

Farming Dynamics

Local investment companies: a novel approach at the heart of regional development

CEPESIU, facilitating regional development as part of a decentralization process.

CEPESIU's regional development strategy.

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CEPESIU¹, facilitating regional development as part of a decentralization process.

CEPESIU is a private entity that promotes development. It was established in 1983 to provide support to small-scale businesses in rural and urban Ecuador.

CEPESIU strategy is based on a systematic effort to bring different social actors together that can play a role in the development of small-scale businesses: small business representatives, local government, universities, NGOs and government programmes.

¹ Originally, the CEPESIU acronym stood for "Center for Promoting and Employment for the Urban Informal Sector." Over time, CEPESIU shifted its focus to the rural world.

CEPESIU set itself the task of contributing to the “buen vivir”² of Ecuadorians by strengthening development financing, in regional and local economies, through its focus on a value chain approach.

As in many other countries, Ecuador is engaged in a reform process, decentralizing both politically and economically. On the political front, there have been transfers of functions and power from the central state to the regions and municipalities. On the economic front, the decentralization has come about mainly through the privatization of economic activities and public services that were in the hands of the state.

In this context, development cannot be conceived of without proper and significant locally oriented development measures, particularly those that target economic development. This implies recognition of the regional basis of the organization of economic activity in each locality. For this reason, strengthening local actors and economic agents is a central element in the development support measures.

An ideal strategy for local economic development includes five elements:

- A sustainable development vision, based on projects that are “profitable” from three perspectives: the economic, social and environmental.
- Real participation by people in their own development.
- A focus on each region’s particular economic strengths.
- Strengthening local institutions.
- Strong integration of the productive infrastructure and all the economic agents in a locality.

CEPESIU’s regional development strategy

Within this framework, CEPESIU defined three strategic priorities in its approach to local development:

Strengthen local actors

This involves improving understanding by local public and private actors of local economic development and its challenges. To achieve this, CEPESIU chose to work with the cantons.

In Ecuador, the state structure is decentralized to 3 levels as shown in the diagram below:

Provinces	The provincial government is composed of the mayors of the various cantons
Cantons	Headed by a municipal government
Rural parishes ³	Headed by a parish government

The law requires local autonomous governments to plan, however, the economic component of these plans is often quite weak. And it is at the cantonal level that regional development policy faces its most important economic challenges, which justified CEPESIU being brought on board. This work with local political authorities is complex, difficult, especially where electoral politics is at play, but also a must in order to build strong local institutions.

CEPESIU performs a diagnosis of the situation of the local cantonal economy as a gateway to the work required and bases participatory workshops on it with a view to formulating a local economic development plan. First of all, the most important economic activities (sectors) are identified.

Stimulate the local economy

Among the identified sectors, 2 or 3 are then targeted in order to maximize the impact on their development. Different criteria are considered, such as size of the population affected by the activity, potential competitiveness of the sector, its level of organizational development, percentage of women involved, poverty level of producers, and so forth.

Bring capital to the local economy and facilitate access to credit.

This strategic priority involves setting up local financial tools: popular investment companies: PICs are local, self-managed funding-savings-credit schemes. They operate as member-owned businesses.

2 Literally, well living.

3 In Ecuador, parishes are administrative entities for rural communities.



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At 31/12/2013	
Number of PICs	803
Number of members	14,758
% women	54%
Total capital of the 803 PICs	US\$3,647,976
Loan portfolio at 31/12/2013	US\$3,615,053
Number of loans outstanding at 31/12/2013	14,467
Loan volume accumulated since inception	US\$18,008,554
Number of loans accumulated since inception	75,014
Average loan size since inception	US\$240

Stimulating the local economy the CEPESIU way: local investment companies

A conceptual framework that puts the focus on key elements

> Local Investments

In a given area, it is often the case that there is both large-scale investment and micro-investment made by family units. And generally-speaking there is much less evidence of intermediate level investment. LICs may represent the missing link.

