

MULTILATERAL INVESTMENT FUND

PROJECT ABSTRACT

REGIONAL

I. BASIC PROJECT DATA

Country	Regional (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Southern Mexico)		
Program Name/Number	Strengthening small rural producers' organizations for access to financial institutions – RG-M1061		
Team Leader/Members:	María Teresa Villanueva (SDS/MSM), team leader; Dan Shepherd (MIF/OPS), Betsy Murray (COF/CCR), pending (LEG), Diego Arias (RE2/EN2), Mark Wenner (SDS/RUR) y Antonio Gaspar (MIF/DEU).		
Date of Request:	March 4 th , 2005		
Beneficiaries:	Approximately 30,000 farmers organized into 48 competitive rural producers' enterprises exporting natural products such as coffee, cocoa, honey, spices, crafts, and fruits and vegetables.		
Executing Agency:	Escuela Agrícola de la Región del Trópico Húmedo (EARTH) through its Center for Business Formation (CFE) partnered with Ecologic Finance as technical advisor and co financier.		
Financing Plan:	MIF (IIIA)	US\$	1,300,000
	Counterpart	US\$	<u>700,000</u>
	Total	US\$	2,000,000

II. BACKGROUND AND PROBLEM STATEMENT

- 2.1 The economic policy and financial market liberalizations that occurred in the late 1980s and early 1990s in Latin America were important but did not create sufficient conditions for the deepening and improved functioning of rural financial markets. With the dawn of the Central American Free Trade Agreement (CAFTA), rural entrepreneurs will face new opportunities and challenges. While markets may become more easily accessible for these entrepreneurs, without adequate technical support to meet international quality standards and without ready access to marketing information, credit, and low cost communications, many of these same entrepreneurs may have difficulties competing successfully. With few exceptions, commercial banks continue to choose not to provide financing in rural areas, especially in small-scale agriculture, due to imperfect and asymmetrical information, high transaction costs, and the high perceived risks. Meanwhile, the majority of microfinance institutions (MFIs) continue to be oriented towards an urban clientele engaged in commercial activities, services and processing, through individual and solidarity lending methods. While MFIs have made huge advances throughout the region in recent years, lack of access to rural financial services by small-scale producers is still a perennial problem.
- 2.2 However, simple access to financial and products markets alone is not sufficient to build sustainable small producers enterprises in rural Latin America. One important obstacle that remains is lack of basic financial skills needed to properly manage the enterprise and to interact effectively with buyers and financial institutions. Small producer organizations are not familiar with how to report, analyze, and interpret financial information about assets,

liabilities, revenues, expenses, equity, and cash flows. This type of financial literacy is essential to grow a successful enterprise and interact effectively with clients, suppliers, and local financial institutions. Would-be rural financiers, regulated and unregulated, are discouraged to interact with these potential borrowers because of the disproportionate amount of time and resources that they have to spend to obtain basic financial data, both during the credit application process and then during the period when the loans are outstanding. Indeed, a fundamental lack of basic financial skills at the rural producer level (businesses and individuals) represents one of the main reasons that rural financial markets continue to be shallow, segmented, and inefficient in Latin America.

- 2.3 This lack of financial management skills has a ripple effect on cooperative and association members, impacting individual rural producer's capitalization, income stability and families. For example, many smallholder farmers affiliated with rural producer enterprises suffer chronically from predatory lending practices due to their lack of understanding of complex financial transactions. Many poor farmer households in rural Latin America confront major working capital constraints with the only source of finance usually being moneylenders who charge monthly interest rates of 5-20%. When farmers cannot repay the loans, the loss of assets from foreclosure can devastate already economically fragile families and communities.
- 2.4 The executing agency for this initiative will be the Escuela de Agricultura de la Región Tropical Húmeda (EARTH) based in Costa Rica. EARTH will execute this Project through its Center for Business Formation (CFE) which is devoted to promote and to strength the development of small- and medium-scale Latin American agricultural businesses to improve their competitiveness, through training, counseling and market research programs. Ecologic Finance, whose headquarters are in Cambridge, Massachusetts, with a field office in Quetzaltenango, Guatemala, will serve as technical advisor. Ecologic Finance is a nonprofit development finance institution offering affordable financial services to community-based businesses operating in environmentally sensitive areas of Latin America and Africa. Ecologic Finance's mission also aims to facilitate its borrowers graduation, whenever feasible and appropriate, to commercial credit.
- 2.5 From the interaction that Ecologic Finance, CFE and the Bank, through different Social Entrepreneurship Projects (SEP), have had with more than 200 rural producers' organizations in Southern Mexico and Central America, it becomes evident that in order for these groups to improve their access to financial services there is a need to: (i) improve producer organizations' financial management planning skills, (ii) strengthen their capacity to better manage their limited financial resources, (iii) develop internal financial management capacity within rural enterprises and its members, and (iv) improve quality of financial and business information from rural enterprises to potential local financiers.
- 2.6 **Project Rationale & Additionality** The MIF and the Bank have significant experience in financing Projects in the Region that are aimed at strengthening and expanding the supply of financial services to rural areas offered primarily by microfinance entities and credit unions. In addition, they are also supporting Projects that are aimed at strengthening production and marketing linkages of rural producers' organizations. The additionality of this proposed Project lies in the fact that there are few organizations that currently offer financial capacity building in the remote rural areas where many of the beneficiary small farmer co-ops operate. This Project will complement efforts being made by other Bank's

