

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK  
MULTILATERAL INVESTMENT FUND

**REGIONAL**

**SUPPORT FOR THE COMPETITIVE POSITION OF CENTRAL  
AMERICAN COFFEES**

**(TC-02-08-02-3)**

**DONORS MEMORANDUM**

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## ANNEXES

Annex I      Logical framework

## **ABBREVIATIONS**

ACE	Alliance for Coffee Excellence
ICO	International Coffee Organization
NGO	Nongovernmental organization
SCAA	Specialty Coffee Association of America
USAID	United States Agency for International Development

## **SUPPORT FOR THE COMPETITIVE POSITION OF CENTRAL AMERICAN COFFEES**

**(TC-02-08-02-3)**

### **EXECUTIVE SUMMARY**

**Direct  
beneficiary and  
executing agency:**

TechnoNicaragua

**Final  
beneficiaries:**

The project beneficiaries include: (i) coffee producers who would participate in the pilot groups; (ii) coffee producers trained in the quality management system; (iii) local professionals and representatives of coffee cooperatives and associations trained in cupping quality coffees; (iv) coffee producers who would participate in new market mechanisms that recognize the quality of coffee through price; and (v) the coffee organizations in each of the five countries that are strengthened through project activities.

**Objective:**

The general project objective is to help enhance the competitiveness of the Central American coffee sector based on high quality. The purpose of the project is to: (i) develop and implement a Central American quality management system for coffee; and (ii) help develop new market mechanisms that recognize quality through price and improve producers' access to such mechanisms..

**Description:**

The project is divided into three components:

**Component I: Development of a quality system for Central American coffee.** This component will create the methodology, protocols, and standards of a quality management system to assist coffee producers in evaluating, improving, and maintaining the quality of their coffee. This system will also help coffee buyers assess product quality at each stage of the process.

**Component II: Implementation of a quality management system for coffee through technical assistance and training.** This component will assist coffee producers with implementing the quality system developed in component I. This component is divided into two parts: (i) the quality management system will be tested in pilot groups, placing emphasis on groups of small and medium-sized producers; and (ii) the quality management system and cupping-related elements will be shared with coffee sector institutions and enterprises and with all interested coffee producers and buyers.

**Component III: Promotion of new market mechanisms for high-quality coffee.** This component will help producers to target new markets both within their own countries and in other regions of the world. On the one hand, the project will help pilot groups to establish relationships and partnerships with exporters and roasters. On the other, it will support the consolidation and promotion of competitions and auctions of quality coffee in Central America.

**Financing:** Method: nonreimbursable (Small Enterprise Development Facility-IIIA)

<b>Amount and source:</b>	MIF:	US\$3,000,000
	Local contribution:	<u>US\$1,615,450</u>
	Total:	US\$4,615,450

<b>Execution timetable:</b>	Execution period:	36 months
	Disbursement period:	42 months

**Environmental and social review:** The executing agency will be evaluating the direct and indirect positive and negative impacts of project activities, including implementation of selection methods. Protocols, quality standards, and selection criteria for producers will be developed taking into account and including environmentally-sustainable measures.

Indirectly, the project will help improve the social situation of producers and the labor force in general. The project seeks to effectively encourage the participation of coffee growers' families and women and indigenous groups in particular in all project activities. The project will not address directly the social impact of the coffee crisis in terms of job creation for permanent and seasonal workers.

The aforementioned measures will constitute the environmental and social management plan. The Committee on Environment and Social Impact (CESI) reviewed and approved the project abstract on 1 November 2002.

**Special contractual conditions:** As a condition precedent to the first disbursement of the contribution, the following will be required: (i) evidence that the process of selecting the project director, pursuant to the Bank's procedures in this regard, has been completed; (ii) evidence that at least two of the agreements between TechnoNicaragua and the project's partner institutions have been signed. For disbursements related to specific activities of the project in each country, in each case evidence will be required that the agreement between TechnoNicaragua and the partner institution in the country in question has been signed.

**Exceptions to Bank policy:** None.

## **I. COUNTRY AND PROJECT ELIGIBILITY**

- 1.1 Nicaragua, Honduras, Guatemala, Costa Rica, and El Salvador were declared eligible for all financing modalities of the Multilateral Investment Fund (MIF). This project is eligible for MIF financing under the Small Enterprise Development Facility (III-A), since it seeks to improve the production practices of small and medium-sized enterprises and thus enhance their competitiveness.
- 1.2 It is a regional initiative in order to: (i) achieve economies of scale in developing materials, thus allowing training methodologies and materials to be disseminated more broadly than in a national project; (ii) strengthen intraregional exchanges of methodologies for producing high-quality coffee; and (iii) take the lessons learned by the different countries on producing and marketing quality coffee and use them in other countries.

## **II. BACKGROUND**

### **A. The nature and magnitude of the coffee crisis**

- 2.1 Over the past five years, the world coffee market has undergone important changes in both the supply and demand sides, which are reflected in the steady increase in world production and export levels and intensified price competition for coffee sold on the commodity market. The sharp increase in production (particularly in Brazil and Vietnam) has led to the accumulation of inventories in producing and consuming countries and the drop in world prices. The current price crisis is not a merely cyclical phenomenon, but also a direct consequence of the new structure of the market. During 2000 and 2001, the significant increase in world supply caused nominal coffee prices to drop to their lowest levels in 30 years—a 100-year low, if adjusted for inflation.<sup>1</sup> Coffee prices have fallen below the cost of production for many Central American coffee producers,<sup>2</sup> which has led to a sharp drop in production levels with consequent reductions in employment, both permanent and seasonal.
- 2.2 Apart from the increase in supply, the coffee sector has undergone structural changes in terms of world demand. These changes in demand include processing techniques that allow buyers to disguise imperfections from lower-quality green coffee beans, thus intensifying the competitiveness of (low-quality) Robusta coffees

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<sup>1</sup> For more information, please see: IDB, USAID, World Bank, “Managing the Competitive Transition of the Coffee Sector in Central America.” Paper for the workshop, “The Coffee Crisis and its Impact in Central America: Situation and Lines of Action,” Antigua, Guatemala, April 2002.

