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ACTION MEMORANDUM FOR THE DIRECTOR

From: Elizabeth B. Warfield, C/PDM TRD

Through: Hilda Arellano, DDIR

Subject: Project Assistance Completion Report (PACR) - Cooperative Strengthening Project (520-0286)

Date: June 13, 1995

Action Requested: That you sign below approving the attached PACR.

Discussion: The PACD of the Cooperative Strengthening Project (520-0286) was August 31, 1994. The attached PACR was prepared by Kim Delaney, TRI and reviewed by PDM. It is in accordance with M.O. 3.2: PACD and Project Phase-out Procedures.

Approved: W Stacy Rhodes Disapproved: ____________

William Stacy Rhodes
Director, USAID/Guatemala-Central American Programs

Date 6/15/95

Attachment:
PACR 520-0286

Drafted: MAlban, PDM MA 6/13
Clearance: TDelaney, PDM TRD

PACR.MDA

PROJECT ASSISTANCE COMPLETION REPORT

COOPERATIVE STRENGTHENING PROJECT

(520-0286)

I. Project Summary

Date of Authorization:	7/18/86
PACD:	8/31/94
Amount Authorized:	$15.45 million
Amount Obligated:	$14.76 million
Counterpart Contribution:	$58.2 million
Implementing Agencies:	National Federation of Savings and Loan Cooperatives (FENACOAC) World Council of Credit Unions USDA PASA

II. Project Description

The Cooperative Strengthening Project was an institutional development program which was designed to strengthen the service delivery and management capabilities of participating cooperative federations and primary cooperatives through a combination of technical assistance, training, policy guidance, credit and financial stabilization assistance to: 1) modernize operating policies and procedures, 2) recapitalize selected organizations and 3) finance new services for small and medium-scale farmers and the rural population in general.

The goal of the project was to improve cooperative capabilities to provide services to their members while generating the income needed to ensure the long-term sustainability of cooperative operations. The purpose of the Cooperative Strengthening Project was to develop viable and effective Guatemalan cooperatives by working with selected organizations to enhance managerial and service delivery capabilities and their performance as profitable enterprises.

At the time the Cooperative Strengthening Project was designed (mid-1985), the cooperative movement was in disarray. A decade of political violence and natural disasters, high inflation, outdated cooperative philosophies and inappropriate operational policies had left the movement financially weak and relatively ineffective in the delivery of services. Its economic base had been destroyed, leadership was intimidated, membership was stagnant or declining and many organizations had ceased to function.

The project was initiated in 1986 to help revitalize the cooperative movement. Cooperatives were viewed as representing a potentially viable and effective way to complement ineffective government programs and channel resources to the rural population. It was considered a relatively high-risk but essential element to reestablishing effective service delivery to marginal rural populations.

The original project design restricted project assistance to the federated cooperative movement of Guatemala. Preservation and improvement of the federated structure was considered a key aspect of the project's strategy. This focus was selected because the federations represented vertically integrated structures, economies of scale, representational strength, a relative degree of institutional development and the ability to achieve a multiplier effect beyond the life of the project. The federated cooperative movement was comprised of ten federations, covering credit unions, agriculture, artisans, consumer goods, fisheries and housing. Of the ten federations, all but two (fisheries and housing) agreed to participate in the project.

In 1989, a mid-term evaluation concluded that the Project was successfully accomplishing its institutional development objectives, though at a slower rate than projected in the original design. Despite the delays in project implementation, there had been some progress. Among the federations, there was a willingness to adopt the institutional reforms, an entrepreneurial spirit had been introduced, and concrete steps had been taken to improve cooperative services and enhance earnings. The project's focus on administration and financial management was appropriate and significant changes in policies, interest rates, pricing, capitalization and delinquency control were underway. The financial stabilization component was highlighted as using a particularly innovative approach that avoided grants and forced participating organizations to "earn" financial assistance over a five year period. The evaluation also identified three key weaknesses:

1) <u>insufficient time and resources:</u> the time frame and resource level of the project were considered inadequate to meet the spirit of the project objectives given the number of organizations being assisted and the need to ensure the sustainability of results by the PACD.

