DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

GUATEMALA

SOCIAL ENTREPRENEURSHIP PROGRAM

PRODUCTION AND COMMERCIALIZATION OF QUALITY ORGANIC COFFEES BY MAYAN SMALL PRODUCERS

(SP/TC-0306013)

FINANCING AND TECHNICAL COOPERATION PROPOSAL

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EXECUTIVE SUMMARY

Executing agency:

For the reimbursable financing component: Ecologic Finance (EF).

For the nonreimbursable technical-cooperation component: Asociación Civil de Pequeños Productores de Café Manos Campesinas ("Manos Campesinas").

Amount and source:

	IDB (US$)	Local (US$)	Total (US$)
Financing:	300,000	370,000	670,000
Nonreimbursable technical cooperation:	161,000	69,000	230,000
Total:	**461,000**	**439,000**	**900,000**

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

Terms and conditions:

Amortization period:	12 years
Grace period:	5 years
Disbursement period for the financing:	42 months
Execution period for the financing:	36 months
Interest rate:	1%

The grace period will apply solely to repayment of principal, not to interest. The credit will be in U.S. dollars.

Problem to be addressed:

The population of southwestern Guatemala (*departamentos* of San Marcos, Quetzaltenango, and Sololá) is predominantly indigenous, rural, and poor. This region offers ideal agroecological conditions—altitude, agroclimate, and soil properties—for the production of high-quality coffee. Coffees of that caliber, and those grown using environmentally and socially sustainable practices, command higher prices on the market. Indeed, "specialty coffees" are the only coffee-industry segment that has been showing robust and steady growth.

Five organizations of small coffee producers in this region, with a total membership of 1,100, make up the "Manos Campesinas" Association, whose core mission is to help its members grow their product and sell it on preferential markets that will bring the producer a better price. Most of the association's members live on what they earn from sales of their coffee. Since its launch during the 1997-1998 crop year Manos Campesinas has worked hard to get its members' coffees into specialty niches such as the organic, fair trade, and gourmet coffee markets. Currently only about half of its members' output is being exported; most of the other 50% has export potential as specialty coffees but is not up to the requisite quality standards.

A number of constraints are keeping these small coffee growers and their organizations from boosting their export sales to specialty coffee markets: (i) little if any credit available to remedy cashflow problems so the producer organizations can amass enough product for export to higher-paying coffee markets; (ii) no system to enable these producers to consistently apply the techniques and standards required for sustained product quality improvements; (iii) lack of knowledge of standards and procedures required to obtain organic and fair trade certification; (iv) lack of the infrastructure needed to meet quality requirements in bulking centers to which members' coffee is delivered; and (v) inadequate administration and management and financial control systems and procedures in Manos Campesinas and its member organizations.

Objectives: The project's objective is to raise the income of small coffee producers in western Guatemala by way of sustained quality improvements and increases in volumes of coffees that can command a premium in the market.

The project will pursue the following specific objectives to achieve sustained increases in coffee sales volumes and quality improvements: (i) increase the producer organizations' access to financing to be able to boost the volumes of coffees being bulked and processed; (ii) achieve sustained improvements in the quality of coffees produced; (iii) increase the volume of quality coffees certified by different specialty markets, primarily the fair trade and organic coffee markets; (iv) improve coffee storage conditions in the member organizations' bulking centers; and (v) improve administration and management and financial control in Manos Campesinas and its member organizations.

Description: **Reimbursable financing component**: Financing Facility for Coffee Commercialization (Bank US$300,000, Ecologic Finance US$370,000)

These funds will be used to make credit more readily available to the member coffee-producer organizations with the aim of increasing the volumes of coffee bulked. The reimbursable funding will finance preshipment credit of US$510 per producer, on average. Coffee producers would have six to eight months to use the IDB funds: this would cover the span from the time a producer delivers the coffee crop to the respective organization's bulking center until Manos Campesinas receives payment from European and U.S. buyers.

Ecologic Finance (EF), the intermediary institution for the credit component, undertakes to create a Capitalization Fund that Manos Campesinas would be equipped to administer directly starting in year 2 of the project. In order to set up and add to this Fund, EF will earmark three percentage points of the interest rate it charges to borrowers under the project's financing component.

