

PD-AAM-979

ISN: 30182

522-0209 / 53

THE "FONDO GANADERO" AS A VEHICLE
FOR LIVESTOCK DEVELOPMENT IN HONDURAS

Small Farmer Livestock Improvement Project
(A.I.D. Project No. 522-0209)
Interim Report

Submitted
May 1983

TABLE OF CONTENTS

	<u>Page No.</u>
I. Introduction	1
II. Background	
(A) Definition	1
(B) Background to the Development of a Fondo Ganadero in Honduras	2
III. Rationale for the Establishment of a Fondo Ganadero	
(A) Economic Development	4
(B) Development of the Agricultural Sector	4
(C) Private Enterprise Development	5
(D) Social Development	7
IV. The Fondo Ganadero in Honduras	
(A) Introduction	9
(B) Capitalization and Financing	10
(C) Organization and Management	12
(D) Activities of the Fondo Ganadero	13
(E) Preliminary Financial Analysis	18
V. Specific Issues Raised in the PID Guidance Cable	
(A) The Fondo Ganadero as a New Credit Institution	21
(B) Other Credit Issues	22
(C) Ownership of the fondo Ganadero	24
(D) Long Run Role of the Fondo Ganadero	25

Attachment I: Organizational Chart for the Fondo Ganadero

Attachment II: PID Guidance Cable (State 036808)

SMALL FARMER LIVESTOCK IMPROVEMENT
INTERIM REPORT

I. Introduction

The Mission has carefully prepared a comprehensive report on the Fondo Ganadero approach to livestock development because of our increasingly firm belief that this approach is the correct one for Honduras. The report contained herein describes the Fondo Ganadero in terms of the concepts upon which it is based, the reality of the Fondo experience in Colombia, and the applicability and adaptability of a Fondo Ganadero in Honduras. The report then presents in considerable detail the design of a Fondo Ganadero for Honduras. The design as presented herein reflects the Mission's work to date with numerous public and private sector entities. While the design presented is very detailed, it is not yet complete. Areas where further work will be necessary before PP submission have been so identified.

The information which follows is submitted in compliance with the interim report request contained in the PID Guidance cable (Attachment II, paragraph 2). All items required by the RefTel are included either in the general discussion or in Section V entitled Specific Issues Raised in the PID Guidance Cable.

II. Background

(A) Definition. Fondos Ganaderos are for-profit, private enterprises (constituted through Escritura Publica as Sociedades Anonimas) that were established in Colombia beginning over forty years ago. There are now 26 Fondos Ganaderos functioning in Colombia. The purpose of the Fondos is to develop, improve, and expand the livestock sector of the country by increasing the size and quality of the national cattle herd and by incorporating more and more producers into the sector. The impact of the Fondos has been in their ability to promote livestock activities in such a way as to have significantly increased the production of meat and dairy products over the past forty years in Colombia. The establishment of the first Fondos came about as a result of a fortuitous convergence of private and public sector interests during the early 1940's. Large cattlemen and public sector officials with private interests in the cattle industry successfully created legislative and financial mechanisms which created and capitalized the Fondos.

In Colombia, the Fondos are capitalized and operations are financed in three ways. First, ownership of the Fondo is established through share purchase. There are two types of ownership shares: Class A stock is purchased by public agencies, is transferrable only within the public sector, and pays dividends in form of more non-negotiable shares; Class B shares are purchased by the private sector, are freely negotiable between parties, and pay annual cash dividends. While Class A stock provided the seed capital for the

establishment of the Fondos, Fondos report that the percent of value of stocks held by the public sector declined to about 10 percent of the total, with 90 percent held by Class B shareholders. By law, however, the public sector has retained 50 percent control of the Boards of Directors of the Fondos; that is, three members from among Class A shareholders and three members from among Class B shareholders.

A second manner in which Fondos are capitalized is through a tax provision allowing for "substitute" investment in livestock passed in 1959 (Inversion Sustitutiva en la Ganaderia). This requires that 1 percent of the net value of every cattleman's capital be returned for investment in the cattle sector in the following ways: .5 percent is placed in the Central Bank as financing for the Fondo Nacional de Ganado, and .5 percent is for the obligatory purchase of shares in the local Fondo. The Fondo Nacional de Ganado finances large purchases of cattle by Fondos. The money is lent to the Fondos at a below market interest rate of 21 percent. This source of financing is very important to the ability of a Fondo to remain liquid, as is discussed in more detail below in Section IV.

The third way the Fondo capitalizes itself is through its normal business operations. The basic business of a Fondo is to lend cattle to producers and potential producers ("depositarios"), referred to herein as "participating producers", for breeding ("cria") and fattening ("engorde") operations. The Fondo enters into contracts with participating producers whereby the Fondo provides animals and the participating producer provides pasture and management. At the end of each calendar year, the value of the herd held by each participating producer is assessed in terms of weight gain (fattening), new calves (breeding), and increase in value of original cattle provided. After having subtracted from this gross increase in herd value the cost of services provided directly to the participating producer by the Fondo (including the interest rate charged to the Fondo on cattle purchased through the Fondo Nacional de Ganado), the Fondo and the participating producer split the difference. In Colombia, this split is regulated by law at 65 percent for the depositario (60 percent in cash, 5 percent in stock in the Fondo), and 35 percent for the Fondo. In this process the Fondo does not transfer ownership of the cattle to the participating producer; the original herd and the calves produced remain the property of the Fondo Ganadero and carry the Fondo's brand. Upon liquidation of a contract, a producer may choose to receive part of his net earnings in the form of cattle, in which case the Fondo sells him a number of cows or calves equivalent to that portion of his earnings he wishes to receive in-kind. The participating producer must have a minimum land and management capability in order to participate in this venture, which provides the participating producer with access to a quantity of quality animals that would normally take him years to acquire or a capital outlay beyond his means.

The Fondo provides technical assistance and supervision to the participating producer as a means of protecting its investment in animal resources. Some Fondos have also developed commercial input sales operations in areas where the private sector is not sufficiently developed. In addition, Fondos own and maintain farms under their direct supervision which provide services to all

cattlemen in the area. These services include the following: stud services of improved breeds of cattle, donkeys, pigs, and horses for genetic improvement of an individual's stock and on-farm training type activities.

(B) Background to the Development of a Fondo Ganadero in Honduras.

The idea for the establishment of a Fondo Ganadero in Honduras came about as a result of the Presidential Agricultural Task Force for Agriculture which visited Honduras in October 1982. The Task Force examined the livestock sector in Honduras and recognized the potential that it has for increased production and productivity keeping in mind its small farmer base. The Task Force recommended that the establishment of a Fondo Ganadero type enterprise in Honduras be thoroughly examined as a means of increasing small farmer incomes and well-being through livestock production.

The Fondo Ganadero experience in Colombia was suggested by the Presidential Agricultural Task Force as an example of a joint public and private sector livestock enterprise that has functioned quite well with small farmer participation over the past 40 years. Through a preliminary examination of the Fondo Ganadero concept the Mission considered it as a potential means of channeling credit resources to small and medium livestock producers that are currently outside of the formal credit system, primarily because of loan guarantee problems. Subsequent examination of the Fondos in Colombia indicated that the very reason that the Fondos developed as in-kind credit operations in Colombia was for some of these same reasons: the existence of smaller, non-commercially oriented producers and potential producers with secure, but untitled land without access to other forms of guarantees generally required by the formal banking system.

After the Mission's PID was approved, the Mission contracted for the services of an administrative and agricultural financing specialist who could assist the Mission in examining the administrative, management and financing aspects of the feasibility, design, establishment, and implementation of a Fondo Ganadero in Honduras. Shortly thereafter a commission composed of this A.I.D. contract employee, the GOH director of livestock programs, and the A.I.D. project development co-chairpersons made a trip to Colombia to visit three Fondos Ganaderos and the Central Bank of Colombia. The result of this trip was a clearer understanding of how these Fondos operate and the larger role that they have played in Colombian livestock development.