<sup>2</sup> Coffee prices have been on the rise in the last six months, but remain at historically low levels.



against washed arabica coffees. Nevertheless, high-quality coffees from Central America remain distinct and have great market differentiation potential.

## **B. The impact of the coffee crisis on Central America**

- 2.3 Low coffee prices are, to a large extent, the reason rural unemployment is reaching worrisome levels in Central America. In the last two crop seasons, seasonal employment in the coffee sector has decreased by more than 20%, while permanent employment has plummeted by more than 50%. More than half of the permanent labor force in the coffee sector is now working at less than half capacity. Wages have also dropped significantly as producers have experienced lower coffee revenues and the supply of labor has swelled because of unemployment.
- 2.4 The situation is especially critical because, unlike other crops, the majority (85%) of coffee producers<sup>3</sup> in Central America work on small parcels of land and/or small-scale processing facilities. A crisis in the sector creates a downturn in the rural economy, accelerates migration to urban areas, and causes instability and social imbalances.

## **C. Coffee quality: characteristics and opportunities**

- 2.5 Central American countries enjoy a unique environment and infrastructure for the production of their coffee in terms of their geography, agro ecology, and agricultural practices. Large coffee producers like Brazil enjoy economies of scale advantages and favorable cost structures. Therefore, they will always win the productivity and cost-reduction race. Nevertheless, Central American countries have the necessary elements to compete in the market with a higher quality coffee. Many areas have ideal agro ecological conditions (altitude,<sup>4</sup> agro climate, and soil conditions), giving them a comparative advantage in the production of higher quality coffees.<sup>5</sup>

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<sup>3</sup> Production/producer refers to primary production/producer as well as processing/processor of coffee. Large producers usually are vertically integrated, while small and medium-sized producers may not necessarily be so. The degree of vertical integration of small and medium-sized coffee producers in Central America varies by country. For example, in Guatemala most small and medium-sized producers have some degree of processing (wet milling).

<sup>4</sup> Some 73% of Central American coffees are produced at an altitude of over 800 meters and 33% over 1,200 meters. High altitude coffee (over 1,200 meters) is produced predominantly by small and medium-sized producers; those producers therefore have the highest potential to produce quality coffee.

<sup>5</sup> For those marginal coffee areas without the potential to produce high quality coffee, the strategy is to support a medium-term process of diversification. Existing tools to support diversification include projects aimed at developing the rural economy in the region, which enjoy over US\$350 million in financing from the IDB (see paragraph 2.19 for a list of some of these projects).

- 2.6 The region has a long tradition of producing coffee and recent and growing experience in the production of coffee based on high quality and product differentiation.<sup>6</sup> The term “high quality” refers to coffee with high standards in cup value and consistency. In turn, high standards in coffee’s cup value and consistency require a low quantity of defects to be present at the green coffee bean phase. High quality coffees, as well as those produced in an environmentally and socially sustainable manner, fetch higher selling prices. In fact, the segment for such special coffees is the only segment of the coffee industry that has shown consistent and notable growth.<sup>7</sup>
- 2.7 According to the International Coffee Organization (ICO) and the Specialty Coffee Association of America (SCAA), the specialty coffee market is far from saturated. Sales of specialty coffees, as a proxy for the higher quality coffee segment, continue to expand by 5% to 10% per year according to the most conservative estimates<sup>8</sup>—a trend that is not expected to change in the next years. The demand for and the volume of transactions of quality coffee in the international market have continued to expand in the middle of the coffee crisis.<sup>9</sup> At the same time, the price differential between high quality coffee and exchange grade coffee<sup>10</sup> has also increased.
- 2.8 A number of coffee organizations are promoting direct, farmer marketing of quality green coffee. The Marketing Partners Program of the SCAA promotes Internet-based green coffee auctions. In addition, based on an Internet platform, the Alliance for Coffee Excellence (ACE) manages a competition and auction of coffee (Cup of Excellence<sup>TM</sup>) that must pass a prior quality threshold. These programs promote coffee quality by internationally recognizing attributes of coffee flavor. In turn, these programs act as marketing channels bringing appropriate value for quality and connecting growers directly to roasters. These experiences demonstrate that as producers improve the quality of the coffee they produce, they are in a position to market coffee at a higher price to the United States, Europe, and Asia. The sustainability of the higher quality segment of the coffee industry is dependent upon the continuing availability of quality coffee from origin.

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<sup>6</sup> According to Specialty Coffee Association of America (SCAA) estimates for 2001, 40.6% of the supply of specialty coffees is from the Central American and Caribbean region.

<sup>7</sup> The National Coffee Association (NCA) calculated average annual growth of about 30% for the last five years.

<sup>8</sup> SCAA Estimates (T. Lingle). Annual Coffee Report 1998. 1999 ICO. May 2000 ICO updates.

<sup>9</sup> Although the quality coffee segment is growing significantly, total worldwide demand for coffee has remained stable, which means that this growth is being offset by losses in low-quality coffee segments.

<sup>10</sup> This is in reference to the New York “C” market price, versus anecdotal prices from recent Internet auctions where the pound coffee was sold at an average price of US\$3 (US\$1.50 the lowest and US\$8.45 the highest).

- 2.9 The coffee quality control process must begin at the farm. At harvest and post-harvest, cleanliness, size, color, and uniformity have a defining impact on coffee quality. Once the producer sells his coffee, as cherries or green coffee beans, he cannot claim a share of the price premium that higher quality commands. Since many producers sell their cherries immediately after harvest, efforts to promote quality improvements should begin with the cherries and proceed later towards the milling operations. Classifying cherries at this early stage would allow producers to reap some of the financial benefits of improved coffee quality at the point of first sale and enable buyers to obtain better quality through premiums in the price paid to sellers based on the quality delivered.

