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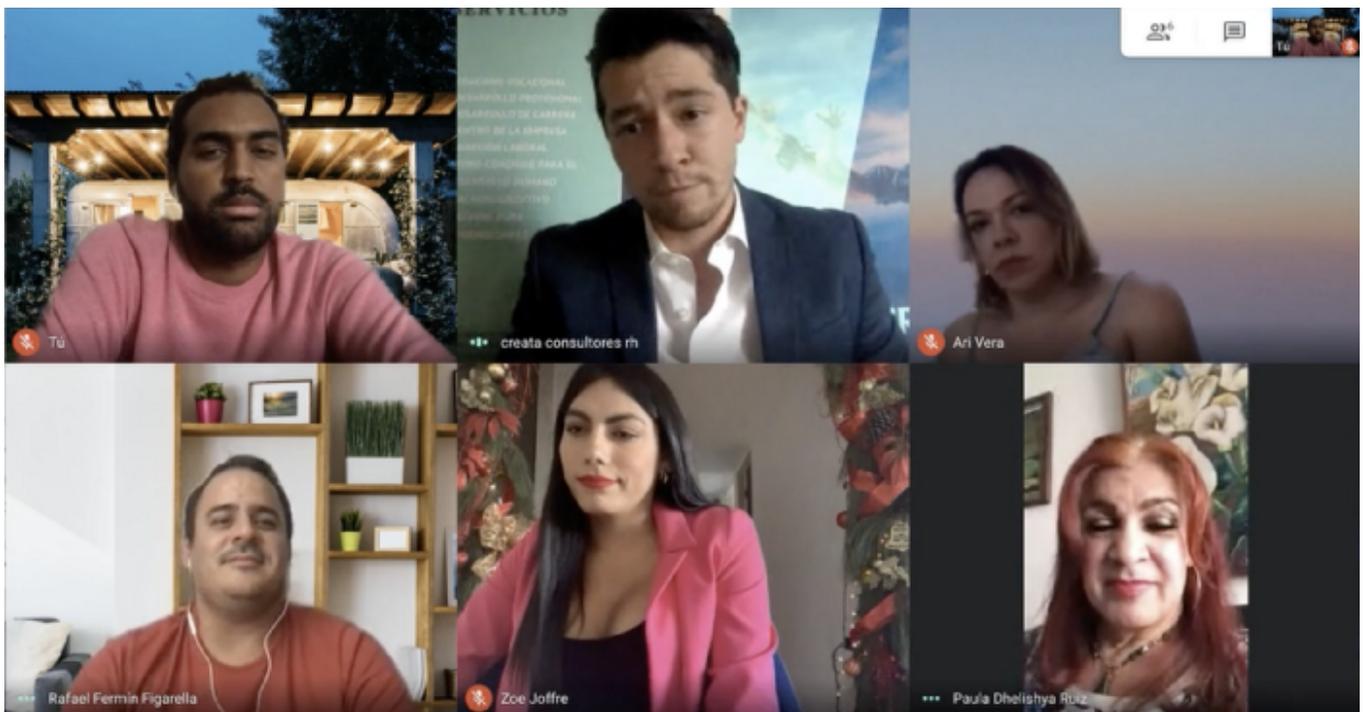


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Investing in LGBTQIA* Enterprises in Mexico - First Impressions

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Impact Assessment Panel Mexico. Photo Credit: FME LGBT+.

After months of discussions with our partners into launching a pilot programme in Mexico, we were faced with a new reality: Covid-19 had hit Mexico hard. By July 2020, the country was about to reach peak infection rates in the first wave, with a second wave already looming.

The economy was hurting badly; people were running out of money fast. The government was trying hard to keep things open, sometimes at the risk of a complete breakdown of the country's healthcare system.

We had to adapt quickly, and rethink our approach. Our initial plan to follow a similar format to [our pilot in South Africa](#) was no longer viable. Travelling to Mexico and moving around the country was out of the question.

Design

We were faced with the choice of either shelving the pilot until it was safe to travel again or going ahead, with a new design. Financing for small and medium enterprises is scarce at the best of times, and it was even harder to come by during this unprecedented time, with no clear end in sight. Hence, we decided to adapt and launch the pilot at the height of the pandemic's first wave – in late August 2020.

