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GUATEMALA

SMALL PROJECTS FINANCING PROGRAM

PROPOSAL FOR FINANCING AND TECHNICAL COOPERATION FOR:

ASOCIACIÓN CHAJULENSE V'AL VAQ QUYOL

(SP/TC-98-01-09-5)

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ABBREVIATIONS

ALTERTEC	Tecnología Alternativa [Alternative Technology]
CESI	Committee on Environment and Social Impact
CPR	Comunidades de Población en Resistencia [Communities with Population in Resistance]
DECOPAZ	Programa de Desarrollo Comunitario para la Paz [Community Development for Peace Program]
FAFIDESS	Fundación de Asesoría Financiera a Instituciones de Desarrollo y Servicio Social [Foundation for Financial Advisory Assistance to Social Development and Service Institutions]
FEDECOCAGUA	Federación de Cooperativas Agrícolas de Productores de Café de Guatemala [Coffee Growers' Federation of Guatemala]
NGO	Nongovernmental organization
PRODERE	Programa de Desarrollo para Desplazados, Refugiados y Repatriados [Development Program for Displaced Persons, Refugees and Repatriates]

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EXECUTIVE SUMMARY

AMOUNT AND SOURCE: IDB: Financing: US\$500,000
Technical cooperation: US\$150,000
Total: US\$650,000

The total amount of the program will be the equivalent of US\$650,000, all of which will come from the Norwegian Development Fund for Latin America.

FINANCIAL Amortization period: 20 years
TERMS AND Grace period: 4 years
CONDITIONS: Implementation period: 3 years
Disbursement period: 4 years
Credit fee: 1%

OBJECTIVES: The program's overall objective is to bring the displaced households of the Ixil community back into the country's economic development process by means of the credit and technical assistance services offered by the Association. The specific objectives are: (i) to improve and expand, on a sustainable basis, the credit services offered by the Association's *Caja Popular de Ahorro y Crédito* [Savings and Credit Union] so that the returning households have access to credit for undertaking operations as small coffee growers; and (ii) to strengthen the Association as an institutional to enable it to respond to the growing demand for credit and technology created by the return of Chajul campesinos to their native lands.

DESCRIPTION: The proposed program is comprised of the following components:

- a. Credit Component: The credit program is designed to provide three types of credit to members of the Association: (i) credit for new plantings of organic coffee; (ii) credit for the purchase of coffee huskers; and (iii) credit for the installation of coffee-drying yards. The number of loans to be provided by the Association to small coffee growers over a four-year period is currently estimated at 1,200.

- b. Technical cooperation: The nonreimbursable technical-cooperation program is aimed at strengthening the Association's institutional capabilities to make it responsive to the growing demand for credit and technology created by the return of Chajul campesinos to their lands.

**ENVIRONMENTAL
CLASSIFICATION:**

The Committee on Environment and Social Impact (CESI) considered the profile of this project on October 2, 1998. The Committee's recommendations were taken into account in designing this proposal.

**TARGETING OF
LOW-INCOME
CLIENTS:**

The target group will be 1,200 small coffee-growers in the region, most of whom are returning to their native lands.

RISKS:

The principal risk associated with the program is that the Association is unable to give its Credit Union the technological strengthening needed to handle the increased credit-portfolio generated by the project. To mitigate this risk, the program will allocate resources under the technical-cooperation component to strengthen the Credit Union.

**THE BANK'S COUNTRY
STRATEGY:**

The Bank's strategy focuses on four specific areas: (i) inclusion of the poor, indigenous and rural population in the process of sustainable development; (ii) expansion and improvement of social services; (iii) modernization of the State; and (iv) development and growth of the private sectors of production (country paper GN-1924-1, approved in October 1996). The present proposal falls under points (i) and (iv) of this strategy.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

It is recommended that the following special conditions be included in the financing and technical cooperation agreement in addition to the standard contractual conditions:

Prior to the first disbursement of resources from the credit component, the Association shall demonstrate to the Bank's satisfaction that it has: (i) hired the consultant for the technical and financial advisory services (paragraph 4.6); (ii) hired the necessary personnel and begun the training process (paragraph 4.7); (iii) installed the computer equipment and placed it in satisfactory operating condition (paragraph 4.8); and (iv) updated the credit regulations (paragraph 4.2).

Prior to the disbursement of technical-cooperation resources, the Association shall submit the terms of reference for hiring consultants to provide technical

and financial advisory services for the rural microcredit program (paragraph 4.6).

At the Association's request, the Bank may disburse up to 20% of the total amount of the technical-cooperation funding as an advance (paragraph 4.9).

A mid-term evaluation of the Association will be performed when 20% of the credit component has been disbursed (paragraph 4.12).

In order to continue disbursements in excess of 20% of the credit component, the Association must submit the findings of the study it is currently performing to determine the economic and financial feasibility of the plan to legally separate the Savings and Credit Union from the Association. If the study shows that the plan is feasible and the Association decides to implement it, the Bank will require a transfer of funds agreement. If the plan is not implemented, the Bank will be requested to indicate its nonobjection to a continuation of the operation under the present arrangement (paragraphs 3.18 and 4.13 (v)).

The Association will submit a final report to the Bank setting forth the results and the benefits obtained. The design of this evaluation will be determined at the mid-term evaluation.

