

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

## **GUATEMALA**

### **SOCIAL ENTREPRENEURSHIP PROGRAM LOAN AND TECHNICAL COOPERATION PROPOSAL**

#### **PRODUCTION AND MARKETING OF EXPORT CROPS GROWN BY SMALL-SCALE FARMERS**

**(GU-S1002)**

This document was prepared by the project team consisting of Fernando Campero (SDS/MSM), Project Team Leader; Gabriela Torres (Consultant); Nohora Alvarado (COF/CGU), and Juan Carlos Pérez-Segnini (LEG/OPR).

**SOCIAL ENTREPRENEURSHIP PROGRAM (SEP)**  
**PRODUCTION AND MARKETING OF EXPORT CROPS GROWN BY**  
**SMALL-SCALE FARMERS**  
**(GU-S1002)**

**EXECUTIVE SUMMARY**

**Executing agencies:** The reimbursable loan component will be executed by Aj Ticonel S.A.

The nonreimbursable technical cooperation component will be executed by the Organization for Business Promotion and Research (OPCION).

<b>Amount and source:</b>	<u>IDB (US\$)</u>	<u>Local (US\$)</u>	<u>Total (US\$)</u>
Loan:	300,000	210,000	510,000
Nonreimbursable technical cooperation:	<u>170,000</u>	<u>30,000</u>	<u>200,000</u>
<b>Total:</b>	<b>470,000</b>	<b>240,000</b>	<b>710,000</b>

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

**Terms and conditions:**

Amortization period:	10 years
Grace period:	5 years
Loan disbursement:	54 months
Loan execution:	48 months
Interest rate:	3%

The grace period will apply solely to the repayment of principal, not to interest. The loan will be denominated in United States dollars.

**Problem to be addressed:** The Guatemalan economy is based on exports of traditional agricultural products such as coffee, sugar, and bananas, which account for 31.6% of its total exports. The crisis in these products has undermined the performance of traditional agriculture and has been particularly severe on small-scale farmers who gain their livelihood from these crops. As a consequence, such farmers have intensified their strategies for diversification and promotion into nontraditional crops, such as leaf and baby vegetables (e.g. Chinese pea, zucchini, and French bean), which have found export markets and offer growth prospects. These markets are increasingly demanding, however, and

access to them is complex, since products have to satisfy a series of entry standards and requirements relating to safety, quality (good agricultural practices, or GAPs), production volume, and the capacity to trace each product back to the farmer that harvested it. They also have to follow complex marketing and logistics procedures. In addition, the production and marketing process requires financing, which is difficult for small-scale farmers and the organizations that work with them to obtain in the financial system.

OPCION and the Aj Ticonel S.A. marketing firm/school, organizations created by professionally educated and committed individuals with a sense of social responsibility, have established an institutional system to facilitate the production and marketing of nontraditional export crops grown by small-scale farmers, by working with grassroots organizations. These two institutions are partly responsible for the fact that over 415 small-scale producers of leaf and baby vegetables from Chimaltenango and other regions in the west of the country are selling their produce on higher-value international markets, thereby obtaining higher prices and earning better incomes. OPCION and Aj Ticonel S.A. have identified a demand for baby vegetables in these markets and hope to expand their operations by incorporating into their system a group of small-scale farmer communities from the Quiché department, given the region's potential for producing nontraditional crops of this type. Farmers currently do not have sufficient access to financial services or production and marketing support to enable them to increase the volume and improve the quality of their crops, and sell their produce on expanding export markets.

If small-scale farmers from Quiché are to successfully enter these markets, a number of problems need to be overcome: (i) insufficient organizational and technical management of production, owing to a lack of specialized advisory services; (ii) lack of access among small-scale farmers to sources of credit enabling them to invest in productive infrastructure and obtain sufficient working capital to purchase seed, production inputs, and appropriate technology to support diversification and improve the quality and competitiveness of their produce; (iii) weaknesses in marketing and new market penetration, owing to a shortage of funds for investment in storage infrastructure, processing, and production quality control; and working capital to enable the marketing firm to finance the timeframes involved in the export process and provide liquidity to small-scale farmers; and (iv) lack of suitable procedures and systems for managerial and financial administration and oversight in OPCION and Aj Ticonel, which detracts from their capacity to provide such

farmers with optimal support services for production, storage, and marketing.

