

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

BOLIVIA

SOCIAL ENTREPRENEURSHIP PROGRAM

EXECUTIVE SUMMARY

EXPANSION OF AGRICULTURAL CREDIT FOR SMALL PRODUCERS

(BO-S1009)

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INFORMATION AVAILABLE IN THE PROJECT TECHNICAL FILES

Preparation

- Project application
- Approved project profile
- FONDECO incorporation papers, legal registration, and bylaws
- Audited financial statements 2007, 2008, 2009
- FONDECO risk rating report by Planet Rating (July 2009)
- Credit Regulations

Document 1	Logical framework
Document 2	Institutional analysis and execution of the operation, with financial projections for the project
Document 3	Technical cooperation milestone planning table
Document 4	Technical cooperation plan of operations, itemized budget, and execution timetable
Document 5	Minimum content for project Credit Regulations
Document 6	FONDECO historical financial statements 2007-2009
Document 7	Procurement plan
Document 8	Summary of project financial terms
Document 9	Loan terms and conditions
Document 10	Integrity review summary

I. BASIC PROJECT INFORMATION

A. Executing agency

- 1.1 Fondo de Desarrollo Comunal (FONDECO)

B. Amount and source of financing

	IDB (US\$)	Local (US\$)	Total (US\$)
Reimbursable financing:	1,000,000	450,000	1,450,000
Technical cooperation funding:	<u>83,000</u>	<u>39,000</u>	<u>122,000</u>
Total:	1,083,000	489,000	1,572,000

Source: Net income of the Fund for Special Operations (FSO).

C. Terms and conditions

Amortization period:	6 years
Grace period:	36 months for principal
Interest rate:	180-day LIBOR + 400 basis points on outstanding balances
Currency:	United States dollars
Execution period	36 months for both components
Disbursement Period:	42 months for both components

- 1.2 The grace period will apply solely to the repayment of principal, not to interest. The reimbursable financing will be denominated, disbursed, and repaid in United States dollars.

D. Statement of no objection

- 1.3 The Government of Bolivia, acting through the Vice Ministry of Public Investment and External Financing (VIPFE), stated its no objection to this project in official letter VIPFE/DGGFEPP/UGF-001306/2010 of 16 April 2010.

E. Problem to be addressed

- 1.4 **Agriculture is one of the most important sectors of the Bolivian economy**, currently accounting for 15% of GDP. The sector has had average annual growth of 2.4% over the last 25 years, in line with Bolivia's national GDP growth.¹ Bolivia's rural economy is built on campesino farming and small-scale agricultural production, which is a source of income for more than 80% of rural households. Farming income is around US\$25 per month per capita, due to low productivity and fluctuating prices on the agricultural production market.²

¹ Excluding years in which the El Niño and La Niña weather phenomena occurred.

² Jimenez, Wilson and Susana Lizarraga. 2004. "Ingresos y desigualdad en el área rural de Bolivia" [Income and Inequality in Rural Bolivia]. UDAPE. La Paz, Bolivia.

- 1.5 **The campesino economy is characterized by its diversity, a low-density rural population, and limited access to labor and financial markets, products and services, land, and investment opportunities.** Furthermore, resources are scarce and low-quality, in terms of both initial endowment and access to monetary, physical, and/or human capital. In this economy, the objective generally is not earnings, but rather to minimize risks, meet needs, and ensure ongoing production through diversification using time-, space-, and variety-based survival strategies.³ Small campesino farmers have been, and still are, the main suppliers of food consumed in Bolivia. The degree to which traditional producers are linked to the domestic market through the sale of their products depends on their location: food produced in remote areas is consumed essentially by those who grow it, whereas most food produced in nearby areas with easy access to local and regional supply centers is sold on the market.⁴
- 1.6 **Agricultural credit in Bolivia.** The Bolivian microfinance industry has seen outstanding growth over the past two decades, particularly in terms of coverage. Few countries have experienced such a rapid expansion of microfinance coverage, in terms of both the number of clients served and portfolio amounts. As a result, a growing percentage of operations have been subject to the discipline of financial markets, and broad sectors of the population previously denied access to institutional financial services have obtained increasingly favorable terms and conditions from microfinance institutions.
- 1.7 Bolivia's microfinance sector is considered one of the most developed and competitive in the region. Nevertheless, financial services have primarily targeted the commercial and urban sectors, to the detriment to the productive and rural sectors. In recent years, microfinance institutions have been expanding their lending rural areas. Despite these efforts, however, a large percentage of loans have been for trade and other nonagricultural activities, and (except in special cases, such as the executing agency for this project) there has been no increase in agricultural microlending. On average, loans for the agriculture sector accounted for only an estimated 7.4% of the total portfolio of the regulated financial system between 2001 and 2008, so financial deepening has lagged in Bolivia's rural areas.
- 1.8 The scant investment in this sector has led to low levels of production diversification and mechanization, restricting growth. There are several reasons for this lag in the provision of financial services suited to the agriculture sector, including:

