



Social Entrepreneurship Program

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Inquiries to: Mr. Alejandro Escobar (extension 3725)

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HONDURAS

SOCIAL ENTREPRENEURSHIP PROGRAM EXECUTIVE SUMMARY

STRENGTHENING THE INTEGRATION OF MICROENTERPRISES IN THE ROSQUILLA CHAIN

(HO-S1008)

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I. BASIC PROJECT INFORMATION

A. Executing agencies

- 1.1 Swisscontact (SC) and Cooperativa de Ahorro y Crédito APAGUIZ (CA)

B. Financing amount and source

	IDB US\$	SC/CA US\$	Total US\$
Reimbursable financing:	300,000	200,000	500,000
Technical cooperation:	<u>230,000</u>	<u>130,000</u>	<u>360,000</u>
Total:	530,000	330,000	860,000
Source:	Net income of the Fund for Special Operations		

C. Terms and conditions

Amortization period:	7 years
Grace period:	2 years for the principal
Interest rate:	4% per annum
Currency:	U.S. dollars
Execution period:	36 months
Disbursement period:	42 months

D. Statement of no objection

- 1.2 The Government of the Republic of Honduras indicated its no objection to the Bank financing for this project in official letter CP-DGN-1000/06, dated 2 October 2006.

E. Problem to be addressed

- 1.3 **The rosquilla sector.** The rosquilla, a corn-based bakery product typical of Honduras, is part of Honduran culture and folklore and has long been a staple of the national diet. More recently, with Honduran emigration to the United States, the rosquilla has become an export product, in addition to being classified as a nostalgia product. A large number of microenterprises¹ concentrated in eastern Honduras engage in rosquilla production.² Although their activities vary, all of these enterprises are linked to the rosquilla-sector supply chain and have experienced strong growth in the last three years. They include enterprises that supply inputs and raw materials (corn, milk, cheese, packaging materials), rosquilla producers, distribution and marketing firms, and both urban and rural end sellers.

¹ In the Department of El Paraíso alone, close to 300 direct and 500 indirect actors have been identified.

² Mainly in seven municipios in the Department of El Paraíso: Danlí, El Paraíso, Alauca, San Matías, Potrerillos, Moroceli, and Yuscarán.

- 1.4 Rosquilla microenterprises in the municipio of Danlí³ have seen increased local and regional demand for their products, with estimated annual local sales of US\$1.2 million, and estimated regional sales of some US\$4 million for 2005. A similar trend in rising demand has been observed in the United States, where annual rosquilla sales amount to 1,400 tons, valued at US\$1 million, with strong potential for continued growth. Nevertheless, the project will support consolidation of the local and regional markets, where producers face greater challenges because of public health, labeling, and distribution system requirements.
- 1.5 The microenterprises and small businesses in the rosquilla chain play a very important role in creating jobs and offering work opportunities for periurban and rural families in the municipio of Danlí. One distinctive characteristic of Danlí is that it is one of Honduras' safest and most stable municipios, allowing for strong entrepreneurial development and the emergence of a microenterprise sector that offers many employment opportunities to young people and women. This is the case for microenterprises associated with the rosquilla chain, most of which are headed by women. These production microenterprises are the main source of employment and family sustenance, not only for female heads of households but also for their children and other relatives who play various roles in the enterprises. Rosquilla production is currently becoming professionalized, with significantly higher production and better quality. This can be seen in the shift from mainly artisanal production to larger-scale production.
- 1.6 A recent study titled "Análisis de la Cadena de Producción y Comercialización de la Rosquilla,"⁴ reveals the following important facts: (i) families employed by microenterprises have an average income of between US\$800 and US\$2000, and in many cases this is their sole source of stable income; (ii) total sales of rosquillas rose to approximately US\$1.2 million in the municipio of Danlí, a figure corroborated in a survey of some 75 points of sale, representing 8% of the total number in the town of Danlí; (iii) rosquillas produced in the municipio of Danlí account for nearly 31% of the national market, the highest for any area in the country; (iv) the different actors in the rosquilla supply chain, especially in the municipio of Danlí, have achieved strong levels of partnering in their different areas of specialization; hence, they have formed what have become known as entrepreneurial clusters, with a view to gaining competitive advantages and bargaining power for purchases of inputs (backward linkages) and marketing (forward linkages); and (v) bottlenecks have been identified, particularly in production practices and financing, that limit the growth capacity of the different participants in the chain.
- 1.7 Key conditions and opportunities are right for enhancing the impact of the rosquilla microenterprise sector and of the more than 900 families that rely on rosquilla production in the municipio of Danlí. Consequently, a series of weaknesses have

³ Other departments in the country also produce rosquillas.