Since the return of this working group from Colombia, it has been active in explaining the Fondo concept to Honduran agroindustry representatives, producers' associations, reform sector groups, independent producers, cooperatives, and GOH officials. Reactions to the idea of the creation of a Fondo have been extremely positive among all groups. Most have presented ideas on how to adapt the model to Honduras in order to make it commercially viable. The Mission's conclusion is that with certain adaptations and on an initially smaller scale, much of the experience of the Colombian model could be transferred to Honduras.

III. Rationale for the Establishment of a Fondo Ganadero

(A) Economic Development. The economic rationale for developing a Fondo Ganadero in Honduras can be examined at the macroeconomic and microeconomic levels. Nationwide, the country suffers a lack of quality animals to process for meat operations and an insufficient quantity of milk for processing. Meat, traditionally the third most important foreign exchange earner in the Honduran economy, behind bananas and coffee, has recently fallen to fourth place, behind wood. The export meatpacking industry has been operating under capacity in recent years and several packing houses have closed their doors because they lack the daily quantity of carcasses necessary to operate profitably; others are simply operating inefficiently. This has important negative repercussions on the overall economy as export earnings from meat have fallen by 50 percent in the past two years (L. 121.5 million in 1980 vs. L. 64.1 million in 1982). The quantity of meat exported has suffered a corresponding decrease, from a high of 29,900 metric tons in 1979 to 15,000 metric tons in 1982. Previously the meatpackers were able to obtain lines of credit from private banks in order to purchase and distribute cattle to associated repasturing or fattening operations. They stopped such operations when their credit sources dried up.

In the processing of pork and milk, the industries have had to import raw materials to meet domestic demand. Over the past year alone, milk imports totalled US DOLS 11 million, another drain on the foreign exchange position of the country. Pork processing industries are currently experiencing an estimated annual production deficit of 3,100 metric tons.

The problems of the small and medium livestock producer were adequately described in detail in the PID. In summary, they employ a production system that is characterized by extremely low productivity levels, and they have little or no access to either credit or technical assistance. Returns to the farmers land, labor, and cash investments under the traditional system are typically lower than 2 percent. To initiate a commercially-viable livestock operation, the smaller producer sector would require heavy infusions of technical assistance and capital. At this time in Honduras neither the public sector nor the private sector individually has the capability to provide either of these inputs. There exists no private sector mechanism for the delivery of technical assistance to producers, and the public sector extension service is just beginning to organize itself in a manner which will enable it to provide some minimum coverage of livestock producers. Both private and public sector traditional credit mechanisms require collateral or other guarantees not normally within the reach of smaller producers, and because of burdensome requirements placed on most loans to the livestock sector, most loans have to be of a magnitude beyond the ability of the smaller producer to either qualify for or repay. The Fondo Ganadero represents a creative alternative to traditional agricultural technical assistance and credit solutions which combines the strengths of both the public and private sectors.

(B) Development of the Agricultural Sector. The Fondo Ganadero in Honduras will contribute to national livestock development by managing a very large herd in an efficient manner with small and medium producer

participation. The Fondo will purchase locally an initial herd of 6,200 head of cattle. This herd is available in country but is currently managed inefficiently in terms of demonstrated productivity coefficients. These indicate that the Fondo can expect to purchase cows which experience a 55% average birth rate, a 20% mortality rate, with little no or culling out or genetic selection. The Fondo will be capable of managing this herd in such a manner as to reach a 75% average birth rate, an average 3% mortality rate, careful culling out and genetic improvement by crossing with pure bred Holstein or Brown Swiss bulls. The net effect, over time, will be an increased supply of genetically superior animals.

The Mission feels that its expectations in this regard are justified by the demonstrated experience of the Fondo Ganaderos in Colombia where the Fondos have contributed to an increase in the size of the national herd, an increase in productivity of the herd that they manage, and an increase in the technological and business capability of the producers that they work with. Since by Colombian law Fondos are required to maintain 60 percent of their operations in breeding farms, they have been contributing to an increase of the national herd since they began. In addition, they have become an important and constant source of higher quality animal stock.

Approximately 8,000 producers have contractual relationships with the Colombian Fondos at present. It's difficult to estimate how many producers have been associated with the Fondos over the years as the length of individual relationships with the Fondos varies considerably. The Fondos themselves have experienced an increase in the productivity coefficients of their herds which has transformed into similar increases in the herds in the areas in which they work.

(C) Private Enterprise Development. In terms of industrial development, the livestock industry in its vertical composition in Honduras consists of a few wealthy businesses and individuals who control commercial processing and exporting facilities, a relatively small group of wealthy private producers who are organized almost exclusively for political and social ends, about 50,000 smaller, mostly non-commercial producers who are unorganized, and some 25,000 other farmers who, because they have a few head of cattle are categorized as "producers", but who in reality are farmers with a few cattle largely for home consumption and savings. The processing sector is the only part of the vertical chain that is developed. The export meat packers are particularly well organized. The external marketing and distribution of Honduran meat and all seven Honduran packing plants are controlled by the same small group of investors. This same group has, in selected cases, also entered into commercial production activities, setting up a few corporate farms for the purpose of supplying their own plants. While they have not succeeded in exerting absolute control over the entire vertical chain that represents the livestock industry, it appears that there has been some collusion in determining prices paid to producers for cattle delivered to the packing houses. Over the years, prices paid in Honduras for cattle destined for export have borne virtually no relationship to the world market price and, until recently, have been uniformly lower than the prices paid in

surrounding countries for cattle of equal quality. The result has been a decreasing quantity of cattle sold to the packing houses; and, consequently an increasing amount of downtime in each plant. An appreciable increase in live animal exports to Guatemala has been another result.

The upper strata of producers largely consists of those who have been able to get access to a sufficient amount of capital to be able to technically upgrade their production practices and lower their per unit costs of production to a point where they can make a profit under the prevailing price structure. These are individuals who have sufficient collateral or guarantees to secure commercial bank loans. Some of these have entered into commercial milk production. Some are selling their cattle to Guatemala at higher prices than those that have, until recently, been paid in Honduras. Many are operating at a loss, but continue to produce livestock in order to meet the requirements of the Agrarian Reform Law. By and large the active members of the various livestock producers' associations come from this sector.

There currently exist 19 cattlemen's associations in Honduras. They are organized regionally, and most associations are members of the National Federation of Honduran Cattle Producers. Other regional associations have dropped out of the national federation because they see no benefit in membership. Most producers do not pay their dues to the local associations because they, too, fail to realize membership benefits. In a few cases, where the benefits of membership are clearly seen, associations are strong and active. By and large, however, producer associations are weak and disorganized. They were created more around political objectives than providing services to their members, and still today are viewed as the mouthpieces for the interests of large landholders. In fact, among poor peasants, the word "ganadero" (cattleman) alone is sufficient to conjure up bad images of large landholders who are against that which might serve to benefit the poor.

The lower strata of the producer sector (in terms of amount of land, and number of head of cattle) is composed almost entirely of individuals who are outside the commercial system. Since the group is large (numbering about 75,000), it must be recognized that there is great variation within this group; some are better off than others. For example some producers and producer groups which have concentrated on milk production have been able to organize cooperatives for the joint financing of collection and cooling equipment. There are no notable exceptions among beef producers. These smaller producers generally do not sale directly to the industrial meat packing sector because they cannot afford to hold their cattle for a period long enough to fatten their cattle. They are largely unable to technify their production because they are not subjects of bank credit. They are by and large unorganized; if they are members of one of the producer associations, they are probably delinquent in their dues and inactive.

In addition, there are a large number of potential producers in Honduras. Many of these consist of reform sector settlements which have land classified for cattle use but which lack the capital and technical expertise necessary to begin production.

