

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**GUATEMALA**  
**SOCIAL ENTREPRENEURSHIP PROGRAM**

**EXECUTIVE SUMMARY**

**FINANCIAL AND ENVIRONMENTAL SUSTAINABILITY FOR SMALL  
RURAL FOREST ENTERPRISES**

**(GU-S1015)**

This document was prepared by the project team consisting of: Floridalma Correa (MIF/CGU); Juana Lourido (MIF/CGU); Krysia A. Ávila (LEG/NSG); and Jessica Villanueva (MIF/ATF) Project Team Leader.

## CONTENTS

|     |   |    |
|-----|---|----|
| I.  | PROJECT OVERVIEW.....   | 1  |
| A.  | Executing agencies.....   | 1  |
| B.  | Amount and source of financing.....                             | 1  |
| C.  | Terms and conditions.....                                       | 1  |
| D.  | Statement of no objection .....                                 | 1  |
| E.  | The problem to be addressed .....                               | 1  |
| II. | THE PROJECT.....  | 6  |
| A.  | Objective and purpose.....                                      | 6  |
| B.  | Proposed execution mechanism.....                               | 6  |
| C.  | Description .....   | 7  |
| D.  | Sustainability and results of the financial analysis .....      | 8  |
| E.  | Credit risk for the Bank.....                                   | 9  |
| F.  | Anticipated outcomes and benefits .....                         | 9  |
| G.  | The Bank's strategy .....                                       | 9  |
| H.  | Coordination with other international cooperation agencies..... | 10 |
| I.  | Environmental and social review summary.....                    | 10 |
| J.  | Special conditions .....  | 10 |
| K.  | Reports, evaluations, and audits.....                           | 11 |
| L.  | Risks and mitigating factors.....                               | 13 |
| M.  | Exceptions to Bank policies.....                                | 14 |

## **ANNEXES**

|           |   |
|-----------|---|
| Annex I   | Logical framework   |
| Annex II  | Institutional Analysis and Execution of the Operation, with Project Financial Projections   |
| Annex III | Performance indicators  |
| Annex IV  | Technical Cooperation Plan of Operations<br>Appendix 1 - Itemized budget<br>Appendix 2 - Technical cooperation timeline<br>Appendix 3 - Scoring for consulting services' terms of reference |
| Annex V   | Summary of the project financial conditions   |
| Annex VI  | Market analysis   |
| Annex VII | Financial covenants   |

## **OTHER DOCUMENTS**

|       |   |
|-------|---|
| Doc 1 | Minimum Elements for the Project Credit Regulations   |
| Doc 2 | Historical financial statements: Rainforest Alliance 2005–2007, Financiera de Occidente 2005–2007 |
| Doc 3 | Draft procurement plan  |
| Doc 4 | Table of Beneficiaries and Sample Economic Model of a SRFE  |
| Doc 5 | Planning table of technical cooperation milestones  |

## **APPENDICES**

Proposed resolution

## ABBREVIATIONS

|            |   |
|------------|---|
| ACARPET    | Asociación de Carpinteros del Petén [Carpenters Association of Petén]                     |
| FEDECOVERA | Federación de Cooperativas de las Verapaces [Federation of Cooperatives of the Verapaces] |
| FIDOSA     | Financiera de Occidente S.A.  |
| INAB       | Instituto Nacional de Bosques [National Forestry Institute]                               |
| LIBOR      | London Interbank Offered Rate   |
| NGO        | Nongovernmental organization  |
| PINFOR     | Programa de Incentivos Forestales [Forest Incentive Program]                              |
| PSR        | Project status report   |
| RA         | Rainforest Alliance   |
| RFE        | Rural forest enterprise   |
| SRFE       | Small rural forest enterprise   |

## I. PROJECT OVERVIEW

### A. Executing agencies

- 1.1 *Reimbursable financing:* Financiera de Occidente S.A. (FIDOSA)  
*Nonreimbursable and technical-cooperation financing:* Rainforest Alliance Inc., Guatemala (RA)<sup>1</sup>

### B. Amount and source of financing

|                                 | IDB US\$                                      | Local US\$ | Total US\$ |
|---------------------------------|---|------------|------------|
| Reimbursable financing          | 850,000                                       | 2,550,000  | 3,400,000  |
| Nonreimbursable financing       | 150,000                                       |            | 150,000    |
| Technical-cooperation resources | 250,000                                       | 160,290    | 410,290    |
| Total                           | 1,250,000                                     | 2,710,290  | 3,960,290  |
| Source:                         | Net income of the Fund for Special Operations |            |            |

### C. Terms and conditions

|                      |                             |
|----------------------|-----------------------------|
| Term                 | 10 years                    |
| Grace period         | 36 months for the principal |
| Annual interest rate | 180-day LIBOR rate plus 3%  |
| Currency             | U.S. dollars                |
| Execution period     | 36 months                   |
| Disbursement period  | 42 months                   |

- 1.2 The grace period applies only to amortization of the principal, not to interest. The loan will be denominated, disbursed, and repaid in U.S. dollars.

