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ECUADOR

SOCIAL ENTREPRENEURSHIP PROGRAM

**STRENGTHENING THE COCOA PRODUCTION CHAIN IN
AFRO-ECUADORIAN COMMUNITIES**

(EC-S1002)

FINANCING AND TECHNICAL COOPERATION PROPOSAL

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EXECUTIVE SUMMARY

Executing agency: Asociación de Productores de Cacao del Norte de Esmeraldas
[Northern Esmeraldas Cocoa Producers Association] (APROCANE)

Amount and source:	IDB (US\$)	Local (US\$)	Total (US\$)
Financing:	245,000	61,000	306,000
Nonreimbursable technical cooperation:	<u>185,000</u>	<u>123,000</u>	<u>308,000</u>
Total:	430,000	184,000	614,000

The resources will be drawn from the net income of the Fund for Special Operations (FSO).

Terms and conditions:

Amortization period:	15 years
Grace period:	5 years
Interest rate:	2% in U.S. dollars
Disbursement period:	48 months
Execution period:	42 months

The grace period will apply only to amortization of the principal, not the interest. The loan will be denominated and repaid in dollars. The financing terms will be set in accordance with the current benchmarks for SEP programs, factoring in the poverty level of the project's end customers and terms applied on other projects targeting the same product category.

Problem to be addressed:

The small farmers of the Afro-Ecuadorian communities in the Esmeraldas province are among the country's poorest, with very high rates of poverty, illiteracy, malnutrition and social exclusion.

Despite these difficult conditions, the small cocoa farmers in Esmeraldas already have an established productive base with great potential. They are experienced and skilled in cocoa production. They have land under cultivation of sufficient productive capacity to fill large orders for cocoa beans, and which boast excellent geographical and climatic conditions for producing high quality cocoa. Yet these small producers face a series of *interrelated problems that prevents them from being profitable and competitive in producing and marketing their cocoa under present conditions* and thus boosting their productivity, the price they get for the product and, consequently, their household income. The problems cover three main areas. (i) The first is *low productivity and quality*, due to insufficient technical expertise, the low density of plantings and failure to renew them, and scant access to improved strains of cocoa plants that could raise yields. They also suffer from limited opportunities and knowledge to introduce organic cocoa and a lack of training, technology transfer and environmentally sound management of their farms. (ii) Second is the *organizational weakness* of the growers' associations, which need institutional strengthening in leadership and management as well as in planning, organization, administration, marketing and finance. These associations also lack the infrastructure to store, sort, grade and market their cocoa under optimal conditions. (iii) Third is *a lack of access to profitable market outlets*, due to the fragmentation of production and trading and the absence of infrastructure, working capital or effective logistics and coordination to offer a quality product to markets of higher volume and value.

Objectives: The project's general objective is to help raise the income of cocoa growers in Afro-Ecuadorian, mestizo and indigenous communities in the Esmeraldas province through a sustainable system of production and marketing that allows APROCANE members to sell a greater volume of their product at higher prices.

The specific objectives are: (i) to raise the cocoa yield and quality of 1,400 producers through the adoption of good production and harvest/post-harvest management practices, (i) to improve environmental stewardship and introduce the organic certification process, (iii) to improve the marketing of cocoa to domestic and international markets, and (iv) to strengthen APROCANE as a growers' association with an active membership and money in the bank that operates in an organized and professional manner.

Description: The program has two components: (i) a reimbursable financing component and (ii) a technical cooperation component.

Reimbursable financing component: (IDB: US\$245,000; Local counterpart: US\$61,000). The resources under this component will be allocated to two categories: (i) investment in basic infrastructure for cocoa bean storage, post-harvest management and marketing (IDB: US\$155,000; local counterpart: US\$31,000); and (ii) working capital financing for APROCANE for cocoa storage and marketing (IDB: US\$90,000; local counterpart: US\$30,000).

