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ECUADOR

SOCIAL ENTREPRENEURSHIP PROGRAM

EXECUTIVE SUMMARY

DEVELOPMENT OF SMALL PRODUCERS IN THE VALUE CHAIN OF THE ANDEAN GOURMET SNACKS EXPORT INDUSTRY

(EC-S1019)

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ABBREVIATIONS

INEC	Instituto Nacional de Estadística y Censos [National Statistics and Census Institute]
kg	kilogram
PSR	Project status report
SEP	Social Entrepreneurship Program
SME	Small and medium-sized enterprise

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I. BASIC PROJECT INFORMATION

A. Borrower and executing agency: Inalproces

B. Amount and source of financing:

	IDB US$	Local US$	Total US$
Reimbursable financing:	400,000	300,000	700,000
Technical cooperation:	250,000	117,325	367,325
Total:	650,000	417,325	1,067,325

Source: Ordinary Capital resources for the Social Entrepreneurship Program.

C. Terms and conditions:

Term:	8 years
Grace period:	36 months for principal
Interest rate:	6% annual fixed rate on balances
Currency:	U.S. dollars
Execution periods:	Technical cooperation: 36 months Reimbursable financing: 33 months
Disbursement periods:	Technical cooperation: 42 months Reimbursable financing: 36 months

The reimbursable financing will be denominated, disbursed, and repaid in U.S. dollars. The grace period applies only to the amortization of principal, and not interest.

D. Statement of no objection: The Bank and the Government of Ecuador agreed that operations with the private sector that have characteristics similar to the current project do not require a prior statement of no objection, which only needs to be provided for informational purposes after the project is approved.

II. BACKGROUND AND PROBLEM TO BE ADDRESSED

Socioeconomic context of Ecuador

2.1 Thirty-seven percent (37%) of Ecuador's population (5.3 million people) lives in rural areas.[1] Agriculture is the primary economic activity in these communities, since their income comes from working their land and selling the fruits of their

[1] Source: National Population and Housing Census–INEC 2010.

labor to others and providing food for their own consumption. Sixty-four percent (64%) of agricultural production units have less than five hectares of land;[2] it is this group that suffers the most from low productivity and limited access to technology, credit, and marketing channels. Although 49% of the rural population in Ecuador is considered poor based on income level,[3] 83% lives in poverty as measured by unmet basic needs indicators.[4]

2.2 Non-petroleum exports from Ecuador primarily consist of traditional products such as bananas, shrimp, coffee, cacao, and white fish. Seventy-six percent (76%) of exports are primary products (with no value added) and 31% of these exports are agricultural products. The export of industrialized products accounts for a mere 24% of total exports.[5] These figures reflect the fact that there are very few productive and commercial initiatives that diversify and add value to export offerings.

Micro, small, and medium-sized enterprise and entrepreneurship in Latin America

2.3 In Ecuador, as well as the rest of Latin America, businesses with fewer than 10 employees (small businesses) create most of the jobs. In 2010, this category of businesses was responsible for 73% of jobs in Ecuador. Medium-sized enterprises (from 10 to 49 employees) generated 13% of jobs, and the remaining 14% were created by large companies (with more than 50 employees), in contrast to the United States where large companies generated 60% of the jobs.[6]

2.4 Last year Ecuador had the highest rate of total early-stage entrepreneurial activity in the region (26.6%).[7] However, it is estimated that around three-fourths of these ventures can be considered subsistence, and only one-fourth are dynamic enterprises.[8] Within this latter group, 'born global' firms are young small and **medium-sized enterprises (SMEs) that stand out because of their strategic** approach, since they penetrate global markets from the time of their inception or very soon after, and are considered as having the highest capacity for growth.[9] However, like other SMEs, they have limited access to financing. It is estimated that the structure of this type of venture is 80% dependent on the founder's capital, with less than 10% in the debt category.

[2] Source: Results of the National Agricultural Census 2000.

[3] Source: Urban Employment and Unemployment Survey–INEC 2012.

[4] Source: National Population and Housing Census–INEC 2010.

[5] Source: PROECUADOR: 2013 Business Guide – Republic of Ecuador.

[6] Source: 2013 Economic and Development Report, prepared by the Development Bank of Latin America (CAF).

