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TRANSFORMING MARKET SYSTEMS ACTIVITY

HONDURAS MARKET SYSTEMS ASSESSMENT REPORT

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INTRODUCTION

It is widely recognized that economic growth is no longer enough. Economies, the world over, have resorted to measure their success based on 'how fast' they are growing. While stable growth is one of the most powerful contributors to poverty reduction, deeper analysis reveals a troubling truth: wealth is unequally generated and distributed, gains in improved livelihoods are being undermined by widening income gaps and increasing vulnerability of lower-income groups.

Honduras for example has experienced steady economic recovery driven by public investments, exports and higher remittances. Latest estimates place the country's economic growth at 4.1 percent in 2017, and a growth of 3.6 is expected for 2018. Despite this favorable outlook, the country faces the highest level of economic inequality in Latin America, and poverty rate remains the same.

The vulnerable and the poor, those who have fewer access to resources, those who interact through weaker and more informal networks, continue to have less influence in the economy and have fewer options to move-up in society to provide a better life for themselves and their families.

The new measure for development should not be just how fast a country is growing, but how competitive, resilient and inclusive it is of the poor, youth, women, and other marginalized groups.

However, the current nature of social, political and economic change in the world is ever more volatile, uncertain, complex and ambiguous. The development paths of countries are less certain. The dynamics and speed of change in markets, the lack of predictability, and the prospects for surprise highlight the need for awareness and understanding of the root causes of issues and events. Economic development must realign to these shifting realities and be better equipped with the tools to diagnose underlying issues and proscribe solutions that cure the problem, and do not just treat the symptoms. The USAID Transforming Market Systems Activity is fundamentally designed to target deep-rooted systemic change in order catalyze long-term, broad-based economic growth.

Our selection of the market systems development approach reflects the challenges at hand. This assessment report brings new tools to bear to sort through complexity of Honduras's market systems to find real opportunities for leverage to create meaningful change. Our belief that solutions must come from within, is reflective of the co-creative approach we took to this analysis.

Included in this report are the contributions of 300 experts from 200 organizations across the 10 economic sectors that shared their vision and ideas with us through focus group workshops. Insights from this report are further founded on in-depth interviews with over 250 individuals and organizations that participated in one-on-one structured interviews with researchers to help explain the root causes of why systems were not working. In addition, through specialized studies more than 270 individuals were consulted to provide us insights into gender and social inclusion, the business enabling environment and end market opportunities for the ten sectors. Finally, more than 40 researchers and analysts invested countless hours to analyze and synthesize this mountain of information and provide the insights that constitute this report.

This report reflects a significant investment of time, energy and resources of stakeholders to provide a solid analytical foundation for the Activity and to generate an information-base to build a shared understanding of the challenges at hand. We hope this is just the first step in engaging with you in a co-creation process to develop meaningful and sustainable solutions.

- *Sergio E. Rivas*
Chief of Party

EXECUTIVE SUMMARY

This report is intended for three audiences. First, this report is meant to provide practical guidance for the USAID/Honduras TMS Activity implementation. Second for TMS stakeholders, both those who have contributed to the development of this report, and those who will contribute to its implementation. Third, we hope as others implement market systems development approaches, this report becomes a useful reference and tool that makes the path easier for other market system practitioners.

The **sector selection methodology** provides a discussion of the process, and the outputs from the initial sector selection process which guided the Activity to select 10 priority economic sectors to analyze. A detailed **methodology** description is in Annex XIII. The **sector analysis results** include a sector selection matrix that highlights the final recommendations of primary sectors for TMS Activity intervention and a discussion for how intervening in those sectors can affects systemic change for all sectors.

Sector analysis summary include an assessment of the analyzed sectors in relation to their potential for positive change across the four criteria established by USAID/Honduras: (i) ability to affect systemic change (ii) ability to affect drivers of migration (iii) potential to raise incomes in DO1 and DO2 zones and (iv) potential for inclusive development. The summary identifies targeted system-level changes and the constraints and opportunities for each identified change.

In recognition of the interconnectedness of economic, political and social systems, TMS conducted specialized studies; including, a **business enabling environment diagnostic, migration study** and **gender and social inclusion analysis**. The summary of these are included in the main body of the text. TMS also identified access to support services and licenses as issues worth exploring in greater detail. For this reason, TMS conducted **social network analysis** which is included in Annex I.

Annexes II-XI include detailed market system analyses structured according to USAID's 5R's framework[1] for each of the 10 analyzed economic sectors. The analysis reflected the need to take a market systems development approach to identify the root causes and dynamics that underlie Honduras's performance, notably in terms of competitiveness, resilience and inclusivity.

Finally, we have included a **glossary** on market systems terminology in Annex XII. There has been a necessary shift in language to more accurately describe the complexity of systems. This has an unintended consequence of creating barriers for others new to the approach to understand. We hope the glossary provides a reference to lower this barrier and motivate others in systems practice.

[1] https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf

SECTOR SELECTION METHODOLOGY

Step 1 of TMS's Inception Phase required identification of ten (10) priority economic sectors *or value chains*. To arrive at ten economic sectors, TMS had to make a set of decisions:

Decision 1: Choose sectors or value chains. The up-front decision faced by USAID/Honduras was whether to orient the analysis around value chains or economic sectors. The TMS Activity prioritized a focus around economic sectors to enable a true co-creation approach, as this is how most stakeholder groups were self-organized, and to provide broad enough boundaries to allow the Activity to act systemically as part of the need for a market systems development approach to achieve its goals.

Recognizing the need for co-creation. One of the main complaints from private sector actors to the USAID mission in Honduras has been the lack of engagement in the design and action planning. From its inception, TMS was designed to have an inclusive co-creation process including a wide range of participants from the private and public sectors, NGO's, other donors, academia, civil society, associations, municipalities, marginalized groups and other USAID activities in the country. There was also a practical challenge of how to run a transparent selection process, in which there are hundreds of value chains in Honduras to choose from. The TMS team designed a methodology based around economic sectors to allow the implementation of a highly participative co-creation process.

Need for a market systems development approach. The state-of-the-art in economic development practice has shifted from the value chain-orientation to a market systems development (MSD) approach over the past few years. The MSD approach requires looking more broadly than the narrow bounds of commodity chains to be able to best identify opportunities to address common challenges in multiple systems and interrelated value chains, maximizing the spillover potential or multiplier effect for technologies, business models and ideas.

