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HONDURAS

FINANCING FACILITY FOR PRODUCTIVE INITIATIVES THROUGH THE SOCIAL ENTREPRENEURSHIP PROGRAM (FAPES)

(HO-S1001)

LOAN PROPOSAL

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ABBREVIATIONS

CODESPA	Fundación Codespa Centroamérica
EA	Executing Agency
EUf	Executing Unit for the Facility
IDB	Inter-American Development Bank
NGO	Nongovernmental organizations
PDO	Private development organizations
SAIC	Spanish Agency for International Cooperation
SEP	Social Entrepreneurship Program

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EXECUTIVE SUMMARY

Executing unit for the facility: Fundación Codespa Centroamérica (CODESPA)

Executing agencies for the projects: The seven to 10 projects to be financed under this facility will be executed by competitively selected executing agencies.

	IDB (US\$)	CODESPA	EA	Total
Amount and source:				
Nonreimbursable financing:	600,000	260,000	370,000	1,230,000
Nonreimbursable technical cooperation:	<u>235,000</u>	<u>90,000</u>		<u>325,000</u>
Total:	835,000	350,000	370,000	1,555,000

These resources will be drawn from the net income of the Fund for Special Operations (FSO) in hard currency.

Execution timetable: Execution period: 42 months
Disbursement period: 48 months

Opportunity that justifies the intervention: Honduras is a country with a population of 6.6 million people. Forty-six percent of the country's total population lives in rural areas where the poverty rate is approximately 75%, whereas the poverty rate in urban areas is 57%. Efforts have been made through the Social Entrepreneurship Program to identify initiatives that would promote economic development and social equity among the country's poor and marginalized groups, while at the same time providing financial, social, and/or community development services to this target population on a sustainable basis.

From its startup in 1978 until December 2003, 27 projects totaling more than US\$14 million were approved under the SEP. Due to its poverty rate, Honduras is eligible to invest of available resources in the financing of SEP projects. However, conditions in the country present two limitations in this regard. The first limitation is the insufficient institutional and managerial capacity of grassroots

groups and organizations that support the development of productive groups and microenterprises located in rural areas and in marginal urban areas eligible for the SEP. This problem affects the number of operations that can be identified and approved in the country. The second limitation is that approximately 50% of the requests that are submitted annually to the SEP for consideration, although they meet the program objectives, require less than US\$150,000 in funding. This amount does not justify the administrative costs for the Bank to individually process and administer these operations.

In order to continue investing in these programs despite the limitations described above, by establishing a nonreimbursable financing facility for SEP initiatives in Honduras, a mechanism could be devised for the financing of productive projects requiring lower levels of funding, on a competitive, decentralized basis. It would also implement a model for project administration and monitoring that would contribute to the strengthening of institutional and managerial capacity on the part of grassroots groups and organizations that serve SEP beneficiaries.

Objectives:

The general objective of the project is to help improve the quality of life of its beneficiaries by generating new employment opportunities, strengthening existing employment, and improving the income and welfare of poor and marginalized groups in Honduras.

Description:

Through the facility, productive initiatives in rural and marginal urban areas will be identified on a competitive basis. They will include business development, services, and certain social and community development projects led or directed by organizations with experience in the execution of productive projects. The initiatives will demonstrate the economic, financial, social, and/or community development impact that they seek to achieve or that they have achieved in the target sector.

Proposed initiatives must meet the following *eligibility criteria*: (i) demonstrate a direct benefit for poor and marginalized social groups that lack access to financial services, business development, and other support services necessary in order to strengthen their livelihoods; (ii) generate new employment opportunities, strengthen existing employment, and/or improve the income and welfare of poor and marginalized groups; (iii) demonstrate their capacity to generate enough income through the activities of the proposed initiative to assure their ability to continue providing services to the end-beneficiaries of the project after project completion; and (iv) carry out activities not considered to be harmful to the natural

environment or to health. If the activities contemplated in the proposal may have any adverse impact on the environment, specific measures to mitigate any such impact must be included.

Nonreimbursable financing component (IDB: US\$600,000; CODESPA: US\$260,000; project beneficiaries and/or executing agencies: US\$370,000).

The minimum amount to be financed with IDB and/or CODESPA resources per project will be US\$45,000, and the maximum will be US\$120,000. Up to 70% of the total cost of the project will be financed with Bank and CODESPA resources. The local counterpart funding may be provided by the project executing agency, project beneficiaries and/or strategic partners. Given that this facility is a pilot project, it is estimated that in this first stage between seven and 10 projects will be financed during an execution period of forty two months.