projects (loans, MIFs and SEP) in the Region targeting small producers' organizations. A list of those Projects is attached as an Annex to this Abstract. Furthermore, this project is fully consistent with the new Rural Development Strategy and Policy that calls for an institutional and social transformation along with economic growth and revitalization¹.

- 2.7 For the MIF in particular, numerous projects have been approved that are focused on providing basic business development services to smaller enterprises in the region. In Central America and Mexico alone, there have been more than ten projects that incorporate such services (see Annex). However, none of these projects had small rural producers organizations as a specific target. By working with such organizations, there is an "economies of scale" benefit from not only being able to assist the organization as a whole, but to also be able to strengthen the knowledge and skills of the individual producers that are members. In the OVE evaluation for MIF's initiatives in Business Development Services, the report highlighted that improved efficiency could be gained by developing platforms that could help to reduce transaction cost (i.e. organizations approach). Additional lessons learned from past experiences will be incorporated into this "second generation" of a BDS program (as referred to in the OVE evaluation).
- 2.8 In addition, current and potential buyers of natural products and private financial institutions interested in such rural producers as potential clients noted that these organizations' future growth is tied to their financial and organizational stability. As a result, the buyers and financial institutions have expressed their willingness to support efforts to improve the financial management capacity of these organizations. As an expression of this commitment, Ecologic Finance counts with US\$125,000 from Green Mountain Coffee Roasters, Starbucks Coffee Company and JP Morgan Chase Foundation to support this Project as part of the counterpart funding. EARTH and Ecologic Finance expect to secure additional resources from this same group as well as other entities, once the Project details with MIF have been further developed.

III. PROGRAM OBJECTIVES AND DESCRIPTION

- 3.1 **Objectives.** The general objective of this project is to improve small rural producer organizations access to financial services. The purpose is to strengthen the financial management skills, financial planning capacity, and internal financial management of rural enterprises.
- 3.2 The Project will equip rural producer enterprises to address their own financial management challenges at both the institutional (e.g., cooperative) and individual (e.g. member farmers) level. Expected results from this Project will translate into rural producers enterprises being able to: (i) access resources from local financial institutions; and (ii) implement their own credit or commercialization funds within their institutions to leverage resources from other financial entities. In addition, local financial institutions will improve their knowledge in how to manage related credit risk from this target group and will design appropriate financial instruments to service this financial market locally.
- 3.3 The Project will lay the groundwork for heightened creditworthiness of participating small rural producers' organizations vis-à-vis local financial institutions by facilitating the

¹ See GN -2334 Rural Development Strategy and GN-2236 Rural Development Policy Profile.

ongoing generation of high-quality financial information for internal and external audiences, especially local commercial banks. With readily available and standardized quantitative data, commercial banks in target countries would likely focus less on information shortfalls and collateral constraints and more on the benefits of new market dynamics that render a growing number of rural enterprises genuinely “bankable”.