Decision 2: Defining economic sectors for selection. Two lists that define economic sectors were used: the standard classification of Central Bank's Nomenclature of Economic Activities of Honduras (NAEH by its Spanish acronym), and the Bank of Honduras (BOH) sector classification for employment (which is aligned with the UN International Standard Industrial Classification of All Economic Activities (ISIC) Rev. 4). Different from these lists, Honduras 20/20 had prioritized tourism, textile and apparel, light manufacturing, business process outsourcing, value-added agriculture and construction as key economic sectors. USAID/Honduras had also prioritized tourism and value-added agriculture as part of TMS design. TMS redefined 21 sectors based on NAEH, BOH and ISIC standard classifications, differentiating Honduras 20/20 and USAID Honduras priorities.

Figure 1 Economic Sectors Defined for Selection

1. Value-added agriculture	12. Business process outsourcing
2. Tourism	13. Business advisory services
3. Lodging and food services	14. Financial services
4. Arts, entertainment and recreation	15. Information communication technology
5. Light manufacturing	16. Transport and logistics
6. Textiles and apparel	17. Wholesale and retail trade
7. Mining and Quarries	18. Energy
8. Construction	19. Waste and sanitation
9. Domestic and personal services	20. Real-estate
10. Health and social services	21. Teaching
11. Public administration	

Decision 3: Establishing selection criteria. USAID/Honduras required a criteria-based approach to the selection of economic sectors for approval. Instructions indicated that criteria should align with the TMS Activity goals and USAID's priority objectives in Honduras. The first screening of sectors focused on selection based on the manageable interests of USAID and in consideration of GoH strategic investment priorities. TMS would not have the mandate to intervene in an economic sector which did not meet these criteria. This first cut led to the elimination of five (5) sectors: mining and quarries, business process outsourcing, public administration, real-estate and teaching as they were not considered within the limited scope of TMS intervention and outside USAID's manageable interest.[2] This led to sixteen (16) – sectors being presented to key stakeholders for their selection.

To further guide the selection of 16 economic sectors, and in consultation with USAID/Honduras, TMS developed four primary qualitative criteria:

Figure 2 TMS Sector Selection Criteria	
1. Ability to affect systemic change	This criterion considered the potential of a sector to affect other sectors in way that magnifies results or results in systemic change. This was defined as either generating demand for products or services from other sector or supplying critical inputs or services to support the growth of other sectors. The criterion also allowed for the consideration of the extent to which the sector would impact long-term, economic complexity within the Honduran economy. This included whether the sector generated important productive capabilities and know-how that could spillover more broadly.
2. Ability to impact the drivers of migration	This criterion considered the creation of accessible job opportunities that would appeal to youth prone to migrate. Considerations allowed for both self-employment and employment by others. The criterion focused on entry requirements of new jobs created, and the extent to which those requirements were likely to match with the skills of youth. Finally, it considered the effects of violence, if known, within the sector with the recognition that some sectors are more prone to crime and violence than others.
3. Potential to raise incomes in DO1 and DO2 zones	This criterion focused on the potential of the sector more broadly to generate jobs, sales and income in DO1 and DO2 zones. DO1 include high-crime áreas of major cities: Tegucigalpa, Tela, La Ceiba, Choloma, and San Pedro Sula. DO2 includes departments in Western Honduras: Santa Bárbara, Copán, Ocotepeque, Lempira, Intibucá, and La Paz. The criterion considered the degree to which the sector was large and/or growing, measured by total exports, gross-domestic-product (GDP) contribution and levels of employment. In absence of statistics, it focused included a more subjective assessment of degree to which the sector would generate jobs, sales and income target zones.
4. Potential for promoting inclusive development	This criterion considered the potential of the sector to promote inclusive development and involvement of vulnerable populations, particularly women, youth, as well as other traditionally marginalized groups such as indigenous populations, people with disabilities, and youth from violent neighborhoods. Youth were defined by USAID as people between 10 and 29 years of age. The criterion considered potential barriers to inclusion of vulnerable populations that would undermine the impact of interventions. Barriers to inclusion mean both access to jobs and upward mobility potential within those jobs. This measure is an assessment of the sector based on available knowledge.

[2] Consideration was made of ADS 225 Program Principles for Trade and Investment Activities and the "Impact on U.S. Jobs" and "Workers' Rights related to limits for interventions that provide financial incentives and other assistance for U.S. companies to relocate operations abroad if it is likely to result in the loss of U.S. jobs or contribute to violations of internationally recognized workers' rights defined in 19 U.S.C. 2467(4).

Decision 4: Letting key stakeholders decide. TMS, in consultation with USAID/Honduras, decided to let external subject matter experts (SMEs) and key stakeholders to provide their expert point of view and experience about economic sectors and ultimately make the decision. Thirty-four top players from government agencies, exporting companies, academia, NGOs, service providers and umbrella organizations and associations were nominated by USAID/Honduras and invited for a one-day session on June 18, 2018 to jointly prioritize and rank economic sectors based on the four selection criteria identified in the table above. This workshop was used to introduce the Activity and MSD approach, and ensure understanding of the selection criteria. Experts were then divided into discussion groups moderated by TMS team members.

Following the discussions, each participant voted through an online, anonymous, survey system using mobile devises. The results were shared with the group. In plenary, participants shared the main arguments discussed within each group. Following this discussion, subject-matter experts had a chance to provide additional feedback and re-rank the sectors as they saw. Based on this plenary discussion, several modifications were made:

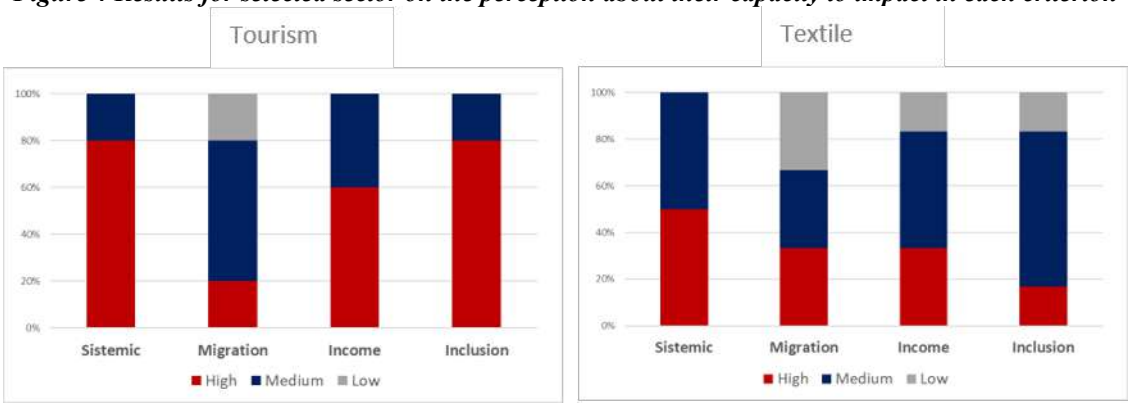
- Tourism ranked second but overlapped with lodging and food services which initially ranked tenth. It was noted that a significant number of tourism actors are hotel and restaurant owners, and it would be strategic to approach analysis for the hospitality and food service sectors from the perspective of promoting tourism, which emerged a clear priority.
- ICT and business services initially ranked third and fourth respectively. Experts noted that how these sectors were considered mutually reinforcing and shared similar characteristics. It was decided to then combine the analysis for both into one with a focus on how these sectors provided cross-cutting services enhance competitiveness and enterprise growth.
- The construction sector, which originally ranked 12th would have been excluded from analysis. However, the combination of two other sectors bumped it up to 10th. One of the reasons for its low scoring was that it was considered to have limited systemic potential, as it was largely focused on residential housing by the GoH. Experts recommended re-prioritizing analysis of the sector on economic or *productive* infrastructure which would be more systemic.

The ten final sectors selected by consensus to be subjected to formative studies and analyses under Step 2 of the Inception Phase are presented in the table below.

Figure 3 Economic Sectors Selected in Priority Order	
1. Value-added agriculture	6. Transport, storage and logistics
2. Tourism, hospitality, food service	7. Arts, entertainment and recreation
3. Business services & ICT	8. Light manufacturing
4. Financial services	9. Wholesale and retail trade
5. Water, waste and sewage	10. Productive infrastructure

This resulted in the exclusion of the following sectors: health and social services, energy, textiles and apparel, domestic and personal services. Of particular interest was the exclusion of the textiles and apparel sector. A comparison of the rating of tourism versus textiles shows expert perceptions that textiles, characterized by the *maquiladora* would do comparatively little to address migration, increase incomes or embrace vulnerable persons for inclusion.

Figure 4 Results for selected sector on the perception about their capacity to impact in each criterion



SECTOR ANALYSIS RESULTS

TMS conducted analysis of each of the selected ten economic sectors – the detailed results of the analysis are included in **Annex A**. The analysis was exhaustive to generate a well-grounded and comprehensive understanding of each sector, and importantly which elements of the market system provide real, tangible opportunities for systemic change, an ability to impact the drivers of migration, potential to raise incomes in DO1 and DO2 zones and potential for promoting inclusive development.

TMS applied USAID's 5Rs framework[3] to conduct market systems analysis for each sector. The 5Rs refers to the roles, relationships, resources, rules and results. This decision reflected the need to take a MSD approach to identify the root causes and systemic factor that underlie Honduras's performance, notably in terms of competitiveness, resilience and inclusivity. This resulted in a list of prioritized system changes, the root causes and binding constraints to change, as well as high-leverage opportunities for intervention. These results were synthesized in a 'Pause and Reflect' workshop that was held September 24 to 28th, 2018 and resulted in final sector selection.

A summary ranking of the economic sectors is included in the table below:

Economic Sector	Sector Selection Scoring				
	Ability to affect systemic change	**Ability to impact drivers of migration**	**Potential to raise incomes in DO1 and DO2 zones**	**Potential for promoting inclusive development**	**Overall Score**
Value Added Agriculture	Medium-High	Medium	High	High	Medium-High ✓
Arts and Entertainment	Low	Medium	Low	High	Medium
Light Manufacturing	Medium	Low	High	Low	Medium
Transport and Logistics	High	Low	Low	Low	Medium - Low

[3] https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf

Tourism	High	High	Medium	Medium	Medium-High	✓
Wholesale Retail Trade	Low	Medium	Low	High	Medium	
BDS/ICT	High	High	Medium	Medium	Medium-High	✓
Financial Services	High	Low	High	High	Medium-High	✓
Water and Sanitation	Medium	Medium	Low	High	Medium	
Infrastructure	Low	Medium	Medium	Low	Medium - Low	

Based on detailed market systems analysis included in Annex A, TMS identified **value-added agriculture** and **tourism** as sectors having clear potential to achieve TMS Activity goals. A detailed discussion of the criteria evaluation, prioritized system changes, binding constraints/root causes and high leverage areas for intervention for these sectors are in the next section below.

The sectors of *business services, ICT* and *financial services* also scored highly in the analysis. A closer evaluation of the prioritized system changes in both sectors revealed a clear focus on expanding services to the SME segment of growth-oriented enterprises. The TMS Activity conducted a rapid entrepreneurship ecosystem assessment and determined the systemic change potential of these sectors would be much higher if they were consolidated with a narrower focus on entrepreneurship promotion.

The third sector for selection was therefore **entrepreneurship services** as a combination of BDS/ICT and financial services, but a narrower focus on services to the growth-oriented SME enterprise profile.

For each economic sector, at least one of the major systems change priorities focused on an issue tied to the business enabling environment. A need for reforms in BEE processes related to business permits and licenses, improving the tax system, investment promotion, business chamber strengthening, and legislative reform emerged strongly throughout each of the sectoral analyses. The TMS Activity further highlighted priority cross-cutting BEE issues through a specialized BEE diagnostic.

The fourth sector for selection was therefore **business enabling environment** as an area with high potential for systemic change across all sectors. Including this as a sector for intervention recognized a common set of stakeholders and approaches that would allow TMS to intervene in a systemic manner.