I. FRAME OF REFERENCE

A. Socioeconomic setting

- 1.1 Guatemala has a population of 11.2 million inhabitants, 58.2% of whom live in 19,000 widely scattered rural communities with an average of less than 2,000 inhabitants each. Per capita product is low – US\$916 in 1996 – and there are widely varying economic levels, as reflected in income-distribution and land-tenure patterns. Indeed, 10% of the population receive 44% of national income while 75% of households – concentrated mainly in rural areas and in shantytowns around the major urban centers – are poor.
- 1.2 The agricultural sector accounts for roughly 25% of the gross domestic product (GDP) and 50% of rural employment. This sector, however, includes a large number of poor farmers who engage in subsistence farming. According to the latest agricultural census (1979), 2.5% of the owners of farms held 65% of the usable land whereas 16% of the land was being cultivated by small farmers, who accounted for 88% of the total number of farms. The same census notes that landless farmers made up close to 36% of the economically active population. Economic conditions among small farmers are particularly unfavorable in the country's northern and western departments, where the population was directly affected by the armed conflict.

B. The return of lands to displaced families in the Ixil area

- 1.3 The Ixil area, in the department of Quiché, was one of the areas most seriously affected by the armed conflict. It is estimated that some 100,000 local residents were displaced from their lands as a result of the hostilities. In the township of Chajul, some of the lands abandoned by the residents displaced were occupied by campesinos groups from other townships in Quiché and Huehuetenango who in turn had been uprooted from their own communities by the conflict. In February 1996, the Pro-Tierra [Land-Recovery] Committees of Chajul, representing the families originally from the northern parts of Chajul, and the Popular Resistance Communities (CPRs), representing the families currently occupying those lands, jointly petitioned the government for assistance in arriving at a peaceful settlement of the land-tenure problem that had existed between the two groups. In April 1998, a framework agreement for the negotiation was signed and the process of resettling the CPRs and returning lands to the displaced Chajul families was officially launched. 1/

1/ The lands for resettlement of the CPR population were acquired by the Fondo Nacional para la Paz [National Fund for Peace] (FONAPAZ).

- 1.4 In 1998, the process of moving CPR families to lands acquired in other departments commenced. At the same time, nearly 95% of the approximately 1,000 Chajul families that it was estimated would return to their home have already done so and have become small coffee growers. During the first stage of resettlement, the Chajul returnees receive food and some housing materials under the emergency program. These programs, however, have no provision for credit assistance for the start of production activities.
- 1.5 The proposed project seeks essentially to bring displaced families of the Ixil community back into the process of national economic development through credit and technical assistance provided by the ***Asociación Chajulense V'al Vaq Qu Yol***, hereinafter also called the Association. This is a community-based organization that provides technical assistance to small growers in the production and export of fully organic coffee. The Association has more than 2,500 members representing a total of 15,000 people in 52 communities of the Ixil Mayan ethnic group. It is worth noting that the Association played a catalytic role in the agreement between the CPRs and the Pro Tierra Committees, monitoring every step in the negotiating process.

C. International markets for organic coffee

- 1.6 The rationale for the program is that sufficient demand exists in world markets to absorb an increasing volume of organically produced coffee. While there are no detailed statistics on the production and export of organic coffee in Guatemala, there is a consensus that the international market for organic coffee is expanding rapidly. It is estimated that the production and export of the product has been increasing at a rate of 25% a year, and by as much as 50% in some years. There are no indications to date of market saturation; in fact, there are periods every year in which the country's exporters cannot keep up with demand.
- 1.7 The Association exports coffee directly to the European market, mainly to the Netherlands, Italy and Germany. In 1997, it began exporting to the North American market. The Association's coffee is in great demand because of its excellent quality and because it is organically grown. Output was only sufficient to meet 80% of total demand for this product during the 1996-1997 biennium. The Association receives constant offers from distributors in a number of European countries and therefore believes that there is enough demand for organic coffee in the European market to absorb the increased production generated by the project.

D. Statement of nonobjection

- 1.8 On April 3, 1998, the Association approached the Bank for financing and technical cooperation, with credit and institutional-strengthening components, for a project to benefit returning low-income campesinos in the Ixil area of Guatemala's department of

Quiché. The Ministry of Finance indicated its nonobjection to this proposal on October 23, 1998.

E. The Bank's strategy

- 1.9 The Bank's strategy focuses on four specific points: (i) bringing the poor, indigenous, and rural population into the process of sustainable development; (ii) expanding and improving social services; (iii) modernizing the State; and (iv) developing the private sectors of production (country paper GN-1924-1, approved in October 1996). The present proposal falls under points (i) and (iv) of this strategy.
- 1.10 It should also be noted that the proposal is consistent with the overall goal of the Bank's Strategy for the development of microenterprise (document GN-1938-3), which is to expand the opportunities in Latin America and the Caribbean through the sustainable and dynamic development of microenterprise. The objective is to promote the necessary conditions for growth and development of the sector in the region, i.e. a favorable regulatory policy and regime, sound and sustainable institutions offering financial and other services to meet the demand of microenterprises, improved access of low-income microentrepreneurs (including the rural population in indigenous communities) to financial and commercial services, and expanded, continuous and permanent flows of resources for investment in microenterprises.

F. The Bank's experience with microenterprise in Guatemala

- 1.11 At the present time, there are five small projects in support of microenterprise, nearing completion. The Bank recently approved two other small projects: one to fund the investment program for the Federación de Cooperativas Agrícolas de Productores de Café de Guatemala [Coffee Growers' Federation of Guatemala] (FEDECOCAGUA) (SP/NF-9805-GU), and the other a project for the Fundación de Asesoría Financiera a Instituciones de Desarrollo y Servicio Social [Foundation for Financial Advisory Assistance to Social Development and Service Institutions] (FAFIDESS), a local nongovernmental organization engaged in fostering the creation of community banks for women (SP/EM-98-07). In addition, the Bank, in May of 1992, approved a US\$10 million credit program for small business and microenterprise (886/SF-GU), which was reformulated in September 1997. The latter program is to be implemented through regulated financial entities and is therefore compatible with this project's objectives.