⁴ Conducted in 2006 by Swisscontact through Regional Business Promotion Program (ProEmpresa) and financed by the Swiss Agency for Development and Cooperation.

- been identified that microenterprises in the area and the producers in the rosquilla chain need to overcome to realize their potential. These weaknesses include:
- 1.8 **Microenterprises in the rosquilla supply chain have found it difficult to increase sales to end consumers.** Many enterprises lack technologically advanced and efficient production processes, limiting their ability to increase sales and meet growing local and regional demand for their products. In particular: (i) rosquilla producers lack the technology to implement good management practices and ensure food safety; traceability, an important consideration in modern markets; basic precautions in workplace, industrial, and environmental safety; and adequate storage of finished products; (ii) producers of raw materials do not comply with minimum practices in food safety (milk), product control and quality (corn), or processes for transporting and storing perishable products (milk and corn); (iii) distributors and marketing agents are not familiar with current requirements for packaging, seals, nutritional information, and storage and transport systems to guarantee product quality and appearance for the end consumer; and, lastly, (iv) microenterprise informality limits their management capacity, their ability to attract skilled personnel and pay competitive wages, and even their negotiating capacity. All these problems, in turn, limit any linkages that the different actors in the supply chain might have with the target end-user market, both locally and regionally.
 - 1.9 **There is no effective partnering among the stakeholders that participate in the various stages and processes of rosquilla production and marketing.** Noteworthy progress has been made in organizing producers and participants in the supply chain, both horizontally and vertically. For example, corn and milk producers have come together to discuss the varieties and prices required by rosquilla producers, and they are organizing by zones and coordinating production dates to ensure availability of the raw materials needed by the sector. Also, rosquilla producers are looking at ways to standardize rosquilla quality (color, taste, and consistency) to deliver more uniform products, in compliance with the minimum standards required by the market. In this sense, the building of partnerships among entrepreneurial clusters according to specialization should be strengthened, allowing them to coordinate and jointly plan other specific commercial, financial, production, packaging, quality, and pricing considerations. By strengthening these cooperative partnering linkages, the sector will be able to move forward in a coordinated manner and address its needs.
 - 1.10 **Producers lack access to credit for needed investments in production infrastructure and equipment** to raise output and improve quality. Although many microenterprises have been able to obtain short-term loans from microfinance institutions, these loans have been for no more than US\$400. Short-term (less than a year) loans for such amounts, although reasonable for meeting an enterprise's working-capital needs, do not enable it to expand its output. For example, several rosquilla microenterprises that began using ovens in the home and employing family labor currently use semi-industrial ovens and employ up to 15 persons.

These microenterprises require capital and investment of about US\$800 to US\$2,000, with more flexible repayment periods.

- 1.11 **Beneficiaries:** The direct beneficiaries are some 900 families belonging to no fewer than 84 microenterprises and small companies in the rosquilla chain,⁵ of which 52 are rosquilla producers, 20 are corn suppliers, 7 are dairy-product suppliers, and 5 are engaged in marketing. These families have net annual incomes below US\$2,000 and engage in agricultural activities, work as laborers, or manage their own microenterprises. The microenterprises and small companies that belong to the rosquilla chain are an important, or the main, source of employment and income for many of these families. The beneficiary families live in communities near the municipio of Danlí: El Arenal, Danlí, Alianza, Las Ánimas, Potrerillos, and Alauca. Although the concentration of microenterprises and small businesses varies from one community to the next, more than 70% of the owners of these enterprises are women,⁶ and their average age is 46. Forty-five percent of the microentrepreneurs own the land on which their business stands and are homeowners, which confirms their status as microentrepreneurs.
- 1.12 **Proposed execution mechanism:** The project will be executed by two agencies. The credit union Cooperativa de Ahorro y Crédito APAGUIZ will be responsible for implementing the financing component in line with the needs of actors all along the chain. The Swisscontact foundation will be responsible for administering the nonreimbursable technical cooperation component and for ensuring a comprehensive approach to serving the project beneficiaries. APAGUIZ and Swisscontact were selected as executing agencies because of the institutional partnership between them, which will strengthen the linkage between specialized financial services activities and the nonfinancial ones envisaged for the project and in which each agency has demonstrated experience. On the technical cooperation side: (i) Swisscontact has experience providing technical cooperation and training services to microenterprises and small businesses in Honduras and throughout Central America; (ii) Swisscontact has a counterpart for the technical cooperation component; and lastly (iii) Swisscontact has prior experience in managing a Social Entrepreneurship Program project (ATN/SF-8585-HO), which is nearing completion, with excellent results, according to the final reports submitted to the Bank's Country Office in Honduras. On the financing side, (i) although other microlending institutions, such as Microfinanciera Covelo and Financiera Solidaria (FINSOL), are active in the project area, their presence there is fairly recent and the products they offer are unsuitable for rosquilla microenterprises. In contrast, APAGUIZ has experience lending to the rural microenterprise sector and especially to several stakeholders in the rosquilla sector; (ii) according to the *Diagnóstico de las Necesidades Financieras* cited above, in the Department of El Paraíso, APAGUIZ is the only credit union providing financial services to the actors in the

