

SUPPORT FOR IMPROVING THE QUALITY AND COMPETITIVENESS OF COFFEE IN THE SIGUATEPEQUE REGION

(TC-02-06-01-6)

EXECUTIVE SUMMARY

**Executing
agency:**

Cooperativa Cafetalera Siguatepeque Limitada (COHORSIL)

**Amount and
source:**

	<u>IDB</u>	<u>Local</u>	<u>Total (US\$)</u>
Financing:	350,000	50,000	400,000
Nonreimbursable technical- cooperation funding:	<u>250,000</u>	<u>180,000</u>	<u>430,000</u>
Total:	600,000	230,000	830,000

The funding will be in foreign exchange, drawn on the net income of the Fund for Special Operations (FSO).

**Terms and
conditions:**

Amortization period:	10 years
Grace period:	5 years
Disbursement period:	42 months
Execution period:	36 months
Interest rate:	2% in real terms (lempiras)

The grace period will apply solely to amortization of the financing and not to interest. A percentage based on the CPI for the preceding 12-month period reported by the Central Bank of Honduras will be added to the interest rate (2%) to ensure maintenance of value.

Problem to be resolved:

Small coffee growers in the Siguatepeque region (PECASIG) have been hard hit by the critical situation affecting coffee growers across the country. They have seen their incomes dwindle and a negative spread emerge between internal and external prices, factors that have adversely affected the economy of the region. The Siguatepeque region grows some of the best coffees in Honduras and Central America, coffees that could be sold in specialty markets, where consumers are prepared to pay a higher price for a quality product. The coffee plantations of most PECASIG members in the Cohorsil cooperative are in areas with the appropriate agroclimatological conditions for producing high-quality coffee. Although Cohorsil has been promoting a culture of quality coffee among its members and customers, and some members are even able to produce varieties that could compete in markets that cater for premium coffees, certain steps will need to be taken by more producers in order to meet the standards of such a market. Hence, Cohorsil will be able to market more quality coffee at more favorable prices for producers. For PECASIG and Cohorsil to accomplish this aim, the following shortcomings must first be overcome: (i) *lack of technical knowledge and market information available for access to specialty coffee markets*. In addition to the favorable agricultural and climatological conditions mentioned earlier, *specialized* methods and practices must also be applied in the production process in order to grow quality coffee. To have access to the specialty coffee market, production and marketing channels are needed to bring the product to the new market; and (ii) *lack of access to credit for inputs and marketing*. The result of the coffee crisis has been that no local financial institution is prepared provide credit for the production, marketing, and sale of Honduran coffee. The inability to gain access to financing prevents PECASIG from giving its productive units proper maintenance, thus undermining yield and the quality of production.

Objectives:

The general objective of the project is to raise the income of small coffee growers in the Siguatepeque region through improvements in the quality of coffee they produce and maintaining its quality at a consistently high level so that they are able to capture premium prices from the sale of their product.

The specific objectives of the project are (i) to introduce production and processing practices and methods that enhance the quality of their coffee on a sustainable basis; and (ii) to gain access to new coffee markets where a quality product will fetch premium prices as a specialty coffee.

Description:

1. **Reimbursable financing component** (IDB: US\$350,000; Local counterpart: US\$50,000).

Fund for high quality coffee production (FPCC) (IDB: US\$75,000; Cohorsil: US\$25,000). The proceeds of the fund will be used to provide working capital for 200 PECASIG that meet the requirements for quality coffee production. This funding will be used to purchase inputs for the production of high quality coffee, including fertilizer, manure, and biopesticides approved by Cohorsil. The cost of inputs for each manzana* of coffee is estimated at US\$260. The funding will be enough to cover 385 manzanas.

Quality coffee marketing fund (FCCC) (IDB: US\$225,000; Cohorsil: US\$25,000). Resources from the fund will be used to finance the marketing and export of quality coffee, thus making it possible to advance to small producers up to 50% of the total cost of production delivered to Cohorsil at the benchmark price on the day of sale, until payment for the exports is received. Assuming a selling price of US\$90/bag of coffee, it is estimated that as many as 6,000 quintals of quality coffee could be financed from this fund during the first three years of the project. Small coffee growers will have access to this fund whenever their production meets the quality standards set for a specialty coffee.

Unlike commercial coffees, which are received and delivered solely during the harvest season, the marketing of quality coffee requires a permanent inventory since quality coffee roasters require monthly delivery of the product throughout the year. This in turn calls for more working capital for a longer period so that the small producer can receive financing from the time the coffee is delivered until such time as Cohorsil actually delivers the product.

Investment in fixed assets (IDB: US\$50,000). The ability to meet the quality standards of the specialty coffee market will depend on the process and the type of machinery used for drying coffee. Accordingly, Cohorsil will need to acquire cylindrical coffee dryers that enhance the processing of the bean and consequently its quality.