### D. Statement of no objection

- 1.3 The Bank's Country Office in Guatemala, through letter CGU-C-3040/2008 of 23 September 2008, requested the no objection of the Ministry of Finance. Pursuant to the tacit approval agreement, as the 30-day period to receive a reply has elapsed, the Bank considers the Government of Guatemala to have no objection to the financing of this project.

### E. The problem to be addressed

- 1.4 **Rural poverty and the forestry sector in Guatemala.** Guatemala is a tropical country with forests covering 35%<sup>2</sup> of its territory (although the forestry sector

<sup>1</sup> This project was submitted by the RA and selected through the Social Entrepreneurship Program's call for proposals in Central America in March 2008.

<sup>2</sup> Guatemala covers an area of 108,889 km<sup>2</sup> of which 37,502 km<sup>2</sup> are covered by forests.

- contributes only 2.5% of GDP), 60%<sup>3</sup> of the population living in rural areas, high demographic growth (2.3% per annum), and 56% of the population living in poverty (22% in extreme poverty). One of the major challenges the country faces is to build economic development models to combat rural poverty while preserving natural resources. Such models must slow agricultural encroachment, the most pervasive problem causing the worst negative impacts on forests, while addressing rural population growth and demands for arable land to offset the dearth of nonagricultural job opportunities or income.
- 1.5 The project covers the departments of Petén, Izabal, Alta and Baja Verapaz (High and Low Verapaz, known as the Verapaces) in northern Guatemala, home to 85% of Guatemalan forests, where soil characteristics are unsuitable for profitable agricultural activities, and to 40% of the economically active population<sup>4</sup>—mostly immigrants in search of economic alternatives, 100% rural, with poverty levels of 65%—who occupied vast swaths of forest for seasonal agriculture and/or pastures. However, with low productivity owing to poor quality soils, they have not managed to improve their income, averaging US\$2,550 a year per family.
- 1.6 **Forest Incentive Program (PINFOR).** In 1997, the Government of Guatemala created PINFOR,<sup>5</sup> running through 2017, to prioritize forest development interventions. The National Forestry Institute (INAB) administers PINFOR as a forest policy tool to promote the supply of competitive forest products, reduce deforestation, and generate environmental services and jobs in rural areas. PINFOR provides a cash subsidy (12,400 quetzals per hectare over six years<sup>6</sup>) granted by the State to owners of forest-covered land used for forestry<sup>7</sup> who execute reforestation or natural forest management projects. The program target is to establish 285,000 hectares of forest by 2017, of which 33,900 hectares have been covered to date (only 12% executed in 10 years). Results show that income from the first thinning (after 7 years, minimum of 5 hectares on average) was US\$10,572 (four times the income from agricultural activities). This experience shows that using forest land through PINFOR is a viable alternative for the economic development of these departments and their population, provided financial resources are available to cover the establishment and production costs, plantations are duly formalized and develop management plans, and a regulatory framework is put into effect for land purchases.

---

<sup>3</sup> Guatemala is the largest country in Central America with a population of 12.6 million.

<sup>4</sup> At present, Petén and the Verapaces have about 1.5 million inhabitants, of which 500,000 are part of the economically active population.

<sup>5</sup> <http://www.inab.gob.gt/espanol/forestal/inversion/nacional/pinfor.htm>.

<sup>6</sup> It is broken down as follows: 3,800 quetzals in the first year for establishment of the plantation; and maintenance payments of 1,400 quetzals in the second year; 760 quetzals the third year; 500 quetzals the fourth year; 310 quetzals the fifth year; and 660 quetzals the sixth year.

<sup>7</sup> The requirements are a minimum of 2 hectares, with a reforestation or natural forest management plan, and a certificate of land tenancy issued by the Land Registry.

