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EVALUATION REPORT
A.I.D. LOAN No. 527-W-057
RURAL ENTERPRISES DEVELOPMENT

12/6/75

In accordance with the Loan Agreement, USAID and the Banco Industrial del Perú ("Bank") conducted an evaluation of the first six month operations of the subject loan, in order to determine whether the Rural Enterprises Development Fund ("Fund") was operating in an efficient and timely manner, reflecting the specific intentions outlined in the Loan Agreement. During a three-week period, USAID personnel conducted interviews with key Bank officials in Lima, and visited two of the four regional branch offices of the Bank where the Fund is operating.^{1/} An evaluation of that part of the subject loan which is being administered by ORDEZA will be conducted in conjunction with the final evaluation of Loan 052.

FUND ACTIVITIES TO DATE

First A.I.D. disbursements under the loan were made to the Bank in August, with an advance of S/.10 million (\$230,521) for sub-lending and S/.3 million (\$69,156) for technical assistance.

During the first six months of the Fund's existence, seven sub-loans totalling S/.1,970,000 (US\$43,777), representing less than one percent of the entire Fund of \$10 million have been approved. Additionally, \$21,615, out of a total of \$300,000 in loan funds destined for technical assistance, were committed in the month of November to purchase vehicles for use at three of the regional branches. No actual disbursements for sub-loans have been made.

Four promotores were hired by the Bank to head the Fund's operations in the regional branches. One of these, the promotor assigned to work in Puno, left the Bank at the end of November; the remaining three (one zoologist, an engineer and an economist) are currently working in Huancayo, Ayacucho and Cuzco respectively. All three of these promotores had previously worked with ORDEZA in Loans 052 and 053.

Under the original Bank Operations Plan, the Fund administration was an autonomous entity, reporting directly to the General Manager; this was changed in October, and the Fund was placed under the organization aegis of the Division of Studies and Development, although in fact it still continues to function fairly autonomously. Adding to the organizational confusion is the fact that the branches traditionally report directly to

^{1/} In Huancayo and Cuzco USAID personnel spoke with branch management and visited potential and approved sub-projects; Puno was not visited since the Fund promotor had recently resigned; Ayacucho had been visited previously by USAID personnel.

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another Bank Division -- Branches -- on all matters affecting them, and there has been a tendency to consider the Fund's activities as branch business, thus subjecting it to the scrutiny of the Lima Branch Division. Both at the Lima and branch level, then, there is confusion as to what lines of authority and responsibility the Fund should assume, and what is and/or should be the proper role of the Division of Studies and Development and the Division of Branches.

Before going into the problems and recommendations for their solution, the evaluators wish to cite several positive steps which the Bank has taken to facilitate the administration of the Fund. These include:

1. The purchase of three Ford four-wheel drive double traction vehicles which will be used in three of the four branch offices where the Fund operates. A fourth vehicle will be procured in the near future. Currently none of the Bank's branch offices has any vehicles, and as a result the Bank by necessity has generally confined its activities to urban areas; in cases where loans have been made to outlying rural areas within the branches' jurisdiction, these have resulted from borrowers' initiative in actively pursuing their interests at the branch level. Since the Fund envisions the type of projects which are likely to be in the more rural areas, and sub-borrowers who have had little, if any, experience with institutional credit, and are unlikely to come on their own initiative to search out the Fund, the vehicles will give the promoters the necessary mobility to effect needed field work.

Lack of mobility has severely hampered the work of the Fund promoters. While they have made trips to outlying areas, using public transport, these have been sporadic and have resulted in only a few potential sub-projects.

2. The Fund promoters in each branch office as well as the Fund Administrator in Lima, have in most cases been able to achieve sound working relations with other GOP entities working in regional development activities. These regional entities include the Ministries of Fisheries and Agriculture, regional offices of INP, SINAMOS and the Agrarian Bank. In some cases, pre-feasibility studies conducted by these agencies have been turned over to the Fund promoters for further development; in other instances, the Fund promoters are working with officials from other entities to develop projects. At the level of Lima, the Fund has established contact with UNIDO (United Nations Industrial Development Organization), in order to coordinate activities in areas where the Fund is operating.

