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Honduras

Small Farmer Organization Strengthening Project:

Results Achieved and Lessons Learned

Prepared by:

Donald Jackson
and
Robert Fries

Agricultural Cooperative
Development International
50 F Street, N.W., Suite 900
Washington, DC 20001

Phone: (202) 638-4661
Fax: (202) 626-8726

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EXECUTIVE SUMMARY

This report focuses on the lessons learned in the process of implementing the Honduran Small Farmer Organization Strengthening Project within the agricultural sector. An assessment of Project efforts with credit unions are presented in a separate study being carried out by the World Council of Credit Unions. The lessons highlighted in this report fit into two general categories: areas of achievement and recommendations for improvement.

A. Areas of Achievement

Early on in the life of the project a decision was made to focus initial efforts on one agricultural organization, UNIOCOOP -- rather than three or four. While this decision may have narrowed the number of farmers it reached directly, it proved to be a wise one. It resulted in a degree of focus that allowed the project to achieve the following three results that are central to project success. Had the Project spread its resources more thinly and divided its attention between two very different types of farmer organizations from the beginning, it is less likely that these results would have occurred.

1. The project succeeded in *developing and transferring* an *effective strengthening methodology* to UNIOCOOP and its affiliates. The process was effective because:

- it was **clear and consistent**, so the cooperatives could enter into it with the **confidence** that they knew the rules;

- by requiring the participation of the directors and manager of each cooperative, relevant **skills** and a **sense of ownership** and control were instilled in the participating institutions; and

- by **linking grants and loans** to **goals and adjustments in financial and managerial** policies, it required the cooperatives to respond to Project assistance with efforts of their own.

2. The project relied on an *integrated approach* both in its implementation, and in its strategy for strengthening UNIOCOOP. The **project components** -- Institutional Support, Financial Stabilization and Credit -- complemented each other in a three-pronged approach to cooperative strengthening. As mentioned above, grants and loans were tied to specific goals and changes, making the specific mechanisms used by the FDF and Project more than just ends in themselves, but means to reinforce other ends. Grants that supported **extension agents** and **computerized accounting systems**, also promoted **cooperative training** and proper **loan management**. A series of **capitalization policies** were adopted by the cooperatives in response to agreements they signed with the FDF. And one of the more impressive mechanisms pain-stakingly negotiated by the Project and FDF -- **debt buy-downs** -- also motivated cooperatives to make specific changes in their credit, administrative and marketing policies.

Furthermore, UNIOCOOP was strengthened by making it a more **integrated system** in three ways. First, the **planning and strengthening process** was transferred not only to the **apex** organization, but to most of its **member cooperatives** as well. This enhanced, rather than diminished, the members' ability to petition the apex. Second, the Project encouraged UNIOCOOP to **define its mission** more clearly, getting it to focus on the reliable and cost-effective delivery of services to its affiliates. This definition provides UNIOCOOP with an economic raison d'etre that responds to the mutual interests of its members. Finally, by **providing credit** for UNIOCOOP to acquire fertilizer and inputs in a time of scarcity, the FDF **reinforced** UNIOCOOP's **economic raison d'etre** and enhanced member loyalty.

3. By providing cooperatives with access to credit and technical assistance with which they can acquire *assets and skills* that *increase* their *productivity and profitability*, the Project promotes more than the stabilization of cooperatives; *it promotes growth.* While much of the initial planning processes revolved around stabilizing the cooperatives, the project is starting to embark on a new emphasis with the more stabilized institutions, planning for growth by investing in productive assets. **Technical assistance** focused on improving commodity quality and marketing has also proved vital to enhancing cooperative profitability. Both **credit** and **stabilization funds** have been used to enhance this as well. The use of stabilization funds is based on the assumption that there are times when the very stabilization of an agricultural cooperative depends on making it more profitable. Fertilizer has been imported. Coffee processing equipment has been purchased and installed. While the assessment team was in the field, a second team was involved in developing a **methodology** for identifying and capitalizing on additional opportunities to increase the capacity and profitability of cooperatives participating in the Project.

This evolution from strengthening to growth is important for two reasons:

- It reinforces the success of the project in strengthening a number of cooperatives to the point that they can "graduate" as viable businesses.

- It provides those not yet ready for graduation with an added, concrete incentive: "We are undergoing a strengthening process not for its own sake, but in order to move from a status of merely maintaining to one of growth."

The project is now poised to reach out to its newer beneficiaries with these lessons learned. As it develops a relationship with DICOMCAFE, FECORAH, and ANACH it knows the importance of a clear, consistent, and participatory methodology for institutional strengthening; an integrated approach to both the strengthening process and institutions; and an emphasis on growth for "graduates."

B. Recommendations for Improvement

Having recognized the achievements in the project, both in how it has been implemented and how it has evolved, it is important to note the four general areas where it can be improved:

- issues of coordination both between the various institutions involved in the Project and between the Project and other entities in the Honduran agricultural sector;
- issues which impact primarily at the UNIOCOOP and individual cooperative levels;
- issues which impact primarily on the FDF; and
- issues related to project disbursements and to USAID.

Issues of Coordination

1) The division of efforts between UNIOCOOP and the FDF should be based on each organization's relative strengths. As such, financial support and technical assistance dealing with financial issues should remain with the FDF, and technical assistance dealing with management, organizational, and agricultural issues should become formal activities better placed within the structure of UNIOCOOP.

2) In working with DICOMCAFE, the project must not undermine its own foreign exchange strategy for UNIOCOOP. The Project's main objective in supporting coffee cooperatives has been to raise the quality of exports in order to achieve top market prices. To this end, volumes under the control of the cooperative movement must be increased to a level that justifies obtaining an export license. As DICOMCAFE can contribute to this effort, it should participate. However, a strategy that benefits both DICOMCAFE and UNIOCOOP must be devised. Ideally, if collaboration between these two current competitors were feasible, it could both increase the quantity and quality of coffee and provide a source of foreign exchange for UNIOCOOP's imports.

3) UNIOCOOP and FEPROEXAH (FPX) should coordinate their activities more effectively. Ways need to be sought to bring together these two organizations and facilitate the accomplishment of their complementary objectives. USAID, as a financial backer of both, should lead the coordination effort. At a minimum, UNIOCOOP needs to inform FPX of the types of commodities its members are capable of producing, and FPX should search out market information -- market windows, price trends, quality standards, and transportation requirements and availability -- for the crops with the highest potential. Ideally, FPX would identify specific markets and support the cooperatives through the entire exportation process. Fees for this service could be charged by FPX.

Issues at the Cooperative Level

1) As the FDF enters into support agreements with *Reform Sector* cooperatives, it must maintain as its goal the development of business-oriented and efficiently managed cooperatives. This will require a clear, consistent and effective methodology that recognizes the differences between the "reform sector" federations and UNIOCOOP. The new methodology should include:

- selection criteria that tie project participation to a cooperative's willingness to conform to the goals of the Project, establish an effective management system, and to orient itself to building a sound economic base;

- greater emphasis on educational services in such areas as literacy, cooperative organization, decision making, and basic accounting and management principles (an expanded education program of this type will require increased Project resources); and

- incentives that respond appropriately to different land tenure systems.

2) Because of very basic differences, *credit unions and agricultural cooperatives* require separate and distinct assistance strategies and performance indicators. While both the Technical Assistance team and FDF staff do a good job of separating the two types of cooperatives, USAID might go further and separate its assistance to these sectors into two distinct projects.

3) The FDF should assist UNIOCOOP in supporting the CHC (Confederación Hondureña de Cooperativas) in its efforts to petition government for an exoneration from the payment of *income taxes* by agricultural cooperatives. The strongest economic argument for this is that the cooperatives are non-profit in character and, through their various levels of capitalization, will invest almost all surpluses in productive uses. Should the government decide against the exoneration, a careful study should be made by the FDF to determine the impact of income taxes and the best way for them to reduce their tax liabilities. This could include "zero-based" profit targeting (assuming required capitalization targets are met), contributions to reserve and blocked member accounts of many types, and improving the quality of services to members.

4) The only way to achieve well managed cooperatives is through long-term educational programs combined with *personnel policies* which attract and hold dynamic, dedicated, and tenured staff. In addition to an upcoming consultancy on staff incentive programs, the Project should continue to work with FDF and cooperative leadership on methods to provide their staffs with production and efficiency incentives that are based on sound personnel policies.

5) While the Project has made great gains in encouraging cooperatives to improve their credit policies, the cooperatives would benefit from discouraging *100% financing of production needs.* Shared risk between farmer and financial institution is important when providing production credit. Pending careful crop and loan analyses, farmer members should be encouraged to the extent possible to self-finance their production credit needs. FDF staff should make every effort to inform cooperative members of the increased vulnerability they accept when they take out loans approaching 100 percent of credit needs. A sliding interest scale could be instituted between the cooperatives and their member borrowers to encourage shared risk, with higher interest rates being charged against higher percentages of financing.