The following **criteria for evaluation** will be used to select the projects to be financed under the facility: (i) improvement in the quality of life; (ii) sustainability and financing; (iii) governance and transparency; and (iv) innovation, use, and application of technologies and methodologies.

With a view to generating and systematizing lessons learned, three cross-cutting criteria have been identified in connection with strategic issues for the sustainable development of production in the country: (i) association development and working in partnerships; (ii) improved productivity and competitiveness; and/or (iii) corporate social responsibility.

Nonreimbursable technical-cooperation funding (IDB: US\$150,000; CODESPA: US\$90,000)

The following activities will be financed under the facility through the nonreimbursable technical-cooperation component: (i) the promotion, dissemination, and systematization of the facility; (ii) the administration and execution of the calls for proposals, and the analysis, selection, oversight, monitoring, and evaluation of the projects to be financed with facility resources; and (iii) evaluations and auditing of the facility.

Executing agencies - beneficiaries:

The executing agencies (EA) that are beneficiaries of the facility may be private development organizations (PDO), foundations, associations, cooperatives, campesino group enterprises, private for-profit enterprises with social goals and/or that work in partnerships with social organizations, cooperative agro-industrial

enterprises, and community or ethnic groups, provided these organizations seek to promote the welfare and economic betterment of poor or marginalized groups.

The *eligibility criteria* for the executing agencies are as follows: (i) they must be legally established and registered in Honduras and be governed by the legal provisions that allow them to enter into commitments with the Bank; (ii) they must operate under institutional conditions that ensure proper resource management and accounting procedures, (iii) they must have a track record of at least one year of operation and experience in the management of budgets of a minimum of US\$20,000 or the equivalent in lempiras; and (iv) they must have the ability to contribute a minimum of 30% of the total cost of the proposed project as a local counterpart contribution by the executing agency itself, the beneficiaries, or other sources.

No executing agency will be eligible if, during the facility execution period, it is executing projects financed with Bank resources in sectors similar to those eligible for the facility and/or if it is executing projects with financing or technical-cooperation funding through CODESPA.

**Environmental
and social
review:**

No proposal considered harmful to the environment under the standards established by the national environmental legislation of Honduras will be eligible for the facility. In its evaluation and selection of proposals, the EUF will use the document that contains the “Guidelines for the Social and Environmental Impact Assessment of IDB Microenterprise Operations” as a point of reference. In any event, all proposals that could have a controllable environmental impact must include financing for measures to mitigate any such impact. In addition, those initiatives that promote respectful and sustainable management of the environment and natural resources of the country will be favored. No project proposing nonforestry or unsustainable uses for currently forested land will be considered.

Likewise, gender equality and social inclusion will be actively promoted by encouraging the presentation of proposals that involve the participation of women in the productive process and the implementation of productive initiatives by the country's different ethnic groups.

**Government
and Bank
strategy:**

The activities to be undertaken as part of the proposed operation are consistent with the Bank's country strategy as established in the country strategy with Honduras (document GN-2238-1), approved on 4 February 2003, in that they are designed to support the country

in its efforts to reduce poverty by promoting greater sustainable growth through increased competitiveness and the improved productive capacity of the poor, in both rural and marginal urban areas.

**Coordination
with other
donors:**

During project design, the lessons learned from the competition for rural productivity sponsored by the World Bank in Guatemala in 2002 and 2003 were taken into account. In addition, the scope of the facility was shared with other donors in order to lay the foundations for cooperation in the dissemination of information about the project and in possible cofinancing during its execution. As a result, organizations such as Swisscontact, the United States Agency for International Development (USAID), and the Spanish Agency for International Cooperation (SAIC) have expressed interest in participating. During the project execution, close coordination will be maintained with other donors and organizations involved in the sector.

Justification:

The proposed financing facility is justified because: (i) it will contribute to improving the quality of life for the beneficiaries, generating new employment opportunities, strengthening existing employment, and improving the income and well-being of poor and marginalized groups in Honduras; and (ii) it will strengthen the institutional and managerial capacity of grassroots and other organizations that support the development of microenterprises and other productive groups that are located in rural and marginal urban areas eligible for the SEP.