Importantly, this strategic selection of sectors allows the TMS Activity to intervene in a systemic manner to positively influence change in the economic sectors which were not directly selected:

Arts and entertainment prioritized the need for a legal framework that included a *Ley Marco de Arte y Cultura* and *Ley de Fomento a la Industria Cinemtografica* that would lend credibility to the sector and enable the industry to grow in a coordinated manner. This legal and institutional framework is included under TMS's selection of business enabling environment. The analysis further pointed to a lack of management capacity and business acumen among art and entertainment firms. This type of support is envisioned to take place under TMS's selection of entrepreneurship services. Finally, the analysis pointed to the strategic opportunity to promote new festivals and products that showcase

Honduras' cultural assets. The promotion of these events is a core element of the tourism strategy of municipalities, and therefore integrated within TMS's selection of the tourism sector. The broader arts and entertainment conception of the *orange economy* is also tightly woven into tourism, as culture is part of Honduras's defining competitive advantage in international tourism markets.

Light manufacturing prioritized the need for a reform to the *Instituto de Conservacion Forestal (ICF)* to expedite the approval of forest management plans and certifications which has proven a bottleneck for the growth of the entire industry, and further a critical issue for the sector to ensure compliance with international AVF-FLEGT standards. The streamlining of administrative processes within the BEE component is inclusive of reforms to ICF and thus would provide an opportunity for TMS to support such efforts. A second system change identified in forest products included the introduction of new supply chain models for processors. There is strong complementary to the value-added agriculture sector, in which supply chain models are analyzed as highly replicable between the two sectors. The flexibility to include forest products are part of the portfolio of products which are part of value-added agricultural sector, amplifies the potential for systemic change and impact.

Transport and logistics prioritized the need for an overall legal framework *Ley Marco* for the logistics sector to address issues such as mandatory liability insurance, weights and dimensions standards, the creation of a certification process for drivers and other key issues. The promotion of such a legal framework is included in BEE regulatory priorities. Other system changes focused on the need for greater innovation by transport and logistics companies and the adoption of technologies for product traceability, integrated delivery services and GPS technologies for fleet management. TMS's selection of entrepreneurship services can help to grow the market of specialized service providers that serve a range of enterprise needs, including transport and logistics. Finally, needed investments in distribution centers, cold storage and road infrastructure overlaps with public-private investment priorities under BEE and as part of value-added agriculture as part of supply chain development.

Wholesale-retail trade prioritized informal trade channels, notably *pulperias*, which serve as distribution channels to lower socio-economic consumers. It also noted the need to support municipal investment in open-air markets and fairs, establishing safer places to do business. Both *pulperias* and open-air markets are important distribution channels and end-markets for the value-added agricultural sector. Focusing on value-added agriculture, including the opportunity to strengthen the supply of local, Honduran products through these market channels, and to put in place contracting and other mechanisms would support the growth of wholesalers and retailers. Furthermore, within tourism the promotion of open-air markets 'tradition' is part of the cultural offer of local destination development.

Water and sanitation identified the need for public and private actors to collectively work together to address water and sanitation services deficits. The sector reflects a leadership dilemma in which there is a lack of authority and responsibility for water and sanitation management. In tourism and value-added agriculture, TMS will work with private industry and local authorities to implement integrated water management insofar as they relate to identified business constraints. This includes support through the BEE component for public-private partners (PPPs) to develop new water and sanitation service delivery models in conjunction with food and beverage companies, hotels and resorts, etc.

Productive infrastructure highlighted the need for stronger public-private mechanisms to encourage new and more transparent investment in infrastructure. This intervention is included primarily in BEE in terms of reform efforts to establish greater fairness and transparency in bidding processes. It also

includes a more bottom-up infrastructure prioritization and project development process with the private sector through industry chambers, municipalities and *mancommunidades*.

To note, a core tenant of the MSD approach is to be deliberate and not take on every noted challenge, but rather to work systemically as part of the market system to intervene only at high leverage areas to influence change. There are many challenges within each of the above sectors, many of which are detailed in Annex A. Beyond the points of complementary noted above for non-selected sectors, the TMS Activity will work in a collaborative manner with other stakeholders in non-selected sectors to mitigate or address the challenges detailed in the Annex but will not directly address them itself.

SECTOR ANALYSIS SUMMARY

The sector analysis summary includes an overall evaluation of the sector across the criteria of (i) ability to affect systemic change (ii) ability to affect drivers of migration (iii) potential to raise incomes in DO1 and DO2 zones and (iv) potential for inclusive development. For each sector, TMS has identified priority system-level changes and the constraints and opportunities for each identified change. These are illustrated in the following table format:

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience
Systems change are changes in the system itself. It is a type of change. There are multiple frameworks to describe these changes - TMS used USAID's 5R's framework to determine which systems-level changes should be prioritized under each of the identified sectors. These systems changes form the basis for Action Plans and the Theory of Change.
What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change
The potential impact of this system change is evaluated in terms of competitiveness, inclusion and resilience: • *Competitiveness* refers to the ability of market system to innovate and add value to products and services in a manner that enables them to become increasingly productive and expand into domestic, regional and export markets. • *Resilience* refers to the ability of the market system to adapt to and recover from shocks and stresses in a manner that reduces chronic vulnerability and facilitates inclusive growth. • *Inclusiveness* refers to the ability of market systems to engage and deliver a sustainable flow of benefits to the poor and otherwise vulnerable or marginalized, whether as producers, service providers, laborers and/or consumers *Systemic change* are changes that have reached a level of scale, sustainability and significance. 'Systemic' is a way of noting the degree to which change has happened. Systemic change refers to changes in the structure or dynamics of systems with significant impacts for system performance. Systemic change requires change at a systems-level - not just piecemeal change in a single part of the system. Systemic change diverts a market system down a new evolutionary path. Desirable systemic changes result in a system that functions more competitively, resiliently and inclusively.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
Binding constraints and root causes are the underlying causes or reasons behind patterns of results. Binding constraints refer to those specific limitations which cause immense deviations from a desired system-level change. Market systems development approaches address binding constraints or root causes, rather than non-binding constraints or symptoms, for why market systems fail to generate competitive, inclusive and resilient results.	*High leverage opportunities* refer to areas in the system that are amenable to change, where a small shift in one area can have a large effect in others. Leverage is driven by feedback loops which compound or amplify a set of results. Leverage happens in areas of the market system that are identified as root causes or binding constraints, but where change is amenable. Typical types of leverage include changing rules, networks, power structures, or mindsets.