3. Probably the most important positive aspect with regard to the Fund is the high degree of interest and commitment to the purposes of the Fund at the level of both the General Manager and the Bank and the Fund Manager. During the course of the evaluation, the General Manager stated, on several occasions, that while he fully expected to see loan funds fully

committed, he felt that the most important aspect of the Fund was not simply to use the funds but to use them in such a way that Bank policy is substantially changed vis-a-vis non-traditional borrowers in terms of guarantees, the use of technical assistance, and active Bank promotion and support of incipient rural enterprises. General Manager Wenzel stated that he sees the real role of the Fund as that of a lever to convince the staff of the Bank that it can in fact act as a true "development" bank without jeopardizing its financial position.

The Fund Manager, Ing° Carlos Dextre, has actively promoted the Fund both in the branch offices and in Lima; his recognition of both the problems and the potential of the Fund have been invaluable to the evaluators.

NOVEMBER MEETING OF FUND PERSONNEL AND BRANCH PERSONNEL IN LIMA

By November, there was a general realization on the part of Bank officials, including the General Manager as well as the Fund administrator, that the Fund has not been successfully utilized during the first six months of its existence. As a result, General Manager Ricardo Wenzel called a meeting in Lima of branch managers, lawyers, Fund promoters and engineers from the four regional branches, in order to emphasize the priority of the Fund within the Bank and to go over procedures for Fund utilization as well as explain the purpose of the Fund. The Head of the Division of Branches in Lima attended this meeting, as well as the Fund Administrator. As a result of this meeting, the Bank management is confident that sub-loan approval will occur much more rapidly, and that current terminal commitment and disbursement dates (January 31, 1977 and July 31, 1977 respectively) will be met.

In addition to the November meeting USAID believes that certain procedural, as well as structural changes may be necessary if the Fund is to operate in the manner originally envisioned and within the time frame stated in the Loan Agreement. Unless these problems are dealt with in an effective and timely manner, USAID is doubtful that the terminal dates will be met.

MAJOR PROBLEMS IN FUND OPERATIONS

Several major problems currently exist which have caused bottlenecks in Fund activities, and jeopardize its future operations. The most important are summarized below:

1. Fund Priority within Bank, and Purpose of the Fund. As mentioned above, the General Manager in November communicated to all branch personnel the priority of the Fund within the Bank. This has had the positive effect of bringing the Fund to the attention of branch professional personnel, all of whom will now be actively involved in Fund activities. On the other hand, if the Fund is simply given priority within the Bank

without a clear understanding of the Fund's purpose on the part of branch personnel, a situation could develop wherein the Fund is expended on a wide variety of projects which are not the type envisioned in the Loan Agreement. Section 5.03(a) of the Loan Agreement states that Project sub-loans shall be made only to those enterprises which do not have normal access to credit on reasonable terms and conditions. At one of the branches visited it was clear to the evaluators that the permanent professional personnel of the branch were not aware of the Fund's stated purposes. At another branch, the promotor himself seemed unclear as to the Fund's priorities.

Simply "moving the Fund" at the branch level is not sufficient; rather the Fund should be applied to those types of sub-projects which fall within the letter and spirit of the Loan Agreement. In one branch, the evaluators were shown on a loan application for a vehicle inspection center, which would generate 29 new jobs. The three members of the sociedad anonima, however, were registered with addresses in high-income areas of Lima (San Isidro, Chama and Santa María de Chosica), and presumably would be eligible for commercial bank financing.

At the other branch visited, the manager stated that his understanding of the Fund was merely that it "offered lower interest rates," and added that the branch office would continue to require 100% guarantees for all sub-loans.^{2/} It was additionally stated that applications from associative enterprises benefitting from the Agrarian Reform would only be considered if they could offer traditional guarantees. If these standards are applied, obviously the Fund is only a lower interest rate extension of the BIP's regular lending activities.

In order to achieve the type of program envisioned in both of the Capital Assistance Paper and the Loan Agreement, it will be necessary to convey not only the priority of moving the Fund at the Regional level but the spirit of the program as well. Traditional bank practices, and traditional guarantees are simply not appropriate when the stated goal of the program is to offer credit "to those enterprises which do not have normal access to credit."

Recommendation: Fund policies in sub-lending which reflect the intent of the Loan Agreement should be made clear to branch office personnel through an official communication from the office of the General Manager.