- 1.7 For the purposes of this project, **rural forest enterprises (RFEs)** are entities dedicated to forest utilization and associated activities, such as management of primary forests and/or plantations, and/or production and processing of wood and non-wood products. The RFEs can be: (i) individually or community-owned, depending on whether land tenancy is held by a person or a community (or association); and (ii) large, medium, or small, depending on the amount of “assets”<sup>8</sup> owned, which is tied to the number of hectares operated and the amount of timber produced and sold. However, the common denominator for these enterprises is that, on the one hand, in order to access PINFOR or concessionaire benefits they must be legally established and have annual business plans,<sup>9</sup> meaning they are part of the formal economy which diminishes risk. On the other hand, although a mature timber business will generate regular earnings (for at least 25 years), the maturation period is lengthy as it takes seven years after establishment for a plantation to start generating revenue.
- 1.8 **RFEs in the context of the project.** Forest utilization and development in Petén is quite different to that in Verapaces or Izabal. In Verapaces and Izabal, timber exploitation is an individual activity carried out under the initiative of plantation owners, with holdings smaller than 5 hectares. In 1990, the government established the Maya Biosphere Reserve in Petén, the largest department of Guatemala, regulating land use and undertaking an effort to legalize forest utilization by creating forest enterprises, mostly community-owned ones, to obtain forest concessions.<sup>10</sup> Consequently, utilization occurs through concessions granted to some 100 families, with an area ranging from 5,000 to 75,000 hectares.
- 1.9 **Rainforest Alliance Inc., Guatemala (RA).** Legally established in Guatemala since 2005, the RA started helping producers grouped in enterprises, or individual producers operating small or medium-sized enterprises, to obtain their certified sustainable accreditation through its sustainable tourism, agriculture, and forestry programs. This work enabled the RA to identify, for purposes of this project, more than 150 rural forest enterprises at varying stages of development, encompassing some 4,000 families. These include: in Petén: (i) 1,200 families in 12 certified sustainable community-managed forest concessions in the Maya Biosphere Reserve, who also own a certified timber products processing plant and trading company—FORESCOM; (ii) 56 owner partners of carpentry workshops, members of the Carpenters Association of Petén (ACARPET), who produce and process wood products; (iii) 120 partners, who belong to the Reforestation Association of

---

<sup>8</sup> Large (A): assets greater than US\$200,000 and sales greater than US\$50,000. Medium (B): assets of US\$50,000 to US\$200,000, sales greater than US\$15,000. Small (C): assets of US\$10,000 to US\$50,000, sales greater than US\$5,000.

<sup>9</sup> This means they are legally established, a government requirement for forest utilization and/or concessions. The corresponding documents are filed with the National Forestry Institute (INAB) and the National Council for Protected Areas (CONAP).

<sup>10</sup> Community forest concessions presently use 445,000 hectares under long-term agreements subject to lengthy forest management plans (25 to 70 years), where each year the enterprises harvest a small percentage of their land (approximately 1%) so as to guarantee forest regeneration.

- Petén, involved in forest plantations; and (iv) 32 female partners, who belong to the Association of women breadnut processors, and process the breadnuts gathered in natural forests. In the Verapaces: (v) the Association of Community Foresters (ASILCOM), which has some 1,000 indigenous community members dedicated to reforestation; and (vi) the Federation of Cooperatives in the Verapaces (FEDECOVERA), whose membership includes 28 cooperatives and 500 families. In Izabal: (vii) 30 families involved in rubber tree plantations.
- 1.10 The RA helped large and medium-sized enterprises, such as FORESCOM and FEDECOVERA, obtain the Forest Stewardship Council (FSC) certification. This seal enabled the companies to find buyers in the United States, Europe, Mexico, and Guatemala (essentially for linear wood for construction). Through formal partnerships with buyers of certified sustainable products and services, the RA also helped FORESCOM line up sales amounting to US\$818,000 in 2007 (40% of which were to export dimensional lumber for construction). Although the RA has limited resources, its work to help *small rural forest enterprises (SRFEs)* has focused on technical assistance activities to support the establishment of timber plantations, such as developing management plans for sound forest utilization, formalizing concessions, etc.. Recently, it worked with the SRFEs on marketing certified products (i.e., molding for the domestic market, and finished products such as decking, among others) through partnerships between large and small companies, and implementing best practices, certification, basic business production processes, and value added.
- 1.11 This project will prioritize helping 32 SRFEs (such as ACARPET members, breadnut gatherers and processors, individual foresters and reforesters) with the following characteristics: (i) low capitalization; (ii) technological constraints (especially machinery) for development and processing; (iii) business activities that are still in the development stage (no business plans); and (iv) no certification and/or accreditation. With RA support, the SRFEs have been working on certification, capacity-building to enhance their competitiveness, better use of concessions, and access to PINFOR to boost their income. However, there are not sufficient resources to meet their needs, and little access to financing to purchase machinery and equipment, cover the cost of establishing plantations, or provide working capital to buy wood, which has consistently limited their growth, and often even restricted their access to newly identified markets.
- 1.12 Interviews with some financial institutions operating in the region, such as BANRURAL, G&T Continental, and the NGO Génesis Empresarial, confirmed the inability for the forest sector to access medium- and long-term financing. Although loans are available for some forest enterprises, they usually have an 18-month term, and are offered to established medium-sized and large enterprises that need working capital to maintain the plantations. ACARPET and the Association of women breadnut gatherers and processors are not even deemed creditworthy because they are considered weak from a business standpoint and lack assets to guarantee a loan.