³ Medeiros, Gustavo. 2006. *Caracterización de los pequeños y medianos productores de soya del municipio de mineros en Santa Cruz- Bolivia*. [Characteristics of Small- and Medium-scale Soya Producers in the Municipio of Mineros, Santa Cruz, Bolivia]. Universidad Católica de Chile. Santiago, Chile.

⁴ Ybarregaray, Roxana. 1997. "Tenencia y Uso de la Tierra en Bolivia" in *Cuestión Agraria Boliviana: Presente y Futuro*. ["Land Holding and Use in Bolivia," in the journal *Cuestión Agraria Boliviana: Presente y Futuro*]. Stampa Gráfica Digital. La Paz, Bolivia.

- (i) **Nature and conditions of agricultural production:** The seasonality of the biological cycles of planting and harvesting; significant cash flow covariance among the inhabitants of a given rural region;⁵ significant impact of exogenous factors, beyond the control of producers, on the results of productive activities; the dependence of results on particular local conditions (microclimates, land tenure, infrastructure, information, access to markets, and market size); excessive vulnerability to climate change and other adverse natural events, combined with the shortage of insurance instruments and other mechanisms to cover such risks; vulnerability to fluctuations in the prices of inputs and outputs, over which there is little or no control; wide geographical scattering of producers combined with low population density; the shortage of information and the high cost of obtaining it; and the great difficulty in correctly assessing production costs and returns to determine whether a failure to meet credit obligations is due to exogenous events, imprudence, or neglect on the part of the producer (verification problems and costs).
- (ii) **Circumstances inherent to the rural environment:** Nonexistent or limited physical infrastructure (i.e., roads, irrigation, electricity, bulking and storage facilities, communications, and other production and sales supports); limitations of human capital, reflected in low literacy and education rates and minimal experience with modern production methods; absence of institutions and legal framework to define and protect property rights and enforce financial contracts; and high transaction costs, as a result of long distances, low population density, and small business volumes.⁶
- (iii) **Nature and circumstances of small agricultural producers:** Limited household wealth, combined with the absence of assets or goods that could be used as conventional security for loans; limited productive opportunities due to the restricted access to assets, markets, and information; failure to separate productive activities and household affairs;⁷ and the varied starting conditions of the producers, related to

⁵ This is due to the seasonality of the sector, in which everyone seeks credit at the same time (for example, during planting), and wants to make deposits and accumulate savings at another time (harvest), leading to a deficit-surplus cycle in liquidity management.

⁶ Transaction costs increase the total cost of financing for borrowers well above the agreed interest payments, or reduce the net return on deposits for investors well below advertised interest rates. Because the transactions are so small, the fixed cost of each transaction cannot be sufficiently diluted, increasing the cost per dollar lent or deposited for both the financial institution and the client. At the same time, the low volume of business in a given area makes it impossible to sufficiently dilute a branch's fixed costs.

⁷ Funds are pooled, so household activities are taken as a whole, requiring consideration of the multiple cash flow sources as well as certain immediate obligations (often related to the family's survival) that affect small producers' ability to pay.

significant disparities in terms of business skills and ownership of other production factors (land, human capital, and information).⁸

Taken together, these obstacles explain the shortage of financial products for the agricultural sector and the difficulties faced by small farmers in meeting the lending requirements of financial institutions. In general, the conditions regarding security, amounts, terms, rates, and payment frequency are ill-suited to facilitate the growth of their crops and/or livestock.