Issues at the FDF Level

1) The FDF needs to develop *clearer policies and processes* in the following areas:

a) Criteria for Selection, Graduation and the Use of Project Components. The establishment of clear, easily understood, and easily quantifiable criteria for the selection and graduation of cooperatives supported under the Project should be elaborated and implemented as soon as possible. **Selection criteria** might include: crops grown, level of technology utilized, level of processing required, number of potential beneficiaries, level of indebtedness, willingness to support business-like management structures, etc. **Graduation criteria** could include such indicators as levels of self-sufficiency and subsidy, liquidity ratios, efficient management, etc. Finally, the FDF must articulate clear policies and guidelines for the **selection and admistration of the three project components.** Once these policies are approved, the actions proposed by the local-hire Project Managers should conform to them.

b) Management Information and Monitoring. Establishing an effective and consistent management information system needs to be a priority for the FDF and the SFOSP. It is needed to monitor the impact of the project, to more clearly assess cooperative needs, and to make more informed and speedy decisions about loans. Efforts in this area should include specifying the **indicators and analysis required for loan approvals,** improving the **standard forms** currently used for monitoring participating cooperatives, **computerized reporting** on project progress and disbursements, and continued assistance with **cost-accounting and monitoring practices** at the cooperative level. In monitoring the cooperatives, the FDF should systematically apply such tools as turnover ratios, margins as a function of variable costs, net operating leverage, in addition to financial ratios such as ROA and ROE. Perhaps a **short-term specialist** would be helpful in structuring this system.

c) Accounting System Conventions. FDF should encourage UNIOCOOP and its member cooperatives to establish Depreciation/ Inflation Reserves to shield windfall profits and reduce over-inflated income tax liabilities. These reserves would have to be in the name of each cooperative and not subject to distribution to members.

d) **Member Level Financial Analysis.** In its promotion of effective monitoring systems, the FDF should encourage the cooperatives to engage in financial analysis at the member level. Essentially, what appears to be lacking at a number of cooperatives is an analysis at the farm level of what the farmer members require in terms of yields and prices in order to cover the variable costs in their operations. At those cooperatives where basic "break-even analysis" is being conducted, a more substantial "sensitivity analysis" could be promoted.

2) ***FDF's future* success depends on developing the capacities highlighted above, securing its independence from FACACH, and providing financial services to cooperatives.** The FDF and the Mission must make every effort to secure its independence from FACACH and obtain a status that will allow the organization to enter into binding agreements, directly receive external funds, and seek a more diversified selection of financial backers for those funds.

Additionally, the FDF should concentrate on the provision of financial services to cooperatives, relying on the Project-supported apex organizations to which the cooperatives belong to supply technical assistance. A number of individuals interviewed expressed a vision of the FDF as cooperative bank. The assessment team's limited assessment can not determine whether such a goal is feasible. Nevertheless, even if it is feasible, evolving into a cooperative bank is a long-term goal. It is important that the future project does not pressure the FDF to grow beyond its institutional capacity. Therefore, FDF's scope of work should remain well-defined. Its level of capital should be large enough to assist the organizations it is assigned to assist by providing funds for financial stabilization and productive investments, but not larger than its capacity to administer resources effectively. FDF should not be pressured to disburse such a volume of funds that it becomes like another BANADESA -- undisciplined and ineffective.

Following is a list of the types of services which could be offered. The list draws heavily from a draft recommendation circulated by Rocael Garcia, et al.

- The **Asset side** of the FDF's balance sheet would reflect the granting of **production credit** to cooperatives for on-lending to members; **investment credit** for productive purposes; and **guarantees** for cooperatives seeking loans in the commercial banking sector.

- The **Liability side** of the balance sheet, would reflect the **management of donor trust funds** for on-lending to cooperatives; access to **rediscounted lines of credit** through the Central Bank; the ability to accept **long-term loan commitments** and **issue bonds.**

- Through additional financial services the FDF might serve as a **foreign exchange broker** for the cooperatives; identify, qualify, and develop selected **development projects** dealing with cooperatives; and continue the current support activities of **Institutional Development and Financial Stabilization** under newly developed selection and graduation criteria.

3) The manager(s) and Board of Directors of participating cooperatives should be considered equally important *points of contact* by the FDF. This should be done in order to broaden the expertise base of the cooperatives, and to enable the Boards to better understand and influence the overall direction of the progress of the cooperatives and to serve as a check on management.

4) The two technical *advisors* working directly with agricultural cooperatives be physically *placed within the apex organizations* to which the cooperatives belong. In the case of the non-coffee cooperatives, this will mean UNIOCOOP. In the case of the coffee cooperatives, this will mean DICOMCAFE and UNIOCOOP.

5) Given the present and planned work loads of the current advisors, it is further recommended that *two additional expatriate advisors* be hired: one to work directly with the **"reform" sector cooperatives** and be attached directly to FECORAH, and a **financial analyst** with extensive experience working with agricultural cooperatives to assist FDF in institutionalizing an effective process for evaluating agricultural cooperatives and their loan requests, and in developing a management information system to support this process.

Issues related to Project Disbursements and USAID

1) To accelerate the Disbursement Approval Process:

- AID should ensure the development of clear, concise formats and data requirements for the submission of all documentation for AID approval or review;

- AID should analyze its approval and review process to make sure that each signature is absolutely necessary;

- The AID regulations covering source and origin of purchased equipment and supplies, including fertilizer, should be studied to determine if there are less time-consuming and costly methods of procuring necessary items;

- Once the FDF obtains its independent status and institutionalizes an effective loan evaluation process, the use of an "imprest" account -- where the FDF would have access to a fixed level of funds that is replenished monthly -- should be studied;

And as mentioned in the previous section, the FDF must:

- articulate clear policies and guidelines for the administration of the 3 components;
- specify the indicators and analysis required for loan approvals;
- ensure that actions proposed by the local-hire Project Managers conform to the approved policies and guidelines; and
- minimize the time required to develop the dictamen, obtain Board approval, and transmit the required documentation to AID.

2) **In terms of Project management**, a clearer **delineation** of the roles of the Chief-of-Party and that of the AID Project Manager could be useful. Additionally, it is recommended that **regular meetings** of the Technical Assistance and the AID Project Manager be cut back to one or two times per month, and that an effort be made to reestablish the practice of including local hire counterparts in these meetings.

3) As explained above in the "Issues at the Cooperative Level" section, **USAID should consider separating into *two distinct projects* its assistance to credit unions and agricultural cooperatives.**

I. Introduction and Methodology

As one of three subcontractors providing technical assistance to agricultural cooperatives through the Small Farmer Organization Strengthening Project (522-0252) sponsored by USAID and the Government of Honduras, Agricultural Cooperative Development International (ACDI) was requested by the project to conduct an assessment. The purpose of the assessment is to:

1. Identify key results that the project has achieved in its work with the agricultural cooperatives, as well as noting those areas where additional attention is needed to maximize project results.

2. Identify basic issues that impact on the success of the project.

3. Make recommendations on how to resolve these issues.

ACDI provided a two-person team to carry out the assessment in Honduras from March 10 to 28, 1991. The team consisted of Donald Jackson, International Outreach Coordinator for the University of Wisconsin's Center for Cooperatives, and Robert Fries, ACDI's Associate Project Officer for Latin America and the Caribbean. Given the complexity of the project, the length of their assignment precluded the team from conducting a full-blown evaluation or impact study. Dr. Jackson spent two weeks in the field, and Mr. Fries one week.

The team reviewed relevant documents from AID, FDF, UNIOCOOP, and the participating cooperatives. Interviews were conducted with:

- the USAID project manager;

- the two technical advisors working in agriculture and the project's Chief of Party;

- FDF's general manager, Technical Assistance division chief and four of its project managers;

- the manager of UNIOCOOP; and

- the managers and/or presidents of five member cooperatives of UNIOCOOP: CREHSUL, COHORSIL, COCALYL, Candelaria, and Olancho.

In order to put the observations and recommendations that are drawn from these sources and developed in this report into a proper context, the following background on the Small Farmer Organization Strengthening Project (SFOSP) is provided.

II. Project Background

In September, 1985, USAID/Honduras signed a Project Agreement with the Government of Honduras for the SFOSP. The project's purpose was to strengthen four cooperative organizations so that they could "serve as channels through which productive resources (e.g. credit, entrepreneurial skills, technology, etc.) could be provided to small farmers throughout the country."[1] These organizations consisted of the national credit union federation (FACACH), and four federations or unions of agricultural cooperatives (UNIOCOOP, FEHCOCAL, FECORAH and ANACH).

Representatives of the Honduran government and USAID formed a Technical Commission to design the mechanisms through which the project would be implemented. Upon completion of this design work, USAID/Honduras and the GOH agreed in September of 1986 to jointly fund a U.S.$ 35.8 million project. The project was to be implemented over a seven year period. It is scheduled to be completed in September 1993. The funding was drawn from three sources:

- an AID loan of $3 million
- an AID grant of $13 million
- a GOH contribution of the equivalent of $19.8 million in ESF local currency.

These funds were to be used to strengthen the cooperative organizations with three project components: Institutional Support, Financial Stabilization and Credit. **Institutional Support grants** would be provided to the five organizations and their member cooperatives to strengthen their institutional capacity. Measures supported by this component might include the purchase of computer hardware and software, salary support for extensionists, and training programs.