2) <u>limited scope:</u> the project was not adequately addressing the fundamental economic issues facing the agricultural cooperatives. Existing business volumes were so low that revenues could not be expected to sustain effective organizations. In particular, the project design did not include sufficient resources to address production, processing and marketing problems, nor to help the federations and cooperatives identify and develop new business opportunities.

3) sustainability: the project was not paying sufficient attention to developing a capacity within the cooperative institutions to sustain project activities and benefits beyond the life of the project. More training was necessary to transfer the requisite concepts, methods, and skills to the participating organizations.

To address these issues and the slower-than-expected implementation rate, a 1990 project amendment extended the project PACD through August 1994, increased project funding by $8 million, eliminated the restriction against working directly with primary cooperatives and greatly expanded the scope of the agricultural cooperative initiative.

In 1992, in a review of project progress, the Mission determined that the project would be more likely to reach its life of project targets if the number of organizations receiving project assistance were reduced. Although important progress had been attained with both the credit unions and the agricultural and artisan cooperatives, a program that included five federations and 57 primary cooperatives was simply too large to implement effectively. In particular, the agricultural and artisan cooperatives would require much more intensive technical support, training and time to develop necessary management skills than foreseen funding levels would permit. In addition, many of the community-based organizations were too small to generate the capital and earnings necessary to sustain effective operations by the PACD.

Therefore, the project was amended in 1992 to reduce funding and redirect project activities at a smaller group of primary cooperatives and federations to ensure that as many as possible would be capable of meeting the project target of sustaining effective operations after the project's PACD. LOP funding was reduced by $3.5 million, the agricultural program was cut in half, and assistance was terminated to one national federation (FEDECOCAGUA) and 15 agricultural cooperatives. The smaller group that continued to receive assistance included the National Federation of Savings and Loan Cooperatives (FENACOAC) and its 20 affiliates, the Coffee Federation of Alta Verapaz (FEDECOVERA) and 9 affiliates, the Artisans Cooperative Federation (ARTEXCO), the Federation of Agricultural Cooperatives (FEDECOAG) and six coffee cooperatives.

III. Summary of End of Project Status

By any measure, the Cooperative Strengthening Project was a success, fully meeting or exceeding the targets set over the life of the project and achieving the project purpose, leaving in place a network of financially viable and well-managed credit unions and agricultural cooperatives. Four federations (National Federation of Savings and Loan Cooperatives (FENACOAC), the Coffee Federation of Alta Verapaz (FEDECOVERA), the Artisans Cooperative Federation (ARTEXCO) and Federation of Agricultural Cooperatives (FEDECOAG)) and 34 primary cooperatives all met the project target of having policies, membership base and capitalization required to ensure long-term viability in providing services to their members.

To ensure sustainability of project efforts, more than $4 million in program generated income from the original stabilization fund and the interest earned on this fund was allocated at the end of the project to project beneficiaries to reinforce their financial viability. Specifically, these funds were allocated to FENACOAC to fund three years of follow-on technical assistance from the World Council of Credit Unions, to ARTEXCO for the purchase of a commercial dye facility and to the agricultural credit funds of FEDECOVERA, FEDECOAG, Renacimiento 59 Coffee Cooperative and the Jalapa Coffee Cooperative Association.

The project's major outputs include the following:

Output	Target	Actual	Percentage of Target Met
5% annual growth of cooperative membership	30,000 members	38,386 members	128%
Number of cooperative members trained	2,500 trained	12,599 trained	504%
15% annual growth of cooperative capital	Q36.1 million in capital	Q63.4 million in capital	176%
15% annual growth of cooperative assets	Q77.3 million in assets	Q164.4 million in assets	212%
20% annual growth of credit union deposits	Q18.3 million in deposits	Q99.9 million in deposits	547%

IV. Planned versus Actual Inputs

The Cooperative Strengthening Project was originally authorized at $11 million. This authorization was increased to $19 million in 1990 and then reduced to $15.45 million in 1992. Of the $14.7 million that was obligated, approximately $13.4 million was expended, leaving a balance of $1.3 million for deobligation.