[7] Based on 2012 results from the Global Entrepreneurship Monitor (GEM).

[8] According to the Inter-American Development Bank, dynamic enterprises are those that within three years of operation become small businesses with at least 10 employees, more than US$100,000 in sales, and a higher rate of growth than average in the sector.

[9] Source: Eisenhardt and Schoonhoven, 1990; Cooper *et al.* 1994.

Problems experienced by small farmers who grow native and exotic vegetable crops

2.5 Inalproces produces and sells snacks made of native and exotic vegetables, primarily for the export market. The raw materials are mostly supplied by small farmers in the mountain and coastal areas of Ecuador. The products processed by this company include Andean potatoes, white carrots, and sweet potatoes, which are considered native crops, as well as plantain, yucca, and beetroot, which are not native to the Americas but are considered exotic products in the snack food industry.[10] Most of these crops are produced by small farmers. For example, 75% of potato plantations are farms with less than five hectares.[11]

2.6 The areas where each crop is grown are spread out in different geographic parts of the country. Yucca and "maqueño" plantain farms are located in Santo Domingo de los Tsáchilas, whereas native potatoes are cultivated along the entire inter-Andean corridor. However, there are several general problems common to all small farmers that grow these types of crops. The most relevant are: (1) limited access to formal credit; (2) lack of access to quality seeds and inputs; (3) lack of adoption of best practices in production, harvest, and post-harvest activities; (4) high logistical costs due to the distance between small farms and storage and consumption centers; (5) organizational weakness of farmers associations; and (6) lack of commercial partnerships.

2.7 The productivity gap between producers that use modern technology and traditional farmers is significant. With respect to the cultivation of native potato varieties, farmers who work with quality seeds harvest more than 20 quintals[12] for every quintal of seed planted, whereas a traditional small farmer only produces 10 quintals. In addition, post-harvest techniques and tools are necessary to increase the revenues of small farmers. It is estimated that in the beet category alone up to 10% of the harvest is lost from not using the proper techniques. The scattering of small plantations also makes production less competitive. Plantain and yucca farmers must travel 180 kilometers to deliver their crops to Quito, paying an average of US$40/metric ton in transportation costs, which represents 17% of the cost to produce maqueño plantain and 50% of the cost for yucca.

Current situation of Inalproces

2.8 Inalproces was founded in 2004 and was formally incorporated in 2010.[13] For Inalproces, agricultural raw materials account for 32% of its direct costs, and receiving a timely supply is critical to its processing operations. Currently, some

[10] In 2012 Inalproces purchased approximately 535 metric tons of raw materials: maqueño plantain (31%), beets (22%), white carrots (16%), native potatoes (11%), sweet potatoes (11%), yucca (8%), and Dominican plantain (1%). This supply mix may vary depending on market demand.

[11] According to the last National Agricultural Census conducted in 2000.

[12] 1 quintal (qq) = 100 pounds.

[13] It was founded in 2004 with the trade name INALPROCES, and operated under its owner's personal identification number (RUC).

of its suppliers are members of associations that have organizational and leadership weaknesses. Inalproces works with seven associations: six small associations with an average of 23 members, and CONPAPA-Tungurahua, which has 70 members and is part of CONPAPA Nacional (a consortium of small potato farmers).

2.9 After beginning operations in 2010 and achieving success with selling its products in more than 20 international markets, Inalproces decided to improve its management model in order to generate profits, focusing its efforts on optimizing its operational processes and expanding its export volume (71% of its sales in 2012), taking advantage of the growth in the segments served in international markets. To this end, Inalproces decided to invest in a new plant with better technology and to introduce a Supplier Development Program. This supplier management system will be based on two strategies: (i) strengthening the associations of its current suppliers in order to lower transaction costs, which entails a gradual shift from obtaining its supplies from individual farmers to purchasing them from small farmers associations, which is expected to increase from 15% to 50% by the end of the project; and (ii) developing a contract-based agricultural system, with custom loans tailored to the needs of the farmers and associations so that they can transfer technology and improve productivity. This system will also build the loyalty of small agricultural suppliers to the industry.

