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HONDURAS

SMALL PROJECTS FINANCING PROGRAM

PROPOSAL FOR FINANCING AND TECHNICAL COOPERATION FOR:

COOPERATIVA MIXTA OCOTEPEQUE (CMO)

(SP/TC-96-06-19-8-HO)

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ABBREVIATIONS

CESI	Committee on Environment and Social Impact
CMO	Cooperativa Mixta Ocotepeque
IA	Intermediary agency

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EXECUTIVE SUMMARY

AMOUNT AND SOURCE:	IDB:	Financing:	US\$500,000
		Technical cooperation	
		(nonreimbursable):	US\$175,000
		Local counterpart funding:	<u>US\$ 25,000</u>
	Total:		US\$700,000

The total amount of the financing will be ECU 625,185, equivalent to US\$675,000, from the European Union Special Fund for Financing of Microenterprises in Latin America.

FINANCIAL	Amortization period:	20 years
TERMS AND	Grace period:	5 years
CONDITIONS:	Disbursement period:	4 years
	Credit fee:	1% annually
	Maintenance of value will apply to the resources of the financing.	

OBJECTIVES: The general objective of the project is to expand the financial market for microenterprises in the departments of Ocotepeque, Copán, and Lempira, by supporting an institution - Cooperativa Mixta Ocotepeque (CMO) - that provides financial services to sectors currently not served. The specific objectives are to: (i) provide access to financial services for a larger number of microentrepreneurs and small farmers in Cooperativa Mixta Ocotepeque's service area; and (ii) strengthen the intermediary to ensure its continuity in the market on sound footing.

DESCRIPTION: The proposed program consists of the following components:

- a. The credit component will allow the cooperative to expand its portfolio and meet the credit needs of very low-income clients. These resources will be lent pursuant to the institution's credit regulations and two additional eligibility criteria: one concerning the sectors to be financed (microenterprises and small farmers) and the other related to the environmental impact of the activities to be financed (paragraph 4.3).

- b. The resources under the technical-cooperation component will be used to finance: (i) the adaptation of the credit methodology to the needs of very low income clients; (ii) the purchase and adaptation of a computerized management information system; (iii) training for the cooperative's staff and board of directors; (iv) the establishment of a scholarship fund for training for small farmers; (v) the purchase of a vehicle; and (vi) a mid-term evaluation (see Annex I).

**ENVIRONMENTAL
CLASSIFICATION:**

The Committee on Environment and Social Impact (CESI), at its meeting of February 6, 1998, approved the project profile. The Committee's recommendations were incorporated into the design of the operation.

POVERTY TARGETING:

The target group is low-income small farmers and microentrepreneurs in the departments of Ocotepeque, Copán, and Lempira, for whom access to credit would give the opportunity to increase their development capacity.

RISKS:

The resources of the operation will enable the CMO to expand its operations in the departments of Ocotepeque, Copán, and Lempira, to reach the lowest-income clients. The high risk of this target population could reduce the quality of the cooperative's portfolio. The technical-cooperation component will help the CMO adapt its credit methodology in order to minimize this risk and improve its work with the target group.

**THE BANK'S COUNTRY
STRATEGY:**

The discussion paper that will serve as a basis for the Bank's country strategy, "Honduras: on the threshold of the twenty-first century", highlights the importance of developing a comprehensive plan to fight poverty, which includes measures such as improving access by small farmers to credit and to improved farming technologies.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

It is recommended that the following special conditions be included in the loan and technical-cooperation funding agreement, in addition to the general contractual conditions:

The cooperative will undergo a mid-term evaluation once 50% of the resources have been committed, in order to ensure fulfillment of the project objectives (paragraph 4.15).

No more than 70% of the resources of the technical-cooperation component will be disbursed until 20% of

the credit component resources have been disbursed (paragraph 3.5).

It is recommended that advances of funds of up to 20% of the amount of the credit and technical-cooperation components be granted (paragraph 4.12).

Prior to disbursement of the financing, the cooperative will submit to the Bank's satisfaction:

(i) evidence that it has hired an independent auditor or a firm of independent public accountants; and

(ii) a program for strict collection and reduced delinquency and refinancing indicators (paragraph 4.7).

I. FRAME OF REFERENCE

A. Socioeconomic context

- 1.1 Annual per capita income in Honduras is very low (US\$657) and there is pronounced inequality. The country's social indicators place it among the least developed in Latin America. According to the government's annual survey figures, 70% of families lived below the poverty line in 1996. 1/ In absolute terms, the number of poor people has been increasing since 1990. In general, inhabitants of rural areas and households headed by women are among the country's poorest.
- 1.2 Agriculture constitutes the most important sector of the Honduran economy. It accounts for 25% of GDP, generates 72% of exports, and employs 52% of the labor force. If marketing and processing activities are included in the agriculture sector, its contribution to GDP is 40%. However, incomes in the sector are concentrated in a small number of companies that benefit from easy access to financing. The great majority of the rural population lacks land or has inadequate plots on which obsolete technology is used. There are 67,000 rural families with annual average per capita incomes of US\$65.
- 1.3 Because of family poverty, urban women have had to undertake unstable economic activities, primarily in sales and services. In rural areas, women's economic participation is more frequently in product processing. Women are also involved in agricultural and craft production activities and in small-scale livestock farming.

1. Microenterprises in Honduras

- 1.4 It is estimated that there are close to 195,000 nonagricultural small businesses and microenterprises in Honduras, 70% of which are located in rural areas. 2/ Most of these companies are very small: 85% have one or two employees and almost 99% have fewer than 10 employees. The small businesses and microenterprises generate jobs for 371,000 wage earners and 86,000 unpaid workers, altogether representing 25% of the economically active population. The microenterprise sector is all the more significant for the

1/ This figure is only indicative of the poverty and income distribution situation, since the annual household surveys from which it was taken appear to have had methodological problems (Honduras: On the threshold of the twenty-first century, discussion paper, IDB).