Financial stabilization resources, generally loans, were to be injected into the cooperative organizations in order to improve their weak financial conditions. Many of these organizations were burdened with high levels of debt and insufficient levels of equity and working capital -- that is liquidity and solvency problems. This component could be pursued through various mechanisms: equity financing, liquidation or merger of selected member cooperatives in the case of an apex organization, the elimination of non-performing assets, debt moratoria or the interruption of debt payment responsibilities, debt restructuring through the deferral of interest or principal payments, the consolidation of creditors, or a rescheduling of loan commitments, interest or principal buy-downs, and the use of loan

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[1] "Small Farmer Organization Strengthening Project Paper - Amendment 1," USAID/Honduras, p. 1.

guarantees. Conditions were to be attached to these loans so that the cooperative's activities and policies would be adjusted to improve its financial statements. Financial stabilization funds were to be repaid with a minimum interest rate of 4 percent. While certain pressures exist to increase this closer to a new-market rate, the overall philosophy of this Project component to bring about financial normalization to recipient cooperatives could be compromised by doing so.

Investment and **production credit** were to be channeled through the private banking sector based on the FDF issuing a Certificate of Eligibility essentially guaranteeing the loan. The interest rate was to be 12 percent to the cooperative, and 17 percent in the case of on-lending to members for production purposes. These rates are expected soon to increase to near market levels in the upper 20's. In general, production credit was not to be disbursed to the cooperatives until they had been strengthened and stabilized by the first two components.

The funding levels of each of the project components is as follows:

- $ 9.67 million for Institutional Support grants and such commodities as computers, office furniture, and vehicles
- $12.37 million for Financial Stabilization loans
- $ 6.5 million for Credit.

The balance, about $7 million, was designated for project implementation, administration, and contingencies. The project has been implemented by the Financial Development Fund (FDF). Due to the Honduran government's resistance at that time to creating a new, independent institution for implementing the SFOSP, the FDF was placed inside an already existing institution, and one of the project beneficiaries -- FACACH.

The FDF was provided with a team of 5 long-term technical advisors through a contract between USAID/H and the World Council of Credit Unions (WOCCU). In fielding this team, WOCCU signed subcontracts with three other cooperative development organizations: the Latin American Confederation of Credit Unions (COLAC), ACDI, and the National Cooperative Business Association (NCBA). WOCCU fielded the chief of party and the computer advisor, COLAC an advisor to work with the credit unions, and ACDI and NCBA each provided institutional advisors to the agricultural cooperatives. These advisors arrived in Honduras during the first half of 1987, and their current contracts run out in September, 1991.

While project plans allowed for assistance to four organizations in the agricultural sector -- UNIOCOOP, FECORAH, and ANACH -- the project focused most of its efforts on UNIOCOOP and its member cooperatives. FEHCOCAL, the coffee federation collapsed before the project got under way. The project then assisted in organizing some of the former

affiliates of FEHCOCAL into the Coffee Cooperatives Central (CCC). The CCC was dealt a death blow when the GOH ruled that it did not qualify for legal charter under the Cooperative Law of 1987.

In January 1991, the Honduran Coffee Growers Association (AHPROCAFE) was qualified for limited project participation. AHPROCAFE consists of both individual producers and cooperatives. Efforts are being made to charter its coffee marketing division, DICOMCAFE, separately from AHPROCAFE, so as to separate the association's business functions from its representational functions. Also within the last year, the FDF has begun to develop a relationship with FECORAH, extending it L. 180,000 in Institutional Support in 1990. ANACH has received assistance through a separate USAID project. This project, implemented by AIFLD, was designed to strengthen 9 of the 16 regional agricultural cooperatives affiliated with ANACH. One of its principal objectives is to develop the cooperatives to the point where they are qualified to receive assistance through the FDF. It is anticipated that FDF will qualify its first ANACH cooperative during the current year.

The project's initial focus on UNIOCOOP was based on a conscious decision of FDF and AID. A qualitative difference exists between UNIOCOOP and the two land reform cooperative organizations. FECORAH and ANACH are exclusively composed of land reform cooperatives, while UNIOCOOP is not. Their functions have long included a strong political component; after all, the land reform cooperatives were formed by individuals who saw the benefit of uniting in their efforts to acquire land. To a greater extent, UNIOCOOP grew out of cooperatives united around business enterprises. Furthermore, "a detailed baseline study on 'Cooperatives in Honduras' identified striking financial and economic differences between the members of FACACH and UNIOCOOP on the one hand, and FECORAH and ANACH on the other hand. FECORAH and ANACH were considered to require a more long-term, intensive commitment within the FDF organization."[2]

Given this difference in the motivations behind their formation and the economic conditions of the two groups of cooperatives, UNIOCOOP's members -- debt burdened and under-capitalized as they were -- were still stronger. Formed around business interests, they possessed an orientation more in keeping with project objectives. The project decided to concentrate its efforts first on the organization better prepared to participate. Accordingly, it is useful to provide a little background on this cooperative organization.

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[2] "Interim Evaluation of the SFOSP," Interamerican Management Consulting Corporation, October 1989, p. 35.

UNIOCOOP, established in 1985, currently consists of 12 cooperatives involved in a variety of services: the sale of inputs and the first stage processing and/or marketing of coffee, melons, fruits, vegetables, basic grains, and poultry. The five original UNIOCOOP cooperatives, and the three coffee cooperatives that joined in 1987 have participated in the project the longest. Diagnostic evaluations of these cooperatives, the first step in the methodology used by FDF and the project, were completed in mid-1988. Development and operating plans were then developed by the cooperatives with technical assistance from project and FDF technicians. Depending on the needs identified in the plans, the cooperatives have received varying amounts of assistance in the form of some or all of the three project components: Institutional Support grants, Financial Stabilization funds, and Credit. The heterogeneity of the cooperatives is illustrated in Table 1.

Table 1

Participation of UNIOCOOP Members in SFOSP

Cooperative	Year affiliated with UNIO-COOP	PRIMARY, secondary crops of co-op's members	Inst'l Support funds disbursed (in thou-	Fin'l Stab. funds disbursed sands of	Credit funds disbursed lempiras)
Maya Occidental	1985	COFFEE,RICE corn, beans	132.0	---	800.1
20 de Marzo	1985	COFFEE, RICE corn, beans, sorghum, yucca	76.5	---	100.0
CREHSUL	1985	MELON, sesame	194.5	3,063.7	1,397.1
Fruta del Sol	1985	CUCUMBER rice	112.5	---	776.0
COHORSIL	1985	FRUITS & VEG coffee	78.8	---	470.0
COCALYL	1987	COFFEE	78.6	1,000.0	2,523.1
Candelaria	1987	COFFEE	62.8	144.0	340.0
Olancho	1987	COFFEE	68.3	159.9	120.0
ALGOSUR	1990	MELON, SOYA, COTTON, rice, corn, beans	DIAGNOS.	IN PRO-	CESS
COOPAVIHL	1990	POULTRY	NO DIAG-	NOSTIC	
COMARCA	1991	COFFEE	DIAGNOS.	IN PRO-	CESS
COAGRO-VAL	1991	MELON	DIAGNOS.	IN PRO-	CESS

Source: FDF Financial Assistance Division, Funding Reports by Component, March 1991

III. SFOSP's Key Results in the Agricultural Sector

The achievements of SFOSP are presented below in three sections, corresponding to the three components set forth in the original project design: institutional development, financial stabilization and credit. This organization is not intended to imply that all the achievements listed under any one section are a result of disbursements from the corresponding fund. Not all of the items included under the Institutional Development section, for example, came about as a result of institutional support grants. Some results grew out of technical assistance provided by FDF, the project team of advisors, and short term consultants. Others grew out of project management decisions, such as the decision to focus initial attention on UNIOCOOP. In short, institutional development, financial stabilization, and increased productivity were effected by more inputs than merely grants and loans. Neither is this organization meant to suggest that any one category remains unaffected by the others. The three areas, while distinct, are interrelated. Weak institutions are hard-pressed to demonstrate financial stability.

A. Institutional Development

1. The project succeeded in developing and transferring a clear and effective methodology to UNIOCOOP and its member affiliates. In the early stages of the project, FDF articulated a clear methodology for strengthening and developing cooperatives. In order to have access to any project grants or loans a cooperative needed to pass through a five step process:

1) **Diagnostico**, where the cooperative is "diagnosed," its operational, administrative, and financial strengths, weaknesses and needs identified;

2) **Development Plan**, a five year plan with specific institutional, production and financial goals that responds to the needs identified in the diagnostico;

3) **Annual Operating Plans** that map out specific work plans and goals for each division in an institution and map out year-long steps for completing the development plan;

4) **Dictamen**, a specific proposal by the FDF technical staff (based on the first three documents) for financial assistance in the form of a grant or loan that will help the organization carry out its annual operating plan; and

5) **Convenio**, a contract negotiated and signed by the cooperative and the FDF that allows for the disbursement of funds (pending AID approval) which are tied to specific goals and conditioned on structural adjustments.

The five steps are taken with assistance from a team of technicians from the FDF, the project team of external advisors, and (at the cooperative level) UNIOCOOP technicians. However, the board of directors and manager of each cooperative participate in the process with

the technical advisors. Through this **participation**, a sense of ownership and control is instilled in the participating institutions. In its visits to cooperatives, the Assessment Team continually encountered a knowledge of and commitment to the development plans on the part of management.

