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HONDURAS

SOCIAL ENTREPRENEURSHIP PROGRAM

PROPOSAL FOR FINANCING AND TECHNICAL COOPERATION

EXPANSION OF FINANCIAL SERVICES IN THE RURAL AREA OF THE DEPARTMENT OF OLANCHO

(SP/TC-0012042-HO)

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EXECUTIVE SUMMARY

Executing agency: Asociación de Desarrollo Integral Comunitario [Comprehensive Community Development Association] (ADICH)

Amount and source:	IDB (US\$)	ADICH (US\$)	Total (US\$)
IDB financing:	100,000		100,000
Nonreimb. Tech. Coop.	100,000	90,000	190,000
Total (US\$)	200,000	90,000	290,000

The Bank's resources will be provided from the net income of the Fund for Special Operations, in foreign exchange.

Financial terms and conditions of the financing component:	Amortization period:	15 years
	Grace period:	5 years
	Disbursement period:	48 months
	Interest rate:	1% in lempiras

The grace period will apply only to amortization of capital and not interest. The financing will be denominated in lempiras. Maintenance of value will be added to the interest rate and will be set on the basis of the Consumer Price Index of the last six months, annualized, using the Central Bank of Honduras as the source of information.

Terms:	Execution period:	42 months
	Disbursement period:	48 months

Problem to be resolved: Microfinance services for the poor, particularly in rural areas where there are no alternative sources of financing, represent a mechanism that helps eradicate the problem of social exclusion and poverty, in view of the fact that they represent practically the only option for access to capital. Credit methodologies involving joint and several guarantees are alternative financing mechanisms through which the

rural and marginal urban population without credit history has been able to gain access to sources of financing. These methodologies include: solidary groups, village banks, rural savings banks, and *bancomunales* [a form of village banking], which in this document are referred to as Empresas Comunales de Ahorro y Crédito [Village Savings and Loan Enterprises] (ECACs).¹

Objectives: The objective of this project is to improve the socioeconomic circumstances of 400 families living in the rural area of Olancho. To this end, the project seeks to expand access to financial services available in the rural area of Olancho and make them sustainable.

The specific objectives are to: (i) expand access to alternative financial services through the establishment and strengthening of ECACs in 24 villages in the rural area of the Department of Olancho; and (ii) implement an institution-strengthening strategy for ADICH to ensure the sustainability of the financial services it provides in the rural area through the ECACs.

Description: **Financing component (US\$100,000)**

The resources from the financing component will be used for ADICH to grant credit under the subordinated debt modality to the ECACs that have been legally set up and established in the villages located in the rural area of Olancho and that meet the eligibility requirements set out in the Credit Regulations. The subordinated debt modality has lower priority vis-à-vis other financial commitments and will therefore make it easier for the ECACs to access other sources of financing. The resources under this component may only be used to grant loans for microentrepreneurs who are ECAC members to finance their activities in industry, agribusiness, trade, services, and agriculture.

Technical cooperation component (US\$190,000)

Expansion of the ECACs (US\$90,500): The following activities will be funded: (i) technical assistance for the promotion, selection, training, and establishment of 20 ECACs and strengthening of the four existing ECACs; (ii) legal technical assistance to facilitate the ECAC formalization process; (iii) hiring of a project coordinator; and (iv) procurement of teaching materials.

¹ ECACs are local enterprises legally recognized as corporations that provide financial services through self-management of own and third-party resources, and receive legal and accounting advisory support through a facilitator. The ECACs are located in the rural area and are run, controlled and owned by the members.

Institutional strengthening of ADICH (US\$14,500): This component will finance: (i) the design of a strategy to ensure the sustainability of ADICH services and technical support for the ECACs; (ii) review of the credit methodology currently used by ADICH and of the manual of procedures for financial products, and update of the Credit Regulations; (iii) hiring of three short-term consultants to provide professional services in the areas of financial management, credit systems, and management information systems; (iv) procurement of a multiple-user information system to facilitate portfolio management, the recording of accounting information, and the cash flow generated by the volume of operations that ADICH conducts; and (v) the development of a tailored administrative structure.