Technical cooperation component (Bank US$161,000, Manos Campesinas US$69,000)

The project will fund the following activities to *help improve and maintain coffee quality*: (i) develop and implement an incentives system to spur quality improvements, and train producers; (ii) purchase cupping equipment and train producers in coffee cupping techniques, and institute a feedback system to develop a better understanding with coffee buyers; (iii) develop and implement a quality management and training system for Manos Campesinas member organizations; (iv) obtain wet-milling technician diplomas and arrange visits for the member organizations to share their experiences, to improve the quality of milling services; and (v) make small water treatment and improvement investments for the Loma Linda organization's wet-milling operations.

To *help increase the volume of certified coffees* the project will furnish funding to design an organic and fair trade coffee certification system and implement a training program for inspectors, promoters, and all Manos Campesinas member coffee growers.

To *improve coffee storage conditions in the member organizations' bulking centers* the project will finance: (i) construction of five small coffee collection facilities in five Pueblo Nuevo communities: Toquián Grande, Santa Lucia, Talux, La Unidad, and Tres de Mayo; (ii) construction of a bulking and storage facility in Malacatán; and (iii) training of staff in charge of each member organization's bulking

centers and training for coffee producers generally in storage management techniques.

To *improve administration and management and financial control in Manos Campesinas and its member organizations*, the project will fund development of an internal control system featuring: (i) a management information system; (ii) a quality management and quality assurance system and an incentives system to improve coffee quality; and (iii) a commercialization fund administration system, with the goal that within three years Manos Campesinas and its member organizations will be able to administer the fund directly.

The project also will finance the following activities to build capacity in Manos Campesinas members for self-managed credit and to administer loan portfolios within the respective organization: (i) design and implementation of a specialized finance training program on managing agricultural lending, for promoters, association executives, and the general membership; and (ii) monitoring and evaluation of the finance training plan's implementation.

There are funds in the project budget as well for: (i) development and establishment of a baseline against which to measure project outcomes, (ii) midterm and final evaluations, and (iii) the corresponding audits.

Beneficiaries: The proposed project's impact area takes in three *departamentos* in southwestern Guatemala: Quetzaltenango, San Marcos, and Solalá. To begin with, the project will benefit approximately 1,100 small coffee producers and their families who belong to five grass-roots organizations that are members of Manos Campesinas: (i) Asociación de Pequeños Caficultores Orgánicos Mayas Mames (APECAFORM), (ii) Asociación de Productores Orgánicos de Café de Sololá (APOCS), (iii) Loma Linda; (iv) Sociedad Civil para el Desarrollo de Colomba (SCIDECO), and (v) Unión de Cooperativas y Asociaciones de Productores Ecológicos Marquenses (UCAPEM).

The project beneficiaries will be small coffee producers whose plots average 0.85 hectares. On average the annual income of these producers and their families is about US$1,500—enough to defray their production costs and basic household expenses but not enough to improve their standard of living. Ninety percent of Manos Campesinas members are of indigenous extraction. Most of them speak Spanish; Mam, Quiché, Tzutuhil, and Kaqchiquel are the most predominant Mayan languages spoken. Eleven percent (126) of the members are women.

Environmental and social review:

The Committee on Environment and Social Impact (CESI) reviewed this operation on 12 March 2004 (meeting 10-04). On the matter of women's participation, one of Manos Campesinas' proposed long-range strategy goals is to achieve significant participation by women as members of the association and in activities it organizes. Its 2005 strategic plan spells out three main gender-related targets: (i) at least one woman on each of its member organizations' board of directors; (ii) 10% of participants in Manos Campesinas activities should be women; and (iii) women should comprise 15% of Manos Campesinas' membership. Manos Campesinas also will develop a gender policy that is to be shared and promoted in its member organizations.