The planned counterpart contribution from FENACOAC and other project beneficiaries was $7.6 million. At the end of the project, the counterpart contribution had risen to more than $58 million, greatly exceeding the planned contribution.

V. Project Accomplishments

The Cooperative Strengthening Project has had a significant impact on Guatemala's cooperative movement. Some organizations have progressed more than others, but all have improved their operating efficiency through exposure to the project's business focus on policy and financial management reform.

The national credit union movement represented by FENACOAC and its affiliates is among the strongest in Latin America. New operating policies and financial disciplines have permitted the movement to grow and provide a wide array of competitively-priced financial services to rural communities. The credit unions have eliminated their dependence on external capital, are mobilizing significant local savings, lending on the basis of ability to repay, controlling delinquency, building institutional capital and planning for the future. Their financial situation is strong and the foundation for future long-term growth has been established.

Similar but less dramatic results have been obtained among the non-credit union organizations. Although smaller in total membership and slower to develop, the organizations have adopted a new, entrepreneurial approach to member services and their financial condition is much improved. All have demonstrated an improved capability to provide effective and competitively-priced services to their members, business volume has increased and capital is growing.

FENACOAC/Credit Union Movement

The credit union system represented by FENACOAC and its affiliates is the largest and strongest of Guatemala's national cooperative organizations. Founded in 1963, FENACOAC has grown to possess a current membership of 43 credit unions with 100,000 individual members and assets totaling over $30 million.

In a 1987 institutional assessment, the Project noted the following problems: a) over-dependence on external financing, b) high operating costs and excessive staff, c) inappropriate capitalization and lending policies, d) significant long-term delinquency in its loan portfolio and e) little effective planning to obtain independence from external capital. In comparison to the other cooperative federations, FENACOAC was considered relatively stable, but much of the apparent stability was due to the existence of long-term inexpensive international loans which had been reinvested in low-risk, high-yielding financial instruments.

The credit union affiliates faced a series of similar problems, in great part due to the widespread use of outdated institutional policies and practices, including a) a reliance on low-interest shares, b) an inability or unwillingness to mobilize savings, c) weak credit administration due to a linkage of loans to shares and a disregard for repayment capacity analysis, d) a dependence on outside subsidized funds to provide liquidity, e) inappropriate collection policies for delinquent loans, f) relatively high operating expenses and low earnings and g) an inability to build institutional capital. Membership in the system was declining and individual credit unions were unable to develop new more effective financial services to revitalize their operations and reverse existing trends.

By the end of the Project, the national credit union movement was better organized, expanding and much healthier than it was in 1987. FENACOAC eliminated its dependence on external resources, reorganized and reduced staff by 50%, completely eradicated loan delinquency in lending and had become more profitable while improving the quality and array of financial services provided to the affiliates. The credit unions made similar progress. Management was better trained, there are much higher capital to asset ratios, loan delinquency is better controlled and reported, and the creation of reserves is more systematic and disciplined. The specific policies for capitalization minimums, delinquency control and reserve creation are far more stringent than those now required of the commercial banking system.

The improvements in credit union financial management skills have been accompanied by greatly improved services to members. Savings are now well-protected, earn a competitive rate of return, and have replaced external borrowing as the principal means to finance the loan portfolio. Resources to finance lending are now readily available, loans are more easily obtained, and policies now permit the credit unions to finance a broad range of productive and non-productive needs. Specific methodologies were developed and are now being utilized to manage the financial system. These include the Business Plan, the PERLAS monitoring system, an accounting system, a guaranty fund and a central liquidity fund.

ARTEXCO

ARTEXCO is a central service organization for 22 handicraft production cooperatives located in the Western Highlands of Guatemala. It was organized in 1976 to provide affiliated cooperatives with improved access to local and international markets. Its membership includes 2,200 people, a majority of whom are small weavers and 65% of whom are women. When ARTEXCO began working with the Cooperative Strengthening Project in 1988, it was encountering a series of operational problems which jeopardized its institutional viability. These included: a) an overdependence on international donations and the marketing assistance of a foreign advisor, b) a very weak affiliate base, c) high operational costs in relation to sales volume, d) inadequate internal control and information systems, e) few written policy guidelines for product pricing, quality, control, capitalization and credit, f) inadequate staff training, g) over-centralization of authority in management and little participation of the Board of Directors, h) unstable demand for Guatemalan handicrafts in both domestic and international markets and i) a lack of strategic planning to increase market share.