By **linking grants and loans to goals and adjustments** in financial and management policies, this methodology is intended to motivate the cooperatives to adopt measures that are in their long-term interest. As the cooperatives grow in their understanding of the importance of these measures, they gain the tools and financial stability that allow them to have greater control over the future of their organizations.

The development of the **Project Manager** position within the FDF has contributed to this institutional development process. The project managers work with individual cooperatives, monitor their improvements, and provide them with an on-going, personal link to the FDF. This system is more effective than the one it replaced, where no one-to-one relationships developed between technical advisors and the cooperatives. Instead of being assigned to specific cooperatives, advisors were responsible for carrying out a given task or function with all the cooperatives. In this way, each advisor was partly responsible for all cooperatives, but no one advisor was responsible for any one cooperative.

Finally, the methodology has been more clearly defined and strictly followed than other processes in the project. Everyone interviewed by the team had the same understanding of the steps in the process. This lack of ambiguity allows both the technical advisors and cooperatives to participate in this process confidently. The rules are clear. As will be discussed later in this report, this **clarity** diminishes after the Convenio stage. FDF advisors, technicians and project participants expressed confusion and concern over the AID approval and disbursal process, as well as the criteria by which the FDF distinguishes Financial Stabilization from Credit. FDF and the SFOSP need to articulate more clearly to people in the field the absolute restrictions that AID is bound to by legislation, and to creatively address any unnecessary bottlenecks that exist in the process.

2. The project has strengthened UNIOCOOP by involving it in the institutional strengthening process. Through their involvement in the methodology described above, UNIOCOOP finally appears to have adopted the process for itself. Under former management, the methodology was not accepted. For this and other reasons, ties between FDF and UNIOCOOP were extremely strained during the second and third years of the project. However, the methodology was bringing about results at the member cooperative level. Since UNIOCOOP's board of directors replaced its general manager, the organization has renewed its involvement in the institutional strengthening process.

At the time of the project mid-term evaluation in late 1989, UNIOCOOP's Development Division was pursuing "rather ambitious aims" that were beyond the capabilities of its five-person staff, including feasibility studies on rice milling, fertilizer blending, and sesame

processing facilities.[3] Today it has focused its energies on institutional development, leaving the planning of operational expansion to its Sales and Marketing Divisions. As indicated in its current Annual Operating Plan, the Development Division is focusing its efforts on:

- coordinating training courses requested by its members in such areas as accounting, financial analysis, the role of the board of directors, and the use of farm specific farm inputs (the division contracts trainers to conduct the courses);
- supporting the cooperatives in their development of annual operating plans; and
- working with the member cooperatives to reactivate their *Grupos Locales de Asociados*, or GLA's, basic units of farmer-members within individual cooperatives that serve as a vehicle for increased member participation and cohesiveness.

3. The project was able to contribute to the development of UNIOCOOP as an integrated organization. While the integration of the various parts of UNIOCOOP -- the apex organization, the member cooperatives, and their respective GLA's -- is far from complete, the project did contribute to this end, both deliberately and by chance.

First, the deliberate decision of the project to focus its efforts on UNIOCOOP allowed it to extend its financial and technical resources to most of the component parts of the organization. Each of UNIOCOOP's first eight member cooperatives have participated in the same development and planning process. Three of the remaining four members have begun the process. The Development Division has begun to work with its members to continue this planning process each year.

Had the FDF and AID decided to spread its resources among the land reform federations, which are composed of hundreds of member cooperatives, it is likely that only a few members in each of the organizations would have participated. Furthermore, given the large differences that exist between UNIOCOOP and the land reform cooperatives, it is less likely that the planning process would have evolved into such a clear and consistent methodology.

Second, by exposing UNIOCOOP, at the apex level, to the planning process, FDF and the project forced UNIOCOOP to define its mission and priorities. It defined itself as a cooperative organization that delivers inputs to its members, markets its member's coffee, and provides institutional and technical assistance. By getting UNIOCOOP to focus on improving its delivery of services to its members, and assisting it with the financial and technical resources to achieve this -- credit for importing fertilizer, and training and technical assistance in improving coffee quality, for example -- the project helped to demonstrate to members the concrete advantage of being part of UNIOCOOP: reliable and cost-effective services.

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[3] "Interim Evaluation of the SFOSP," p. 40.

Clearly, there are limits to this development. The services have not always proved to be timely or reliable, reducing member confidence in UNIOCOOP. Some of its members may have joined as much for receiving access to project resources as for access to UNIOCOOP's services. Nevertheless, the fact remains that through the project, UNIOCOOP has gained both a deeper understanding of its economic role and a greater determination to strengthen it.

Finally, there is the unintended way in which the project contributed to UNIOCOOP's integration. In a well-integrated hierarchical institution, information and influence flow from the bottom-up as well as the top-down. The former is often more difficult to achieve than the latter. The original project design focused initial attention at the top level, UNIOCOOP, with the hope that by strengthening it, it in turn would strengthen its members: a top-down strengthening process. However, due to an impasse that developed between the project and UNIOCOOP, efforts were shifted to the member cooperatives. As these more basic units strengthened their abilities and defined their objectives, they began to put pressure on UNIOCOOP to change. The bottom forced the top to respond. UNIOCOOP resolved its conflict with FDF and the project from within -- by the decree of its board, in response to pressure from below.

4. Institutional Support grants proved to be a practical way to strengthen the cooperatives. Some L. 2.1 million in such grants have been disbursed to agricultural organizations by the FDF. (Another 3.5 million were disbursed to the credit unions.) Theoretically, these funds were intended to provide the cooperatives with commodities and services that would make them more efficient businesses. These commodities and services would not be productive investments themselves, but were intended to complement such investments. A number of examples will help to illustrate this distinction.

The project purchased **computer hardware and software** for UNIOCOOP, many of its member cooperatives, and FECORAH, using institutional support grants. This activity, despite its complications (there were delays involved in the acquisition process, and the software still lacks modules for managing loan and cost accounting information) has allowed UNIOCOOP's member cooperatives to move from a manual to an automated system of accounting. The accountants the team encountered were comfortable with the system, having been trained and supported by FDF's computer technicians, and positive about the time it saved them.

A second commodity that was well received in the field were **two-way radios** that were distributed to the coffee cooperatives, which allowed them to keep in continuous contact with the UNIOCOOP coffee marketing office in San Pedro Sula, the office coordinating their coffee sales. For the cooperatives without access to telephones, this was an extremely effective use of grant funds.

A third example of an effective use of funds was **salary support** for key employees, such as the employees within UNIOCOOP's development division. This division, which does not generate income for UNIOCOOP is still vital to the development and integration of the system.

Similar support was provided for extensionists at some of the member cooperatives, and for training of staff and directors.

These grants were effective not only for the commodity or service they allowed the cooperative access to, but also for the institutional improvements the cooperatives committed to in signing any Institutional Support agreement with FDF. For example, in a convenio signed between FDF and COHORSIL last year, the cooperative received L. 50,426 to be used for salary support of key employees, a training program, an audit, a radio set, and computer maintenance. At the same time, they agreed to carry out a number of activities -- from timely payments of loans to BANADESA, to a range of training sessions for their members and directors.

B. Financial Stabilization

1. A number of effective capitalization policies have been instituted and accepted in the cooperatives. In visiting the cooperatives, the assessment team noted some common capitalization policies. These had been adopted by the boards of directors in compliance with conditions set forth in the convenios the cooperatives signed with FDF. Typical measures included the capitalization of all net earnings over the next five years, 5% on each loan issued to a member, as well as 1.5% on the payment a member receives for products marketed through the cooperative. Such practices guarantee a continuous increase in equity for cooperatives that had historically been burdened by insufficient, if not negative levels of equity.

2. FDF was instrumental in developing an effective vehicle for debt reductions, debt buy-downs. A number of the UNIOCOOP cooperatives were strapped with excessive levels of outstanding debt. For example, CREHSUL and Fruta del Sol had accumulated large debts to a BANADESA-administered trust fund created under the Honduran "model co-op" project in the early 1980's. The fund provided production credit that cooperatives could lend out to their members. Due to a number of factors -- including slack administration, outstanding loans that members had not paid back to their cooperative, and the use by cooperatives of loan reflows for purposes other than repaying BANADESA -- CREHSUL and Fruta del Sol each ended up owing several million lempiras to BANADESA, levels that they could not repay.

After assessing the true value of BANADESA's outstanding loan to CREHSUL, by determining the value of the cooperative's loan portfolio, fixed assets and equipment, FDF entered into negotiation with BANADESA. After a long process, BANADESA agreed to sell to FDF their outstanding loan with CREHSUL at a price significantly below face value. FDF purchased the L. 5.8 million debt for L. 2.56 million, signing agreements with CREHSUL and BANADESA that set up a range of conditions, including the following:

- CREHSUL will repay FDF the L. 2.56 million at an annual interest rate of 4%.

- CREHSUL will consider the L. 3.24 million difference between its former debt with BANADESA and its current debt with FDF as an increase in capital. However, following a thorough effort at collecting old debts owed to CREHSUL by its members, CREHSUL will have to write off bad debts as losses, which will reduce this injection of capital.

- CREHSUL will make a number of specific changes in its credit, administrative, and marketing practices and policies.