- 1.9 In their research paper on agricultural credit in rural Bolivia, Gonzales Vega and Rodriguez Meza (2004) conclude that the most effective way to provide access to financial services for small producers is to develop innovative credit and deposit mobilization technologies that overcome the obstacles to financial transactions in rural areas, particularly for the agricultural sector.
- 1.10 **Fondo de Desarrollo Comunal (FONDECO) and the challenge of serving small rural producers.** FONDECO is a development financial institution (DFI) that focuses on financing for the rural economy. It has been a DFI for 14 years, and before that operated as a revolving fund of the Centro de Investigación y Promoción del Campesinado [Center for Campesino Research and Promotion] (CIPCA). Over this time it has developed innovative lending technologies to meet the needs of its clients in rural areas. Today, it has a network of 17 branches located in the departments of Chuquisaca, Santa Cruz, Tarija, Cochabamba, and La Paz, and a main office in Santa Cruz de la Sierra.
- 1.11 Agriculture is the primary economic activity in all of the areas where FONDECO operates. The small-scale farmers in these areas have limited access to basic services such as education, health care, clean drinking water, sewer systems, and permanent housing. Despite these conditions, a significant number of these farmers have nevertheless been able to surpass the subsistence threshold and sell part or all of their produce on the market, making them potential loan candidates. The areas in which FONDECO works vary in terms of the type of production (manual or mechanized) and their relationship with the market (providing food for the domestic market or soya or sugarcane for the foreign market). The branches in San Julián, Minero, San Pedro, and Yapacaní (Department of Santa Cruz) have the highest concentration of small-scale farmers who are integrated into the market.
- 1.12 FONDECO's 30 years of experience working in the rural area has given it an understanding of the specific environment and the unique characteristics of its clients. The positive and negative results of its operations have enabled it to gain know-how and gradually lower its operating costs and risks, thereby improving its lending products and adapting loan terms and conditions to meet the needs and particular circumstances of its clients.

⁸ González Vega, Claudio and Jorge Rodríguez Meza. 2004. *El crédito agropecuario en las áreas rurales de Bolivia: Notas preliminares*. [Agricultural Credit in Rural Areas of Bolivia: Preliminary Notes.] The Ohio State University. Proyecto Premier. La Paz, Bolivia.

- 1.13 FONDECO is currently using a tool that it developed, called CRP (Costos, Rendimientos y Precios) [Costs, Returns and Prices], which collects, on a semiannual and annual basis, information on cost, return, and price trends for each of the regions it analyzes. This tool enables FONDECO to optimally monitor agricultural calendars, agricultural records, production systems, returns (by area), and price projections for farm produce in the five departments where it works, thus providing a key input for determining clients' ability to pay and the risks of extending them credit.
- 1.14 FONDECO has also developed, tested, and implemented innovative lending products specially designed for the agricultural sector. The products currently offered are:
- **Current microlending for agriculture:** targeted exclusively to finance agricultural activities with credits from US\$500 to US\$40,000.
 - **Micro-warrant:** seasonal credit of US\$500 to US\$20,000 to finance the sale of grains (initially rice and corn), enabling small producers to obtain better prices. Strategic partnerships were established with rice millers and seed mills that bulk the grain. The credit is secured by the grain harvested and stored.⁹
 - **Contract farming:** seasonal credit of US\$500 and US\$20,000 to finance the final stage of cultivating, harvesting, and sale of agricultural products, generally for export (initially coffee, sesame, and beans). Strategic partnerships were established with bulking/export companies, which guarantee the purchase of client produce with future sales contracts. These contracts are part of the security for the credit.
 - **Current microlending for livestock farming:** exclusively to finance livestock activities with credits from US\$500 to US\$40,000.
 - **Livestock microlending:** targeted to farmers who own land and cattle and have at least one year of experience. This product finances the purchase of cattle for rearing, breeding, fattening, and meat and milk production; infrastructure; land; investment in livestock farming; and equipment for livestock farming. Credits are offered in amounts from US\$2,000 to US\$15,000, and the security required is a pledge on the cattle.
- 1.15 The steady growth in FONDECO's operations demonstrates that there is still potential demand for agricultural credit in the areas where it works, and it is therefore planning to deepen and expand its line of financing for this sector. Nevertheless, in order to offer more agricultural lending products, FONDECO must obtain additional long-term resources, the reason for its application for the Bank's Social Entrepreneurship Program.