The project's strategy was designed to strengthen the international marketing program by introducing a broader, more business-like approach to services and internal operations. Project support included: 1) technical assistance to develop written policy guidance and improve Board/management relations and 2) training for ARTEXCO staff in accounting and budgeting, cost and inventory control, pricing of services, marketing and strategic planning.

By the end of the Project in 1994, ARTEXCO had become a leading exporter of Guatemalan handicrafts to U.S. and European markets. It is virtually independent from international donor assistance, a series of new operating policies had been adopted (including pricing, inventory and quality control, ordering of raw materials, and operations of its dying facility) and internal operations are well-controlled. All of ARTEXCO's accounting, ordering, inventory control and billing is computerized. The previous poor relationship with the cooperative affiliates had improved and entrepreneurial ties now exist that have translated into better quality finished products and improved international sales. The cooperatives have very good access to international markets through ARTEXCO and they are provided with guidance in product design, market information, management and administration. New, improved dyes are now available through ARTEXCO at competitive prices, the quality and delivery time for finished products is much improved and international markets have responded with increased purchases. From 1987 to 1993, for example, sales jumped from Q179,375 to Q1.9 million, an increase of 1003%.

FEDECOVERA

FEDECOVERA is a regional federation of coffee cooperatives operating in the departments of Alta and Baja Verapaz. Founded in 1973, the Federation has 24 affiliated cooperatives with a membership of approximately 5,500 farmers. The Cooperative Strengthening Project began working with FEDECOVERA in 1987 when an institutional assessment was completed. This assessment identified a broad range of problems which were likely to destroy the system if left uncorrected, including: a) a complete lack of internal information control systems, operating manuals and policies, b) absence of a disciplined system for credit allocation and loan administration and recovery, c) high accumulated loan deficiency, d) poor definition of lines of authority within both the Federation and among its affiliates, e) extreme paternalistic approach to service delivery and a lack of business focus, f) high operating costs in relation to income, g) extremely weak member capitalization and non-existent sense of ownership, h) low and declining coffee yields, inconsistent processing quality and weak market linkages, i) widespread illiteracy and extremely weak Federation and cooperative leadership, and j) a lack of clear goals and strategic planning required to reverse historical trends.

The development of the FEDECOVERA system represented one of the more difficult challenges faced by the Project. Project assistance focused on technical guidance in all aspects of cooperative administration, organizational development and policy, salary support for a credit supervisor and an agronomist to improve production technologies, intensive training for federation employees and leaders in strategic planning, problem recognition and solution, credit to finance coffee production and intensive agricultural production and processing assistance to improve yields and quality.

By the end of the project, FEDECOVERA had successfully reduced staff to cut costs and improve efficiency, internal controls, administration and management are much improved, strict budgets are now in-use, a new credit policy has reduced loan delinquency to acceptable levels, and an effective agricultural extension program had improved coffee yields and quality among the affiliates. The affiliated cooperatives also made significant progress, but language and educational limitations will continue to impede their long-term development. The cooperatives are widely dispersed and isolated, educational opportunity is limited, and they remain very dependent on the Federation for guidance and support. Notwithstanding their problems, internal controls, administration and planning have improved, farmers are adopting new production practices, coffee quality is greatly improved and exportable yields have increased by approximately 40% and repayments of long past-due obligations have surpassed initial expectations.

Jalapa Coffee Cooperative Regional Association

The Project began working with four independent coffee cooperatives located near Jalapa in early 1991. All were loosely organized institutions with no full-time staff, few written policies, and a combined membership of 250 small coffee producers. The cooperatives' credit union program with their members was very informal. Loans were not documented, no collateral was required, and loan amounts were simply determined by the amount of liquidity available. Few financial controls were applied and loan repayment was often delayed. This greatly increased financing costs and virtually eliminated any possibility of building cooperative capital.

