



Fondo Creas

Smart Capital for Impact
Businesses in Ecuador

Fondo Creas is the first impact investment fund in Ecuador comprised entirely of domestic capital. The Fund aims to address finance gaps in a country with the highest early-stage entrepreneurial activity in the Latin-American region. It does so through a flexible and patient financial instrument that grants freedom to entrepreneurs while ensuring financial returns to the Fund and promoting impact at scale.

Fondo Creas

Smart Capital for Impact Businesses in Ecuador



LOCATION:
Ecuador



YEAR OF FOUNDATION:
2019



TYPE OF INVESTOR/SILO:
Funds and asset managers



SECTORS:

- Entrepreneurship and small and medium-sized enterprises (SMEs).



CONTINUUM OF CAPITAL:

Impact investing



MAIN PARTNERS:

- Sistema B
- Alianza para el Emprendimiento e Innovación.

SDGS¹:



MOTIVATION OR PROBLEM TO BE SOLVED

Ecuador has one of the highest per capita entrepreneurship rates in the world; yet, there is a significant gap in access to financing for entrepreneurs (*missing middle*).



NON-FINANCIAL SUPPORT OFFERED:

- Strategic and operational strengthening
- Impact management and measurement
- Corporate governance.



FINANCIAL INSTRUMENT:

Equity

RESOURCES INVESTED OR DONATED:

USD 5 million

with investment tickets ranging from USD 80,000 to USD 200,000.



FINAL BENEFICIARIES:

Triple-impact businesses.



IMPACT:

- Reduction of CO₂ generated per product
- Improvement of **equipment** and **processes** to reduce energy consumption
- Compensation projects that **engage** the community
- Reduction of irrigation, **use of rainwater**
- Recovery of oils and **polluting materials**
- Use of waste in the **circular economy**
- **Innovation** in materials
- Sustainable agriculture based on reducing resources used in production and maintenance of **ecological balance**
- **Access** to health services
- **Gender equity** based on leadership
- Direct and indirect **job creation**

¹ While these are the main goals, Fondo Creas may invest to support the advancement of any SDG.



OVERVIEW

Ecuador has one of the highest rates of entrepreneurship in Latin America and the world. It is estimated that during the last decade close to 30% of Ecuadorians had initiated the process of starting a business, or owned one that was less than 42 months old, which makes up the highest Total early-stage Entrepreneurial Activity (TEA) in the region, followed by Peru and Chile.² The main motivation for Ecuadorian to become entrepreneurs lies in the need to earn an income, especially due to the limited opportunities offered by the local labor environment.³ This means that TEA due to necessity is 15.36 percentage points higher in Ecuador than the average in Latin America and the Caribbean.⁴

Despite the efforts of the Ecuadorian government to promote innovation as an instrument to transform the country's productive matrix,⁵ including the creation of the *Fondo Emprende: Ecuador Productivo* Fund,⁶ the financing context in the country is far from robust—among other things due to the scarce engagement of the private sector, as well as the existence of legal and bureaucratic barriers that restrict entrepreneurs' access to diverse financial instruments.

The *Fondo de Inversión de Impacto Capital Responsable para el Emprendimiento Ambiental y Social del Ecuador (Fondo Creas)* was created in this context in 2019 as the first impact investment fund in Ecuador, financed entirely by local investors. Its purpose has focused on helping the financing and scaling of



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² ESPAE, Escuela de Negocios (2017). Emprendimiento: 10 años sin evolución sustancial. Accessed at: <https://www.espae.edu.ec/noticias/emprendimiento-10-anos-sin-evolucion-sustancial/#:~:text=DIEZ%20A%C3%91OS%20SIN%20EVOLUCI%C3%93N%20SUSTANCIAL&text=La%20TEA%20continua%20alta%20aunque,estar%20en%20etapa%20de%20proyecto>

³ Calle, J., Calle, S., & Zambrano, E. (2020). Entorno emprendedor en Ecuador y el impacto de la ley orgánica de emprendimiento e innovación. Accessed at: <https://www.eumed.net/actas/20/desarrollo-empresarial/23-entorno-emprendedor-en-el-ecuador.pdf>

⁴ Global Entrepreneurship Monitor (2018). Resultados de Ecuador para el 2017 (p. 29). Accessed at: <https://www.gemconsortium.org/file/open?fileId=50078>

⁵ Alianza para el Emprendimiento e Innovación (2013). Ecuador, un país emprendedor e innovador en el 2020. Accessed at: https://unctad.org/system/files/official-document/epf_npd02_Ecuador_es.pdf

⁶ This fund had a total of USD 10.5 M to promote productive innovation, working under a seed capital scheme to develop social businesses.

the impact of social and environmental businesses located in the *missing middle* of financing⁷. Based on this purpose, Fondo Creas has sought to build a diversified investment portfolio among different sectors, such as tourism, the circular economy, and sustainable agriculture.