Branch personnel should become cognizant of the fact that technical assistance - both in the preparation and follow-up of sub-projects - can, in fact, frequently substitute for traditional banking practices. It should

^{2/} The Credit Manual for the Fund states that items purchased with sub-loan funds will be the sub-loan's guarantee.

be made clear that non-traditional borrowers, including associative enterprises created as a result of the Agrarian Reform, should be given priority attention, and that full guarantees are not required.

2. Problem of Locus of Fund Supervision and Administrative Authority. At the present time, the administrative system under which the Fund operates is not adequate. There is considerable confusion as to where administrative and supervisory authority lie, and there is a need for more regular information flows on matters concerning the Fund to the office of the General Manager.

Annex I to the Loan Agreement specifically states that the Program Unit of the Fund will be the central organization unit for the administration of the Fund, and be responsible for promotion, project development, and implementation of sub-projects, including the provision of technical assistance. Such a unit was organized within the Bank, but with the shift in organizational locus of the Fund from a special unit under the General Manager to the Division of Studies and Development in October, neither the authority nor the responsibilities of the Fund are currently clearly defined, especially at the working level. The Fund has been separated, operationally, from the Division of Studies and Development, but continues to be under its organizational control. This is complicated by the fact that at the level of the regional branches all reporting is generally done directly to the Division of Branches, and there appears to be a deep-seeded reluctance on the part of branch managers and other permanent branch personnel to change this reporting procedure in matters concerning the Fund.^{3/} The Fund, as currently set up, does not have sufficient weight within the Bank to command the support of the regional branches, especially in terms of reporting or requesting assistance.^{4/}

There is also a lack of regular information flows concerning the problems and progress of the Fund from the operating level to the office of the General Manager. Since the Fund represents a departure from the Bank's traditional lending policies, there are bound to be initial misinterpretations and misunderstandings especially at the level of the

^{3/} The dependence of the regional branches upon the Lima Division of Branches is carried to the point where in Cuzco the branch office has disregarded communications from the General Manager's office unless the Division of Branches also sends approval.

^{4/} A case in point was witnessed in Cuzco where the promotor and two engineers have requested permission to attend a week-long evening seminar on tourism evaluation techniques, at a cost of S/.2,000 (\$50) each. The promotor felt that the course would be of significant help in future Fund activities. The request was forwarded by the branch manager to the Division of Branches, which turned down the request.

offices. The branch offices report their problems with the Fund not to the General Manager nor to the Fund manager in Lima, but rather to the Division of Branches.

Recommendation: The Fund should be given a specific institutional position within the Bank, where both operational and administrative responsibility is clearly defined. Only in this way will regular supervision of the Fund activities at the regional branch level be feasible and a status achieved whereby the General Manager is kept fully informed of the problems and progress of the Fund. Several possible alternative or combination of alternatives appear to exist. Three are presented below:

- (a) The Fund could be placed, organizationally, under one of the existing Bank Divisions which would have operational authority over its activities. The most logical Divisions would appear to be either the Division of Credit or the Division of Branches. In either case, the regional branch management and Fund promoters would direct specific problems and/or requests for assistance to the Manager of the Division. Ing° Dextre would, in effect, act as a Special Assistant to the Division Manager.
- (b) The Fund could revert to its previous status, as an independent unit established directly under the office of the General Manager, with Ing° Dextre assuming the effective status of a Manager within the Bank hierarchy. This office would handle field requests, coordinate the provision of technical assistance and other Bank resources, and report directly to the Bank General Manager.
- (c) The General Manager could appoint a member of his own staff to work full time with the Fund at least until that point where all branches are committing project funds at a level consistent with financial projections for reaching the terminal commitment date (S/.12 million a month in Cuzco and Huancayo, and S/.8 million a month in Ayacucho and Puno.) This person would spend the bulk of his time in the four regional branch offices, and would be given specific authority from the General Manager to make decisions and necessary procedural changes which will facilitate the Fund's activities.

Whichever alternative is decided upon by the Bank, it is important that an official written communication be issued by the office of the General Manager, outlining the scope of authority and responsibility of each of the Bank Divisions involved.