⁹ This innovative product was created by FONDECO and is now being replicated in Nicaragua, with FONDECO technical assistance, by Cooperativa 20 de Abril.

- 1.16 FONDECO has extensive experience and know-how in the sector where it works. It also has proven credit technologies that are adapted to its target population, which is reflected in the quality of its portfolio. FONDECO has demonstrated sufficient technical, financial, and administrative capacity to carry out this project.
- 1.17 **Beneficiaries.** The direct beneficiaries of the project will be some 500 rural producers in the departments of Santa Cruz, Chuquisaca, and Tarija, who will receive loans to finance operating capital and/or investment in livestock rearing and fattening; planting and harvesting of agricultural produce; machinery and equipment; expansion of crops and herds, etc. Their activities include planting and harvesting rice, soybeans, sugarcane, and fruit trees; rearing and fattening animals, etc.

II. THE PROJECT

A. Objective and purpose

- 2.1 This project will contribute to increase the financial resources available to Bolivia's agricultural sector. The purpose is to provide small-scale farmers in Santa Cruz, Tarija, and Chiquisaca with financial resources that meet their specific needs (security, payment plans, and terms), in order to develop their agricultural activities.

B. Description

- 2.2 In order to meet these objectives, two components will be financed: a reimbursable financing component for US\$1.45 million (IDB: US\$1 million; and FONDECO: US\$450,000), and a nonreimbursable technical cooperation component for US\$122,000 (IDB: US\$83,000; and FONDECO: US\$39,000). Both components will be executed by FONDECO.
- 2.3 The **reimbursable financing component** will be used to finance the expansion of FONDECO's agricultural lending portfolio to approximately 500 small-scale farmers in rural areas, providing them with the resources to meet their needs related to operating capital and/or investment in crop planting and harvesting, livestock rearing and fattening, machinery and equipment, expansion of crops and herds, etc. As part of this project, FONDECO will offer five types of loans: (i) current microlending for agriculture; (ii) micro-warrant; (iii) contract farming (primarily coffee, sesame, and beans); (iv) current lending for livestock farming; and (v) livestock microlending. The resources committed by the Bank and FONDECO for this project will be used exclusively for the agricultural loans described above. The maximum amount for loans financed with Bank resources will be US\$10,000, to ensure that the credits made possible through the SEP reach the lowest-income clients. The Bank's financing to FONDECO will bear an annual interest rate of 180-day LIBOR plus 400 basis points, in U.S. dollars. The term will be 6 years, with a 36-month grace period. The Credit Regulations approved by FONDECO's Board of Directors will govern the granting of credit.

- 2.4 FONDECO will onlend the Bank funding at a market rate on outstanding balances, denominated in U.S. dollars or in bolivianos. The terms will be up to 36 months for operating capital and up to 60 months for investment loans, and will be determined primarily by the loan amount and the client's cash flow and credit history. The "Project Credit Regulations," available for consultation as document 5 in the project technical files, provide further detail regarding the terms of the lending products.
- 2.5 The **technical cooperation component** will support four main areas: (i) activities necessary to expand agricultural credit in the target areas; (ii) technical advisory support and environmental and social risk management training; (iii) dissemination and documentation of results; and (iv) support for project execution. The resources will be used primarily for: (a) market studies to expand operations in the 4 Cañadas and Bermejo regions; (b) promotion and dissemination of materials related to FONDECO products and technical bulletins on the management of agricultural land and livestock; (c) purchase of equipment and training for loan officers; (d) hiring of an environmental expert to design a manual and train FONDECO staff members on the social and environmental aspects of agricultural production; (e) studies to measure poverty and the impact of agricultural credit on clients' living conditions; (f) documentation, publication, and dissemination of project outcomes; and (g) contracting of project evaluations and audits. The "Technical Cooperation Plan of Operations," available for consultation in the project technical files, describes this support in greater detail.

