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Social Entrepreneurship Program

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SOCIAL ENTREPRENEURSHIP PROGRAM

**MARKETING AND DIVERSIFYING THE PRODUCTION OF SMALL
COFFEE GROWERS IN THE HIGHLANDS OF PIURA**

(SP/TC-02-12-03-7)

FINANCING AND TECHNICAL COOPERATION PROPOSAL

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(SP/TC-02-12-03-7)

EXECUTIVE SUMMARY

Executing agency: Central Piurana de Cafetaleros (CEPICAFE) [Piura Federation of Coffee Growers]

Financing:	Financing (European Commission):	<u>US\$</u> 448,000	<u>EUROS*</u> 421,089
	Nonreimbursable technical-cooperation funding (European Commission):	145,000	136,290
	Local contribution:	<u>165,000</u>	<u>155,088</u>
	Total:	758,000	702,467

The proceeds of the financing will be drawn on the European Economic Community Special Fund for the Financing of Microenterprise. For accounting purposes, the resources here committed by the Bank will be recorded in EUROS.

* Exchange rate: US\$1.00=EUROS 0.93993 as of 25 March 2003

Terms:

<u>Financing:</u>	
Amortization period:	12 years
Grace period:	3 years
Disbursement period:	42 months
Interest rate:	2% in dollars
Currency:	United States dollar

Technical-cooperation funding:

Execution period:	36 months
Disbursement period	42 months

The grace period will apply to amortization of principal only, not to interest. The financing will be denominated in EUROS, and disbursed in United States dollars. The financing will be repaid in United States dollars.

Problem that needs to be resolved:

Small-scale coffee growers in the highlands of Piura have developed a time-tested model for modernizing the coffee industry that has given them an edge in world markets. With a focus on its members by whom it is managed and operated, the Federation has the capacity, infrastructure, contacts, and basic experience in furnishing credit to small rural producers. Yet, it is hampered by a number of obstacles that prevent the Federation from expanding the benefits it provides and offering them to a greater number of small producers while ensuring that the quality of these benefits and services are sustainable over the long term. These problems are: (i) *insufficient resources to meet the growing credit needs of a large number of small producers and bringing new associations into the present system*; (ii) *the area is overly reliant on a single product (coffee) for family income*; (iii) *limited capacity of the CEPICAFE to meet world demand and continue to compete on specialty coffee markets*; and (iv) *a need to improve systematically and effectively the tasks of credit analysis, credit approval, and credit recovery by the grass roots coffee associations and CEPICAFE*.

Objectives:

The general objective of the project is to increase and diversify the income of small-scale coffee growers in the highlands of Piura.

The specific objectives are (i) to meet the credit needs of some 2,500 small coffee growers by providing more credit for production; (ii) to support the process of diversifying present production to include organic sugar; and (iii) to consolidate CEPICAFE's commercial and business management so that its members are served more efficiently and promptly and are able to compete on a sustainable basis

Description:

To attain the proposed objectives, the project is divided into two components: (i) a reimbursable financing component; and (ii) a nonreimbursable technical-cooperation funding component.

Financing component (European Commission: US\$448,000; CEPICAFE: US\$90,000). This component is divided into two subcomponents: (a) US\$480,000 to expand the small producer credit portfolio; and (b) US\$58,000 for investment in fixed assets of production.

Resources for portfolio expansion: (European Commission: US\$400,000; CEPICAFE: US\$80,000). The proceeds of this subcomponent will be used to augment the capital available for credit to coffee growers. The tasks envisaged will (i) bring 850 additional families grouped together in 10 new associations (APPCAFE) into the credit program to support and market the Federation's agricultural

production, through financing to sustain the producers (during the crop cycle), including pre-harvest and marketing (short-term credit) and to minister to the needs of 1,650 existing members; (ii) purchase and replace equipment used by members in coffee production and processing (mechanical pulpers, shelter, and drying patios; and (iii) provide initial investments to diversify production (organic sugar cane plantations) and expand planted areas of organic coffee. New medium-term credits (of up to 4 years) will finance organic sugar cane and organic coffee crops.