**Objectives:** The project's **general objective** is to enhance incomes among small-scale farmers from the Quiché region, by raising technical skills for the production of nontraditional crops and improving their access to the international market.

The **specific objectives** of the project are: (i) to increase farmers' access to loans for working capital and investments for the production of nontraditional crops; (ii) to increase the value-added of their products through improvements in technical crop management, product diversification, and better storage and production processing systems; (iii) strengthening the marketing system for exporting their produce; (iv) strengthening institutional capacity at OPCION and Aj Ticonel to provide efficient services to small-scale farmers.

**Description:** The project has two components:

**1. Reimbursable loan component** (IDB: US\$300,000; Aj Ticonel S.A.: US\$210,000)

This component will finance three subcomponents: (i) a credit program for small-scale farmers; (ii) working capital from Aj Ticonel for the marketing and export of nontraditional crops; and (iii) investments to facilitate the logistics of storage and production processing operations for farmers.

- a. **Small-scale farmer credit program (CAPA).** Resources in this subcomponent will be used to meet farmers' financing requirements for working capital and investment for the production of nontraditional crops (leaf and baby vegetables). The funds will make it possible to extend working capital loans to around 500 small-scale farmers during project execution, enabling them to purchase seed, production inputs, small tools, and other items.

Credits for productive investments can be extended individually or on a collective basis (i.e. for individual farmers or for legally established grassroots farmer organizations). Funding will be provided to construct small greenhouses, droplet irrigation systems in farmers' land plots, and storage centers strategically located in the region to benefit various farmer organizations.

- b. **Working capital for marketing and export (CEX).** Funding will be provided to meet the working capital needs of Aj Ticonel S.A. in marketing and exporting the nontraditional crops grown by small-scale farmers (mainly leaf and baby vegetables), enabling them to receive immediate payment for their produce, and thereby increasing their liquidity and helping to finance their production operations.
- c. **Investments for storage and production processing.** These resources will be used to finance: (i) the equipping of four mobile refrigerator trucks to be used to store products in locations close to the farmers' villages; and (ii) installation of a conveyor belt in the central Aj Ticonel S.A. storage and processing plant, to optimize product processing times and enhance quality for export.

As part of the strategy to spread the benefits of the operation, facilities will be provided to enable small-scale farmers to purchase shares in the marketing firm Aj Ticonel S.A. Funding for this purpose will be generated from within the project itself, based on an interest spread of 7% per year resulting from: (i) a "shadow" interest rate of 10% that Aj Ticonel will pay on balances owed on the Bank loan; and (ii) the interest rate of 3% it will actually pay to the Bank on such balances. The proceeds of this rate spread will be used to create an "Aj Ticonel S.A. Capitalization Fund" (FOCAP), which will be used to help small-scale farmers buy shares in the firm. The minority stake held by the farmers will be acquired over the lifetime of the project, enabling them not only to improve their knowledge of export markets—and hence their ability to benefit from them—but also to have a share in the firm's profits. By taking producer interests into account, the project will also help to improve the firm's governance.

FOCAP will be governed by charter that establishes the manner in which the beneficiary small-scale farmers are to hold equity in Aj Ticonel S.A., including: (i) eligibility and selection criteria for share issues to farmers; (ii) how FOCAP funds that accumulate in the special account are to be used; (iii) criteria for setting share value; (iv) mechanisms, amounts, and frequency for share issues to small-scale farmers; (v) transaction accounting criteria; and (vi) mechanisms to ensure that minority shareholder interests are properly represented on the firm's board of directors.

## **2. Nonreimbursable technical cooperation component** (IDB: US\$170,000; OPCION: US\$30,000)

Resources under this component will be used to improve the quality of agricultural production by implementing an improvement plan that involves the use of GAPs by small-scale farmers. In addition, financing will be made available to train trainers, with technical agronomists among OPCION and Aj Ticonel staff being given specific knowledge on GAPs and agricultural diversification, for subsequent transmission to the farmers. Funds will also be made available to train small-scale farmers on business issues, establish a system of barcodes to facilitate marketing, and strengthen executing agencies' administrative and managerial skills. Capacity strengthening will also be provided to enable executing agencies to provide better-quality services to small-scale farmers, and consulting services will be funded to ensure effective project coordination and execution.

Resources have also been included for the following: (i) a project launch workshop; (ii) development of socioeconomic and environmental baselines to measure project outcomes; (iii) external audits; (iv) midterm and final evaluations; and (v) consulting services to support project monitoring and supervision. The two latter categories will be directly contracted by the Bank's Country Office in Guatemala.