C. Sustainability and results of the financial analysis

- 2.6 The project's financial viability was evaluated based on: (i) an analysis of FONDECO as a microfinance institution capable of sustaining a sound financial position, meeting its financial obligations to the Bank, and continuing to offer the lending products supported by the project once the financing has ended; and (ii) establishment of competitive financial terms that will enable FONDECO to meet the demand of its target clientele, cover the operating costs associated with these services, and generate sufficient profits to repay the Bank loan.
- 2.7 FONDECO's historical financial statements (in the project technical files) demonstrate a sound financial position and levels of operations, equity, and profitability that will enable it to generate sustainable operating surpluses. FONDECO has been expanding operations since its foundation and has demonstrated reasonable management of its agricultural lending portfolio (43% of its total portfolio). As of December 2009, its portfolio in arrears (more than 30 days past due) was 4.33%, and its risk coverage ratio (loan loss reserves / portfolio in arrears) was 134%. Total equity as of December 2009 was US\$3.1 million. FONDECO's net earnings have also been growing, and are positive, registered at US\$251,942 in fiscal year 2009. The IDB financing is equal to 31% of FONDECO's equity as of December 2009, and would raise the institution's leverage ratio (liabilities/equity) from 2.9 to 3.3, which is considered a sufficient for a microfinance institution. Furthermore, the financial projections for the project (in

the project technical files) show that FONDECO will be able to generate increasing profits on its new portfolio, starting in the first year of the project and continuing throughout the Bank's financing and once it has ended. The conclusion, therefore, is that FONDECO will be able to meet its financial obligation to the IDB and sustain the development and growth of its agricultural credit program.

D. Credit risk for the Bank

- 2.8 FONDECO has shown positive trends in terms of portfolio growth, portfolio quality, profits, and asset and equity levels. According to project projections, this loan will enable it to continue along the same path. FONDECO's management of other funding for its portfolio also has been, and continues to be, positive.¹⁰ In addition, FONDECO is in the process of meeting the conditions for regulation by the Financial System Supervision Authority (ASFI), which in the future will help to lower risks related to its financial position. In July 2009, Planet Rating gave FONDECO a B+ rating. As a result, the Bank's credit risk for this operation is limited.

E. Expected outcomes and capture of benefits

- 2.9 The direct benefit of the Bank resources will be captured by approximately 500 small-scale farmers in Santa Cruz, Tarija, and Chuquisaca, who will gain access to credit to finance their operating capital and/or investment needs, and increase their production capacity. By the end of the project, FONDECO will have expanded and consolidated all of the products in its agricultural lending program, as part of the range of financial services it offers its clients. Its new outstanding portfolio will be more than US\$1 million, in some 600 agricultural production loans. Its portfolio in arrears (more than 30 days past due) will be 5% or less, generating sufficient income to cover all of its financial and operating costs.

F. The Bank's strategy

- 2.10 The Bank's country strategy with Bolivia (document GN-2485-2 of 28 October 2008) identifies opportunities for the majority and development with identity among its four pillars. This includes supporting microfinance institutions (MFIs) in improving their lending technologies to offer financial services to unserved niches and regions. This operation is compatible with the country strategy, in that it will enable FONDECO to pioneer the financing of agricultural lending to small-scale farmers in rural areas, whereas few other MFIs offer credit products for this population.

G. The MIF's strategy: Framework of access

- 2.11 The agenda to "expand and diversify the penetration of microfinance services for unserved rural populations" falls within the framework of access to microfinance. The objective of this agenda is to broaden the reach of microfinance institutions to

¹⁰ Financiers OIKOCREDIT and FONDESIF have witnessed FONDECO's good performance in repayment of loans for US\$3 million and US\$4 million, respectively.

unserved, marginalized rural and urban populations, primarily through support for microfinance institutions (loans, technical assistance resources, equity, etc.). In this sense, this project falls under the MIF access framework and is in line with the objectives of the agenda, in that it seeks to serve small-scale farmers in rural areas.