SECTOR 1: VALUE-ADDED AGRICULTURE

Ability to affect systemic change. The agricultural sector overall is characterized by strong end-market signals that trigger a weak-supply side response. In other words, production is non-responsive to the market opportunities that exist, resulting in significant lost opportunities for Honduras to successfully compete and grow into higher-value national, regional and international markets. There is potential for systemic change for the entire Honduran agricultural sector by acting strategically within

value-added stages of agricultural supply chains. The introduction of new supply chain models that improve the transmission of market signals, and crowd-in private sector investment, would have a significant upstream effect on employment and sales at input supply, production, transport, processing and distribution supply chain stages. There is momentum already as some leading agroindustry players are pushing this status quo by rolling out new supply chain models. Examples include Walmart, Inalma and COHORSIL which are improving supplier contracting, supporting input supply and technical services, as well as investing in pre-processing facilities to improve reliability of quality. There is a strong systemic change potential to scale and institutionalize these promising efforts at a market system-level. Further, within this sector there is strong potential for the spillover of new supply chain models for forest products, construction materials and artisanal crafts in the same geographic zones. This includes in intermediary functions – transport, storage, wholesale and retail – that cross both agricultural and non-agricultural, especially forest and non-forest timber products supply chains. This brings an opportunity to move into more complex, higher value-added products that bring with it increased incomes, better paying jobs as well as know-how that can spillover into other areas of the economy.

Ability to impact the drivers of migration. Population growth, reduced landholdings and climate volatility are considered key drivers behind the economic decision for rural-to-urban migration, and beyond, where there are no urban economic opportunities. Agricultural jobs are at risk and there is high vulnerability of the sector to result in increased migration. Honduras remains in lower value-added, fresh and lower grade processed products which has put the economy in more volatile markets. Reducing economic pressures – notably the volatility of the sector – to economic and weather shocks, is likely to significantly reduce the frequency of events that drive vulnerable people to migrate. Rural workers who do not own means of production, also known as "*wage workers*" are at a much greater disadvantage and are concerned with securing higher a fair wage, increased work opportunities, safer conditions, and improved stability. A focus on value-addition opens off-farm and non-farm job opportunities providing a wider range of economic activities that potential migrants could engage-in in the search for work[4]. In Honduras, rural wage labor, typically low-paid manual labor in agriculture and other rural economic activities, is also the most important form of employment for the poorest households[5].

Potential to raise incomes in DO1 and DO2 zones. An incredible seventy-one percent of the total value of exported goods by Honduras is agricultural products. All product areas analyzed for this sector report (i.e. processed and/or transformed fruits, vegetables, poultry, coffee, cacao, dairy, beans, plantains, potatoes, and sweet potatoes) are experiencing growing demand, in Honduras and/or abroad. The strongest up-surges are domestic opportunities for packaged fruits and vegetables, mainly at supermarkets, for plantains and potatoes as snack foods, and for coffee to satisfy the emergent coffee culture and expansion in the number of coffee shops. Experts have noted that the sector provides one of the fastest ways of reaching thousands of smallholders and creating massive numbers of jobs in rural areas. The sector is already one of the largest employers in Honduras and the country has revealed its competitive advantage in several product categories already. Value-addition creates both demand for on-farm agricultural and forestry products from producers in DO2 areas, and demand for off-farm jobs through transformation of agricultural products as well as other rural supply chains. It is estimated, for

[4]https://beamexchange.org/uploads/filer_public/ee/ae/eeaea120-176d-49a6-b694-8fb33c414e28/wage_labour_ediscussion_report.pdf

[5] While the Honduras migration data is not disaggregated enough to fully measure the wage labor dynamics, this is based on local SMEs perception and within the broader literature on rural wage work.

example, that agriculture generates between 1.2 and 3 on-farm and off-farm jobs for every farmer[6]. Experience has shown that a focus on focusing on supply chain development of value-added enterprises e.g. packhouses and processing facilities which cooperate with U.S. and international buyers is proven to be the fastest way in Honduras of creating large number of jobs in rural areas.

Potential for promoting inclusive development. In general, there are many opportunities for women, youth, returned migrants, indigenous and Garifuna populations within the value-added agricultural sector. Many of the crops identified have extensive coverage within indigenous and Garifuna populations. There are ample opportunities in both on-farm and off-farm opportunities through value-addition offering strong inclusion potential for landless or land-insecure poor, women and youth to engage in meaningful economic opportunities. Returned migrants have often acquired skills abroad in agricultural jobs that can be applied locally. The agricultural sector employs a significant number of persons with disabilities in harvest and post-harvest activities.

1. AGRO-INDUSTRY EXPANDS MARKET ACCESS INTO HIGH-VALUE END MARKETS

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Agro-industry expands market access into high-value end markets

There are opportunities to both expand market share in which Honduran food industry companies already have an advantage as well as diversification opportunities in non-traditional destinations for Honduran products, such as Central and South America, the Caribbean Islands, Western Europe, Asia, etc. Expanded market access is reflective of the ability of Honduran enterprises to better meet the attribute demands defined by quality, price, reliability of customers that constitute unique segments of markets at a lower cost, higher value or in differentiated manner than other competing countries.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

High-value markets are less prone to shocks, and therefore more **resilient**, and offer more **inclusive** employment opportunities for marginalized persons, e.g. landless youth prone to migrate, in value-added stages such as processing, transport, etc. The ability to step into high-value products and markets requires higher productive capabilities to compete. The know-how that enterprises and industries invest in to supply products and services **competitive**ly to high-value markets is further transferrable to other complex products, increasing economic complexity and diversity in the economy overall, as enterprises draw on those productive capabilities to pursue more new product and market opportunities.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Difficulty in identifying buyers due to lack of updated directories and limited experience selling to diverse markets • High rejection rate for products for fresh export market without strong processing channel redundancy option • Difficulty in accessing certifications related to quality supply required by higher-value market channels • Limited coordination of supply chain to meet increasingly complex product requirements of high-value markets	• Strengthen market intelligence to help agro-industry identify new market opportunities to expand market share • Identify market opportunities and facilitate buyer linkages for alternative processing of fresh produce rejects • Develop a directory and facilitate matchmaking between processors and buyers from diverse markets • Facilitate most relevant third-party certification programs and expand pool of accredited certifiers • Promote foreign direct investment and alliances with regional companies to acquire needed capabilities