### **Beneficiaries:**

It is estimated that the project will directly benefit, in a number of different ways, some 500 small-scale farmers mainly in the municipios of Uspatan and Cuné in the Department of Quiché, a largely indigenous region. All beneficiaries will gain access to credit services for working capital, 60% will undergo management training, and 80% will receive onsite technical assistance in GAPs. Moreover, with access to credit, some 62 farmers will be able to set up irrigation systems on their land where there are water springs, and a further 15 will install greenhouses. The OPCION/Aj Ticonel system currently serves 415 farmers in the region, and project activities will make it possible to assist an additional 90. The family group structure means that the project is likely to affect some 3,500 people in rural areas.

The project will help improve the socioeconomic status of small-scale farmers working with the OPCION/Aj Ticonel system, by raising their incomes through higher volume and better quality of their leaf and baby vegetable crops—as a result of technical assistance in GAPs and enhanced access to credit for their working capital needs—and by strengthening capacity to market the produce from their land.

**Environmental and social review:**

At meeting 19-04 of 14 May 2004, the Committee on Environment and Social Impact (CESI) made suggestions for assessing the potential impacts of an expansion of the agricultural frontier and/or alteration of the frequency of itinerant farming. To prevent and mitigate the project's impacts on these areas, two actions will be undertaken: (i) inclusion of measures in the Credit Regulations to ensure that the agricultural frontier is not being expanded without mitigation measures being taken; and (ii) technical assistance to promote the use of production technologies that are compatible with environmental protection, to ensure that the crops will be managed by systems that avoid degradation of such resources as soil and water and encourage farmers to participate in government programs to restore forest and other resources. In addition, at project launch, an environmental baseline will be established for the project's area of influence, and this will be verified in the midterm evaluation. The training to be provided for farmers will also cover issues such as: (i) agrochemical management; (ii) control of pests and plant health; and (iii) labor health.

**Government and Bank strategy:**

The Bank's current country strategy with Guatemala involves helping it to face the challenges of sustainable economic development, with poverty reduction as a top priority. The strategy has three main pillars: (i) economic growth, stability, and competitiveness, with special support to the competitiveness of productive sectors; (ii) equity, social safety nets, and human capital development, including actions specially targeted on uprooted population groups, such as indigenous people; and (iii) modernization of the State and governance (Country Paper GN-2149-1, June 2001). The project proposal fits within points (i) and (ii) of this strategy. The Bank is in the process of approving a new country strategy that emphasizes poverty reduction in the social domain and increased competitiveness in the economic-productive sector. The project is also consistent with these priorities.

The operation is also set within the parameters of the Social Entrepreneurship Program (SEP), since its final beneficiaries are small-scale, low-income, mainly indigenous farmers located in economically depressed rural areas, who stand to benefit from a project that helps to raise their incomes.

**Coordination with other donors:**

In relation to the technical assistance activities included in this project, during the analysis mission there was coordination with other entities involved in the sector, such as the Ministry of Agriculture and Food and the Association of Exporters of Nontraditional Products, so as to avoid duplication and pool efforts. The World Bank referred the IDB to Aj Ticonel and OPCION. The latter won the first rural productivity

award sponsored jointly by the World Bank and the Soros Foundation in Guatemala.

**Rationale:**

The project is important because: (i) it will have a substantial impact on the incomes of rural families by improving productive and business management in farming activity; (ii) it will help make small-scale farmers more competitive in responding to the new demands of international markets, and thus less vulnerable vis-à-vis producers from more developed countries; and (iii) it will strengthen two intermediary institutions with a clear social-entrepreneurship orientation, serving small-scale farmers.