G. The Bank's experience with displaced population groups

- 1.12 The Bank is financing the Programa de Desarrollo Comunitario para la Paz [Community Development for Peace Program] (DECOPAZ), (968/SF-GU and 984/SF-GU), approved in November 1996, the objective of which is "physical, human and social recapitalization of the

areas most severely affected by the armed conflict." The total amount of the loan is US\$50 million, US\$9.3 million of which is earmarked for the creation of a seed-capital fund for market-based and sustainable production projects to be implemented by marginalized population groups in 16 townships of the department of Huehuetenango and of Ixcán in the north of Quiché. DECOPAZ does not cover the area of Ixil where the activities of this project are to be carried out. It is hoped that this project will provide useful information for implementing the DECOPAZ project, since it includes a credit component for settlers in rural areas affected by the recent armed conflict.

H. Justification of the proposal and target group

- 1.13 The project is justified because: (i) concentrating as it does on areas affected by the armed conflict, it can offer a specific example of how the private sector can develop in a context of social peace; (ii) the Association has succeeded in promoting social development and economic autonomy in the Ixil area through the direct exportation of organic coffee to world markets; (iii) the Association is the only entity in the Ixil area with the institutional capability for providing technological and financial services to the returning campesinos who aspire to rejoin the country's economic development process.

II. THE PROGRAM

A. Objectives

- 2.1 The program's general objective is to bring families from the Ixil community uprooted by the conflict back into country's economic development process through the credit and technical assistance services offered by the Association. Also, the project will, help improve the technology used to grow organic coffee and open up new markets for the small coffee growers, as well as to local assistance for the areas affected by the armed conflict.
- 2.2 The specific objectives are: (i) to improve and expand, on a sustainable basis, the credit services offered by the Association's *Caja Popular de Ahorro y Crédito* [Savings and Credit Union] so that returning households have access to a source of credit for operations as small coffee growers; and (ii) to strengthen the Association as an institutional so that it can respond to the growing demand for credit and technology created by the return of Chajul campesinos to their native lands.

B. Description

1. Credit component

- 2.3 The credit program is designed to provide three types of credit to members of the Association: (i) credit for new plantings of organic coffee; (ii) credit for the purchase of coffee huskers; and (iii) credit for the installation of coffee-drying yards. The number of loans to be provided by the Association to small coffee growers over a three-year period is currently estimated at 1,200. ^{2/} The amount required by the Association for carrying out this program is US\$500,000.

2. Technical cooperation

- 2.4 By means of the nonreimbursable technical-cooperation program (see Annex I) the Bank will provide the Association with technical advisory services for institutional and financial strengthening of the Savings and Credit Union to enable it to offer efficient credit services to small coffee growers in the Ixil area on a sustainable basis. These services will include: (i) installation of financial and information systems; (ii) updating of credit regulations and procedures; (iii) purchase and installation of computer equipment; (iv) hiring of a resident accountant; and (v) development of a Plan of Action for training 50 community representatives in financial and credit services.
- 2.5 It is important to note that the Association will assume the responsibility for financing the direct technical advisory services to new coffee growers in organic coffee production. To this end, the Association will extend the network of community promoters to seven new communities to which displaced families are returning. These advisory services are being paid for by the Association to Tecnología Alternativa (ALTERTEC) at a cost of approximately US\$14,000 per year. (See paragraph 3.4).

C. Cost and financing

- 2.6 The total amount of the project is US\$650,000. The program will be financed with resources from the Norwegian Development Fund for Latin America.
- 2.7 The amount for the credit component will be US\$500,000. This component will have a disbursement period of four years and an

^{2/} The Association estimates will grant 1,200 credits over a three-year period in a projected amount of US\$500,000. The breakdown by purpose would be as follows:

- a. 700 credits for new plantings,
- b. 250 credits for the purchase of huskers, and
- c. 250 credits for the installation of drying yards.

amortization period of 20 years with a four-year grace period. The credit fee will be 1%. The technical-cooperation funding, in the amount of US\$150,000, will be nonreimbursable. The period for disbursement of these funds will be four years.

- 2.8 The grace period will apply to principal repayments only. Interest will be paid annually. Principal will be amortized over 16 years after the grace period. A maintenance-of-value fee, based on the value of the dollar expressed in quetzales, will also be charged; i. e. the credit portfolio will be required to maintain its value in terms of U. S. dollars.

III. THE INTERMEDIARY ORGANIZATION

A. Identity and objectives

- 3.1 The Association is a community-based, not-for-profit, non-political technical, cultural, economic and social assistance organization. It was founded in 1988 by a group of former members of the Ixil Unión cooperative, which was destroyed by the violence of the armed conflict. Its principal objective is to develop and nurture a spirit of community solidarity and promote improvements of all kinds among the Maya-Ixil ethnic group.

B. Activities of the Association

- 3.2 In 1989, with the assistance of a Dutch firm, the members of the Association began to produce organic coffee for the alternative European market. Later, the Association received technical and financial support from the Development Program for Displaced Persons, Refugees and Repatriates (PRODERE) for the purpose of increasing its members' coffee output and equipping a dry-processing facility with a view to producing green coffee (café oro) ^{3/} in the Ixil area. In 1991, PRODERE approved the first credits, provided funds for consolidating the Association's management, and financed the training of technical promoters to advise the coffee growers. The Association then entered a period of rapid growth, and by the end of 1997 it had more than 2,500 members representing 15,000 individuals in 52 Maya-Ixil communities.
- 3.3 The following table shows the geographic breakdown of the Association's membership as of July 1998:

^{3/} Café oro is a dry processed coffee produced for export. It is obtained by removal of the husk known as the parchment.