> Diversified family-based economy and risk

The family-based economics of poorly capitalized actors rely on diversification of activities and resources in order to manage risk. This means that a family will be reluctant to invest "massively" in a single activity. The LICs concept addresses this concern insofar as it brings several small local investors together, each with limited means. LICs is therefore above all a new opportunity for risk diversification and income for families.

> Particular attention is paid to organizational issues

Often these issues are neglected in the feasibility studies of an economic activity, when they are essential to the chances of an initiative's success. With LICs, statutes are made a priority, with responsibilities, rights and duties clearly defined. Another choice that is clearly made is that of specializing. Indeed, in a collective investment management process, learning happens in at least two areas : management of the investment organization itself and of the activity invested in. Learning, especially organizational learning, is quicker when fields of activity are limited. Another factor is also relevant: the cost for members of being part of an organization (both financial contributions and time given over to it). The specialized nature of an organization allows its members to identify more clearly the benefits in return for their investments.

In the organizational field, three factors are taken into consideration:

The size of the initiative: to minimize risks, LICs identify the smallest size at which to start the business, with a view to balancing development potential and minimizing losses in the event of failure.

The governance model: often, with this type of collective enterprise, everyone wants to participate in all decision-making, which weighs down management and generates conflicts. The governance model therefore clearly defines decision-making roles and mechanisms and responsibilities at three levels: strategy and risk management level; management's decision-making competencies and responsibilities; the operational management of the business. These are laid out in the statutes and rules and regulations known to all concerned.

Clarifying expectations: a person who is involved in a collective investment may have various expectations: the return on their investment, access to services that the investment will produce, payment as an employee or casual worker in the company that is created ... Lack of clarification with regard to these expectations is one of the most common sources of difficulties and failures in collective enterprises. It is therefore important to clarify at the outset how the project will meet the expectations and motivations of participants. This clarification essentially concerns two central factors, which are capital and labour.



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Identifying LICs⁴

Once a number of important sectors have been identified for a region (the canton), a specific diagnosis is performed: who are the actors in the value chain, in and outside the region? Who are the producers? What companies are involved? This diagnosis is performed by the CEPESIU team, who may also call on external experts.

The first step is to establish a schematic map of the value chain. This allows you to locate all the actors in the product chain, from the production phase all the way to retail.

Once the map has been established, a number of quantitative data are researched such as the number of firms, number of persons employed, female participation, production and sales volumes, revenues generated, profit margins, labour remuneration levels, average worker occupancy time, potential market size, and so on.

This diagnosis helps identify where the bottlenecks are in a given value chain, whether it's a problem of raw materials supply, product quality, low value added to the product, insufficient quantity, transportation, marketing and sales, access to adequate financing, etc.

This diagnosis helps identify where the bottlenecks are in a given value chain.

4 The concept behind LICs was developed by Carlos Domenech, who works at CEPESIU.

An example of this analysis: the production of bricks in Chambo canton.

Location: This canton is located in the northeast of Chimborazo province, 8 kilometres from Riobamba. This is an area of 160 km² and a population of 10,541 inhabitants, 64% of whom live in rural areas. The poverty index is 74%, while extreme poverty stands at 35%.

Product: there is significant production of tiles and bricks. 221 households are directly involved (manufacturing), as well as 140 carriers. There are 203 kilns in the area, but 68 producers do not have one and must outsource firing. It is in Quintus where most of the canton's activity is concentrated. 1.8 million bricks are made monthly in the roughly 120 kilns in operation. Only about 50% of installed capacity is used.

The sector:

- > Necessary inputs: land, sawdust, wood
- > Production chain: production of bricks or tiles, firing, sale
- > Stakeholders: suppliers of raw materials, manufacturers, sellers
- > Markets: Chambo, Riobamba and nearby (Ambato, Pelileo).

The market is relatively stable but trending downward, for four reasons:

There are other brickyards near the major cities that are in the same marketplace;

There are alternative products at competitive prices;

New materials and construction technologies have been developed;

Reduced purchasing power makes access to home ownership more difficult.

The market in Chambo turns over roughly US\$150,000 per month, but with a producer who loses money. This process of decapitalization is offset by a complementary agricultural activity. In response, many producers seek funding from large entities which sell the bricks: the rates on offer are high and borrowers are obliged to sell their bricks to the lender.