Over the past three years, Fondo Creas has provided investment and technical assistance to early-stage social and environmental businesses⁸— a stage considered critical for their consolidation—and whose annual turnover does not exceed USD 1 million. Before this fund was created, Ecuador did not have locally-financed impact investment options for social businesses. Fondo Creas, thus, emerged as a pilot fund for these purposes, accumulating a funding target that amounts to USD 5 million. By April 2022, the fund's committed capital was USD 1.8 million at the first closing. The 20 active investors in the fund at that time are Ecuadorian individuals who make their contributions independently. Progress is expected to be made to achieve the remaining USD 3.2 million in 2022.



INNOVATIVE FACTORS

At least three innovative aspects can be highlighted when analyzing Fondo Creas: the financial instrument used to support entrepreneurs; the investment process; and the dimensions of non-financial support. Regarding the first, according with Ecuadorian law, the Fund has been structured as an investment trust, making equity investments only in corporations (SAs) or simplified stock companies (SASs). The investment is, therefore, made as redeemable equity, which allows investments in a model whereby entrepreneurs can buy back the shares acquired by the Fund between one and five years after the investment, as shown in figure 1. Investment amounts range from USD 80,000 to USD 200,000, accounting for a minimum of 10% and a maximum of 49% of the total value of the business's equity.

The repurchase of the investment takes place under flexible terms in agreement with each entrepreneur

7 The missing middle refers to the group of micro, small, and medium-sized enterprises (SMEs) that are too large for microfinance funding and too small for traditional investors or even impact investors. To learn more about the term, see: <https://www.upayasv.org/blog/the-missing-middle-is-more-complicated>.

8 Six months to two years since their creation.

and based on their capital needs and repayment capacity. In the event that entrepreneurs have an outstanding early performance, they are allowed to reinvest in scaling their businesses. In any case, the repurchase is expected to translate, at a minimum, in the full buyback of shares for the agreed price. In the best-case scenario, the Fund expects a three-time initial investment return over a period of five years. A performance matrix is used to estimate these cases, which calculates the assigned rate of return based on the business's sales growth and the years that the non-financial support lasts.

"It proved difficult to sell the venture capital concept in this country. Many investors decided to wait and see how it goes, [as] it is a new experience." Corinne Lebrun, Manager and Founder, Fondo Creas.

The business selection scheme has well-defined stages. To start with the application, Fondo Creas has an online form from where entrepreneurs can consult the criteria and the Fund's investment thesis.⁹ Applicants are expected to show an efficient performance in terms of the financial indicators evaluated, especially in terms of profitability, operation, liquidity, and indebtedness as eligibility criteria laid out by the Fund. The companies, organizations, enterprises, and social businesses that apply are encouraged to provide detailed information on their main environmental and/or social impact milestones integrated into their business models.

The next step is a meeting where the parties introduce themselves in greater depth, highlighting the Fund's operating model and impact goals. When there is good fit, the parties work together for one or two months on an initial proposal that will be submitted to the larger investment committee. During the years of the Fund's operation, thirty companies have been addressed this body.