CUADRO 1: MEMBERSHIP OF THE ASSOCIATION, JULY 1998

TOWNSHIP	NO. OF MEMBERS	COMMUNITIES
Chajul	1,525	20
Nebaj	421	15
San Juan Cotzal	456	9
Chiantla (Huehuetenango)	109	7
Cunen	31	1
	2,542	52

Source: Asociación Chajulense Secretariat, July 1998.

- 3.4 The basic services provided by the Association are the marshaling, processing, warehousing and export of organic coffee. In furtherance of its principal activity as a marketer of export-grade coffee, the Association is responsible for purchasing and processing its members' crop and exporting it to the European market. The prices paid by the Association are based on the cost of growing the coffee at the producer level and on the selling price abroad. The Association's community promoters provide technical training to the area's coffee growers. It receives support from ALTERTEC, a Guatemalan NGO that promotes organic farming, to improve the knowledge and skills of its promoters. In addition, NATURALAND, a German entity specializing in the production of organic coffee, is in charge of quality control at every stage of the process, from growing to export of the product.
- 3.5 The Association allocates 10% of the selling price of each pound of coffee to protection of the Visis-Cabá biosphere reserve, a 45,000 hectare tract regarded as an area of key importance to the conservation of Guatemala's biodiversity.
- 3.6 The Association has grown significantly over its seven years of operation. In 1990 it had approximately 250 members; by 1992, the number had risen to 1,700, and by 1997, to 2,500. Sales increased from 1,000 quintals in 1989 to 5,321 in 1997. The Association's operations are commercially profitable, and its net revenues are distributed among a number of social activities in the community.
- 3.7 In addition to the organic coffee project, the Association has a textile crafts project and offers a variety of services to the community, including freight transportation, a clinic and naturopathic pharmacy, a hardware store, a grocery and a legal office.

C. Savings and Credit Union

- 3.8 The *Caja Popular de Ahorro y Crédito* [Savings and Credit Union] was established in 1993 as a unit of the Association to provide credit services to its members. The Credit Union is capitalized by revenues from coffee sales and craft products and contributions from PRODERE. In 1996 and 1997, it granted 725 loans totalling 712,539 quetzals (approximately US\$118,750). The purpose of the Credit Union is to finance the working capital requirements of coffee growers, cattle raisers, artisans and other producers in the area. In spite of the Association's experience in credit management and the practices it follows in providing concessionary funds, i.e. charging the average market rate and maintaining rigorous criteria with respect to interest charges and arrearages, the increase in administrative work generated by the Bank's financing may raise the total workload beyond the Credit Union's existing capacity. This makes it important to bolster its current capacity so that the Association can handle the increase in its portfolio resulting from the Bank's financing.

D. Credit technology

- 3.9 Most of the credits granted by the Association's Savings and Credit Union are for coffee-growing-related activities, whether new plantings, maintenance of existing ones or for huskers and drying yards. The term of the credit is based on the growing cycle of the crop in question as well as the cash-flow requirements of all production activities. Accordingly, a grace period may be granted in certain cases but not in others. The most commonly granted terms are four years, with two years' grace for new plantings and two years, with no grace period, for huskers and drying yards. Interest is charged at 18% per annum, payable semiannually. The interest rate on arrearages is set by the credit regulations at twice the regular interest rate, or 36% per annum. As a general rule, interest cannot be capitalized and there is no grace period permitted on interest. Credits are also provided for other purposes such as the purchase of livestock or investment in looms, sewing machines and carpentry tools.
- 3.10 Loan requests from members residing in a given community must be sponsored by the Association's area representative, subject to verification that the applicant is a responsible person. Subsequently, the Credit Union's portfolio manager makes the necessary visits to verify the information contained in the application. The Association has no Credit Committee as such, and the responsibility for reviewing requests and deciding whether and on what terms to grant the financing is assumed directly by the board of directors.

E. Strengths and weaknesses of the institution

- 3.11 The Association's principal strengths are: (i) the leadership and learning capacity exhibited by its board of directors in promoting socio-economic development in the country's poorest rural communities; and (ii) its institutional ability to generate stable earnings for its members through the marketing of organic coffee. Its principal weakness lies in the incipient status (technologically speaking) of the Savings and Credit Union.
- 3.12 The Association's board of directors, democratically elected by the members, has from the outset taken the initiative in promoting a variety of projects that have helped to improve the lot of the residents in communities severely affected by the armed conflict, a fact which has earned the board the recognition of a number of national and international agencies active in the country's Northeast, inter alia PRODERE, USAID, the European Union, and the National Fund for Peace (FONAPAZ). Evidence of the board's learning capacity is that, notwithstanding the limited educational level of its members, it has been able, in less than seven years, to learn to manage the sophisticated operations involved in the production of organic coffee and its sale in foreign markets.
- 3.13 The processing and marketing of the Association's organic coffee are well established activities. Both the processing and exportation of the coffee have yielded excellent results, which appear to be sustainable in financial terms. The Association would be able to process and market additional volumes, and up to now the organic coffee market has given no signs of saturation. These positive factors indicate that the Association will have no difficulty in marketing the added amounts of coffee generated by the membership of the returnees in the Association.
- 3.14 Measured against the progress in the organic coffee marketing project, the development of the Savings and Credit Union is still in its early stages, both as regards the information and control systems and the definition of efficient procedures. Strengthening the Credit Union's capacity is essential to ensure that the Association will be able to administer the increase in its portfolio resulting from the Bank's financing. Accordingly, the technical-cooperation component envisages institutional strengthening to support the Credit Union in providing technical advisory services and ongoing training to its staff in administrative management of the credit program. However, given the Credit Union's past experience in this respect and the sustainability principles underlying its operation, and taking into consideration the growing cycle of coffee, it is believed that this support should take the form of a "hands on" or "learn by doing" activity and provision is therefore made for the Association to begin its credit program concurrently with the strengthening scheme.