3. Branch Office Technical Capacity and Coordination of Internal and External Technical Assistance to the Fund. After talking at length with three branch Fund promoters and visiting two of the regional offices, the evaluators concur with Bank officials in the opinion that the technical capacity at the branch level is currently too limited to carry out all of the functions necessary for Fund success (viz., the identification of potential projects, preparation of pre-feasibility profiles and feasibility studies, and post-disbursement follow-up). A reasonable estimate of the time period required to carry out all necessary steps in sub-project approval at the level of the branch offices, prepared by the Bank, is as follows:^{5/}

--Receipt of Loan Application

--Get confidential report on credit rating of applicant
(up to two weeks)

--Loan Application, together with Confidential Report
submitted to Administration of Branch for pre-
qualification (one day)

--Pre-Qualification (one day)

--Preparation of pre-feasibility study (one to two weeks)

--Completed study to Branch loan committee

--Administration review of completed study (two days to
one week)

--Review by Branch loan review committee (one day)

--Preparation of loan contract by Branch legal office
(one week)

--Disbursement

A "reasonable" length of time, then, for a sub-project to be approved or disapproved is likely to be approximately one month. Until November, the individual promoters were virtually working alone in the

^{5/} This time frame is for those sub-loans which the branch has authority to approve (S/.1 million in Ayacucho and Puno; S/.1.5 million in Cuzco and Huancayo. Between these limits and S/.2 million, the Lima office must give its approval, which is likely to take an additional two weeks. S/.2 million sub-loans must presently be referred to USAID for approval (at least during the first six months of regular sub-lending activities), which could require an additional two weeks.

branch offices and quite obviously were incapable of handling more than a very few sub-projects each; since the November meeting in Lima, where the General Manager instructed all branch personnel to work with the Fund, the burden upon the individual promotores has been somewhat eased, but it is clear that even the entire technical resources of the branch office will not be sufficient to handle the expected volume of loan applications and the technical studies necessary to process them.

USAID's financial analyst calculated that in order to reach the terminal commitment date of January, 1977, each branch must make the following average monthly sub-project approval amounts:^{6/}

--Puno	:	S/. 8,000,000	(\$177,777)
--Cuzco	:	S/.12,000,000	(\$266,666)
--Ayacucho	:	S/. 8,000,000	(\$177,777)
--Huancayo	:	S/.12,000,000	(\$266,666)

In the case of Huancayo and Cuzco, this may be translated to mean approval of approximately ten projects per month (one of around S/.5 million and nine averaging approximately S/.750,000), and approximately one sub-loan of S/.5 million and four averaging S/.750,000 in the Puno and Ayacucho branches. And these are, of course, in addition to the normal lending activities of the Bank's own traditional credit lines.

At the present time, all branches have a substantial backlog of pending Fund loan applications (about 30 each in Cuzco and Huancayo and somewhat less in Puno and Ayacucho). The Division of Studies and Development in Lima recently sent up teams of Lima-based technicians to identify further possible sub-projects, and came up with 80 such possibilities in Huancayo alone. The backlog of studies and facility of new project identification bears out the contentions made in the Capital Assistance Paper that a large latent demand exists in these areas for non-traditional rural enterprise credits. What is lacking, however, are the resources to move from the project identification stage to actual commitment of funds and implementation, and in order to make sub-loans on a timely basis there is an obvious need to supplement the branch offices' technical capacity.

Three possibilities exist to expand this capacity: (1) more effective utilization of the Bank's own internal technical resources, chiefly those of the Division of Studies and Development; (2) contracting external consultants from the Peruvian industrial or commercial sector on a case-by-case basis; or (3) use of either loan technical

^{6/} See Annex I to this Report.

assistance funds or a part of the Bank's \$500,000 administrative counterpart funds to hire additional full-time technical personnel to work at the various regional branches.

The Division of Studies and Development has a staff of approximately thirty junior and medium level technicians (economists, project analysts, industrial engineers) and approximately five senior level technicians. The depth of expertise which exists the Division was not evaluated for purposes of this report, but it is probable that several technicians could be utilized on a full-time basis at the level of the regional branches. For more specialized expertise, however, the Division would not be able to provide needed technical capacity, and the possibility of contracting external consultants, on a case-by-case basis might be considered.^{7/} A final solution might be that the Bank utilize available funds provided under the loan agreement to increase the technical staff at the branch level.^{8/}

A major problem in utilizing either internal or external technical expertise again appears to lie with the uncertainty at the branch level as to where requests should be directed. During the evaluation trips to the branch offices, a number of projects were visited which were clearly beyond the technical capacity available at the branch office, yet no official request had been made -- or appeared to be forthcoming -- for assistance from the central offices of the Bank. This was not due to a lack of recognition that such assistance was necessary, but rather to the fact that nobody seemed to be clear as to where the request should be directed. The promoters felt that such requests should be channeled through the offices of the Fund, whereas the branch managers felt that the Division of Branches should handle the request. The result of this confusion is that requests are simply not being made to anyone.