**D. The strategic response for Central America**

- 2.10 Roaster and processor industries have shown a remarkable capacity to add value to green coffee beans. In doing so, these actors have been able to create and develop a number of brands and have captured value by targeting increasingly segmented and fragmented consumer markets. At present, there is a real interest of roasters and processors in ensuring a stable supply of high quality coffees from Central America due to their business necessities of maintaining the consistency of their blends offered to consumers. However, to participate in increased value generation, producers need to improve processing, develop supply and distribution chain linkages, and pursue promotion strategies that feature their coffee's competitive advantage.
- 2.11 Currently, the market incentives for producing quality coffee are not fully transmitted backwards in the chain to the level of the first sale. Coffee producers do not always have incentives to improve the quality of their cherries, wet parchment or green coffee because they are often paid an average wholesale price for their product. This problem is partly the result of the lack of an established and recognized system for classifying coffee quality at this first point of sale in the chain (cherries), constraining the recognition of quality through price premiums. In order to break this vicious circle, the project will develop, among other things, technical capacities for classifying, grading, and sorting of cherries and/or green coffee while the producer still has ownership of the product.
- 2.12 Producers, and also buyers in some cases, must manage a variety of elements to avoid and prevent defects and maintain quality during the harvest and post-harvest. Such a strategy of improving quality should entail managing the entire coffee productive process in an integral way, from planting to distribution of the green coffee beans. The quality-improvement strategy should concentrate on: (i) helping producers in geographic areas with the potential to produce quality coffee (e.g. high altitude) to effectively generate, preserve, and extend this quality; develop value-added; and pursue effective promotion and marketing; and (ii) quality improvements that can be recognized at the first sale by the producer, either when they sell their coffee cherries or when they have their cherries custom-milled while

maintaining ownership of the wet parchment or stored wet parchment and of the green coffee sold for export.

- 2.13 The attributes of quality that attract high prices at export markets or auctions are assessed by professional cuppers, looking for desirable flavor (aroma and taste) and texture characteristics. These desirable characteristics in turn reflect low levels of visible defects. Both desirable and undesirable attributes are manifested and can be identified while the cherries are still on the tree, at the harvester's bags, and during the milling, transportation, and storage processes. Defects should be removed as soon as possible, as a matter of good processing practice and to improve quality early in the process when buyers can pay and, particularly, when sellers can charge a price based on the quality of the coffee transacted.
- 2.14 Such a strategy is key for the Central American countries for several reasons: (i) roasters are willing to pay more for a reliable and consistent supply of quality coffees; (ii) given the agroecological conditions (altitude, soil conditions, varieties, etc.), the Central American countries have the necessary elements to improve the quality of their coffee and compete in the high quality segments of the market; and (iii) since their competitive advantage lies in producing quality coffees, assisting coffee producers to develop and strengthen their long-term relationships with exporters, importers, and retailers will increase sector awareness on transferring the profits to the producer and improve their ability to negotiate prices, including premiums for quality.

#### **E. MIF Strategy**

- 2.15 Successful project execution would have a positive impact by enhancing the competitiveness of Central American coffee. Establishing a quality system specifically for the coffee sector would create an **innovative**, permanent service for coffee producers and buyers, as well as suppliers of those services. In addition, it would have a **demonstration effect**, by promoting access to new markets other than those that exist today.

#### **F. Relation with other initiatives and organizations**

- 2.16 In response to requests made by the various governments in Central America, the IDB, the World Bank, and the United States Agency for International Development (USAID) formed a joint working group that undertook assessments of the coffee industry situation in order to develop specific recommendations for a competitive transformation of the coffee industry. The three organizations funded the costs of a series of consultancies that produced analytical reports about the nature and the specific obstacles confronting the coffee sector in Central America. These findings were synthesized in a joint paper of the IDB, USAID, and the World Bank discussed at the regional workshop on "The Coffee Crisis and its Impact on Central

America: the Situation and Lines of Action,” which was held in Antigua, Guatemala, from 3 to 5 April 2002. Participants included Ministers of Agriculture from the various countries, coffee producers, coffee buyers and roasting companies, NGOs, and coffee industry experts.

- 2.17 Based on the discussions and consensus reached at the regional workshop in Antigua, Guatemala (see paragraph 2.16), USAID and the IDB identified the need for coffee producers in Central America to improve the quality of their product to compete in world markets. Based on this strategy, USAID conceived a regional project (El Salvador, Costa Rica, Panama, Guatemala, Honduras, Nicaragua, and the Dominican Republic) that, based on the workshop’s consensus (quality), will promote the linkage of coffee producers with the industrial sector, particularly of the United States, and will review the development of coffee-growing policies in the countries of the region. The amount approved for the USAID project was US\$3.8 million.<sup>11</sup> The proposed MIF/IDB project is different<sup>12</sup> because it places emphasis on quality in the first links of the chain and, in particular, on the first sale, prior to wet-milling. In addition, the MIF/IDB project will work with pilot groups of producers to develop market alternatives that recognize quality through price.
- 2.18 The MIF currently has an approved project in Central America on “Integration of Small-Scale Coffee Cooperatives” (ATN/ME-6540-RG). The objective is to improve productivity and competitiveness of small coffee producers in El Salvador, Honduras, and Nicaragua through vertical integration. The project focuses on business services, integration of small-scale coffee cooperatives, and assistance for the processing and marketing phase of the coffee business. The project was approved in 1999 and the first of two components was implemented successfully.<sup>13</sup> However, the second component was not implemented due to problems encountered before implementation began.
- 2.19 In addition, there are several IDB projects that are financing or that will finance activities that benefit producers of quality coffee. These projects also support effort to diversify away from coffee production. Of particular importance are: Program for Natural Resource Management in Upper Watersheds in Guatemala (GU-0133), Food and Agricultural Productivity Reactivation (NI-0159), Retooling Agro-enterprise (ES-0119), Trinational Program for Sustainable Development in the Upper Lempa River Basin (CA-0034), Revitalization of the Rural Economy

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<sup>11</sup> This amount could increase depending on the contributions of each of the USAID offices in the above-mentioned countries.