**Risks:**

Four main project risks have been identified: (i) *Institutional risk*: although the partnership between OPCION and Aj Ticonel is a strength of the project, management complexities in project execution could generate discrepancies and a lack of coordination between the two institutions. *Risk mitigant*: The proposed operating mechanism entailing an ad hoc committee (PEC) to be set up with members from both institutions, and a project coordinator with mainly liaison and coordination functions, should make proper execution of the project more likely. (ii) *Market risk*: Although demand and reasonable market prospects have been identified, the behavior of the export market and the market for inputs could generate slumps in volumes and sale prices that would cause losses for the marketing agency and producers. *Risk mitigant*: An allowance for marketing losses as envisaged in the CEX operating regulations to be approved by Aj Ticonel and enhancement of crop quality and implementation of GAPs will improve producers' competitive position and make them less vulnerable to market requirements. (iii) *Risk*: Aj Ticonel could abuse its bargaining power in its dual role as buyer and financier for small-scale producers. *Risk mitigant*: Enabling producer organizations to participate in Aj Ticonel S.A. equity will help mitigate this risk, since these organizations will form part of the firm and will have access to its information and decision making. Aj Ticonel will also report to the Bank the profit margins that the firm generates with project resources in its dealings (business and lending) with small-scale farmers. (iv) *Risk*: Natural risks that harm production and could affect loan repayment (e.g. climate changes or pests). *Risk mitigant*: Although this risk cannot be controlled, OPCION will provide technical assistance and training in comprehensive crop management and adoption of GAPs, to minimize the potential negative effects of weather phenomena or pests.



**Special contractual conditions:**

As a condition precedent to the disbursement of funds under both components, the executing agencies will present evidence to the Bank's satisfaction of: (i) having signed an interinstitutional cooperation agreement formalizing arrangements for strategic and administrative coordination between the two executing agencies; (ii) having formed the Project Executing Committee (PEC) consisting of two representatives from OPCION and two from Aj Ticonel; and (iii) having selected the project coordinator.

In addition, for disbursement of Bank funds for the **Loan Component**, Aj Ticonel S.A. will submit the following to the Bank's satisfaction:

- a. As a condition precedent to the **first disbursement**: (i) evidence that its board of directors has approved: (1) the CAPA Credit Regulations; (2) the CEX Operating Regulations; and (3) the FOCAP charter; (ii) evidence that the FOCAP special account has been opened at a national Bank; and (iii) a report from the financial management consultant hired using technical cooperation resources, certifying that Aj Ticonel has upgraded its management procedures and systems to expand its lending operations.

FOCAP funds may be used only for project beneficiary small-scale farmers (or their organizations) to buy/issue shares of Aj Ticonel S.A. They may not be used for any other purpose without the Bank's prior consent.

- b. **To disburse more than 50%**, Aj Ticonel S.A. will demonstrate to the Bank's satisfaction that it has started the process of incorporating small-scale farmers into the equity of the trading firm. Evidence of this will be the subscription, by small-scale farmers or their grassroots organizations, of an initial block of Aj Ticonel S.A. shares (or of an equivalent document that ensures participation by producers in the firm's equity).

For disbursement of **more than 30% of the technical cooperation resources**, Aj Ticonel will have begun disbursement of the loan component resources, and deliver to the Bank's satisfaction the findings of: (i) the socioeconomic baseline, with initial measurements for the indicators presented in the logical framework and those agreed with the Bank during project preparation; and (ii) the environmental baseline and recommendations made by the environmental consultant to mitigate impacts in that domain.

**Reports and evaluations:**

**Baseline:** The executing agencies will compile and analyze relevant data for monitoring the project's performance indicators. At the start of the project, OPCION will hire a consultant to establish baseline parameters and design the system of indicators to monitor and evaluate project activities and performance. This will complement or update both the indicators set out in the project's logical framework and the performance indicators agreed upon with the Bank. The baseline study will establish and validate initial measurements for all these indicators, along with others as deemed necessary. It will also include compilation of socioeconomic data on the target group, making it possible to measure the change in beneficiary incomes. Once agreed upon, these parameters and indicators, along with those contained in the logical framework, will become the baseline for monitoring project performance. The executing agencies and the Bank will use the monitoring system and indicators for project supervision and evaluation purposes. These indicators will be considered in the progress reports and in the midterm and final evaluations.

**Progress and monitoring reports:** At the start of the project, OPCION and Aj Ticonel will present a joint plan for the first 12 months of project execution.