2.10 Inalproces has experience in the development of suppliers. In 2010, Acdi-Voca selected it to execute its Local Economic Development Project financed with funds from the United States Agency for International Development (USAID). This initiative established a commercial relationship between the company and small farmers in the border provinces and won the award for “Best Corporate Social Responsibility Project in Ecuador” from the German Agency for International Cooperation (GIZ) and the German-Ecuadorian Chamber of Commerce (2011).

The snack market

2.11 The international snack food market is valued at US$334 billion, with a 7% average annual rate of growth in the period 2012-2015. The United States is unquestionably the biggest market for this type of product, with a per capita consumption of 10 kg/year, although it is a mature market with an estimated growth rate of 4%. Countries in the Asia Pacific region, Latin America, and India represent the regions with the highest growth.[14] Consumption in Latin America still lags far behind per capita consumption in the United States; for example, in Mexico it is 3.8 kg/year.[15]

2.12 The snack market in Ecuador is valued at around US$105 million, with an annual per capita consumption of around 3 kilos. The size of the market in Ecuador is

[14] Source: Bakery and Snacks - Market Assessment 2012.

[15] Source: Industria Alimenticia: La actualidad del Segmento de las Botanas en México [Food Industry: The Current Snack Market in Mexico].

much smaller than in Colombia, which is estimated at nearly US$1 billion, or the Chilean market valued at US$436 million. Locally, there are a few national industries that produce snack foods from nontraditional raw materials (such as Cronquis and Delencanto), along with a significant presence of large multinationals such as Frito Lay.

2.13 **Request for resources:** Based on its experience over the last three years, Inalproces knows how to identify and select the essential raw materials it needs, and is familiar with the gaps that must be filled in terms of the organizational skills of the associations and the level of technology that must be transferred to small farmers in order to increase their productivity. Because Inalproces is an export SME with little access to credit to finance its own working capital, much less the working capital of small farmers, it decided to request funds from the IDB's Social Entrepreneurship Program (SEP) to cofinance the creation of a credit fund that would enable it to grant loans to small producers of native and exotic vegetable crops to improve their productive infrastructure, obtain quality inputs, or expand their production areas. This mechanism is indispensable given that young SMEs such as Inalproces do not have access to financing for expansion purposes, and small farmers do not have access to any financing, particularly in the case of nontraditional crops produced on a small scale. In terms of the technical cooperation component, these resources would be used to strengthen and coordinate the local capacities of the stakeholders involved in the project, in order to: (i) increase productivity and build the capacities of the associations; (ii) strengthen Inalproces's institutional framework with respect to its management of small producers; and (iii) systematize and disseminate the project outcomes.

2.14 Because it is a new, small company, Inalproces does not have a line of credit to finance its capital and investment needs, which are currently directly financed by its shareholders. It also does not have the resources to establish a credit fund to meet the needs of its rural suppliers. The SEP loan will directly benefit small farmers who grow nontraditional crops and do not have access to formal lines of credit. It will also provide access to credit for Inalproces, an export SME with a high potential for growth that applies economic and social inclusion principles throughout its entire supply chain.

2.15 **Beneficiaries**: Inalproces currently has a base of 110 small farmers that grow beets, sweet potatoes, yucca, white carrots, plantain, and native potatoes in the provinces of Imbabura, Carchi, Loja, Santo Domingo de los Tsáchilas, Tungurahua, Pichincha, and Cotopaxi,[16] with the following demographics: 49% Afro-Ecuadorians, 40% indigenous, and 11% mestizos. Of these individuals, 56% are men and 44% are women. On average, 53% of the farmers have monthly

[16] The beneficiary farmers live in rural communities with high levels of poverty based on unmet basic needs. Small beet farmers have a poverty rate of up to 86.6%. The rate for white carrot farmers is as high as 76.6%; farmers that grow maqueño plantain and yucca in the province of Santo Domingo de los Tsáchilas, 93.4%; and the poverty rate for sweet potato farmers in Loja is 74.6%.

incomes of less than US$250 (whereas the basket of basic goods defined in 2007 costs US$436.56)[17]. Only 6% have monthly incomes of more than US$450. In terms of education, the majority (52%) of these farmers have completed primary school, 21% have secondary education or craft training, and only 7% have technical training or higher education.

