



Social Entrepreneurship Program

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To: The Board of Executive Directors
From: The Secretary
Subject: El Salvador. Executive summary of a proposal for financing and nonreimbursable technical-cooperation funding for a project to enhance the competitiveness of small-scale shrimp production. Social Entrepreneurship Program

Inquiries to: Mrs. María Teresa Villanueva (extension 3128)

Remarks: This operation is being presented in accordance with Resolution DE-183/98 entitled "Reform of the Small Projects Program and creation of a Social Entrepreneurship Program," and meets the criteria established in document GP-75-9.

On **20 June 2003**, the date on which the five-day circulation period required for this document expires, the President, or such officer as he may designate will approve this operation

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**Other
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DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

EL SALVADOR

SOCIAL ENTREPRENEURSHIP PROGRAM

**PROJECT
COMPETITIVENESS OF SMALL-SCALE SHRIMP PRODUCTION**

(SP/TC-02-11-02-1)

PROPOSAL FOR FINANCING AND TECHNICAL-COOPERATION FUNDING

This document was prepared by the project team consisting of Andrés Baquero (SDS/MSM), Eduardo Cucinelli (Consultant), Leyda Fajardo (LEG/OPR), Bernadete Buchsbaum (LEG/OPR), Rafael Rivera (COF/CES), and María Teresa Villanueva (SDS/MSM), Project Team Leader.

COMPETITIVENESS OF SMALL-SCALE SHRIMP PRODUCTION

(SP/TC-02-11-02-1)

EXECUTIVE SUMMARY

Executing agency: Fundación Usulután II (FU2)

Amount and source:	IDB (US\$)	Local (US\$)	Total (US\$)
Financing:	640,000	318,000	958,000
Nonreimbursable technical cooperation:	<u>165,000</u>	<u>102,000</u>	<u>267,000</u>
Total:	805,000	420,000	1,225,000

The resources will be drawn from the Fund for Special Operations (FSO) in foreign exchange.

Financial terms and conditions:

Amortization period:	7 years
Grace period:	2 years
Disbursement of financing:	54 months
Execution of financing:	48 months
Interest rate:	3%

The grace period will apply solely to the amortization of principal, not interest. The currency for the financing will be United States dollars.

Issue to be addressed: Since the signing of the Peace Accord in 1992, approximately 3,800 families have been settled in the department of Usulután. Most are displaced by war and living in extreme poverty. Some 57% are veterans, and 12% disabled. These families have banded together in cooperatives to farm livestock, vegetables, and shrimp.

The group includes 11 shrimp farming cooperatives with 164 hectares of shrimp ponds. The cooperatives are poised to become more competitive, but lack the resources to do so. Their uncompetitiveness stems from: (i) insufficient working capital and infrastructure, and difficulty obtaining credit; (ii) inadequate production technology; (iii) poor business management and lack of marketing capacity on the part of the cooperatives. Moreover, a preliminary environmental impact study on shrimp farming conducted during project evaluation revealed that limited access to technical advice and information on

El Salvador's environmental regulations had kept the cooperatives from performing the environmental assessment required for an environmental operating permit. The facilities are running a risk, since the Ministry of Environment and Natural Resources (MARN) has the authority to shut down operations not in regulatory compliance.

Objectives: The objective of this project is to raise the incomes of close to 900 poor rural families involved in 11 shrimp farming cooperatives by making them more competitive.

The project aims to make the cooperatives more competitive through the following specific objectives: (i) facilitate access to credit as a source of working capital and capital investment funding for 11 shrimp farming cooperatives in the department of Usulután; (ii) improve shrimp farming methods, boosting production volume and returns; (iii) develop the shrimp cooperatives' ability to build associations, manage their business, and market their product; (iv) improve environmental management of shrimp farming by the cooperatives.

Description: To accomplish these objectives, the project has two components: (i) a reimbursable financing component and (ii) a nonreimbursable technical cooperation component.

Reimbursable financing component (IDB: US\$640,000; and FU2: US\$318,000)

Working Capital Facility (IDB: US\$150,000; and FU2: US\$150,000). Working Capital Facility proceeds may be used for larvae, concentrates, health management, preventive and curative shrimp care, pump system fuel, payroll, and the purchase of tools and other inputs for production. On average, the Working Capital Facility will disburse three loans per year (one per production cycle) to each cooperative for the purchase of these inputs. The loan amounts will range from US\$10,000 to US\$40,000 per production cycle for each cooperative, to be repaid at the end of harvesting.