⁵ The microenterprises and small firms in the chain are raw-materials suppliers and producers, marketing channels, and consumers of rosquillas.

⁶ Based on “*Diagnóstico de las necesidades financieras de los actores de la cadena de producción de Rosquillas y Miel*”, Departamento de El Paraíso, April 2006, César Valenzuela.

rosquilla chain; (iii) the same study and the financial conditions in the technical files indicate that these agencies offer conditions more in line with the needs of the actors in the chain than do other financial institutions, particularly regarding repayment terms, methodology for individual loans, insurance on outstanding amounts, and frequency of payment; and lastly, (iv) APAGUIZ, as a member of the Federación de Cooperativas de Honduras (Association of Honduran Cooperatives, FACACH), has received technical cooperation funding under a Multilateral Investment Fund project on financial and operations management aimed at raising its PEARLS financial rating.⁷

II. THE PROJECT

A. Objectives

- 2.1 The objective of the project is to promote the production linkages of rosquilla microenterprises in the municipio of Danlí to improve the standards of living of families directly involved in those microenterprises. The purpose of the project is to enhance the competitiveness of microenterprises integrated into the rosquilla supply chain in the municipio of Danlí by raising their productivity, modernizing their processes, and improving their distribution and marketing systems.
- 2.2 The project's specific objectives are to (i) enhance the technical and productive capacity of the different actors in the rosquilla supply chain and the creation of partnerships; (ii) help rosquilla microentrepreneurs improve their marketing processes and systems to consolidate and expand their markets; and (iii) provide medium-term financing for microentrepreneurs so that capital is available for infrastructure and equipment investments allowing them to improve the quality of their products and make them more efficient.

B. Description

- 2.3 The project has two components: a reimbursable-financing component, for US\$600,000 (IDB: US\$277,000; local counterpart contribution: US\$587,000), and a nonreimbursable technical cooperation component, for US\$366,000 (IDB: US\$220,000; local counterpart contribution: US\$150,000). The financing component will be executed by APAGUIZ, and the nonreimbursable technical cooperation component by Swisscontact.
- 2.4 The **reimbursable-financing component** will be used entirely to meet the financing needs of actors in the rosquilla chain, as follows: (i) 56% for production infrastructure; (ii) 36% for production equipment; and (iii) 8% for working capital. The local counterpart funding will be contributed in cash by APAGUIZ and by the

⁷ PEARLS is a financial evaluation methodology that makes it possible to rate cooperatives in terms of their financial discipline and performance and their financial statements. According to the PEARLS indicators, APAGUIZ's overall efficiency as of March 2006 was 76.94%, giving it a "BB" rating, equivalent to a "good" financial performance.