2. Nonreimbursable technical cooperation component (IDB: US\$250,000; Cohorsil: US\$180,000).

Development and implementation of sustainable production and processing methods to improve coffee quality at a consistently high level (US\$132,000; US\$76,200). To develop and implement production and processing methods to enhance the quality of coffee, the following activities will be financed: (i) hiring of an agronomist specializing in quality coffee production and processing, with experience in the specialty coffee market; (ii) hiring of four

* Equivalent to approximately 0.7 hectares or 1.75 acres.

agricultural experts to provide technical assistance and transfer specialized quality production technologies to 200 PECASIG; (iii) acquiring and setting up a pilot moist hulled bean plant; (iv) hiring of an industrial engineer for reconversion of PECASIG moist beans; (v) providing training to PECASIG on the requirements for marketing a quality product in terms of drying, preparation, quality control, packaging, and export; (vi) training in leadership, negotiation, and administration for women members supplying coffee to Cohorsil; and (vii) acquiring ISO 9001 quality certification.

Development and implementation of a system for marketing and selling quality coffee through Cohorsil (IDB: US\$98,000; Cohorsil: US\$103,800). The success of the project will depend on Cohorsil identifying and evaluating the type of coffee market it can penetrate with the variety and quality of the coffee produced. This means determining the potential value of Cohorsil coffee compared with other varieties and doing whatever is necessary to penetrate the market niche for this type of coffee and its potential buyers.

The proceeds of this component will be used to finance the following activities: (i) hiring of an international consultant (or firm) specializing in marketing and sales, with experience in the upscale international coffee market, and preferably the specialty coffee market; (ii) hiring of a local consultant with experience in marketing and sale of coffee; (iii) training for Cohorsil in coffee quality and the requirements for importing quality and specialty coffees into the United States; (iv) sending coffee samples to tasting laboratories and professional tasters; (v) developing and producing marketing information and materials; (vi) forming a tasting team; (vii) offering an in-service course for a tasting laboratory in Nicaragua; (viii) training for the Cohorsil team and PECASIG in coffee tasting; (ix) organizing visits for buyers of quality coffee who purchase from Cohorsil; (x) taking part in specialty coffee fairs; and (xi) becoming a member of the Specialty Coffee Association of America (SCAA). The activities described here could be adapted based on the recommendations of the expert in quality coffee marketing who will be hired to develop a marketing plan.

Cohorsil undertakes to disseminate information on the methods and skills it acquires under the present operation to other groups and cooperatives that satisfy the requirements for quality coffee production. Such information will be disseminated through the Mountain Training and Research Center (CICAM), an entity that it administers, and through the Special Coffee Association of Honduras (ACEH).

In addition, the proceeds of the financing will be used to fund a

midterm and a final evaluation (IDB: US\$20,000).

Environmental and social review:

The Committee on Environment and Social Impact reviewed this operation on 19 July and 27 September 2002. The Committee's recommendations have been incorporated into the loan document.

Benefits:

The direct beneficiaries of the project will be approximately 200 PECASIG who cultivate from 1 to 10 manzanas of coffee, employing on average 5 to 10 workers for each productive unit (including plantation management and workers to harvest and process the coffee bush fruit). This represents about 12.5 families per producer. The PECASIG are located in rural communities in the municipalities of Siguatepeque, Comayagua, Jesús Otoro, Intibucá, La Esperanza, and Masaguara in the departments of Comayagua and Intibucá. Most of these producers live below the poverty line and have only limited access to health services and education. As the operation will have an economic impact on all of the families involved, the project is expected to benefit some 2,500 individuals engaged in all of the activities carried out on the plantations. At least one half of the beneficiaries are not members of Cohorsil although they use its services to market their products.

Risks:

The risks associated with the project are (i) *Risk*: world specialty coffee prices may fall as a result of supply outstripping demand. *Mitigating factor*: Although the project will not be able to control the external market, the project's focus on improving quality and the marketing campaign for the product is expected to place Cohorsil's production in a captive market that recognizes its quality; (ii) *Risk*: production is affected by adverse weather conditions caused by natural phenomena. *Mitigating factor*: there is no direct way to mitigate this risk. However, Cohorsil must maintain a stable financial condition with the necessary reserves to meet any crisis that may arise in the wake of a natural disaster; (iii) *Risk*: there is no effective demand in the specialty coffee market for the product supplied by Cohorsil. *Mitigating factor*: training and technical assistance in sales and marketing will make it easier for Cohorsil's quality product to position itself more firmly on the basis of its relative value within the market, either in the specialty coffee market or some other segment that is prepared to pay a higher price for quality coffee.

The strategy of the government and the Bank:

The project activities proposed are consistent with the priorities identified in the Bank's poverty reduction strategy (PRS). One of the major challenges noted in that document is to speed up the pace of growth through greater competitiveness and initiatives in different sectors and geographic areas that are conducive to bringing the benefits of development to the entire population. This project is consistent with, and relevant to, the PRS and with the government's

specific strategy of supporting actions to promote agribusiness, including making the coffee and forestry industries more competitive. Also, the project is consistent with the Bank's strategy for Honduras, which seeks to promote rural economic development that brings with it improvements in the quality and efficiency of coffee growing and processing.