Subcomponent for investment in basic infrastructure: To help APROCANE's growers build their capacity to store and market cocoa under optimal conditions, this subcomponent will finance investment in suitable infrastructure and equipment for APROCANE, including large sheds, tarpaulins, drying beds, fermenting areas, machinery, equipment and a flatbed truck.

Subcomponent for APROCANE's working capital: APROCANE will use the working capital financing to pay cash to small producers for their cocoa beans and to cover their warehousing and marketing costs during the business cycle. It takes from 15 to 90 days to be paid by the domestic exporters and importers. This time delay requires APROCANE to have a high degree of liquidity. The project's working capital financing for warehousing and marketing will help keep APROCANE and the growers from having to sell their produce at low prices to other middlemen. The working capital financing will help to support the marketing component during warehousing, fermentation, drying and marketing of the growers' cocoa. It is essential for APROCANE to have sufficient liquidity at the outset to

ensure that the produce is stored, and that the collection centers' and growers' workers are paid, so that they can compete with the middlemen, other warehousemen, and distributors.

Nonreimbursable technical cooperation component: (IDB: US\$185,000; Local counterpart: US\$123,000). The resources under this component will be allocated to four categories: (i) The first is to improve cocoa production. It will address the problem of low cocoa yield and quality through technology transfer, sound environmental management, organic certification and technical management of the plantations. (ii) The second is to improve cocoa marketing by solving market access problems and the logistical difficulties of marketing cocoa beans. (iii) The third is organizational strengthening to support APROCANE, so that it operates in a more organized and professional manner. (iv) The last category is oversight and evaluation consisting of a baseline study, technical and institutional support for APROCANE, and project monitoring and evaluation.

Market and marketing strategy:

APROCANE has identified two markets for fine/quality cocoa beans: the domestic market and the international market. The marketing strategy in the domestic market is to: (i) continue to supply the main exporters of cocoa beans located in the Guayaquil region and (ii) develop new contacts to supply the domestic agroindustry with the cocoa beans they need. The international strategy will be to focus on market niches for fine/quality cocoa, mainly in Europe, by developing a proprietary brand so the product becomes recognized over the medium term. The strategy includes: (i) developing a line of certified organic production, (ii) developing, with Fair Trade, recognition of APROCANE's produce as fair-trade products, and (iii) exporting jointly with the Union of Ecuador's Cocoa-growing Campesino Organizations (UNOCACE), with which a relationship has been established to begin export operations and (iv) becoming a member of the National Association of Cocoa Exporters (ANECACAO).

Environmental and social review:

The Committee on Environment and Social Impact (CESI) reviewed this operation at meeting 06/04 of 13 February 2004 and approved it as proposed in the profile. It should be noted that the natural fermentation and drying of the cocoa beans to be done at the collection centers does not generate significant waste. The cocoa beans are sun-dried.

Beneficiaries and expected outcomes:

The direct beneficiaries are some 1,400 small farmers of the Esmeraldas province. Most are of African (Afro-Ecuadorian) or mixed descent. Their per capita income ranges from US\$337 to

US\$844 a year on average, compared to national per capita income of US\$1,351.

The program will yield the following direct and measurable benefits to these cocoa growers: (i) no fewer than 1,400 cocoa growers will market around 10,500 cwt of cocoa a year in an organized fashion through the APROCANE marketing system; (ii) the average real price to the growers from selling their cocoa beans will rise; (iii) the net income of the cocoa grower families will increase by at least 20%, (iv) 50 hectares of certified organic cocoa will be planted; (v) the average cocoa yield will increase from 3.4 cwt (155 kg) to 600 cwt (270 kg) per hectare; and (vi) APROCANE will conduct direct, planned and regular sales of the product totaling over US\$600,000 a year. APROCANE will also invest the surpluses received from selling the cocoa, after covering its financial, operating and principal repayment expenses, in productive or social/environmental projects to improve socioeconomic conditions for the region's vulnerable groups.