Risks:

The following facility risks were identified: (i) the process of decentralizing the execution, administration, and monitoring of the SEP project facility by COF/CHO and CODESPA may not be effective; (ii) the EA working with the targeted group of beneficiaries may lack the interest or capacity to apply for funding and participate in the facility; and (iii) changes in Honduran national legislation may affect the strengthening and sustainability of the EAs.

To mitigate the first risk, CODESPA has been involved in facility design and in drafting the project documents and annexes. In addition, supporting instruments such as an operations manual, an internal workshop for the launching of facility and expeditious consultation and monitoring mechanisms have been established through COF/CHO to guarantee that the facility will be administered in keeping with the Bank's requirements. To mitigate the second risk, mechanisms for the promotion and dissemination of the project have been designed to be consonant with the characteristics of the target group and the project's stated objectives.

In addition, a public relations professional will be hired to ensure that communication with these groups is effective and to help build strategic partnerships that will contribute to the motivation of the EA interested in participating in the facility, statistics and assist them in their participation. While no specific action can be guaranteed to mitigate the third risk, the current trend in the legal framework is to increase participation on the part of civil society organizations.

**Special
contractual
clauses:**

As a condition precedent to the first disbursement of the nonreimbursable financing component, the la EUF must submit the following documents, to the Bank's satisfaction: (i) the final version of the model agreement to be signed by the EAs and the EUF; and (ii) the financing plan for each project that was approved as a result of the first call for proposals, detailing the source of funds that will support the different initiatives (IDB, CODESPA, or other cofinancing).

No more than 20% of the resources of the nonreimbursable technical-cooperation component may be disbursed until the projects corresponding to the facility's first call for proposals have been approved.

At least 50% of the projects approved under the facility must receive nonreimbursable cofinancing through CODESPA. The Bank and CODESPA will allocate no less than 30% and up to 50% of the total amount of resources earmarked for nonreimbursable financing to projects selected through the first call for proposals.

**Reports and
evaluations:**

Facility reports: The EUF will submit a semiannual report to COF/CHO that will include the status of financial and technical execution of the facility as a whole and of the different projects underway as a group. In particular, the report will describe: (i) progress in the projects and their budgetary execution; (ii) activities for technical assistance, promotion, dissemination, selection, evaluation, analysis, administration, and monitoring carried out by the EUF; (iii) the strategic partnerships established during project execution; (iv) any obstacles encountered and the mechanisms established to overcome them; (v) the level of compliance with the benchmarks for the projects and for the facility; and (vi) lessons learned and recommendations to improve the effectiveness of the project and the facility.

The Bank will review the contents of these reports, including the results presented within them. If any significant deficiencies in the execution of the facility are encountered, the Bank may suspend the

disbursements under the facility until such time as the EUF takes satisfactory measures to correct the deficiencies.

Auditing: During the facility execution period, within 120 days after the close of each fiscal year, beginning with the fiscal year in which disbursements under the nonreimbursable financing component begin, and during the project execution period, the EUF will submit a financial report audited by independent public accountants. The financial report will detail how the Bank's nonreimbursable technical-cooperation component and nonreimbursable financing have been used, and will verify the local counterpart contributions.

Evaluations: A midterm and a final evaluation will be conducted and will be financed with the Bank contribution. The midterm evaluation will be carried out 12 months after the first call for proposals is issued under the facility. This evaluation will analyze the mechanisms for the execution of both the facility as a whole and a representative sample of the projects then in execution. With regard to the projects in execution, the following aspects will be evaluated: (i) the relevance of the criteria used to evaluate projects for selection and the extent to which the projects meet those criteria in practice, (ii) EA performance in the application of the funds disbursed and in the execution of activities; and (iii) achievement of project benchmarks.

The evaluation will analyze the general performance of the UEF in administration of the facility, including the following elements: the promotion and dissemination of the facility, the process of calling for proposals, evaluating them and selecting them, and the monitoring of projects in execution.

The final evaluation will be carried out 15 months after the second call for project proposals is issued. This evaluation will focus on the achievement of the facility objectives and those of a representative sample of projects in execution, and will deepen the analyses presented in the midterm evaluation. The final evaluation will also review the effectiveness of the strategic partnership between the Bank and CODESPA, and will provide input to the Bank for decision-making on whether the experience of having financed initiatives under the facility warrants proceeding with a replenishment of the facility.

**Exceptions to
Bank policy:**

None