

PROPOSAL FOR FINANCING AND TECHNICAL COOPERATION FOR:
CENTRAL DE SERVICIOS PARA EL DESARROLLO DEL ESTADO DE MÉXICO
(SEDEMEX)

FUNDACIÓN QUERETANA PARA EL DESARROLLO RURAL
(FQDRAC)

CENTRAL DE SERVICIOS PARA EL DESARROLLO DE PUEBLA
(DEPAC)

EXECUTIVE SUMMARY

AMOUNT AND SOURCE:	Financing:	US\$1,500,000 (loc.curr.)
	Technical cooperation:	US\$ 540,000 (loc.curr.)
	Total:	US\$2,040,000

Disbursements to be chargeable to the net income of the Fund for Special Operations.

INTERMEDIARY ORGANIZATIONS:	SEDEMEX, FQDRAC, and DEPAC will be the intermediary organizations, while the Mexican Rural Development Foundation (FMDR) will serve as advisory agency during the implementation of the projects.
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FINANCIAL TERMS AND CONDITIONS:	Amortization period:	15 years
	Grace period:	5 years
	Disbursement period:	3 years
	Fee:	1% per year

OBJECTIVES:	The objectives of the program are: (i) to raise the household income levels of rural microproducers and microentrepreneurs; (ii) to create and/or consolidate employment opportunities in the rural areas where the projects in question are to be executed; and, (iii) to strengthen the capacity of the executing agencies to provide credit, marketing, and training services to rural microproducers and microentrepreneurs.
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DESCRIPTION:	Under the operation, three reimbursable financing arrangements will be provided to the intermediary organizations in the amount of US\$500,000 each, as well as three nonreimbursable technical cooperation programs in the amount of US\$180,000 each.
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ENVIRONMENTAL CLASSIFICATION:	The Environment Committee, at its meeting of March 28, 1995, classified this as a Category II operation.
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RISKS:

The principal risks entailed by the operation have to do with the following: (i) the fact that the organizations lack significant experience in marketing the products derived from some of the proposed projects; and, (ii) the program could come to outpace the level of institutional development of the executing organizations. However, the wide-ranging proposed technical cooperation program will help to address the chief deficiencies identified at the organizations concerned, and will help to promote the institutional strengthening of the executing organizations so that after the three-year program period has elapsed, these organizations will be capable of administering IDB funds by themselves without any help from the advisory agency (FMDR). The aim here is to reduce the possibility that the risks described above may materialize.

**THE BANK'S COUNTRY
STRATEGY:**

The three projects discussed in this document reflect the priorities set by the Bank and Mexico in the areas of expanding assistance for microenterprises and strengthening the organizations engaged in providing credit, training, and technical assistance for the microenterprise sector. In addition, by placing special emphasis on training for and targeting loans at women microentrepreneurs, the projects will serve the IDB's policy of further integrating women into the development process and improving the economic status of women.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

It is recommended that advances of funds be authorized in the amount of 25 percent, both in respect of the amount of reimbursable financing and in respect of the technical cooperation funds.

As conditions precedent to the first disbursements, the intermediary organizations in each case must: (i) submit the agreement(s) signed to obtain advisory assistance from the FMDR in the area of funds management; (ii) have adopted the credit regulations agreed upon with the Bank; (iii) submit a portfolio recovery and arrears reduction plan to the IDB's satisfaction.

In addition, as a condition precedent to the first disbursement under the technical cooperation operations, the intermediary organizations must sign contracts for the provision of services, at least those for the specialists in microentrepreneurial and agricultural credit.

I. FRAME OF REFERENCE

A. Background

1. The requests

- 1.1 The Fundación Mexicana para el Desarrollo Rural [Mexican Rural Development Foundation] (FMDR) requested a short-term mission to evaluate five projects in November 1993. This mission selected the three intermediary organizations identified below. The FMDR, which will serve as the advisory organization, was the executing agency for a similar IDB project approved in 1989. This project was executed in the State of Guanajuato under the terms of the agreement SP/SF-88-09-ME and was successfully completed toward the end of 1992.

2. Statement of non-objection

- 1.2 The Government of Mexico, through the Secretaría de Hacienda y Crédito Público (SHCP) [Secretariat of Finance and Public Credit], has stated that it has no objection to having the IDB participate in the financing for the projects proposed in this document.

3. The government's strategy

- 1.3 As part of the economic restructuring program, the Mexican authorities are committed to achieving improvements in the living standards of the lowest-income groups of society. A series of measures has accordingly been undertaken, in which assistance for microenterprises is one of the main priorities. This assistance has taken the form of three programs: one, carried out by Nacional Financiera, S.N.C. (NAFIN); another, implemented through the Programa Nacional de Solidaridad [National Solidarity Program] (PRONASOL); the third program is being executed by Procedimientos Procampo (PROCAMPO).
- 1.4 The NAFIN program transfers funds to commercial banks and development institutions (generally governmental) in order to ensure that these funds reach small- and medium-scale enterprises. However, the NAFIN program has had the greatest impact on small-scale enterprises and microenterprises in the formal sector (of larger size); access for the informal sector has been minimal, complicated by the nature of the program's operating arrangements.
- 1.5 PRONASOL reflects a new approach to social spending targeted at extreme poverty. Since December 1988, PRONASOL has disbursed an average of US\$1 billion per year; although this figure represents only 0.4 percent of GDP, the funds released under the program have already achieved significant results, not least because broad swaths of the population have now become actively involved in the process.

- 1.6 The PROCAMPO program, which provides direct assistance to rural producers, is scheduled to become fully operational by the Fall-Winter cycle 1994/95, with a lifespan of 15 years, and a budget exceeding US\$4 billion for 1994, and will be implemented through the Secretaría de Agricultura y Recursos Hidráulicos [Secretariat of Agriculture and Water Resources] (SARH).

4. The Bank's strategy

- 1.7 The three projects discussed in this document reflect the priorities set by the Bank and Mexico in the areas of expanding assistance for microenterprises and strengthening the organizations engaged in offering credit, training, and technical assistance for the microenterprise sector. In addition, in placing particular emphasis on training and targeting credit at women microentrepreneurs, the projects will serve the Bank's strategy of further integrating women into the development process while improving their economic status.

B. The microentrepreneurial sector in Mexico

1. Characteristic features of the sector

- 1.8 The Mexican economy has a growing informal sector which encompasses the full range of economic activities. The size of this sector is attributable to the fact that the formal economy is unable to create jobs commensurate with the rate of increase in the labor force. Surveys carried out by the National Institute of Statistics, Geography, and Data Processing indicate that in 1991, 14.53 percent of the economically active population in Mexico was unemployed or underemployed. According to information obtained from the National Survey of the Informal Economy for the year 1990, microenterprises 1/ employ six million people, a figure which represents 35 percent of the economically active population of Mexico without including the public sector and agriculture. This survey also indicates that the informal sector accounts for a 10 percent share of GDP, and its share is even greater in the sectors of commerce and services.

1/ A microenterprise in Mexico is defined as having fewer than 15 employees, although this definition varies from one sector of the economy to the next.

2. Agricultural microenterprises

- 1.9 According to the Secretariat of Finance, small-scale rural producers and their families comprise 78.5 percent of the "ejido" sector, ^{2/} and 81.8 percent of the rural population nationwide. During the 1980s, agriculture began to languish, and its annual growth rate diminished from 2.3 percent in the 1970s to 1 percent per year, at a time when the rate of population growth was 2.7 percent. However, since 1990, the sector has returned to the growth levels recorded in the 1970s. ^{3/} By law, any microproducer who is in lawful and peaceful possession of land is considered a prospective borrower. However, most microentrepreneurs do not qualify for credit from conventional sources in Mexico, on account of banks' internal policies which have to do with risk factors and considerations of inadequate collateral. In general, rural families number six members on average. The family has a home in the built-up area of the ejido, where it has its house, which is built of bamboo wood or otate grass covered with mud for the walls, earth for the floor, and palm for the roof.

3. Status of women microentrepreneurs

- 1.10 Women account for 27 percent of the economically active population in Mexico. In addition, women are well-represented in the informal activities of microenterprises in Mexico. In low-income urban areas, one third of homes are headed by women. Furthermore, women in the rural sector have a critical role to play in agricultural production. Women are a crucial labor force from the standpoint of weeding, sowing, planting, and harvesting of crops, to say nothing of livestock breeding. However, their labor is largely unremunerated. In addition to performing agricultural and domestic tasks, rural women generally engage in other work, e.g., commerce or cottage industries.

C. Problems facing the rural sector

- 1.11 Beginning in 1989, the markets for the productive resources of rural areas, including land as a factor of production, were liberalized. Accordingly, substantial modifications were introduced in the management of policy instruments applicable to agriculture and the rural environment: (i) guaranteed prices have been retained only for corn and beans, while a system of negotiated prices is being established for all other products; (ii) public expenditure on rural development is increasing faster than total expenditure and is being redeployed into irrigation infrastructure construction; (iii) subsidies for rural areas, while maintaining

^{2/} The "ejido", or collective farm, is a rural population unit having legal status and its own net worth.