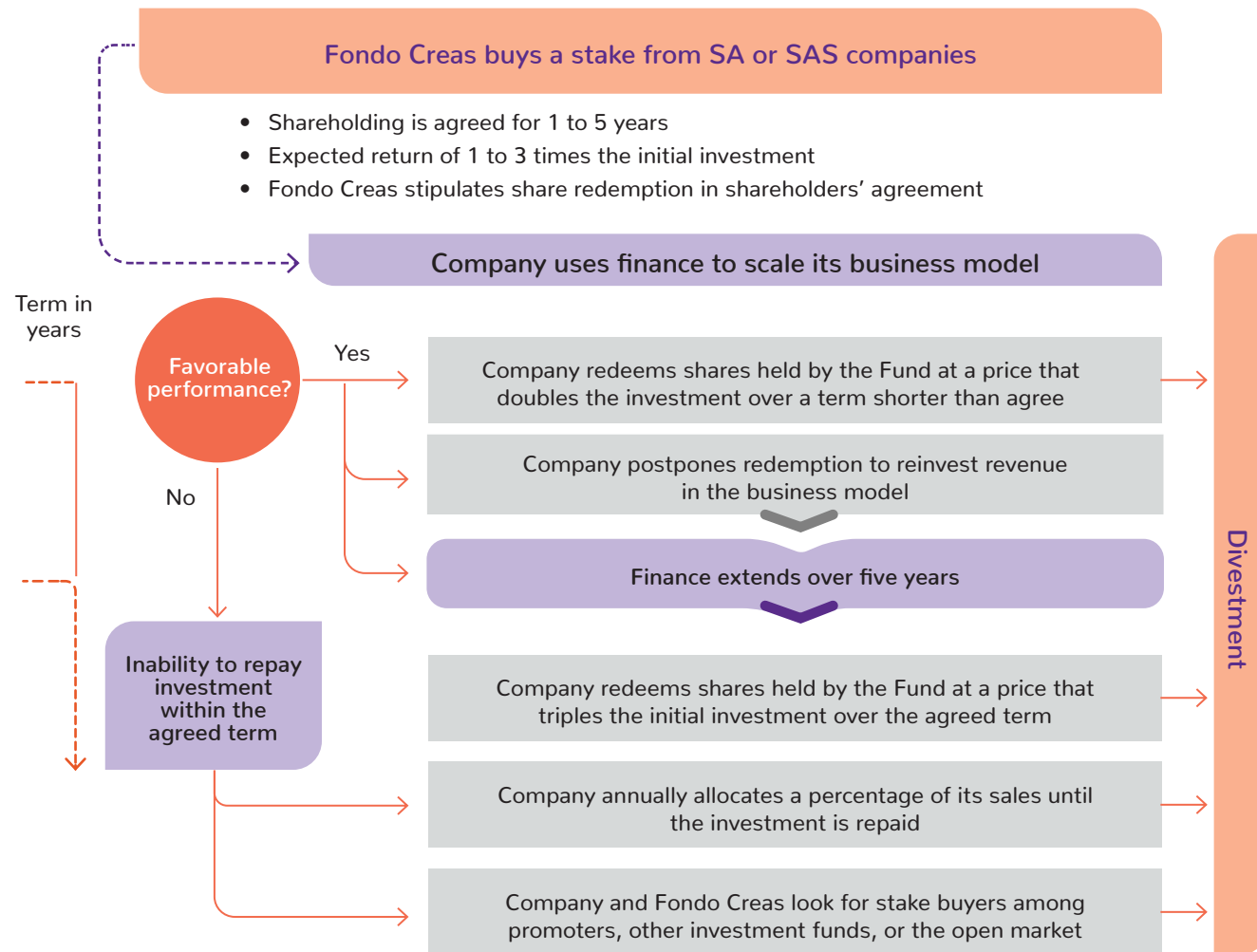
The investment committee has an evaluation grid to identify the market, the business opportunity, the competition, and available performance figures; and based on this information, the investment proposal is put to the vote. In the case the decision is positive, the due diligence is carried out with the legal support of a law firm with considerable experience advising social businesses. It is expected that applicants are up to date with their obligations, and that there is no apparent risk for the Fund to become



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⁹ Available at: <https://creasecuador.com/>

Figure 1. Reimbursable capital structure as employed by Fondo Creas.



Source: prepared by the authors based on information shared by Fondo Creas in an interview, March 2022.

a shareholder, especially regarding the legal, tax, financial, environmental, and labor obligations of the financed company. Furthermore, the Fund performs an impact due diligence, in which the business is requested to complete the B Analytics from B Corps tool¹⁰ to evaluate its performance within the five dimensions that it proposes,¹¹ and to identify areas for improvement and build a roadmap. There is also a financial due diligence with the purpose of having a closer look into the figures and projections of the business to be financed.