The financing provided will benefit approximately 2,500 growers, of whom 850 will be joining CEPICAFE for the first time. Also, over 300 additional hectares of organic coffee and 120 hectares of organic sugar cane will be planted.

Funds for investment in fixed assets of production: (European Commission: US\$48,000; CEPICAFE: US\$10,000). The proceeds of the financing will be used to assist CEPICAFE with (i) the construction of a 200 m² coffee and sugar storage and packing facility. The facility will be built in the city of Piura on land contributed by CEPICAFE (US\$30,000); (ii) the addition of two “enhanced modules” for processing granulated panela sugar (US\$20,000); and (iii) a small machine for packaging granulated panela sugar according to the specifications and requirements of local and world markets (US\$8,000). The new facility and machinery will ameliorate the storage and processing services that CEPICAFE provides to its members, and will help bring high quality products to customers on a timelier basis.

Technical-cooperation component (European Commission: US\$145,000; CEPICAFE: US\$75,000). This component will target activities having an impact on (i) updating and strengthening strategies for marketing coffee and panela sugar so that CEPICAFE can be assured of secure and sustainable markets for its products; and (ii) strengthening credit portfolio management to ensure efficient and sustainable credit services to CEPICAFE’s small producer members.

This component will finance the following activities: (i) the hiring of specialists in marketing and managing a panela sugar and coffee exchange; (ii) actions to trade and market granulated panela sugar; (iii) the hiring of specialists to prepare portfolio management programs; (iv) hiring of a specialist in microfinance; (v) purchase of equipment for portfolio management and credit supervision; (vi) hiring of the project coordinator, management personnel, and credit department support staff; (vii) training for producers, the management personnel of the associations, and CEPICAFE staff; and (viii) commissioning of external audits and assessments.

CEPICAFE's contribution to the technical-cooperation funding (US\$75,000) will help defray the cost of hiring management and support staff for the project, specialists for consulting work, the project management expenses, and one of the audits. A breakdown of this component is found in the Plan of Operations (Annex I).

CEPICAFE has identified an NGO, Programa Integral para el Desarrollo del Café (PIDECAFE), to expedite the training component proposed for organizations and producers (subparagraph (vii)). It will enter into an interagency agreement with PIDECAFE for the producer and association training component. The rationale for selecting PIDECAFE is given below under "Exceptions to Bank Policy".

Environmental and social review:

This operation was reviewed by the Committee on Environment and Social Impact on 14 February 2003. At that meeting (06-03), the Committee approved the operation as proposed in the profile. The project includes activities for enhancing production of a line of organic crops and organic certification of the coffee and sugar cane production system. The project also seeks to develop mechanisms that would encourage the active involvement of women in decision making within the organization and the family economic unit.

Beneficiaries:

The direct beneficiaries will be about 2,500 members of CEPICAFE, who are grouped together in over 50 grass roots organizations (Asociaciones de Pequeños Productores de Café – APPCAFE), organizations legally established in the provinces of Ayabaca, Morropón, and Huancabamba in the highlands of Piura. These small producers are mainly coffee growers, with coffee accounting for nearly 80% of annual income, which is estimated to average US\$850 per family per month. On average, each producer cultivates an area of approximately one hectare, producing on average 9 qqs of coffee per hectare. Producers who grow organic sugar cane have on average 0.6 hectares under cultivation, and produce 50 MT/hectare. Most of these producers live below the poverty line and have limited access to education and health services.