The Fondo Ganadero is a producer oriented business enterprise. In Honduras it would fill a void that currently exists. It would organize profit oriented business enterprises at the producer level, where organization is lacking. Since its business is to produce cattle on a big scale, the Fondo itself serves as a commercial tool working in favor of producers. It buys cattle in large numbers, and can serve an effective role in improving the conditions under which cattle are bought and sold. It sells quality cattle for slaughter in quantities large enough to be able to influence the price paid. It will control the marketing of a quantity of milk each year sufficient to negotiate fair contracts for its participating producers.

The Fondo Ganadero offers an excellent opportunity for the various groups that make up the Honduran livestock sector to participate in the sector's development. Producers and potential producers, meat packing plants, dairy processing plants, and livestock related industry will have a common base on which to build the sector quantitatively and qualitatively.

(D) Social Development. The social impacts of the establishment of a successful Fondo Ganadero are significant. The Fondo Ganadero operates in a manner designed to target resources toward those groups within the agricultural sector who are currently outside the formal, commercial system; the Fondo overcomes those barriers which to date have prevented poorer rural people from becoming commercial livestock producers. In addition, because the Honduran Fondo Ganadero will fill a void in the vertical integration of the livestock industry, its operations will provide direct and indirect economic and social benefits to the entire producer sector.

Because the establishment of a Fondo Ganadero could benefit either directly or indirectly the entire producer and industrial livestock sector, the definition of the Fondo's "target group" is necessarily loose. The different groups described above (Enterprise Development) are all potential beneficiaries of different activities of the Fondo Ganadero.

The direct beneficiaries of the in-kind lending program of the Fondo Ganadero (the "participating producers") will be non-commercial producers. Eighty percent of the Fondo cattle held in deposit will be on non-commercial farms. The Mission proposes to define this group in the following manner:

- (1) Individual farmers with less than 100 has. of land, who:
 - (a) have a minimum of 20-40 hectares, and a maximum of 50-100 hectares of native pasture available; that is, the actual load on the land is less than the land's capacity;
 - (b) have a level of assets below that required for commercial bank guarantees;
 - (c) earn 60 percent of their income from on-farm activities;
 - (d) can present proof of their peaceful possession of the land;
 - (e) must be able to begin operations with a minimum of 21 head of cattle.

(2) Production groups or cooperatives with less than 100 hectares per family, which:

- (a) have a minimum of 20-40 hectares of native pasture available; that is, the actual load on the land is less than the land's capacity;
- (b) have a level of assets below that required for commercial bank guarantees;
- (c) earn 60 percent of their income from on-farm activities;
- (d) have a minimum of a provisional property title to the land;
- (e) must be able to begin operations with a minimum of 30 head of cattle.

Given these definitions, the target sector for cattle breeding and fattening operations is potentially composed of over 16,000 individual farms which already have some experience in cattle production and over 1,000 group farms, some of which have livestock production experience. The Mission anticipates that among group participating producers, the participation of agrarian reform settlements will be high. One of the major problems encountered in the agrarian reform sector is the high desertion rate among land reform beneficiaries, primarily due to the lack of access to capital which would allow the groups to undertake productive activities. In many cases, reform groups leave land lying fallow because they do not have the financial resources to put it into production. Thousands of independent livestock producers are affected by essentially the same situation, resulting in an inefficient exploitation of cattle ranches and a low per hectare cattle load. These situations will be addressed by the Fondo Ganadero.

The swine component of the Fondo's operations is very experimental. Some Fondos in Colombia have successfully dealt with swine production, but very much as a side line. The rationale for introducing the swine component in the Honduran Fondo is two-fold. First increasing domestic swine production responds to the macroeconomic situation; Honduras has a deficit of pork. Pork is currently the most expensive meat at the retail level yet, when it is available, it sells fast. A growing private sector processing industry has responded to this opportunity, but requires more quality animals to process. Secondly, given the structural composition of the livestock producer sector and its small farmer base, swine production, given its low level of land and infrastructure requirements, is a viable alternative for producers who operate on a scale below that which can be considered commercially viable for cattle production. Entering into commercial, technical swine production can significantly increase the incomes of individuals within this group, and the quality and quantity of pork produced.

The requirements for entry into swine production activities of the Fondo differ substantially. Potential participating producers are those who:

- (1) have less than 20 hectares of land (20 hectares per family on group settlements) with potential to produce on farm the majority of the animals' energy requirements;

- (2) earn 80 percent of their total income from agriculture;
- (3) have a level of assets below that required for commercial bank guarantees; and,
- (4) can present proof of their peaceful possession of the land.

The Fondo Ganadero will strengthen reform sector and independent livestock producers by creating efficient economic production units. Participating producers will directly benefit from activities which will result in higher employment and greater income. The Fondo Ganadero also offers an opportunity to those small livestock producers who do not have a land title but use national land for livestock production. With in-kind credit, these producers will be able to meet the agrarian reform requirements on cattle density and will be eligible for a title to their plots.

The promotion and incorporation of small and medium livestock producers into commercial operations as a result of their transformation into efficient economic production units will strengthen the livestock sector. In another sense, it will assist in the consolidation of the sector. While differences of opinion will undoubtedly arise between the producer sector and the industrial sector, between the private sector and the public sector, and between smaller producers and large commercial producers, the Fondo Ganadero establishes a common ground and forum for common producer interests to prevail.

The Fondo owned and operated farms will provide the services described in Section IV below on demand to all producers with access to the farm. Services will be provided on a commercial basis.

More indirect benefits of the Fondo's operations will be diffused throughout the producer sector. Among these are the following:

- (1) Producers with an excess of improved cattle, including a few commercial breeders, will realize an alternative market for their cattle. The Fondo's first year purchase of cattle (6200 head) will be significant, after which it is anticipated that the Fondo will make fairly regular annual purchases to expand its operations.
- (2) Unorganized producers currently marketing their cattle without knowledge of market conditions will benefit from the influence of the Fondo in the market and from marketing information dissemination activities of the Fondo.

IV. The Fondo Ganadero in Honduras

(A) Introduction. The Honduran Fondo Ganadero will be a private enterprise constituted as a Sociedad Anonima established with mixed public and private sector capital. Producers who have expressed an interest in providing initial capital for the establishment of the Fondo and Mission representatives have begun consultations with the intention of legally constituting and

registering the Fondo at the earliest possible date. Given the experience of the Colombian Fondos regarding the level of effort necessary to operate profitably, the working group has concluded that in Honduras only one Fondo will be necessary. Of the three Fondos visited in Colombia, all provided services and programs over land areas geographically larger than Honduras and with numbers of cattle and participating producers larger than that which could be contemplated in Honduras for some years to come.

(B) Capitalization and Financing. In addition to the A.I.D. contribution to the financing of a Fondo Ganadero, initial capitalization and financing for the Fondo will result from the sale of shares. At the present time, the financing of a special credit line to the Fondo as currently exists in Colombia is not contemplated. However, the Mission has agreed to lend its assistance to producer associations which have expressed an interest in establishing a "timbre ganadero", with the purpose discussed below. In addition, a portion of each participating producer's milk income will be destined for Fondo capitalization.

(1) In Honduras, three classes of shares will exist:

(a) Class A stock will belong to public sector entities and may be purchased in cash or in-kind. These stocks are only negotiable within the public sector. Cash dividends will not be paid to these entities; rather, dividends will be reinvested in the Fondo through automatic share purchase. The working group recommends that public sector shares be purchased in-kind and, only as necessary, in cash. The in-kind capital would come in the form of two farms, one in Choluteca currently operated by the MNR and Porto Arturo on the north coast, owned and operated by INA. Shares for the appraised value of these facilities will be issued to the Central Government and to INA (as an autonomous agency). Preliminary negotiations indicate that both INA and the MNR are willing to turn these or similar facilities over to the Fondo with the understanding that ownership and operations of the facilities pass to the Fondo. These two farms will be important to the ability of the Fondo to provide certain of its services (training and genetic improvement), and they will serve as a home base for operations; that is, as a base from which cattle can be distributed among participating producers, from whence technicians can operate, input services and training provided. Preliminary indications are that the COH will not be in a position at this time to make a large cash contribution to the creation of a Fondo.