F. Financial situation

- 3.15 The Association has grown significantly during its seven years of operation. Sales rose from 1,000 quintals in 1989 to 5,321 quintals in 1997. Its operations have been commercially profitable every year, although results have fluctuated widely from year to year depending on world coffee prices and, consequently, on coffee-retention policies. Yearly net revenues are distributed among a variety of community social activities.
- 3.16 These fluctuations explain why profits were equal to 5% of sales revenues in 1995, but 33% in 1997. The latter percentage, however, was due in part to the inventories of finished product withheld from the market because of the drastic decline in the price of a quintal of organic coffee.
- 3.17 In any event, it can be affirmed that the Association's net operating margin is close to 7.5% if allowance is made for the inventory-management effect. Moreover, while the Association does not produce separate financial reports or statements for the credit component, a number of analyses and assumptions made in the field with respect to its figures supported a finding that the credit operation is sustainable and even profitable. In addition, the members were found to be keenly interested in depositing their savings in the Credit Union, thereby ensuring a flow of added resources for credits over the longer term.
- 3.18 In view of the foregoing, the Association is studying the various organizational schemes allowed by the laws of Guatemala to determine the possibility of separating the activities of the Credit Union as such from the rest of the Association's activities. This would be done, however, only if the study showed that the separation would provide specific benefits to the organization and its members. As a result, it was decided to include the feasibility of such a legal separation among the items to be covered in the mid-term review. The Bank will evaluate the results of the study along with the wishes of the Association itself in deciding upon appropriate action and determining whether to continue disbursing resources.
- 3.19 In 1997, the total assets of the Association amounted to US\$1,309,000, the largest single item being current assets, which had increased significantly from 1995 owing to the signing of an agreement with the European Union. Liabilities, including credits payable to suppliers, were only 18% of assets. Net worth consists of: 65% capitalized surplus (65%) and foreign donations (35%) (see Annex II).
- 3.20 The credit portfolio accounted for roughly 12% of assets in the year-end financial statements. This is due to the fact that the planting season is the first quarter of the year and, since it is not the Association's policy to grant extensive grace periods,

repayments have been made by the latter part of the year. As these are agricultural loans, average portfolio turnover is one year and three months. Even though the accounting records pertaining to the credit operation are not part of a formal accounting system and are therefore not totally reliable, it was possible to determine that arrearages, measured as the portfolio in arrears as a percentage of total portfolio, came to less than 5%.

IV. IMPLEMENTATION OF THE PROGRAM

A. Responsibility for implementation

- 4.1 The responsibility for administering and implementing the program will lie with the Association.

B. Credit component

- 4.2 The credit component will be implemented in accordance with a set of credit regulations that will be subject to review and acceptance by the Bank prior to the first disbursement. At the present time, the Credit Union has a set of credit regulations that conform in general to agricultural credit criteria but which nonetheless require review to make them compatible with modern and more universally applicable technology. The revised regulations should establish the conditions of loans in terms of objectives, terms, costs, penalties, etc.
- 4.3 The interest rate the Association charges its members for credits offered with resources of this program should be at least equivalent to the average lending rate in the Guatemalan financial market and in any event should cover the program's operating costs.

C. Institutional strengthening

- 4.4 The institutional-strengthening phase will be implemented by: (i) hiring a firm of specialists in microcredit to provide technical assistance to and monitor the credit program; (ii) hiring a resident accountant; and (iii) purchasing computer hardware and software licenses for an effective management and credit information system.
- 4.5 The Association will utilize the technical-cooperation resources to finance the activities specified in the following paragraphs.
- 4.6 The Association will hire a firm of consultants to provide technical, financial and institutional advisory services for the rural microcredit program. The services of the firm will include: (i) establishing the information and financial systems for the Savings and Credit Union; (ii) updating the regulations and

procedures of the credit program; (iii) training and ongoing supervision of staff of the Credit Union; and (iv) implementing a credit training system for 50 community representatives. Hiring of the consultants will be a condition precedent to the disbursement of the funds for credit, and presentation of the consultants' terms of reference will be a condition precedent to the disbursement of the technical-cooperation component.

- 4.7 In order to increase the Credit Union's administrative capacity, a resident accountant will be hired. The latter will be expected to ensure transparency in fund management and to segregate, by means of differentiated accounting codes, the Credit Union's accounting records and those pertaining to other activities of the Association. Also, the Association has agreed to assign two full-time credit analysts to be paid out of funds of its own. These experts will work directly with the present head of the Credit Union, who will assume direct responsibility for financial operations under the project. Hiring the resident accountant and demonstrating that the Association has hired the requisite staff to handle the growing demand for credit will be conditions precedent to the first disbursement of resources for the credit component.
- 4.8 Computer systems will be installed. This will include: computer hardware and protection equipment, a power generator, purchase of software and the pertinent licenses for simultaneous access to newer and lower-cost versions, as well as advisory services on installation and technical support. Having this equipment installed will be a condition precedent to the first disbursement for the credit component.
- 4.9 At the request of the Association, the Bank may advance up to 20% of the technical-cooperation funding.

