



# ADOBE CAPITAL MEXICO

Supporting Growth of Social Enterprises

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## I. Impact Investing Ecosystem

### 1.1 Impact Investing in Latin America

Impact investing has become a hype for both private and non-profit sectors, and this has also become true in Latin America. During the last ten years, impact investing in the region has gone from a handful of specialized international players investing primarily for diversification purposes to more than 50 players. These investors and fund managers are both local and international, and have a diverse portfolio by investing across different phase of the business venture funding life cycle to various sectors and geographies.<sup>1</sup>

Even though impact investing is still in the early stage of development in Latin America, the market has been showing rapid growth. In 2014, Latin America consisted for approximately 19% of the global impact investment market, with a total of US\$2 billion in committed capital. The region represents approximately 16% of invested capital, which is US\$800 million. Currently, a conservative estimation of available capital for impact investing for the region is US\$ 2.3 billion. That contains all of the US\$1.2 billion managed by firms headquartered in Latin America, and 15% of the \$7.2 billion managed by firms headquartered outside the region.<sup>2</sup>

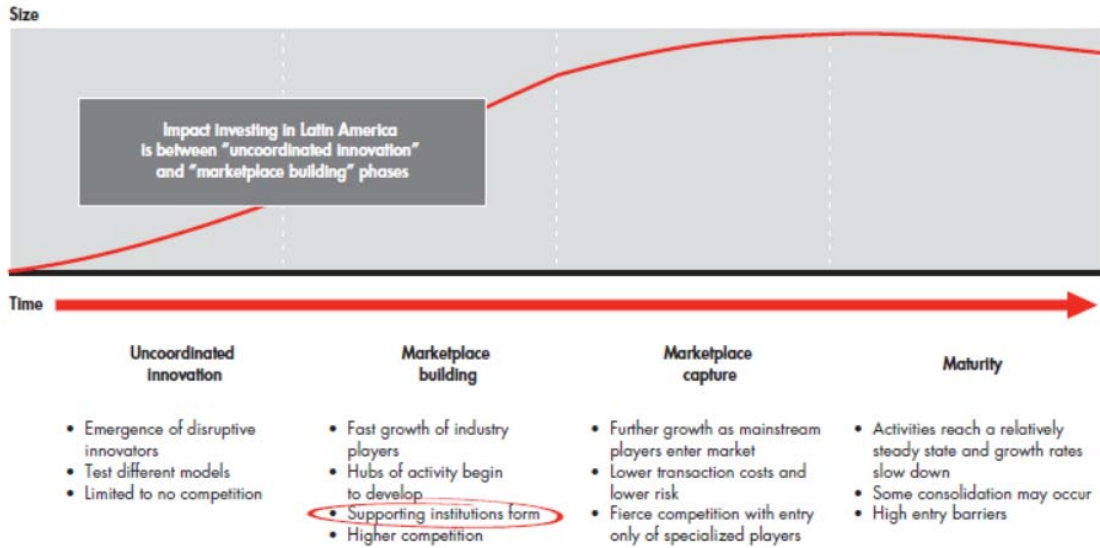
Initial impact investment in Latin America were made from firms abroad. However, recent trends are showing increase in locally created and development impact funds. This shift is not only critical for the growth of the investments in both numbers and amount, but they also tend to provide capital to earlier stages in the social business venture cycle than do foreign-based funds. Local funds are better positioned to navigate the legal and regulatory challenges which is considered as a major constraint for further growth in the impact investing landscape in the region. In the cycle of market development, the industry in Latin America is still in its early stage. It is moving from “uncoordinated innovation” phase into “marketplace building”. There are still some key ingredients that are still missing, including the institutional infrastructure and regulations needed to support the marketplace development.

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<sup>1</sup> “The State of Impact Investing in Latin America: Regional trends and challenges facing fast-growing investment strategy”, Andre Leme, Fernando Martins and Kusi Hornberger, Bain & Company, 2014

<sup>2</sup> “The Impact Investing Landscape in Latin America: Trends 2014&2015. Special focus on Brazil, Colombia, and Mexico”, LAVCA, Aug 2016

Figure 1: Impact Investment Market in Latin America



Source: "The State of Impact Investing in Latin America: Regional trends and challenges facing fast-growing investment strategy", Bain & Company

The countries with the most deals in number and amount in the region are Brazil, Mexico, Colombia, and Peru. Between 2014 and 2015, these four countries as totaled in US\$386.7 million in investment with 132 deals.