<sup>12</sup> The complementary areas between the USAID project and this MIF/IDB project will be specified in the agreement to be signed by the executing agency and Chemonics (see paragraph 4.3).

<sup>13</sup> The first component (“Improvement of Cooperatives Management”) included providing technical assistance to second-tier cooperatives in various areas; while the second component (“Regional Coffee Marketing Initiative”) intended to create a regional marketing center as a trading company.

(HO-0144), and Program for Support of Sustainable Agricultural Production (CR-0142).

### **III. PROJECT OBJECTIVES AND COMPONENTS**

#### **A. Objectives**

- 3.1 The general objective of the project is to help enhance the competitiveness of the Central American coffee sector based on high quality. The purpose of this project is to: (i) develop and implement a coffee quality management system at the Central American level; and (ii) help develop new market mechanisms that recognize quality through price and improve producers' access to such mechanisms.
- 3.2 This objective will be met through implementation of three components: (i) development of a quality system for Central American coffee; (ii) implementation of a quality management system for coffee through technical assistance and training pilot groups; and (iii) promoting new market mechanisms for high-quality coffee.

#### **B. Components**

##### **1. Component I: Development of a quality system for Central American coffee (MIF US\$185,875; Local US\$108,000)**

- 3.3 This component will create the methodology, protocols, and standards of a quality management system to assist coffee producers in measuring, improving, and maintaining the quality of their coffee. This system will also help coffee buyers assess product quality at each stage of the process. To prepare the quality management system, a consultant will be hired to work with the executing agency on examining the strengths and weaknesses of the coffee sector in all five countries. That analysis will focus on identifying defects that affect coffee quality. The consultant will determine the main defects—both physical and cup defects—and establish how they affect coffee quality and will pay special attention to the classification of coffee cherries before they are milled. This input will be used to prepare the quality management system. During this process, the consultant will work with the participating institutions (see paragraph 4.3), private enterprise, and government agencies related to the coffee sector.
- 3.4 While the analysis of strengths and weaknesses is being performed, a consultant will identify and document best practices in Central America. First, a consultant will define the main indicators of quality in each phase of the coffee handling process. Then, a format will be prepared based on those indicators to perform a quantitative and qualitative analysis of coffee farms, wet-milling plants, and dry-milling plants.

- 3.5 The methodology and materials for the quality management system will be established in accordance with the aforementioned analysis and best manufacturing practices. Manuals, training materials, posters, and other tools will be prepared to help coffee producers adopt the quality management system. One of the areas that is expected to be improved is the classification of cherries by size or color before processing. This could also have a significant impact on quality; therefore recommendations and innovations will be made to improve this part of the process.

**2. Component II: Implementation of a quality management system for coffee through technical assistance and training (MIF US\$1,855,455; Local US\$605,130)**

- 3.6 This component will assist coffee producers with implementing the coffee quality system developed in Component I. This component is divided into two parts: (i) the quality management system will be tested in pilot groups, placing emphasis on groups of small and medium-sized producers. These pilot groups of producers will receive technical assistance to facilitate use of new technologies and new working methods, including cupping-related ones; (ii) the quality management system and cupping-related elements will be shared with coffee sector institutions and enterprises and with all interested coffee producers and buyers. This will be done through a series of conferences and courses and the distribution of written information.
- 3.7 Twelve pilot groups of producers with potential to produce high-quality coffee will be selected to test the quality management system. In principle, the pilot groups must have the following characteristics: (i) agroclimate conditions for producing high-quality coffee (see paragraph 2.14); (ii) appropriate varieties for producing high-quality coffee; (iii) adequate infrastructure for producing high-quality coffee; (iv) sufficient potential production volume to supply the market with several containers of quality coffee per year; (v) willingness to share information on their processes and to play a demonstrative role for other producers; (vi) strong organization and sound leadership capacity; (vii) legally established; and (viii) willingness to pay part of the cost of the technical assistance. The groups will be distributed among the five countries involved in the project and will represent a variety of circumstances (e.g. individual wet-milling plants, central wet-milling plants, shipment of cherries). The project would select the pilot groups taking into account exporters and roasters who are interested in establishing a relationship with groups of small and medium-sized producers. This will enable the groups to implement the quality management system in accordance with exporter and roaster requirements.
- 3.8 At the outset of the work with each group, the team will determine the main coffee defects and will relate them to the problems the group encounters during the entire

process through to exportation. Based on the outcome of Component I (see paragraph 3.5), the project will assist at least one pilot group<sup>14</sup> in using machines for cleaning and for classifying cherries by size and color—an important innovation for enhancing coffee quality. The project will produce manuals, posters, and CDs outlining the quality management system for producers and technicians. It will also launch a web site to provide this information on the quality management system.<sup>15</sup>

- 3.9 After the system is tested in the pilot groups, it will be shared with the entire coffee industry. The project will organize presentations and conferences targeting producers, coffee institutions, exporters, and government representatives to explain the quality management system. The project will also invite consulting firms and experts working in the coffee sector so that they can expand the local supply of coffee quality management services. At the presentations and conferences, the project will share the results of the analysis of strengths and weaknesses, the results of the benchmarking exercise, and key points in the quality management system implemented in the pilot groups. This presentation and the training will be based on those experiences and the most important lessons learned. Finally, press conferences will be organized to ensure that information on the quality management system reaches as many producers as possible.
- 3.10 In addition to technical assistance for quality management, the project will provide technical assistance to pilot groups for organizing the operations, managing costs, and establishing the accounting controls required for transparent administration. The project will also help groups of producers with business plans, new technologies, information technology, and project management. The project will help at least ten pilot groups invest in wet-milling plants and cupping laboratories. The project is limited to co-financing specific improvements, for which the pilot groups must cover 50% of the investment.
- 3.11 The project will also provide support for improving local cupping capacity. Cupping gives producers important feedback for fine-tuning their quality management system. Here, the project will train cuppers to recognize defects and special qualities in coffee. It will also train them to relate defects in the cup to specific problems during the harvesting, wet-milling, transportation, and classification processes. Producers in the pilot groups will be trained to cup coffee and to recognize the characteristics of their coffee. The project will also work with the managers of the cupping laboratories to help them improve the selection, preparation, and roasting of coffee samples.

