Management Response

Enclude, now a Palladium Company, welcomes the findings and recommendations stemming from the learning-focused evaluation of the Variable Payment Obligation Program (VPOP). The report demonstrates early indications of the validity of the program's underlying theory of change: collateral-light cash-flow based lending products bundled with enterprise growth services (EGS) can enable small and growing businesses (SGBs) to expand. Borrowers indicated that the loan has enabled them to fulfil their financing needs more quickly, propelling growth. Similarly, EGS were largely viewed positively by the entrepreneurs, although they did need to be further customized depending on the business' characteristics. On the supply-side, BAC reported that the VPOP portfolio is profitable, although EGS costs are not fully covered by the fees embedded into the cost of the loan.

The onset of a severe economic and political crisis in Nicaragua in April 2018 derailed the expansion of VPOP. All bank lending ceased completely, and the economy contracted by nearly 5% over the next 9 months. While the adverse business environment negatively affected many VPO borrowers, they appear to have demonstrated more resilience than many other businesses in BAC's SME portfolio.[1] One VPOP borrower even experienced 36% growth. While more research is needed to demonstrate causality, we hypothesize that their resilience may be rooted in enhanced management practices resulting from the EGS and Agora's ongoing mentoring of the VPOP entrepreneurs. Flexible loan repayment also may have contributed to their success.

As the crisis in Nicaragua enters the second year, bank lending to SGBs and SMEs has remained nearly non-existent. We have consequently shifted our focus towards to second phase of the project: expansion into other markets in the region. In engaging with potential local bank partners (LBPs), we have incorporated many of the recommendations within the report, and we expect to fully implement many of them as we ramp up the program through 2019 and 2020.

1. **Targeting of Enterprises**: In working with new LBPs, we are encouraging them to define the segment that will be targeted for the VPOP, which may or may not have a gender component. Given the underlying loan characteristics, women are often particularly well-served by the product and we anticipate that many institutions will continue to decide to work with this segment.

2. **Technical Service Provision – Financial Product**: While the exact loan characteristics will need to be finalized with each partner bank, we are especially keen to increase the quantum of financing for working capital available to the participating entrepreneurs based on our experience in Nicaragua, and we aim to prioritize this component in discussions with future LBPs.

3. **Technical Service Provision – EGS**: As noted in the evaluation, SGB maturity deeply impacts the utility of the predefined EGS modules. While entrepreneurs reported that the new modules positively impacted their businesses, personalized EGS provision on a large scale is not sustainable. Moving forward, we are considering requiring the four basic modules and allowing entrepreneurs to pay additional fees for more content. We also will more closely align the kind of EGS meant to be offered under VPO with the stage of growth of the enterprise and the maturity of the entrepreneur.

4. **Scalability**: Recognizing the need to enhance program management and improve documentation and knowledge management, we have continued to grow our team. We have defined internal knowledge management procedures and repositories and we believe these structures will be even more critical as VPOP expands.

5. **Partnership Selection and Partnership Structure**: We firmly believe that much of the early success of the VPO Program can be attributed to the strong relationships between the partners. When

[1] As of March 2019

incorporating new partners, we will continue to ensure that each partners' role and responsibilities is fully encapsulated in the MOU.

By incorporating many of the recommendations into the VPOP program, we aim to streamline processes and improve sustainability as we expand into new markets – both at the LBP and local EGS provider level, as well as at the program level. We anticipate having a sufficiently robust mix of experiences, such that we can really show proof of concept, as suggested in the itad evaluation, based upon a larger evidence base for commercial viability and development impact. Increasing scale and further VPO loan portfolio performance should also facilitate better prospects for attracting third party funders. In turn, we set the stage for further expansion in LAC and beyond.

In summary, we agree with the overall thrust of the evaluation. We have already adopted and adapted many of the itad evaluation recommendations and have begun to see the results therefrom. To wit, as of April 2019, across four different countries in LAC, two additional financial institutions have signed MOUs to initiate the implementation of pilots, and we are in the final stages of MOU negotiations with two additional financial institutions.