III. THE PROJECT

A. Objective and purpose

3.1 The goal of the project is to help boost the incomes of small producers who grow native and exotic vegetable crops in Ecuador. The purpose is to strengthen the links in the value chain of the Andean exotic vegetable industry in order to position the products in high value markets.

3.2 The model includes providing technical assistance and reimbursable credit to small producers at competitive rates. This project is consistent with Inalproces's expansion plan to meet the needs of the international market while supporting the agricultural production of small farmers in nontraditional crop categories. To this end, the IDB will provide a reimbursable loan and technical cooperation resources to Inalproces.

B. Description

3.3 **Reimbursable financing component**: The total amount of the required financing is US$700,000, with US$400,000 contributed by the IDB and the remaining US$300,000 provided by Inalproces. The Bank resources will be used to establish a direct credit fund of US$190,000, which the company will channel to 135 small farmers who grow nontraditional crops, who will receive a reimbursable loan averaging US$946.50 to be used to purchase production inputs (quality seeds and other supplies) during the project's execution period. By rotating resources, 135 farmers and/or farmers associations are expected to receive credit from the fund over the life of the loan. The small farmers will repay the loan in six-month periods depending on their crop harvest seasons, at an annual rate of 11%, which is much less than the 32% annual rate they currently pay. In addition, the associations and/or small farmers may obtain a loan averaging US$10,000 with a two-year term and semiannual payments at an annual rate of 13%, in order to improve their production infrastructure or increase their planting area.

3.4 The remaining proceeds of the reimbursable loan will be used to finance Inalproces's working capital in the amount of US$185,000 to cover the company's operating needs, and US$25,000 to purchase fixed assets. Using the local contribution and as part of this project, Inalproces will finance new equipment valued at US$150,000 for its new plant, with US$150,000 in additional

[17] Source: Ecuador in figures: http://www.ecuadorencifras.gob.ec/wp-content/descargas/Canasta/ipc_informeanaliticocanastas_09_2013.pdf.

working capital to purchase the crops harvested by the farmers included in the program.

3.5 To determine this project's area of intervention, Inalproces will select areas that meet the following criteria: (i) agroecological conditions suited to the production of the required raw materials; (ii) poverty levels above the national average; (iii) reasonable geographic location in terms of covering logistical costs; and (iv) acceptable organizational levels of the suppliers.

3.6 To select the associations and farmers that will directly benefit from this project, the following criteria will apply: (i) preference will be given to women since they account for a high percentage of farmers involved in small-scale agriculture; (ii) their incomes depend on agricultural activity; (iii) they live on the productive unit; (iv) the associations have previous experience in commercial activities; and (v) the board of directors of the associations is trusted by its members.

3.7 Inalproces has experience in providing technical assistance and purchasing agricultural raw materials from small producers. It has not been involved in any previous activities related to managing loans for small farmers, but by having detailed knowledge about the productive work of small farmers as well as storage logistics and market information, it will be able to properly monitor the use of the loans and handle their repayment. Furthermore, the technical cooperation resources are expected to strengthen credit management through the formulation and implementation of credit regulations, where procedures will be defined and processes will be automated. The agricultural procurement department will be trained on the implementation of this new activity in the company. Also, since Inalproces will be the buyer of the products delivered by small farmers, it has the advantage of being able to deduct the loan principal and interest from the payments owed to the farmers for the products they supplied.

3.8 In terms of the financing received for working capital, the loans will be repaid by the farmers and/or farmers associations to Inalproces based on the approved cash flow, taking into account harvest times and market prices at the time of payment. In terms of the financing to be used for productive assets, the investment needs of the associations/farmers will be analyzed and a cash flow will be prepared based on the members' harvest seasons. Based on its experience in managing its current network of suppliers, Inalproces will: (i) select the productive areas and crops categories that will be financed by the loans; (ii) select the beneficiary small farmers and/or farmers associations; (iii) provide technical assistance and carry out activities to monitor the use of the funds; and (iv) monitor sales to guarantee the repayment of the loan.