- 3.4 **Component I: Financial Management Training & Business Basics.** Through centralized workshops and follow-up instruction during the non-harvest months the Project will assist producer organizations to become strong, transparent organizations, capable of delivering quality services to their members and buyers. Decentralized workshops and on-site advisory services during the harvest and export period will provide direct “hands on” support during the busiest time of the year for producer enterprises, offering opportunities to apply the financial management lessons learned earlier. This financial capacity building component will not only improve basic business skills, but will also enable participants to meet baseline requirements for access to credit from local financial institutions.
- 3.5 **Component II: Internal Financial Management.** The Project will assist producers’ organizations in the design and development of internal financial management programs that provide an alternative to current financial practices. Some participating organizations will already have internal savings and loan programs, which can serve as models for the other participating organizations. The objective of these efforts will be to address individual members’ working capital constraints by building the internal capacity of participating organizations to provide financial resources to its members according to the organization’s capacity and members’ needs.
- 3.6 **Component III: Financial Literacy.** The Project will identify and train internal resource persons in participating organizations who are qualified to undertake and coordinate basic financial literacy training for primary society leaders and individual farmer members with little formal education. Targeting members and their primary society leaders, the purpose will be to enhance understanding and interpretation of basic financial concepts that are vital to the financial health of their farmer-owned organizations. EARTH University will play a lead role in developing standardized curricula and didactic materials to support these field-based activities. Furthermore, in each year of the Project, from September through December, qualified interns from EARTH’s student population will be placed in participating enterprises to support the financial literacy work of these internal resource persons at the primary society level.
- 3.7 **Component IV: Financial Sector Training.** To attract commercial lenders to this market niche, the Project will engage local banks, which traditionally shy away from rural financial markets due to perceived risks, high transaction costs, and asymmetrical information. Local bank representatives will be invited to participate in certain training workshops. This will provide bank representatives with ongoing opportunity for interaction with program participants, allowing them to better understand these rural enterprises – their technical capacity, specialized markets, supply chains, business cycles, risk profiles and financing needs. At the same time, by exposing local banks to existing relationships between alternative lenders and these rural producer groups, domestic financial institutions will learn how they might adopt innovative rural lending approaches developed by specialized financial institutions in the absence of local banks (e.g., focusing on cash flow-based versus strictly collateral-based lending).

IV. COST AND FINANCING

- 4.1 The total cost of the project and its structure is estimated to be US\$2.000.000, of which the MIF will contribute with US\$1.300.000 and EARTH, Ecologic Finance and other funders will contribute with US\$700.000, of which 50% will be in cash. The project will have a total duration of 48 months and disbursements of 54 months.

V. EXECUTING AGENCY AND EXECUTION STRUCTURE

- 5.1 The executing agency for this initiative will be EARTH through its CFE. EARTH is a private university dedicated to providing education in agricultural sciences and natural resources, and to contributing to the sustainable development of the humid, tropical region. EARTH was established in 1993 in Costa Rica with funding from the Costa Rican Government, the U.S. Agency for International Development and the Kellogg Foundation. With a total enrollment of four hundred students, representing 18 different countries in Latin America. EARTH is an internationally recognized center of education devoted to the responsible and sustainable development of agriculture in the humid tropics of the Americas. CFE promotes the development of small- and medium-scale Latin American agricultural businesses to improve their competitiveness, through training, counseling and market research programs. CFE uses a high-quality, interdisciplinary, professional team that promotes and supports organized business initiatives such as: cooperatives, growers' associations and agricultural businesses through a highly interactive process.
- 5.2 EARTH/CFE is currently implementing the Project, "Business Advisory Services for Small Farmers" (ATN/ME-7724-RG) financed with MIF resources. Project final disbursement is expected in October 2005. The Project's objective was to increase the competitiveness and productivity of rural producers and small agroindustries in Central America through the improvement of their business skills. Project funded market information campaigns covering three times more producers than foreseen (3,000). It provided training sessions, followed up by advisory services over time in a continuous improvement scheme, reaching more than 2000 producers; more than double than the expected number. EARTH/CFE continues to be contracted by producer groups beyond the original project scope. All of the MIF funds will be expended by the end of the original disbursement period, a sustainability fund exists based on project income, and EARTH provided more counterpart resources than originally established. EARTH/CFE competitively contracted third party training and advisory services and maintained strict supervision and quality control on behalf of their client producer organizations.
- 5.3 Ecologic Finance will serve as technical advisor. Ecologic Finance is a nonprofit development finance institution offering affordable financial services to community-based businesses operating in environmentally sensitive areas of Latin America and Africa. Founded in 1999, Ecologic Finance finances loans in the range of \$25,000 to \$500,000 loans to commercially- viable businesses that do not meet traditional requirements to access credit from local financial institutions. With over US\$8 million in low-interest capital from over 50 private investors and multilateral investors, including the Bank, the fund has made available 125 loans, with a gross value of \$18.5 million to rural producer organizations located in Mexico, Central America, Peru, Bolivia, Ecuador, Brazil, Kenya, Rwanda and Uganda. Based largely in rural communities that lack equitable access to capital, social services, and external markets, Ecologic Finance borrowers have repaid 69

loans totaling \$9.8 million. In September of last year, the Bank, through its Social Entrepreneurship Program, approved a US\$300,000 loan to Ecologic Finance that will be used to finance a commercialization fund to support a coffee producers association called Manos Campesinas based in Guatemala².