Risks:

The program could face three main risks: (i) price fluctuations in the international market could affect the financial projections and growers' motivation to introduce new technologies; (ii) natural effects such as weather conditions, blights or diseases could affect crops; and (iii) the sales volume targets may not be met.

The program will take the following steps to mitigate these risks:

Risk (i): The fine/flavor cocoa to be grown under the program, is aimed at a high-quality market segment (chocolate makers), a specifically Latin American market niche that represents at most 5% of the world's cocoa market. Prices in this segment are not as volatile as those for cocoa beans or hybrid cocoa, so that there should not be significant variation from projected prices. The project's marketing goals and price targets are conservative without future speculation. Rather, they are based on the average prices to the growers over the last five years plus a 15% premium for export produce. **Risk (ii):** Although the project can hardly eliminate the risk of bad weather conditions and blights, measures will be taken to reduce the effects they could have on crops. The program promotes practices that will minimize possible damage to the plants and the harvest through the production skills and techniques that the agricultural extension agents transfer to the growers, backed by the organic production specialist. These include the proper management of the plantations by cleaning the crops, controlling light and shade, controlling excessive dampness, phytosanitary pruning and the systematic elimination of cocoa pods and sick branches. The growers will also apply insecticides, repellents and organic fertilizers while exercising proper care and selection of

genetic material to propagate the crops; **Risk (iii):** APROCANE has set the project sales targets based on its previous experience, negotiations with potential buyers and conservative projections. This risk will be mitigated through its strategy of partnerships with domestic and international companies that need to buy significant volumes of cocoa throughout the year. APROCANE's ability to obtain additional sales contracts will be strengthened by using technical cooperation resources to engage the professional services of an expert in international cocoa marketing. This technical and commercial support will help to identify and open additional markets beyond those APROCANE has already foreseen. It will help APROCANE to make contacts with new buyers, draw up an export marketing strategy, and make concrete recommendations on expanding the marketing of its produce and creating new and more advantageous markets.

Role in the Bank's country strategy with Ecuador:

The project activities are consistent with the top priorities of the Bank's current country strategy with Ecuador, inasmuch as they represent a concrete effort to alleviate poverty, improve productive infrastructure and promote social inclusion.

Coordination with other official development agencies:

APROCANE has established contacts with the European Union's comprehensive rural development project in Esmeraldas, to look into ways of coordinating technical assistance to several groups it is organizing in the communities where APROCANE works. APROCANE has also approached the PRONORTE program of the United States Agency for International Development (USAID), and coordinates with it through the Ecuadorian-Canadian Development Fund (FECD), which has a seat on PRONORTE's board.

Rationale:

The project rationales is that: (i) it will help to increase the net incomes of some 1,400 Afro-Ecuadorian, mestizo and indigenous low-income cocoa producers; (ii) it will improve the quality of fine/flavor cocoa and the harvest will be sold as "premium grade" to international markets at higher prices; (iii) it will establish closer and more permanent ties between the cocoa producers of Esmeraldas province and market niches; (iv) it will increase organized production to meet market demand; and (v) APROCANE is an organization that mainly supports Afro-Ecuadorian, mestizo and indigenous farmers experienced in managing production-oriented cocoa projects. It has the capacity to carry out the proposed activities.

Special contractual clauses:

As conditions precedent to the first disbursement of resources under the basic infrastructure investment subcomponent (reimbursable financing), APROCANE will deliver the following to the Bank's

satisfaction: (i) evidence that it has legal possession of, or easements or other pertinent rights to, the land where the infrastructure is to be built in Esmeraldas; and (ii) the plans approved by the municipality of Esmeraldas for construction of the collection center, and evidence that it has all the licenses and permits necessary to begin work, issued by the competent authorities under Ecuadorian law.

As conditions precedent to the first disbursement of resources under the working capital subcomponent (reimbursable financing), APROCANE must deliver the following to the Bank's satisfaction: (i) evidence of the local counterpart contribution of US\$30,000 for this subcomponent; and (ii) the regulations governing working capital use, approved by APROCANE's board of directors.