The idea is to transform this bottleneck into an investment opportunity through the creation of a local company.

In principle, the bottleneck problem could be resolved by a single actor. But in order to promote regional development, it is more appropriate that small local producers themselves address the issue by creating a business that meets this need.

What is a LIC?

LICs are entrepreneurial type organizations usually formed by small producers who come together to find solutions to common production and/or marketing problems in a value chain. These enterprises are set up with capital contributions from individuals and are run and controlled by their members.

LICs either start out as formal entities, or are defacto companies, which gain legal form at a secondary stage.

As noted above, one of the key elements of the methodology involves addressing the bottlenecks in a given industry and in so doing strengthen business ties between actors, especially those links in the value chain of greatest importance to small local producers. Therefore the initiatives must be of great interest to the producers concerned.

This interest is reflected in the producers' motivation and decision to use their own resources as venture capital. This requires clearly demonstrating that the investment proposal actually addresses a genuine problem and that the solution is seen as necessary and viable.

LICs receive technical support from CEPESIU and may possibly hire a professional as a manager. But to a large extent, they are entities run by the producers themselves. A feature of LICs is therefore the deep involvement of the producers. The concept of risk-taking by shareholders lies at the heart of this initiative, which must be of a size from the outset that is suited to the financial and management capacity of its members.

In this sense, the initial capital required has to be within the means of the founders, who must provide a substantial share of at least in the order of 40%. Supplementary funding may come from other investors (local government, private development actors, and so on).

Members with prior experience in the sector are a requisite in the group running a LIC project. Once the group has been established, the process may continue through the following stages:

> The pre-operative stage

The business plan is worked out with the group. This is the central tool used in developing LICs. This plan focuses on developing four components:

The market study defines the product or service that the company will offer and the possible competition that exists from other suppliers to the market. It also reports on existing and potential demand. Finally, it specifies the price at which the product or service may be offered.

The technical study looks at the following: the size, location, engineering (infrastructure, equipment, any

buildings) and the technology (all the processes that need implementing).

The financial evaluation estimates the hoped for revenue and the investment and operating costs, in order to establish a cash flow forecast (different scenarios) and identify financial indicators.

The organizational assessment considers both the organization to be put in place to carry out the activity (job descriptions, associated skills, support staff needed) and legal aspects (legal and administrative steps to take). These organizational elements are reflected in the statutes of the entity.

> **Formal incorporation of the company**

A constitutive general assembly takes place: it approves the statutes, elects members and officially registers the capital contributions. Three types of statutes are possible:

Limited company: has from 2 to 15 shareholders; liability is limited to the capital that has been contributed. It is not possible to transfer shares to third parties.

Company: this model is favoured by CEPESIU. This type of entity is formalized by a contract before a notary.

Public limited company: has a minimum of 5 shareholders. It has a more open statute with shares that are transferable to third parties.

> **Supporting LICs**

For a period of 12 to 18 months, CEPESIU focuses on monitoring the business plan, the management of the company and the market.

CEPESIU may also act as a co-investor (financing equipment or providing working capital). This contribution is planned to cover the term of the business plan (3-5 years). An exit plan is provided at the outset, usually making use of reinvested accumulated profits. CEPESIU never contributes more than 49% of the capital.

Noteworthy achievements

There are 48 LICs across four provinces (Chimborazo, Esmeraldas, Guayas and Napo) which included the country's three major agro-ecological zones: Costa, Sierra and Oriente (Amazon).

In addition to their shareholders CEPESIU believes that the 48 LICs also benefit 1,271 producers.



Province	Chimborazo	Esmeraldas	Guayas	Napo	Total
Number of LICs	25	11	9	3	48
Number of registered shareholders	405	968	175	57	1,605 ⁵
% Women	62%	23%	38%	28%	38%
Share capital	US\$437,878	US\$1,997,788	US\$159,632	US\$38,603	US\$2,633,902

5 Note that this data is not available for all LICs; this figure should be considered a minimum figure.

A wide variety of sectors are involved:

- > In the food industry: milk and cheese (9 LICs), cocoa and honey (2), coffee, corn, poultry, broccoli, onion and dried garlic and more.
- > In the services industry: agricultural inputs shops (6) tourism (2), fishing inputs markets (3) ice production for fishing (6), brick market and so on.