2/ Honduras: Diagnostic study of financial services for the microenterprise sector and recommendations for a support program (1996). Consultant's report submitted to the Bank.

Honduran economy if one factors agricultural small businesses and microenterprises into the equation.

- 1.5 Small farmers devote their efforts and limited resources to subsistence agriculture. They use low-level technology, have little access to financial services or technical assistance and training, face legal problems related to land tenure, and work for tiny production surpluses marketed by middlemen.

2. The departments of Ocotepeque, Copán, and Lempira

- 1.6 The highest concentration of poor people live in the rural section of western Honduras, where 36.5% of the households are in the poorest decile, with spending below US\$4 per month. The service area of Cooperativa Mixta Ocotepeque (CMO) includes three departments - Ocotepeque, Copán, and Lempira - in northwestern Honduras. In the rural areas of these departments, 96.1% of households live below the poverty line, with 88.4% in extreme poverty, and only 3.9% of the households can be considered not poor. Of all Honduran households in the poorest 5%, 44.2% live in this region.

B. Statement of nonobjection

- 1.7 Cooperative Mixta Ocotepeque (CMO) submitted a request for financing and technical-cooperation funding to the Bank under the Small Projects Financing Program. The government, through the Ministry of Finance, expressed nonobjection to the Bank's participation in the financing of the proposed program on February 19, 1998.
- 1.8 Under its by-laws, the CMO is legally empowered to receive loans from national and international institutions and to grant loans to its members for the purpose of improving their socioeconomic status.

C. The government's strategy

- 1.9 As part of the process to strengthen the economy, the Government of Honduras has assigned priority to the low-income sector. In this context, institutions like the CMO can play a significant role in providing this sector with savings, credit, input, and training services and contribute to the development of a geographically remote region of the country.

D. The Bank's strategy

- 1.10 The discussion paper that will serve as a basis for the Bank's country strategy ^{3/} highlights the importance of implementing a comprehensive plan for combatting poverty, including measures such as greater access to credit and improved farming technologies for small-scale farmers. It also mentions the importance of stimulating a general increase in private sector productivity. Lastly, it emphasizes the importance of finding sustainable solutions that do not depend on external funding.
- 1.11 The proposed operation is consistent with the general goal of the Bank's microenterprise development strategy (GN-1938-3), which consists of expanding economic opportunities in Latin America and the Caribbean through sustainable, vigorous microenterprise development. The objective is to promote the conditions necessary for the sector's growth and development in the region, in the form of a favorable policy and regulatory framework, solid and sustainable institutions that offer financial and other services to meet microenterprise demand, improved access for low-income microentrepreneurs (including women and indigenous peoples) to financial and business services, and expanded, uninterrupted flows of resources for investing in microenterprises.

E. The Bank's experience with microenterprise in Honduras

- 1.12 The Bank's experience with microenterprise in Honduras has been limited to the context of the Small Projects Financing Program, through which 20 operations were approved over the course of 19 years, amounting to a total of US\$9.2 million, with technical-cooperation funding totaling US\$1.6 million. The program is estimated to have reached 23,000 microentrepreneurs. In two operations, 95% of the clients are women. The results of these operations have been mixed. In most cases, short-term impact has been positive but sustainability has only been achieved in a few cases. No new operations have been approved since 1994, due to a lack of concessional resources. There are currently two operations about to be completed.
- 1.13 Two operations with resources from the Multilateral Investment Fund (MIF) have been approved for Honduras: (i) a rural entrepreneurship development program (US\$1.9 million), the purpose of which is to turn 1,960 participants (small agricultural producers and microentrepreneurs, young entrepreneurs, and staff from training agencies) into successful and environmentally responsible entrepreneurs; (ii) an incentive program for private-sector investment in training (US\$1.9 million), the beneficiaries of which are 270 private companies operating in the construction, tourism, and wood

^{3/} "Honduras: On the threshold of the twenty-first century", Regional Operations Department 2, January 1998.

processing sectors, and their employees, training providers, and business groups that promote quality management; and (iii) a regional project that included Honduras and involved in support for the sustainable development of microenterprises in Central America (US\$1.7 million), to work with a network of institutions to improve the quality of nonfinancial services for microentrepreneurs, involving technology, access to markets, and the environment. These three projects have encountered no problems to date.

II. THE INTERMEDIARY AGENCY

A. Identity, origin, and objectives

- 2.1 Cooperativa Mixta Ocotepeque Ltda. (CMO) is a savings and loan cooperative in the department of Ocotepeque, Honduras. It was granted legal status on December 12, 1989, under Agreement No. 89 in Volume I, Book II.
- 2.2 The CMO's overall objective is to improve the economic, social, and cultural circumstances of its members and the community in which it operates and to boost the income of its members by increasing production and productivity and promoting savings, investment, work, and proper use of credit.
- 2.3 The CMO is planning to expand its services to low-income microentrepreneurs and small-scale farmers in its service area.

B. Administrative characteristics

- 2.4 The general assembly is the highest authority of the CMO and consists of all the members. It elects the seven members of the board of directors, the three members of the oversight board, and the members of the credit, delinquency, education, and appraisal committees. In the operations area, the cooperative has 32 employees under the leadership of a professional manager who hails from the region, with a degree in accounting and finance, and experience in international trade. The breakdown of the approximately 5,000 members of the CMO by profession is as follows: farmers, 29%; teachers and professors, 18%; homemakers, 17%; merchants, 10%; laborers, 6%; and others, 20%.
- 2.5 The CMO currently has a central office and three branch offices, located in Ocotepeque, Encarnación, Concepción, and Cucuyagua, respectively. Each office has its own local boards and committees, so that control and participation can be focused at the local level. Nevertheless, the branches are supervised by the central office's administrative board monthly. The branches legally belong to the CMO and follow the procedures and guidelines of the central

office in all matters pertaining to the delivery of financial services.