As for organic certification, Manos Campesinas' stated 2005 target is to see organic systems in use in 80% of its members' coffee plantations. The project proposed here includes funding to assist the association's efforts to help more producing units become organic-certified. With respect to shade-grown coffee, all the Manos Campesinas member organizations operate at altitudes between 1,500 and 1,800 meters above sea level, so they have to plant coffee and maintain their production systems in the shade, preserving the existing forest. In fact, 100% of their coffees are being shade-grown in one form or another. The coffee farmers also plant different plant varieties that provide temporary shade, as well as productive trees that are important both for household consumption and as saleable products.

The government's and the Bank's strategy:

The Bank's strategy for its activities in Guatemala is to support the government's endeavors to manage the challenges of sustainable economic development, with poverty reduction as a priority. The strategy's three main action focuses are: (i) economic growth, stability, and competitiveness, with special support to production-sector competitiveness; (ii) equity, social protection, and human capital development, including actions targeted to uprooted populations such as indigenous groups; and (iii) modernization of the State and governance (country paper GN-2149-1, June 2001). The project proposed here pursues focuses (i) and (ii) of the strategy.

The proposed operation also fits the parameters of the Social Entrepreneurship Program, inasmuch as its end-beneficiaries will be small, mostly indigenous coffee producers living in economically depressed rural areas, who stand to benefit from a venture that will help boost their incomes. The project likewise is consistent with the Bank's action focuses and activities in Central America's coffee sector which has seen a price crunch in recent years; these include support for coffee producers—particularly small and mid-sized growers—who have the potential to produce quality coffees, so they

can improve and maintain the quality of their product and thereby make the sector more competitive.

In April 2003 the Bank approved a MIF-funded regional project "Supporting the Competitive Position of Central American Coffees" (ATN/ME-530-RG), with the twofold aim of: (i) developing and implementing a regionwide quality management system to improve and preserve coffee quality; and (ii) providing support to access various existing market segments for coffee and increasing access to new marketing mechanisms. The proposed project complements, but does not duplicate, the MIF project's support for sustainable quality improvements and access to new marketing mechanisms. As for instituting a coffee quality system, the MIF operation calls for regionwide technical assistance to lay the foundations and develop the general lines of such a system, whereas the project proposed here would help set up a system and internal quality controls tailored to Manos Campesinas, to be derived from the regional system established by the MIF. On the marketing mechanism side, the MIF is supporting the launch and operation of innovative approaches of this kind. The proposed project would deliver support directly to Manos Campesinas to give it access to such a mechanism. RE2/EN2 also is in charge of another regional technical-cooperation project (ATN/FC-8353-RS) to help diversify the coffee industry. The project proposed here complements the Bank's initiatives, its focus being to help small coffee producers secure financial resources to successfully gain a permanent foothold in the specialty coffees market and thereby raise their incomes.

Donor coordination: During the analysis mission, plans for the technical assistance activities envisaged in this project were coordinated with other coffee industry organizations such as Asociación Nacional del Café (ANACAFÉ) and Asociación Gremial de Exportadores de Productos No Tradicionales (AGEXPRONT), to avoid overlaps and ensure that activities are mutually complementary.

Rationale: The proposed project is important because it will: (i) enhance prospects for a group of producers and their families to considerably raise their annual incomes (increases of more than 70%) and their standard of living, and (ii) help strengthen an association that is owned by the project beneficiaries themselves and has been a vehicle for delivering significant benefits to Manos Campesinas members.

Risks: Among the risks that could arise in this project are the following: (i) Adverse climatic conditions or natural weather events could affect output and productivity. The project's plan for a contingency reserve for unforeseeables will lessen the effect of any such eventuality. Furthermore, credit will be disbursed only against delivered product.

(ii) World coffee prices might come down further. This project cannot control the external market, but it is hoped that the operation's focus on product quality improvements will give Manos Campesinas' specialty coffees a clear competitive advantage. (iii) There might not be effective demand for Manos Campesinas products in the specialty coffees buyer market. According to a recent survey, buyers are keen to increase the volumes of coffee they buy from Manos Campesinas.