D. Period for implementation of the program

- 4.10 The period for implementation of the program will be 36 months (three years).
- 4.11 The disbursement period for the credit component will be 48 months. The first disbursement of funds for this component will be contingent upon the Association's having procured the software needed for monitored management of a growing number of credit operations, having hired the resident accountant, and having entered into a contract with a firm to be responsible for monitoring and technical support.

E. Mid-term evaluation

- 4.12 An expert consultant in microcredit, assisted by an expert in institutional development, will perform a mid-term evaluation with a view to correcting any deficiencies that may have arisen in the course of the program. To this end, the Bank's Office in Guatemala

will contract directly for the consulting services needed for such an evaluation, the cost of which will be charged to the technical-cooperation funding. The evaluation will be made when 20% of the resources of the credit component have been disbursed.

- 4.13 The purposes of the evaluation will be: (i) to verify that the Association has managed the credit program efficiently on the basis of the credit regulations and procedures as updated in the institutional-strengthening stage; (ii) to verify that the members have used the credits according to the criteria laid down for the credit program; (iii) to review the accomplishments of the program and determine the advances the Association has made toward its goal of meeting returnees' credit requirements; (iv) to present the terms of reference and content of the final evaluation; and (v) in order to access more than 20% of the resources allotted to the credit component, the Association will be required to submit the findings of its study, currently under way, to determine the economic and financial feasibility of establishing a legal separating the Savings and Credit Union and the Association. If the study shows that such a course of action is viable and the Association decides to implement it, the Bank will require a funds transfer agreement. Should it not be implemented, the Bank will be required to indicate its nonobjection in order to continue operating under the current arrangement.
- 4.14 The Bank will review the findings and recommendation of this evaluation and, if it views them as satisfactory, will authorize the Association to continue to make commitments of funds, chargeable to the credit component or, if applicable, to implement other pertinent measures. The remainder of the credit-component resources (80%) will not be committed until the Association presents evidence that appropriate action has been taken to remedy the deficiencies identified in the evaluation.

F. Final report on results

- 4.15 The Association will submit a final report to the Bank setting forth the results and benefits obtained. The design of this report will be determined at the mid-term evaluation.

G. Use of surpluses

- 4.16 During the term of the agreement, the income generated by project activities will be used to cover operating costs, and surpluses, if any, will be used to increase the number of beneficiaries of the activities proposed herein.

H. Portfolio in arrears

- 4.17 Throughout the proposed program, the Association will take appropriate steps to ensure that total arrearages of more than 30 days are below 5% of the total portfolio. In the event of

noncompliance with this provision, the Bank reserves the right to defer disbursements, always taking into account any circumstances that would justify a temporary increase in the rate of arrearages.

I. Environment- and gender-related issues

- 4.18 Traditionally, women in Ixil tended to devote themselves to unremunerated activities. This, however, is changing. Approximately 500 of the Association's 2,500 members are women who are active participants in the craft textiles project. Women also play a significant role in coffee-growing, either as growers or helpers of member growers. The Association is interested in encouraging participation by its women members in the credit program.
- 4.19 Environmental protection is the central focus of the Association's activities. The Association has a policy of not promoting any practice involving the use of chemical fertilizers, and the regulations for the organic coffee project prohibit the use of chemical fertilizers or pesticides by its members. Its promoters provide ongoing training to its members to help them maintain and improve their organic coffee growing practices. In addition, all of the coffee husks and other organic processing wastes are used for compost. The Credit Program will support and encourage the adoption of organic coffee growing practices by returning families so they do not contaminate the soil with chemical fertilizers.

J. Progress reports

- 4.20 The Association will be required to submit to the Bank a progress report on the program within 60 days after the close of each calendar year for the duration of the program. The last such report will constitute the final report and should contain a summary of the results achieved, measured against the original objectives of the program. Based on the advances achieved, the report should include data on improvements in the institutional capacity of the Association, particularly as regards its progress toward self-sufficiency in its operations.

K. External audit

- 4.21 For a period of five years, beginning with the year in which disbursements commence, the Foundation should present to the Bank' within the first 120 days after the close of each calendar year, its financial statements and those of the program. The statements must be certified by an independent auditor or a firm of independent public accountants acceptable to the Bank.

V. FEASIBILITY AND RISKS OF THE PROGRAM

A. Socioeconomic feasibility

- 5.1 It is estimated that a small coffee grower in the Ixil area normally cultivates between 0.5 and 1 hectare and produces between 10 and 15 quintals of cherry or parchment coffee. In 1995-1996, this resulted in annual sales of Q.5,000 (US\$850) to Q.7,500 (US\$1,200). In spite of the Association's apparent positive impact on the economic status of its members, based on these revenue figures, the population in the area can still be characterized as living in extreme poverty. Furthermore, the government's resettlement program does not include any credit services for the returning families. The expansion of credit facilities offered by the Association through this program will therefore exert a significant impact on the resettlement of 1,000 displaced families and increase the incomes of small coffee growers in the areas of the recent armed conflict.
- 5.2 It is important to note that there are no formal credit facilities in the project area. Strengthening the Association's Savings and Credit Union as an effective agency to administer the credit program will provide small farmers in remote areas with continuing access to a credit.
- 5.3 Finally, improving the Association's organic coffee growing and marketing practices will provide a specific example of a way in which the private sector can contribute to the socioeconomic development of the areas severely affected by the armed conflict.