Figure 2: Number of Deals and Size by country, 2014-2015

Country	Number of Deals	Total Invested (US\$ M)	Average Deal Size (US\$ M)
Brazil	48	\$68.9	\$1.5
Mexico	45	\$64.7	\$1.6
Peru	23	\$210.4	\$11.7
Colombia	16	\$32.7	\$2.2
Nicaragua	10	\$24.1	\$2.4
Bolivia	8	\$24.6	\$3.1
Ecuador	7	\$199.6	\$28.5
Costa Rica	5	\$211.0	\$42.2
Guatemala	5	\$1.7	\$0.3
Paraguay	3	\$93.8	\$46.9
El Salvador	3	\$8.4	\$2.8
Chile	3	\$1.1	\$0.4
Other	11	\$10.8	\$4.7

Source: The Impact Investing Landscape in Latin America 2014-2015, LAVCA












## 1.2 Impact Investing in Mexico

Since 2012, the impact investing industry in Mexico has been booming with investors understanding the market as a hub for impact entrepreneurship activity. With Mexico's large and diverse economy, the local entrepreneurial environment has been strengthening. Such vibrant ecosystem has driven the development of social impact enterprises as well. Most players are relatively new with the industry going through growth and changes.

Impact investing in Mexico has seen a quite a bit of institutional support and promotion from the government. Government regulations and the creation of the National Institute for Entrepreneurship (INADEM) have stimulated the growth of private equity markets and are accelerating entrepreneurship in Mexico. Recently, Mexico has also joined the G8 Impact Investment Task Force and created the National Advisory Board to advocate and strengthen the sector. In addition, the close relationship that Mexican corporations have with their US partners allow them to be important players in the local impact investing market.

Impact investors headquartered and investing in Mexico manage a total of US\$392 million. In addition, international firms that invest in Mexico manage US\$6.3 billion. The largest sectors that closed deals during 2014 and 2015 are financial inclusion, health care, agriculture, community development, and energy.

Figure 3: Deals and Amount in Mexico by Sector, 2014-2015

Sector	Number of Deals	Total Capital Deployed (US\$M)	Average Deal Size (US\$M)
 FINANCIAL INCLUSION (NON-MFI)	8	\$11.1	\$1.6
 FINANCIAL INCLUSION (MFI)	7	\$31.8	\$4.5
 HEALTH	6	\$5.9	\$1.2
 AGRICULTURE	5	\$5.2	\$1.0
 COMMUNITY DEVELOPMENT	4	\$0.3	\$0.1
 ENERGY	3	\$2.5	\$0.8
 RENEWABLE ENERGY	3	\$0.8	\$0.3
 TECHNICAL ASSISTANCE SERVICES	3	\$0.5	\$0.2
 EDUCATION	2	-	-
 HOUSING	2	-	-
 OTHER	2	-	-

Source: The Impact Investing Landscape in Latin America 2014-2015, LAVCA

Mexico-based firms tend to seek higher return rates than international investors. In addition, it has been shown that post-investment engagement is critical to the success of social enterprises.

Providing strategic contacts, understanding customer and market data, and offering recruitment support represent a few things investment firms are increasingly doing to support their portfolio.

There is also room for improvement. It is necessary that the private sector plays a significant role in the impact investment ecosystem by investing in, buying, and scaling social enterprises. The government should also get more involved by defining and regulating impact measurement in order to create policies that incentivize impact investing. It is also crucial to create a legal structure where impact enterprises can operate. With more tax incentives and developed legislative systems in place, the government can also participate in innovative ways of social financing such as green bonds or social impact bonds. Geographically, most impact investing seems to be very centralized in Mexico City, with very little activity in other regions of the country. More activities should be fostered outside of the capital.<sup>3</sup>

## **II. Adobe Capital**

### **2.1. Fund's History and Progress**

#### Adobe Capital and Adobe Social Mezzanine Fund I

Established in 2012, Adobe Capital is a fund manager headquartered and investing in Mexico. In addition to providing convertible loans to social enterprises, the partners are active members in portfolio company boards, providing business acumen and building networks. These financial instruments along with fund managers have proven to be well-suited for impact entrepreneurs who aim their companies toward long-term growth rather than committing to be acquired by strategic investors.