1.13 **Major problems facing RFEs** will have to be addressed in order to equip them with the necessary tools to enhance their competitiveness, seize opportunities to increase their revenue, and increase the sources of jobs for the families in them. The problems include:

- (i) *The absence of medium- and long-term financing mechanisms suitable for the forestry business (terms of up to seven years), to provide investment loans to improve the installed capacity in terms of equipment, machinery, infrastructure, and plantations, or medium-term working capital to finance raw material harvesting cycles, and business and production cycles to fill international buyers' orders. The short-term loans (up to 18 months) are usually offered by financial institutions to medium-sized businesses only to finance working capital to maintain timber plantations, not to start or invest in lasting improvements to the plantations. Financial institutions are reluctant to offer medium- to long-term financing owing to the perceived risks of medium-term forest credits, and the lack of credit technology allowing them to customize products to meet the financial needs of the RFEs.*
- (ii) *Small rural forest enterprises do not have the management skills and tools to build their business, especially with respect to planning plantation operations, harvesting, and investments, resulting in low returns and reduced income for the companies. Small enterprises know the basics about managing a timber business, but have not developed skills to: (i) develop business plans and capacity-building plans so as to implement best business and commercial practices to become sustainable and profitable; and (ii) properly manage credits and plan investment so as to ensure responsible use of resources.*
- (iii) *Difficulty gaining access to markets for certified sustainable products which would allow them to obtain better prices. This is due to limited training and advice to design products or services, failure to implement best practices, inexistence of processes for primary and secondary value added, lack of strategic partnerships and productive linkages, and failure to follow up on commercial purchase orders and queries from buyers to facilitate access to certified markets.*

1.14 **Beneficiaries.** The direct beneficiaries of the project will be 72 rural forest enterprises and their families (some 2,000 people) in the three project intervention areas. The 72 enterprises will be in the forest plantation, and wood and non-wood products processing sectors, and an additional 30 families will be grouped in a yet to be determined number of companies with a view to establishing rubber tree plantations. The breakdown includes 20 large, 20 medium-sized, and 32 small enterprises (document 4 in the technical files provides details about the

beneficiaries). In addition, the 40 large and medium-sized enterprises will directly employ some 350 people living in the project intervention area.

## **II. THE PROJECT**

### **A. Objective and purpose**

- 2.1 The principal objective of the project is to contribute to the economic and business development of small rural forest enterprises (SRFEs), based on sustainable management of natural resources. The purpose is to design and implement medium- and long-term financing mechanisms, providing technical support allowing the forestry sector, in particular *small rural forest enterprises*, to improve their profitability and meet market demand for certified sustainable products and services.

### **B. Proposed execution mechanism**

- 2.2 The project will be executed by two institutions. Financiera de Occidente S.A. (FIDOSA) will be responsible for implementing the reimbursable financing component, and the NGO Rainforest Alliance Inc. (RA), headquartered in Guatemala, will be responsible for administering the nonreimbursable technical cooperation and the nonreimbursable financing components. An executing unit and an advisory committee will be established (described in Annex IV – Plan of Operations), to ensure a comprehensive approach to serving the project beneficiaries, strengthening the linkage between the specialized activities of the financial and nonfinancial services contemplated in the project, for which each institution has the required expertise.
- 2.3 Technical-cooperation resources and nonreimbursable financing: (i) the RA has experience working with small rural and community agroforestry enterprises, delivering training services and technical assistance in Guatemala and throughout Central America; (ii) it is supported by a multidisciplinary professional technical team with experience in marketing and market access, in addition to having a counterpart to execute the technical-cooperation component; and lastly, (iii) it has prior experience managing a MIF project (ATN/ME-10610-GU), currently in execution, on payment for environmental services.
- 2.4 Regarding the financing, FIDOSA has prior experience managing debt and investment portfolios related to the agroforestry sector, investing in its own rubber tree plantations, with a portfolio of US\$7.7 million. This gives FIDOSA a better understanding of the business model and financing needs for the forestry sector, and the small and medium-sized enterprises the project will support. Annex V on the Financial Conditions presents a comparison of financial institutions (banks, finance companies, microfinance institutions), and the terms and conditions for loans to rural enterprises that fail to meet the requirements of the RFEs, in particular concerning conditions and method.