^{3/} Country Programming Paper, Mexico: Rural Development Strategy.

the downward trend recorded in previous years, are undergoing changes in their relative composition; (iv) aid measures provided in the form of public prices and rates are growing in importance; and, (v) financial subsidies are declining.

- 1.12 In designing rural development policy, account has been taken of the commitments which the Mexican Government has recently undertaken vis-à-vis international organizations. These commitments impose certain limits on the government's decision-making latitude within its domestic economic policies, as is the case with the signing of the NAFTA, and Mexico's membership of GATT.
- 1.13 With respect to NAFTA, domestic aid for agricultural sectors is held to be of vital importance. However, it is also recognized that such aid may distort the flow of international trade and production. NAFTA stipulates that all prior protectionist arrangements which Mexico had maintained in respect of certain agricultural products are to be eliminated immediately, and replaced by the adoption of a tariff, the rate for which is to be decreased over a maximum period of fifteen years until reaching zero. In addition, with the implementation of NAFTA, a nontariff import quota has been established, which will steadily increase in the course of the tariff reduction period, until it is fully liberalized in the transition period. Imports that exceed the quota will pay the equivalent tariff.

II. INTERMEDIARY ORGANIZATIONS

A. Central de Servicios para el Desarrollo del Estado de México

1. Identity, origin, and objectives

- 2.1 The Central de Servicios para el Desarrollo del Estado de México [Development Services Center for the State of Mexico] (SEDEMEX) was established on November 15, 1972 at the initiative of local entrepreneurs, who were guided by the philosophy and methods of the FMDR. In its initial stages, SEDEMEX focused on areas such as training, technical assistance, basic social education, and financial management. Subsequently SEDEMEX turned its attention to the distribution of fertilizers, agricultural machinery, cottage industries, and stockbreeding, as well as outreach activities for rural microenterprises.

2. Organization and administration

- 2.2 SEDEMEX has a General Assembly of Associates comprised of local entrepreneurs, that meets once a year. Every two years, the General Assembly selects a Board of Directors, currently numbering

six entrepreneurs and professionals from the area of Toluca. SEDEMEX's operations staff consists of an administrative manager, a secretary, and three technicians/outreach workers.

3. Track record

- 2.3 In its heyday (1978-1980), SEDEMEX provided training and services for 211 campesino groups, involving 2,250 direct beneficiaries and 13,500 indirect beneficiaries engaged in farming and/or cottage industries. At that time the operations staff numbered 25 individuals, handling projects in 13 municipalities in the State of Mexico (11 percent of its total territory).
- 2.4 Between 1974 and 1981, SEDEMEX arranged for and distributed an average of 510 tons of fertilizers, herbicides, and insecticides per agricultural cycle. In addition, US\$500,000 in bank credit were organized, managed, and administered for the purchase of 25 tractors, which served to cultivate 2,125 hectares, benefiting 675 microproducers, with 100 percent loan recovery.
- 2.5 For the credit operation, SEDEMEX used the commercial banking and agricultural trust (FIRA) systems of the Bank of Mexico, as all of the operations are channeled through these credit sources.

4. Financial position

- 2.6 SEDEMEX's financial position was analyzed on the basis of financial statements for 1991, 1992, and 1993, in nominal terms, shown in Annex III in U.S. dollar equivalents. Also shown are adjustments taking account of inflation, thus making it possible to compare the three years under consideration in real terms.
- 2.7 SEDEMEX's financial situation has shown favorable trends in terms of the increase in assets over the last three years. For example, total assets increased by 2,000 percent, rising from US\$2,538 in 1992 to US\$41,397 in 1993. Of the total assets figure for 1993, 99 percent were accounted for by current assets while the remaining 1 percent was accounted for by fixed assets. Current assets consisted of US\$3,833 in available money; US\$33,237 in accounts receivable, primarily from the Fundación de Ayuda Social (FAS) [Social Assistance Foundation], a local institution which grants loans to finance the operating costs of institutions such as SEDEMEX; and US\$4,000 in advance payments for procurement of equipment. With respect to non-current assets, these were accounted for by office equipment in the amount of US\$312.
- 2.8 Total liabilities for 1993 were US\$30,340, representing a substantial increase in comparison with previous years; 96 percent of 1993 liabilities were represented by a loan from the Mexico Office of the FMDR to meet SEDEMEX's operating costs. However, the liquidity index is 1.36, and SEDEMEX would have to generate other sources of income if in the short term it is to have any

expectation of achieving self-sufficiency without recourse to grants or loans from the FMDR. The proposed project has a contribution to make in terms of implementing this strategy. Net worth grew from US\$91 in 1991 to US\$11,057 in 1993, reflecting an increase in SEDEMEX's operations as well as the fact that grants and donations received were managed in an appropriate fashion.

- 2.9 SEDEMEX's total income shows a steady increase over the three years under consideration, amounting to US\$39,581 in 1993. All of this income came from grants from private individuals or enterprises in the State of Mexico. Expenditure also increased in relation to previous years, reflecting an increase in SEDEMEX's activities, even though the credit program had not yet gotten under way. It should be noted that SEDEMEX has not taken into account the inflationary effects on its financial position; its financial statements must be adjusted accordingly (see Annex III).

B. Fundación Queretana para el Desarrollo Rural A.C.

1. Identity, origin, and objectives

- 2.10 The Fundación Queretana para el Desarrollo Rural A.C. [Queretana Rural Development Foundation] (FQDRAC) is a nonprofit civil association that was formed on May 4, 1976. Its purpose is to promote the advancement and social and human progress of campesino groups, by providing services related to the social organization of production, technical assistance, marketing, administration and financial assistance.

2. Administrative considerations

- 2.11 As currently organized, FQDRAC has a General Assembly of Associates which is its ultimate authority. The General Assembly convenes once a year. The Board of Directors, which consists of five members, is elected by the General Assembly and is comprised of five leading figures from the business and professional communities from the area of the city of Querétaro. FQDRAC's staff consists of five full-time employees including one administrative manager, one field manager/technician, two technicians/outreach workers, and one secretary.

3. Track record

- 2.12 FQDRAC provides financing, advisory services, technical training, and basic social education to campesino groups on a firsthand basis. These campesino groups are comprised of small-scale agricultural, stockbreeding, or craft producers who organize themselves into production associations and form democratically organized working units.

- 2.13 The revolving fund set up with CODESPA resources had a current portfolio of US\$30,997 as at October 30, 1993. These loans had been granted to four groups of beekeepers for a total of 44 beneficiaries. In addition, with NAFIN resources in 1991, 14 projects were assisted for a total of US\$460,000; in 1990, 26 projects received credit in the amount of US\$916,000; and in 1989, loans were granted to 57 projects for a total of US\$1,500,000. FQDRAC has approximately US\$42,000 in overdue loans to 12 groups consisting of 100 people. This portfolio has been in arrears for over one year, and FQDRAC is in the process of rescheduling some of the loans, although other of the loans are now the subject of enforced debt collection proceedings. It should be mentioned that FQDRAC has been required to pay to NAFIN the debt which the campesinos failed to settle on the overdue loans mentioned above. The funds associated with these loans originated with NAFIN, and that is why they do not appear in FQDRAC's financial statements.

4. Financial position

- 2.14 FQDRAC's financial position was analyzed on the basis of financial statements for 1991, 1992, and 1993, in nominal terms, shown in Annex III in U.S. dollar equivalents. Also shown are inflation-adjusted financial statements to allow for comparisons in real terms of the amounts of money over the three years under consideration.
- 2.15 The financial position of FQDRAC shows favorable trends in terms of the increase in assets over the last three years. For example, total assets have increased by 42 percent, rising from US\$45,736 in 1992 to US\$65,029 in 1993. Of the total assets for 1993, 83 percent were accounted for by current assets while the remaining 17 percent were accounted for by fixed assets. Current assets consisted of US\$3,451 in available money; US\$30,997 in loans receivable in respect of credits granted with CODESPA resources (an increase of 66 percent in the delivery of loans), and US\$19,828 in advance payments. With respect to the figure for non-current assets, one vehicle and several items of office equipment accounted for US\$10,753.
- 2.16 It should be mentioned that the portfolio of loans involving own resources donated by CODESPA is not in arrears. However, FQDRAC should have a reserve for doubtful loans which would make provision for the possibility that certain loans might fall into arrears.
- 2.17 Total liabilities for 1993 were US\$2,544, reflecting a substantial reduction in comparison with 1992 as a result of the fact that it had become possible to pay debts contracted in earlier years. The liquidity index is 26, which bears witness to FQDRAC's comparative financial soundness in the short term. FQDRAC's net worth increased at an annual rate of 23 percent from US\$41,032 in 1991 to US\$62,485 in 1993, reflecting a reduction in liabilities.