The entire application and assessment process had to be moved to a virtual format. Luckily, both our investment partner [Viwala](#) and our civil society partner [FME LGBT+](#) were ready to embrace this challenge.

Application

The application process is now entirely online. Entrepreneurs can apply directly through the website of either [Viwala](#) or [FME LGBT+](#) (which in turn links to Viwala). The application process takes no longer than ten minutes and includes requests for basic information about the company, such as its business model and tax number. This ensures the businesses are formally registered. Applicants also grant Viwala access to their tax information for the initial credit analysis (see next section for more).

To ensure a direct link to LGBTQIA* communities, only members of FME LGBT+ are eligible to apply. Membership is free for companies but includes an onboarding process to establish their relationship with the communities.

Assessment

Once the application has been submitted, [Viwala](#), our investment partner, is able to pull the company's historical financial data directly from the Mexican tax office (online). This ensures relatively high data accuracy and consistency, allowing an effective and swift credit analysis at scale. Following the financial assessment, the entrepreneurs are

invited to participate in a 30-minute call with one of Viwala's credit officers to discuss their business model and get a sense of their financial projections. If the business and financial analysis is positive, the entrepreneur will receive an indicative offer.

Once the indicative offer has been accepted, the entrepreneurs are asked to present their case to an impact assessment panel. The panel ascertains how the business might positively impact the LGBTQIA* communities and makes recommendations for improvements (e.g. formalised diversity, equity and inclusion policy, future hiring from the most marginalised LGBTQIA* groups). The recommendations are incorporated into the deal documentation as an integral part of the transaction. In cases where the panel does not see enough positive impact and find there to be little or no room for improvement, the process will stop. Each applicant is therefore required to meet business and financial criteria as well as the criterion of achieving a positive impact. Based on the financial and impact assessment, in a final step each transaction is presented to an investment committee. Dreilinden has one out of five votes on the committee and, as a last resort, the right to veto any approved transactions.

The panellists assessing the impact of a business are Mexican LGBTQIA* activists and representatives of the trans and gay communities. The panel was put together with the help of FME LGBT+, with a view to having significant representation from trans communities. Dreilinden is not part of that panel. We deliberately did not want to influence this part of the process as we think it is most valuable if the assessment is done independently and from a purely local perspective. Panellists are compensated for their time by Dreilinden.

We made the conscious decision to separate the financial assessment and the impact assessment. Each committee carries equal weight – if the business does not live up to the expectations of the credit committee or the impact assessment panel, there will be no loan. It was important to us to give each of these topics the necessary platform for their discussion by experts in the field. We also wanted to avoid any potential conflicts of interest, where one committee felt it had to compromise for the sake of the other.

Structure

In order to streamline the application, assessment and structuring processes, we decided to focus on a single investment structure: a revenue-based lending facility. This is a debt instrument where repayment of principal and interest is linked to revenue generated

(similar to a royalty model). The beauty of this structure is that it allows for seasonality and moves in parallel with a business's performance. During months when revenue is low, the absolute repayment amount is lower, and during strong months repayment is higher.

The total cost of the loan is fixed at the outset and includes a small due diligence fee. There are no additional charges (such as arrangement or early repayment fees) or administration costs, which often make it hard to determine the all-in costs for business owners. We also incorporated a rebate system into the structure – should the business be able to repay the loan more quickly than originally envisaged, it will receive a substantial discount on the interest rate. Until now, we have also limited the maximum tenor to 48 months.

The size of the loans depends on the credit analysis of the company applying. Loans to date range anywhere between MXN 400,000 (USD 20,000) and MXN 5,000,000 (USD 250,000).

Technical assistance

Ever since we started designing the pilot programmes, we had been planning on incorporating a technical assistance programme alongside any investment activity. The increasing economic uncertainty, however, highlighted the importance of supporting the entrepreneurs on their journey. In [our mentorship programme in South Africa](#) we experienced first-hand how entrepreneurs react and cope differently during these trying times. Hence, we wanted to ensure that the Mexican businesses we invest in receive the necessary support.

[FME LGBT+](#), through its extensive network of LGBTQIA* aligned mentors, is now offering targeted coaching for each of the entrepreneurs, depending on their impact deliverables as well as their own business and organisational needs. The mentors are by and large volunteering their time, with Dreilinden giving support with overheads and administration costs.