## C. Description

- 2.5 Three components will be financed to achieve the project objectives: a reimbursable financing component in the amount of US\$3.4 million (IDB: US\$850,000 and FIDOSA: US\$2.55 million) executed by FIDOSA; a nonreimbursable financing component in the amount of US\$150,000 from the IDB; and a nonreimbursable technical-cooperation financing component in the amount of US\$410,290 (IDB: US\$250,000 and Local counterpart: US\$160,290), executed by the RA.
- 2.6 The **reimbursable financing component** will fund investment and working capital for 72 rural forest enterprises (32 of which will be small enterprises) in the departments of Petén, Izabal, and the Verapaces, to establish and manage forest plantations, process non-timber forest products, and/or market processed wood products. The project activities will include designing the financing mechanisms and determining the credit conditions. Based on the RA's diagnostic assessments, FIDOSA will consider: (i) medium- and long-term (5- to 7-year terms) investment loans of US\$2,500 to US\$250,000<sup>11</sup> to improve installed equipment, machinery and infrastructure capacity, and to establish plantations; and (ii) medium-term (up to 60 months) working capital loans of US\$2,500 to US\$250,000 (depending on number of hectares) to pay for the exploitation of raw material, business and production cycles, and processing of orders from domestic and international buyers. IDB resources will only be used to finance the SRFEs, with loans not to exceed US\$25,000.
- 2.7 The Bank's financing for FIDOSA will accrue interest at a variable annual rate equivalent to the 180-day U.S. dollar LIBOR rate plus 3%, with a 10-year term, and a 36-month grace period. FIDOSA will lend its capital and Bank resources to program clients at an annual rate of the 90-day LIBOR plus an amount to be determined according to market conditions in Guatemala both for investment loans or working capital. Conditions for the loan products are described in greater detail in document 1 "Minimum Elements for the Project Credit Regulations."
- 2.8 The **nonreimbursable financing component** will be used to finance production infrastructure upgrades and seed working capital for 20 SRFEs, including to: (i) procure equipment to process small trees, as well as to process and market smaller diameter wood products; (ii) procure equipment and machinery to process non-timber products (including breadnut and xate palm); (iii) procure carpentry equipment such as small-scale timber drying kilns, planers; and (iv) establish small seed capital funds for young people's community enterprises. This component will be executed by the RA to benefit the SRFEs that have achieved a minimum level of business development and capacity (selection and eligibility criteria are shown in the Plan of Operations). The investment plan for each SRFE, to be prepared under the technical-cooperation component, will include the financial requirement to improve production and business capacity.

---

<sup>11</sup> For forest plantations, loans per hectare of reforestation will amount to US\$520; investment and working capital loans will be provided for plantations with 5 or more hectares.

- 2.9 Nonreimbursable financing is justified by the fact it will directly help 20 *small rural forest enterprises* in need of building their operating and financial resources, that, at the start of the project, do not meet the requirements to assume debt. As indicated above, the SRFEs have a basic understanding of the timber business but no fixed assets for capitalization. The project, therefore, aims to build on their entrepreneurial skills so that by year two of the project, they may be eligible for reimbursable financing.
- 2.10 The **technical-cooperation component** will provide assistance to design and implement financing mechanisms for RFEs, and implement a program to provide technical assistance, training, and support for the 72 RFEs aiming to: (i) ensure certified sustainable products are successfully placed on the markets; and (ii) prepare the SRFEs to access financing and allocate financial resources efficiently to offset the limitations affecting these small enterprises, increase their competitiveness, improve profitability, and satisfy market demand for certified sustainable products and services. The technical-cooperation component will also support the RA's efforts to standardize and publish the project outcomes allowing the RFE financing model to be replicated in other countries where the agroforestry sector could become a linchpin for economic and social development. It will also support project coordination, evaluation, and audit. This support is described in greater detail in the Plan of Operations for the technical cooperation, available in the project technical files.