- BANADESA will make the paid portion of CREHSUL's loan available to the UNIOCOOP affiliates for production and investment credit.

This debt buy-down built on the success FDF experienced in its negotiation of a smaller one involving Lago de Yojoa's outstanding loan with BANHCAFE. These two buy-downs account for L. 3.2 million out of 4.4 million disbursed by the project so far under the Financial Stabilization component. Similar arrangements are currently being negotiated with 20 de Marzo and Fruta del Sol. The remaining funds were loaned either for productive investments in machinery, such as coffee dryers and an input store, or to provide working capital for CREHSUL to export melons.

Similar investments in productive assets, including coffee drying equipment and another cooperative store, were financed by the FDF under its Credit component, at interest rates of 12%, rather than 4% and 6%. According to Project Implementation Letter 29 for SFOSP, Financial Stabilization may take the form of "equity financing, forced liquidation or merger of affiliates, liquidation of non-productive assets, debt moratoria or forbearance, debt restructuring or amortization, buy-downs, debt guarantees, and uncollectible loan write-offs." (p. 18) The investments in productive assets that have been financed under the financial stabilization component were considered "equity financing," with the added liquidity being used to purchase equipment vital to the cooperative's viability. While using these funds for productive investments is a creative and welcome stabilization mechanism, it is unclear how FDF decides which investments are "vital" and warrant "equity financing," and which are considered "investment credit needs," and thus financed under the Credit component at higher rates of interest. A clearer policy needs to be articulated to FDF employees and borrowers.

3. Through policy changes and increased earnings UNIOCOOP has outpaced most of the key financial indicators set forth in its development plan. The UNIOCOOP experience under the project illustrates the effect that policy changes promoted by FDF through the Institutional Support and Credit components of the project (UNIOCOOP received no Financial Stabilization loans) can contribute to the financial stability of an organization. According to the 1990 Evaluation of UNIOCOOP prepared by FDF:

- UNIOCOOP's current ratio improved from 1.1 to 1.6 between 1988 and 1990.

- It's average recovery period for accounts receivable was reduced from 150 days in 1987 to 25 days in 1990.

- Total sales, return on equity and net margins have all increased consistently since 1988.

Such developments reflect improvements in liquidity, efficiency and productivity. These results have come about in part due to more efficient operations and policies to reduce debt and increase capital. These changes correspond to conditions placed on UNIOCOOP in its convenios with FDF. To judge from the team's interview with the current manager of UNIOCOOP, these conditions are viewed as constructive changes and not unwelcome impositions.

Nevertheless, there again are limits to project success in this area. The financial statistics were not adjusted to reflect the devaluation of the currency and the high rates of inflation during 1990, after they had imported some of their fertilizer. Furthermore, while UNIOCOOP's assets have increased more than 400% since 1986 (again, not adjusted for inflation), to L. 6.8 million, it borrowed more than 8 million last year to purchase fertilizers and other inputs. This has a profound effect both on its indicators and its operations. There are wide fluctuations in some of the key indicators during the course of the year. For example, 1990's balance sheet demonstrates equity as 42% of assets. However, it also illustrates a low level of inventory. Once UNIOCOOP borrows money to import additional fertilizer, equity as a percentage of assets will decline significantly.

This effect that credit has on the balance sheets reflects the seasonal nature of UNIOCOOP's business, and, consequently, its dependence on large amounts of credit. Up to this point, the bulk of its credit for purchasing inputs has come from the FDF. BANADESA is unable or unwilling to loan UNIOCOOP funds at the rate it needs. Depending exclusively on FDF is likely not a long-term solution, given FDF's limited resources and lengthy approval process which already has contributed to significant delays in getting fertilizers to the field when they are needed.

C. Credit

1. The project demonstrated proper flexibility in its use of Credit for both investment and production purposes. As was already explained, a number of the cooperatives had gotten into financial trouble through their ineffective handling of production credit loaned to them by BANADESA. The project did not want to compound this problem and wisely refused to make production credit available to the cooperatives until they were financially stabilized, and cured of their old lending habits. As a result, production credit would not be utilized until several years into the project. But there was another, more effective use for these funds.

In 1988, in the face of a fertilizer shortage, this other use became apparent: working capital that would generate earnings and strengthen the cooperative organizations. As a result, the project loaned UNIOCOOP the Lempira equivalent of $2.125 million so that it could import fertilizers. Since that time, the project has disbursed a total of more than L. 25 million in agricultural credit, as follows:

- L. 17,664,700 for purchase of fertilizer and other inputs
- L. 2,610,600 for working capital
- L. 2,071,100 for farm-level production credit
- L. 1,164,100 for warehouse construction/other fixed assets
- L. 947,500 for coffee drying and melon packing equipment
- L. 328,000 for debt refinancing
- L. 250,000 for vehicles

As the numbers indicate, the Credit component of the project has been used for much more than production credit at the farm level. The bulk of the resources have been used for the purchase of inventory and productive equipment. Providing cooperatives with access to credit with which they can acquire assets that increase their productivity and profitability is a central achievement of this project. It marks a passage from an emphasis on *stabilizing* cooperatives to one of helping them to *grow*. This emphasis should be incorporated into the project's future work with agricultural cooperatives that have graduated from the stabilization process.

2. Providing credit for UNIOCOOP so that it can acquire inventory has generated significant positive results. First, as already mentioned, UNIOCOOP's access to fertilizer imports, along with efforts to decrease costs and improve the recovery of accounts receivable, have contributed to UNIOCOOP's financial stability. Fertilizers and other imports has been the primary source of income for the organization. Additional efforts to decrease the costs of fertilizer will further add to UNIOCOOP's efficiency.

One mechanism for this may be the investment in a fertilizer blending and bagging facility, so that UNIOCOOP can respond to the specific fertilizer needs of its members while importing bulk fertilizer at a cheaper price than it currently imports already bagged material. A number of individuals involved with the project expressed a frustration that UNIOCOOP was not moving forward with deliberate speed on a feasibility plan for such a facility.

Second, contributing to UNIOCOOP's ability to efficiently distribute fertilizer at a low cost to members is central to the integration of UNIOCOOP as a cooperative system. The

importing of fertilizer in Honduras has traditionally been controlled by a few players. This limited number of suppliers has been able to charge high prices to the farmer. UNIOCOOP, who has a 20% market share and a mission to efficiently distribute inputs at a fair cost to its members, has a major impact on the fertilizer market. According to its manager, when UNIOCOOP ran out of fertilizer this year the local price increased by nearly 40%. While this may have been a result of a number of factors, it is clear that UNIOCOOP's participation in this limited market reduces costs for the farmers.

This fact has become UNIOCOOP's economic raison d'etre. It is a vital role that ties its members to the system. It has grown considerably in this role over the last two years. In 1988, when UNIOCOOP imported fertilizer in a time of scarcity, members did not have priority access to UNIOCOOP's fertilizers. Rather, non-members were buying more fertilizer than members. This fact, along with other questions of ethics, contributed to the dismissal of the former manager by the board. Since then, UNIOCOOP has been building member loyalty by providing a vital service to them fairly and efficiently.

This is not to say that the UNIOCOOP system is completely integrated. There is more work to be done in cultivating member loyalty. Frustrations over the late arrival of fertilizer to the field -- due to foreign exchange problems and credit approval delays -- were expressed to the team. Similarly, a frustration exists among the coffee cooperatives about the seriousness with which UNIOCOOP views its role as a coffee marketer. This service is also part of UNIOCOOP's mission, a role it has taken on following the demise of FEHCOCAL and the entry of a number of coffee cooperatives into the system. It is viewed as a viable source of foreign exchange, which it can use to import fertilizer. UNIOCOOP has announced its intention to obtain the facilities needed to qualify for a coffee exporting license. In the eyes of some of the cooperatives, progress in this area has been slow.

3. Investments in productive assets at co-op level have also led to positive results. The coffee cooperatives in particular have benefitted from this activity. Investments in coffee dryers have increased their capacity, and should lead to higher quality and lower costs. The new dryers are fueled by burning waste products of coffee processing, rather than diesel. The impact of these investments is most dramatically seen in the case of Lago de Yojoa, the coffee cooperative with the greatest potential for coffee production in UNIOCOOP. Last year their doors were closed. This year, new management and the catalyst of the new equipment and participation in the planning methodology have reactivated member participation, and a sense of enthusiasm and vision.

D. Training and Technical Assistance

1. One effective dimension of training and technical assistance within the project has been its attention to "quality" and the marketing process. The quality of a farmer's product has a significant effect on the price he can get for it. This is especially true in the case of exports, where products that do not meet international standards will not be purchased. The

project has estimated that Honduras loses $25 million a year in foreign exchange due to the discounting of its coffee because of quality. Significant efforts have been made by the project to improve the quality of melons and coffee.

Salary support was provided to extensionists in the coffee cooperatives, a "training of trainers" program was provided to them, and a formal quality training course was developed and published in collaboration with CADERH, a Honduran training institute. This training is both crucial and an uphill battle because current Honduran marketing practices for coffee do not provide incentives for quality.