Institutional analyses of the four coffee cooperatives identified the following common problems: a) poor accounting, b) complete absence of internal controls over cash, loan portfolio, inventory and other assets, c) no written policies or procedures to guide internal decision-making, pricing of services or credit, d) no member statistics or written records of land under production, average yields, marketing channels, or inputs used, e) high levels of high-cost external debt with the exporting firm and f) poor processing infrastructure and a variable quality final product.

The absence of full-time cooperative staff slowed implementation during the first year of project assistance. Training programs had to be presented in the evenings or weekends when the volunteer leaders had time available. This delayed the development and approval of new operating guidelines, but it did permit active participation from interested Board members and assured the eventual acceptance of the new business orientation. During the first year, the cooperatives developed a series of key policies and procedures to guide their operations. Annual budgets were prepared, credit and capitalization policies were approved, and appropriate accounting nomenclature was developed to provide for basic financial management and control. In 1992, the cooperatives organized a regional office in Jalapa to centralize their accounting.

By the end of the project, the regional association was fully operational.

Monthly financial statements were being prepared for each cooperative and cooperative contributions financed 100% of the operational overhead. New technologies were adopted in the cooperatives, leading to an increase in coffee yields from 20 to 26 quintales/manzana and the quality of the final product was improved due to the remodeling of the coffee processing facilities.

<u>Renacimiento 59 Coffee Cooperative</u>

Renacimiento 59 is an independent coffee cooperative which provides credit, processing and marketing service to 142 medium-scale producers in Jutiapa. Established in 1985, the cooperative possesses a large wet milling capacity and markets a large volume of relatively high grade coffee through a private exporter. In addition to processing and marketing coffee, Renacimiento 59 also provides members with production credit financed with advances received from the export firm. In a 1991 institutional analysis, when the cooperative was experiencing severe financial and organizational problems, the Project found that daily management, loan approvals and investment decisions were being made by the Board of Directors in a manner not consistent with sound business practices. No written guidance nor procedures were used to guide operations, internal controls for loans, cash management, and inventories did not exist, and accounting was poor and financial statements were often completed after months of delay.

The wet milling operation was also poorly managed. The quality of processed beans was mixed, conversion rates from cherry to parchment state was high and far too many laborers were being hired during peak processing periods. Processing costs were high and cooperative income low due to the mixed quality of the final product and low prices. The ability of the wet mill to process all member production was also severely constrained by a lack of sufficient water during peak periods. Finally, the financial situation of the cooperative was weak. Member capitalization was minimal and the ability to retain earnings and build capital restricted by high costs and small margins.

The cooperative responded quickly to the Project's rehabilitation program. By the end of the project, a highly-skilled full-time manager was hired, Board/management relations had improved, written policy guidance was developed and in use, legal action was taken to recover the delinquent portfolio, outstanding obligations to the export firm were refinanced on favorable terms, and a computerized accounting program was introduced to prepare monthly statements. Infrastructure improvements to the processing facility resulted in a significant improvement in coffee quality and conversion ratios, and a well was drilled and eliminated the traditional water shortage problems. The improvements also reduced the need for manual labor and the processing facility's costs of operations. Finally, the agricultural technical assistance program and the changes in cooperative management and decision-making have renewed member commitment to the cooperative. Members have increased their share contributions to provide adequate working capital and 100% of non-productive assets are now financed with retained earnings.

FEDECOAG

FEDECOAG, formed in 1975 as an organization dedicated to the defense and representation of the small-scale farmer, offers limited income-generating services to its affiliates. FEDECOAG was successful in attracting assistance from international donors for a variety of socially-oriented development programs, but it lacked many of the basic elements for long-term economic viability. The 48 affiliated cooperatives were generally small, widely-dispersed organizations which produced a broad variety of agricultural crops. The cooperatives had few written policies, accounting and administration was rudimentary and part-time employees or volunteers managed day-to-day operations. Membership totaled approximately 8,000 farmers.