Recommendation: The Bank should make a firm decision as to how technical assistance funds are to be utilized, and establish procedures for making either technical assistance funds or technical expertise

^{7/} Examples of potential sub-projects which probably fall outside of the competence of the Division of Studies and Development are: a shoe factory near Jauja (Huancayo) and expansion of a textile mill in Cuzco. These are both relatively sophisticated projects which would require a substantial degree of specific expertise.

^{8/} If permanent additional technicians were to be added to the branches offices, it is doubtful that the type of competence required could be obtained at salaries presently offered to Fund promoters, and the Bank would have to consider offering substantially higher salaries to attract top quality technicians.

at the branches for a period no less than the time remaining to commit the Fund (i.e. one year).

3. Operating Expenses at Regional Office Level. A major problem, according to the promotores, is the lack of operating expenses available to the Fund at the Regional level. The following specific problems were cited:

- (a) All request for furniture, office equipment, secretarial help, etc. must be made by the branch manager to the Department of Branches in Lima, which frequently results in long delays.
- (b) Promotores must finance trips to outlying areas within branch jurisdiction out of their own pocket, then request reimbursement from the branch on the basis of actual receipts. The promotor in Cuzco claimed that he generally received about half of what he had spent, given inability to collect receipts from rural bus and colectivo lines and small rural pensiones and restaurants.

Recommendation: Given the need for more rapid action with regard to Fund activities in the regional offices, it is recommended that the Bank consider the establishment of a petty cash fund for financing Fund activities in each branch office. The fund would be on the order of magnitude of S/.100,000 (\$2,222) in each branch, and the promotor and other technicians working on Fund business could draw upon this to finance short field trips, purchase locally available equipment, such as calculators or typewriters (up to a maximum amount to be established by the Bank), upon approval of the branch manager. All purchased items would be accompanied by receipts, and a standard per diem established for field trips. The evaluators recognized that purchases made locally will undoubtedly result in somewhat higher unitary costs, since the Lima Offices realizes discounts through bulk purchasing, but it is felt that the time element is of sufficient importance to warrant these higher unitary costs.

CONCLUSIONS: The Bank clearly recognizes the problems which have resulted in the slow initial activity of the Fund, and personnel at all levels of both the Lima office and the branch offices have indicated their concern with remedying these problems. What is now needed is positive action consistent with this recognition and concern.

Recommendation: It is recommended that USAID and the Bank conduct a joint evaluation of commitment and disbursement activities of the Fund, as well as the use of technical assistance funds in June of 1976, in order that both A.I.D. and the Bank may make internal decisions as to the overall success of the Fund and prospects for its future.

Review of accounting system to be implemented by the Industrial Bank of Peru for the Rural Enterprises Development Loan, based on visit to Cuzco branch of Bank.

ACTIVITY Project: AID Loan 527-W-057 - Rural Enterprises Development

TRAVELLER César Espino S. Principal Analyst I

DATES December 1, 1975 to December 3, 1975

ITINERARY City of Cuzco and surroundings

FINDINGS AND ACCOMPLISHMENTS

1.0 The accounting system: The "Accounting Division" of the Industrial Bank of Peru has prepared a chart of accounts for the registration of operations of the Rural Enterprises Development Loan. This chart of accounts which was formerly discussed with AID Controller's Office financial analysts, has been distributed to the Bank's branches along with a set of typical accounting entries. The accountability of the Project will be made within the Bank's accounting system through a set of identifiable accounts for the Project except for the "cash" since the resources of the Project will be commingled with those of the Bank. This latter fact implies that whenever a balance sheet is prepared the cash availability of the Project will be determined by arithmetic difference between credits and debits.