Capital Investment Fund (IDB: US\$420,000; and FU2: US\$150,000). Proceeds from this fund will finance capital investments in the shrimp farming cooperatives as follows: (i) overhaul existing infrastructure (unused evaporation ponds for salt making) for use as shrimp ponds, expanding the existing production area; (ii) equip ponds with gates, suction pumps, and pump stations; and (iii) improve the condition of the shrimp ponds currently in operation. Credit will be extended to the cooperatives progressively in phases over three years. The scale of the capital investments will range from US\$19,000 to US\$68,000 per cooperative. In certain cases, with the Bank's prior nonobjection,

Capital Investment Fund proceeds may be used to finance the plant and equipment purchases necessary to better market the product and/or adapt it to the volume, quality, packaging, and presentation demands of each market the project succeeds in penetrating.

The Working Capital Facility and Capital Investment Fund will be administered by a formal, private intermediary financial institution (IFI).

Capital deepening (IDB: US\$70,000; and FU2: US\$18,000). These funds are earmarked for construction of a shrimp larvae hatchery consisting of a modular structure that will use alternative technology in order to: (i) lower equipment costs without reducing larvae-raising capacity and efficiency; and (ii) provide for a least-cost solution for eventual expansion of the hatchery. IDB resources will fund investments in: (i) infrastructure; (ii) electrical facilities; (iii) tanks; and (iv) building materials. FU2 will fund the purchase or lease or land on which to build the hatchery. These investments are itemized in Annex II.

The hatchery will be managed by FU2's Business Management Institute (*Centro de Gestión Empresarial*, CGE) and will be ready to begin supplying larvae to the cooperatives in project year one, when they are certain to meet the stringent phytosanitary requirements for higher-quality production. Technical cooperation funding will be used to purchase the minimum equipment needed to operate the hatchery.

Nonreimbursable technical cooperation component (IDB: US\$165,000; and FU2: US\$102,000)

Improve shrimp farming methods, boosting production volume and returns. The technical cooperation component will benefit the cooperatives by funding: (i) a shrimp farming specialist to support the cooperatives in all areas relating to the production cycle, so that CGE can focus on marketing the cooperatives' combined shrimp output; (ii) an animal nutrition specialist to provide technical advice on better feeding during both the larval and fattening stages; (iii) a disease specialist to provide technical advice on all the requirements for better health management of the shrimp during both the larval and fattening stages; and (iv) a genetics specialist to provide technical advice on the hatching, quality control, and, especially, genetic enhancement of larvae. As part of the Bank's contribution to better phytosanitary conditions under the project, technical cooperation funding also will be used to purchase the minimum equipment needed to operate the shrimp larvae hatchery.

Develop the shrimp cooperatives' ability to build associations, manage their business, and market their product. The technical cooperation component will benefit the cooperatives by funding: (i) a specialist in organization and association-building to support ongoing efforts by the cooperatives to establish an association of cooperatives or shrimp farming association; (ii) a marketing specialist to develop a marketing plan involving alternative mechanisms that would cut out middlemen and increase returns; (iii) sales promotion activities and travel to enhance marketing skills and support marketing plan execution; (iv) training internships for producers to visit shrimp farming businesses or organizations and share their experiences; and (v) management training for cooperatives, so they can better manage their businesses.

Improve environmental management of shrimp farming. In view of the need for the cooperatives to obtain the environmental permits required by national law, as well as the recommendations of the Committee on Environment and Social Impact (CESI) and the preliminary environmental assessment report for the project, the technical cooperation component will fund an environmental consultant or firm that will: (i) conduct environmental impact assessments and studies; (ii) oversee implementation of the recommended environmental impact measures; (iii) provide environmental training to CGE and the cooperatives; and (iv) help the cooperatives apply for and obtain the environmental permits required by national law.

Technical cooperation resources will also be used to fund external monitoring of the project, midterm and final evaluations, and an audit to determine how the Bank resources were used.

**Environmental
and social
review:**

The Committee on Environment and Social Impact (CESI) reviewed this operation at its 13 December 2002 meeting (46/02). As a result of this review, an exclusive environmental management component was added (see project description).

**Coordination
with other
donors:**

This project has been developed in coordination with other donors, especially the local country offices of the European Union (EU) and the United States Agency for International Development (USAID), both of which have worked with FU2 and the cooperatives to benefit from the project. The project will also strengthen, supplement, and help ensure the sustainability of the local economic development actions undertaken through the EU-funded Agrarian Reform Support Project (1994-1998). It will consolidate and lend continuity to the management model that USAID promoted by helping get the CGE up and running in FU2 (2000-2002).