- 2.18 Total income for 1993 was US\$81,144, down 44 percent in relation to 1992, largely as a result of the fact that a FQDRAC-owned building was sold in 1992 for the sum of US\$66,086. Grants and donations, largely from the private sector and private individuals, remained unchanged between 1992 and 1993. Expenditure also decreased from US\$122,653 in 1992 to US\$54,192 in 1993, indicative of a restructuring of FQDRAC's operations. Earnings were positive for 1993 (US\$26,952), a sign of efficient management by the new Board of Directors.
- 2.19 Profits obtained on the portfolio were 9.6 percent. Operating costs are US\$32,000 or 103 percent of portfolio, i.e., the net margin is (93.4 percent). Add to this the implicit cost of capital (44 percent), which is given by inflation and its negative economic effect on net worth (15 percent of US\$62,485) and on the quasi-donation loan from CODESPA (15 percent of US\$40,000), although one must also take account of the positive effect of inflation on equipment, given that the value of the equipment also increased (15 percent of US\$10,753). The subsidy indicator (1.431 percent) means that the profit margin (9.6 percent) would have to increase approximately 14 times to 147 percent in order for FQDRAC to be able to cover all its costs. This margin is impossible to obtain, and accordingly, the only way to achieve breakeven point is by increasing the volume of the portfolio. The proposed project would help FQDRAC to generate income in respect of interest on loans granted with the revolving fund, and thus it would be possible to achieve the self-sufficiency needed to strengthen FQDRAC in the medium and long terms.

C. Central de Servicios para el Desarrollo del Estado de Puebla A.C.

1. Identity, origin, and objectives

- 2.20 The Central de Servicios para el Desarrollo del Estado de Puebla A.C. [Development Services Center for the State of Puebla] (DEPAC), was incorporated on June 7, 1971. DEPAC's objective is to help bring about increases in productivity, to promote the human development of individuals and rural associations in an integrated fashion, and to support the responsible use of the environment. DEPAC defines "development" as well-rounded personal growth in individual and social terms.

2. Organization and administration

- 2.21 DEPAC consists of a General Assembly of Associates, which is the leadership body, as well as a Board of Directors, consisting of seven entrepreneurs and professionals drawn from the Puebla area. Elections are held every two years. DEPAC's staff is comprised of 16 full-time employees. These employees are divided into four departments: (i) Administration; (ii) community outreach; (iii) projects and programs; and, (iv) resource mobilization. In order to improve the quality of the work, DEPAC sets aside

4 percent of the amount of its payroll for the purpose of developing and training DEPAC personnel.

3. Track record

- 2.22 Since 1971, DEPAC has granted loans intended for activities such as agriculture, stockbreeding, beekeeping, trade workshops, and housing construction. DEPAC operates by granting guarantees vis-à-vis banks, with the result that DEPAC's credit operations are very similar to banking operations.
- 2.23 Over the last three years, loans for an amount of US\$742,100 have been approved for 647 campesinos organized into groups, with maturities in the range of one to five years, in seven regions of the State of Puebla, where agriculture is the most important sector. The current portfolio as at November 30, 1993 was US\$634,380. The overdue portfolio (90 days or more) was US\$265,660 or 42 percent of the total current portfolio. It should be noted, however, that only 10 percent of these loans are considered non-collectible. The remaining 90 percent are being recovered slowly, although 48 loans are the subject of court-ordered debt collection proceedings. It should be mentioned that the high rate of arrears has been to a very great extent attributable to weather-related problems (droughts and frosts) which have hit small farmers.
- 2.24 Beginning in 1993, DEPAC was involved in the establishment of a Savings and Loan Fund, which as at November 30 claimed 200 members, a current portfolio of US\$40,000 and savings totaling US\$46,000. The arrears as at that date amounted to 4.6 percent. Instrumental in the establishment of this Fund was a grant of US\$150,000 from the Belgium Organization known as ADRAI, belonging to Louvain University. The objective of this Fund is to instill habits of saving and cooperation among its members, as well as to provide credit intermediation services. At present, DEPAC grants loans solely to Fund members, since, as was noted in the preceding paragraph, the "portfolio at risk" of the revolving fund was very high, and it was very dangerous to continue operating in the same fashion.

4. Financial position

- 2.25 DEPAC's financial position was analyzed on the basis of financial statements for 1991, 1992, and 1993, in nominal terms, given in Annex III in U.S. dollar equivalents. Also shown are adjusted financial statements for the loans portfolio (reserve for doubtful and non-collectible loans), with adjustments for inflation to allow for comparisons in real terms among the values in the various headings for the three years under consideration.

- 2.26 DEPAC's financial position has shown favorable trends in terms of the increase in its assets over the last three years. For example, total assets increased by 24 percent, rising from US\$1,150,845 in 1991 to US\$1,429,628 in 1993. Of the total assets in 1993, 60 percent were accounted for by current assets while 40 percent were accounted for by non-current assets. Current assets were comprised of US\$14,681 in available money, US\$674,380 in loans receivable, US\$43,843 in other accounts receivable, and US\$130,345 in assets invested in the organization of lotteries. With respect to non-current assets, buildings and land accounted for US\$504,383, while furniture, equipment, and vehicles accounted for US\$53,138. It is worth mentioning that the construction of the new DEPAC headquarters, built with own resources drawn from the accumulated net worth generated by the success of the lotteries conducted in recent years.
- 2.27 The portfolio of loans more than 90 days' in arrears was US\$265,657 as at November 30, 1993. If such loans were found to be non-collectible, then that would have a negative impact on the total assets, as it would then be necessary to clear the portfolio of the sum of US\$265,657, thereby reducing assets and therefore net worth. DEPAC did not make that adjustment to its financial statements given that 90 percent of these loans overdue by more than 90 days are expected to be recovered.
- 2.28 However, DEPAC would have to establish a 100 percent provision corresponding to 90 percent of the loans in arrears by more than 90 days (US\$239,091). This provision would have to be distributed over the three years under consideration. ^{4/} DEPAC would have to adjust the balance sheets for the three years in question, as well as the profit and loss accounts, which would have implications for the provision expenditure accounts, and consequently profits and net worth for the three years; 10 percent of the other loans in arrears by over 90 days (US\$26,566) would have to be declared non-collectible and removed from the 1991 portfolio where they originated (see Annex III).
- 2.29 Total liabilities were US\$1,154,297, representing a substantial increase over previous years. This is attributable to the fact that DEPAC was required to finance its operating costs with short-term bank loans. This was due to the losses caused by the unexpected results of the lotteries conducted over the last three years. Consequently, DEPAC's liquidity index is negative, because its current liabilities (US\$1,036,670) are greater than its current assets (US\$863,249). DEPAC is in the process of negotiating with Banco Confía to agree on a more appropriate financing plan to reduce the cost of contracted loans, which currently stands at

^{4/} Seventy percent would have to be provisioned for 1991, 20 percent for 1992, and 10 percent for 1993.

32 percent. DEPAC's net worth fell from US\$610,900 in 1991 to US\$275,331 in October 1993, reflecting losses recorded over the last three years.

- 2.30 DEPAC's total income has been stable over the three years under consideration, amounting to US\$1,174,152 in October 1993; 78 percent of this income was generated by sales of tickets for DEPAC's lotteries. While this income has remained constant over the three years in question (US\$1,000,000), the costs associated with conducting lotteries have increased from US\$757,862 in 1991 to US\$979,620 in 1993. It is this tendency for costs to creep upward that caused the losses (US\$134,193 in 1991, US\$186,402 in 1992, and US\$150,683 in 1993).
- 2.31 DEPAC must analyze all the costs involved in generating income in respect of credit-related activities. Earnings on portfolio are 13.34 percent (US\$89,966 out of US\$674,380). Operating costs are US\$114,952, 5/ or 24.6 percent of the portfolio, i.e., the net margin is 11.26 percent. To this must be added the implicit cost of capital (+2.94 percent), which is given by inflation and its negative economic impact on net worth (US\$41,300) and on quasi-donation loans (US\$22,500), and the positive impact of inflation on the revaluation of fixed assets (US\$83,628). The subsidy indicator (62.37 percent) signifies that the profit margin on portfolio (13.34 percent) would need to increase by 62.37 percent to 21.66 percent in order for DEPAC to be able to cover all its costs in the long term.
- 2.32 Faced with these conditions as described above, DEPAC has taken the following action: (i) it has reduced its current costs; (ii) it has promoted programs involving an intermediation spread; (iii) it has changed its credit practices; (iv) the Board of Directors has adopted a decision to contribute (effective January 1994) fresh resources to DEPAC on a regular basis (US\$1,000/month); (v) it has restructured the terms and conditions of bank credit to obtain concessional maturities and financing; and, (vi) it reviewed and changed sale strategies in its lotteries, beginning October 1993.
- 2.33 DEPAC has over 20 years' experience in granting credit and providing technical assistance to low-income campesino groups. Since 1993, the Board of Directors has come to grips with the problems which DEPAC is facing, and changes have been implemented in DEPAC's operating arrangements. This is the case with the Savings and Loan Fund, which in very short order has attracted

5/ These are as follows: (i) direct costs (US\$40,000); (ii) indirect costs which represent 40 percent of DEPAC's total (US\$102,086); and (iii) provisioning costs for doubtful loans (US\$23,909), which corresponds to 10 percent of the total provisions established for the three years under consideration.

200 members, mobilizing savings and granting loans. The proposed project will help DEPAAC to achieve operational and financial self-sufficiency, while strengthening its administrative infrastructure.