B. Institutional feasibility

- 5.4 The Association's experience, its results to date in terms of both coverage expansion and the marketing of organic coffee, and its institutional credibility are the principal guarantors of this project's viability. Its rapid organizational growth is attributable mainly to the leadership and learning capacity of its board of directors. It is anticipated that with the technical assistance to be offered under the technical cooperation component, the Association will quickly familiarize itself with the administrative management of the credit program.

C. Financial feasibility

- 5.5 The rapid growth of the international markets for organic coffee and the excellent quality of the coffee the members produce, together with the Association's coffee marketing ability, offer the best assurance that the members will receive a stable return from the production of organic coffee (see paragraphs 1.6 and 1.7).

- 5.6 While the Association has projected a sharp devaluation of the quetzal in year 1 (12% per annum), followed by moderate devaluations beginning in year 2 (5% annually), it expects to maintain the dollar value of its portfolio.
- 5.7 Projections of the Credit Union's future activity show administrative costs equal to roughly 7% of the average portfolio. This percentage, which is low compared to the usual level in the microcredit industry, is achievable because the community representatives are volunteers whose only compensation is a per diem allowance and the cost of their transportation to the communities.
- 5.8 The net margin of the Credit Union, taking into consideration the administrative costs mentioned above, the financial costs of the operation, maintenance of value, and a 3% per annum provision for the portfolio, comes to more than 30% per annum.

D. Risks of the operation

- 5.9 The principal risk associated with the program is that the Association's fails to strengthen its Credit Union technologically to the extent that it can handle the increased credit portfolio generated by the project. To mitigate this risk, the program will devote its first three months to strengthening the Credit Union with the resources of the technical-cooperation component. The first disbursement of funds for the credit program will be contingent upon the Association demonstrating that the portfolio information and control systems have been installed and are operational.

VI. JUSTIFICATION AND RECOMMENDATIONS

- 6.1 The proposed program is consistent with the Bank's policy of supporting economic development of direct benefit to marginalized groups without access to credit in the formal banking system. The Association has the potential to respond on a sustainable basis to credit requirements of low-income rural microentrepreneurs. In order to realize this potential, it needs an additional financing program and a technical cooperation program to strengthen it as an institutional.
- 6.2 The foregoing analysis supports the conclusion that implementation of the program is feasible under the terms and conditions proposed herein. Accordingly, the Management of the Bank hereby presents to the Board of Executive Directors for its consideration the proposed resolution for financing and nonreimbursable technical-cooperation funding for the Association, with the recommendation that it be approved.

PLAN OF OPERATIONS

I. BACKGROUND

- 1.1 In addition to the request for financing, the Asociación Chajulense V'al Vaq Quyl (the Association) applied for nonreimbursable technical-cooperation funding to support the implementation of the program proposed in the financing document.

II. OBJECTIVE

- 2.1 The objective of the proposed technical-cooperation operation is to strengthen the Association institutionally to enable it to respond to the growing demand for credit and technology generated by the return of the Chajulan campesinos to their native lands.

III. DESCRIPTION OF THE PROGRAM

- 3.1 The objective of the operation will be achieved through the activities described below.

A. Technical advisory services

- 3.2 Funding will be made available to the Association under the technical-cooperation program for use in the institutional and financial strengthening of its Savings and Credit Union to enable it to offer efficient credit services on a sustainable basis to small coffee growers in the Ixil communities. These services will include: (i) installing the financial and information systems; (ii) updating the credit regulations and procedures; (iii) purchasing and installing computer equipment; (iv) hiring additional staff for the Credit Union; (v) training Credit Union staff; and (vi) developing the Action Plan for providing training in financial and credit services to 50 community representatives.

B. Increase in the administrative capacity of the Savings and Credit Union

- 3.3 As a means of increasing the Credit Union's administrative capacity, the program will finance the services of a resident accountant, whose area of activity will be management and control of the Credit Union's loan portfolio. Beginning in the fourth year of implementation, the Association will assume the cost of the accountant's position. The Association, for its part, using

resources of its own, will assign two credit analysts to the Credit Union to serve on its team of advisors. These experts will work directly with the person currently in charge of the Credit Union, who will bear direct responsibility for the project's financial operations. It is important to note that the advisor/analysts must be members of the Association or at least permanent residents of Ixil communities. This will ensure that the Association continues to benefit from the administrative capacity installed during the program.

- 3.4 The installation of computer systems to facilitate the management of the Credit Union's financial and information systems will proceed concurrently. The items to be procured include computer and computer-protection equipment, a power generator, and software. The program will also finance the cost of advisory services to help install the equipment and technical support in its operation.

D. Mid-term evaluation

- 3.5 A mid-term evaluation will be conducted for the purpose of:
(i) verifying that the Association has managed the credit program efficiently on the basis of the credit regulations and procedures as updated during the institutional strengthening stage;
(ii) making certain that members have utilized the credits in accordance with the criteria established for the credit program;
and (iii) reviewing the accomplishments of the program and determining the extent to which the Association has progressed toward its goal of meeting the credit needs of returning families.

IV. COST AND FINANCING

- 4.1 The total cost of this nonreimbursable technical-cooperation operation has been estimated at approximately Q.945,000 (equivalent to US\$150,000), and will be financed in accordance with the detailed budget shown below. The resources for financing the program will come from the Norwegian Development Fund for Latin America.