(b) Class B stock will correspond to the producer sector, transferrable only in the case of retirement of the producer from livestock operations. Class B stock will pay annual dividends. There are three ways in which capitalization will come from this sector. First, in the case of both Class B and Class C stock, a sales program will be launched and voluntary purchase

encouraged. It has been suggested by several producer groups that if voluntary purchases were to be made and attributable to the Project as counterpart (without which the Project could not be approved), the required level of private sector resources could be mobilized. Secondly, participating producers will automatically receive a percentage of their earnings in shares. In Colombia, this is fixed at 5 percent, but could be different in Honduras depending on the financial feasibility of the different operations (breeding, fattening, and swine breeding). Finally, as is demonstrated below, in order to initiate operations, the Fondo will have to purchase some 6200 head of cattle. It has been determined that such cattle are available in Honduras, largely in the South where for a variety of reasons (largely the Agrarian Reform Law) producers are overstocked. These producers currently have little market for these cattle and look forward to the creation of the Fondo and its entry into the market as a major cattle buyer. All Honduran producers who sell cattle to the Fondo will receive a portion of the purchase price per animal in Class B shares.

In addition to these three mechanisms, the working group has been discussing with cattlemen's associations, at their request, the possible assistance that AID might lend them to establish a "timbre ganadero" (cattle stamp). The stamp is something that the producers have been in favor of for sometime as a means of financing their own associations. They feel that the same mechanism could serve as an obligatory class B share purchase program for the Fondo. (see below)

The working group has discussed the possibility of crediting a portion of the A.I.D. funds for an advance on the purchase of Class B shares. These shares could then be registered against future payment. As the shares are paid, either through voluntary or obligatory mechanisms, the capital will then be utilized to finance other project inputs. This could conceivably off-set the need for a cash purchase of shares by the public sector.

(c) Class C stock will be purchased by other private sector industries or individuals. This stock will pay dividends and be freely transferrable within the private sector. The working group has also discussed the possibility of installing some mechanism for obligatory industrial (meat packers, milk processors, pork processors) purchase of shares, and have decided that formulae can be developed for determining an annual level of capital subscriptions required of those industries directly benefiting from the Project. For example, the Fondo will during its first operational year be in a position to guarantee to X milk plant the delivery of X amount of milk, with increases over time. This plant will then be required to purchase shares on an annual basis in an amount relative to the total amount of fresh milk it receives, including Fondo owned milk.

Mechanisms have yet to be developed to prevent individuals or companies from owning shares of more than one type. These will be developed in order to prevent control from being concentrated within one interest group.

(2) Timbre Ganadero. The possibility of establishing a "timbre ganadero" has been discussed in Honduras for some time. The "timbre", as proposed, is a fixed fee paid upon the sale of cattle. At the present time, each bill of sale must have attached to it a municipal stamp for the sale to be legal. As currently proposed, the cost of this stamp will be increased from 1 to 5 Lempiras. The 5 Lempiras will then be distributed between the municipality, the Fondo Ganadero, and the cattlemen's associations. If the Fondo were to receive L. 2.00 of the price of each stamp, based on 1982 sales information, approximately US DOLS 600,000 could be generated in this way. Proof of payment will be accepted by the Fondo in return for shares in the Fondo. The cattlemen's associations are firmly behind the establishment of such a system, and it is felt by producers and government officials alike that the political environment at the present time is conducive to the passage of the required legislation. The Mission has agreed to work with the associations and legal consultants to proceed with the "timbre ganadero".

(3) Milk Generations. Producers participating in breeding operations of the Fondo will realize significant daily income from the sale of milk produced by Fondo cattle. The Mission has explored various means of directing the value of some of the milk produced to the Fondo. The problem is one of control. After lengthy discussions with the industry, producers, and producer groups, it has been decided that the best method for achieving this is to require under the Fondo-Producer contract that one liter per cow per day be delivered to a local collection station specified in the contract. Preliminary financial analyses indicate that this is a fair portion of milk to be attributed to the Fondo and will serve as a significant source of operating funds for the Fondo. The designated collection station will be responsible for collecting and paying the Fondo for the value of milk delivered. Because this milk represents a portion of that produced by Fondo-owned cattle, this money will be attributed as income to the Fondo and shares will not be issued in return. The remainder of the milk produced will be sold by the producer who will retain the earnings.

(C) Organization and Management. The Fondo in Honduras will be headed by a Board of Directors elected at annual shareholder meetings. After discussions with all sectors, the Mission has come to the conclusion that representation on the Board should be allocated as follows: Public Sector (2 seats to be reserved for the Minister of Natural Resources, or his designee, and the Executive Director of INA, or his designee), Producer Sector (5 seats freely elected by the holders of Class B stock, with a minimum of three seats reserved for participating producers or ex-participating producers of the Fondo), Industrial Sector (2 seats freely elected by holders of Class C

stock). The Board of Directors will select a General Manager of the Fondo who will name an Assistant Manager with prior approval of the Board. The Fondo will be organized in accordance with the organigram attached (Attachment I).

(D) Activities of the Fondo Ganadero

(1) Animal Lending Program. The Fondo in Honduras will maintain in its operations the same emphases as the Fondos in Colombia. The Fondo will be required to maintain a minimum of 60 percent of its herd in breeding operations. The purpose of this requirement is to ensure that the primary objective of the Fondo is met; i.e., to expand cattle production in the country. In Honduras, a law already exists which prohibits the slaughter of cows of reproductive age. The regulated minimum of 60 percent will further require the Fondo to comply with this objective. The Fondo will also be required to maintain at least 80 percent of its cattle in deposit on the lands of small producers as defined above. These may be individuals or groups, but they must fill the general prerequisites established above. The purpose of this requirement, too, is to maintain the focus of the Fondo on its primary objective of expanding cattle production through the incorporation of new, commercially viable production units into the sector.

(a) Cattle Breeding (dual purpose) - The primary activity of the Fondo will be its dual purpose cattle program. This activity is similar to the Colombian Fondo emphasis on beef cattle breeding activities except that the milk variable is included. Data from the CATIE research experience indicates that in Honduras breeding herds can effectively function producing both milk and calves.

Detailed cost, income, and productivity projections for an example Fondo dual purpose operation are currently being prepared. Preliminary indications are that in such an operation the Fondo will provide a minimum of 20 cows and 1 bull to a farmer that has a minimum of 20 hectares of native pasture (13.5 hectares of improved pasture with an additional capacity to produce supplemental feedstuffs). This level of effort of land and animals is considered optimum for a family operated farm without the need for additional labor. At the end of one year this herd will have produced US DOLS 3,402 of milk at current prices and 13 calves with a value of US DOLS 1,925.

75 percent of the benefits of the milk production will remain with the participating producer. 60 percent of the value of the calves, minus the cost of services, will be paid to the producer. Since any increased value of the original herd provided is not calculated, inflation on the value of the original stock is prevented from being a major factor in the value increase paid to the participating farmers.

It is anticipated that the Fondo will require 4,000 open or bred half breed heifers and 200 purebred brown swiss or holstein bulls during the first year in order to work with approximately 150 participating producers. The 4,000 heifers will be half breed crosses of brown swiss or holstein with brahmin or creole stock. The Fondo will purchase these animals locally through the cattlemen's associations which have indicated that sufficient animals exist. Purchase will be undertaken in the form indicated above in Section IV(B)(1)(b). An additional 1,000 heifers will be purchased per year during the second two years of Fondo operations.

(b) Cattle Growing Out/Fattening. This operation will essentially work in the same way it works in Colombia. A number of cattle will be lent to a participating producer for fattening or finishing off, weight gains will be calculated at the end of the year, and earnings will be calculated on the value added.

The growing out/fattening of cattle destined for the slaughterhouses requires a greater degree of capital investment on the part of the farmer in order to provide a land and forage production capacity that can sustain high animal weight gains. There is no problem in Honduras in obtaining one or two year old animals suitable for fattening in the same manner described above. The problem has been that the vast majority of farmers are not capitalized enough to take on both the land improvement and animal purchase costs. It should be recognized from the outset that in its first years, the Fondo will work with those producers who already have some minimum of improved pasture and infrastructure.