- microenterprises themselves. The loans, which will be denominated and repaid in lempiras, will be granted in cash.
- 2.5 The Bank financing will be in local currency at an annual interest rate of 4% plus maintenance of value. The loan will be repaid over a ten-year term, with a four-year grace period on principal. Interest will be payable semiannually on the outstanding balance. Through its microlending unit, APAGUIZ will onlend the Bank resources to rosquilla microenterprises and small producers (in amounts between US\$2,000 and US\$30,000), at an average rate of 19%; to dairy enterprises (in amounts between US\$4,000 and US\$6,000), at an average rate of 19%; and to corn producers (in amounts between \$200 and US\$1,300), at an average rate of 21%. The terms will vary according to the type of activity. Infrastructure and production-equipment loans will be for up to four years with a one-year grace period; while working capital loans will be for between six and eighteen months. The conditions of the Bank financing to APAGUIZ and on subsequent loans to the businesses and small producers will not distort the local lending market, but provide terms and conditions more suited to agricultural activity than those generally available, thus directly benefiting rosquilla microenterprises and small businesses and producers.
- 2.6 The **technical cooperation component** will support the micro and small entrepreneurs in: (i) developing management and commercial skills; (ii) achieving qualitative and quantitative improvements in their production; adapting best manufacturing practices (BMPs) manuals, introducing essential practices and providing technical support for the monitoring of improvements; boosting productivity and production in terms of quality, public health, and safety; (iii) obtaining legal registration for their production units and strengthening and consolidating the partnership process; and (iv) sustainably positioning themselves, by designing and developing new products, establishing commercial interlinkages, helping them coordinate sales plans, register their brands, and look for new clients. The technical cooperation plan of operations, available in the project technical files, describes this support in greater detail.
- C. Sustainability and findings of the financial analysis**
- 2.7 Project sustainability is ensured by three main factors that, maintained over time, will ensure the project purpose is attained: (i) increase in working capital and lending for investment, which will enable microenterprises to consolidate their client and supplier portfolios and improve their positions in local and regional markets; (ii) incorporation of management and technical skills by microenterprises, enabling them to improve the quality of their products and adopt production processes compatible with the good practices increasingly demanded in local and regional commercial agreements; and (iii) establishment of an association of rosquilla producers and affiliated enterprises as a regional interest group, to monitor and carry out the actions outlined in the technical cooperation component.
- D. Credit risk for the Bank**
- 2.8 APAGUIZ has achieved operating and equity ratios and a profitability level that has enabled it to generate a moderate but consistent profit, and the Bank loan represents

just a small part of its funding (5% of total liabilities as of June 2006). Also, the project financial projections (see the technical files) show that from the outset the financing component will post a modest profit, as will APAGUIZ in the medium and long term (with an expected 17% growth in earnings, with a similar improvement in its portfolio).

E. Expected results and capture of benefits

- 2.9 Upon completion of the project, the microenterprises associated with the rosquilla sector and their employees are expected to have captured the following benefits: **microenterprises:** (i) a 30% average increase in net income over the baseline for microenterprises participating in the project through year three; (ii) a 30% reduction in employee turnover at rosquilla microenterprises; (iii) a 25% increase in local rosquilla sales; (iv) introduction of BMPs and good agricultural practices by at least 60% of the enterprises; (v) a 30% increase in earnings of enterprises in the chain through year three; (vi) at least 60% of the microenterprises legally registered; (vii) formation of 10 entrepreneurial clusters in the sector; and (viii) at least 50% of microenterprises are operating under inter-enterprise coordination agreements; **employees:** (i) at least 300 new jobs created as a result of the expansion in microenterprise activities; (ii) better working conditions (salaries and work benefits) for 80% of positions; and (iii) 30% increase in income of microenterprise employees.

F. The Bank's strategy

- 2.10 The project activities are consistent with the priorities outlined in the Bank's Updated Strategy with Honduras (document GN-2251-3) of April 2004, insofar as the project promotes a competitive agricultural sector. Likewise, the project fits in with the poverty reduction strategy supported by the Bank and achieved in the country by consensus with civil society.

G. Coordination with other donor-funded programs

- 2.11 In preparing the operation, the project team consulted several international-cooperation agencies active in the region that are supporting rural producers in the country. In these consultations, the project team found that the rosquilla sector is not currently being supported by other agencies. Swisscontact, with the help of the Swiss Agency for Development and Cooperation, has conducted entrepreneurial and financial assessments, enabling it to understand the problems being faced by microenterprises in the chain. Yet, there are not expected to be any donor agencies with which work can be coordinated.

H. Summary of environmental and social review

- 2.12 The Committee on Environmental and Social Impact (CESI) reviewed this operation on 14 July 2006 (meeting 28-06), without making any comments.