2. AGRO-INDUSTRY ENTERPRISES IMPLEMENT NEW, IMPROVED SUPPLY CHAIN MODELS

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Agroindustry enterprises implement new, improved supply chain models

A shift in supply chain practices and models to those which are value-additive (i.e. the success of my business depends on yours) would allow Honduran industries to compete in higher-value market segments as enterprises cooperate to better meet quality, quantity and timeliness requirements. Improved supply chain models take on various forms, such as performance-based contracts or commission-based brokerage schemes in which grades and standards are clearly

[6] International Finance Corporation. (2013). IFC Jobs Study: Assessing Private Sector Contributions to Job Creation and Poverty Reduction.

communicated and there are financial and non-financial incentives that rewards for better performance.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

Improved supply chain models strengthen end-market signals to agricultural producers. This results in more market-responsive production decisions which provide **inclusive** economic opportunities for producer households. Supply chains that are better able to meet end-market standards are more able to attract investment, financing, and promote the establishment of specialized service providers. As such, a virtuous dynamic emerges that can enhance cooperative relations pulling in investors and services, further aligning the incentives and enhancing **competitiveness** vis-à-vis attractive end markets. The adoption of supply chain models strengthens connectivity at an industry-level between input suppliers, producers, traders and manufacturers. Industry-level connectivity allows individual enterprises to specialize to focus on core competencies and outsource non-strategic or non-competitive functions. Increased connectivity and diversity strengthen market system-level **resilience** as supply chains can better adapt and absorb to shocks. This process of industry integration and enterprise specialization increases **competitiveness** of the entire market system. Furthermore, the demonstration of new supply chain models can create a copying effect whereby others imitate models that are proven. These models can be transferable beyond agricultural to other manufacturing supply chains, including forest and NTFP products. Moreover, a deliberate approach to piloting, refining, and rolling-out such practices and monitoring for their effectiveness, to test and refine models builds adaptive capacity into the market system to help ensure long-term **resilience**.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Producers are unaware of requirements for higher-value products e.g. grades, standards, consistency, safety, etc. • Predominance of informal market channels 'coyotes' which compete intensively on the spot market • Geographic dispersion and small scale of farmers makes transaction costs of direct sourcing relatively high • Shortage of enabling services and incentives e.g. profit sharing to motivate value-additive strategies by suppliers • Limited exposure to supply chain models and/or capital willing to invest in trial of new models	• Promote alliances between processors, input suppliers and other input and service providers to communicate market requirements as part of progressive sales strategies • Strengthen market intermediaries e.g. traders, coyotes, lead farmers, farmer groups, to manage supply chain operations of lead firms to create better economies of scale • Support challenge and performance funds and development alliances to buy down risk and motivate adoption of supply chain models and investment in new ventures • Showcase desirable practices through media showcasing, industry forums, awards and recognitions, etc. • Facilitate verbal and written agreements to establish clear set of rules to govern supply chain relationships • Establish acceleration services targeted at MSMEs to take on important intermediation and support service functions e.g. spraying, soil testing, micro-franchising, etc. • Benchmark best practices with more advanced exporting countries e.g. Chile, Peru, Colombia and Cost Rica

3. MORE DEVELOPED SUPPORT SERVICE MARKETS ESTABLISH FOR AGROINDUSTRY

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

More developed support service markets establish for agroindustry

Academy and private sector service providers create local innovations that address market-based necessities, establishing a business model in which the private sector is willing to continue to pay for services, which facilitates their long-term adaptation to the changing market needs and incorporating a growing number of actors who can access these services.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

A private sector that is better able to innovate and develop dynamic solutions based on local knowledge and R&D would be more productive and able to **compete** in markets over the long-term. Service markets that deliver necessary support to enterprise to discover new markets, invest in product development and access the necessary resources to grow their operations are vital ingredients to the success of agro-industry. Such support services markets strengthen know-how and the ability to adequately plan for and mitigate shocks and stresses and expand access to resources to help market systems recover from shocks invest in transformative **resilience** capacities. The degree to which such support service markets provide an economic ladder for marginalized groups and can result in more **inclusive** economic opportunities.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Lack of trust in confidentiality and protection of intellectual property by engaging with R&D service	• Promote development and use of ICT tools e.g. videos, interactive guides and manuals supported by mobile

providers • Support services are not tailored to practical private-sector needs, particularly MSMEs, such as filling out product specifications, proofing labels, scoping product costs, etc. • The universe of service demands is broad, and the number of service providers are limited in geography and/or scope of services to support different commodities • Traditional support service delivery models are cost-effective particularly for disperse, rural microenterprises	devices to lower cost and expand outreach of services to MSMEs • Strengthen intellectual property rights, protocols and contract enforcement to create stronger trust with academia • Promote greater awareness of private sector needs through diagnostic (prospecting tools) and workshops and support to gather and analyze information on enterprise needs • Disseminate information on availability and contacts of support service geared towards agro-industry • Establish blended investment models to scale new providers of specialized services based on identified gaps

SECTOR 2: TOURISM

Ability to affect systemic change. Crafting a competitive tourist destination requires significant collaboration between public and private actors at the network level rather than the firm level. Municipalities, hotels, restaurants, commercial activities, and stakeholders in the *orange economy* must work together as clusters to develop an attractive destination experience. There is potential to address the coordination failures that undercut the effectiveness of tourism investments and develop the capacity of public and private actors to effectively promote tourism. The root causes include a top-down orientation to priority-setting that has reportedly demotivated industry-wide transformation. Private sector players and public entities however seem willing and able to innovate and reform, suggesting that change is feasible. The tourism sector provides a fertile ground to test more collaborative efforts where the business community, chambers and associations, municipalities, *mancommunidads* and other local stakeholders come together to identify and address shared complex social and economic issues. This includes the promotion job creation through local competitiveness initiatives - such models of public-private engagement are replicable, if successful, to other economic sectors. In addition, the sector has the potential to attract large international players and visitors to Honduras. This would have a systemic impact in signalling that "Honduras is open for business." The tourism sector has furthermore very large, potential indirect and inducted impacts on interrelated sectors such as agriculture, arts and entertainment, food services and hospitality, construction and transport.