As conditions precedent to the first disbursement of technical cooperation resources, APROCANE must deliver the following to the Bank's satisfaction: (i) the terms of reference for the consulting assignments and advisory support to be funded with the technical cooperation resources in the first six months of the project; (ii) evidence that the project coordinator has been selected; and (iii) an execution plan that includes annual targets for project objectives and outcomes. The plan will include a work execution timetable for meeting the performance indicators set in the project and the logical framework, to monitor and oversee progress.

The disbursement timetable for the technical cooperation resources will be determined in keeping with the plan agreed with the Bank for disbursement and execution of the reimbursable financing component.

Given the need for liquidity to hire the experts and specialists who are essential to start the program, and the need to provide APROCANE with working capital, the Bank will establish a revolving fund using both the loan proceeds and the technical cooperation resources, in an amount of up to 20% of their respective totals, based the business plan and disbursement timetable that APROCANE will submit for the Bank's approval.

Ex post review may be used for the procurement of consulting services or goods and services valued at up to US\$5,000 (with the exception of the terms of reference). The Bank's nonobjection will not be required for procurements of goods under US\$1,000, provided that the purchase is carried out under criteria of efficiency and relates directly to the activities included in the work plan.

**Reports and
evaluations:**

Reports: APROCANE will submit progress reports to the Bank's Country Office 45 days before the end of each calendar semester, with a final report due 60 days after the last disbursement. These reports will include an analysis of the performance indicators and progress made in executing the work plan, including: (i) progress in setting up the infrastructure, machinery and equipment covered by the project; (ii) a report on collection center operations; (iii) the terms on which the cocoa is stored, processed and sold; (iv) measurement of program performance with respect to introducing technology, productivity gains and quality enhancement; (v) progress toward obtaining organic certification; (vi) progress and outcomes in implementing environmentally sound production methods; (vii) information on working conditions (health and safety) in the collection centers; (viii) tracking of changes in the prices to the growers for cocoa sold under the program; (ix) information on the use of APROCANE's surplus funds for investments or activities that benefit its members; and (x) a summary of the APROCANE's contribution in cash and in kind at the time of each report. The first project report must include socioeconomic data on the target group, collected in the baseline study before the program activities began, which can be used to compare the change in productivity and income of the project beneficiaries. The final report will contain a summary of what has been achieved, compared to the original objectives and the baseline.

Evaluations: The Bank will use technical cooperation resources to contract for a midterm and final evaluation of the project. It will contract for a midterm evaluation to be done 24 months after the first disbursement of loan proceeds. The midterm evaluation will measure preliminary outcomes towards meeting the project objectives and other intermediate effects, including an analysis to contrast the information in the most recent six-monthly project report with the actual progress made. The indicators presented in the logical framework and in the table of project performance indicators, as well as in the progress reports, will be used for such measurements.

A final evaluation will be done 42 months after the first disbursement disbursement. It will measure and document: (i) outcomes in meeting the project objectives, (ii) outcomes of the working capital financing and how it was administered, (iii) the marketing and sales of cocoa beans, including volumes, quality and prices, (iv) economic and social indicators on the beneficiary families, and (v) the lessons learned from the project. The baseline data compiled on the beneficiaries will serve as a basis for measuring the change in productivity indicators and

beneficiary income as a result of the project.

**Exceptions to
Bank policies:**

To ensure that the program is properly implemented, the Ecuadorian-Canadian Development Fund (FECD) will be contracted directly to provide technical assistance, support, and project oversight throughout execution period. The reason justifying direct contracting is that the FECD possesses extensive experience with APROCANE and the information systems necessary for monitoring development projects, the excellent reputation, professionalism and technical expertise of its technical staff, and confidence of the project executing agency's members in the FECD. We therefore ask for a waiver of Bank policy, to allow this direct contracting with US\$30,000 of the technical cooperation resources.