- 5.4 Ecologic Finance also has as objective to be a prototype for lending approaches and financial instruments that are both profitable and supportive of rural economic development with the expectation that local financial institutions will adopt this business model. For example, in one instance former EcoLogic Finance borrowers in Chiapas, Mexico, after working with this organization for two years, began receiving financing from a private-public financing venture called Fondo Accion/Banamex, the parent financial institution of which is Citibank. Nowadays, Fondo Accion/Banamex is using the same factoring method that Ecologic Finance applied in a dozen countries in Latin America and East Africa.

VI. ENVIRONMENT AND SOCIAL IMPACT

- 6.1 The Project is expected to lead to positive environmental and social impacts. Among the main target group are community-based enterprises that have passed social and environmental tests through securing third-party certifications such as Fair Trade, Organic and Smithsonian Migratory Bird Center's "bird friendly" seal, as these organizations are considered to be stronger than their contemporaries and thus can benefit more from the financial capacity building activities of this proposed Project, which should help enhance their long-term success and sustainability. This Project will assist the selected cooperatives to become strong, transparent organizations, capable of delivering high quality services to their members and buyers. The Project will strengthen financial literacy skills of cooperative managers and individual growers belonging to the participating cooperative enterprises. Being part of the Fair Trade movement, many of these organizations are already leaders in integrating farmers of various indigenous backgrounds as well as in fostering gender equality.

VII. MAJOR ISSUES

- 7.1 The key following aspects should be taken into consideration during the analysis of the project proposal: (i) the criteria for selecting the participating producers' organizations; (ii) the Project's execution mechanism; (iii) quantification of expected project results; (iii) responsibilities and coordination aspects between EARTH and Ecologic Finance; (iv) coordination with other Bank Projects in the Region addressing the same beneficiaries; (iv) Project components activities and budget; (v) cost recovery mechanisms; and (vi) confirmation of counterpart funds.

VIII. ACTION PLAN

- 8.1 The following is a preliminary schedule for the project's approval process:

CESI	May 2005
CRG	June 2005
Donors Committee	August 2005

² "Apoyo a Pequeños Caficultores Mayas" (ATN/SF-8863-GU and SP/SF-0426-GU).

MIF MEMORANDUM OF ELIGIBILITY

I. PROJECT SUMMARY

COUNTRY:	REGIONAL
PROJECT:	Strengthening small rural producer's organizations for access to financial institutions
FINANCING:	
	MIF (Facility III-A): US\$ 1,300,000
	<u>Counterpart:</u> US\$ 700,000
	Total US\$ 2,000,000

II. MIF ELIGIBILITY

The Committee agreed that this proposal is eligible for MIF financing under the Small Enterprise Development Facility. The MIF has been actively supporting programs that promote private sector competitiveness. In addition, this project is part of the *Small and Medium Enterprise Development (SME)* group and the *Business Development (BDEV)* subgroup. The team should take into account the following issues in the design of the operation:

III. ISSUES

- The Background section should provide additional information, indicating the problem statement, presenting current conditions in the countries, highlighting other similar programs and stating MIF additionality within the context.
- The Project Team should review and change project objectives and the project title should also be changed accordingly. The logical flow between project title, objectives and components should be carefully addressed.
- The Project Team should indicate how the activities relate or complement other MIF/Bank operations. Specific reference should be made to the previous MIF operation with this requesting institution (ATN/ME-7724-RG). In addition, if the project scope should include southern Mexico, reference should also be made to the MIF operations with Banrural/Finrural.
- Project beneficiaries as well as project geographical scope should be clearly determined.
- The Project Team should include issues of corporate governance and instruments such as factoring as topics during the proposed training activities.
- With reference to Component IV, the Project Team should provide information on the proposed activities and the criteria for selection.
- The Donors Memorandum should have a clear execution mechanism. The role of Ecologic Finance should be addressed.
- The Donor Memorandum should address the issue of sustainability of the activities proposed beyond the period of project execution.

- The expected results of this project should be clearly expressed in the Donors Memorandum. They should be measurable and subject to evaluation. Proper indicators and benchmarks should be included.
- All counterpart commitments should be confirmed prior to the distribution of the document to CRG.