#### **D. Sustainability and results of the financial analysis**

- 2.11 Project sustainability hinges on three key factors that, should they remain over time, will assure achievement of the project goals: (i) expanded working capital and investment loans for SRFEs to consolidate growth and establish ties, under better conditions, with other actors in the agroforestry chain; (ii) business-like management of forest plantations and community concessions by SRFEs, respecting best agroforestry practices, to facilitate access to certified product markets with better prices, improve and stabilize income, and be competitive in full compliance with national and international trade agreement provisions; and (iii) availability of loan mechanisms tailored to the sector's needs, allowing FIDOSA to position itself as a leading entity in rural Guatemala, serving as an example to induce other financial entities to support the sector through a proven credit method.
- 2.12 FIDOSA is financially stable owing to its equity (US\$20.5 million), a return on equity of 7.2%, operational adequacy of 171%, and the quality of its credit and investment portfolio (75% of assets), with a 0% delinquency ratio ( $\geq 30$  days) as of December 2007. It therefore has the capacity to assume the financial obligation to the Bank and support the development and consolidation of the new credit product for RFEs. What is more, financial projections show that the new product could generate positive cash flows from year one and sufficient surplus to ensure its operational sustainability during and after the term for Bank financing. Moreover, SRFEs financial benefit projections (document 4) show that access to credit under

the right conditions could boost their income *from US\$520 per hectare to US\$1,550 per hectare each harvesting cycle*. Also, changes to plantation management will generate positive environmental impacts, promoting reforestation and conservation of natural resources. Exploitation will be in keeping with soil characteristics, decreasing the crop use of non-arable land and pressure on the agricultural frontier.

#### **E. Credit risk for the Bank**

- 2.13 The credit risk for the Bank is minimal because FIDOSA's operations, capital, and earnings are such as to generate significant surpluses on a regular basis. Furthermore, the Bank loan is equivalent to a small proportion of its funding (2.1% of total liabilities at December 2007). As part of its analysis of this operation, the project team performed an integrity and anti-money laundering review in accordance with IDB guidelines (document CC-6093), finding no element of risk for the proper execution and management of the project.

#### **F. Anticipated outcomes and benefits**

- 2.14 The direct beneficiaries will be some 2,000 individuals connected with the 72 RFEs, who will enjoy: (i) regular access to medium- and long-term working capital and investment loans at very reasonable rates, to increase their competitiveness and boost their profitability; (ii) enhanced know-how, technology and practices to manage the forest business and/or plantations, thereby improving productivity indices, achieving product certification, adding value through processing and/or manufacturing, and increasing agroforestry earnings; and (iii) responsible use of forest resources to ensure income sustainability over time. It is further anticipated that the SRFES participating in the project will: (i) see net income increase by at least 30%; (ii) reforest 1,650 hectares; and (iii) implement forest management practices that will have a positive impact on forest and natural resources conservation, especially in the case of the Maya Biosphere Reserve community concessions, and build on their current strategies to earn a living by opening new development possibilities.
- 2.15 At the end of the three-year execution period, FIDOSA will have added new financing mechanisms for the agroforestry sector that could potentially be offered within the entire project area and other areas in the country. In fact, FIDOSA will have added an agroforestry line of credit to its credit product offering, with a new portfolio amounting to more than US\$3.4 million, and 120 new loans with a risk portfolio equal to or less than 3%. Sufficient income would be generated to cover all of its financial and operating expenses, in addition to a surplus for institutional capitalization.

#### **G. The Bank's strategy**

- 2.16 The project activities are consistent with the priorities in the Bank's strategy with Guatemala of 6 May 2005 (document GN-2355-1), principally with respect to sustainable growth, promoting the sustainable development of natural and cultural resources, with special emphasis on the Maya Biosphere Reserve—the project intervention area—and development of micro, small and medium-sized enterprises

in the agroforestry sector. The project will improve the competitiveness of SRFEs through access to resources to meet market demand for certified sustainable products and services, thus generating more income, jobs, and a market incentive to conserve biodiversity and natural resources.

#### **H. Coordination with other international cooperation agencies**

- 2.17 During preparation of this operation, the project team consulted with national and international agencies involved with the forestry sector in Guatemala. An agreement was reached with United States Agency for International Development—with whom the RA is executing a program to establish forest enterprises in Guatemala—to coordinate technical assistance and seek complementarities with the project. The team also coordinated with the Instituto Nacional de Bosques (INAB) [National Forestry Institute] to confirm that the Forest Incentive Program (PINFOR) would remain in effect through 2018. The INAB indicated that the SRFEs needed support in promoting business management in harmony with the environment. It was further agreed that the Bank, FIDOSA and the RA would make every effort to coordinate project activities with interventions carried out by other agencies during program execution.