Through the PEC and the Bank's Country Office in Guatemala, OPCION and Aj Ticonel will jointly submit reports on project progress and the use of Bank resources within 60 days following the end of each calendar semester. These will include: (i) a description of progress achieved both in implementing the project execution plan and in terms of its indicators, together with a report on key achievements, and a list of difficulties encountered in meeting the project targets and objectives, and in relation to the current execution plan; (ii) an updating of performance indicators and the project execution plan for the following 12 months, including measures to overcome obstacles identified; (iii) information on benefits transferred to small-scale farmers both in economic terms and in terms of training and technical assistance on production and marketing issues; (iv) information on the execution of environmental and gender activities; (v) status of the use of Bank resources and counterpart contributions paid; (vi) data on the accumulation of FOCAP funds (with evidence of deposits made during the period) and use thereof (including the number and value of shares acquired by small-scale farmers and the purchase facility used); (vii) information on the effective rate of lending through CAPA, and a comparison with reference interest rates on loans for similar operations within the financial system; (viii) data on activities undertaken to introduce and develop new varieties of exportable products and their outcomes; (ix) a list of prices charged by the firm to its customers, prices paid to

producers during the reporting period, and product prices on the local market, showing that small-scale farmers receive an adequate price for their produce; (x) data on tax credits accumulated in their favor and recovery thereof to the benefit of the firm; and (xi) statistical and financial information on the earnings of Aj Ticonel S.A., and on the transfer of assets and liabilities thereto by Aj Ticonel Unipersonal. The last of these reports, which will constitute the final project report, will contain a summary of achievements in terms of project objectives.

*Annual audited financial reports of the loan component:* Within 120 days following the close of each fiscal period during project execution, starting with that corresponding to the fiscal year in which loan disbursements begin, Aj Ticonel S.A. will deliver a report to the Bank containing financial statements for the project's loan component and movements on special accounts, certified by an independent auditor acceptable to the Bank. Funds have been set aside in the budget for this purpose. Aj Ticonel S.A. will also submit annual financial statements reviewed by an external auditor. Within 120 days following the end of the period for the last disbursement under the nonreimbursable technical cooperation component, OPCION will file a financial report certified by independent authorities showing how the Bank contribution was used.

**Evaluations:** In order to evaluate project progress and take any corrective measures that may be needed, a *midterm evaluation* will be done when 50% of the loan proceeds have been disbursed or 24 months of execution have elapsed, whichever occurs first. The evaluation will measure fulfillment of the proposed objectives, and the extent to which performance indicators and those contained in the logical framework are being attained. Items to be evaluated will include the following: (i) the project's impact on the socioeconomic situation of small-scale farmers in relation to data compiled at the start of the operation (baseline); (ii) the performance of the lending program and access to it by beneficiaries; (iii) the behavior of CEX; (iv) the performance of storage, post-harvest processing, and marketing systems; (v) the status of asset and liability transfer from Aj Ticonel Unipersonal to Aj Ticonel S.A.; (vi) the benefits to small-scale farmers deriving from use of the FOCAP funds, and the affordable purchase of shares in the Aj Ticonel marketing firm, as measured by the performance indicators agreed upon with the Bank; (vii) the environmental impact of activities carried out and mitigation measures taken, bearing in mind the original project baseline; (viii) institutional coordination and execution capacity in OPCION and Aj Ticonel; and (ix) the quality of information presented in the six-monthly progress reports.

A *final* project evaluation will be done once the loan component execution period has expired. This will focus on analysis of the process undertaken by OPCION and Aj Ticonel, documenting lessons learned and paying special attention to the following: (i) degree of implementation of GAPs by farmers; (ii) improvements in production and reduction of losses; (iii) marketing structure and development of new products; and (iv) socioeconomic indicators for farmers and institutional-financial indicators for the executing agency.

The Bank's Country Office in Guatemala will directly hire independent consultants to perform these evaluations, charged against the technical cooperation funds set aside for such purpose.

**Monitoring and supervision:** The Bank will review the findings and recommendations of progress and evaluation reports. The executing agencies and the Bank's Country Office in Guatemala will hold project monitoring meetings every six months to discuss the half-yearly report, progress achieved in fulfilling performance indicators, and the work plan. The outcomes of these half-yearly reports and meetings will determine future disbursements on this operation. Should significant shortcomings be detected in project execution, the Bank may suspend disbursements until OPCION and/or Aj Ticonel, as the case may be, take the necessary corrective steps.

Technical cooperation resources have been set aside to hire a consultant to help monitor and supervise project execution. These services will be directly contracted by the Bank's Country Office in Guatemala and charged against the technical cooperation resources.

**Revolving fund:**

Revolving funds will be established for 10% of the total amount of the loan component and 10% of the technical cooperation component. The Bank's Country Office in Guatemala will be responsible for contract management and project supervision.

**Exceptions to Bank policies:**

None.