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<sup>14</sup> This pilot group will be selected based on the characteristics mentioned in paragraph 3.7 but also in accordance with the production system of the area in general and of the producer in particular. A region will be sought where the first sale of coffee is in the form of cherries.

<sup>15</sup> The web site will be set up by the executing agency during the three years of project execution and will be transferred to the local partner institutions at the end of the project (see paragraph 4.3).



- 3.12 Training courses will be held in the main coffee-growing areas of each country. A consultant will be hired to conduct the courses, which will be based on the work philosophy developed in the pilot groups. This training, however, will be directed at a larger number of producers. The training will be in the form of practical courses covering key elements of the quality management system, including harvest and post-harvest practices. Most of the training will be conducted on farms or at milling plants, so producers can see and practice with elements of the quality management system. It will be organized in conjunction with coffee institutions (see paragraph 4.3) so that the latter can strengthen their capacity and play a prominent role in improving coffee quality.
- 3.13 The project will organize cupping courses for cuppers and producers to improve cupping practices, to be taught by an international cupping expert. Cupping training will be open to cuppers in cooperatives or associations, cuppers in private enterprise, or independent cuppers. The training will teach cuppers to relate defects in the cup to specific problems in the harvesting-for-export process. Participants will also be taught to cup for special qualities and to understand buyer preferences in the United States, Europe, and Japan. Finally, the training will include cupping competitions, to enable cuppers to demonstrate their skills. Those competitions could be used to select cuppers to participate in events such as the Cup of Excellence<sup>TM</sup> (see paragraphs 2.8 and 3.16).

**3. Component III: Promotion of new market mechanisms for high-quality coffee (MIF US\$553,595; Local US\$337,920)**

- 3.14 This component will help producers target new markets both within their own countries and in other regions of the world. On the one hand, the project will help pilot groups to establish relationships and partnerships with exporters and roasters. This must take place at the outset of the project so that the pilot groups implement the quality management system in accordance with the requirements of exporters and roasters. On the other, it will support the consolidation and promotion competitions and auctions of quality coffee in Central America. These incipient market mechanisms fully recognize coffee quality, strengthen the local capacity of cuppers, and build the relationship between producers and roasters. These events also play an important role in raising the awareness of coffee quality among retailers, roasters, and consumers.
- 3.15 To assist groups of producers in marketing their product, the project will help them to prepare pamphlets and presentations, send samples, obtain certification for alternative markets (e.g. fair market, organic, eco-friendly), and broaden their base of contacts with other exporters and roasters. To that end, the executing agency will use its contacts outside of the country in the coffee sector and will help producer groups to establish direct relationships with buyers.

- 3.16 The project will support quality coffee competitions and auctions in Central American countries. The Cup of Excellence™ is an example of this type of competition that evaluates coffee samples from producers from an entire country. The samples undergo a series of cuppings, first by a jury of national cuppers, then by a jury of international cuppers. The winning coffees are auctioned over the Internet to international roasters. The project will contribute funding to hire event organizers and cover other expenses. An effort will be made to recover costs and to finance events with more private resources. The project will work in conjunction with coffee institutions, exporters, cooperatives, government entities, the Alliance for Coffee Excellence (ACE), and the Specialty Coffee Association of America (SCAA).
- 3.17 A consultant will be hired to identify and analyze other different market experiences that recognize coffee quality. The quality coffee competitions and auctions have the potential to develop into more permanent mechanisms for marketing high-quality coffees. These new market mechanisms could serve as a permanent intermediary between buyers and producers of coffees of excellent quality. Based on the outcome of this activity, a consultant will evaluate the demand of a more permanent market and assess the feasibility of establishing one. The risks of expanding current competitions and auctions will be assessed and the strengths and weaknesses of similar models evaluated. The project will work closely with roasters, exporters, the ACE, and the SCAA, and the results will be shared with interested parties in the coffee industry.
- 3.18 A regional workshop will be held at the end of the project to disseminate the results and the lessons learned. The specific purpose will be to profile the most appropriate market mechanisms for selling high-quality coffee, relevant experiences, and technical and financial tools, and it will serve as a forum for promoting interaction between buyers and Central American producers. Representatives from coffee organizations, importers, exporters, roasters, and NGO and government representatives working in this sector will be invited to attend.

#### **IV. EXECUTING AGENCY AND EXECUTION MECHANISM**

##### **A. Beneficiary and executing agency**

- 4.1 TechnoNicaragua will be the beneficiary and will be responsible for executing the project and for contributing the counterpart resources. TechnoNicaragua is a non-profit institution whose mission is to develop and promote services to build local capacity and find business solutions to address rural poverty. For purposes of execution, TechnoNicaragua will take advantage of TechnoServe's presence and facilities, with offices in Guatemala, El Salvador, Nicaragua, Honduras, and Costa Rica. TechnoServe has over 25 years of experience in technical assistance for producing and marketing coffee and has worked to improve the productivity,

quality, and profitability of coffee producers in Latin America. TechnoNicaragua has experience as the executing agency for the MIF training project for agricultural business development in the departments of León and Chinandega (ATN/MH-5611-NI), which ended the second quarter of 2001 with satisfactory results.