The operation also fits in with the parameters of the Social Entrepreneurship Program insofar as the final beneficiaries are small coffee producers who are members of a cooperative in economically depressed rural areas and have presented the Bank with a proposal for generating higher income from the activities in which they are engaged.

During project implementation, the executing agency will seek complementarity with other initiatives of the Bank and other development institutions that are presently being planned with a view to serving as a pilot experience with lessons learned that can be applied to other projects having to do with the sector. Such projects include a regional initiative of the Multilateral Investment Fund (MIF) to support the competitive position of Central American coffee producers (TC-0208023), now in preparation, that is scheduled for approval in 2003 and a USAID initiative that is being prepared to support the Central American coffee strategy. Also, insofar as is possible, the project will take in the recommendations emanating from the study on the social consequences of the coffee crisis in Central America (ATN/FW-7985-RG approved on 20 August and now in progress).

Justification:

The project is justified because (i) it promotes opportunities for producing more stable income for project beneficiaries, small coffee growers in economically and socially depressed rural areas of Honduras; (ii) the project beneficiaries satisfy the requirements for producing quality coffee; (iii) Cohorsil is a cooperative with the technical, operating, and administrative capacity to carry out the project successfully; and (iv) this project can serve as a pilot experience which could be replicated in other parts of the region with similar characteristics, with lessons learned that could be applied to other Bank-financed projects in the same sector.

Special contractual clauses:

As a condition precedent to the first disbursement of the technical-cooperation funding component, Cohorsil shall present, to the Bank's satisfaction, a work plan that sets out annual targets for fulfilling the objectives and results of the project. The plan shall include a timetable for complying with the performance indicators, which would make it possible to monitor and supervise the project as it proceeds.

As a condition precedent to the first disbursement of the financing for the quality coffee production fund (FPCC), Cohorsil shall demonstrate, to the Bank's satisfaction, that: (i) it has hired an expert in production and the agricultural extension workers; and (ii) the FPCC regulations have been approved by Cohorsil's board of directors.

As a condition precedent to the first disbursement of the financing for the quality coffee marketing fund (FCCC), Cohorsil shall present: (i) a letter of intent to purchase quality coffee plots and to pay a premium for the quality; and (ii) the FCCC regulations approved by Cohorsil's board of directors.

**Reports, audits,
and
evaluations:**

Reports: Cohorsil shall submit to the Bank, within 60 days after the end of each six-month period, semiannual progress reports and reports on the use to which Bank financing has been put. Such reports will include (i) a description of the progress made in implementing the work plan and its indicators, as well as a report on the main accomplishments and any problems encountered in fulfilling the targets and objectives and their relationship with the current plan; (ii) an update of the performance indicators and the project work plan for the following 12 months, including the steps taken to overcome any difficulties encountered; (iii) information on the economic benefits that have been transferred to the PECASIG as well as the benefits in terms of training and technical assistance in production and marketing; (iv) information on environmental and gender activities undertaken, which should include indicators that monitor environmental improvements in terms of reduced pollution; (v) a statement showing the use to which Bank financing and counterpart contributions have been put; (vi) statistical and financial information on Cohorsil's financial results; (viii) activities to disseminate and replicate the pilot experience to other groups of coffee growers in the country who are in a position to produce quality coffee.

The first project report must provide (i) socioeconomic information on the target group before commencement of the project, setting out for comparison any changes in the beneficiaries' income; and (ii) a base line to gauge improvements in the environment particularly in terms of (a) reductions in point water pollution; (b) reductions in water volume used; and (c) the conversion of the residue from the processing of subproducts into organic manure.

The Bank will review the content of these reports as well as their conclusions and recommendations. If any significant shortcomings are found to exist, the Bank may suspend all further disbursements until such time as Cohorsil has taken satisfactory steps to correct the

problems.

Within 120 days after the close of each financial year for the duration of the project, Cohorsil will submit to the Bank financial statements examined by independent auditors. In addition, within 120 days after the final disbursement of the technical-cooperation component, Cohorsil will submit an audited financial report showing how the Bank's contribution and the local counterpart funding have been employed.

Evaluations: The project will serve as a pilot experience to help small coffee growers who produce and sell quality coffee fetch a better price for their product. At month 18 of the project, a midterm evaluation will be performed to evaluate the progress made and to take any corrective action that may be needed. This evaluation will gauge the extent to which the proposed objectives have been fulfilled and whether the project indicators have been satisfied.

In the interests of documenting the experience and measuring the accomplishments of the project, a final evaluation will be conducted when 80% of the project financing has been disbursed. This evaluation will focus on an analysis and learning material collected from the process, with an assessment of the extent to which the project objectives have been met. These objectives are (i) enhanced production and processing methods to raise the quality of coffee on a consistent basis; (ii) access to new premium coffee markets where customers are willing to pay more for a quality product; and (iii) transfer of expertise and methods learned under the project to other groups of small coffee growers with the means of producing a quality product.

Independent consultants engaged directly by the Bank's Country Office in Honduras will perform the evaluations. The costs incurred will be charged to the technical cooperation component.

**Exceptions to
Bank policy:**

None.