It is expected that the Fondo will require 2,000 one to two year old bull calves to initiate operations with 50 participating producers. Approximately 1,000 additional animals per year will be purchased during the second two years of the Fondo. The breeding operations of the Fondo will also be a source of animals for the fattening operations.

(c) Swine Breeding - This small, pilot program will work in essentially the same way as the cattle breeding operation. Farmers will be supplied with breeding units by the Fondo. The farmer will be expected to grow on farm as much as possible of the energy supply for the animals and the Fondo will supply a supplemental protein source. There are certain varieties of bananas and platanos in Honduras that are sources of energy for swine. Depending on market conditions and the capability of the individual producer, the Fondo and the farmer will decide whether to sell the offspring from this operation as feeder pigs or attempt to fatten the animals on the same farm. A market for feeder pigs has been developing in the San Pedro Sula region.

It is expected that the Fondo will require 100 breeding sows to initiate operations with 10 participating producers. Additional animals will be purchased or raised on the Fondo's farms as required for expansion of swine activities.

(2) Training. As indicated above, it is anticipated that the groups most likely to participate in the Fondo will be individuals and reform groups who are currently do not have livestock, or who are small producers managing their herds at a technically and economically inefficient level. Comprehensive discussions with representatives of all segments of the livestock industry, including potential producers, has underlined the need to develop a comprehensive, technical training program for potential participating producers. In conjunction with the Pan American Agricultural school, the Ministry of Natural Resources, and local producers associations, a two-week training program will be developed. Participation in this program will be a contractual requirement of the potential participating producer before animals are delivered to his farm. The purpose of this training is not to convert every potential participant into a livestock technician, but rather to ensure that every participating producer possesses the basic animal management skills which will be required under his contract. The training is intended to be a serious, hands-on course after which, depending on the performance of the individual, the Fondo reserves the right to deny participation in the lending program.

The Fondo will cooperate actively with the Ministry of Natural Resources Livestock Directorate in its training programs. In addition to participating in the training of potential Fondo participating producers as described above, the MNR will participate in an orientation training program for Fondo technicians. This participation will focus on training techniques to be utilized by Fondo technicians in their one-on-one field contacts (training the trainers) and in providing an up-date or review of current livestock technology and research applicable to Honduras. This latter role will be very important in maintaining technological consistency in the extension services provided to Fondo participating producers and those provided through the Ministry.

(3) Technical Services. The technical services component of the Fondo is based on a program of regular visits by Fondo technicians to the participating producers. The primary purpose of these visits is for the Fondo to supervise and protect its investment in livestock, and provide necessary follow-up on the training received by the participating producers. For the Fondo, the primary measure of investment protection is the maintenance of the productivity of the herd. What the Fondo seeks through the provision of technical assistance is an actual technological improvement in the management of the herd by the producer, leading to a productivity increase.

The productivity of the herd is increased through the utilization of an improved technology package both for the dual purpose and growing

out/fattening operations. The Fondo supervision will be primarily concerned with the implementation of a vigorous animal health program with regular vaccinations and a proper feeding program that utilizes supplemental feedstuffs, as required, and mineral salts. The difference between the Fondo technical assistance program and the public sector one is that the Fondo has a vested profit interest in whatever technological innovation it promotes. It will therefore only promote those technological innovations for which it is insured of a definite return on the investment.

The Fondo's staff making farm visits will consist of animal production specialists, veterinarians, agronomists, and assessors. The sole responsibility of the assessors will be the annual assessment of the participating producer's herd. The primary focus of the technical personnel will be general animal husbandry. The role of these technicians is very important not only as a source of technical assistance for the participating producers but also as a means for the Fondo to follow-up on its participating producers. Each visit will result in a standardized, fill-in-the-blank report on the operations of the participating producer. If the participating producer is found to be in violation of his contract, he will be warned in writing. If the practice continues, the animals will be removed from the farm. Experience in Colombia suggests that the threat has to be real, even though it has not had to be exercised often there.

Conditions for removing animals from the farm of a depositario have to be clearly outlined in the contract. From our discussions with producer associations and potential participants, a series of "what if" questions have been repeatedly asked. Most of these questions have to do with the responsibility for the risk involved in managing the herd loaned to a given individual. For example, if an animal dies, the participating producer will be obliged to save that part of the hide which contains the brand to present to the Fondo technician on his following visit. If a cow is stolen, the participating producer will be obliged to show to the visiting technician his copy of the complaint filed with the local police. In general, if something of this nature happens once to a participating producer who is generally managing his herd well, it is recorded and forgotten. Fondo and producer share the loss in profits, the Fondo loses the investment. If it happens more than once, the case is more thoroughly examined and the participating producer is officially warned. In almost all cases, regardless of blame, the cattle will be removed from the farm on the third mishap of this nature.

After analyzing of the existing target group in Honduras, the working group has determined that there is a large demand for farm management assistance. This is especially true of recently settled reform group farms. In order to keep itself accountable to the Fondo, the producers will have to maintain a minimal level of records. Many producers will need instruction and follow-up to reach this minimum level. In response to this need, the Fondo will designate members of its auditing and

administrative staff to visit producers and assist them in setting up, understanding, and utilizing their records. This service will be paid in its totality by the producer or producer group either upon receipt of the service or on account attributable to producer earnings at the moment of contract liquidation.

(4) Credit and Provision of Inputs. While some of the Fondos in Colombia have entered into commercial input sales activities, the working group does not feel that this should be the case in Honduras during the Fondo's early years. In Colombia, Fondos moved into this area in response to a perceived need from participating producers for a specific input not readily available through private sector sources. The result was that in some of the areas, where the private sector was non-existent, the Fondo developed large, commercial input sales operations in response to overall demand. In other areas, the private sector was well developed, but for whatever reason, chose not to provide certain inputs required by the Fondo of its participating producers. The case in point is mineral and salt supplements. The working group suggests that the same principle be followed in Honduras. The Fondo should only enter into direct input provision where the product cannot be secured through commercial sources. If the Fondo does begin to provide inputs (probably salt), it will do so only on a commercial basis.

If current restrictions on commercial credit continue (especially the nature of collateral required), one program that should be developed in the Honduran Fondo is a small, in-kind credit program for participating producers. Given the expansion of the target group contemplated, certain minimal infrastructure needs will have to be in place before a potential producer could receive animals from the Fondo. These include forage choppers, fencing, corrals, and provisions for dipping the animals. It may also include inputs necessary for pasture improvement. Fondos in Colombia have been able to meet the minimum needs of some of their participating producers by providing the inputs in-kind as an advance on the earnings of the participating producer. The Fondo will also charge an interest rate to the depositario on this advance which reflects the Fondo's cost.

(5) Services Provided to All Livestock Producers. The Fondo will also provide services to all producers from the farms that it owns and manages. The Fondo will maintain high quality herds and offer stud services to farmers interested in genetic improvement of their cattle, horses, swine, and donkeys. In addition the Fondo will provide it's own training for area livestock producers through field days and demonstration activities on these farms.

In response to producers' needs for marketing and price information, the Fondos will develop a series of daily radio spots in which will be announced the prices paid for Honduran beef on the international market, the prices paid on the hoof at the export processing plants and at sample municipal slaughterhouses. This is a very low-cost, easy to

implement activity that can have a profound effect on the ability of private producers to profitably market their cattle and to make informed economic decisions regarding the value of a specific dual purpose animal vis-a-vis milk production and slaughter.

Another related marketing problem is the condition under which the sale of live animals to intermediaries takes place. Intermediaries subsequently resale the animals to other producers, fattening farms, or the slaughterhouses. These sales usually take place on the farm without the benefit of scales and without the seller really knowing what prices are being received elsewhere for cattle of equal weight, age, sex and quality. On request the Fondo will make available to individual producers the services of an experienced cattle assessor who will assist in determining a fair price for his live cattle. The service will be provided at cost plus fee.