Local contribution (US\$90,000): ADICH will provide the local counterpart in an amount equivalent to US\$90,000. These funds will be used to fund part of the cost of the project coordinator and facilitators. Staff training, supplies, and transportation expenses will also be covered. In addition, four motorcycles will be purchased to make it easier to provide technical assistance to the ECACs, since they operate in communities located between 12 and 15 kilometers from the municipal seats, with access limited by poor road conditions.

Beneficiaries: The project's target market is comprised of 400 rural families living in the Guayape River valley, who participate in the ECACs and are willing to comply with the requirements and regulations for their operation. The project beneficiaries are people who operate rural businesses at the subsistence level, such as: farmers, street vendors, owners of small poultry and pig farms, grain vendors, agricultural input stores, small staples stores, and other activities undertaken by small rural businesses.

Environmental and social review: The recommendations of the Committee on Environment and Social Impact have been taken into account for the design of this operation. The project will be based on the activities that ADICH has been carrying out under its other support programs that include environmental and gender issues. Project coordination will encourage the ECACs to organize environmental safety and health modules for the workplaces (businesses) of the members and to design mechanisms to ensure a gender approach in project execution. Project coordination will encourage microentrepreneurs who are associated with the ECACs to meet the sanitary and environmental requirements enacted by the Ministry of Health and the Ministry of Natural Resources and Environment, and adopt practices consistent with the protection of the environment and natural resources.

Government and Bank strategy:

The Bank's strategy in Honduras set out in the country paper (document GN-2070-1 of 14 October 1999) proposed an assistance strategy that takes as its starting point the need to restart rapid growth and reduce poverty through the reconstruction process. The program of support for the 1999-2001 period agreed by the Bank and the Government of Honduras includes programs to promote private-sector participation, particularly on the part of microenterprise and small and medium-sized business.

This project is consistent with the objective of the Social Entrepreneurship Program, which seeks to promote social justice and the economic development of poor, marginalized groups by promoting financial, social, and community development services efficiently and on a sustainable basis.

Risks:

The project's main risk is that the target population will not understand the concept of corporations and their implications and will therefore not participate in the establishment of the ECACs. To offset this risk, ADICH will use technical-cooperation resources to develop an information and dissemination plan that explains the model under which the ECACs will operate as well as the advantages and benefits of this model to the members, compared with other credit access modalities.

A second risk is the implementation of an agricultural debt forgiveness policy that could affect the recovery of agricultural credits because of the confusion that the policy generates among campesinos. To offset this risk, ADICH will maintain an ongoing information program with the ECACs that emphasizes the origin of the resources and the impact that bad management could have on the ECACs.

A third risk related to the ECAC methodology is the fraud that could be committed by some of their members, problems that are common in village banks. ADICH will counteract this risk by: (i) providing technical support to the ECACs for the establishment of suitable mechanisms for financial records and control of the enterprise; and (ii) training the Boards of Directors and auditors of the ECACs in fraud detection.

Special contractual clauses:

Because of the need to support ADICH in project planning and administration, in particular with respect to fulfillment of the conditions precedent to the first disbursement of the technical-cooperation resources, the Bank will authorize disbursement of up to US\$3,000 in technical-cooperation resources to defray the cost of hiring the project coordinator for three months. This disbursement will be made once ADICH has met the conditions set forth in the General Conditions of the financing and technical cooperation agreement.

As a condition precedent to disbursement of the remainder of the technical-cooperation resources, ADICH will present: (i) final terms of reference for the consultants to be hired with technical-cooperation funds; (ii) a project implementation plan, which includes annual targets for accomplishing of proposed activities. The implementation plan will include: (i) a timetable for fulfillment of performance indicators, which will make it possible to monitor and supervise progress; and (ii) the collection of socioeconomic data on each target group before the start of project activities to compare changes in income experienced by the group that benefits under the project with those experienced by a group that does not.

Prior to the first disbursement of the financing component resources, ADICH will present to the Bank's satisfaction: (i) the final Credit Regulations and evidence that they have been implemented; and (ii) the list of ECACs that meet the requirements established in the Credit Regulations for access to financing resources.

Evaluations:

During the project execution period, ADICH will submit audited financial statements to the Bank within 120 days following the end of each fiscal year. In addition, within 90 days after the deadline for the last disbursement of the nonreimbursable technical-cooperation operation, ADICH will present a financial report audited by independent authorities showing how the Bank's contribution was spent. The transportation and computer equipment will be acquired pursuant to the Bank's contracting and procurement procedures.