Based on the above, an agreement is established with all the conditions to be addressed, committing to each of the terms. The purchase, reinvestment, penalties, and corporate governance requirements are adjusted in the proposal, which is finally submitted to the formal investment committee to obtain final approval. Additionally, this agreement sets out an accompanying fee to help cover the Fund's administrative costs. This fee is between 8% to 9% of the total financing and is calculated based on the current average passive interest rate and the lending rate for small enterprises. The rate may be higher if the business does not meet the impact goals defined in the shareholders' agreement, and may even be doubled. As of May 2022, this accompanying rate covered 50% of the Fund's operating and administrative costs. The remaining percentage is covered by investors as part of the capital contributions. It is expected that, as the Fund's portfolio expands, the accompanying fee will be able to cover all operating costs.

Finally, in addition to the investment scheme described above, Fondo Creas provides non-financial support to the social businesses it invests in in two key dimensions. On the one hand, it participates in each business's board of directors and keeps a seat for as long as it has a share. Generally, businesses do not have a board of directors before the investment is agreed. Therefore, the Fund helps to consolidate the foundations for solid corporate governance to scale impact more efficiently, being the first and only external member in its composition.

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¹⁰ For more information, see: <https://bimpactassessment.net/es/mide-lo-que-importa>.

¹¹ Governance, Employees, Environment, Community and Customers. For more information, see: <https://sistemab-caminobmipymes.thinkific.com/courses/camino-b-mipymes>.

Participation in corporate governance is mainly focused on strategic planning exercises with monthly meetings scheduled for this purpose. The Fund's representation on the board of directors is required to have veto power, and the representative's considerations be taken into account when relevant decisions are made. However, this is not intended to impose a restrictive approach to strategic decisions, but rather to formalize planning and accountability processes, without the Fund being perceived as an external control body.

So far, the Fund's director, Corinne Lebrun, is the one who participates directly in the boards of directors of the Fund's investees. It is expected that, as the investment portfolio grows, it will be the investors themselves who will become involved. The Fund's participation consists mainly of mentoring based on the areas of knowledge and expertise of entrepreneurs, ranging from operations to finances and their business model.

The second relevant dimension of non-financial support has to do with the technical assistance and goal alignment to define the business's impact monitoring and evaluation practices. Each portfolio enterprise has clearly-defined impact goals, which are in line with the Fund's own goals.

Fondo Creas supports its portfolio enterprises through the Camino +B training program, delivered by Sistema B, that seeks to help them be certified as B Corporations.¹² Sistema B is one of the Fund's main partners, especially as a result of the free training it offers,¹³ which allows for the alignment of impact measurement metrics.

It is important to note that if the entrepreneurs fail to meet their impact goals, there is an early divestment clause that binds them to purchase the shares held by the Fund.

¹² Fondo Creas expects at least 90% of its portfolio enterprises to become certified. Currently, 4 out of 6 portfolio companies have said certification.

¹³ For more information, see: <https://sistemab-caminobmipymes.thinkific.com/courses/camino-b-mipymes>.



LESSONS

Since its creation as the first impact investment fund in Ecuador, Fondo Creas has accumulated valuable experience in supporting and guiding social and environmental businesses in the country. By establishing itself as a pioneering fund, with a financial instrument specially adapted to the country's legal framework, Fondo Creas has paved the way for future impact investment schemes in Ecuador—as has recently happened with IMPAQTO Capital, which has had experience in financing startups in the region and has focused on the Ecuadorian context.

Moreover, Fondo Creas's active participation in each investee's corporate governance has enabled the Fund to build a close relationship with its operation, and allowing it to intervene in strategic decisions that can help scale its impact. The Fund expects investors to become more involved in each investee's board, focusing efforts on planning and accountability processes and preventing participation from becoming taxing or controlling.

Targeting a particular industry could hinder financial returns and impact, therefore, the Fund does not restrict its investment to a particular sector, allowing to diversify its portfolio and stakes in different markets. This has led to satisfactory early results. While the Fund's financed businesses have not yet completed exits, one of the supported businesses redeemed 30% of Fondo Creas's shares in 2022, thanks to an outstanding performance as a result of the first year of non-financial support. Additionally, the consolidation of a diverse portfolio has been a significant challenge in standardizing the impact measurement criteria, for which Fondo Creas has collaborated with Sistema B to fill in the gaps, although implementation is still ongoing.

Fondo Creas has worked efficiently considering the Ecuadorian legal system and the resolute involvement of current investors. Going forward, it will be important for the Fund to have a greater number of investors who believe in the potential of impact investment, dare to explore new territories, and are willing to take greater risks. The possibility of exploring new financing instruments or a wider range of social businesses, whether locally or regionally, will require the structuring of a new fund.



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