Special contractual conditions:

Reimbursable financing component

As a condition precedent to the first disbursement from the reimbursable financing, EF will have to provide the Bank with the following: (i) evidence that EF has opened and is operating a branch in Guatemala; (ii) detailed Credit Regulations, approved by the EF board of directors and signed jointly with Manos Campesinas, governing administration of the project funds; and (iii) an agreement between Manos Campesinas, its member organizations, and EF, setting out: (a) the member organizations' undertakings with respect to the coffee deposited in their bulking centers, which will serve as security for receipt of the financing; and (b) each party's responsibilities and minimum conditions to ensure that coffee will be properly stored and transported to the place of delivery for export.

As a condition precedent to EF's first transfer of funds from the Capitalization Fund to Manos Campesinas, the latter must demonstrate to the Bank and to EF that: (i) the technical assistance activities to build financial management capacity in Manos Campesinas and in its member organizations, and the finance training program, are being carried out in accordance with the work plan; (ii) Manos Campesinas has adequate management systems in place to administer a loan portfolio; (iii) its staff have the skills to adequately manage a loan portfolio; and (iv) it has a set of credit regulations acceptable to the Bank.

Nonreimbursable technical-cooperation component

As a condition for the first disbursement under this component, Manos Campesinas will deliver the following items to the Bank's satisfaction: (i) the Coordination Agreement signed with EF, which sets up the Project Coordination Team (PCT); and (ii) an implementation plan, one element of which will be annual targets for attaining the project's objectives and outcomes. This plan must include a timetable for achieving the performance indicators, by reference to which the operation's progress can be tracked and supervised. In addition, Manos Campesinas is to provide terms of reference for the consultants and advisory support that would be

funded under the technical cooperation component in year 1 of the project.

Before the Bank will disburse funds for the component to improve storage conditions for coffee bulking, which includes funding for small infrastructure works to improve coffee bulking and storage facilities, Manos Campesinas must present, to the Bank's satisfaction: (i) evidence that the land on which the structures will be built is owned by Manos Campesinas or any of its affiliated associations, and (ii) approved plans for construction or improvement of the bulking or storage facility.

Reports and evaluations:

Reports: Manos Campesinas and EF will submit joint progress reports to the Bank's Guatemala Country Office, via the PCT, 60 days after the end of each six-month period, and a final report 60 days after expiration of the time limit for the last disbursement. The reports are to include the following: (i) a description of progress on the project's implementation plan and indicators and an account of the main achievements and problems encountered in reaching the targets and objectives, referencing the then-current plan; (ii) an update of the performance indicators and of the project implementation plan for the next 12 months, including planned measures to remedy any problems identified; among the performance indicators to be reported on are improvements in coffee storage conditions and Manos Campesinas' management and financial administration; (iii) information on the benefits that have been passed along to small producers—economic, training, and technical assistance for production matters, credit, and marketing and sales; (iv) information on environmental and gender-related activities carried out; (v) a statement of the use of Bank funds and counterpart contributions; (vi) information on the effective interest rate on credits that the intermediary institution has extended to Manos Campesinas under the project's financing component and on how the intermediation spread for Bank funds was distributed; (vii) a comparison of EF's effective lending rate with interest rates charged on other loans with comparable risks offered by other financial institutions in rural Guatemala; and (viii) statistics and financial data on Manos Campesinas' economic results. In addition, the first project report must provide a compilation of pre-project socioeconomic data on the target group, to be able to compare changes in sales and in beneficiaries' incomes.

The Bank will review these reports' content and findings and their recommendations. If it encounters significant deficiencies in the project's implementation the Bank may suspend disbursements of project funds until EF and/or Manos Campesinas, as applicable, takes satisfactory corrective action.

For the financing component—audited annual financial reports: Within 120 days after each fiscal year-end throughout the life of the project, starting the year corresponding to the fiscal year in which the first financing-component funds are disbursed, EF will provide the Bank with a report containing financial statements of the financing component and activity in the special accounts, accompanied by the opinion of an independent auditor acceptable to the Bank. There are funds in the project budget for this purpose. EF also will submit its annual financial statements signed by a qualified public accountant.

Within 90 days after the end of the disbursement term for the nonreimbursable technical-cooperation component, Manos Campesinas will present an audited financial report showing how the Bank's contribution was used.