3.9 **Nonreimbursable technical cooperation component:** The technical cooperation resources are expected to benefit 200 individuals and will total US$367,325, of which US$250,000 will be contributed by the Bank to cofinance technical assistance activities to improve the production, harvest, and post-harvest activities of small farmers, strengthen the organization of farmers associations, provide institutional strengthening to Inalproces to improve its relationship with its suppliers, disseminate the outcomes and lessons learned, manage the project, and cover other expenses related to execution, such as the baseline, midterm and final evaluations, audits of disbursements, procurement, and contingencies. The local contribution will total US$117,325, which will be used to improve skills to ensure the quality control of the post-harvest management of the production of small farmers and associations, training farmers and associations on food safety and security, systematize traceability, develop new products that use the raw materials supplied by small farmers, cover participation at specialized fairs to disseminate the management model with small suppliers, produce an institutional video on the project experience, and cover the project management costs and accounting audits of Inalproces. The Plan of Operations for the technical cooperation component, which can be found in Annex V of the project's technical files, describes this support in greater detail.

C. Sustainability and findings of the financial analysis

3.10 The financial viability of the project was evaluated based on: (i) the growth rate of Inalproces's sales in recent years and its projected future sales; (ii) improvement in the productive and commercial capacity of Inalproces as a result of the recent investment in the new processing plant, which will double the plant's installed capacity; (iii) the anticipated reduction of costs resulting from: (a) the greater productive efficiency of the plant; and (b) the purchasing arrangements to be implemented with suppliers under this project; and (iv) the potential increase in per-hectare productivity that will help farmers earn higher incomes to repay the loan they received from Inalproces. Calculations of the projected revenues and expenses of small farmers and Inalproces were based on conservative scenarios in terms of the increase in sales and costs. The projections are consistent with the growth of the industry and increased agricultural productivity.

3.11 The projected financial statements demonstrate that with the improved productive capacity of the new plant installed in 2013-2014 and the improved mechanism for purchasing raw materials from the farmers to be implemented under the project, Inalproces will be able to continue its growth trends in national and international markets and generate better profit margins. The loan from the Bank will give it more working capital to purchase raw materials and have higher volumes of quality raw materials supplied by the farmers that receive a loan from the company. The projections show that during the life of the loan, the company will be able to continue to profitably grow, with sales increasing from US$1.5 million in 2014 to US$3.8 million in 2020, and growing profits (with a return on equity ranging from 11% to 20% over the life of the loan). In addition, by capitalizing the contributions of the members and retaining profits, the company will significantly increase its net worth, from US$839,439 in 2014 to more than US$2.5 million in 2020. The projections indicate that the debt-equity ratio will not exceed 1:1 during the life of the loan.

3.12 Given that the financial conditions of the loan will only allow disbursements if the company demonstrates its profitability and solvency (see paragraph 2.36 on covenants), the risk of the company being unable to repay the loan or becoming over-indebted is mitigated.

D. Credit risk for the Bank

3.13 The credit risk of this operation for the Bank is high, since Inalproces is an SME that has not yet reached its breakeven point and has low net worth levels. However, the support provided to the company by the SEP is warranted because of the expected impact the project will have on the sales and incomes of the small farmers that supply Inalproces, the opportunity to develop a new model to boost the growth of an export SME, and the development of small farmers who grow nontraditional crops. The reasons for this high risk rating refer to the fact that (i) Inalproces has recorded losses in the last three fiscal years; (ii) it is a young company with growth potential that requires organizational strengthening to improve its operations; (iii) it has a weak financial position with a low net worth, although its net worth has increased in recent months. Despite this risk, the project is justified since this model seeks to directly help 256 low-income families, developing entrepreneurial skills and generating productive activities in these rural communities. The financial risks of the project and loan will be mitigated by: (i) the technical cooperation activities that seek to strengthen the entrepreneurial skills of small farmers and farmers associations; (ii) the support provided to Inalproces under the technical cooperation component, which will help it design and implement processes and procedures appropriate for the prudent management of the loans granted to farmers; (iii) the development of new products that will increase the demand for raw materials and the company's sales; (iv) the financial conditions of the loan (covenants) that will ensure that the loan proceeds will not be disbursed if Inalproces fails to demonstrate financial profitability and prudent solvency levels; and (v) the ability to repay the loan is based on the growth of its sales, reduction of costs, and therefore improved profitability of the company.