C. Activities

2.6 The cooperative primarily offers financial services in the form of savings and loans. Loans for purchasing and improving homes or land account for 44% of the portfolio, while 38% represent consumer, transportation, or debt consolidation ^{4/} loans. Currently only a small percentage of resources target urban or rural microenterprises (industry, 2%; commerce, 3%; and agriculture, 13%). However, in terms of the number of loans granted, agriculture is the predominant sector, with 850 loans, or 40% of current lending as of October 31, 1997.

2.7 The CMO offers five credit products detailed in the following table.

Product	Nominal Rate	Term	Payments	Savings ^{a/}	Effective Rate ^{b/}
Housing	32%	48 months	Monthly	33%	45%
Transportation, industry, land	32%	36 months	Monthly	33%	45%
Consumer	32%	24 months	Monthly	33%	45%
Commerce	34%	12 months	Monthly	33%	48%
Agriculture	32%	36 months	Monthly	33%	45%
	34%	12 months	Annual	33%	37%

^{a/} These savings are compulsory, constitute a guarantee, and accrue interest. For "double" loans (with 50% compensatory savings), a rate of 30% is offered. For "automatic" loans (up to 95% of the value of the contributions), the rate is 22%.

^{b/} The cooperative's annual effective rate is generally higher than that offered by banks in Ocotepique. The only exception is the effective rate for single-payment agriculture loans.

2.8 In addition to the CMO, there are four entities in Ocotepique offering credit to microentrepreneurs and small-scale producers in the department. Two of them are nongovernmental organizations that do not have a very high level of sustainability, another is a State-owned bank that offers subsidized financing to a limited number of borrowers, and the fourth is a private bank that works with a trust fund from the State, which guarantees 100% of the loans that this bank grants to small producers in the region.

2.9 The savings service offered by the CMO is what has allowed the institution to grow over the last few years. Currently, it has US\$2.3 million in member shares, US\$780,000 in passbook savings and

^{4/} Financing granted to individuals who owe money to moneylenders.

US\$1.5 million in fixed-term deposits, the only financial service provided to nonmembers. The following table breaks down the savings products and return offered.

Product	Rate
Member shares	11%
Passbook savings	23%
Fixed-term deposits (3 months)	27%

2.10 The institution's conservative policies, such as requiring high levels of compensatory savings, are due to a board of directors strategy to cultivate a reputation as one of the region's soundest and most reliable financial institutions. This seems to have had significant results judging by the total amount of savings deposits the cooperative has managed to attract.

2.11 The cooperative offers its members and the community two additional nonfinancial services. One is an input store, which turns a profit and has an accounting structure completely separate from the financial services' structure. The other service is training, supported through the institution's social development fund. This training activity is targeted to the needs of the members (informational talks on the cooperative, leadership courses, etc.). The education committee periodically hires experts to conduct training seminars on subjects of interest to the members.

D. Credit technology

2.12 The CMO promotes its credit services through talks given by the education committee, radio spots, bulletins, and through the members themselves. A potential borrower has an interview at one of the cooperative's offices (central or branch) with the manager or loan officer, to receive more detailed information on the credit policies and lending terms and conditions: amount, terms, amortization, security, and payment dates.

2.13 Once the loan application is received from the borrower, it is reviewed and information is checked regarding guarantees, if any, and the member's payment history, savings, and participation in the cooperative's activities. If required, the report of the technical evaluator on the mortgage guarantees will be attached. In the case of farm loans in excess of US\$750, the plots will be visited. The officer or manager then issues an opinion on the loan application and forwards it to the credit committee.

2.14 Applications are received every day and are submitted to the committee at its weekly Saturday meeting. Some 15 to 30

applications are processed each week. The committee abides the credit regulations in its decisions. The loan officer is authorized to approve automatic loans (amounts below the member's savings balance). The processing time ranges from eight to 10 working days.

- 2.15 The recovery activities are the responsibility of the collections officer, based on a list he prepares monthly and manually, doing collections when the second instalment falls due. The borrower is visited at home and informed of the delinquency and an agreement is reached on how he or she will get up-to-date on payments. If this does not work, a written request is personally delivered on two separate occasions. The third notification includes copies to the guarantors. Payment plans can be negotiated, either with the collections officer, the loan officer, or the manager. If the outcome is negative, the matter is sent to the legal representative for proceedings to begin, initially out of court and as a last resort in court.

E. Financial situation

- 2.16 The financial analysis of the CMO was conducted on the basis of financial statements for fiscal years 1995 through 1997, which appear in Annex II, expressed in dollars of the United States of America.
- 2.17 Total assets as at December 31, 1997, were US\$5.6 million, representing a 64% growth since 1995. Close to 70% of the assets were loans receivable. Loans receivable grew 40% in 1997 over 1996. Liquid assets represented 19% of total assets. 5/ The investment item shows works in progress relating to the construction of new branches.
- 2.18 Liabilities as at December 31, 1997, were US\$2.8 million, 89% of which represented savings accounts. It should be noted that the cooperative's fund has been formed almost exclusively through member shares and by attracting savings from the department's inhabitants.
- 2.19 Net worth as at December 31, 1997, was US\$2.8 million, consisting of a US\$400,000 reserve, US\$86,000 in surpluses to be distributed, and US\$2.3 million in member shares. 6/ Net worth at the end of 1997 was 66% higher than in 1996.

5/ The high amount of liquid assets in 1997 was due to the planned investment for construction of a new branch in Gracias. Liquid assets in 1995 and 1996 were much lower.

6/ The CMO, like almost all cooperatives in Honduras, records savings as net worth rather than partnership assets. Given that the savings cannot be withdrawn while the member or his guarantor has unpaid loan balances, the coverage is similar to typical net worth.