(E) Preliminary Financial Analysis. A preliminary investment plan is presented below. The budget is based on a total herd size of 6200 head of cattle, 100 sows and 210 participating producers. Income from annual production and administrative expenses and operating costs are included.

MINIMUM INITIAL INVESTMENT

(US DOLS 000)

ANIMAL INVESTMENT

6200 head of cattle distributed as follows:

(200 producers with average of 30 head)

4000 2-3 yr. old females @ L. 900 ea.

1,800

200 bulls @ L. 2000 ea.

200

2000 weaned males @ L. 250 ea.

250

100 sows @ L. 300 ea.

15

Sub-Total Animal Investment

2,265

START UP ADMINISTRATIVE EXPENSES

Office equipment and services

250

Vehicles (15 Jeep type pick-ups @ US DOLS 15,000)

285

and 1 cattle truck @ US DOLS 60,000)

Farm rehabilitation

450

Sub-Total Administrative Start-up Expenses

985

FIRST-YEAR OPERATING COSTS

(US DOLS 000)

Salaries:

General Manager (L. 5000 x 13 annual pay periods)	32.50
Assistant Manager (L. 4000 x 13)	26.00
Chiefs of Department (3 x L. 3500 x 13)	68.25
Audit Department	
Technical/Commercial Department	
Financial/Administrative Department	
Professional technicians (9 x L. 2500 x 13)	146.25
Farm Managers (2 x L. 2500 x 13)	32.50
Farm Management technician (1 x L. 2500 x 13)	16.25
Veterinarian (1 x L. 3500 x 13)	22.75
Vaccination assistant (1 x L. 1500 x 13)	9.75
Assessors (3 x L. 1000 x 13)	19.50
Accountants (2 x L. 1000 x 13)	13.00
Secretaries (5 x L. 600 x 13)	19.50
Field Laborers (10 x L. 6/day x 220 days)	6.60

Subtotal Salaries

412.85

Other Operating Costs:

Office Supplies and Expenses	50.00
Vehicle Fuel and Maintenance	50.00
Farm operating costs	50.00
Inputs and Supplies (salts, vaccines, etc)	100.00
Feed	160.00
Animal Transport	10.00
Travel and PerDiem	50.00
Depositario Training	45.00
Miscellaneous	10.00

Subtotal Operating Costs

525.00

Subtotal First Year Operating Costs

937.85

TOTAL INITIAL INVESTMENT

4,187.85

INCOME AT THE END OF FIRST YEAR

(US DOLS 000)

PRODUCTION INCOME

Value of Calves Produced	410.40
Value of weight increase	484.00
Value of Milk Marketed (4.0 l/dy)	707.00
Value of swine produced	230.00
<u>TECHNICAL SERVICES INCOME</u> (6 percent of herd value)	136.00
<u>INTEREST INCOME</u> (16 percent of herd value)	362.40
<u>INPUT COSTS RETRIEVED</u>	260.00
<u>FARM INCOME</u>	<u>100.00</u>

TOTAL FIRST YEAR INCOME 2,689.80

LESS: PARTICIPATION PAID TO CLIENTS
(Minus value of inputs)

55 percent in cash on calf and weight increases	139.15
5 percent in Fondo shares on calf and weight	12.70
75 percent milk income	530.25
55 percent in cash on swine produced	193.60
5 percent in Fondo shares on swine	<u>17.60</u>

TOTAL COST OF FIRST YEAR LIQUIDATIONS 893.30

NET EARNINGS FOR FONDO GANADERO 1,796.50

.....

ESTIMATED EARNINGS AND LOSSES FOR FONDO GANADERO

Income from calves, weight increases, swine and milk	627.00
Income from Technical Services	136.00
Interest Income	362.40
Farm Income	100.00
Inputs	<u>260.00</u>

TOTAL INCOME 1,485.40

Total costs first year 937.85

FIRST YEAR EARNINGS 547.55

.....

In sum, the overall financial picture of the Fondo Ganadero for the first year is as follows:

	(US DOLS)
Total Initial Investment	4,187,850.00
Participant producer earnings (cash)	863,000.00
Participant producer shares issued (Class B)	30,300.00
Gross Earnings of Fondo Ganadero	1,485,400.00
Operating Cost of Fondo Ganadero	937,850.00
Net Earnings of Fondo Ganadero	547,550.00

A major problem of the Fondo Ganadero as a business enterprise is liquidity. Cash flow has been a historical problem of the Fondos in Colombia, and preliminary calculations for a Honduran Fondo indicate it will be a concern here. The problem is related to the structure of Fondo operations, and is easy to see.

In order to incorporate lower income producers and new producers who do not have the capacity to carry over cattle inventory without realizing cash income, the Fondo retains ownership of the animals and pays the participating producer in cash the increase in value of the herd. As indicated in the above financial analysis, US DOLS 863,000.00 in cash will be destined to participating producers during the first year in this manner. Some of this is capital paid out on calves produced. The Fondo, however, will have to hold these calves for a minimum total of two and one-half years after the first contract liquidation before their value can be realized in cash income to the Fondo (when the males are presented for slaughter). While various cash flow analyses are still underway, it is clear that the tendency toward liquidity exists. The Mission feels there exist various alternatives to combat the problem and is currently exploring each in more detail. These include: 1) ensuring the financial strength (equity, assets) of the Fondo to the point where it will be an eligible and attractive, short-term commercial borrower; 2) using a portion of the funds generated from the "timbre ganadero" to establish a Central Bank credit line which will provide short-term financing for this purpose; 3) using a portion of funds generated under a PL-480 milk program for the same purpose; and, 4) the feasibility of paying the 55 percent increase in value on calves produced in the form of the calves themselves. This last alternative would be attractive for those participating producers who wish to establish or increase their own herd.

V. Specific Issues Raised in the PID Guidance Cable.

(A) The Fondo Ganadero as a New Credit Institution. The Fondo Ganadero is a for profit business which provides credit and technical services on an in-kind basis. In view of its findings regarding the acceptability, adaptability and support for this institution, the Mission is extremely positive about the Fondo's long-run ability to meet a specific and significant demand for livestock credit in Honduras. As explained above, the Fondo seeks

to incorporate into the commercial livestock industry those producers and potential producers who currently are outside of the reach of both commercial bank credit programs and the public sector extension service. By and large these producers are not subject to bank credit because of their lack of collateral to secure loans. To service the technical assistance needs of increasing numbers of producers through the public sector extension service would require an increase in the size of that extension service that is unacceptable to, and not sustainable by an austerity minded GOH.

Experience in Honduras has clearly indicated that credit and technical assistance have to be linked at the farm level for the goals of increased profitability and production to be reached among the target group. A credit program without technical assistance can only succeed within a target group that already is technically experienced. Technical assistance without credit can only succeed if the individual farmer is able to secure credit through the banking sector. As stated above, the Project's target group is neither technically experienced, nor is it able to secure credit through normal bank channels. For this reason, the Mission will not propose a Fondo Ganadero which provides technical assistance divorced from the in-kind credit program.

The Fondo Ganadero without the cattle lending program is not financially feasible. The Fondo's in-cash income comes from two sources. It charges fees for the services it provides on its own farms. These fees are designed to finance the operations of those farms. Given that the farms also serve as the genetic laboratory of the Fondo, it is expected that profits realized on farm operations will, at best, be minimal. The Fondo will generate most of its income from the sale of its animals and milk. Because the animals remain the possession of the Fondo, the Fondo itself realizes the profits from the sale of the animals for slaughter. In addition, the Fondo will receive income from the sale of that portion of milk delivered by a participating producer to a participating milk collection or processing facility. Profits on these operations will provide the working capital to off set the costs of the technical assistance personnel. If the Fondo did not own animals, and served, instead, solely as a source of technical assistance, beneficiaries themselves would have to pay directly the costs of the technical assistance. Without establishing the mechanism whereby beneficiaries are allowed to pay the costs of technical services at the moment they are best able to afford it, and without guaranteeing that both credit and technical assistance are in place at the proper time, experience in Honduras indicates that producers will not pay for technical services.