Adobe Capital is currently the only Fund in Latin America that offers mezzanine structures that incorporate royalty-based repayment that responds to the needs of local entrepreneurs. In 2012 Adobe Capital launched its first impact fund, Adobe Social Mezzanine Fund I (ASMF I), which raised US\$20 million from international investors and has carried out seven investments in sectors with strong development effect such as health care, education, low-income housing and energy.<sup>4</sup>

#### Adobe Mezzanine Fund II

Currently, Adobe is fund raising for Adobe Mezzanine Fund II (AMFII) and implementing lessons learned from its first fund. One primary learning from the ASMF I has been a strategic evolution in impact measurement and management. Adobe regularly reviews the IRIS metrics reported by its investees to confirm they generate value and reflect on-the-ground impact. It also requires that all portfolio companies to pursue a GIIRS rating within six months of receiving investment

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<sup>3</sup> "The Impact Investing Landscape in Latin America: Trends 2014&2015. Special focus on Brazil, Colombia, and Mexico", LAVCA, Aug 2016

<sup>4</sup> <http://www.adobecapital.org/>

capital. Adobe thinks that such changes offer greater clarity around each company's impact intentions and impact measurement practices.<sup>5</sup>

AMF II will build on the first fund's innovations by designing products that match fund expectations, portfolio companies' needs, and impact entrepreneurs' profiles. Most investments will continue to be structured as revenue-based convertible loans, which have strong demand from the target market segment. Such structure allows entrepreneurs to avoid upfront dilution of ownership in the companies and do not require a collateral. The cost of debt is variable rather than fixed. The Fund also retain a senior position within the company's balance sheet and has the option to convert its debt into equity to participate in future upside. AMF II may make equity investments in the case that the instrument is fully aligned with the company's needs, the entrepreneur's profile and vision for company growth, and well-defined exit strategies.

### The Team

Adobe Capital has two partners. Erik Wallsten is Co-Founder of Adobe Capital and Partner at New Venture. Prior to joining New Ventures, Erik had extensive experience in venture capital, private equity and real estate sectors in Mexico. Erik received an MBA from the University of Chicago Booth School of Business and holds a Bachelor of Science degree in Industrial Engineering with Honors from Universidad Iberoamericana.

Rodrigo Villar launched New Ventures Mexico in 2004 and was instrumental in the creation of Las Paginas Verdes, the only sustainable product directory in Mexico and one of the largest in the world. As an Ashoka fellow, Rodrigo is widely recognized as one of the country's leading figures on social and environmental sustainability, and accordingly received the 2008 UBS Visionaries Social Entrepreneur of the year award. Rodrigo received an MBA from Royal Melbourne Institute of Technology in Australia and holds a Bachelor of Accounting and Financial Management degree from the Tecnologia de Monterrey.<sup>6</sup>

## **2.2. New Ventures and LIIF**

### New Ventures Mexico

Over the past 12 years, New Ventures has been contributing to the development of the ecosystem for social and environmental enterprises in Mexico. Adobe Capital leverages its close relationship with New Ventures for strategic activities. New Ventures screened and identified over 3,000 leading small and medium sustainable businesses in Mexico that are expected to experience high growth in the coming years. Enterprises that have gone through New Ventures' acceleration program also present themselves as potential investees for Adobe.

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<sup>5</sup> "Impact Investing Trends: Evidence of a Growing Industry", GIIN, December, 2016

<sup>6</sup> <http://www.adobecapital.org/>

## Latin American Impact Investment Forum

The Latin American Impact Investment Forum (LIIF) is an event organized by New Ventures that has positioned itself as the most important gathering in Latin America to strengthen the social entrepreneurship and environmental and impact investing ecosystem.<sup>7</sup> The forum is held every year and has rapidly increasing participation over the years.

### **2.3. Performance and Portfolio Companies**

#### Performance

Now in its fourth year, ASMF I has begun to see steady repayment in its portfolio. The Fund is at its early stages of maturity with portfolio companies not yet having repaid their loans entirely and with only one exit to date. Looking at comparable funds in the region, it is estimated that the Fund's internal rate of return (IRR) would be in the 20-30% range.

#### Portfolio Companies

- FINAE, S.A.P.I. de C.V. SOFOM ENR

FINAE is a financial institution that grants student loans to young Mexicans who are part of the base of the pyramid and want to study a bachelor's degree or a postgraduate course in any of the universities within Mexico. FINAE has designed student loan products that suit the market needs.<sup>8</sup> Created in 2006, FINAE has granted collage loans to more than 7,500 students, out of which 88% belong to the Base of the Pyramid segment. Adobe Capital has 14.3% of the ownership and Rodrigo Villar has a seat on one of the seven Board of Directors.

- Biogramimex, S.A. de C.V.

Biogramimex manufactures cleaning supplies that are 100% biodegradable in 30 day by using natural raw materials.<sup>9</sup> The investment was in the form of a senior convertible loan.

- SalaUno Salud, S.A.P.I. de C.V.

With the mission to eliminate unnecessary blindness in Mexico, SalaUno Salud provide low cost diagnostic services.<sup>10</sup> As of end of 2016, SalaUno Salud had expanded to 10 diagnostic clinics. Adobe Capital has 11.3% of the ownership and Erik Wallsten has a seat on the seven-person Board of Directors.