III. THE ADVISORY AGENCY

A. Fundación Mexicana para el Desarrollo Rural

1. Identity, origin, and objectives

- 3.1 The Fundación Mexicana para el Desarrollo Rural [Mexican Rural Development Foundation] (FMDR) is a nonprofit civil association, legally incorporated under Mexican law on November 15, 1969, pursuant to instrument No. 23297, executed vis-à-vis Notary Public No. 68 of Mexico City.
- 3.2 The FMDR is involved in setting up socioeconomic outreach units known as development centers in various areas of Mexico, in the interests of allowing the FMDR's expertise to be replicated nationwide. The FMDR provides each of the centers with technical, administrative, or financial assistance services which, owing to their nature or scope, the centers are unable to obtain for themselves. Each of the centers in turn provides services directly to campesino groups, supplying them with the technical, organizational, and financial advisory services and training needed to enable them to manage their resources efficiently. These campesino groups are comprised of small-scale farmers, stockbreeders, or craftsmen, who join forces for production purposes and gather around the cooperative philosophy, forming democratically organized working units. The FMDR, the development centers, and the campesino groups, are collectively referred to as the "FMDR Movement".
- 3.3 The FMDR and the development centers obtain financial support from approximately 1,400 individuals and enterprises whose contributions have helped to build up the FMDR's portfolio and to cover its operating costs. At this time, the FMDR can claim 34 development centers, which are serving and assisting 722 campesino groups in productive projects involving over 14,340 members, directly or indirectly benefiting a rural population of more than 80,000 people.
- 3.4 The institutional objective of the FMDR is to achieve increases in productivity, to promote the well-rounded human growth of individuals and rural associations, and to ensure that this growth can ultimately be self-sustaining. This objective is actively pursued by means of a methodology comprised of a set of action principles which guide all of the FMDR's operations. These are the following: (i) solidarity; (ii) the dignity of human beings; (iii) self-help;

(iv) efficiency; (v) demonstration effect; and, (vi) respect for nature.

2. Organization and administration

- 3.5 The General Assembly of Associates is the ultimate authority of the FMDR, and it is comprised of five founding members, and 151 associate members who meet once a year. The Board of Directors is comprised of 25 leading figures from the business and professional communities. The Board of Directors is elected every two years by the General Assembly of Associates. The Board of Directors is responsible for the running of the FMDR, with this responsibility being exercised through committees which monitor and oversee the operations.
- 3.6 The staff at the FMDR's headquarters, located in Mexico City, is comprised of 35 full-time employees, divided into five departments. It is worth noting that the operational staff consisted of 85 employees in 1987, given that the development centers obtained technical support directly from the Mexico City Office at that time. Over the last six years, services have been spun off to the development centers, with the result that it has been possible for the Mexico City Office staff to be reduced.
- 3.7 The FMDR's main activities involve services intended to increase the efficiency of the centers' operations and to enhance the effectiveness of the overall policy of the Foundation Movement. These activities may be summarized and grouped together into the following four areas: (i) technical; (ii) institutional organization; (iii) training; and, (iv) projects.
- 3.8 The technical support for the centers consists of the following: (i) project evaluation and analysis; (ii) research and technical exchange programs; (iii) research, development, and publicization of the results of demonstration projects; (iv) development of experimental programs at special centers established for the purpose; and, (v) technical training and advisory services.
- 3.9 The support for the institutional organization of the development centers takes the following forms: (i) legal advice; (ii) computerized information system; (iii) advice with respect to administrative matters, such as the establishment of accounting systems, and project management and supervision; (iv) liaison between board members and operating plants; (v) counterpart assistance for new development centers; (vi) assistance with respect to financing campaigns and fund-raising; (vii) communications and institutional "image"; and (viii) financial assistance.
- 3.10 Training involves the following: (i) professional development and upgrading for managers, outreach workers, technicians, and campesino managers; (ii) development of technical training programs from the administrative, economic, and financial standpoints;

(iii) microregional research; (iv) diploma course in rural development; (v) specialized courses; and (vi) fellowships and education abroad.

- 3.11 Project-related assistance takes the following forms: (i) assistance with respect to project design and presentation; (ii) obtaining funds at the international level; (iii) administrative follow-up and monitoring; (iv) assistance in preparing progress and impact reports.

IV. THE PROGRAM

A. Objectives

- 4.1 The program's objectives are: (i) to raise the household income levels of rural microproducers and microentrepreneurs; (ii) to create and/or consolidate employment opportunities in the rural areas where the projects are to be executed; and, (iii) to strengthen the capacity of the intermediary organizations to provide services in the areas of credit, marketing, and training for rural microproducers and microentrepreneurs.
- 4.2 Specifically, the projects are intended: (i) to establish revolving credit funds for a total equivalent to US\$1,246,000 for the purpose of providing financing for approximately 3,200 beneficiaries during the three-year project execution period; (ii) to make investments in machinery and facilities for the modernization of brick-making plants and the diversification of agricultural activities for a total equivalent to US\$254,000; (iii) to improve and expand the capacity of intermediary organizations to manage the growth in their credit and technical assistance programs as envisaged in these projects; (iv) to improve the management of intermediary organizations so that they can progress toward financial self-sufficiency; and, (v) to provide technical training and assistance for approximately 3,200 rural microproducers and microentrepreneurs, in order to enable appropriate technologies to be used and increases in productivity to be achieved.

B. Description of the program

- 4.3 The operation makes provision for three reimbursable financing arrangements for the intermediary organizations, in the amount of US\$500,000 each, as well as three nonreimbursable technical cooperation programs for the same organizations, in the amount of US\$180,000 each.

1. Reimbursable financing

4.4 The funds supplied by the IDB will be used to set up three revolving credit funds (local currency equivalents) through SEDEMEX (US\$500,000), FQDRAC (US\$332,000), and DEPAC (US\$414,000). The funds associated with the program will be used to grant loans which, during a three-year period, will benefit approximately 3,200 small-scale farmers in accordance with the following distribution: SEDEMEX, 1,400; FQDRAC, 600; and DEPAC, 1,200. The loans will be intended for financing working capital (agricultural inputs, raw materials, purchases of goods for marketing, wages, etc.), fixed assets (tools, equipment, machinery, etc.) and perennial crops for the program's beneficiaries.

4.5 In addition, the program makes provision for financing investments for a total of US\$254,000 in accordance with the following distribution: FQDRAC, US\$168,000; and DEPAC, US\$86,000.

a. SEDEMEX

4.6 The subcredits will be used to finance the following activities: (i) sheep-farming using technically advanced grazing methods (US\$190,000); (ii) production of crafts (US\$39,000); (iii) household modules for rabbit-breeding (US\$79,000); and, (iv) establishment and production of peach orchards (US\$192,000).

b. FQDRAC

4.7 The subcredits will be used for: (i) the production of fruit and horticultural crops; (ii) the procurement of beekeeping equipment; and, (iii) the financing of fixed assets for rural microenterprises such as tortilla-making factories and the production of crafts.

4.8 In addition, FQDRAC will invest in: (i) equipment for two nurseries for the production of seedlings, and a sorting center (US\$60,000 each); (ii) construction of 12 dikes or artificial pools to facilitate fruit cultivation during periods of drought. The FQDRAC will be the owner of this equipment and will charge for services provided to campesinos.

c. DEPAC

4.9 Subcredits will be used: (i) to promote the technique of minimum farming or conservation farming, which makes it possible to reduce production costs by 20 percent by reducing farming activities involving the plow, while boosting the production of seeds (corn, wheat, sorghum, beans) in the medium and long term by increasing the efficiency with which water is utilized by the soil while preserving the arable topsoil; (ii) to promote the establishment of artificial pastureland, and a system of programmed grazing instead of the standard livestock housing systems; (iii) to acquire tractors, a precision planting machine, fumigation equipment, goats

or oxen, milking equipment and facilities, and electric fences for the handling of animals in artificial pastureland; and, (iv) to create non-agricultural productive microenterprises with a view to providing employment for the rural population.

- 4.10 In addition, DEPEC will make investments in: (i) equipment for research into and production of hazelnuts, chestnuts, and cherries (US\$20,000); (ii) modernization of three small-scale brick-making plants (US\$36,000); and (iii) the purchase of a special precision planting machine for conservation farming (US\$30,000). DEPEC will own the equipment and will charge for services provided to campesinos.

2. Nonreimbursable technical cooperation

- 4.11 As a result of the diagnostic evaluation of the institutional situation, the parallel technical cooperation program will place emphasis on the following areas: (i) strengthening the financial, managerial, and technical capacity of the intermediary organizations; (ii) design and implement an appropriate credit methodology for the intermediary organizations, in an attempt to optimize their operational efficiency while offering financial products tailored to their beneficiaries; and (iii) strengthening the infrastructure of the intermediary organizations to enable the credit and investment program to be supervised more effectively. Annex I provides a detailed plan of technical cooperation operations.
- 4.12 In light of these priorities, the technical cooperation operation makes provision for hiring experts in the following areas: (i) microentrepreneurial/agricultural credit; (ii) information systems; (iii) training; (iv) marketing, and (v) new agricultural technologies. All of these experts will be added to the personnel already on staff at the organizations concerned. In addition, the budget for each project includes funds to allow the Bank to hire international experts who will carry out interim evaluations of the program.
- 4.13 In addition, the technical cooperation operation makes provision for financing equipment intended for expanding and improving the operational capacity of the intermediary organizations. Accordingly, funds have been included in the budget to purchase computer equipment, vehicles, and audiovisual and photographic equipment.