E. Expected outcomes and benefits

3.14 The project will benefit 135 small farmers in rural communities with high poverty indicators, who will receive an average loan of about US$946.50, which will lead to an average 40% increase in productivity due to the use of improved seeds and good production, harvest, and post-harvest practices, along with an average 20%-25% reduction in production costs. A technical team will be formed that will offer technical assistance to small farmers with appropriate methodologies and monitor the project's outcome indicators. New rural and urban jobs will be created as a result of greater productivity in the field and the operating and commercial growth of Inalproces.

3.15 The institutional strengthening of Inalproces through technical cooperation and reimbursable financing for working capital is expected to increase the company's sales by 147% and its net profits are expected to reach about US$275,899 in 2016. The growth of this export SME will set an example for new entrepreneurs and Ecuadorian companies that are entering export markets. This growth is ultimately expected to provide new market opportunities for small farmers. In addition, exports with value added will increase, as will diversification and the opening of new markets for Ecuadorian products.

F. Bank strategy

3.16 The project is consistent with the Bank's country strategy with Ecuador for the period 2012-2017, since it promotes access to financing and rural development. The Bank will promote direct support for service providers through interventions aimed at increasing access to financial services for low-income populations located in areas with a low level of financial activity. With respect to rural development, the Bank will give priority to projects that increase the inclusion of small producers in the productive chains for national and export markets. In addition, this operation will contribute to the efforts of the Ecuadorian government in connection with the 2013-2017 National Plan for Living Well, by improving local conditions and capacities for economic inclusion. It will also contribute to the goal of transforming the productive structure which seeks diversification and the creation of greater value added in national production and strengthening of low-income groups and cooperative associations, and micro, small, and medium-sized enterprises in the productive structure.

G. Strategy of the Multilateral Investment Fund (MIF): Access Framework

3.17 The project is part of the "Finance and Rural Business" strategic area of the Social Entrepreneurship Program, since it will strengthen value chains, production, processing, and marketing, and will support the agenda for "helping small farmers access higher-value markets" in the Access to Markets area.

H. Summary of the environmental and social review

3.18 The environmental and social review team (ESR) cleared the project on 15 October 2013. This was classified as a category C operation, and it is not expected to have any negative environmental impacts. Environmentally friendly technology packages will be adopted, and the production of native root crops will be encouraged. These crops are currently produced on a small scale and could therefore become endangered in the future. The project will have a positive social impact by promoting association-building and the participation of women in productive and commercial activities.

I. Special conditions, disbursements, and procurement

3.19 As conditions precedent to the first disbursement of the reimbursable financing resources, Inalproces will submit the following to the Bank's satisfaction: (i) the environmental permit authorizing the operation of the new plant; (ii) the company's audited financial statements for the period 2012-2013, with evidence of having addressed the comments made in the 2012 Audit Report; (iii) credit regulations approved by Inalproces's board of directors; and (iv) the technical cooperation agreement signed with the Bank.

3.20 As conditions precedent to the disbursement of the technical cooperation resources, Inalproces will submit the following to the Bank's satisfaction: (i) evidence the project coordinator has been selected; and (ii) the annual work plan for the first 12 months of the project.

3.21 **Disbursements of the reimbursable financing**: Disbursements of the reimbursable financing resources will be contingent on Inalproces's fulfillment of the minimum institutional performance indicators agreed on with the IDB. These indicators will include parameters such as Inalproces's debt/equity ratio and net profits. The following table presents a summary of these indicators.

Indicators/Conditions	Formula	Parameter in the month prior to disbursement
Total debt/equity of Inalproces	Total liabilities/net worth	≤ 2
IDB debt/equity of Inalproces	Liabilities with the IDB/net worth	≤ 1
Net profit	Net earnings after taxes, calculated on the last 12 months prior to disbursement	≥ 0

3.22 The second disbursement will be contingent on Inalproces demonstrating that 50% of the resources released for disbursement 1 were used to create the credit fund.

3.23 It is estimated that there will be at least four disbursements, the amounts of which will be in line with the investments to be made as specified in the project technical files. The first disbursement is estimated at a maximum of US$60,000 and subsequent disbursements will be based on the loans granted in each six-month period and the company's working capital needs. Priority will be given to funds used to provide loans to small rural producers over funds used to finance the company's working capital.