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7 <http://nvgroup.org/inversiondeimpacto/en/conoce-mas-el-flii-2/>

8 <http://www.finae.com/en/index.html>

9 <http://www.biogramimex.com/greenland.html>

10 <http://www.salauno.com.mx/know-salauno.html>

- NATGAS Queretaro, S.A.P.I. de C.V.

Founded in 2012, NATGAS Queretaro seeks the orderly and scalable development of the Natural Gas Vehicle market in Mexico.<sup>11</sup> The company is growing fast with two investment offers. Adobe Capital owned roughly 6% and has a convertible loan with the company and Erik Wallsten is on the Board of Directors. With the company experiencing rapid growth and need of larger capital, Adobe Capital exited this investment in May of 2017.

- Comunidades Que Renacen, S.A.P.I. de C.V.

The company provides affordable housing options for low income families in three northern states of Mexico.<sup>12</sup> The company has been looking into expanding to Guadalajara city. Adobe Capital has provided convertible loans and has representation on the Board.

- Vehiculos Liquidos Financieros, S.A.P.I., SOFOM ENR (Velifin)

Based in Mexico City, Velifin is a wholesale provider of financing solutions to SOFOMs (unregulated financial intermediaries) and other non-banking financial institutions (NBFIs) whose end clients are local SMEs. This investment totaled MXP\$55 million (US\$2.9 million) in exchange for 33% of Velifin's equity.

## **2.4. Measuring Impact**

When selecting portfolio companies, Adobe Capital favors companies with impact metrics directly linked with key operational or financial metrics, such as number of clients, volume of sales, or revenues directly showing social or environmental impact for the type of client, product, or service that it provides. This is not only a way to ensure that the social or environmental missions are built-in to companies' core business models, but also reduces additional costs of measuring social and environmental impacts since these metrics are already tracked to assess businesses' operational and financial success.

### **III. Innovative Structures and Exit**

Impact investing is different from traditional venture capital or private equity. In addition, traditional exit strategies of IPO or sales might not be in the best interest of the entrepreneur or for the mission lock of the enterprise. Therefore, innovative structures to accommodate the needs of the entrepreneurs and different approach to deal structuring should be implemented.

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<sup>11</sup> <http://www.natgas.com.mx/index.html>

<sup>12</sup> <http://provive.mx/referidos/>



### 3.1 Innovative Structure

#### PymeCapital

According to the World Bank, nearly 65% of small-sized firms and more than 50% of medium-sized firms in Mexico face growth limitations due to a lack of financing, figures which are higher than those of other countries in the region, such as Nicaragua, Peru, Bolivia, Brazil, and Venezuela.

One fund that has an innovative structure to effectively tackle this gap is PymeCapital.<sup>13</sup> PymeCapital, based in Bolivia, is a private equity, venture capital, venture debt and mezzanine investment firm. Founded in October 2007, PymeCapital has investment and financing operations in Bolivia and Nicaragua, and has initiated activities in Guatemala, Honduras and the Dominican Republic. The Fund seeks to invest in agribusiness, manufacture, tourism in Latin America and generally takes between 20% and 49% stake in its portfolio companies.<sup>14</sup> PymeCapital strives to generate both financial and non-financial impact through focusing on enterprises that are socially and environmentally responsible.<sup>15</sup>

PymeCapital provides innovative financing to add value to the operations for sustainable businesses. Their financial instruments can be used independently or in combination.

- **Venture Capital Investments (Long term):** The investment generates income for investors through dividends and capital gains. In order to apply for this instrument, the enterprise has to meet the following criteria.
  - Participation of the ownership in the company between 20% and 49% of the shares
  - Agreements that define the conditions of exit of the fund, which are agreed upon when PymeCapital makes its investment in the company
  - Dividends versus capital of 4 x 1
  - Put & Call Options
- **Joint Ventures (Short and medium term):** Requirements to apply for a Joint Venture are below.
  - PymeCapital participates up to 60% of the investment, earmarked for working capital financing
  - Conditions of exit are agreed at the beginning of the investment
  - Flexible scheme of guarantees
- **Loans (Short, medium and long term):** Debt financing are made with the conditions below.
  - Loan amount is subject to the project's needs, between US\$150,000 and US\$1,000,000
  - Maximum periods of 10 years and grace periods do not exceed 2 years
  - Interest rate negotiated based on market rate

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13 <http://www.pymecapital.org/web/>

14 <http://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=140793733>

15 <https://www.oikocredit.coop/funding/equity-investments/equity-partner/10926/pymecapital-latin-american-fund-sa>

- Flexible scheme of guarantees
- The resources disbursed will not be applied to expenditures that do not contribute to the operation of the enterprise

PymeCapital has approximately US\$5.2 million in assets and also provides non-financial support. Technical assistance is provided in the areas of governance, productivity, and to implement Social Audit System (SAS) which is PymeCapital's own social and economic impact management tool.