Ability to impact the drivers of migration. In many cases the first step of migration is local, from the rural areas to cities such as Ceiba, Tegucigalpa, Tela, and San Pedro Sula. Once there, migrants get caught by violence, unemployment, and poor living conditions. The only available job is often informal self-employment, as street vendors, etc. These jobs are purported to be the last stop before external migration and are highly vulnerable to shocks and violence. Tourism offers an opportunity to create local jobs at or near such communities to provide an alternative source of livelihoods in labor-intensive hospitality industries that have reasonable skill requirements suited towards potential youth migrants. Investment in accommodation, restaurants and attractions to serve increased tourism can create large numbers of formal jobs, including in rural areas in Occidente (culture and nature tourisms) and Tela and La Ceiba (nature, sun & beach tourism). Jobs created in this sector are likely to be stable, provide decent income and accessible to young males either as waiters, animators, or maintenance services. Increased tourism and local economic activity is also likely to benefit large numbers of people self-employed in the industry operating small *pulperias*, transport, etc. The sector can provide an economic ladder for poor and marginalized populations in these communities, which can further shape perceptions about the future long-term aspects of staying in Honduras. Tied to tourism is the creative or *orange economy* which can reinforce a *sense of place* to shape citizen's place-based identity motiving them to stay, establish roots and invest in the long-term development of their community.

Potential to raise incomes in DO1 and DO2 zones. Honduras is measurably the lowest performing tourism destination in the Central American region. At the same time, Honduras has a wealth of underdeveloped tourism assets and potential which include a UNESCO's world heritage Maya Site of Copan, pristine beaches such as Arrecife Capiro in Tela, and natural parks such as Pico Bonito or Celaque. This makes Honduras highly competitive with respect to other Central American countries in terms of the relative strength and diversity of its offer. The tourism sector is already a sizeable employer, despite the stagnation in international visitors. Intervening in this labour-intensive industry can generate significant numbers of formal jobs and improve the incomes of large numbers of people employed in the industry. Further, there are a multitude of jobs indirectly supported by the industry in complementary industries. The tourism industry has a multiplier effect between 1.5 to 2 complementary jobs generated for each one job generated in tourism[78]. Tied to tourism is the creative or *orange economy* which offer hidden, yet significant employment through fairs and festivals whose economic impact is significant, as they involve a range of goods and services, including accommodation, food, sale of artisinal crafts and complementary activities. The rise in festivals is linked to an increase in both international and particularly domestic tourism.

Potential for promoting inclusive development. The tourism sector has potential for promoting inclusive development, although it will require significant efforts to make it happen. Despite the high-levels of visibility of women and other disadvantaged groups in the tourism sector, the analysis revealed not so subtly 'hidden' forms of discrimination. Cultural and nature tourism products that allow local communities to be part of the work offer pro-poor growth potential, especially if these communities are engaged in a bottom-up approach to destination development. Inclusiveness however will not happen without a concerted industry push for greater equality and empowerment. Tourism, with the creative or *orange economy* also offers a distinct opportunity to address perceptions and re-write narratives, both local and international, to draw tourists to visit and encourage marginalized people to settle and stay in Honduras. The destination development process offers an avenue to reclaim 'lost spaces' to violence or underinvestment and motivate for citizens and tourists alike to come together. The sector offers strong synergies with placed-based approaches in DO1 high-density areas, which are supporting community-based programs aimed at violence prevention and workforce development programs to provide market-led job training, particularly for the tourism sector.

1. PUBLIC AND PRIVATE ENTITIES BETTER COLLABORATE TO MARKET HONDURAS TO INTERNATIONAL TOURISTS.

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience
Public and private entities better collaborate to market Honduras to international tourists Honduran institutions protect and rebuild an image of safety and attractiveness for international tourists, resulting in more tourists identifying Honduras as a destination to visit and booking travel to its destinations. Image is a composite of news, branding, user reviews and content from influencers that tell the story of Honduras to international audiences.
What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change
The increased perception of Honduras as a safe, secure and attractive destination will motivate tourist arrivals and result in greater **competitiveness** measured by tourism spending, job growth and investment. The institutionalization of marketing and communication capabilities within tourism institutions will strengthen the **resilience** capacities of the industry to effectively anticipate and adapt to a broad range of crises, which can prove to be major shocks to the tourism industry in Honduras. This successful marketing of a more **inclusive** Honduran offer than simply the Bay Islands will drive greater tourism revenues into marginalized communities of DO1 and DO2 zones.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*

[7] https://seepnetwork.org/files/galleries/477_Tech_Note_Econoic_Impact-ENG.pdf

[8] https://www.wttc.org/-/media/files/reports/economic-impact-research/regions-2018/world2018.pdf

• The perception of Honduras as an unsafe and insecure destination undermines international visitation – driven by prevalent travel warnings and media coverage • Lack of crisis management framework and institutions experienced in strategic marketing and public relations • Institutional overlap between national entities responsible for branding and marketing efforts: Marca País, 2020 Honduras Plan, Pro-Honduras, and IHT • Lack of data to develop more informed marketing strategies taking advance of full spectrum of media	• Promote user-generated content via TripAdvisor, Facebook, Instagram, local media and blogs to improve image and support the rebranding of Honduras as a destination • Strengthen the strategic communication and crisis management capabilities of national tourism institutions • Facilitate closer collaboration and clarify responsibilities between public entities responsible for marketing • Support destination organizations to develop capacities promote strategic marketing of local destinations focused on the right international market segments

2. PUBLIC-PRIVATE ALLIANCES ARE FORTIFIED TO DEVELOP NEW, INTEGRATED DESTINATION PRODUCTS

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Public-private alliances are fortified to develop new, integrated destination products

The establishment of more well-defined and transparent processes for public-private alliances improves collaboration among destination stakeholders to develop, invest in and market destinations. Tourism sector actors coalesce at a network level aligning interests and priorities in destination product development. Example destinations include Atlántida, Gracias Convoca, Ruta del Café, Ruta Lenca, and regional MICE events.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