Beneficiaries: The project's direct beneficiaries will be 11 shrimp farming cooperatives involving some 900 families. Since entire families will feel its economic impact, the project is expected to benefit at least 5,000 people indirectly.

Risks: The project carries the following risks: (i) fluctuations in the world shrimp market may affect sales for the project; (ii) the Ministry of Environment and Natural Resources may not allow the cooperatives to operate if they do not obtain environmental operating permits; (iii) natural disasters again may strike the department of Usulután; and (iv) the shrimp farmers may invest their loans in nonfarm activities that do not raise their income; since many rural families live at the subsistence level, there is a considerable risk that loans may be diverted to household consumption.

The project will mitigate these risks as follows: (i) FU2, through the CGE, will advise the cooperatives on production and sales decisions based on market price fluctuations; (ii) nonreimbursable technical cooperation resources will fund the environmental assessments and other requirements for every cooperative to obtain an environmental operating permit. Bank-funded capital investments will seek to minimize the potential damage to shrimp ponds from natural disasters, yet this risk is not easily mitigated. Certain financial institutions in El Salvador are starting to develop products to insure agricultural investments, and in the medium term may want to explore coverage for the aquaculture sector. The project will monitor this initiative.

To mitigate the risk of loans being diverted for consumption, the greater part of the funding will be in kind. An added advantage is that inputs and services can be purchased at lower cost in bulk than by a single cooperative. The FU2, the IFI, and the cooperatives will agree on a mechanism whereby FU2 coordinates the collective purchase of inputs and services prior to loan approval, so that the cooperatives receive the funding in kind, not cash, except in special cases. FU2 and the cooperatives are already following this practice.

**Government
and Bank
country
strategy:**

The proposal is consistent with the Bank's strategy with El Salvador as set out in the country paper (document GN-2121-3) approved on 11 July 2001, inasmuch as the operation will: (i) support private sector development, emphasizing production projects and access to services for small-scale farmers in rural areas; (ii) contribute to integral development of the rural economy and help raise productivity by providing business development services to small farming operations; (iii) encourage diversification of farm output; (iv) promote the benefits of cooperative enterprise; and (v) foster production activities compatible with environmental protection efforts.

Rationale: The Bank support for this group of small-scale shrimp farmers is justified because: (i) the beneficiaries are located in the department of Usulután, where the unemployment rate is highest and poverty levels have climbed from 62% to 72% since the 2001 earthquake; (ii) this producer group is poised to become more competitive, but lacks the financial and technical resources to do so; and (iii) shrimp is a nontraditional crop in demand on domestic and foreign markets.

The project presents the following opportunities: (i) to strengthen, supplement, and ensure the sustainability of other donors' actions that need to be consolidated in order to raise beneficiary incomes; (ii) to generate a stable income for small-scale farmers over the entire year; (iii) to promote second-tier associations in a segment of society in need of greater negotiating power and the organizational, legal, and strategic resources to develop economies of scale; (iv) to develop comparative competitive advantages that will enable the cooperatives to increase their negotiating power and increase their income; and (v) to support cooperatives in minimizing the environmental impact of their operations and obtaining environmental operating permits.

**Special
contractual
clauses:**

Once the general conditions precedent to the first disbursement have been fulfilled, as established in the loan and technical cooperation agreement, the Bank will authorize disbursement of up to US\$5,000 of the contribution for the purpose of hiring a financial consultant to identify and select an IFI to administer the reimbursable financing component.

Prior to disbursement of the remaining funds under the technical cooperation component, FU2 must submit, to the Bank's satisfaction, a business plan tailored to local conditions in El Salvador and in the target sector at the time the project is approved. The nonreimbursable technical cooperation funding for building the hatchery will not be disbursed until FU2 has submitted, to the Bank's satisfaction, a signed agreement with the project-beneficiary cooperatives, in which FU2 promises to meet these cooperatives' shrimp larvae production needs on a priority basis.

As conditions precedent to the disbursement of resources under the reimbursable financing component, FU2 must submit, to the Bank's satisfaction: (i) the agreement entered into with the IFI selected to administer the reimbursable financing component; (ii) the credit regulations approved by its board of directors; (iii) evidence that it has opened a reserve and guarantee account at a commercial bank, to be credited cumulatively in advance with the equivalent of the next payment due under the reimbursable financing component; and (iv) evidence that the premises for the shrimp larvae hatchery have

been bought or leased, along with documentation showing that the premises meet the requirements for such an operation.