### **3.2 Exit**

#### Adobe's Exit Strategy

With the quasi-equity structure, the loan repayments effectively become progressive "exits" in which the fund gradually diminishes its potential convertible equity in its investments. In cases where a company valuation grows at a faster rate than expected and provided there are interested buyers, the Fund will have the possibility to convert their debt into equity positions to pay off the remaining loan balance and profit from a sale.

#### Other Exit Strategies

Options for equity investors to achieve liquidity are staged dividend payments and redemption based exits. Staged dividend payments to investors can achieve partial or complete liquidity through requiring a company to make payments until they achieve a specified cash-on-cash return target. These payments are variable as they are linked to a percentage of revenue or cash flow. This links the timing of liquidity to the company's performance. Normally there are certain limits to the returns, but in case the enterprise successfully completes a traditional exit the investors have a mechanism to participate in a higher return.<sup>16</sup> A redemption clause allows the company to agree on buying back investor's equity stake in the business at a specified point in time at a pre-agreed price. Such clause of proactively providing options for liquidity, entrepreneurs can make their investment opportunity more persuasive to impact investors.<sup>17</sup>

Debtholders are also adapting structures that will give more flexibility to the entrepreneur. One form of this is linking debt repayment to percentage of revenue or cash flow. Also, a longer term horizon, such as 10 years for repayment with a grace period of 18-24 months can be helpful for the entrepreneur. Company friendly terms such as no pre-payment penalty can also be helpful.

For investors to avoid exit issues, revenue share agreements that offer investors to participate in the growth of a company without purchasing ownership is a compelling option. These structures entitle the investor to a certain percentage of a company's revenue stream over the agreed upon period. Most revenue share agreements have a finite time frame and often a capped multiple to the investor.

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<sup>16</sup> "Innovative Deal Structures for Impact Investments", Diana Propper de Callejon and Bruce Campbell

<sup>17</sup> <http://www.bluedotlaw.com/rethinking-exits/>

#### **IV. Adobe Capital in the Impact Investing Space and Recommendations**

Adobe Capital has proven itself to be an innovative fund playing a critical role during the early development stage of impact investing in Mexico and in Latin America. With its highly-experienced team and leveraging its strategic partnership with New Ventures, ASMF I has successfully fund raised and invested in well-established impact enterprises. The Fund has been assuring the investees are impact driven by requiring GIIRS ratings to be updated periodically. The upcoming challenges for ASMF I would be to help investees exit in a way that is aligned with the entrepreneur and show impact at the Fund level. Unlike entrepreneurs in the U.S. that seek an IPO or a strategic sale after a certain period of operation, many entrepreneurs in Mexico prefer to grow the business for a longer time. This is especially true with social enterprises that are mission driven and entrepreneurs feel a moral connection to the company and its cause.

The Fund can create a favorable exit structure by offering self-liquidating products and including staged dividends or redemption based exits. Another way Adobe can provide longer term investment and partnership to the enterprises is to create a holding company. One example of this is Bridges Fund Management's is Bridges Evergreen Holding.<sup>18</sup> Evergreen was created as a successor to Bridge Fund Management's fund that finances early stage social businesses to provide equity and quasi-equity investments for long-term, patient capital. Since Evergreen is structured as a holding company and not a fund, there are no requirement to seek exit and it produces yields for investors through dividends and loan interests. Developing such structure could also allow Adobe to work longer term with the management teams.

Adobe Capital has plans for growth. Currently, the team is fund raising for Adobe Mezzanine Fund II for US\$40 million, which is twice the size of AMSF I. It expects the deal size to be larger, with median deals of US\$7-8 million. Also, Adobe Capital is planning to expand its investment geographically with 20% of AMF II portfolio concentrating outside of Mexico followed by Adobe Mezzanine Fund III which will have a regional focus. Adobe Capital believes and wants to prove that investing in social enterprises is more profitable than traditional venture capital funds. Moreover, Erik believes that with social enterprises having a competitive edge, impact investing firms should result in higher IRR. Adobe Capital intends to continue providing much needed funding for social enterprises that lack the access to capital for growth in the Latin American and Caribbean region.

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<sup>18</sup> <http://www.bridgesfundmanagement.com/for-investors/bridges-evergreen-holdings/>