- 2.20 Total income for 1997 was US\$1.8 million, representing an increase of 49% over 1996 and 143% over 1995. This growth was the result of an expanded credit portfolio, in particular the increase in the number of loans granted to small-scale farmers. Until now, the CMO has received no financial support from international development agencies.
- 2.21 Total expenditures of US\$1.5 million in 1997 reflected an increase in financial costs but a drop in operating expenses with respect to 1996.
- 2.22 The cooperative's loan portfolio consists of 2,120 loans to members, in an average amount of US\$1,600, ranging from US\$300 to US\$10,000. Delinquency, measured as a percentage of the total portfolio, was 10.8% at the end of the year. It has increased over the past year, in part because of the rapid growth of the portfolio and in part because of the increase in the proportion of farm loans, a sector with which the cooperative had no experience. It should be noted, however, that almost half the delinquent portfolio is covered by compulsory savings balances maintained by the borrowers at the cooperative. In addition, 50% of the delinquent loans are covered by mortgage guarantees.

F. Characteristics of the target group

- 2.23 Men account for 60% of the cooperative's clients, while women comprise the remaining 40%. The clients in the microenterprise sector are low-income people with small economic units employing five people or less, with varying financing needs, according to their stage of development. The economic units to be covered under the project would be low-capital-formation units involving simple, rudimentary production activities. Examples of microentrepreneurial activities frequently financed by the cooperative are: bakeries, machine shops, tailor's shops, eateries, beauty parlors, and carpentry shops.
- 2.24 The small-scale farmers who have been serviced by the cooperative so far have grown vegetables, coffee, potatoes, and basic grains and have raised cattle for meat and milk and poultry. In addition, the CMO will provide loans to small farmers growing onions and other vegetables.

G. Strengths and weaknesses of the institution

- 2.25 The CMO, as a member of the Federation of Honduran Cooperatives (FACACH), received an "A" rating for its financial soundness and is one of the seven institutions out of 90 that received the top rating. Although the institution's indicators are among the strongest found in Honduras, there is room for the CMO to improve its financial performance, particularly as regards the quality of its loan portfolio. Delinquency must be controlled through

stricter collection programs when working with lower-income clients.

- 2.26 With regard to the administrative and management information features of the CMO, the methods are simple but slow, because of the lack of computerized systems. Indicators such as delinquency currently are only available one month after each client's payment date. Other key information such as delinquency broken down by category is not available, making strategic decision-making at the management or board level difficult. While an effort was made to computerize the cooperative's accounting work, the program adopted was not suited to the institution's needs and the CMO currently does its accounting and portfolio control manually. With projected growth, it is imperative for information on the portfolio to be automated.
- 2.27 The institution's credit methodology must be adjusted to the needs of the lowest-income clients. This would imply adjusting terms in some cases, shortening and simplifying procedures, and strengthening verification, selection, and collection activities.

III. THE PROGRAM

A. Objectives

- 3.1 The general objective of the project is to expand the financial market for microenterprises in the departments of Ocotepeque, Copán, and Lempira, by supporting an institution that offers financial services to sectors that currently have no access to such services.
- 3.2 The specific objectives are to: (i) provide access to financial services for a larger number of microentrepreneurs and small farmers in Cooperativa Mixta Ocotepeque's service area; and (ii) strengthen the intermediary to ensure its continuity in the market on sound footing.

B. Program description

1. Loan component (US\$500,000)

- 3.3 The reimbursable resources will allow the cooperative to expand its portfolio and meet the credit needs of clients with lower incomes than the ones they have been serving thus far. These resources will be lent pursuant to the institution's credit regulations and two additional eligibility criteria: one concerning the sectors to be financed (microenterprises and small farmers) and the other related to the environmental impact of the activities to be financed (paragraph 3.24).

2. Technical cooperation (US\$175,000)

- 3.4 The nonreimbursable resources under the technical-cooperation component will be used to finance: (i) the adaptation of credit methodologies to the needs of the lowest-income clients; (ii) the purchase and adaptation of a computerized management information system; (iii) training for the cooperative's staff and board of directors; (iv) the establishment of a scholarship fund for training for small farmers; (v) the purchase of a vehicle; and (vi) the mid-term evaluation.
- 3.5 No more than 70% of the resources of the technical-cooperation operation will be disbursed until 20% of the credit component's resources have been disbursed.

C. Cost and financing

- 3.6 The amount of the loan will be the equivalent of US\$500,000 in ECUs on the date of project approval, disbursed in local currency pursuant to the Bank's standard procedures. The resources will be reimbursable, with an amortization period of 20 years and a grace period of five years. A credit fee of 1% per year will be charged. In addition, a rate to maintain the value of the lempiras will be applied. The principal will be amortized for 15 years after the grace period expires. The amount of the technical-cooperation operation will be the equivalent of US\$175,000 in ECUs on the date of project approval, disbursed in local currency pursuant to the Bank's standard procedures. These resources will be provided on a nonreimbursable basis. The program will be funded from the resources of the Special Fund for Financing of Microenterprises.

D. Sizing

- 3.7 Over the last three years, the portfolio has been growing at an annual rate of 40%, representing US\$1 million in new loans each year. Inasmuch as the project would provide the CMO with US\$125,000 each year for four years, the resources would account for a minority portion of the cooperative's portfolio. However, taking into account the portion of the portfolio currently targeted at microentrepreneurs and small-scale farmers (US\$700,000), it is expected that the program funds will enable the cooperative to increase its microlending portfolio by 29% in the first year. In addition, credit methodology changes introduced through the technical-cooperation component will allow the CMO to service its new clients better.

IV. PROGRAM EXECUTION

A. Responsibility for execution

- 4.1 The CMO will be responsible for administration and execution of the proposed program. It will sign a financing and technical-cooperation agreement with the Bank and will carry out the program in accordance with the terms set forth in this document and its annexes. The activities will be conducted with current CMO staff, with support from the specialized firm or institution that will be financed under the technical-cooperation component.