(B) Other Credit Issues. The PID guidance cable correctly points out that the Mission has proposed a project credit component additional to the Fondo Ganadero's in-kind credit activities. As originally contemplated this credit was destined for the following purposes:

- (1) Credit for introduction of a technological improvement package on smaller farms independent of the Fondo Ganadero;

(2) Complementary credit for Fondo potential participating producers for minimum infrastructure, pasture improvement, and equipment required before delivery of cattle; and,

(3) Credit for producer groups or cooperatives for the installation of milk and meat marketing infrastructure (e.g., milk collection/cooling facilities, scales, etc)

Existing demand for livestock credit in Honduras is high. The Mission has recently completed an overview analysis of the demand for livestock credit in Honduras and has determined that substantial demand for credit for all of the purposes described above, including in-kind credit, exists. There are various reasons for this. The first reason is the lack of credit available through commercial sources for 90 percent of all cattle producers and 95 percent of pork production units. This is largely due to the collateral problem thoroughly described in the PID and subsequently in cables from the Mission (Tegucigalpa 605 and Tegucigalpa 4105). The World Bank/Central Bank livestock development program, implemented through commercial banks and BANADESA, is currently the only significant source of credit for livestock development in Honduras. It does not reach the producer groups described above because of the same collateral issue and also because of certain structural requirements also discussed in the cables mentioned above. A second reason that demand for livestock credit is high is because of the diversification needs of producers and producer groups. Due largely to restricted quotas and falling prices, both coffee and sugar producers (among others) have recognized the need to diversify. Livestock, for which no meat quota currently exists and for which milk represents a significant cash income, is an attractive potential investment for these groups. A third significant reason for high demand for livestock credit is that during the past year alone approximately 225 new groups have been settled under the Agrarian Reform Law. These groups are, largely by definition, settled on land that is not under production. Many of these groups have been settled in traditional livestock areas with land apt for pasture. They represent a large, vocal group of potential producers who, for the same reasons of collateral, are not subjects of commercial bank credit.

Given the reception the idea of the establishment of a Fondo Ganadero has received thus far, especially within the producer and processing sector, the Mission has decided not to propose a parallel production level credit/technical assistance component of the project independent of the Fondo Ganadero (credit purpose #1 described above). With respect to the need for complementary credit for Fondo participating producers (#2, above), the Mission is continuing its dialog with World Bank staff in Honduras, and continues to count on the efforts of AID/W to gain more flexibility under the World Bank/Central Bank program to meet these needs. The Mission will continue to examine other alternatives for meeting these needs, one of which is the establishment of a credit line within the Fondo Ganadero.

A credit line for marketing infrastructure will continue to be part of the Mission's proposal. Small infrastructure packages have been developed (maximum cost US DOLS 130,000), and the livestock sector development plans, currently under preparation, will identify placement of such infrastructure.

(C) Ownership of the Fondo Ganadero. Based on the experience of the Colombian Fondo Ganaderos and the political, financial and social realities of the Honduran livestock sector, the Mission believes that for a minimum period of time ownership, voting rights, and representation on the Board of Directors of the Fondo Ganadero should be regulated. The system of ownership and representation described above (Section IV), including the different classes of stock and the number of seats on the Board of Directors, has been developed after extensive discussions with analysis of all of the different interests that make up the livestock sector. The Mission is convinced that at this time, and for the first years of the Fondo Ganadero, the distribution of ownership and representation described above is the only way to ensure both the financial commitment of all groups and the guarantee that neither the public sector nor the agribusiness sector will gain absolute control of the Fondo and direct its activities towards their own, rather than producer welfare. We base this on the following principles and conclusions:

- (1) The power to determine the Fondo's management and operations, its current priorities, and its future directions should be held by the private, producer sector.
- (2) Such determinations should take into account and be influenced by sound private agribusiness experience and practices.
- (3) Such determinations should take into account and be influenced by GOH policies. In turn, GOH policies as they affect the livestock sector should be influenced by organized producers.
- (4) The Fondo needs to capitalize itself by tapping as many sources as possible. Capitalization is one means of ensuring a shareholder's commitment to the success of the company. However, he who perceives or realizes a benefit from the Fondo will assist in the capitalization only if he is ensured a voice in guiding the company. This is how the investor will protect his investment and ensure that he will continue to benefit from the operations.
- (5) Neither the public nor the private sector alone has the capability to deal with all aspects of the Fondo. The private commercial producer sector has technical expertise necessary to guide the Fondo. The private agribusiness sector has the management expertise to guide the Fondo. The public sector has the development expertise to guide the Fondo and the power to determine national policies which will assist the Fondo and the producer sector.
- (6) Capitalization from the public and private industrial sector can be mobilized early. The process of capitalizing shares from the producer sector, which should control the Fondo, will take some time. To allow either the public or the private industrial sector to control the Fondo from the beginning (the result if one or the other is excluded) carries the danger of a take over (either de facto or de jure) which could prevent the Fondo from realizing its producer orientation.

We do not, however, believe that eventual complete private ownership of the Fondo is impossible. In fact, the Mission supports the eventual conversion of all public sector stock in the Fondo into Class B (producer) ownership shares. For this reason, the Mission will negotiate with the public sector the inclusion of a covenant in the loan agreement which will call for transfer of public sector stock by the end of the Project life given that certain conditions have been met. It is unclear at this point how mandatory, or what the conditions for such a covenant will be. We anticipate completion of negotiations before the Project Paper is submitted for AID/W review.

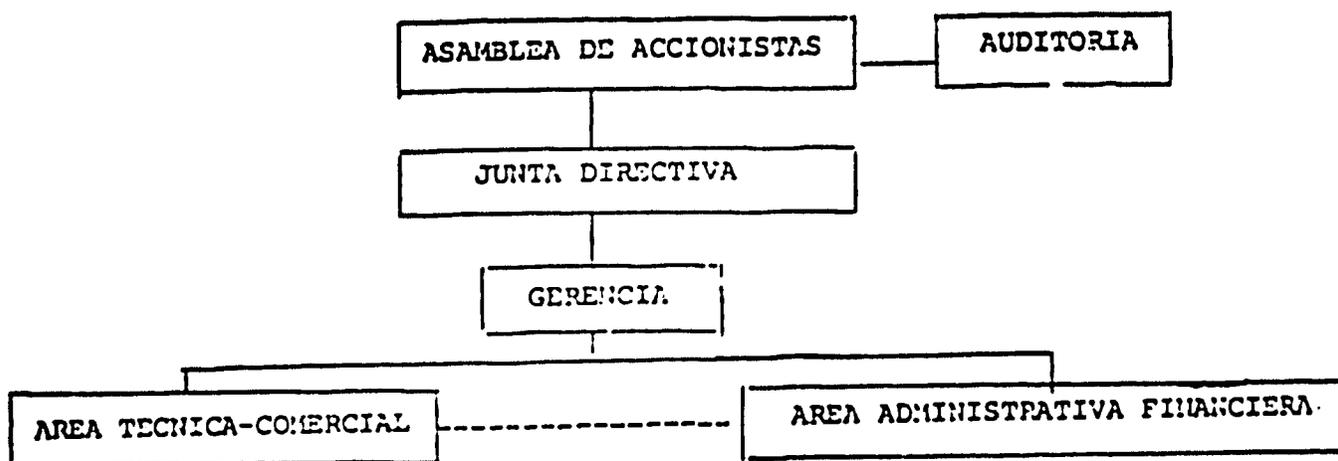
(D) Long Run Role of the Fondo Ganadero. Based on our discussions with public and private sector representatives, the Mission views the long run importance of the Fondo Ganadero in two ways. First, it will become an important self-financing source of credit and technical assistance for increasing numbers of smaller producers, thereby playing an important role in the expansion and improvement of animal production in the country. Secondly, it will play an increasingly powerful role in promoting producer interests at the national level.