C. Cost of the program and its financing

I T E M	CREDIT FUND	INVESTMENT	REIMBURSABLE FINANCING	NON REIMBURSABLE TECHNICAL COOPERATION	TOTAL
1.1 SEDEMEX	500,000		500,000	180,000	680,000
1.2 FQDRAC	332,000	168,000	500,000	180,000	680,000
1.3 DEPAC	414,000	86,000	500,000	180,000	680,000
TOTAL	1,246,000	254,000	1,500,000	540,000	2,040,000

D. Program execution

1. Responsibility for program execution

- 4.14 The intermediary organizations will be accountable to the Bank for the administration of the financing and technical cooperation agreement, and they will execute the project in accordance with the terms of this document and its annexes. The intermediary organizations will negotiate with the FMDR to receive its advisory assistance in managing loan funds, and will pay up to 5 percent of the amount of such funds in order to receive such services. In addition, it will supervise compliance with the terms established in this program and the utilization of the credit regulations proposed in Annex IV. Separately, and as a condition precedent to the first disbursement, the intermediary organizations will sign agreements with the advisory organization to receive management assistance for a period not to exceed three years. During the project execution period, the intermediary organizations will use the nonreimbursable technical cooperation provided by the Bank to strengthen their administrative infrastructure facilities.
- 4.15 The total cost of the program, including the parallel technical cooperation, has been estimated at the equivalent of US\$2,040,000, in accordance with the breakdown provided in the above table.
- 4.16 The amortization period for the funds intended for the credit and investment program will be 15 years, including a grace period of five years and an annual fee of 1 percent on debit balances. The disbursement period will be 36 months reckoned as from the signing of the agreement, and the resources in question will come from the net income of the Fund for Special Operations.
- 4.17 Responsibility for the management and execution of the proposed projects will rest with each of the intermediary organizations. The activities in question will be carried out by the employees which each organization currently has on staff, with assistance from the consultants envisaged in the plan of technical cooperation operations.

2. Credit regulations

- 4.18 The standard credit regulations which will govern the execution of the program are shown in Annex IV of this document. These regulations are consistent with IDB rules and policies, and they are consistent with banking and financial laws and practices currently encountered in Mexico. It will be a condition precedent to the first disbursement of each financing that the intermediary organization in question must have adopted the credit regulations agreed upon with the Bank.

3. Intermediate evaluation of the phased execution of the program

- 4.19 With expenses chargeable to the parallel technical cooperation operation, the Bank will directly hire the consultants needed to conduct an intermediate evaluation of the credit and technical cooperation programs. This review will be designed to ascertain how well the programs are progressing in comparison with their original objectives and to ensure that the programs are proceeding according to plan. The evaluation, which will be governed by the terms of reference set out in Annex II, will be conducted when 50 percent of the financing for each intermediary organization has been disbursed.

4. Period for disbursement of funds

- 4.20 The funds associated with the financing and technical cooperation will be disbursed over a period of 36 months reckoned as from the effective date of the agreement in question.

5. Advances of funds

- 4.21 By its very nature, the program requires that liquidity be available in the form of financial resources in amounts sufficient to ensure a rapid and timely supply of credit and in order to initiate the consulting services needed to strengthen the intermediary organizations from the institutional standpoint. Accordingly, each intermediary organization will be provided with advances of funds for a maximum of up to 25 percent, both in respect of the amount of reimbursable financing, as well as in respect of the technical cooperation.

6. Reports

- 4.22 During the execution of the program and during the 60 days after the end of each calendar six-month period, the intermediary organizations will be required to submit to the Bank a report on the progress of the program. This report must include inter alia detailed information on the status of the loans portfolio. The final report must contain a summary of the results achieved in comparison to the original objectives of the program.

7. Use of recoveries

- 4.23 During the life of the financing agreement, the recoveries generated by the amortization payments in respect of loans granted using the program's resources, when they accumulate in excess of the amounts needed to service the IDB's financing, may only be used by the intermediary organizations to grant new loans that are substantially in accordance with the rules established in the financing agreement and in the credit regulations for the program under consideration here, unless the IDB gives written authorization to the effect that such recoveries may be used for another purpose.

8. Portfolio quality

- 4.24 The quality of the portfolios of the intermediary organizations will be evaluated using the indicator referring to the portfolio at risk, i.e., the capital balance of loans that are more than 30 days in arrears in the payment of an installment, and the balance of loans in court-ordered debt collection proceedings, with respect to the total stock of investments under the program. Intermediary organizations should take appropriate measures to ensure that this indicator stays under 5 percent of the total portfolio. If this rule is not complied with, the Bank reserves the right to suspend or defer disbursements.
- 4.25 Given the present portfolio situation of the intermediary organizations, as a condition precedent to the first disbursement, the organizations in question must submit an arrears recovery and reduction program satisfactory to the Bank.

9. External audit

- 4.26 During a five-year period, beginning with the year in which the disbursements begin, and within the 120 days after the end of the fiscal year, the intermediary organizations must submit to the Bank their own financial statements and those applicable to the program, approved by an independent auditor or independent firm of public accountants acceptable to the Bank.
- 4.27 It will be a condition precedent to the first disbursement of the financing resources that the intermediary organizations must submit to the Bank's satisfaction their plan, chart, or code of accounts to record the accounting transactions associated with the program, and that the organizations in question must have reached an agreement with the Bank with respect to the auditor, or auditing firm, that is to provide the audit opinions referred to in the preceding paragraph.

10. Environmental considerations

- 4.28 Even though the dimensions of the productive activities to be financed are such that the activities in question are liable to have but a negligible potential impact on the environment, the following measures have been included in the project in order to minimize such risks: (i) project eligibility criteria which will prevent financing from being provided for polluting activities and/or activities with a harmful effect on the environment; (ii) activities to provide training and education for ultimate beneficiaries, with environmental content, and (iii) the requirement that the intermediary organizations, and the organizations advising them, must ensure compliance with the precautionary measures included in the credit regulations. At its meeting on March 28, 1995, the Environmental Management Committee (CMA) classified the program under Category II.

V. BENEFICIARIES

A. Characteristic features

- 5.1 The projects will benefit 3,400 low-income campesinos, 6/ located in the State of Mexico (SEDEMEX), 7/ the State of Querétaro (FQDRAC), 8/ and the State of Puebla (DEPAC), 9/ whose principal activity is individual farming (or smallholding farming), including "ejidatarios," "colonos," and "comuneros". All of these small-scale producers share certain common characteristics: (i) they work at the subsistence level, with limited capital and negligible technology; (ii) they provide household manpower; and, (iii) they lack individual access to institutional sources of credit, training, and technical assistance. The typical activities are confined to the production of basic seeds and, on a smaller scale, dual-purpose stockbreeding (meat and milk).
- 5.2 Notwithstanding the above, these producers hold considerable potential in terms of human resources and land. The projects seek to develop alternative strategies for these producers on the basis

6/ Breakdown as follows: 1,400 producers for SEDEMEX; 600 for FQDRAC; and 1,200 for DEPAC.

7/ Communities of La Provincia, El Depósito, Lodo Prieto, San Juan Palo Seco, Jaltepec, Dios Padre Tlalchichilpa, Guarda de Guadalupe, and San José del Rincón.

8/ The region of Amealco-Huimilpan, Valle de Querétaro, and the semi-urban area of the city of Querétaro.

9/ Tepeaca, Acatzingo, San Salvador El Seco, Mazapiltepec, Zoltepec, Xoxotla, Huejotzingo, Tepango, Municipio Libre, Municipio Unión, etc.

of higher-yield economic activities in the short, medium, and long terms.

- 5.3 As one analyzes the population groups served by the intermediary organizations, one identifies three subgroups of agricultural producers: (i) the submarginal agriculture group, in which the potential of the land is so low, that the prospective yield is barely sufficient to pay for the inputs at current prices; (ii) the self-consumption (or subsistence) agriculture group, in which the capacity of the land is greater, and it is thus possible to increase earnings by supporting intensive farming; and, (iii) the intensive agriculture group, a category which extends to large-scale agricultural enterprises. The first group is considered "welfare level," the second group is considered "capable of being developed," and the third group is considered "advanced or developed." The beneficiaries of the program are found mostly in the second of these three groups, although producers in the first group will also benefit from training activities.
- 5.4 In the rainy agricultural zones, employment is typically seasonal. Agricultural activities encompass the months running from April to August, which correspond to the rainy season. In regions under irrigation, agricultural employment is permanent for those who have a plot of land. As one would expect, temporary migration from rural to urban areas is high. It is considered that up to 60 percent of the rural population must leave their communities in search of employment. It is further believed that each year, 10 percent of the active rural population migrates permanently to urban areas or to other countries.
- 5.5 The socioeconomic profile of the potential beneficiaries of the project is as follows: (i) most have not completed primary education; (ii) families number six family members on average; (iii) their homes are built of stone, partitions, and adobe, with cement floors; (iv) household income is in the range of US\$83-US\$186 per month, and depends on the number of days worked and any other kinds of work done by the family members. ^{10/}

B. The role of women

- 5.6 The intermediary organizations regard their programs as "integrated rural development programs," which means that from the cultural, social, and economic standpoints, women are to be included as an integral part of the development process. In these programs, the increase in productive activity resulting from the proposed financing will only achieve its optimal level within the same context; i.e., if women are actively involved as community leaders,

^{10/} This figure is much lower than the average household wage for Mexico.

above and beyond their traditional roles as mainstay of the nuclear family and producer.