H. Summary of environmental and social review

- 2.12 The Environmental and Social Impact Review Secretariat (ESR) team approved this project on 1 March 2010 (ESR 09-10) and recommended that FONDECO's environmental and social processes and procedures be examined carefully during the analysis, using the relevant Bank policies as a reference. This operation falls under section B.13 of Operational Policy OP-703.
- 2.13 Project analysis and design resulted in the following agreements with FONDECO with regard to environmental and social matters: (i) FONDECO currently applies a n exclusion list of activities ineligible for financing in its overall portfolio; it will adapt and expand this list according to the Bank's recommendations in the "Guidelines for Analysis of the Environmental and Social Impact of IDB Microenterprise Operations" of August 2003; (ii) FONDECO will use the technical cooperation resources to contract specialized consulting services on environmental issues for financial and nonfinancial services, particularly for rural and agricultural clients, in order to incorporate environmental risk analysis and mitigation measures into its credit policies, with a focus on risks related to agricultural activities, and to monitor these policies and provide training on them. These policies will enable FONDECO to reduce the risk of financing activities that could have an adverse environmental impact by mitigating and managing any environmental risks identified in its operations and providing its clients with incentives to adopt sustainable, environmentally-friendly practices in their productive activities. (iii) FONDECO's credit application form and credit analysis procedures (including its Credit Regulations) will include questions designed to identify and mitigate potential environmental and social risks before approving credit; (iv) the technical cooperation resources will also be used to finance the participation of one or two FONDECO staff members in training on environmental and social issues for financial institutions offered by the Inter-American Investment Corporation (IIC), and training on environment and microfinance offered by FMO of the Netherlands; (v) a review of implementation of social and environmental criteria in credit analysis and loan-making will be included in the project evaluation; and (vi) FONDECO, in coordination with CIPCA, will prepare educational materials on health, safety, and environmental issues, which it will distribute to its agricultural clients, such as a list of prohibited pesticides, first aid in case of human exposure to agrochemicals, and guidelines for proper use, handling, and storage of agrochemicals.
- 2.14 FONDECO's clients are primarily low-income, small-scale farmers in rural areas, and it will not discriminate among its clients on the basis of gender, race, or business size. It will hire credit agents from the areas of operation, to ensure that these officers have a broad understanding of the particular traditions, customs, and

cultures of its clients. It will hire bilingual staff (Spanish and Aymara or Quechua) when necessary to serve clients in their primary language. Sixty-two percent of FONDECO's clients are women, and village banks are required to have all-women boards of directors, in order to promote trust among bank clients and management. FONDECO will contract consulting services to measure the impact of its operations on the lives of its clients (productivity, income, growth of productive or commercial activity, living standards, etc.) and report on the social impact of the project.

I. Special conditions, disbursements, and procurement

- 2.15 As a condition precedent to the first disbursement of the reimbursable financing, FONDECO will provide the following, to the Bank's satisfaction: (i) a general work plan, including a projected timetable for disbursements and targets to be met; and (ii) an institutional baseline.
- 2.16 As conditions precedent to disbursement of the technical cooperation resources, FONDECO will provide the following, to the Bank's satisfaction: (i) evidence that a project coordinator has been appointed; and (ii) the annual work plan for the first year of the project.
- 2.17 Disbursement of the loan proceeds will be contingent on FONDECO's ability to achieve the institutional performance indicators (covenants) agreed upon with the IDB, which may be adjusted on a yearly basis in the annual work plan. The indicators will include parameters for the portfolio in arrears, equity exposure, and return on equity, among others. Document 3 in the project technical files contains a list of indicators, the formulas for establishing those indicators, and acceptable targets to be verified at the start of each fiscal year; the table below summarizes this information. There are expected to be three disbursements during project execution. The first two will be for up to US\$333,000, and the third for up to US\$334,000.