B. Credit regulations

- 4.2 The institution will continue to grant loans pursuant to its existing credit regulations. If, during the course of the project, the regulations need to be updated to be more consistent with the needs of the new clientele, such an update will be done in consultation with the Bank. In any case, to grant program resources, two additional criteria having to do with the activities to be financed and environmental considerations will have to be taken into account.
- 4.3 For a project to be eligible for financing, it must meet the following criteria: (i) the microenterprise's proposal must be technically and financially feasible; (ii) it must strengthen job opportunities or generate new ones; (iii) markets where its production could be absorbed must be accessible; and (iv) the activities should be nonpolluting and should have no adverse impact on the environment, unless such impact is covered by a mitigation plan. 1/
- 4.4 Program resources may not be used to finance: (i) the purchase of real estate; (ii) the payment of debts, dividends, or return on capital; (iii) the purchase of stocks, bonds, or securities; (iv) consumer goods; (v) the leasing or purchase of land, houses, or commercial buildings; (vi) the purchase of vehicles for personal use; or (vii) the payment of taxes.
- 4.5 The lending rate will be calculated to cover the following five elements: (i) the operating costs of the credit program; (ii) the finance charges, including the opportunity cost of money; (iii) inflation; (iv) loan loss provisioning; and (v) a profit margin, to ensure a positive real interest rate. It should be noted that the fact that the cooperative will be receiving soft funds to finance portfolio expansion does not involve lowering the

1/ The Bank will provide the CMO with a list indicating environmentally harmful activities.

finance charges in calculating the lending rate. The purpose of the soft funds is to allow the CMO to gradually improve its yields and capitalize at a faster rate, thereby making it possible for it to service a larger number of microentrepreneurs and small-scale farmers in the future.

- 4.6 During execution of the proposed program, the CMO will take appropriate measures to ensure that delinquency in the loan portfolio remains below 5% for amounts over 30 days past due. If this provision is not fulfilled, the Bank reserves the right to defer disbursements, although circumstances that would justify a temporary increase in the delinquency rate will be taken into account. To this end, the CMO will present information to the Bank semiannually on the performance of the loan portfolio. Moreover, as part of the technical-cooperation component, the cooperative's loan loss provisioning policy will be reviewed.
- 4.7 Prior to disbursement of the reimbursable resources, the cooperative will submit to the Bank a strict collection program and plan to reduce delinquency and refinancing indicators.

C. Technical-cooperation component

- 4.8 To achieve the objectives of this component, the CMO will hire the services of a firm or institution specializing in farm credit and with experience in information technology. This firm or institution will provide comprehensive support to the cooperative to fulfill the objectives of the technical-cooperation component. It will work with the cooperative to adapt its credit methodology to the needs of the lowest-income clients and to automate management information flows. The main functions of the specialized firm will be to: (i) design a strict collection program that will enable the cooperative to maintain a low delinquency rate; (ii) establish a loan loss provisioning policy; (iii) design new credit products and possibly adjust the institution's credit regulations; (iv) implement a computerized management information and accounting system; (v) establish appropriate indicators for use by the Bank in monitoring the institution's financial performance and credit program; and (vi) train the CMO's staff so that it has the skills needed to expand the cooperative efficiently and with sensitivity to environmental concerns.
- 4.9 The CMO will be responsible for hiring the specialized firm or institution, which will be done in accordance with the Bank's procedures for selecting and hiring consulting services. The cooperative will also be responsible for: (i) procuring computer equipment (hardware, software, and printer) for the central office and two of the branches; 8/ (ii) purchasing a vehicle to make it

8/ The third branch operates in an area with no electricity.

easier to travel between the central office, the branches, and the distant plots of the small-scale farmers; and (iii) setting up a scholarship fund and establishing a selection process for awarding scholarships to small-scale farmers.

- 4.10 A mid-term evaluation will be conducted once the CMO has committed 50% of the resources of the loan. The consultant to conduct the evaluation will be hired directly through the Bank's Country Office.
- 4.11 The CMO will follow the Bank's rules, procedures, and policies for the procurement of goods under the program.

D. Advance of funds

- 4.12 The program requires that funds be available in amounts sufficient to grant loans quickly and on a timely basis and to streamline the process of expansion and institutional strengthening of the CMO. It is recommended that an advance of funds of up to 20% of the financing and technical-cooperation funding be granted.

E. Progress reports

- 4.13 During program execution, within 60 days after the end of each calendar year, the CMO will submit a progress report to the Bank. The last of these reports will constitute the final report and will contain a summary of the results obtained compared with the program's original objectives. On the basis of the progress achieved, the report will assess whether the CMO's institutional capacity improved, particularly with respect to expanding its services to the low-income clients.
- 4.14 For a period of five years starting in the year that disbursements begin, within 120 days after the end of each calendar year, the CMO will submit its own and the program's financial statements to the Bank, audited by an independent auditor or firm of independent public accountants, which will be hired to the Bank's satisfaction and as a condition precedent to the first disbursement of the loan.

F. Mid-term evaluation

- 4.15 In order to support the strengthening of the CMO and to any correct deficiencies that might arise during implementation of the operation, a consultant with experience in microenterprise programs of this type will conduct a mid-term evaluation on whether the objectives and the conditions for execution of the program components have been fulfilled, once 50% of the resources of the loan have been committed. To this end, the Bank's Country Office will directly hire the consulting services needed for this evaluation to be conducted, using resources from the nonreimbursable technical-cooperation component.

- 4.16 The purpose of the evaluation will be to review the progress achieved under the program and to determine whether the procedures used for executing the loan component are sound. This evaluation will include in particular a review of: (i) the income levels of the clients served by the CMO, (ii) the delinquency rate, (iii) awareness campaigns on environmental protection measures, (iv) profitability and efficiency of services rendered, and (v) status of implementation of the technical-cooperation component and its impact on the cooperative.
- 4.17 The Bank will review the findings reported in and recommendations arising from the evaluation and, if it deems them satisfactory, will authorize the CMO to continue committing resources under the loan or require it to take corrective measures. Should significant deficiencies in program execution be found in the course of the mid-term evaluation, the Bank will not authorize the CMO to continue committing resources until it takes the measures necessary to correct such deficiencies.