C. Estimated number of beneficiaries

- 5.7 The proposed program will serve approximately 3,200 rural microproducers and microenterprises over a three-year period. In light of the average size of the family unit, approximately 19,200 will benefit indirectly from the program.

VI. VIABILITY, JUSTIFICATION, AND RISKS OF THE PROJECTS

A. Socioeconomic viability

- 6.1 The funds for the program will be directed toward the financing of small farmers and low-income microentrepreneurs, who currently lack access to credit within the conventional financial system. This program will thus make a contribution toward improving the living conditions of some 3,200 families (19,200 people), whose current incomes are below the level estimated by the Bank and the Government of Mexico as defining low-income groups.
- 6.2 The execution of the proposed program will make it possible to consolidate the functioning and operation of small-scale units of production, and this in turn will strengthen and increase employment levels in the rural sector and in marginal urban areas. In addition, with the technical training and assistance facilities provided, the beneficiaries will be able to improve their training for work, which will lead to higher productivity and hence higher incomes. Major economic benefits will also be obtained, such as reductions in rural migration to urban centers; the favorable impact on the ecological system resulting from reforestation; and the fact that the program's beneficiaries and their families will be able to achieve higher cultural and educational standards.

B. Institutional viability

- 6.3 The advisory agency (FMDR) has an appropriate legal framework as well as a flexible organizational structure that is well-suited to the working requirements that will be entailed by the execution of the projects in question, and is also capable of accommodating the expected increase in the FMDR's volume of operations. The FMDR's personnel receive constant training and have a fine track record in the administration of projects intended for the target group. This track record includes a successful operation with the IDB (SP/SF-88-09-ME).
- 6.4 The three intermediary organizations have gone through periods of institutional crisis; it is accordingly recommended that the FMDR

be used as an administrative/advisory agency on a temporary basis. For example, SEDEMEX found that it had to reconsider its action strategies, given that the economic, political, financial, and market conditions that had been prevailing in the agriculture sector had changed radically, which jeopardized SEDEMEX's capacity to respond to producers' needs. Thus, beginning in April 1993, SEDEMEX temporarily suspended operations, only to resume in August 1993. The following measures were taken at that time: (i) identification of models potentially capable of offering economic viability in their execution, and (ii) linkage with a variety of institutions and enterprises (both public and private sector) with connections to the agriculture sector, in the interests of maximizing the effectiveness of SEDEMEX's own actions and offering producers new facilities in the areas of technology, marketing, training, organization and administration of agricultural enterprises.

- 6.5 FQDRAC's operations were affected in 1988 when it was announced that the aquifers in the Valle de Querétaro were being rapidly exhausted, and the zone was declared off limits. By 1990, FQDRAC was feeling the cumulative effects of the new situation, and entered a critical phase which lasted for three years. With the appointment of a new President in July 1993 (a young businessman, with industrial and administrative experience, and a keen interest in social issues), the Board of Directors took on a new look, which served to encourage the participation of a dynamic new group eager to make a contribution to the task of solving problems in rural areas of Mexico. The liabilities which had accumulated in previous years have at last been paid off, and monthly donations have increased from US\$2,000 in June 1993 to US\$6,500 in November 1993.
- 6.6 DEPEC experienced three years of losses in its operations; this had an adverse impact on DEPEC's accumulated net worth. In addition, as a result of macroeconomic changes, the farming system has been affected by declining producer prices and rising cultivation costs, as well as by the glut of imported grain on the market (chiefly wheat). Under these conditions, the economics of the typical producer have reverted to self-consumption cultivation. In response to this situation, DEPEC has sought to promote changes in agricultural technology (reduced farming and confined intensive grazing) in an attempt to reduce costs and boost farmers' profit margins. Furthermore, these changes have been aimed at introducing agricultural practices more closely in keeping with a rational use of natural resources.
- 6.7 The problems facing the three intermediary organizations described above will be corrected in the course of the three-year program period. In order to achieve the institutional strengthening of the three intermediary organizations, the program includes a nonreimbursable technical cooperation operation for the purpose of hiring consultants to strengthen these organizations' services in the areas of lending, training, and technical assistance for

beneficiaries, as well as accounting and management information systems. The experts to be hired will complement the work done by the employees already on staff at the intermediary organizations.

C. Financial viability

- 6.8 The funds associated with the program will be used to finance productive activities that show financial feasibility, previously determined in accordance with the methodology employed by the intermediary organizations, on the basis of eligibility criteria and the terms for the subloans as established in the credit regulations.
- 6.9 Given that the subloans will be granted at interest rates that are positive in real terms and which cover intermediation costs and risks, the projects will generate resources sufficient to achieve the envisaged targets, in addition to the capitalization of the three intermediary organizations, the maintenance of the value of the revolving credit funds, and increases in the net worth of the organizations. Moreover, in those projects in which investments of appropriate technology are being made into existing production systems, such investments will be made on the basis of their own feasibility analysis, with acceptable rates of profitability.
- 6.10 Furthermore, the parallel technical cooperation will enable the intermediary organizations to achieve satisfactory administrative and operational standards ensuring the continuity of these programs, which are intended to benefit small-scale farmers and microentrepreneurs belonging to the lowest-income groups in Mexico.

D. Justification

- 6.11 The proposed projects comply with the eligibility criteria of the Small Projects Financing Program, as established in documents GP-75-7 and GN-1238-2, since they will directly benefit marginalized groups, create employment opportunities, promote the involvement of women, and encourage the use of appropriate technologies.

E. Risks entailed by the operations

- 6.12 The main risks entailed by the operations have to do with the fact that: (i) the intermediary organizations lack significant experience in marketing the products associated with some of the proposed projects; and, (ii) the program could come to outpace the levels of institutional development of the intermediary organizations. However, the wide-ranging proposed program of technical cooperation will address the principal shortcomings identified within the intermediary organizations and will aim to consolidate these organizations from the institutional standpoint, so that after the three-year program period these organizations will be able to administer IDB funds by themselves without

assistance from the advisory organization (FMDR). All of these arrangements can be expected to minimize the risks outlined above.

VII. CONCLUSIONS AND RECOMMENDATIONS

- 7.1 The foregoing considerations indicate that the execution of the proposed projects is viable. Accordingly, the Management of the Bank recommends that the Board of Executive Directors approve the financing in each case, and is thus submitting for the Board's consideration the proposed financing and nonreimbursable technical cooperation resolutions contained in Appendix I.
- 7.2 Furthermore, it is recommended that over and above the general contractual conditions, the financing and technical cooperation agreement be made to include the following special conditions precedent to the first disbursement of the approved financings.
 - a. The intermediary organizations must submit the signed agreement or agreements with respect to the advisory assistance in the management of funds by the FMDR, setting forth the rights and obligations of the parties, the timetable of execution of technical cooperation activities, and the use of resources in accordance with the terms and conditions prescribed in this document.
 - b. The intermediary organizations must each submit a plan for recovering loans and reducing arrears to acceptable levels. This plan must set as a goal that of reducing the portfolio at risk to 5 percent or less of the total portfolio by the time that 50 percent of the reimbursable financing has been disbursed.
- 7.3 Finally, it is recommended that authorization be given for funds to be advanced up to a rate of 25 percent, both in respect of the amount of reimbursable financing and in respect of the technical cooperation.

INTER-AMERICAN DEVELOPMENT BANK
SMALL PROJECTS FINANCING PROGRAM
PLAN OF TECHNICAL COOPERATION OPERATIONS

Central de Servicios para el Desarrollo del Estado de México (SEDEMEX)
Fundación Queretana para el Desarrollo Rural (FQDRAC)
Central de Servicios para el Desarrollo de Puebla (DEPAC)
MEXICO
(TC-94-03-36-2, TC-94-03-37-0, TC-94-03-38-8)

I. BACKGROUND

- 1.1 In addition to the request for financing submitted by the executing organizations SEDEMEX, FQDRAC, and DEPAC under the Small Projects Financing Program, nonreimbursable technical cooperation has also been requested in order to assist the execution of the projects proposed in the financing document.