Risks:

Associated with the program are three potential risks (i) *Risk*: production may be adversely affected by poor weather conditions caused by natural disturbances, such as El Nino, with production losses that would probably lead to portfolio arrears. *Mitigating factor*: there is no factor that directly mitigates this risk. However, CEPICAFE will implement a new policy on reserves for bad loans, which will help give it the financial stability and the provisions to better meet such risks; (ii) *Risk*: prices in different specialty coffee markets cannot be maintained because supply has risen to exceed demand. *Mitigating factor*: The project is unable to control the external market. However, the relationships that CEPICAFE has

developed with buyers in these markets, coupled with the project focus of concentrating on product quality and finding new markets, is expected to enable the organization to place its production in captive markets that recognize the quality of the coffee and the integrity of the seller. Also, the technical-cooperation component is designed to help CEPICAFE penetrate and position itself in a full range of specialty markets. The idea is to help CEPICAFE to establish itself in as many specialty markets as possible as a means of reducing risk. In a critical situation like the one presently affecting the traditional coffee market, specialty markets, which are inherently more independent of traditional markets, will need to be identified, thus cushioning CEPICAFE from the effects of such risk; (iii) *Risk*: effective market demand for CEPICAFE's panela sugar does not materialize as expected. *Mitigating factor*: the technical assistance for trade and marketing planned for the project, as well as the business relationships that CEPICAFE has forged with contacts in organic fair trade markets, will make it easier to find a niche for panela sugar in these markets, thus contributing to steady growth in sales at home and abroad.

**The Bank's
country
strategy:**

The project activities are consistent with the priorities set out in the Bank's most recent country strategy with Peru (GN-2205-1 of 24 September 2002) insofar as (i) financial (credit) and nonfinancial (marketing, training, and organizational) services will be provided to small producers *to improve their productivity and competitiveness* and broaden their market participation; (ii) opportunities will be created *to increase the income* of low-income households in rural areas; and (iii) *efforts to reduce poverty* will be supported through sustainable services that reach the poor living in the highlands of Piura.

**Coordination
with other
official
development
institutions:**

During the design stage, the project team was in touch with other development agencies that are financing or carrying out projects or programs to help bring small producers into organic produce and fair trade markets, raise their productivity, and strengthen grass roots organizations. These institutions include Stichting Doen, Trans Fair USA, Oxfam Great Britain, Equal Exchange, and the World Bank. Such contacts were useful in gathering information on markets, strategies in support of organic crop producers, and future initiatives that could create synergies with the present project. During project execution, CEPICAFE will seek complementarity with initiatives of the Bank and other development institutions that are now in preparation, so that such initiatives can serve as a pilot experience and draw on the lessons learned for use in other sector-related projects. One example of such projects is the Bank's pilot program for the diffusion of information technologies in social programs (ATN/SF-7119-RG), part of which will be carried out in the Piura region. The project will also seek to complement another project

financed by the European Union in conjunction with German World Food Aid (Deutsche Welthungerhilfe). This program seeks to promote the sustainable development of coffee farming in northeastern Peru through activities in the departments of Piura, Amazonas, and Cajamarca.

Justification:

The proposed project is justified because (i) the 850 small producers joining CEPICAFE for the first time will be able to increase their income considerably through membership in a production chain that sells their products in organic and fair trade markets, which pay prices from 50% to 100% above those in conventional markets; (ii) the project will enable CEPICAFE's 2,500 members who do not have access to credit in the regular financial system to obtain new lines of credit on favorable terms and conditions to finance far more of their production needs; (iii) the project will strengthen and help consolidate an institution that belongs to and is managed by the project beneficiaries themselves; and (iv) CEPICAFE is an institution with proven experience that has the technical, operating, and administrative capacity to carry out the project successfully.

Special contractual clauses:

As a condition precedent to the first disbursement of the financing, CEPICAFE shall submit, to the Bank's satisfaction: (i) a copy of the minutes of the meeting of CEPICAFE's board of directors at which a policy has been approved to establish a reserve for bad loans (provisions) in the organization's loan portfolio; (ii) reliable documentation evidencing that the land on which the storage facility is to be built is owned by CEPICAFE (a record from the municipality showing title to the land); (iii) the approved construction plans; and (iv) the results of the competition for the technical personnel in charge of managing the storage facility construction works.