In the province of Esmeraldas, CEPESIU works with the Belgian development cooperation agency in support of LIC created by fishermen.

Two examples



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In the peri-urban area of RIOBAMBA, production of honey and derivative products

6 honey producers partnered to create the company. They brought 48 hives as their capital contribution. CEPESIU provided a supplementary contribution intended primarily for improving the quality of the material. The LIC's total capital amounts to US\$19,970.

A beekeeping specialist is one of the project's partners.

20 other beekeepers, while not shareholders are also partners in the project: they supply honey.

The company intends to develop in two stages:

- > Stage one, improve and increase production, including increasing the number of floors in existing hives;
- > Stage two, launch a range of derivative products: biscuits, cakes and energy bars, caramels, royal jelly and so forth.

Mostly they produce eucalyptus honey and to a lesser extent alfa-alfa and maize honey.

The company operates a shifting hives system: the hives are displaced according to flowering periods.

Current production per hive is 20 pounds per year, on average. But the sector remains artisanal and ultimately the intention is to structure a real industry to compete with imported Argentine honey which is sold by the large supermarket chains.

EL TEJAR cheese dairy, near RIOBAMBA

Founded in 2012, but formalized in early 2014, the company now includes 54 shareholders from the farming community but benefits more than 100 producers.

Its purpose? To provide a sales outlet for members' milk production, by turning it into cheese, in a region where there is significant demand for such products. Cheese products are mainly sold in the coastal city of Guayaquil.

Current production is modest: 50 kilos of cheese is produced every day. The producer is offered a price of 36 cents per litre. The cheese is sold at US\$1.7 per kilo. The community's remoteness remains an impediment to the collection of greater quantities of milk and the company's growth.

A young woman from the community who works for the cheese dairy makes US\$170 per month.

At present, the cheese dairy is able to balance its books. In order to develop, it would have to collect more milk, both by attracting producers from further afield, and by improving production (forage quality, improved dairy breed).

The area relies heavily on its livestock: each family has 1 to 2 cows, which translates into daily production of 10 to 16 litres (equivalent to US\$3.6 to US\$5.76 per day).

In conclusion

According to Cecilia Padilla, CEPESIU's director, LICs are "modern" economic instruments that enable poor producers to effectively exercise their citizenship, giving them the opportunity and right to access the formal economy. In this sense, they are in line with the Ecuadorian policy of decentralizing productive development.

They assume a culture of enterprise exists, a vision where profit and accumulation of wealth is not demonized and are no longer taboo. According to CEPESIU, the associative model is indeed not the most appropriate one when it comes to adapting to market conditions and working with other businesses.

LICs are part of a social and popular economy. They bring together small, mostly rural producers and develop the productive base of a defined territory, thus laying the foundation for sustainable economic development.

It will be interesting to follow the evolution of this "model" in future years, a model that mixes an open-minded view of economics and an approach to development that focuses on poor producers.

This issue of "Farming Dynamics" was written by Marc MEES, who is in charge of knowledge management at SOS Faim. It is based on documents made available by CEPESIU and a field visit conducted in March 2014.

SOS Faim and the farmers' organizations

For several years, SOS Faim has supported different farmers' organizations in Africa and Latin America. SOS Faim publishes *Farming Dynamics* which deals with the development challenges faced by agricultural producers' and farmers' organizations.

This publication is available for download in French, English and Spanish on SOS Faim's website: www.sosfaim.org.

Apart from *Farming Dynamics*, SOS Faim publishes *Zoom microfinance*, which provides analysis on the aims, models and implementation conditions of aid to microfinance institutions. This publication is also available for download in French, English and Spanish SOS Faim's website: www.sosfaim.org.

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When strengthening women's rights also helps tackle poverty: successful experiences in the Andean countries

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"Sharing the financial burden of land development: a new ambition for rice farmers in Office du Niger in Mali"