II. OBJECTIVES

- 2.1 The objectives of the proposed technical cooperation operation will include the following:
1. Strengthen the financial, managerial, administrative, and technical capacity of the intermediary organizations, by providing assistance aimed at improving their administration, accounting, and credit management systems.
 2. Design and implement an appropriate credit methodology for the intermediary organizations, with a view to maximizing the efficiency of these organizations' operations while offering financial products that are well-tailored to the types of beneficiaries involved.
 3. Develop technical training and assistance programs for the ultimate beneficiaries using environmentally appropriate technologies, as well as basic concepts from the fields of administration, finance, and marketing.
 4. Strengthen the infrastructure of the intermediary organizations, the better to equip them to manage the credit and investment program, in the interests of ensuring that the requested resources are utilized, managed, and recovered in an appropriate fashion.

III. DESCRIPTION OF THE PROGRAM

3.1 In order to achieve the proposed objectives, the technical cooperation program makes provision for hiring the following consultants (the terms of reference are given in Annex II):

1. Microentrepreneurial/agricultural credit. Specialists in credit technology applied to small-scale credits will be hired for a period of 18 months for the three intermediary organizations. These specialists would be responsible for making adjustments to the credit methodology currently used by the intermediary organizations, tailoring that methodology to accommodate the projected growth in the organizations' loan portfolios, seeking to increase the involvement of women, cover operating costs, enhance the efficiency of credit services, and maintain high quality in the loan portfolios (by keeping arrears to a minimum).
2. Information systems, for which computer specialists are to be hired for a period of three months for each executing agency. These specialists will be responsible for designing and/or redesigning the computer systems used to maintain the organizations' accounts, to manage the loan portfolios, to record general information on the program, and to generate reports needed for decision-making purposes at the institutions themselves.
3. Microentrepreneurial training. Specialists in microentrepreneurial training will be hired for a period of 18 months for the three intermediary organizations. These specialists will be responsible for identifying the most urgent training-related needs, as well as designing a training program well-suited to each type of target beneficiary, in which emphasis is placed on maximizing the involvement of women. In addition, these experts will assist in providing training and skills development for personnel on staff at the intermediary organizations, upgrading their capacity to perform their respective duties as outreach workers, organizers of group activities, and field technicians.
4. Marketing. Specialists will be hired for a period of 12 months for the three intermediary organizations. These specialists will provide the beneficiaries with advisory assistance and training in product marketing (presentation, quality, new crops, new products, etc.). At the same time, these specialists will help develop group-based marketing mechanisms, and will make contacts with buyers, with the aim of expanding the markets for the products sold by the beneficiaries.

5. Short-term specialists, hired for periods of up to 30 days (up to the equivalent of three months per consultant), to provide technical assistance and training courses in specific subjects (e.g., production of new crops, beekeeping, agroindustrial production, expert in brick-making plants, specialist in pastureland and forests, lamb farming, etc.) in accordance with the specific needs identified by the managers of the intermediary organizations and the executive staffs of SEDEMEX, FQDRAC, and DEPAC.
6. Evaluation of institutions and credit programs. International specialists or international consulting firms will be hired for a total period of up to 40 days. These specialists will be responsible for evaluating the progress of the program once 50 percent of the financing resources have been committed. In addition to carrying out this evaluation, these specialists will advise the intermediary organizations on how best to deal with any problems identified in the implementation of the credit program, and they will make recommendations aimed at making it possible for the program objectives to be achieved while enabling compliance with the terms stipulated in the agreements with the Bank.

IV. COST AND FINANCING

- 4.1 The total cost of this nonreimbursable technical cooperation program has been estimated at the equivalent of US\$540,000, which will be financed by the Bank in accordance with the budget set out in the attached table.
- 4.2 The Bank's contributions, up to an amount equivalent to US\$180,000 for each organization, will be made available on a nonreimbursable basis, and will be chargeable to the Fund for Special Operations. Disbursements will be made within a period of 36 months reckoned as from the date on which the agreements in question are signed.
- 4.3 At the request of the intermediary organizations, the Bank may make an advance of funds for an amount not exceeding 25 percent of each technical cooperation operation. Such advances, when made or renewed, will be regarded as disbursements, and organizations wishing to have such advances renewed will have to submit itemized accounts on the use of funds disbursed and spent.

CATEGORIES	SEDEMEX	FQDRAC	DEPAC	TOTAL
2.1 Consultants' fees <u>1/</u>	135,000	135,000	135,000	405,000
6.3 Computer equipment <u>2/</u>	10,000	10,000	10,000	30,000
6.3 Office equipment and training	10,000	10,000	10,000	30,000
6.3 Vehicles <u>3/</u>	12,000	12,000	12,000	12,000
8.2 Fees for external evaluation <u>4/</u>	5,000	5,000	5,000	15,000
9.8 Contingencies	8,000	8,000	8,000	24,000
T O T A L	180,000	180,000	180,000	540,000

- 1/ For the three intermediary organizations, this includes in each case: specialist in microentrepreneurial/agricultural credit (US\$2,000/month x 18 months); specialist in information systems (US\$3,000/month x three months); specialist in microentrepreneurial training (US\$2,000/month x 18 months); specialist in marketing (US\$2,000 x 12 months); and, five specialists working in specific areas such as pastureland and forest production, brick-making plants, nurseries, new crops, beekeeping, etc. (US\$2,000/month x three months a piece).
- 2/ Includes PC486, with 80MB hard disk and 4MB of RAM. In addition, a laser printer and accounting and loan portfolio management software will be acquired.
- 3/ Includes a four-wheel-drive truck.
- 4/ Includes an evaluation of up to 40 days' duration, and advisory assistance for the intermediary organizations provided by an international or local expert (lump sum). This includes fees, international travel, and per diems.

V. EXECUTION OF THE PROGRAM

- 5.1 The consultants will be hired separately by the three intermediary organizations in consultation with the advisory agency, with the exception of the international consultants responsible for carrying out the evaluations of the program, who will be hired directly by the Bank. As a condition precedent to the first disbursement under the financing, the intermediary organizations must sign the contracts for the provision of services, at least those for the specialists in microentrepreneurial/agricultural credit.

VI. JUSTIFICATION

- 6.1 The technical cooperation operations will make a direct contribution to ensuring that the programs are successfully executed and that the programs' objectives are duly achieved. In view of the fact that the credit programs will represent an expansion of the activities which the intermediary organizations are presently engaged in, it is considered that these technical cooperation operations are necessary to strengthen the operational, administrative, and technical foundations upon which these

organizations are based. Thanks to these technical cooperation operations, these efforts to expand the organizations' sphere of operations can do much to maintain and improve quality in the management of services and the monitoring of beneficiaries.

- 6.2 The technical assistance envisaged in this program will equip the intermediary organizations with the tools and procedures they need in order to improve the services and coverage which they provide for their end-users. In addition, the intermediary organizations will be further strengthened and thus better equipped to play a more active role in assisting lower-income groups in Mexico.
- 6.3 Furthermore, the need to keep track of expanded credit portfolios, not to mention the additional complexity entailed by assisting and supervising an enlarged network of customers, will require the installation of computerized information systems.
- 6.4 In conclusion, the success of the programs to a large extent will be determined by the above-described components of the technical cooperation program, which are considered essential to the effective implementation of the projects.

VII. DISBURSEMENTS

- 7.1 The disbursements associated with each operation will be made over a period of 36 months reckoned as from the date on which the respective agreements are signed. At the request of each intermediary organization, an advance of up to 25 percent of the amount of the pertinent technical cooperation operation may be made available in order to ensure the liquidity necessary for the program to be successfully implemented.

VIII. REPORTS

- 8.1 Within the 30 days after the end of each calendar six-month period, the consultants will submit progress reports to the intermediary organizations and to the advisory agency, with copies for the IDB, indicating the progress that has been achieved in the performance of their activities. In addition, within the 30 days after the date on which their contracts are completed, the contractors must submit a final report indicating the results achieved and setting out recommendations for future action.

- 8.2 With assistance from the advisory agency, the intermediary organizations will submit to the Bank an evaluation of the reports submitted and of the work done by each consultant, within the 60 days after the reports are received.
- 8.3 With assistance from the advisory agency, the intermediary organizations will submit to the Bank a financial report itemizing the expenditures made with funds drawn from the Bank's nonreimbursable contribution, and they must do so within the 120 days after the end of the calendar year in which the final disbursement under the program is made. This report must be approved by independent auditors acceptable to the Bank.

IX. SUPERVISION

- 9.1 Responsibility for supervising these technical cooperation programs will rest with the Management of each intermediary organization. Also, the advisory agency will supervise the execution of the technical cooperation programs through its regional coordinators. The IDB will supervise the programs through its country office in Mexico, which will have technical responsibility for the operation.
- 9.2 Basic responsibility for this operation will rest with the Country Division, at IDB Headquarters.

