear that the technical and productive development of small producers requires long-term support and accompaniment. This includes ongoing technical assistance, access to financing and support in administrative tasks. By adopting a comprehensive approach to support, programs can help producers build sustainable and successful businesses over time.

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