Standard measurements are by volume, rather than weight, despite the direct correlation between weight and quality. Similarly, exporters in Honduras tend to pay only one price for exportable coffee, while the world market will pay a premium for high quality coffee, and discounted coffee prices for lower qualities. Producers therefore do not separate premium coffee from discount coffee. The exporter does, and absorbs the benefit of the premium price offered on the international market.

While there is currently little incentive for the farmer to produce higher quality coffee under current practices, the project's decision to focus on quality has made some headway. A number of the UNIOCOOP coffee cooperatives have changed their measuring system from volume to weight, as has DICOMCAFE. The training program is designed to raise producer's consciousness about the significance of quality. With continued attention to this area, the project can have a significant effect on the coffee sector.

In the area of melons, emphasis has been placed on post-harvest handling. A recent consultancy has uncovered a number of inexpensive changes that the three melon cooperatives can make in their packing and cooling processes in order to increase the quality and value of their melons. Additional attention has been given to increasing management's understanding of the international marketing process. CREHSUL, like other businesses breaking into a new international market, had experienced payment problems with brokers. In order to familiarize the staff with the marketing process in Miami, the project supported a training visit for the manager and extensionists. This provided them with a concrete understanding of the importance of quality and supply effects on price, the importance of phyto-sanitary conditions and regulations, and the process their melons encounter after being shipped from Honduras. This, and the opportunity to have personal contact with their brokers, increased their confidence in dealing with the international market.

IV. Areas for Improvement

As a result of the past four years of Project activity a number of critical lessons have been learned which will be presented below. For the purposes of presentation, these have been divided into four categories:

- issues of coordination between the various levels of the Project, and between the Project and other entities in the Honduran agricultural sector;
- issues which impact primarily at the UNIOCOOP and individual cooperative levels;
- issues which impact primarily at the FDF level;
- issues of coordination between the Project and USAID.

A. Issues of Coordination

1. The FDF and UNIOCOOP. Presently the FDF provides both financial and technical assistance services to UNIOCOOP and its member cooperatives. Up until now these services have been well utilized and appreciated as both organizations have been developing their respective areas of influence and expertise. In the near future, however, as UNIOCOOP becomes financially stable and expands its services to members, its role will have to change. This change will likely concern both the focus and dimension of its technical assistance efforts, as well as the mechanisms it uses to deliver such service.

The role of the FDF will also change, particularly with regard to those cooperatives which have graduated from the strengthening process, where FDF's role will probably be limited to credit and training. Additionally, as the FDF enters into a new phase of assisting other types of agricultural cooperatives and farmer organizations (FECORAH, ANACH and AHPROCAFE), it is only natural that some healthy competition will be encountered between the various cooperatives, which exist in relatively close proximity to each other and produce some of the same crops for the same markets. In this regard, it is appropriate for the Project to consider the appropriate division of responsibilities, as well as complementary areas, between the FDF and UNIOCOOP. Likewise, new development strategies for dealing with the "reform" sector such as the cooperatives of FECORAH and ANACH will also have to be designed.

This division of responsibilities should reflect the relative strengths of both institutions. As such, financial support and technical assistance dealing with financial issues should remain with the FDF, while technical assistance dealing with management, organizational, and agricultural issues are formal activities better placed within the structure of UNIOCOOP. This division of responsibilities and the coordination of activities will be further discussed in other sections concerning the future role of technical assistance to the Project, the definition of counterpart relationships, and the future role of the FDF.

2. UNIOCOOP and DICOMCAFE. Currently the FDF Project is providing financial and technical assistance to five UNIOCOOP affiliates which are involved in the marketing of coffee grown by their members. This assistance has included support for the provision of fertilizers and other agro-chemicals, computerized information management, planning and programming of future activities, coordination of marketing arrangements for eventual export, and credit for processing infrastructure, production and marketing.

Recently, the Project has also begun to work with the Marketing Division (DICOMCAFE) of the Coffee Producers' Association (AHPROCAFE), principally in providing technical assistance for the installation of a computerized information system. This 46,000 member association collectively represents the coffee growers of the country and is composed of individual farmer members, as well as 12 to 20 cooperatives.

While world coffee prices are currently depressed due to a collapse of the International Coffee Agreement and worldwide overproduction, the local market for coffee exported from Honduras is extremely competitive and the price paid to growers can vary substantially depending on quality, exporter commissions, and the level of value added achieved in the various stages of processing. Key factors in achieving the highest possible prices are the ability to maintain quality through access to processing facilities, and the ability to obtain an export license which currently requires a minimum of L. 2.0 million in working capital. AHPROCAFE has an export license. UNIOCOOP does not.

Competition for the purchase of coffee from growers, in spite of low world market prices, is also keen due to two additional factors:

- the need for potential processors and/or exporters to handle sufficient volumes to achieve economies of scale in either activity; and

- a relative scarcity of foreign exchange which results in non-agricultural businesses and individuals engaging in coffee trading for the sole purpose of obtaining foreign currency in order primarily to finance the importation of consumer durable goods for resale.

Due to the relatively high profit on durable goods, traders engaged in this last activity are sometimes willing to incur losses on their coffee trading activities. Last year, for example, they purchased coffee from producers at a price higher than they could resell it on the world market. Given this situation, it is appropriate for UNIOCOOP to continue with its efforts to become an exporter of coffee, which will in turn generate foreign exchange which it can then use for the importation and sale of fertilizers and other agro-chemicals.

There are at least two lessons learned from this for the Project and the coffee cooperatives it is trying to assist:

- UNIOCOOP must endeavor to increase the volume of its coffee operations, both at the individual cooperative level and by increasing the number of coffee cooperatives affiliated to it, in order to achieve the highest economies of scale possible; and

- the coffee-related activities of both UNIOCOOP and its member cooperatives must be as efficient as possible in order to compete in an activity where the potential for profit is minimal.

UNIOCOOP must be highly competitive both in its economic operations and in recruiting additional well-managed cooperatives to its organization. While the assessment team has not had sufficient time to research this issue fully, it appears on the surface that increasing FDF support to DICOMCAFE, and the potential competition that this represents, could run counter to its long-term strategy of supporting UNIOCOOP. Due to its membership base, DICOMCAFE has a much greater potential for volume-based success with coffee exports and, as such, can potentially respond to what the Project has to offer in a more efficient way than UNIOCOOP. However, the Project must structure its work with DICOMCAFE so as to complement, rather than undermine, its foreign exchange strategy for UNIOCOOP.

3. FDF/UNIOCOOP and FEPROEXAH (FPX). Some of the twelve cooperatives affiliated to UNIOCOOP are already producing for the non-traditional export market or have plans to do so in the near future. With the exception of coffee the export crops under consideration, both presently and in the future, (melons, cucumbers, sesame, and a wide variety of other fruits and vegetables) are defined as non-traditional exports. These crops are distinguished by the characteristics that they are often highly or semi-perishable, and have relatively unstable markets that demand strict quality and other standards. Indeed, the experience of Honduras with these types of crops in the past has, for the most part, been fraught with high degrees of risk, often leading to failure.

For the past several years, the USAID Mission to Honduras and the Honduran government have been supporting a project to promote the exportation of non-traditional manufactured and agricultural exports from the country. In the case of agricultural produce, this promotion has focused on the gathering of market intelligence (market windows, specifications, transportation, etc.), and the dissemination of this information to potential exporters. Nevertheless, the Federation for the Promotion of Exports (FPX, formerly called FEPROEXAH) has been greatly under-utilized by the agricultural cooperative sector of the country. Information from FPX to the cooperatives has also been limited. Furthermore, the ACDI team could identify only one collaborative effort between the UNIOCOOP cooperatives and the FPX (Fruta del Sol and cucumbers) which had been attempted.

B. Issues at the Cooperative Level

1. The Reform and Non-Reform Sector Cooperatives. Until recently, FDF has dealt almost exclusively with non-reform sector cooperatives (with the exception of reform sector

cooperatives which themselves are members of an UNIOCOOP-affiliated cooperative). However, in recent months a group of FECORAH cooperatives has been identified by FDF staff for support and initial Project activities have begun principally in the areas of organization, planning, and data management. The FDF also plans to begin work this year with CARCOMAL, a large ANACH-affiliated regional cooperative.

To the extent that these cooperatives possess a different set of characteristics from those belonging to UNIOCOOP, they will require a modified development assistance strategy on the part of the FDF. It should be underscored, however, that this strategy should maintain the essential elements of the goals for the Project in terms of well managed, business-oriented cooperatives strengthened with the three components of institutional support, financial stabilization, and credit. However, the means to achieve this strengthening need to be adjusted to take into consideration the particular resource base of these cooperatives.

Specifically, the members of these cooperatives tend to be relatively land rich (in terms of individually and collectively farmed plots), but resource poor, especially considering such indicators as education, literacy, and experience with management and organizational issues. This appears to be true at the individual member level, as well as at higher management levels. These cooperatives also face higher levels of debt -- the land they received from the government came with a sizable long-term loan. Furthermore, the lower value crops they produce (staple grains, for example) limit their ability to repay debt. Anecdotal information also indicates that these cooperatives tend to be managed not by hired employees, but by elected boards of directors and temporarily assigned government employees. Lastly, since most of these cooperatives contain a combination of individually and communally farmed plots, there is a tendency for members to take care of their own subsistence plots first, and to address the needs of the communal plots only if time and resources remain.