CREDIT REGULATIONS

Article 1. General conditions

The organizations involved in the proposed projects, Fundación Mexicana para el Desarrollo Rural (FMDR) (hereinafter called "the advisory agency"), and Central de Servicios para el Desarrollo del Estado de México (SEDEMEX), Fundación Queretana para el Desarrollo Rural (FQDRAC), and Central de Servicios para el Desarrollo de Puebla (DEPAC) (hereinafter called "the intermediaries"), are private nonprofit civil organizations established for the purpose of promoting technical and financial assistance for low-income microentrepreneurs and microproducers in Mexico (hereinafter called "the beneficiaries"). The programs will be financed by the Inter-American Development Bank (hereinafter called "the IDB") and carried out by each of the intermediaries separately through Credit Committees set up autonomously within each intermediary, in accordance with the following the terms and conditions:

Article 2. Objectives and description of the program

The main purpose of the program is to facilitate access to credit and the coverage of lending, management training, and technical assistance for low-income microentrepreneurs in poor urban areas and low-income microproducers in rural areas through activities calculated to raise and improve production, productivity, and sales, thereby enhancing the social and economic conditions of individuals and households. As part of the program, credit, training, and technical assistance projects would be carried out for the financing of: (a) production infrastructure, (ii) machinery, (iii) equipment, and (iv) working capital.

Article 3. Beneficiaries

The beneficiaries of the programs will be persons and/or groups of persons in low-income urban and rural areas of the states of Mexico, Querétaro, and Puebla.

Article 4. Use of program resources

The proceeds of the program will be used to finance fixed assets and working capital for manufacturing, business, and service activities carried out by microentrepreneurs that are considered technically and financially feasible.

Article 5. Training and advisory assistance

The intermediaries, through their advisors and promoters, will disseminate and provide initial guidance to potential beneficiaries, encouraging their participation individually or as a group

with joint and several guarantees. The training and technical assistance will cover subjects having to do with cooperation and the community, leadership, business activities such as marketing, costs, accounting, production, quality control, finance, and human relations. This will be supplemented for those approved for investment loans with information on investment projects.

Article 6. Financing

The intermediaries may grant financing to individual microentrepreneurs and microproducers as well as to community groups.

Article 7. Eligibility criteria

To be eligible for lending under the program, a microentrepreneur or microproducer must:

- (i) be of legal age,
- (ii) have operated the business unit for at least 12 months, in the case of individual credits,
- (iii) not have regular access to conventional sources of credit,
- (iv) have monthly sales equivalent to US\$5,000 or less, or total assets equivalent to US\$30,000 or less,
- (v) have a maximum of five permanent paid employees,
- (vi) derive most of his/her income from the microenterprise or agricultural operation, and
- (vii) have an identifiable location.

Article 8. Selection criteria for project financing

The general criteria to be used in considering requests for financing under the program shall be as follows:

- (i) the business must generate sufficient cash flow to cover the loan,
- (ii) the economic unit must turn a profit and profits must be reinvested in the microenterprise or agricultural operation
- (iii) the microentrepreneur or small farmer must demonstrate technical and administrative capacity to run the business,
- (iv) the business must generate or strengthen employment,
- (v) the business must have a large enough market for its products or services,
- (vi) the business must use sufficient labor and appropriate technology, and
- (vii) the business must use production methods and practices that do not cause pollution or deplete natural resources serving as raw materials.

Article 9. Restrictions on the use of program resources

The program resources shall not be used to finance:

- (i) the purchase of real estate or construction,
- (ii) the payment of debt, dividends, or the return on capital,
- (iii) the purchase of shares, bonds, and other securities,
- (iv) the purchase of vehicles for personal use, and
- (v) the payment of taxes.

Article 10. Terms and conditions of the loans

- (i) **Currency:** The loans granted out of program resources will be denominated in local currency.
- (ii) **Amounts:** Microenterprises may receive financing from program resources in amounts that overall do not exceed the equivalent in local currency of US\$3,000 in the case of working capital loans and of US\$6,000 in the case of purchases of fixed assets. Under no circumstances may a single borrower assume indebtedness in excess of the equivalent of US\$6,000 with program resources. The maximum amounts in the case of group loans shall be the equivalent of US\$30,000 in local currency, subject to the individual limits stipulated above.
- (iii) **Terms:** The executing units shall determine the amount of the subloans taking into consideration the type of investment, the cash flow of the economic unit, and the beneficiaries' ability to pay. The subloans will be granted for the following terms: (a) for a maximum period of 48 months in the case of investments in fixed assets or crop financing; and (b) for a maximum period of 12 months in the case of working capital loans.
- (iv) **Interest rate:** To ensure that the lending rate charged to the final beneficiaries is positive, the intermediaries will use as a benchmark rate the current weighted average rate paid by banks on deposits plus three percent. A spread will be added to this base rate to cover transaction costs and to establish a reserve for bad debts. The lending rate will be variable and adjusted every six months.
- (v) **Manner of payment:** Principal and interest will be paid on a weekly, monthly, quarterly, or six-monthly basis depending on the nature of each loan.

- (vi) Prepayment: The loans will be considered due and payable and the balance repayable on demand in any of the following events:
 - (a) failure to pay in full or in part any of the installments, in accordance with the terms of the loan contract in respect of both principal and interest on the dates specified;
 - (b) if, without the written consent of the executing agency, the beneficiary should encumber or assign to a third party the assets being financed or pledged as security; and
 - (c) if the information provided by the beneficiary in the loan application is found to be false.
- (vii) Repayment: The intermediaries shall provide the beneficiary with a repayment schedule showing amounts due and payment dates of installments of principal and interest, the loan amount, and interest rate.

Article 11. Guarantees

Any of the following guarantees may be demanded: (i) joint and several guarantee secured by a bill of exchange signed by the members of the group, (ii) chattel mortgages, (iii) collateral security, (iv) deeds of title, (v) cash guarantees, (vi) personal signature of the beneficiary, or (vii) solvent co-debtor.

Article 12. Credit Committee

The Intermediaries' Credit Committee will be formed by a minimum of three individuals, to be members of the management and/or officials of the entity. The Credit Committee will have the following functions:

- (i) to comply with and enforce the Regulations;
- (ii) to take decisions on (approve, deny, or defer all credit applications, in accordance with the criteria, terms, and amounts specified in the Regulations;
- (iii) to approve and sign minutes of the Committee recording consideration of applications for credit submitted and the decisions taken, including the conditions (amount, term, manner of repayment, interest rate, guarantees, etc.) and/or the reasons for denial or deferment;

- (iv) to organize administrative processing and physical receipt of loans by beneficiaries approved for loans; and
- (v) to analyze the information concerning the advance of the program including the status of the portfolio and any problems with recoveries so that steps can be taken to correct the situation.

Article 13. Registration and control

The transfer of program resources will be recorded separately in the accounting records of each intermediary under the heading "IDB Revolving Fund Project". To this end, the intermediaries will keep records in accordance with the chart or plan of accounts approved by the IDB prior to the first disbursement of the proceeds of the financing. These records shall identify the loans granted, indicating how the recoveries were used, so that statements of financial condition earnings, and source and applications of program funds can be prepared.

Article 14. Amendment of Regulations

These Credit Regulations may be amended while the project is under way in order to bring it into line with the requirements of the project. The Bank will be required to express its nonobjection in writing for a modification to take effect.

PROPOSED RESOLUTION

MEXICO. FINANCING AND TECHNICAL COOPERATION TO THE CENTRAL DE SERVICIOS
PARA EL DESARROLLO DEL ESTADO DE MEXICO 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, to enter into such agreement or agreements as may be necessary with the Central de Servicios para el Desarrollo del Estado de Mexico, of the Estados Unidos Mexicanos, 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) nonreimbursable technical cooperation for the execution of the program, in accordance with Annex I of said document.

2. That up to the equivalent of US\$500,000 in pesos mexicanos, is authorized for the purposes indicated in paragraph 1(a), and up to the equivalent of US\$180,000 in pesos mexicanos, for the purposes indicated in paragraph 1(b), both chargeable to the net income of the Fund for Special Operations.

PROPOSED RESOLUTION

MEXICO. FINANCING AND TECHNICAL COOPERATION TO THE FUNDACION QUERETANA
PARA EL DESARROLLO RURAL 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, to enter into such agreement or agreements as may be necessary with the Fundación Queretana para el Desarrollo Rural, of the Estados Unidos Mexicanos, 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) nonreimbursable technical cooperation for the execution of the program, in accordance with Annex I of said document.

2. That up to the equivalent of US\$500,000 in pesos mexicanos, is authorized for the purposes indicated in paragraph 1(a), and up to the equivalent of US\$180,000 in pesos mexicanos, for the purposes indicated in paragraph 1(b), both chargeable to the net income of the Fund for Special Operations.

PROPOSED RESOLUTION

MEXICO. FINANCING AND TECHNICAL COOPERATION TO THE CENTRAL DE SERVICIOS
PARA EL DESARROLLO DE PUEBLA 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, to enter into such agreement or agreements as may be necessary with the Central de Servicios para el Desarrollo de Puebla, of the Estados Unidos Mexicanos, 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) nonreimbursable technical cooperation for the execution of the program, in accordance with Annex I of said document.

2. That up to the equivalent of US\$500,000 in pesos mexicanos, is authorized for the purposes indicated in paragraph 1(a), and up to the equivalent of US\$180,000 in pesos mexicanos, for the purposes indicated in paragraph 1(b), both chargeable to the net income of the Fund for Special Operations.