G. Environmental considerations

- 4.18 The CMO will take special care to ensure that the beneficiaries of its programs comply with Honduran environmental legislation and that the activities they undertake do not damage the environment in any way. The CMO's credit regulations will include eligibility criteria that would limit financing for activities that pollute or have an adverse impact on the environment, unless a mitigation plan is included. In order for these measures to be implemented, the technical-cooperation component provides for financing an environmental awareness class for the CMO's management and education committee. It should be noted that the CESI reviewed the operation's profile at its February 6, 1998, meeting.
- 4.19 One of the measures taken to protect the environment is a program of training scholarships to be financed under the technical-cooperation component, aimed at small-scale farmers. Community leaders who are members of the cooperative will be chosen to go spend one week at one of the country's organic farming centers, 9/ where environmental education is an integral part of the curriculum.

9/ These centers include Centro Lomalinda, Escuela Agrícola Panamericana, and Fundación Banhcafé.

V. PROGRAM FEASIBILITY AND RISKS

A. Socioeconomic feasibility

- 5.1 The program will contribute to improving the living conditions of low-income microentrepreneurs who are members of the cooperative, and their families, in the departments of Ocotepeque, Copán, and Lempira. Based on the projected growth of the microcredit portfolio (see paragraph 5.4), some 2,300 loans averaging US\$500 will be granted to microentrepreneurs and small-scale farmers in the area over the life of the project. Including the families of the microentrepreneurs, it is expected that benefits will devolve upon 11,500 people. The expected results are increased earnings for the beneficiaries, growth of the financed enterprises, the learning of financial discipline derived from loan repayment, and the development of a business culture in the project's service area.

B. Institutional feasibility

- 5.2 The CMO has demonstrated that it has the capacity to manage a loan portfolio and to generate enough revenues to cover its costs. The CMO's credit policy shows that the institution applies one of the basic principles of microfinance: working with rates that reflect operating costs and the high risks inherent in this segment of the market, while offering low-income clients products tailored to their needs.
- 5.3 The CMO has an adequate legal foundation, with a flexible organizational structure compatible with the various requirements of program execution and the prospect of an increase in the volume of operations. Its human resources are involved in an ongoing training process.

C. Financial feasibility

- 5.4 With assets of US\$5.6 million and a loan portfolio of close to US\$4 million, the CMO's absorption capacity is considerable. Current loans to microentrepreneurs and small-scale farmers total about US\$700,000. The projected growth of the microcredit portfolio during the life of the program is detailed in the following table:

Year	Portfolio at start of period <u>a/</u>	New resources	Financial revenues <u>b/</u>	Portfolio at end of period	Annual growth rate	Number of loans <u>c/</u>
1	700	125	76	901	29%	381,250
2	901	125	96	1,123	25%	481,875
3	1,123	125	119	1,366	22%	592,563
4	1,366	125	143	1,429	20%	714,319
<u>a/</u> Amounts in thousands of U.S. dollars. <u>b/</u> Based on a spread of 10% annually, which is the difference between the CMO's regular financial cost and that of the project resources (will apply to new funds only). In addition to the margin, there may be a portfolio growth margin of about 3%. <u>c/</u> Based on the average portfolio for the period, divided by the average loan amount of US\$500 (lower than the current average amount).						

- 5.5 The project's financial feasibility depends on the CMO's continuing to calculate its lending rate on the basis of the factors cited above (see paragraph 4.5) and on the adjustments in the credit methodology that will be implemented as part of the activities to be financed under the technical-cooperation component.

D. Risks of the operation

- 5.6 The resources of the operation will enable the CMO to expand its operations in the departments of Ocotepeque, Copán, and Lempira, to reach low-income clients. The high risk of this target population could reduce the quality of the cooperative's portfolio. The technical-cooperation component will support the CMO as it adapts its credit methodology in order to minimize this risk and improve its work with the target group.

VI. JUSTIFICATION AND RECOMMENDATIONS

- 6.1 The CMO is one of the few sustainable institutions working in the departments of Ocotepeque, Copán, and Lempira, which seeks to serve the credit needs of low-income small farmers and microentrepreneurs. It has exhibited the two key characteristics for success in implementing projects of this type: the capacity to manage a loan portfolio with sound financial indicators and the willingness to serve low-income sectors in the departments. In addition, it should be noted that the proposed program is consistent with the eligibility criteria of the Small Projects Financing Program set forth in documents GP-75-7 and GN-1238-2.
- 6.2 It can be concluded from the above analysis that the program is feasible subject to the terms and conditions proposed in this document. Accordingly, the Management of the Bank recommends that the Board of Executive Directors approve the financing and hereby

submits for its consideration a proposed resolutions for financing and nonreimbursable technical-cooperation funding for Cooperativa Mixta Ocotepeque.

PLAN OF OPERATIONS

INSTITUTIONAL STRENGTHENING FOR COOPERATIVE MIXTA OCOTEPEQUE (CMO)

(TC-96-06-19-8)

I. BACKGROUND

- 1.1 In addition to the request for financing, Cooperative Mixta Ocotepeque (CMO), hereinafter also referred to as the IA [intermediary agency], asked for nonreimbursable technical-cooperation funding to support execution of the program proposed in the financing document.

OBJECTIVES

- 1.2 The objectives of the proposed technical-cooperation operation are:
- a. To support the CMO in developing its credit methodology, to create a supply that is more suited to the needs of small-scale low-income farmers and microentrepreneurs, who are the program's target group.
 - b. To support the CMO in modernizing its financial management, by incorporating the use of a computerized information system and providing training courses for management, the board of directors, and the committees.
 - c. To contribute to the training of small-scale farmers in new, environmentally-sound production techniques through a scholarship fund.