Indicators/Conditions	Number of disbursements and estimated amount		
	1st disbursement	2nd disbursement	3rd disbursement
	US\$333,000	US\$333,000	US\$334,000
Portfolio in arrears (more than 30 days) ¹¹	≤ 8%	≤ 8%	≤ 8%
Equity exposure ¹²	≤ 0%	≤ 0%	≤ 0%
Average return on equity (ROE)	≥ 2%	≥ 2%	≥ 2%
Capital adequacy ratio	≤ 15	≤ 15	≤ 15
Growth of portfolio amount	≥ 5	≥ 5	≥ 5

- 2.18 **Execution period and disbursement mechanisms.** The execution period for the technical cooperation component is 36 months, and the disbursement period is

¹¹ Formula: (Principal balance of loans more than 30 days in arrears plus refinanced portfolio) / Principal balance of the gross portfolio.

¹² Formula: (Portfolio in arrears – reserves for uncollectible amounts) / equity.

42 months. Disbursements of the technical cooperation resources will be contingent upon the achievement of milestones, which will be agreed between FONDECO and the IDB along with their means of verification.¹³ Achievement of milestones does not exempt FONDECO from responsibility to meet the project's objectives. Under the risk- and performance-based project management method, once the agreement is signed, the authorized representatives appointed, and the other agreed conditions met, the resources necessary to execute the project and achieve Milestone 1 will be disbursed (up to 25% of the total amount). In subsequent stages, disbursements will be made upon submission of evidence that the milestone has been met, in accordance with the agreed annual work plan. Initially, ex post review will be used, a with review before each disbursement by the supervision auditor. The method and frequency of these reviews may be modified by the IDB based on the findings of reviews and/or subsequent institutional analyses performed during project execution.

- 2.19 **Procurement.** FONDECO will procure goods and consulting services in accordance with Bank policies (documents GN-2349-7 and GN-2350-7). FONDECO will submit a procurement plan to the IDB for consideration before initiating any procurement or contracting processes.¹⁴ This procurement plan will be reviewed and updated annually. The institutional analysis shows that FONDECO presents a low risk with regard to administration of the technical cooperation resources; therefore, procurement will be subject to ex post supervision. The application and frequency of these reviews may be modified by the IDB based on the findings of reviews and/or subsequent institutional analyses performed during project execution.

J. Reports, evaluations, and audits

- 2.20 **Indicators and baseline.** FONDECO will be responsible for compiling and analyzing relevant information to monitor the project performance indicators. At project start, FONDECO will deliver an institutional baseline to the IDB, including information on its number of clients, financial indicators, portfolio, etc. The baseline and logical framework indicators will serve as a reference for monitoring project performance. FONDECO and the IDB will use these indicators in their periodic monitoring of the project. The indicators will be used for the final project evaluation. The logical framework indicators may be modified by agreement between the IDB and FONDECO.
- 2.21 **Financial supervision.** In order to facilitate supervision of the reimbursable financing, FONDECO will deliver the following to the IDB: (i) its audited financial statements, annually; (ii) financial statements signed by FONDECO's financial manager, quarterly; and (iii) information regarding important changes in the

¹³ The preliminary list of milestones for the technical cooperation component is available for consultation in the project technical files (document 3).

¹⁴ A draft procurement plan is available for consultation in the project technical files.

- institution (such as changes with the Board of Directors or Management or with regard to its equity, financing, etc), twice yearly or as it becomes available.
- 2.22 **Reports.** For the technical cooperation component, FONDECO will be responsible for delivering project status reports (PSRs) to the IDB within 30 days after the end of each calendar semester, or more frequently on such dates as the IDB may determine with at least 60 days advance notice to FONDECO. These reports will follow a format previously agreed upon with the IDB and will contain information on project execution, milestones met, and completion of project objectives as stated in the logical framework and other operative planning instruments. Problems encountered during execution will also be reported, along with possible solutions and information on their evolution and the application of policies and procedures to monitor the social and environmental aspects of the portfolio. Within 90 days after the end of the execution period, FONDECO will deliver a final PSR to the IDB, highlighting the results achieved, project sustainability, and lessons learned. PSRs will also include, among other information, a description of the technical assistance and training received, the quality of this assistance and training, and the results.
- 2.23 At the IDB, MIF staff at the bank's Country Office in Bolivia will have basic responsibility for monitoring the technical cooperation component and the loan, using the abovementioned reports to assess progress.
- 2.24 FONDECO will deliver its audited financial statements to the IDB no later than 120 days after the close of each fiscal year. FONDECO will ensure that this project proceeds in accordance with the performance indicators established in the logical framework and its annexes. The IDB may suspend disbursements if there are significant adverse deviations from these indicators, particularly: (i) profitability (ROE); (ii) portfolio growth; and (iii) total portfolio in arrears (more than 30 days past due, not including the outstanding refinanced portfolio). If it is detected that these indicators have deteriorated significantly, FONDECO will have 30 days to reach an agreement with the IDB as to the measures necessary to improve its performance. Once these 30 days have lapsed, the IDB may suspend or cancel future disbursements if the situation has not improved to its satisfaction.
- 2.25 **Audits.** FONDECO will establish and assume responsibility for maintaining effective financial accounts, internal control mechanisms, and record-keeping systems for the project, consistent with IDB/MIF accounting and auditing rules and policies. FONDECO will prepare the financial statements for the project at the end of execution of the technical cooperation component. Project financial statements will be audited *at the end* of the technical cooperation execution period. Supporting documents for disbursement requests will be subject to *ex post* review on an *annual* basis.
- 2.26 The application of ex post review of procurement processes and supporting documents for disbursements may be modified by the IDB based on the findings of reviews and/or subsequent institutional analyses performed during project execution.