I. Special conditions

- 2.13 As a condition precedent to the first disbursement for **both project components**: APAGUIZ and Swisscontact must deliver, to the Bank's satisfaction: (i) the institutional coordination agreement between APAGUIZ and Swisscontact for project execution; and (ii) evidence that the project coordinator has been selected and that the Swisscontact executing unit has the requisite level of facilities (offices, furniture, and equipment).
- 2.14 As a condition precedent to the first disbursement of the **reimbursable financing**, APAGUIZ must present, to the Bank's satisfaction: (i) the Credit Regulations⁸ of the program approved by its board of directors; and (ii) evidence that the financial products have been designed for microenterprises in the rosquilla sector.
- 2.15 The Bank will not disburse more than 50% of the technical cooperation funding to Swisscontact until APAGUIZ has disbursed at least 25% of the reimbursable financing.

J. Reports, evaluations, and audits

- 2.16 **Reports.** APAGUIZ and Swisscontact will deliver progress reports to the Bank's Country Office within 60 days after the end of each six-month period. These reports will include an analysis of the extent to which the performance indicators have been met, any problems encountered during project execution, the steps taken to correct the problems, and the projections for the following six-month period. The reports must also include, at least: (a) in the case of the **reimbursable financing**: (i) the component's financial status and financial indicators; (ii) the review of the credit-access ratio for microenterprises originally identified; (iii) modifications and/or adaptations to the credit methodology and interest rates on the financial products; and (b) in the case of the **technical cooperation** funding: (i) a summary of the work done by the consultants and the technical cooperation provided; (ii) information on who has received training and in what areas; (iii) information on the outcomes of participation in commercial events; and (iv) a list of new clients (purchasers) working with partnerships.
- 2.17 **Reviews.** The project calls for two evaluations, to be performed by individual consultants selected and contracted by the Bank's Country Office in Honduras out of the technical cooperation funding. A midterm review will be carried out 18 months after the first disbursement or when 50% of the resources have been disbursed, whichever occurs first, and another 36 months after the first disbursement. The first review will measure, at least: (i) the response of the project to the problems originally identified and on which it is based; (ii) progress made in raising microenterprise earnings, production quality and productivity and in improving business management capacity and operating stability over the initial baseline; (iii) the degree to which project performance indicators have been met, especially microenterprise access to credit through the reimbursable financing

⁸ The basic terms of the Credit Regulations are contained in document 1 in the project technical files.

- component; (iv) lessons learned and recommendations for improving project execution; and (v) executing agency institutional and coordinating capacity.
- 2.18 In addition to the areas specified for the first review, the final evaluation will gauge and document: (i) the project's effects on the groups examined in the initial review; (ii) the extent to which the project objectives have been met; (iii) lessons learned; and (iv) the project's sustainability.
- 2.19 **Audits.** Annual audits of the financing component will adhere to the Bank's auditing policies and will be covered out of the technical cooperation funding. In addition, Swisscontact will defray the cost of a final financial report audited by independent auditors acceptable to the Bank, showing how the technical cooperation funding was used and verifying that counterpart funds were contributed.

K. Project-related risks and mitigating factors

- 2.20 **Market risk.** The project will target a sector or group of enterprises that make a single product: rosquillas. Specifically, rosquilla microenterprises have machinery and infrastructure intended primarily for producing and marketing this product. This focus on a single product could constitute a market risk for project execution if demand levels off or decreases. However, three factors mitigate this risk: (i) the microenterprises have demonstrated they are dynamic enough to be able to diversify production to other baked products or pastries in the event of declining demand for rosquillas; (ii) the other actors in the rosquilla chain work with other sectors and could become suppliers for other microenterprises without much trouble; (iii) rosquillas are an economical, widely consumed product, demand for which is unlikely to decline, even in an economic crisis. In the event of downward pressure on the rosquilla price, the technical cooperation component is expected to provide the expertise for making this product more efficiently, at less cost. **Business culture and vision of change:** The microenterprises linked to the rosquilla chain have made considerable headway in partnership building, cluster development, and communications, and formation of the Association of Rosquilla Producers (ARSO); nevertheless, there is always the risk that the enterprises will not coordinate their efforts or collaborate sufficiently to achieve the project objectives. To mitigate this risk, the project includes actions to (i) provide training in management and governance not only to ARSO's current directors but also to other association leaders who might hold top positions in the future; and (ii) promote the participation of association members through the publication of information brochures with technical cooperation funding.

L. Exceptions to Bank policy

- 2.21 None.