II. PROGRAM DESCRIPTION

- 2.1 The objectives of the technical-cooperation operation would be achieved by the IA through the following activities:
- 2.2 The CMO will hire the services of a firm or institution specializing in farm credit and with experience in information technology. This firm or institution will provide comprehensive support to the cooperative to fulfill the objectives of the technical-cooperation operation. However, the cooperative will be

fully responsible for fulfillment of the operation's objectives. The firm or institution will work with the cooperative to adapt its credit methodology to the needs of low-income clients and to automate management information flows. Under these advisory services, the following areas will be covered: (i) the collection and delinquency-reduction program adopted by the cooperative; (ii) the loan loss provisioning policy; (iii) the design of new credit products and possible adjustments to the institution's credit regulations; (iv) the implementation of a computerized management information and accounting system; (v) appropriate indicators for use by the Country Office in monitoring the institution's financial performance and credit program; and (vi) training for the CMO's staff so that it has the skills to expand the cooperative efficiently and with sensitivity to environmental concerns.

- 2.3 The CMO will also be directly responsible for: (i) procuring computer equipment (hardware, software, and printer) for the central office and two of the branches to facilitate the flow and management of financial information; 1/ (ii) purchasing a vehicle to make it easier to travel between the central office, the branches, and the distant plots of the small-scale farmers; and (iii) setting up a scholarship fund and establishing a selection process for awarding scholarships to small-scale farmers.

A. Hiring of consultants

- 2.4 The CMO will be responsible for hiring the specialized firm or institution, pursuant to terms of reference agreed upon with the Bank prior to selection of the firm and in accordance with the Bank's guidelines for selecting and hiring firms or agencies. The firm or agency will be hired within the first three months of program execution.

B. Mid-term evaluation

- 2.5 The Bank, through the Country Office in Honduras, will hire directly the consulting services needed to conduct the mid-term evaluation on the IA's execution of the program, once approximately 50% of the resources of the financing have been committed.

C. Procurement of equipment

- 2.6 The cost of the equipment and materials to be purchased with technical-cooperation resources will account for less than 30% of the total amount of such resources and the CMO will follow the Bank's rules, procedures, and policies for the procurement of goods under the program.

1/ The third branch operates in an area with no electricity.

D. Training program

- 2.7 Training for IA staff will be supported by covering the cost of courses in administration, computer technology, and microenterprise and farming credit technology. The operation will finance local travel expenses to attend technical seminars and information-sharing events with other entities that provide rural credit, in order for the rural microlending technology to remain as efficient as possible. Lastly, a scholarship fund will be established to finance courses on production and environmental techniques for small-scale farmers, who will be selected by the CMO's education committee and will undertake to pass on their new know-how to their communities.

III. COST AND FINANCING

- 3.1 The total cost of the nonreimbursable technical-cooperation operation has been estimated at US\$175,000 equivalent, which would be financed in accordance with the budget appearing below. The resources to finance the operation would come from the European Union Special Fund for Financing of Microenterprises.

COST OF THE PROGRAM
(in U.S. dollars)

CATEGORY	CMO	IDB	TOTAL
2.1 FEES		50,000	50,000
Specialized firm or institution			
5.1 STAFF TRAINING		<u>56,000</u>	60,000
CMO staff <u>a/</u>		16,000	
Traineeships		10,000	
Scholarships (farmers and others) <u>b/</u>	4,000	30,000	
6.3 EQUIPMENT		<u>46,000</u>	67,000
Computer equipment	11,000	31,000	
Transportation (vehicle)	10,000	15,000	
8.2 EVALUATION <u>c/</u>		15,000	15,000
9.8 CONTINGENCIES		8,000	8,000
TOTAL	25,000	175,000	200,000

a/ 8 modules x 25 participants x US\$80

b/ 5 technical packages x 50 participants x US\$120

c/ Includes a mid-term evaluation, once the IA has disbursed 50% of the resources of the financing.

IV. PROGRAM EXECUTION

- 4.1 The institutional-strengthening component will be carried out concurrently with the credit component, which would be approved at the same time as this technical-cooperation operation. The CMO will be responsible to the Bank for execution of the technical-cooperation operation.
- 4.2 The consultants will be hired by the IA, with the exception of the consultant who is to conduct the mid-term evaluation of the program, who will be hired directly by the Bank.
- 4.3 The IA will provide any logistical support, i.e. secretaries, office space, telecommunications services, electricity, etc., needed for the program to be carried out smoothly.

V. JUSTIFICATION

- 5.1 The proposed technical-cooperation operation is justified because:
 - a. It will support the IA in managing, controlling, and monitoring the credit procedures and practices needed so that the cooperative can meet the needs of the target group.
 - b. It will support the development of operating tools that can be used for decision-making, based on reliable information on the status of the portfolio.
 - c. It will contribute to raising environmental awareness and disseminating new production techniques among the area's small-scale farmers.
- 5.2 The effectiveness of the proposed financing depends, to a large extent, on the proposed technical-cooperation component.

VI. DISBURSEMENTS

- 6.1 The resources of the Bank's contribution will be disbursed within 48 months after the effective date of the agreement. No more than 70% of the resources of the technical-cooperation operation will be disbursed until 20% of the credit component resources have been disbursed.
- 6.2 At the IA's request, an advance of funds of up to 20% of the total amount of the technical-cooperation operation may be provided, in order to ensure a timely flow of funds for the program. The setup

and replenishment of the advance will be considered a disbursement. Accordingly, the IA will submit detailed accounts to the Bank on how the funds disbursed and spent were used.

VII. REPORTS

- 7.1 Consultants' reports. The contract that the IA will sign with the specialized institution or firm will include the requirement that the latter submit to the IA, with a copy for the Bank for approval: (i) semiannual progress reports on the project, within 30 days after the end of each six-month calendar period, starting from the day it begins work; (ii) a final report, to be submitted within 30 days after the work is completed, indicating the results achieved and evaluating them from the standpoint of the original program objectives, making recommendations for the future; and (iii) any additional report that the IA or the Bank may reasonably request with regard to the progress of the work.
- 7.2 The IA's reports. The IA will submit to the Bank, to the latter's satisfaction: (i) annual progress reports on the program, including comments on the work performed by the consultants; (ii) an assessment of the reports submitted by the experts, within 30 days after the end of each contract; and (iii) a financial report audited by independent auditors, within 120 days after the end of the calendar year in which the final disbursement is released, showing the way in which the Bank's contribution was used.