Partners

It would have been impossible to launch such a project at the height of a pandemic without our trusted partners in Mexico. [FME LGBT+](#) and [Viwala](#) have proved to be invaluable, and we are fully aware that without their teams' professionalism,

enthusiasm and help, this pilot would not have been possible. It was a challenging start as the three of us had never worked in this constellation before. Communication between everybody involved is critical to our mission, and we continue to improve, united by our common goal to increase access to finance for LGBTQIA* entrepreneurs.

Traction to date

We were pleasantly surprised by the response the revenue-based lending facility received from LGBTQIA* communities. Since the launch in late August, we have received over 110 applications from a wide range of businesses. Out of those, we have approved and disbursed four loans, with a further transaction in the final stages.

The most common reason (approx. 42%) why an application was unsuccessful is that business owners did not respond to our requests for an interview. We are yet to work out the causes behind that.

The second most common reason (approx. 40%) is the size of the businesses. Many had annual sales below MXN 250,000 (USD 12,500), which makes it extremely challenging for a company to sustain financing beyond a micro loan.

Initial observations and limitations

Temporary vs systemic change

The pandemic has significantly altered the environment we operate in. Business models previously considered tried and tested are no longer viable. This begs the question of whether market dynamics have changed for good or are simply experiencing a prolonged but temporary blip. This is certainly a challenging starting point from an investment perspective!

We are not under pressure to deploy capital, but at the same time we felt that if ever there was a need for financing, it was now. Hence, we opted to press ahead, despite the prevailing uncertainties. The revenue-based financing structure, combined with the technical assistance programme, provided us with the necessary security that we could manage our risks effectively without hollowing out the business or simply standing on the sidelines.

Reaching the most marginalised

As mentioned earlier, only members of FME LGBT+ are eligible to apply for financing at this stage. While membership is free for businesses, some time and resources are required for the onboarding process.

We are also concerned about the increasing digital divide: we recognise that not all entrepreneurs have access to the necessary online resources and information.

Both the membership requirement and the digital divide leave us with blind spots and ultimately limit our reach, in particular within the most marginalised communities.

Product

For the launch of the pilot, we decided to limit our offering to a single product. This allowed the process to be streamlined and effective, with the goal of providing applicants with an investment decision within two to three weeks. The smallest loan we have disbursed to date is for MXN 400,000 (USD 20,000). However, as noted above, a significant portion of applicants (40%) require even smaller loans.

Informal sector

All applicants must be formalised businesses in order to be considered. However, over 50% of workers in Mexico are employed in the informal sector, leaving a significant number of potential businesses without access to the programme. FME LGBT+ offers formalisation support, but labour regulations and the complexity of the system in general make it a challenging proposition. We are yet to crack this challenge and are still looking out for potential approaches.

Where do we go from here?

As human rights funders and impact investors, it is our duty to increase the resilience of LGBTQIA* communities. Philanthropic efforts and investment activity need to act in concert. Different forms of capital, from grants and investments to hybrid/blended solutions, are needed to support the establishment of more resilient and visible systems.

Initial data from our pilot in Mexico confirm (once more) that companies require different types of capital depending on where they are on their entrepreneurial journey. However, this requires a different approach and appetite for risk than conventional lending or investing. Financial inclusion requires philanthropic efforts and investment capital to work hand in hand.

We are exploring the possibility of expanding the suite of products on offer by adding, in an initial phase, another two products. The first is a revenue-based loan targeted at companies that have not been able to access any credit in the past and that generate revenue of around MXN 250,000 (USD 12,500). We are deliberately choosing to offer these small loans because of the significant demand we are witnessing from the entrepreneurs that apply to us. The second product is aimed at the most marginalised, who often have no other choice than to become entrepreneurs as other jobs are out of reach for them. This is shorter-term financing aimed at catalysing and accelerating the growth of the business. We will report back as soon as we have some initial findings on how this is working out.

About Stefan Bollier

Stefan is a member of Dreilinden's investment committee. He is the founder of Swiss based Impact Advisors LLC which is advising Dreilinden on the development and implementation of the foundation's impact investment strategy.

About Dreilinden

Dreilinden is a Hamburg-based foundation dedicated to advancing societal acceptance of gender and sexual diversity. Founded in 2007, Dreilinden has been at the forefront of supporting sexual orientation, gender identity and expression, and sex characteristics with grants and investments. Kindly note that Dreilinden does not accept any grant applications at this time.

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