#### **I. Environmental and social review summary**

- 2.18 The Environment and Social Review (ESR) team approved the project on 12 September 2008, and the project was classified as category “C.” The project will have no adverse social or environmental impact because the beneficiary RFEs have a long-standing commitment with the Forest Stewardship Council (FSC) certification process, whereby they are required to apply the highest existing international standards for the timber industry. The project also contains a number of significant features relevant to social inclusion—gender, indigenous populations, and community-based—because more than half the project beneficiaries are women and/or belong to indigenous groups in Verapaces. Gender mainstreaming has been given special prominence, particularly with respect to production and export of non-wood products.
- 2.19 In addition, the project specifies that: (i) training for FIDOSA technicians and credit analysts will cover the August 2003 IDB guidelines for social and environmental impact analysis in microenterprise operations; and (ii) because financial mechanisms could be linked to management of native forests, the project Credit Regulations will include a clause providing for credit to be awarded in accordance with the Bank’s Environment and Safeguards Compliance Policy, in particular directive B.09 – Natural habitats and cultural sites.

#### **J. Special conditions**

- 2.20 As conditions precedent to the first disbursement of the *reimbursable financing*, FIDOSA will submit, to the Bank’s satisfaction: (i) the final agreement negotiated and signed between the RA and FIDOSA; (ii) FIDOSA’s approval of the Credit Regulations governing new financing mechanisms for the RFEs, designed in phase one of the project; and (iii) the first annual work plan developed by the RA with the

- project Advisory Committee's approval, specifying the financial requirements for RFEs in the first year of the project, and commitment to *pari passu* disbursements of IDB and FIDOSA resources.
- 2.21 As conditions precedent to the disbursement of the *technical-cooperation resources*, the RA will submit, to the Bank's satisfaction: (i) evidence that the Project Coordinator has been selected; (ii) the terms of reference for consulting and advisory services to be financed with technical-cooperation resources in the first six months of the project; and (iii) evidence that FIDOSA and the RA have signed an agreement for the coordinated execution of activities relating to financing, training, and technical assistance for the SRFEs.
- 2.22 As conditions precedent to the disbursement of the *nonreimbursable financing*, the RA will submit, to the Bank's satisfaction: (i) selection and eligibility criteria for the SRFEs that will benefit from nonreimbursable financing approved by the Advisory Committee; and (ii) business plans for the SRFEs slated to receive nonreimbursable financing, reflecting the need for these funds.
- 2.23 **Disbursements.** Disbursements of project technical-cooperation resources and nonreimbursable financing will be contingent upon the achievement of milestones, which will be agreed to by the RA and the IDB, and checked against the means of verification. Achievement of milestones does not exempt the RA from the responsibility to reach project targets. Under the Project Management Based on Risk and Performance modality, the funds needed to execute the project until the achievement of milestone 1 (up to 10% of the amount of the contribution) will be disbursed following the signature of the agreement, the appointment of authorized representatives, and fulfillment of any other agreed conditions. Subsequent disbursements will be contingent upon the presentation of proof the milestone has been met, in accordance with the agreed annual plan.
- 2.24 The Bank will disburse reimbursable financing resources following a disbursement schedule prepared by the RA as part of the first annual work plan, approved by the Advisory Committee, and later submitted to the Bank with the program's plan of operations. The first disbursement will amount to 25% of the total amount of the financing component, with funds contributed *pari passu* with FIDOSA resources.
- 2.25 **Procurement.** Goods will be procured and consulting services contracted by the RA in accordance with Bank policies contained in documents GN-2349-7 and GN-2350-7. Price comparison will be used to procure goods. The Bank will review contracts for goods and consulting services *ex ante*. The Procurement Plan (see document 3) will be reviewed every six months.
- K. Reports, evaluations, and audits**
- 2.26 **Reports.** FIDOSA and the RA will be responsible for presenting project status reports (PSRs) to the Bank within 30 days after the end of each six-month period. These reports will follow a format previously agreed with the IDB and will contain information on project execution, achievement of milestones and outcomes, and contribution to attaining the objectives contained in the logical framework and other