VIII. SUPERVISION

- 8.1 The consulting services will be supervised by the IA. The Bank will also supervise the proposed programs through the Country Office in Honduras.

IX. EVALUATION CRITERIA

- 9.1 The evaluation of this technical-cooperation operation will be performed through an analysis of the proposed objectives and the extent to which these were achieved, based on the reports described in paragraph 7.1 above, and of the quality of the work performed during its execution. The evaluation shall consider the criteria that will be established to assess the financing and technical-cooperation components, as described in paragraph 4.15 of the financing proposal.

COOPERATIVA MIXTA OCOTEPEQUE
BALANCE SHEET AT DECEMBER 31
(US\$)

ACCOUNT/HEADING	1995	1996	1997
ASSETS			
LIQUID ASSETS	193,404.92	252,635.47	1,051,572.15
General cash account	78,367.32	48,256.87	42,355.17
Petty cash		157.89	195.49
Exchange fund		4,075.19	6,428.57
Banks		72,325.97	249,575.71
Investments	115,037.59	127,819.55	753,017.22
CURRENT ASSETS	2,110,173.44	2,985,204.10	4,159,902.19
Loans receivable	2,037,784.69	2,921,785.13	4,109,922.94
Nonperforming loans	(42,499)	(62,149)	(85,823)
Interest receivable			85,620.49
Notes receivable	33,668.98	16,372.15	78,219.31
Prepayments		2,948.55	1,915.52
Inventory	81,219.07	106,247.14	170,046.78
LONG-TERM ASSETS	71,761.31	169,042.36	238,805.67
Investments	8,674.63	11,351.65	21,330.87
Property and equipment	84,356.28		
Land		11,743.27	10,991.39
Buildings and construction under way		119,615.29	183,536.21
Furniture, equipment and vehicles		55,574.77	66,589.08
Accumulated depreciation	(21,270)	(29,243)	(43,642)
DEFERRED ASSETS	6,773.92	1,778.38	2,115.15
Unamortized expenses	1,461.09	1,461.09	1,461.09
Prepaid expenses	5,271.59		
Revenue stamps	41.24	317.29	654.06
TOTAL ASSETS	2,382,112.58	3,408,660.31	5,652,395.27

ACCOUNT HEADING	1995	1996	1997
LIABILITIES			
LIABILITIES	837,626.85	1,190,348.18	2,000,000.00
Accounts payable	349,520.82	478,499.90	779,062.77
Deposits	390,763.75	601,072.85	1,494,014.88
Due	33,398.14	51,764.71	87,773.69
Accounts payable	63,944.13	59,002.72	139,015.08
LIABILITIES	60,560.81	132,157.39	140,119.41
	60,560.81	132,157.39	140,119.41
LIABILITIES	81,170.47	121,639.63	100,453.06
Payroll taxes		67,944.24	100,453.06
Grants	81,170.47	52,195.36	80,961.26
		224.52	224.52
Investment		1,275.52	1,275.52
Due in advance			800.00
LIABILITIES	979,358.13	1,444,137.20	2,000,000.00
	1,402,755.45	1,964,523.11	2,000,000.00
Grants	1,182,018.55	1,642,015.52	2,340,228.41
	148,066.45	233,137.88	365,638.33
	36,287.00	36,287.00	36,287.00
Income over expenses	36,383.45	53,082.71	86,541.35
LIABILITIES + NET WORTH	2,382,113.58	3,408,660.31	5,000,000.00

COOPERATIVA MIXTA OCOTEPEQUE
CONSOLIDATED INCOME STATEMENT AT DECEMBER 31
(US\$)

ACCOUNT	TOTAL	TOTAL	TOTAL
	1995	1996	1997
	733,633.42	1,194,223.13	1,194,223.13
Assets	327,093.36	520,203.01	858,430.91
Investments	38,858.10	37,089.64	221,090.00
Revenues	37,899.46	48,508.04	6,699.12
	7,940.50	33,577.27	16,449.01
	321,842.01	554,845.17	681,955.47
	591,818.67	1,025,449.52	1,025,449.52
Liabilities	111,586.42	67,816.38	112,174.03
Reserves	2,702.05	21,710.32	23,396.85
	96,816.54	276,345.82	587,003.62
Unfunded	278,485.80	484,507.64	586,663.38
	46,767.31	86,181.26	96,262.68
Reserves	2,798.12	3,308.97	3,524.70
Int	6,537.07	9,512.45	11,659.47
Utilities	6,353.38	7,714.25	9,285.84
Guarantees	17,676.92	32,753.45	46,194.93
Depreciation and appraisals	11,672.30	9,114.71	24,248.87
Funds		9,323.29	
Reserves	3,548.87	3,255.51	5,959.53
Governing bodies	853.94	994.03	1,961.98
	6,019.95	12,911.44	19,624.13
DEFICIT	141,814.75	168,773.61	2,194,223.13
PROVISIONS	103,970.55	115,690.90	1,194,223.13
BE DISTRIBUTED	36,383.45	53,082.71	

PROPOSED RESOLUTION

HONDURAS. FINANCING AND TECHNICAL COOPERATION TO THE COOPERATIVA
MIXTA OCOTEPEQUE WITHIN THE PROGRAM FOR
FINANCING SMALL PROJECTS

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, as Administrator of the Special Fund for the Financing of Microenterprises of the European Community, to enter into such agreement or agreements as may be necessary with the Cooperativa Mixta Ocotepeque, of the República de Honduras, to grant it, within the Program for Financing Small Projects, approved by Resolutions DE-85/78 and DE-147/79: (a) reimbursable financing for the execution of the program referred to in Document PR-____; and (b) non reimbursable technical cooperation for the execution of the program, in accordance with Annex I of said document.

2. That up to the sum of 459,400 ECU, is authorized for the purposes indicated in paragraph 1(a), and up to the sum of 160,790 ECU, for the purposes indicated in paragraph 1(b), both chargeable to the resources of the Special Fund for the Financing of Microenterprises.