- 2.27 The IDB/MIF will engage independent auditors to audit the financial statements and perform ex post reviews of procurement processes and supporting documents for disbursements. The cost of these services will be covered by the IDB contribution, in accordance with Bank procedures. FONDECO will perform an annual audit of the Bank's loan, along with the annual audit of its institutional financial statements.
- 2.28 **Evaluation.** A final evaluation of this project will be conducted by an individual consultant selected and engaged by the Bank's Country Office in Bolivia using the technical cooperation resources. The final evaluation will measure and document such information as: (i) the project's response to the problems initially identified that gave rise to the project; (ii) allocation of the reimbursable financing resources and area of coverage; (iii) a review of application of the social and environmental policy and procedures for a sample of loans; (iv) lessons learned; and (v) project sustainability.
- 2.29 The IDB will review the findings and recommendations of the PSR and evaluation report. FONDECO and the Bank's Country Office in Bolivia will hold monitoring meetings every six months to review progress made in meeting the performance indicators and following the work plan. The outcomes of the PSRs and meetings will determine future disbursements under this operation. If there are significant deficiencies in project execution, the IDB will take such measures as it may deem appropriate, suspending disbursements if necessary.

K. Project risks and mitigants

- 2.30 This project faces three potential risks. **Risk 1: Weather-related risk:** Natural disasters or natural phenomena in the project area could affect clients' ability to pay. **Mitigating factors:** FONDECO performs an annual evaluation of weather-related risks in the regions where it operates and its potential areas of expansion. Based on the results of this analysis, FONDECO determines which areas to eliminate, scale back, or expand operations. FONDECO is also diversifying its agricultural portfolio to include different lines of business and geological strata, and analyzes its portfolio concentration in terms of sectors and business lines, in order to minimize this risk. Furthermore, FONDECO has a policy not to make loans to single-crop farmers, thereby encouraging campesinos to diversify their production and reduce risk. **Risk 2: Foreign exchange risk:** A macro-devaluation or restricted access to foreign currency could reduce certain FONDECO clients' ability to pay and/or the quality of FONDECO's assets, which would undermine its ability to repay its financial obligations denominated in foreign currency. **Considerations:** As of 30 December 2010, FONDECO's liabilities were approximately US\$9.3 million, with an outstanding portfolio in dollars of approximately US\$9.4 million. **Mitigating factors:** FONDECO makes periodic calculations in order to ensure currency matching, identifying the percentages of its assets and liabilities in each currency. Any mismatch is adjusted through rate policies and foreign exchange transactions. **Risk 3: Regulatory environment:** There is a risk that possible changes in the regulatory environment could affect the DFI regulation

process and FONDECO's growth and ability to capture savings. **Mitigating factors:** While this risk is difficult to mitigate, FONDECO participates in FINRURAL's lobbying of the ASFI and the Ministry of Finance, to ensure that the DFI regulatory process and environment move in the right direction.

L. Exceptions to Bank policies

2.31 None.