- operative planning instruments. The PSR will also describe any problems encountered during execution and outline possible solutions. Within 90 days after the end of the technical-cooperation execution period, FIDOSA and the RA will submit a final PSR to the Bank, which will highlight results achieved, the sustainability plan, and lessons learned. This report will be prepared by the project Coordinator in coordination with the Advisory Committee.
- 2.27 The status reports will include a review of compliance with the performance indicators and progress achieved in executing the work plan, including: **Reimbursable financing component (FIDOSA):** (i) number of loans to RFEs, average amounts, and total lending (including investment and working capital loans, broken down by type of RFE); and (ii) portfolio performance indicators, including at-risk portfolio and current portfolio balance, disbursements by range of amounts and terms. **Nonreimbursable financing component (RA):** (iii) number of beneficiary SRFEs and access to reimbursable financing; (iv) in the case of SRFEs given reimbursable financing, provide the data required under that component. **Technical-cooperation component (RA):** (v) training and technical assistance program activities; (vi) degree of compliance with business plans, strengthening SRFEs, and productivity indicators; (vii) marketing of certified timber and non-timber products produced under the project (price, volume, buyers); and (viii) a summary of RA contributions in cash and in kind as of the report date. The first semiannual report will provide socioeconomic and production data about the first clients at the start of the project. The RA will continue gathering baseline data about all clients when they join the program, and use this information to measure program outcomes.
- 2.28 MIF staff at the Bank's Country Office in Guatemala (MIF/CGU) will assume basic responsibility for monitoring the project within the Bank, using the aforementioned reports to verify progress. The RA and FIDOSA will take steps to ensure that this project is implemented in conformity with the performance indicators established in the logical framework and the corresponding annexes. The IDB may suspend disbursements should there be significant deviations from the performance indicators (Annex III), in addition to the financial covenants (Annex VII) in the case of the reimbursable financing. Should the indicators deteriorate significantly, the RA and FIDOSA will have 30 days to reach an agreement with the IDB on the measures needed to improve their performance. At the end of this period, if the situation has not improved to its satisfaction, the Bank may suspend or cancel future disbursements. Lastly, the RA will send its annual audited financial statements to the Bank during project execution; and FIDOSA will send its annual audited financial statements to the Bank during the 10-year loan amortization period.
- 2.29 The RA and FIDOSA will establish and be responsible for maintaining adequate financial accounts, internal control mechanisms, and filing systems for each project component, in accordance with IDB/MIF accounting and audit rules and policies. The RA and FIDOSA will prepare financial statements for each project component upon project completion. The MIF will use contribution resources to contract



- independent auditors to perform the audit of financial statements immediately after the indicated time frames.
- 2.30 **Evaluations.** The project provides for two evaluations to be conducted by independent consultants selected and contracted by the Bank's Country Office in Guatemala with technical-cooperation resources. A *midterm evaluation* will be carried out 18 months after the first disbursement or when 50% of the total funds have been disbursed, whichever occurs first, and a second one 36 months after the first disbursement. The first evaluation will measure, at least: (i) the project response to the problems originally identified that gave rise to the operation; (ii) progress made in improving income for the SRFs, forest productivity, and SRFs' management capacity; (iii) degree of compliance with project performance indicators, especially access to credit by the SRFs through the reimbursable financing component; (iv) the lessons learned and recommendations to improve project execution; and (v) the institutional capacity and coordination of the executing agencies.
- 2.31 The *final evaluation* will measure and document the following, in addition to the issues listed for the first evaluation: (i) project impact on the groups studied in the initial evaluation; (ii) the outcomes in terms of fulfillment of project objectives; (iii) the lessons learned; and (iv) project sustainability.
- 2.32 **Audits.** Annual audits of the financing component will be conducted in accordance with applicable Bank policies. The cost of the audits will be covered by the Bank's technical-cooperation resources. These resources will also be used to cover the cost of preparing a final financial report audited by independent auditors acceptable to the Bank, showing how the technical-cooperation resources were used, and verifying the contribution of counterpart funds.

## **L. Risks and mitigating factors**

- 2.33 **Market risk.** The project aims to support a sector or group of enterprises operating in the field of wood and non-wood products gathered in forests and agroforestry plantations. This concentration could present a market risk for project execution should demand for the product level off or decrease. However, two factors mitigate this risk: (i) the SRFs have shown dynamism looking to diversify their production, encompassing non-wood products; and (ii) certification of the products and of the chain of custody entrusted to the RA could open another market alternative and the SRFs could become suppliers for other, larger companies. **Risk of business culture and perception of change.** Although the SRFs with which the RA is working have made great strides in partnering and marketing, there is always the risk that the enterprises (especially when community-based) will not fully coordinate or cooperate to achieve the project objectives. To mitigate this risk, the project envisages actions to: (i) select SRFs with prior experience in the agroforestry business; (ii) provide training in management and governance not only to current leaders, but also the leaders of community-managed concessions who could potentially fill these positions in the future; and (iii) provide technical assistance and advice on an ongoing basis to the SRFs through the RA business

consultants to ensure they put to use the know-how and best practices learned during the capacity-building and training phase.

**M. Exceptions to Bank policies**

2.34 None.