Evaluations: With funds from the technical cooperation the Bank will commission a midterm review and a final evaluation of the project. The midterm review that the Bank will conduct via its Guatemala Country Office 18 months after the first disbursement will measure progress achieved in the following areas: (i) increases in the income of small coffee producers in western Guatemala; (ii) volume increases and improvements in quality of coffees sold in premium markets; (iii) increase in access to credit so Manos Campesinas member organizations can increase the volumes of coffee bulked and processed; (iv) sustained improvement in the quality of the coffees produced; (v) increase in the volume of coffees certified by various specialty markets, primarily the fair trade and organic coffee markets; (vi) improvements in coffee storage conditions in the member organizations' bulking facilities; and (vii) improvements in Manos Campesinas' administration and management and financial control. The evaluation report is to recommend any corrective action needed in regard to the project activities.

The final evaluation, to be performed when 90% of the technical cooperation funding has been disbursed, will: (i) measure outcomes achieved through the fulfillment of objectives and performance indicators; (ii) review any special issues and implementation of the midterm review recommendations; and (iii) outline lessons learned in the project.

The Bank will review the progress report and evaluation report findings and recommendations. At semiannual project monitoring meetings the PCT and the Bank's Guatemala Country Office will discuss the six-month report, progress achieved toward the performance indicators, and the work plan. The results of the twice-yearly reports and meetings will determine future disbursements for the project. If the Bank encounters significant deficiencies in the

project's implementation it will take such measures as it deems appropriate, including suspending disbursements if necessary.

Exceptions to Bank policy:

According to the Bank's operational policy (OP-706) governing the Social Entrepreneurship Program, to serve as an executing agency an intermediary institution must be legally registered and established in the interested country. As an exception to that policy's basic criterion number 4 it is recommended that Ecologic Finance (EF) be the executing agency for this project's financing component. A corporation created and organized under the laws of the State of Massachusetts, United States of America, EF does not yet have a subsidiary legally registered and established in Guatemala.

The rationale for selecting EF is as follows: (i) That agency has relevant experience, having been engaged in lending to rural organizations of low-income small producers whose output is exported, in Guatemala and elsewhere in Latin America. For several years it has had a working relationship with Manos Campesinas and its member organizations that stand to benefit from this project. Operating in remote parts of the country and institutionally weak, these organizations have difficulty accessing local agencies like EF that are prepared to lend to them. (ii) EF has an office in the city of Quetzaltenango from which it can service the project; it is in the process of setting up a branch with legal personality under Guatemalan law. (iii) The component that EF would execute will be used in its entirety to provide credit to beneficiaries located in Guatemala; none of the funding will be used to defray the executing agency's direct costs. (iv) EF will contribute resources to assist the project's small-producer beneficiaries: (a) as the project's co-finance provider, furnishing US$370,000 in counterpart funds—more than the Bank's US$300,000 contribution to that component; and (b) by way of a Capitalization Fund to be created from the contribution of three percentage points of the interest spread on the loans EF makes using the financing-component resources, which will come both from the Bank's contribution and from EF resources. The Capitalization Fund would be set up in year 2 and transferred to Manos Campesinas at the end of the project, subject to achievement of some predetermined indicators. (v) There is nothing in Guatemalan law that might foreseeably impede EF's performance.

The exception being recommended is consistent with the functions mandated in the Agreement Establishing the Bank, applicable particularly to private-sector entities, "to encourage private investment in projects, enterprises, and activities contributing to economic development and to supplement private investment when private capital is not available on reasonable terms and conditions" and to

"cooperate as far as possible with national and international institutions and with private sources supplying investment capital."

When circumstances warrant, Bank group members (PRI, IIC, MIF) that work with private-sector entities assign responsibilities for their operations to intermediary institutions that are registered and established in nonbeneficiary member countries of the Bank, on condition that the project beneficiaries are in the beneficiary countries (the case of the operation proposed here). However, for its Social Entrepreneurship Program the Bank opted for a more stringent policy: the executing agency must be legally established in the project country—hence the need for the exception recommended here.