The accounting mechanism prepared for the Project does not include specific accounts for registering equipment acquisitions for the Project. The Bank's intention is to incorporate these assets to the property account of the Bank itself. This treatment will result in a distortion factor whenever a balance sheet is prepared for the Project. In my discussions with the Lima Accounting Officers I have pointed out this problem with some detail and agreement was reached as to the need to review this issue after my field trip return.

All AID capital contributions as well as the GOP counterpart deposits will be identifiable within the Bank's accounting structure for the Project.

The following is the balance sheet for the Project as of November 30, 1975.

RURAL ENTERPRISES DEVELOPMENT PROJECT

Balance Sheet as of November 30, 1975

Assets

Current:

Cash in banks		S/.80,500,986.17
Total Assets		<u>S/.80,500,986.17</u> =====

Liabilities

Capital Contributions:

A.I.D.	S/.13,000,000.00	
GOP	<u>67,500,986.17</u>	
		S/.80,500,986.17

Capital for Operations:

GOP		996,680.15
Expenses Incurred		<u>(996,680.15)</u>
Total Liabilities		<u>S/.80,500,986.17</u> =====

As subsidiary, the Bank's branches will utilize sub-borrower cards to register disbursements, repayments, interest charges and other information to feed the accounting system.

In Cuzco I found that although a copy of the Chart of Accounts had been received by the Accountant, the latter thought that it was unofficially distributed because the covering letter (Circular) was not signed by the Lima Head of Branches. On the spot we had a meeting with the Manager to discuss this issue. Agreement was reached as to the need to implement the system because the circular was signed by the General Accountant of the Industrial Bank who is the pertinent authority on accounting matters. Besides, two sub-loans were on the threshold of being approved and executed. Similar attitudes are also found in other Project implementation areas, e.g. legal, which are retarding loan execution.

Conclusion

The accounting system outlined for the Project is not a full-fledged double entry system. The cash availability of the Project will be determined by arithmetic subtraction i.e. credits less debits.

Recommendation

Periodic inspections should be made to the Bank's branches to test check accounting registrations to avoid a sub-valuation of the "cash account" as well as to avert any implementation bottlenecks.

- 2.0 AID advance to the Project: On August 5, 1975 AID made the first disbursement (S/.13.0 million) for the Project to cover 90 days cash requirements. More than 120 days have elapsed and no disbursements have been made to end-users. Is the Bank using this money? No way to know it because there is not a separate cash system (Trust Fund) for the Project. To avoid this problem Project Managers should be reluctant to accept estimated cash-requirements which are too optimistic.
- 3.0 Scope of financial analysis in the feasibility studies: In Cuzco I have found that the financial analysis component under each feasibility study is extremely limited. The potential sub-borrower is not financially analyzed either in retrospection or in projection and very little is done on present status. I was informed that the Accountant of the Bank, on a partial basis, prepares the financial information since the Project in Cuzco has not been provided with a full time financial analyst. One way to overcome this deficiency is to require 100% collateral for each sub-loan and this is what the Bank is doing in Cuzco but the latter is against Loan Agreement intentions.

Conclusion

Financial analysis is almost non-existent on sub-loan requests in Cuzco.

- 4.0 Table 1 shows potential demand for sub-project financing, as determined in the Capital Assistance Paper, along with allocation of Funds for sub-lending by regional branch, and a projection of average monthly sub-lending necessary to meet time considerations.

TABLE 1

	(1) ^{a/}	(2)			Total	(3)	(4)	(5)	(6)		(7)	(8)
	Potential Demand	Expected Disbursements Accord. Operations Plan Dec '75	Dec '76	Dec '77		Total	Total (2) (1) x100	Disbursements As of Dec '75	Money Available for Sub-Loans AID/GOP	Expected Disbursements to Meet Target Date 1976	July 77	Projects Identified Oct. 30, 1975
Puno	S/.261.0	14.0	41.0	26.5	81.5	31%	- . -	90.3	61.2	35.1	50.9	83%
Cuzco	315.0	16.0	62.0	57.4	135.4	43%	- . -	144.4	91.2	53.2	60.0	65%
Ayacucho	85.5	14.0	41.0	26.5	81.5	95%	- . -	96.3	61.2	35.1	19.8	32%
Junin	225.0	16.0	62.0	57.4	135.4	60%	- . -	144.4	91.2	53.2	39.8	43%

^{a/} From CAP Paper