## **B. Execution mechanism**

- 4.2 TechnoNicaragua will hire a project director, a financial manager, and an administrative assistant for project execution. The director will be responsible for: (i) managing project activities in accordance with the action plan; (ii) contracting goods and services; (iii) supervising the consultants hired; (iv) controlling budget management through established procedures; (v) processing requests for disbursement of the Bank's contribution; (vi) preparing statements on the resources used; (vii) presenting administrative and technical reports to the Bank; and (viii) coordinating the necessary actions with partner institutions for the project (see paragraph 4.4). The project director will be supervised by the Board of directors of TechnoNicaragua.
- 4.3 Although TechnoServe already has branch offices in each country, for the purpose of the project, it is important to ensure the involvement of entities representing coffee companies. Therefore, in each country, the executing agency will coordinate project activities with a partner institution that has ties to the coffee sector. The partner institutions identified are: Nicaragua: *Asociación de Cafés Especiales* [Association of Specialty Coffees] (ACEN); Guatemala: *Asociación Nacional del Café* [National Coffee Association] (ANACAFE); Costa Rica: *Instituto del Café* [Coffee Institute] (ICAFE); Honduras:<sup>16</sup> *Instituto Hondureño del Café* [Honduran Coffee Institute] (IHCAFE); and El Salvador: *Consejo Salvadoreño del Café* [Salvadoran Coffee Council] (CSC). These national partners will participate in the training sessions, the selection of pilot projects, and the organization of conferences and events, working to enhance their capacity and leadership visibility in the area of coffee quality. To ensure coordination, the executing agency will sign cooperation agreements with each partner institution (see Annex IX for a model agreement). Also, to ensure coordination with the USAID-supported initiative (see paragraph 2.17), the executing agency will sign a coordination agreement with Chemonics,<sup>17</sup> which is to be signed in the first year of execution of this project.

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<sup>16</sup> The *Central de Cooperativas Cafetaleras de Honduras* [Coffee Cooperatives of Honduras] (CCCH), the *Asociación de Cafés Especiales de Honduras* [Association of Specialty Coffees of Honduras] (ACEH), and the *Asociación de Café para la Exportación de Honduras* [Honduran Association of Coffee for Export] (ADECAFEH) could also be partner institutions.

<sup>17</sup> Chemonics is the executing agency for the USAID project (see paragraph 2.17).

- 4.4 The project execution period will be 36 months and the disbursement period, 42 months. The Bank will set up a revolving fund with up to 10% of the total amount approved. The executing agency will procure goods and services and engage the consulting services needed for project execution, in accordance with Bank and MIF policies and procedures.
- 4.5 **Accounting and auditing.** The executing agency will keep adequate internal accounts and financially control project funds. The accounting system will be organized to provide the necessary documents, allow for verification of transactions, and facilitate timely preparation of financial statements and reports. The project files will be available in order to: (i) identify the monies received from the different sources; (ii) report on project expenses in accordance with a chart of accounts approved by the Bank, distinguishing between MIF contributions and funds from other sources; and (iii) include the necessary breakdown to identify the goods procured and services hired, as well as the use of those goods and services. The executing agency will also: (i) open separate, specific bank accounts to manage the MIF contribution and local counterpart funds; (ii) process disbursement requests and their respective expenditure justifications, in accordance with Bank disbursement procedures; and (iii) present to the Bank annual financial statements audited by an independent firm acceptable to the Bank and semi-annual financial reports on the status of the revolving fund.
- 4.6 **Degree of preparedness.** The design, budget, and activities were prepared involving the project participants.

## V. COST AND FINANCING

<b>Budget (in US\$)</b>				
<b>Components</b>	<b>MIF</b>	<b>Local</b>	<b>Total</b>	<b>%</b>
Development of a quality system for Central American coffee	185,875	108,000	293,875	6.4%
Implementation of a quality management system for coffee through technical assistance and training	1,855,455	605,130	2,460,585	53.3%
Promotion of new market mechanisms for high-quality coffee	553,595	337,920	891,515	19.3%
Administration	218,600	534,400	753,000	16.3%
Evaluation	50,000	-	50,000	1.1%
Financial audit	18,000	-	18,000	0.4%
Contingencies	118,475	30,000	148,475	3.2%
<b>TOTAL</b>	<b>3,000,000</b>	<b>1,615,450</b>	<b>4,615,450</b>	<b>100.0%</b>

- 5.1 The total project cost is estimated at US\$4,615,450, broken down as follows: (i) US\$3,000,000 in non-reimbursable funding from the Bank with MIF resources (Small Enterprise Development Facility: III-A); and (ii) US\$1,615,450 in counterpart funds contributed by TechnoNicaragua. A summary of the main line items and project financing is presented in the table above. The detailed budget can be found in the project's technical files.
- 5.2 **Sustainability.** This project contains several elements related to sustainability: (i) development of a quality management system will create a mechanism that can be replicated by producers interested in improving coffee quality and will enhance their competitiveness; (ii) the capacity of the entrepreneurs, professionals, and technicians who participate in this project will be improved permanently through the strong technical assistance project and training in the area of competitiveness of coffee enterprises (management, quality management, retailing, and marketing); (iii) the approach to training trainers will ensure that the service providers and producers selected as trainers will be capable of replicating the training activities without support from the project; (iv) the project intends to establish the local capacity of cuppers in each country who could help companies to improve product quality, and those cuppers will continue to serve in that capacity after the project is completed; and (v) because this regional project will be executed in coordination with a group of partners in each country (see paragraph 4.4), those partners are expected to be strengthened during this process to put them in a position to continue the activities after project completion.

## **VI. BENEFITS AND RISKS**

### **A. Benefits**

- 6.1 The direct benefits for the pilot groups participating in the project include: (i) increased economic efficiency from implementing the quality system, which, in turn, will improve the quality of the coffee sold and make more efficient use of the raw material (coffee cherries); (ii) increased premium (as a percentage of market price) received for coffee sold as a result of the higher quality; (iii) a better understanding of the demand for quality coffee as a result of increased cupping capacity; and (iv) deeper relationships with buyers (exporters/roasters).
- 6.2 The project benefits are as follows: (i) it will promote sharing of information on the results of the quality system implemented in the pilot groups (demonstration effect); (ii) it will increase the number of cuppers of quality coffee, greatly reducing gaps in the Central American coffee industry's understanding of demand for quality coffees; and (iii) it will increase and expand marketing channels for quality coffee, by supporting alternative market mechanisms.