This situation has three implications for the Project. First, the selection criteria for these types of cooperatives should clearly address the willingness of potential groups to conform to the goals of the Project, to develop effective management systems, and to orient themselves to building a sound economic base for the cooperative. Second, much more emphasis will have to be placed on educational services to be provided to these cooperatives in such areas as literacy, cooperative organization, decision-making, and basic accounting and management principles. An expanded education program of this type would require increased Project-provided resources since those of the cooperatives would not be sufficient to cover the costs required. Third, should the economic survival of the cooperative depend on the crops to be grown on communal lands, sufficient incentives must be provided to assure the availability of resources for this activity while also guaranteeing the members' ability to meet subsistence needs on their individual plots.

2. Credit Unions versus Agricultural Cooperatives. At present, the FDF Project attempts to address the needs of both credit unions and agricultural cooperatives. The vast majority of persons interviewed agreed that these very different types of cooperatives need to be assisted by very different mechanisms, and evaluated by very different indicators. Should

..here remain any reluctance to accept these differences, or should anyone still prefer to treat both types of cooperatives the same, the following concisely illustrates the points of divergence between credit unions and agricultural cooperatives.

Credit Unions	Agricultural Cooperatives
1) Members generally better educated.	1) Member education levels generally more heterogeneous.
2) Quite similar, one to another.	2) Quite different, one from another.
3) One type of services offered to members (financial).	3) Many types of services offered to members.
4) Relatively less susceptible to exogenous factors.	4) Often highly susceptible to exogenous factors.
5) Relative ease in management.	5) Often complex to manage.
6) Relatively less risk involved.	6) Relatively more risk involved.

3. Cooperatives and the Economic Structural Adjustment Decree. Historically, a series of Laws (including, most recently, the Cooperative Law of 1987) had declared cooperatives exempt from import, export sales, and income taxes. In May of 1990, this exemption was ended by economic structural Adjustment Decree 18-90, which explicitly requires cooperatives to pay import, export and sales taxes. Confusing the matter, however, is the fact that while Decree 18-90 does not provide for any exemptions to the paying of income taxes, it does not specifically overturn the 1987 law exempting cooperatives. This has resulted in a temporary legal void as to the actual obligation of cooperatives in terms of income taxes which will have to be decided by the courts, or by the Congress through an amendment to the law.

During this time of uncertainty over their income tax liability both political and economic strategies have been proposed by cooperatives. In the political arena, the cooperative movement is petitioning government to uphold the 1987 law exempting them from income taxes (but not import, export, or sales taxes), based on the fact that they are non-profit organizations requiring the surpluses they generate for capitalization purposes. If this fails, economic strategies could be adopted to reduce the tax liabilities of the cooperatives. These could include zero-based profit targeting, where each cooperative is managed so that, either through increasing the "free" services provided to members or decreasing the fees and prices charged to members, no profits are shown at the end of each accounting cycle and no income taxes would therefore be owed. This strategy, however, by not allowing for surpluses, would also not allow for capitalization to take place, either through retained earnings or the distribution of earnings to member share accounts.

This has led to another proposed strategy which includes petitioning government to allow cooperative surpluses (and those of any other business enterprise faced with the same situation) to be taxed at the net amount of profits after distributions to capital reserve accounts and share accounts have been made. In an attempt to convince government of the worthiness of this concept, the strategy would also include the stipulation that capital reserves could not be withdrawn from the cooperative for a specified number of years. In the case of distributions to member share accounts, a similar provision could be applied; or if these shares are permitted to be withdrawn, the tax liability would be passed on to the individual member at the time of the withdrawal.

4. Staff Turnover and Incentives. The Project correctly places heavy emphasis on the management capability among the cooperatives it is assisting as an essential element to their success. As such, in many ways it attempts to convince the membership groups and boards of directors of these cooperatives to provide salaries and other incentives at sufficient levels to attract and retain the best managers and staff possible.

Nevertheless, it is often difficult for the members and many boards to accept this due to their relative poverty and the historical lack of profitability in their cooperatives, and in the agricultural sector in general. In many cases, this reflects the short term view in which the members live, versus a longer term view in which good management could make a difference. As a result, manager and staff salaries are often not competitive and incentive programs, such as the remuneration of key staff being a function of sales or gross profits, are almost non-existent.

Over time this has led to relatively high turnover rates in the cooperatives as key staff leave to seek better opportunities elsewhere. Particularly problematic is the fact that these departing staff members have often been the recipients of lengthy and costly technical assistance and training programs provided by the Project. This greatly diminishes the efficiency of the Project as additional technical assistance and training programs must be provided to continuously upgrade new staff. Finally, it should be noted that significant turnover has occurred within the FDF itself.

5. The Over-Use of Production Credit. Agricultural production credit is a very necessary and important facet of many development projects. In most situations it represents the difference between the resources that a producer readily has available and those required for the short term growing of a particular annual crop. The division between those resources provided by the producer and those provided by a lending source represent a shared risk between the borrower and the lender. In the case of many developed and developing countries, those resources provided by the borrower are normally in the form of land and/or labor with the lender providing cash for the purchase of required inputs, or "voucher credits" which can be exchanged for non-labor inputs at specified retail outlets.

While the cooperatives have made impressive gains in the management and recovery of production credit, there remains an issue worth mentioning: some cooperatives provide production credit to their members in amounts as great as 100% of production costs. This credit, distributed out of a trust fund provided under a previous, USAID-financed project (Model Cooperatives), not only covers the cost of all purchased inputs, but all labor requirements, and an estimated 50 percent of land rental payments as well. This practice saddles the cooperative, primarily -- and only secondarily BANADESA -- with almost all the production, price and marketing risks, while the borrower assumes virtually no risk at all. Given BANADESA's poor track record in enforcing the timely collection of its production loans, and the fact that below market interest rates are being charged, the cooperative is placed in an even riskier position.

Not only does this practice enforce the "subsidy" mentality which has been inherent in most public agricultural lending in Honduras over the past decades, but it also overexposes the cooperatives and their farmer members to risk. While the granting of 100 percent production credit is not a practice of the FDF (which has granted limited production credit to date), the provision of these loans is in fact an implicit part of the Annual Operating Plans which are prepared by the managers and boards of directors of the various cooperatives with the assistance of FDF staff.

It is important to note that this practice is not necessarily reflective of all of UNIOCOOP's members. In fact, the COHORSIL cooperative only channels loans to members who have their own land, and only up to a maximum of 80 percent of production costs with 50 percent being the average.

C. Issues at the FDF Level

1. Clearer Processes and Policies

a. FDF Criteria for Selection, Graduation, and the Use of Project Components. There are two critical points of analysis for a cooperative in regards to the FDF: the selection criteria for qualifying as a Project participant eligible for Project support, and the evaluation criteria for a Project-supported cooperative to graduate from needing further assistance. While established, written criteria exist at the FDF for the selection process, an informal process which favors "flexibility" is preferred. The assessment team does not wish to counsel against flexibility in Project implementation, but we are somewhat concerned with the lack of clear, precise and measurable guidelines for either selection or graduation.

Additionally, the FDF is capable of providing three general types of assistance under the Project: Institutional Development, Financial Stabilization, and Credit for capital investment and production purposes. Each component provides different types of support and requires different terms of repayment from the cooperatives. Although specific written criteria exist for determining the type of support a given cooperative will receive, these have also been "suspended" in favor of a case by case, flexible analysis of the cooperative's needs based on

each local-hire Project Manager's assessment of the case. This has led to staff frustration during the planning process in not knowing what will finally be approved by the FDF Board of Directors. Examples of this are financial stabilization loans for coffee dryers, and institutional development grants to augment working capital at several cooperatives.

This lack of clear and consistent criteria not only leads to frustrations on the part of staff and confusion on the part of the cooperatives, but also holds the potential for charges of favoritism and mismanagement.

b. Management Information and Monitoring. To date there has been very limited progress in the development of a relevant management information system for the agricultural cooperatives. Given its heterogeneity, the agricultural sector is less accommodating to standard financial ratios than the credit union sector. It deals with a variety of commodities, not just money. Relevant statistics must reflect this reality, and systems for collecting this data must be in place at a number of levels.

First, FDF should base its financing decisions on sound data, but it has not yet developed adequate systems for gathering this sort of data. For example, the standard monitoring form currently used by the FDF tracks the number of members in a cooperative, its total sales of inputs, the value of products marketed through the cooperative (not adjusted for inflation), and the amount of outstanding loans it has to its members. There is no readily available historical data concerning production levels, acreage, yields, prices paid to members for their crops, or net margins on sales. Furthermore, the FDF financial division apparently tracks grant and loan disbursements on handwritten sheets of paper, despite the fact that the information has been entered into their computer. Given this scarcity of data, one reason for the length of time it takes AID to approve disbursements is the fact that they must send requests back to FDF for additional information and analysis.

Work is being done to improve this situation at the FDF. Apparently a new form has been developed with the assistance of project advisors that will track some of the indicators not currently monitored. A cash flow program has been designed by the FDF coffee advisor and technician to be used in the field to identify loan needs for individual farmers. If effective, this information may serve as a foundation for developing a proper management information system, not only at the FDF, but at the UNIOCOOP and cooperative levels as well.