3.24 **Disbursements of technical cooperation resources:** Disbursements of the technical cooperation funds will be contingent on verification of the fulfillment of the milestones, using the means of verification agreed to by the executing agency and the MIF. Fulfillment of these milestones does not release the executing agency from the responsibility to fulfill the indicators in the logical framework and meet the project objectives. Under the risk and performance-based project management model, project disbursement amounts will be determined based on the project's liquidity needs, for a maximum period of six months. These needs will be mutually agreed on by the MIF and the executing agency and will reflect the activities and costs programmed in the annual planning exercise. The first disbursement will be contingent on reaching Milestone 0 (conditions precedent) and successive disbursements will be made when the following two conditions are met: (i) verification by the MIF that the milestones have been reached, as stipulated in the annual plan; and (ii) the executing agency has provided support documentation for 80% of the cumulative funds advanced.

3.25 **Execution period and disbursement mechanism:** The execution period for the financing component is 33 months, and the disbursement period is 36 months. The execution period for the technical cooperation component is 36 months, and the disbursement period is 42 months.

3.26 **Procurement:** For the procurement of goods and consulting services, the executing agency will comply with the IDB's procurement policies (documents GN-2349-9 and GN-2350-9). Given that the diagnostic needs assessment of the executing agency resulted in a high level of needs/risk, the project team decided that, based on Appendix 4 of the aforementioned policies, the executing agency, which is in the private sector, will use procurement methods based on the Bank's policies. In addition, all procurement processes will be subject to semiannual ex post review; however, to strengthen the executing agency in the first three months of the project, ex ante reviews will be performed to train the executing agency in these processes. Before beginning any procurement processes, the executing agency will submit the project procurement plan to the MIF for approval. This plan will be updated annually or whenever there is a change in the methods and/or the goods or services to be procured.

J. Reports, evaluations, and audits

3.27 **Performance indicators:** To monitor and track the project's key management and performance indicators, Inalproces will maintain a database and a system for monitoring the project activities and indicators. Inalproces will also be responsible for compiling and analyzing information relevant to the monitoring of the performance indicators established in the project's logical framework. Inalproces and the IDB/MIF will use these indicators for the management and periodic supervision of the project. These indicators will in turn be used as parameters in the final evaluation of the project. The indicators in the logical framework may be modified by the IDB/MIF and Inalproces.

3.28 **Monitoring of the reimbursable financing:** To facilitate the monitoring of the reimbursable financing, Inalproces will submit the following to the IDB during the life of the loan: (i) annually, its audited financial statements; (ii) semiannually, its financial statements signed by its accountant and legal representative; and (iii) semiannually or when information becomes available on important changes in the institution (e.g., its board of directors or management, equity, financing, etc.).

3.29 **Status reports:** Inalproces will be responsible for submitting project status reports (PSRs) to the MIF within 30 days after the end of each half of the calendar year or more frequently, on the dates determined by the MIF, after having provided Inalproces with at least 60 days' advance notice. The PSRs will report on the progress made in project execution, fulfillment of milestones, outcomes, and their contribution to achieving the project objectives, in accordance with the logical framework and other operational planning instruments. They will also cover problems encountered during execution and possible solutions. Within 90 days after the end of the execution period, Inalproces will submit a final project status report to the MIF, which will focus on outcomes, the sustainability plan, findings of the final evaluation, and the lessons learned.

3.30 The IDB's MIF specialist in Ecuador will have basic responsibility for monitoring the financing and technical cooperation components, using the aforementioned reports to verify the degree of project execution.

3.31 Inalproces will ensure that the execution of this project complies with the performance indicators established in the logical framework and annexes in the project technical files. The IDB/MIF may suspend disbursements in the event of any significant negative deviations from those indicators.

3.32 **Financial oversight:** Inalproces will establish and be responsible for keeping proper accounting records, as well as internal control and filing systems for the project, pursuant to the Bank/MIF's rules and policies on financial management. Given that the diagnostic needs assessment of the executing agency resulted in a high level of need/risk in the financial management area, the supporting documentation for disbursements will be subject to semiannual ex post reviews.