- 6.3 **Beneficiaries.** The project beneficiaries include: (i) coffee producers participating in the pilot groups; (ii) coffee producers trained in the quality management system; (iii) local professionals and representatives of coffee cooperatives and associations trained in cupping quality coffees; (iv) coffee producers participating in new market mechanisms that recognize the quality of coffee through price; and (v) coffee organizations in each of the five countries that were strengthened through project activities.

## **B. Risks**

- 6.4 The project could face some risks as a result of: (i) the possibility that future demand for quality coffee may unexpectedly change; (ii) coffee producers' financial constraints, which could prevent them from making the changes needed to implement the quality system; and (iii) the possibility that the lower production volume may prevent some new alternative market mechanisms from expanding marketing channels for quality coffee. These risks will be mitigated as follows: (i) the first risk will be mitigated by providing training to national cuppers that will enable the industry and producers in particular to quickly and efficiently adapt to buyers' new needs and requirements; in this way, producers will agilely respond to changes in demand; (ii) the second risk will be mitigated by cutting participation costs for producers, making their involvement more accessible and, it is hoped, boosting their interest in the project; moreover, consolidation of the local capacity of trained professionals will reduce the cost to producers of implementing the quality system; and (iii) the final risk will be mitigated through analysis and the design of the market mechanism, which seeks to prevent saturation in marketing quality coffees.

## **VII. MONITORING AND EVALUATIONS**

### **A. Supervision and monitoring**

- 7.1 **Monitoring.** The executing agency will prepare and present to the Bank's Country Office in Nicaragua project progress reports within thirty (30) days of the end of each six-month period and a final report within 30 days of the final disbursement. Those reports will adhere to a format agreed to with the Country Office and will discuss project activities and finances, as well as the results measured according to the execution indicators identified in the project logical framework. The Country Office will use these reports to oversee progress in implementing the project and to prepare a Project Completion Report within three months of the final disbursement.
- 7.2 The executing agency will be responsible for compiling and analyzing relevant information for ongoing monitoring of the main indicators set forth in the logical framework in Annex I of this document or those amended by mutual agreement of

the Bank and the executing agency. The executing agency and the Bank will use those indicators for project supervision and evaluation, and they must be borne in mind in preparing the semi-annual progress reports and in the midterm and final evaluations.

## **B. Evaluations**

- 7.3 The Bank will use project funds to hire external consultants to perform two evaluations: a midterm evaluation 18 months after the project is declared eligible for disbursements or when 50% of the resources have been disbursed; and a final evaluation after the end of the execution period. The Bank will prepare the terms of reference for those evaluations in collaboration with the executing agency. The midterm evaluation will examine project progress and overall performance, placing particular emphasis on: (i) the usefulness and acceptance of the quality management system by pilot groups; (ii) the economic assessment of implementation of that system; and (iii) the level of satisfaction of users of project services. Recommendations on necessary adjustments to the use of the remaining funds will be made based on the results of the analysis. For the final evaluation, the external consultants will evaluate the project's impact on a broader basis. In particular, it will evaluate: (i) the impact on quality and on the economic situation of the pilot groups in the quality system designed in Component I; and (ii) the development impact of new alternative market mechanisms that recognize quality through price. The consultants will also use the logical framework in Annex I or a version amended by mutual agreement of the Bank and the executing agency. The executing agency will provide access to all information and documents needed to perform the evaluations.
- 7.4 The Bank's Country Office, with the support of the project team and the executing agency, will conduct annual performance reviews to determine to what extent project objectives are being met. Those reviews will determine the annual counterpart needs and whether the project is to be continued, suspended, or canceled.

## **VIII. ENVIRONMENTAL AND SOCIAL IMPACT**

- 8.1 The traditional way of producing coffee in Central America, using naturally-growing trees as shade, not only conserves soil and water like a forest, but also supports a variety of plants and animals and serves as a natural moderator of the microclimate. The environmental issues are common to all levels of technification of production and processing, regardless of scale.
- 8.2 The executing agency will evaluate the negative and positive indirect and direct impacts of the activities to be financed by the project in each component, including the implementation of sorting methods, i.e. water and soil conservation, use of

environmentally sound technology for processing, waste management, etc. (which will also be reflected in the price premium). In addition, the producers who have potential for production of high quality coffee are located in higher altitudes using natural shade and other sustainable management methods (i.e. water and soil conservation methods) and minimal agrochemicals, if any. The development of protocols and standards for quality, as well as the criteria for selection of producers will consider and include environmentally sustainable measures. The above outlined measures will constitute the environmental and social management plan.

- 8.3 On the social side, the challenge for the project is to adequately engage the participation of producer households and women and indigenous groups in particular in all program activities and to ensure socially- and culturally-suitable training and communications. By improving the quality of the coffee produced and hence increasing the premium over the market price, the project indirectly aims to improve the livelihood of small and medium-sized producers. The project will not directly deal with the social impacts of the coffee crisis in terms of creating new jobs for the seasonal and permanent labor force. By assisting small and medium-sized producers with potential to produce high quality coffee in creating new market mechanisms and opportunities and providing training and awareness-raising sessions, the project indirectly helps to improve the social situation of the producer and of the labor force in general.

## **IX. EXCEPTIONS TO BANK POLICY**

- 9.1 There are no exceptions to Bank or MIF policy.

## **X. SPECIAL CONTRACTUAL CONDITIONS**

- 10.1 As a condition precedent to the first disbursement of the contribution, the following will be required: (i) evidence that the process of selecting the project director, pursuant to the Bank's procedures in this regard, has been completed; (ii) evidence that at least two of the agreements between TechnoNicaragua and the project's partner institutions have been signed. For disbursements related to specific activities of the project in each country, in each case evidence will be required that the agreement between TechnoNicaragua and the partner institution in the country in question has been signed.