Both UNIOCOOP and its member cooperatives need to strengthen their management information systems. The automation of accounting systems that was made possible by the project should provide these businesses with the detail and time they need to monitor their financial status more closely. Project technicians have placed special emphasis on the use of cost accounting procedures so that the cooperatives can monitor the profitability of their different operations. Such monitoring system have been developed and implemented in CREHSUL and Maya Occidental, and are scheduled to be operational in Olancho, Candelaria, and COHORSIL by the end of the year.

c. Accounting System Conventions. Devaluation and inflation are both relatively new events in Honduras, and consequently accounting practices for dealing with them are not widely known or understood. The clearest example of this is the relatively high net surplus in Lempiras shown on the UNIOCOOP Profit and Loss Statement for last year. To a great extent, this net surplus is the result of devaluation. UNIOCOOP purchased fertilizer at the old exchange rate of Lempiras to one dollar and was able to sell it at its new Lempira value, which was closer to 5:1. Not only does this potentially expose the organization to a relatively high tax liability, but it also gives a false image of the true results of the accounting cycle. Since the GOH tax regulations do not allow enterprises to revalue their inventories and reduce their tax liabilities, a suggestion has been put forth by some to create a devaluation/inflation reserve to which these types of windfall profits could be distributed. In order for the government to accept this, however, it is most likely that withdrawals could not be made from this reserve for a specified number of years.

d. Member Level Financial Analysis. Under the Project, the vast majority of the staff's energies are directed at the cooperative level in terms of technical assistance, training, and financial services. This concentration of efforts is directed at placing the cooperatives on a sound financial footing both in terms of profitability (the short run), as well as in terms of capitalization (the long run). This is seen as a positive and correct development philosophy by the vast majority of those interviewed both inside and outside of the Project. Nevertheless, the assessment team questions the potential narrowness of the Project's efforts if the economic conditions of cooperative members themselves are not monitored and improved as well.

In this regard, it appears that an important underlying assumption has been made that if the cooperative does well, then the members should also be doing well. One Board member interviewed by the team summed up this concept succinctly: "Pueda que la cooperativa anda bien, pero nosotros los socios andamos mal".

While the FDF staff have generated farm-level crop budgets as a guide in performing loan analyses in such cooperatives as CREHSUL, these efforts have constituted "breakeven analysis," not a full-blown "sensitivity analysis" that assesses farmer viability against a range of price and production scenarios. The assessment team believes it would be appropriate for the FDF to expand the focus of financial analysis to those production lines of farmer members which are processed or marketed by the cooperatives. This should build on the experiences of production credit for coffee, rice, and other crops already in place. What is suggested here is not a reversal of past trends towards market-based management decisions in favor of cost-based ones, but rather keeping members' costs in mind as cooperatives decide whether or not to enter into new activities with a particular commodity.

2. Future of the FDF. As has been clearly established, the role of the FDF in the Project is changing as it solidifies its presence in the cooperative development field. Nevertheless, five issues must be resolved before the FDF can move on to fulfill its role:

- its current placement within FACACH was seen from the beginning as a temporary solution to a political impasse (See Interim Evaluation of the Project, October, 1989.), which at the present time is neither productive nor expedient;

- its lack of independent standing is an impediment to the FDF's ability to act on its own, enter into legally binding contracts, and plan for the future;

- this lack also complicates Project implementation making it more difficult to delegate host country contracting authority to the FDF by USAID and to make use of such concepts as an imprest fund;

- the lack of clear selection and support criteria which are known to FDF staff and cooperative managers, leaders, and members; and,

- the current provision of both financial support and technical assistance, the principal activity of which is to plan for the provision and disbursement of the financial support, holds the potential for conflicts of interest.

3. Point of Contact between the Project and the Cooperatives. The principal point of contact between the FDF and the cooperatives has been primarily the General Manager, followed by the Board of Directors. This strategy is based on the belief that without sound business management the Project funded services to the cooperatives would be much less efficient in terms of the expected transfer of knowledge and experience. An example of the implementation of this strategy is the case of the Lago de Yojoa coffee cooperative which was suspended from assistance by the Project for much of 1990 because its Board of Directors had fired the manager and did not look for a replacement until recently.

While this strategy is based on a valid concept of promoting sound business management for the member cooperatives, it has several potential drawbacks including:

- the primary responsibility for the sound financial condition of the cooperative lies in the Board of Directors;

- for those cooperatives temporarily without paid managers, it could leave the Project without the ability to influence, direct, or assist the management selection process (this was not the case at Lago de Yojoa, where the coffee advisor did work with the Board in its selection of a new manager);

- it could have the tendency to perpetuate the fact that the management of these cooperatives is already quite thin;

- it holds the potential for not supporting democratic, grassroots decision-making on the part of members and their elected boards of directors; and

- as was mentioned above, it appears that many of the reform sector cooperatives hold an ingrained bias against the hiring of paid managers which will limit the potential for the Project to work with them.

4. The Placement of Expatriate Technical Assistance Advisors. The FDF and UNIOCOOP, the respective roles of the FDF UNIOCOOP are changing. Up until now, the Project has provided five external technical assistance advisors to the FDF: one Chief of Party to advise the FDF Manager on financial, organizational and administrative issues; one to deal with issues of information management at the FDF and among the cooperatives; one advisor to the FACACH credit unions; and two institutional development advisors, one working with AHPROCAFE and the coffee cooperatives of UNIOCOOP, and one working with the UNIOCOOP and FECORAH non-coffee cooperatives. When they arrived in 1987, they were appropriately placed within the FDF since both FACACH and UNIOCOOP were too weak to use them efficiently on a permanent basis.

Now after almost four years of technical assistance activity, UNIOCOOP is judged to be sufficiently well constituted to take advantage of permanent, resident technical advisors to assist in supporting its own activities, as well as those of its coffee and non-coffee member cooperatives. The transfer of at least two of the advisors from the FDF to UNIOCOOP would have several advantages. It would:

- increase the advisors' utility by better integrating them into the organization's day to day operations and decision-making;

- reduce the potential for criticisms of the FDF in terms of possible conflicts of interest stemming from the organization's dual role of providing both funding and technical assistance to the same cooperatives;

- speed up the bringing to fruition of opportunities increasingly faced by the strengthened cooperatives; and

- improve the image of UNIOCOOP by its member cooperatives, as well as by other potential member cooperatives.

D. Issues Relating to USAID and the GOH

1. The Disbursement Approval Process. The current Project disbursement process is long and complicated, involving both the GOH and the USAID Mission. Mission approval is required for all original disbursements of grant funds or local currency. Disbursements of reflow funds require a USAID review if they exceed L. 500,000. Disbursements of financial stabilization reflows do not need Mission approval. Furthermore, the Mission approval process requires a minimum of three signatures, and typically four or five.

Two factors complicate this process: the FDF's lack of legal status, which limits its ability to make direct disbursements; and a lack of clear policies and guidelines for disbursements that are known, understood, and appreciated by the FDF staff. With remarkable frequency, disbursements for specific UNIOCOOP or individual cooperative strengthening support are held up, or returned to the FDF from the Mission, because of missing or unspecific information. One of the objectives of the Project is to transfer to the local-hire staff the technology for effectively analyzing the financial stability of agricultural cooperatives and the feasibility of their proposed investments. The relevant indicators and processes for such analysis should be institutionalized within the FDF before all the funds have been disbursed and converted to reflows, at which point AID will be less directly involved in the disbursement process.

Disbursement delays are substantial in terms of lost opportunities and momentum. For example, last year's disbursement for fertilizer to UNIOCOOP arrived after the fertilizing season had begun. (In the case of procured fertilizers, US source and origin legislation applies, as well as the use of US ships. This often leads to higher costs than could otherwise be found on the open market.) In another example, financial stabilization loans last year for coffee processing equipment arrived after the season had ended.

2. USAID Project Management. The SFOSP is managed by a contract hire staff member and his assistant located in the ARDO office of the Mission. There is no clear delineation between their roles. The management process includes detailed weekly staff meetings between USAID Project Management and the Project Technical Assistance Team. These meetings are held in the USAID offices and normally run between 4 and 6 hours in length. They require both a written and an oral report from each technical advisor during which the past week's activities are analyzed and the next week's are planned. Preparing for and attending these meetings account for between 10 and 20 percent of the technical assistance team's weekly efforts, especially given the opportunity cost of keeping the team in Tegucigalpa since they can not travel to their respective cooperatives in the time remaining during each meeting day. While they recognized that some otherwise unobtainable results have been accomplished through these meetings, the investment members of the Technical Assistance Team expressed frustration with the amount of time that these meetings require.

Additionally, the assessment team understands that, in the past, meetings were held at the FDF and were attended by its employees, as well as by the Technical Assistance team and AID Project Manager. By all accounts these meetings were discontinued "due to a lack of frankness and open expression," and, "a loss of efficiency." Unfortunately, this represents another lost opportunity for technology transfer to take place. Ideally, the assessment team would have preferred to have seen greater emphasis placed on improving group dynamics and the efficiency of the combined meetings, rather than separating the two groups. If there remains any possibility to constructively involve the local hire counterparts in regular meetings, so as to share in the dialogue and to participate in the exchange of ideas, the assessment team recommends it be attempted.