3.33 The IDB/MIF will hire independent auditors acceptable to the Bank to conduct the ex post reviews of procurement processes and disbursement support documentation. The cost of these contracts will be financed out of the IDB/MIF's contribution pursuant to Bank procedures.

3.34 During project execution, the frequency of the ex post reviews of procurement processes and disbursement support documentation, as well as the need for any additional financial reports, may be modified by the MIF based on the findings of the ex post reviews conducted by the external auditors.

3.35 **Evaluation.** The project calls for the preparation of a baseline and the execution of a midterm and final evaluation, which will be the responsibility of an individual consultant selected and hired by the Bank's Country Office in Ecuador, using technical cooperation funds. The baseline will be prepared based on the list of Inalproces's current suppliers. The midterm evaluation will be conducted 18 months after the loan contract is signed, or when 50% of the resources have been disbursed, and the final evaluation will be conducted 36 months after the agreement is signed. The final evaluation will measure and document the following: (i) completion of the project activities with respect to the planned timetable and budget; (ii) the degree of attainment of the project's expected outcomes and impacts in response to the problems originally identified in the project design; (iii) the degree of fulfillment of the project's management and performance indicators; (iv) the performance achieved in the mitigation of the project's risks; (v) the effects, outcomes, and impacts achieved by the project in the target group with respect to the project's goal and purpose; (vi) in particular, the situation of the beneficiaries identified in the baseline and the improvement in their quality of life with respect to project targets; (vii) the sustainability of the supplier development model; and (viii) the lessons learned.

3.36 The MIF will review the outcomes and recommendations listed in the PSRs and evaluation reports in order to reach an agreement with Inalproces on the activities conducive to implementing the recommendations. To this end, Inalproces and the MIF's team in Ecuador will meet every six months to monitor the progress made, and will review the fulfillment of the management and performance indicators with respect to the agreed upon annual work plan. In the event there are significant deficiencies in project execution, the IDB/MIF may take any steps deemed appropriate, including the suspension of disbursements if necessary.

K. Project risks and mitigating measures

3.37 The project has the following main risks. **Risk 1: Changes in the regulatory framework:** Changes in labor, tax, or environmental regulations may even further affect Inalproces's profitability. **Mitigating factor:** Inalproces will adjust its organizational structure and review its cost structure to identify where there is room for improvement. In addition, marketing conditions will be adapted to ensure higher profitability margins. Inalproces has traditionally implemented a pull strategy of selling first and then purchasing the raw materials to be produced. However, at times this strategy has not enabled it to generate profitability due to finding raw materials that cost more than the estimated price, after the contracts have been negotiated. The development of a supplier program could mitigate this risk. **Risk 2: Climate changes could affect production volumes:** Climate changes could affect the production of key raw materials and make them more expensive, or the absence of such climate changes could lead to higher volumes than expected. **Mitigating factor:** The technical assistance received by farmers could trigger early warnings of this situation. The development of new products made from the agricultural raw materials the project seeks to promote could absorb any surplus production. **Risk 3: Tariff policies make export products more expensive:** Despite growth in international markets, tariff policies could make the importation of Ecuadorian products more expensive, with a loss of competitiveness with respect to other international suppliers. **Mitigating factor:** Diversifying markets and segments and establishing a personal relationship with customers could mitigate a potential increase in product prices, and joint strategies could be identified to achieve greater differentiation of Inalproces's products. **Risk 4: Credit operation:** Inalproces does not have previous experience in managing credit for its suppliers. **Mitigating factor:** (i) The technical cooperation activities include the formulation and implementation of credit regulations; and (ii) the crops harvested by the suppliers will be used to pay the amounts they owe, which will facilitate the recovery of the portfolio. **Risk 5: Increase in the cost of raw materials:** There may be an increase in production, input, and/or labor costs as result of changes in Ecuador's social or commercial policies. **Mitigating factor:** (i) The relationship between Inalproces and its suppliers will be strengthened, which will lead to fulfillment of the agreements made; and (ii) the associations will be strengthened to make group purchases and create economies of scale. **Risk 6: Association weaknesses:** Difficulty in organizing farmers association or the dissolution of these associations due to a lack of leadership in the areas or as a result of competition. **Mitigating factor:** The technical cooperation component includes activities related to organizational strengthening.

L. Exceptions to Bank policy

3.38 None.