In order to ensure simultaneous execution of the financing and technical cooperation components: (i) no more than 40% of technical cooperation funding will be disbursed until after FU2 has begun disbursing the financing component; and (ii) before disbursing more than 50% of financing component resources under the project, FU2 must submit, to the Bank's satisfaction, (a) evidence that the shrimp larvae hatchery is operational, and (b) the marketing plan prepared by the marketing specialist to be hired using technical cooperation funds.

Reports and evaluations:

FU2 will submit *progress reports* to the Country Office within 60 days after the end of each six-month period, and a final report within 60 days after the end of the disbursement period. The reports will: (i) describe progress on the project execution plan and indicators, as well as major milestones and obstacles encountered in meeting the project goals and objectives and in following the respective plan; (ii) update the performance indicators and project execution plan for the following 12 months, outlining steps to overcome any obstacles identified; (iii) supply information on how the small-scale shrimp farmers have benefited economically and in terms of training and technical assistance received; (iv) present consolidated financial statements and performance indicators for FU2 and the IFI-administered financing component, including the number and interest rates of loans made to farmers and the delinquency rate; (v) describe CGE and hatchery operations in terms of output and revenue, showing evidence that project-beneficiary cooperatives are being sold larvae at below-market prices; (vi) describe the extent to which technology and productive infrastructure have been built up under the project; (vii) supply information on the execution of environmental management plans under the project, as well as on the status of the environmental operating permits required by national law; and (viii) summarize FU2 cash and in-kind contributions as of the date of each report. The first report must also present baseline socioeconomic data on the target group prior to project initiation, for comparison with the beneficiaries' subsequent sales and income.

During project execution FU2 must submit, within 120 days after the end of each fiscal year, starting with the fiscal year in which the first disbursement is made under the financing component, its audited financial statements and a financial report prepared by independent authorities, showing how the Bank's contribution has been used.

Evaluations. A *midterm* evaluation will be conducted 24 months after the first disbursement under the financing component, to assess the project's progress and take any corrective action that may be required.

This evaluation will measure the extent to which the project objectives and performance benchmarks referred to above and in the logical framework have been attained. Specifically, it will measure: (i) executing agency performance; (ii) how the project has helped small-scale shrimp farming cooperatives to strengthen their associations and boost output and sales; (iii) the number of subloans granted and how they were used; and (iv) the implementation of environmental management plans under the project, and the status of the environmental operating permits required under environmental laws. The Bank will review the findings and recommendations of the midterm evaluation. In the event of substantial shortfalls in project execution, the Bank will take such action as it deems necessary.

A final evaluation will be conducted once 90% of the financing and technical cooperation funding has been disbursed, to document project execution and measure its success. This evaluation will focus on reviewing FU2's performance for the purpose of learning from its experience, with special attention to: (i) the system for marketing the product and identifying new markets; (ii) the type of association established among the cooperatives, its cohesiveness, and whether it has sufficient management capacity for the assets purchased using Bank funds to be transferred to it; (iii) economic and financial indicators for both the cooperatives and FU2; (iv) the extent to which partner shrimp farmers share in the cooperatives' surplus earnings, as an indicator of how better off the participating families are economically as a result of the project; (v) the outcome of implementing the project's environmental management plan and the process of obtaining environmental operating permits required by national law; and (vi) lessons learned from the project.

Monitoring. Given the project's complexity and the need for constant field supervision in a region geographically remote from San Salvador, technical cooperation resources will be used to fund a consultant who will support the Country Office specialist on external monitoring of the project. The Bank's Country Office in El Salvador will hire this outside consultant for technical monitoring of project execution. The consultant will visit the project in order to: (i) observe progress on project activities in the field; (ii) note any difficulties encountered and the steps taken to address them; (iii) make any and all recommendations deemed necessary to meet the project objectives; (iv) verify the financial indicators for the lending component and for FU2; and (v) submit a project performance monitoring report (PPMR) on his or her findings.

This monitoring will be conducted within 15 days after the Bank receives FU2's semiannual progress report. As background for the monitoring visit, the consultant will refer to: (i) the executing

agency's progress report to the Bank; (ii) the plan of operations and project indicators; (iii) other material information on project execution contained in the main project document, especially guarantee reserve account *activity and statements*; and (iv) prior monitoring reports.

**Exceptions to
Bank policy:**

None.