As conditions precedent to disbursement of the *technical-cooperation funding*, CEPICAFE shall present, to the Bank's satisfaction: (i) the terms of reference for the consulting work and the advisory assistance that will be financed out of the proceeds of the technical-cooperation funding in year one of the project; (ii) evidence that the project coordinator has been hired; (iii) a copy of the interagency agreement between CEPICAFE and PIDECAFE, approved by the board of directors of each institution, for the activities scheduled in the training plan for the small producers and management of APPCAFE; and (iv) a works plan that includes the annual targets that must be met for compliance with the project objectives and results. The works plan shall include a schedule for satisfying the performance indicators established for the project, which will make it possible to monitor and supervise the progress of the operation.

For disbursement of more than 50% of the *technical-cooperation funding*, CEPICAFE shall demonstrate to the Bank that: (i) CEPICAFE's credit department has disbursed to the Federation's members at least US\$200,000 of the proceeds of the project financing component; (ii) the specialist in coffee marketing and trade has submitted the final report updating the strategy for marketing the product; and (iii) the specialist in panela sugar marketing and trade has satisfactorily completed his tasks, and come up with a marketing strategy.

Under the program, cash resources will be needed to provide fast and timely loans and to facilitate the technical assistance envisaged. It is therefore recommended that the Bank set up a revolving fund of up to 20% of the aggregate amount of the two components.

The Bank will recognize as expenses chargeable to the local counterpart corresponding to the technical-cooperation funding up to US\$3,000 incurred since 1 February 2003 in hiring the specialist, to draw up the portfolio management program.

Reports and evaluations:

Reports: CEPICAFE will submit *progress reports* to the Country Office within 60 days after the end of each six-month period and a final report within 60 days after the deadline for the last disbursement. Such reports shall include (i) a description of the progress made in executing the project and attaining the indicators, as well as a report on the main accomplishments, indicating any problems that may have been encountered in meeting its targets and objectives and in connection with the present plan; (ii) an update of the performance indicators and the project execution plan for the following 12-month period, describing what has been done to overcome any obstacles identified; (iii) information on how the small producers have benefited financially and on the benefits they have received in terms of training and technical assistance in connection with production, credit, and marketing; (iv) information on the progress of environmental and gender activities; (v) a statement showing how Bank resources and the counterpart contribution have been applied; and (vi) statistical and financial information on CEPICAFE's operating results, including the use of the surpluses from marketing and financial intermediation. In addition, the first project report shall contain socioeconomic information on the target group before commencement of the project setting out for purposes of comparison the changes in the project beneficiaries' sales and incomes.

Evaluations: Within 18 months after the date of the first disbursement, the Bank will commission out of the technical-cooperation funding, a midterm evaluation to assess the progress

made on the project and to indicate what steps should be taken, if necessary, to correct the situation. Such an evaluation will determine the extent to which the proposed objectives as well as the indicators in the logical framework have been fulfilled. In the interests of documenting this experience and measuring the accomplishments, the Bank will commission, out of the technical-cooperation funding, a final evaluation of the project when the project financing component has been fully disbursed. Such an evaluation will focus on an analysis of the CEPICAFE process and documentation on the lessons learned from the process, evaluating the extent to which project objectives have been achieved. The initial data on the beneficiaries will serve as a basis for gauging any benefits that the beneficiaries may have derived from changes in productivity, product quality, and income as a result of the project. In measuring these aspects of the project, consideration will be given to the indicators in the logical framework and the table of project performance indicators.

**Exceptions to
Bank policy:**

As an exception to the consultant selection procedures, whereby an open competitive bidding is required for training activities for organizations and producers, it is recommended that PIDECAFE, a nongovernmental organization, be hired directly at a cost of up to US\$32,000. Given this NGO's technical advantages, which are described below, such contracting would comply with the requisites of section GS-403 of the Procurement Manual. The choice of PIDECAFE as executing agency is justified because (i) it has offices, trained field staff, and many years of experience in the project area; (ii) it has been carrying out with APPCAFE and individual producers other training programs having to do with organizational strengthening and business management with real-time participative methodologies; (iii) it has more experience and a greater understanding of the production, processing, and marketing of coffee and panela sugar than any other institution offering training in the project area; and (iv) the activities it has carried out with small producers and APPCAFE in the past has earned it their trust and confidence.