At the time of the institutional assessment of FEDECOAG in 1987, its future was in serious doubt. A combination of poor administrative and operational practices and an over-dependence on external donor assistance had resulted in serious financial losses to both the federation and the cooperatives. FEDECOAG had the following problems: a) inappropriate operational policies, b) over-dependence on grant-funded international assistance, c) inadequate capitalization, d) poorly trained staff and leadership, e) high loan delinquency, f) a weak and declining membership base, g) widely dispersed small cooperative affiliates with limited economic potential, h) few profitable service programs and i) a high level of unprofitable fixed assets.

Through Project assistance, FEDECOAG has successfully shifted from its former role as an intermediary of socially-oriented donor programs to become a business-oriented institution that is financially healthy and relatively independent from external assistance. Federation services have been redefined and a new more productive relationship has developed with the affiliated cooperatives. 24 inactive or insolvent affiliates were purged, federation staff was reduced by 50% and a computerized accounting system is now used to manage and control all internal operations. The computer system permits FEDECOAG to provide centralized accounting services to its smaller affiliates on a cost-reimbursable basis, greatly improving its ability to track the progress of the affiliates.

FEDECOAG's credit program was redefined, new policy guidance was introduced, and production loans began. Interest rates on lending was raised to market levels, recoveries on past-due accounts has greatly improved, and delinquency on new lending has been maintained at less than 5% for several years. Finally, a debt restructuring agreement with the Agricultural Development Bank (BANDESA) was successfully negotiated, eliminating the threat of foreclosure and greatly improving the long-term financial situation.

FEDECOAG's most important source of income is now derived from a widespread network of input supply stores located in five regions of the country. Gross sales in 1993 totaled more than half a million dollars. By the end of the project, FEDECOAG had well-trained management, well-developed operating policies and procedures, realistic and profitable service programs and a greatly improved financial situation. The future of the FEDECOAG system will now depend on its ability to address the limited potential of its current affiliate base, attract new members by offering competitive high-quality services and generate increased economic activity and earnings.

VI. Lessons Learned

There were both positive and negative lessons learned from the Cooperative Strengthening Project. Some of the reasons for the project's success were the following:

- o clearly defined objectives, policies and operating principles
- o direct daily involvement of the USAID project manager, facilitating coordination with the Mission and compliance with project norms and procedures
- o excellent project direction from a person with sufficient interpersonal skills, discipline and technical knowledge to make difficult decisions and work with a wide range of project staff
- o the use of pilot programs in the introduction of new concepts to gradually gain acceptance of the new techniques
- o the establishment of monitoring and control systems that allowed Project staff to rapidly respond to problems in implementing organizations
- o consistent application of Project norms to all organizations involved in the Project, creating greater discipline among project beneficiaries
- o well-organized, motivated and well-supervised technical Project team
- o successful development of a fee-for-services mentality among Project staff and implementing institutions to break prior dependence on free donor resources.

Some of the lessons learned from the project are the following:

- o the scope of the project design should match the available technical and human resources (the original design of the Cooperative Strengthening project was too expansive for the funds and technical capacity that were available)
- o relationships with project beneficiaries and implementing organizations should be as direct as possible to avoid delays in implementation (originally, the Project provided all assistance through cooperative federations, which created bureaucratic problems and delays)
- o before a project expansion is approved, future funding should be relatively

secure (the inclusion of agricultural export organizations in 1990 resulted in the use of a lot of Project resources and time that could have been better spent on other activities, especially since these organizations were later excluded from the project due to budget cuts)

- low salary levels in the cooperatives lead to rotation of personnel and the training of many cooperative staff who have now left the cooperative system. To avoid a waste of training opportunities, the Project should have tried to address the issue of staff rotation.

- since computerization was not a large part of the Cooperative Strengthening Project's initial design, this lead to an ad hoc development of computer systems that were not standardized across institutions, leading to problems with transfer of data and unnecessary expenses in the development of new systems.

Drafted by: TRI:KDelaney KD Date: 6/9/95

Cleared by: C/TRI:RPeterson [illegible] Date: [illegible]