In its animal lending program, the work of the Fondo is to incorporate more producers into commercial operations and to graduate them from the Fondo. The Fondo earns its income by increasing its herd size. The Fondo's best interests are served by dividing this herd into smaller herds of a minimum size (21 animals or more) and placing them on increasing numbers of participating farms. Alternatively, as participating producers work with Fondo cattle over a number of years, assuming their land area is fixed, they need less and less additional cattle. The Fondo, since it cannot economically service increasing numbers of smaller (below the minimum) herds, must graduate these producers. Likewise, graduated producers will have reached a level of technical expertise and will have acquired financial resources and capital assets sufficient to gain entry into the formal commercial credit system. Since this program is the basic business activity of the Fondo, it will be in the Fondo's best interest to both increase the total number of participating producers included in the program at any one time, and to replace participating producers in need of less in-kind credit assistance (animals) with those who need more. While the Mission proposes that the Fondo begin operations in a limited number of geographic regions of the country, normal economic incentives will force the Fondo to expand into other areas in search of more participating producers, as its assets, management, and technical assistance delivery capabilities increase. In this way and as the Fondo matures over the years, it will move out of its original target group in two ways. First, it will seek out newly created, frontier farm units of the same minimum or larger size. Secondly, it may expand its activities to smaller existing units as its financial ability to provide for the implementation of a complete technical renovation package increases; i.e., as the Fondo is able to provide financing for inputs which will increase the carrying capacity of a smaller (less than 20 hectare) farm so that it can receive the minimum number of cattle.

As described above in Section III(C), the Honduran livestock producer sector is virtually unorganized, although there exist certain producer associations which could serve as a basis for organizing it. For the majority of livestock producers the problem is one of the image of these associations and the lack of membership benefits. The Fondo will serve as a vehicle through which the producer sector can organize itself. This is particularly important given the existing strength of the industrial sector. The Mission has already witnessed in the coffee sector several successful examples of what organized producers can do for themselves once serious business-oriented, producer controlled institutions are established. We look forward to replicating part of that experience within another sector.

ATTACHMENT I

ESQUEMA DE ORGANIZACION
DEL FONDO GANADERO DE HONDURAS



MEDICOS VETERINARIOS
ZOOTECNISTAS
AGRONOMOS
EXTENSIONISTAS
VACUNADORES
FINCAS PROPIAS
AVALUADORES
INSPECTORES
LIQUIDADORES

CONTABILIDAD
ESTADISTICA
CONTROL GANADOS
ACCIONISTAS
DIVIDENDOS
LIQUIDACIONES
PERSONAL
ARCHIVO

UNCLASSIFIED

RESOLVED AND THE POTENTIAL ADAPTABILITY OF THIS MODEL TO THE HONDURAS SITUATION FIRMLY ESTABLISHED PRIOR TO THE DEVELOPMENT OF THE PP, MISSION IS ASKED TO SUBMIT THE INTERIM REPORT BY THE END OF MARCH.

3. TARGET GROUP: THE MISSION'S DEFINITION OF POTENTIAL BENEFICIARIES IS FARMERS WITH 5 TO 50 HECTARES AND UP TO 30 HEAD OF CATTLE, ALTHOUGH TYPICALLY FARMS OF THIS SIZE HAVE LESS THAN 15 HEAD OF CATTLE. THE MISSION SHOULD EXAMINE CAREFULLY THE FEASIBILITY OF LIMITING THE PROJECT BENEFICIARIES TO SMALL FARMERS ON THE LOWER END OF THE SIZE/INCOME SCALE. SPECIFICALLY, THE FINANCIAL/ECONOMIC ANALYSIS SHOULD EXAMINE THE PROJECT'S FEASIBILITY WITH TARGET GROUPS CONSISTING OF FARMERS WITH FEWER THAN 15 HEAD OF CATTLE AND SWINE PRODUCERS WITH LESS THAN 10 HECTARES.

4. MARKET DEMAND: THE PP SHOULD CONTAIN A THOROUGH DEMAND/SUPPLY ANALYSIS, INCLUDING BOTH THE INTERNAL AND EXTERNAL DEMAND FOR HONDURAN MILK, PORK, AND MEAT, PRICE ELASTICITIES, POTENTIAL NEW MARKETS, AND A CLEAR ESTIMATE OF THE INCREASED LEVELS OF MILK, BEEF, AND PORK PRODUCTION EXPECTED TO RESULT FROM THIS PROJECT.

5. FINANCIAL FEASIBILITY: THE DAEC STRONGLY CONCURRED WITH THE MISSION IN THE NEED TO UNDERTAKE A THOROUGH FINANCIAL FEASIBILITY ANALYSIS OF THE CATTLE PRODUCTION MODEL. AS A PRIMARY TECHNOLOGICAL COMPONENT OF THE

PROJECT, FINANCIAL VIABILITY SHOULD BE ANALYZED IN TERMS OF THE CATTLE PRODUCTION MODEL'S ROLE IN THE ENTIRE FARM SYSTEM (I.E. CROPS AND LIVESTOCK), ALTERNATIVE LAND USES, AND COSTS OF THE PACKAGE VS. PAYBACK CAPABILITY. GIVEN THE LONG PAYBACK PERIOD OF THIS MODEL, COST-EFFECTIVENESS OF THIS PACKAGE FOR THE SMALL PRODUCER AT MARKET INTEREST RATES SHOULD BE FULLY EXPLORED.

6. CREDIT: THE RATIONALE FOR INCLUSION OF A CREDIT COMPONENT WAS UNCLEAR IN THE PID, IN LIGHT OF OTHER EXISTING SOURCES OF CREDIT FOR SMALL LIVESTOCK PRODUCERS. WE CONCUR WITH MISSION'S ASSESSMENT THAT IF THE IBRD PROJECT COULD BE EXTENDED TO THE SMALL LIVESTOCK PRODUCERS, A CREDIT COMPONENT WOULD BE UNNECESSARY. BUREAU WILL ASSIST IN MISSION EFFORTS TO PERSUADE THE IBRD TO MODIFY ITS CRITERIA TO PERMIT THE INCLUSION OF SMALL FARMERS. SHOULD THESE EFFORTS NOT SUCCEED AND IF A CREDIT COMPONENT IS INCLUDED IN FINAL PROJECT DESIGN, THE PP SHOULD ANSWER THE FOLLOWING QUESTIONS: (1) WHAT IS THE EXISTING DEMAND FOR CREDIT FOR LIVESTOCK PRODUCTION? (2) IS THE TARGET GROUP FOR THE FONDC GANADERO THE SAME AS THAT FOR CREDIT CHanneled THROUGH THE PRIVATE BANKS? AND (3) IS THE

ET

#6808

UNCLASSIFIED

UNCLAS SECTION 02 OF 02 STATE 036808

AIDAC

LEGISLATION REQUIRED TO ENSURE BANK ACCEPTANCE OF CATTLE AS COLLATERAL TO ENSURE THAT THE SMALL PRODUCERS HAVE ACCESS TO CREDIT? IF SO, WHAT ARE PROSPECTS FOR AND TIMING OF THIS LEGISLATION AND HOW DOES IT AFFECT THE CREDIT COMPONENT?

7. GGH MILK POLICIES: DURING PP DEVELOPMENT THE MISSION SHOULD ENTER INTO A POLICY DIALOGUE WITH THE GGH TO ENSURE THAT THE IMPORTS OF EEC DRIED MILK AND DAIRY SUPPLIES THROUGH P.L. 480 DO NOT CREATE A DISINCENTIVE OR LIMITATION TO INCREASED HONDURAN MILK PRODUCTION RESULTING FROM THIS PROGRAM. THE POLICY ISSUES SHOULD BE RESOLVED PRIOR TO IMPLEMENTATION OF PROJECT COMPONENTS AFFECTING MILK PRODUCTION. DAN

BT
#409

UNCLASSIFIED