COST OF THE PROGRAM

CATEGORY	US\$
1. Fees of consulting firm	
A. Technical and financial assistance	15,000
B. Implementation of the 50 community representatives program	15,000
C. Ongoing training and monitoring	
Subtotal	32,000
2. Fees of resident accountant	62,000
3. Implementation of computer system:	18,000
A. Equipment, protection, power plant	15,000
B. Software license or acquisition	10,000
C. Advisory assistance installation/use	12,000
D. Technical support	8,000
Subtotal	45,000
4. Evaluations	20,000
5. Contingencies	5,000
TOTAL	150,000

V. JUSTIFICATION

- 5.1 The proposed technical-cooperation operation is justified because:
- a. It will promote the institutional strengthening of the Association to enable it to respond to the growing demand for credit and technology generated by the return of Chajulan campesinos to their native lands.
 - b. It will help create an efficient and sustainable program offering credit facilities to farmers in the area affected by the recent conflict.

VI. DISBURSEMENTS

- 6.1 The Bank's contribution will be disbursed over a period of 48 months beginning on the effective date of the agreement. At the Association's request, the Bank may advance up to 20% of the total amount of the technical-cooperation funding.

VII. REPORTS

- 7.1 Reports of the consulting firm. The contract entered into by the Association should include a commitment by the firm to provide to the Association, with a copy to the Bank and for the Bank's approval: (i) within 30 days after the close of each calendar half-year following the date of commencement of the work, a semiannual progress report setting forth the progress made in implementing the program; (ii) within 30 days after the date of completion of the work, a final report indicating the results achieved and evaluating them in the light of the program's objectives and subsequent recommendations; and (iii) the contract must also include a commitment to provide the Association or the Bank with any additional information either of them may reasonably request with respect to the progress of the work.
- 7.2 Reports of the Association. At the close of the institutional strengthening stage, the Association will present a report to the Bank containing evidence of compliance with the commitments to establish the team of advisors for the Credit Union, install computer equipment, and update the credit regulations and procedure as well as the technical-assistance action plan. The Association should also provide the Bank with annual progress reports, satisfactory to the Bank, setting forth the advances made in implementing the program. These reports must include indicators of portfolio management: growth, demand, turnover, delinquency rates, percentage of women served, etc.
- 7.3 Audit report. For a period of five years, starting with the year in which disbursements begin, the Association must submit to the Bank within the first 120 days after the close of each calendar year for a five-year period, starting with the year in which disbursements begin, its financial statements and those of the program, audited by an independent auditor or a firm of independent public accountants, acceptable to the Bank.

VIII. SUPERVISION

- 8.1 The services of the consulting firm will be monitored by the Association. In addition, the Bank will supervise the program through its Country Office in Guatemala.

IX. EVALUATION CRITERIA

- 9.1 This technical-cooperation operation will be evaluated in terms of its stated objectives and the extent to which these objectives were reached and on the basis of the reports referred to in paragraphs 7.1 and 7.2 as well as the quality of the work performed during its implementation.

FINANCIAL STATEMENTS
in US\$000 (exchange rate: US\$1 = Q6)

	12/31/95	12/31/96	12/31/97
Current Assets:	288	570	985
- Cash and banks	23	350	504
- Credits receivable	192	136	148
- Interest receivable	6	41	61
- Supplies	23	23	18
- Inventory	44	20	254
Fixed Assets:	682	418	324
TOTAL ASSETS	970	988	1,309
Short-term liabilities:	--	--	--
Long-term liabilities:	181	189	234
- Credits payable	175	171	222
- Interest payable	6	17	12
Capital	789	800	1,075
- Net worth	403	403	403
- Prior-period earnings	333	387	397
- Current-year earnings	53	10	275
TOTAL LIABILITIES AND CAPITAL	970	988	1,309

STATEMENT OF INCOME AND EXPENSES
in US\$000 (exchange rate: US\$1 = Q6)

	1995	1996	1997
Sales revenue	1,056	1,026.5	836
- Processed coffee	953	956.8	729
- Others	103	69.7	107
"Financial" and other income	6	168	188
- Interest	--	23	20
- Recoveries	--	0.3	2.5
- ECDS Fund	--	142.7	163.5
- Miscellaneous	6	2	2
TOTAL INCOME (Operations)	1,062	1,194.5	1,024
Operating expenses	1,162	1,179	825
- Coffee processing	761	825	691
- Depreciation	127	129	111
- Other operating expenses	167	201	258
- Opening inventory	152	45	21
- (Closing inventory)	(-45)	(-21)	(-256)
Other expenses	0.2	309	79
- European Community project	--	307	62
- Other	0.2	2	17
TOTAL EXPENSES	1,162.2	1,488	904
OPERATING GAIN/LOSS	-100.2	-293.5	120
OTHER INCOME (grants)	153.5	303.5	155
- European Community funds	152.5	183.5	91
- Miscellaneous grants	1	20	64
- Coffee crop prefinancing	--	100	--
Gain in the period	53.3	10	275

PROPOSED RESOLUTION

GUATEMALA. FINANCING AND TECHNICAL COOPERATION TO THE ASOCIACIÓN
CHAJULENSE V'AL VAQ QUYOL, 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 Norwegian Development Fund for Latin America, to enter into such agreement or agreements as may be necessary with the Asociación Chajulense V'AL VAQ QUYOL, of the Republic of Guatemala, 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 US\$500,000, is authorized for the purposes indicated in paragraph 1(a), and up to the sum of US\$150,000, for the purposes indicated in paragraph 1(b), both chargeable to the resources of the Norwegian Development Fund for Latin America.