## SUPPORTING THE COMPETITIVE POSITION OF CENTRAL AMERICAN COFFEES LOGICAL FRAMEWORK

Narrative Summary	Indicator	Means of verification	Assumptions
<b>End</b>			
To help enhance the competitiveness of the Central American coffee sector through high quality.	Increase in the percentage of Central American coffee sold over the market price <sup>1</sup> at the end of year three.	Anonymous survey of exporters	There are no political and climatological disasters.
<b>Purpose</b>			
To develop and implement a Central American quality management system for coffee, improve access, and develop new market mechanisms that recognize quality through price.	10% increase in the percentage of coffee from pilot groups sold over the market price and classified above the quality level of the international market <sup>2</sup> by the end of year three.	Baseline and annual surveys of pilot groups	Coffee quality can be improved earlier in the production chain.
<b>Components</b>			
I. Development of a quality management system for coffee	Best practices identified and incorporated into the quality system before the end of year one.	Project files	Producers are interested in and willing to help develop the system.
II. Implementation of a quality management system for coffee through technical assistance and training	Benefits of the quality system tested through the experiences, increased coffee sales, and premiums obtained by the pilot groups by the end of year three.	Baseline and annual survey of pilot groups	Producers have the resources necessary to make the changes and implement the quality system.
III. Promoting new market mechanisms for high-quality coffee	Increase in the amount of coffee sold through new mechanisms by the end of year three.	Project files	There is sufficient volume for the new alternative market mechanisms to expand high-quality coffee marketing channels.
<b>Activities</b>			
1.1 Identify, in the different harvest and post-harvest phases, defects and their causes that affect coffee quality, as well as positive cupping attributes.	<ul style="list-style-type: none"> <li>Analysis completed and document prepared in the first six months before the end of the first year.</li> </ul>	<ul style="list-style-type: none"> <li>Consultant's report</li> </ul>	

<sup>1</sup> Market price is defined as the price for “C” coffee on the New York exchange plus or minus the country differential.

<sup>2</sup> The level of quality of the international market is given by the standard classification (green coffee beans) of the New York “C” market.

Narrative Summary	Indicator	Means of verification	Assumptions
<p>1.2 Identify and document best practices for minimizing defects and boosting cupping attributes.</p> <p>1.3 Define the quality management system and prepare materials.</p>	<ul style="list-style-type: none"> <li>• Best practices in several institutions in the region identified in the first six months.</li> <li>• System defined and tested by coffee organizations in the first nine months.</li> </ul>	<ul style="list-style-type: none"> <li>• Consultant's report</li> <li>• Materials published</li> </ul>	
<p>2.1 Implement the quality system in pilot groups of producers.</p> <p>2.2 Implement the quality system for cupping and the use of laboratories.</p> <p>2.3 Provide additional technical assistance to pilot groups of producers on business administration and organization.</p> <p>2.4 Help pilot groups of producers to invest in wet-milling plants and cupping laboratories.</p> <p>2.5 Disseminate information on the quality management system tested in the pilot groups, through conferences, manuals, posters, and articles in the press.</p> <p>2.6 Train producers on the best practices identified.</p>	<ul style="list-style-type: none"> <li>• 20% drop in defects in top quality coffee in the pilot groups by the end of year two.</li> <li>• 10% improvement in the cupping grade for premium coffee produced by the pilot groups by the end of year two.</li> <li>• 10% grade improvement in an evaluation of institutional capacity by the end of year two.</li> <li>• Five pilot groups with equipment installed in the next crop season by the end of year three.</li> <li>• 15 conferences or presentations held with 750 participants trained; manuals, posters, and CDs distributed; web sites established.</li> <li>• 5,000 manuals distributed.</li> <li>• 5,000 posters distributed.</li> <li>• 1,250 CDs distributed.</li> <li>• Web site established.</li> <li>• 15 press conferences on the quality management system.</li> <li>• 3,000 producers trained.</li> </ul>	<ul style="list-style-type: none"> <li>• Service delivery agreements and monitoring reports.</li> <li>• Service delivery agreements and monitoring reports.</li> <li>• Service delivery agreements, baseline and annual surveys, and monitoring reports.</li> <li>• Annual surveys and proof of purchases.</li> <li>• Event records (programs; information bulletins; lists of participants). Accessible web pages.</li> <li>• Examination results. Event records (programs; information bulletins; lists of participants).</li> </ul>	

Narrative Summary	Indicator	Means of verification	Assumptions
2.7 Train cuppers and producers on cupping practices and their importance in quality management.	<ul style="list-style-type: none"> <li>450 producers trained.</li> <li>225 cuppers trained.</li> </ul>	<ul style="list-style-type: none"> <li>Examination results. Event records (programs; information bulletins; lists of participants).</li> </ul>	
<p>3.1 Help pilot groups of producers to establish relationships and partnerships with exporters and roasters.</p> <p>3.2 Strengthen and promote competitions and auctions for quality coffee in Central America.</p> <p>3.3 Analyze other market experiences that recognize coffee quality.</p> <p>3.4 Use successful experiences to establish a new, permanent market mechanism that recognizes quality.</p> <p>3.5 Hold a final regional conference at project's end to demonstrate the final outcomes and experiences.</p>	<ul style="list-style-type: none"> <li>Eight new relationships forged between groups of producers and exporters or roasters.</li> <li>Six competitions and/or auctions organized.</li> <li>1,500 producers participating.</li> <li>Coffee sold through auctions for US\$0.30/lb over the market price.</li> <li>Alternative market arrangements identified.</li> <li>New market mechanisms used that recognize quality and have the potential to be permanent.</li> <li>An event with 150 participants.</li> </ul>	<ul style="list-style-type: none"> <li>Letters of commitment from exporters and roasters.</li> <li>Quarterly technical reports. Event records (programs; information bulletins; lists of participants).</li> <li>Consultant's report</li> <li>Project files</li> <li>Event records</li> </ul>	