The development of new, integrated and **competitive** destination products results in more attractive visitor experiences and increases demand for tourists to visit Honduras. Increasing numbers of visitors and improved experiences further signal to international tour operators and large international hotel chains that Honduras is "open for business" and to invest and start operating in Honduras, resulting in the creation of more and **inclusive** economic opportunities. Such models for effective public-private collaboration strengthen the enabling environment for effective public-private collaboration and investment, proving a replicable model for other sectors. The relationships and networks that this process enables strengthens social capital, provides a sense of trust and reciprocity to build **resilience** capacities to absorb and adapt to risks.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• A top-down orientation to priority-setting has dissuaded membership engagement in CANATURH and resulted in distrust of IHT, undermining public-private alliances • A lack of consensus for a tourism governance framework with clear vision and shared objectives has undermined the effectiveness of Law of Tourism Promotion to attract FDI • There is more limited experience supporting public-private partnerships (PPPs) for the tourism industry	• Facilitate public-private actors to develop shared consensus for the tourism industry that includes priorities for destination development, promotion, investments, etc. • Strengthen organizations in the tourism sector to establish greater transparency and bottom-up decision-making processes that is inclusive of diverse private sector actors • Promote destination management organizations and tourism districts as local mechanisms to develop new and integrated destination products • Facilitate exploratory visits and support feasibility assessments by international tour operators, airlines and hotel chains to invest and open operations in Honduras

3. TOURISM ENTERPRISES INNOVATE PRODUCT AND SERVICE OFFERS TO ATTRACT HIGHER MARKET SEGMENTS

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Tourism enterprises innovate product and service offers to attract higher market segments

Tourism enterprises including hotels, tour operators and attractions innovate to develop more attractive visitor experiences. Innovations could take the form of, upgrading of hotel facilities, sourcing of local food products by restaurants to offer a stronger Honduran culinary experience, or the development of new destination packages by tour operators.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

A stronger end-market customer orientation represents a systemic shift in mental models in which operators of hotels, restaurants and attractions engage in a continuous cycle of innovation to better meet customer demands. This has a reinforcing effect in which tourism enterprises innovate and **competitive**ly deliver improved travel experiences to an ever-increasingly discerning and sophisticated travel consumer market, which in turn increases sales and sustainably generates **inclusive** employment. The innovation processes encourage experimentation and learning, which are key **resilience** capabilities that will enable enterprises to better anticipate and respond to shocks and stressors.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Limited knowledge about tourists of higher market segments and experiences they are seeking – Honduras has fallen behind due to low levels of international visitors • Low levels of customer engagement on web-based and mobile travel platforms is due to low ICT literacy skills • Enterprises lack available data to be able to inform market-relevant product and service innovation • Weak competition in certain tourism segments – e.g. tour operators - lowers appetite for innovation • Lack of risk-tolerant capital for enterprises to invest in innovative products and services	• Promote ICT skills training through local service providers to manage web-based travel platforms • Support development and dissemination of market intelligence to help enterprises understand customer segments • Work with tourism chambers and destination management organizations to facilitate visitor experience audits, visitor surveys and conduct other relevant data collection • Demonstrate innovation processes with tour operators, attractions and hotels to develop products and services • Facilitate new tourism start-ups and product innovations by supporting access to entrepreneurship services

4. TOURISM ENTERPRISES ACCESS DIVERSE AND QUALIFIED TECHNICAL AND MANAGERIAL STAFF

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Tourism enterprises access diverse and qualified technical and managerial staff

Hotels and tourism enterprises recruit, hire, train and promote diverse staff with the right skills in destination management, hospitality services, technology use, event management, marketing and customer services.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

A more diverse and qualified staff that is **inclusive** of marginalized groups is better able to meet the high-quality standards of a range of tourists and to keep pace with global **competition**. This ensures that local destinations can deliver the quality services and experiences that international tourists require. Better visitor experiences result in positive word-of-mouth and better online ratings, increasing destination visibility and resulting in more visitors. This creates a virtuous cycle of enterprise and job growth. Investment in employee development is associated with higher levels of **resilience** and the ability of enterprises to react to and respond to disturbances. Graduating tourism students are also better able to insert themselves into the workforce and establish a career path in tourism and hospitality industries that reduces incentives to migrate.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Institutional challenges with INFOP continue to undercut the effectiveness of public vocational training efforts • Low perceived returns to workforce training – considered as a cost and not an investment • Tourism training is 'academic' and not geared around valuable, practical and soft skills required by industry • Low tourism demand limits pressure for tourism enterprise to invest in workforce development • Employer-based stigma and discrimination, driven by biases, hinders hiring more diverse pool staff	• Support efforts by other initiatives to reform INFOP and put in place a more effective workforce training program • Facilitate the development of more valuable vocational curricula as part of broader alliance framework between academia, public and private sector • Establish ICT training modules for hospitality industry for on-the-job learning opportunities to make better use of online booking and customer relationship marketing • Strengthen adoption of certifications for accommodation, food and beverage establishments to motivate investments • Communicate behavior changes for more inclusive hiring practices among tourism enterprises (see GSI section), increasing awareness of implicit and explicit biases

SECTOR 3: ENTREPRENEURSHIP SERVICES

Ability to affect systemic change. Honduras's economy does not appear well-structured with a sufficient number of SMEs to grow sustainably and inclusively. Few large companies dominate and can exert monopolistic influence in industries. It is highly costly for medium-to-large firms to transact directly with the many small and informal microenterprises, raising supply chain costs and lowering overall industry productive capabilities. Honduras has dropped by eight spots in the GEI with respect to technological readiness, business sophistication and innovation. Entrepreneurship services offers the potential to facilitate new entrants to revitalize old and grow new industries through the injection of

innovations, new ideas and competitive players. However, a market asymmetry has limited the supply of support services to MSMEs and has caused the current predicament, in which there is little effective demand among MSMEs for these services, yet there is a vast unserved real demand, despite the demonstrable value of these services to their businesses. The establishment of a commercial market for entrepreneurship services will lead to broader systemic change, as innovation, growth capital, and market-savvy skills lead growth-oriented firms to improve their capacity grow and enable the entry of a new cadre of innovation-driven enterprises. There are promising signs that systemic change is feasible. The CDE network has grown rapidly in Honduras, averaging 5,000 new micro-small businesses each year to their client list and is developing emerging relationships with Chambers of Commerce to facilitate business registration and other processing. The market for ICT services is also changing rapidly as increased mobile and broadband connectivity open-ups opportunities for the digitalization of businesses through digital marketing and e-commerce are potential disruptors to industries with strong potential to catalyze systemic change. An entrepreneurship ecosystem is emergent, if insular, highly fragmented, and concentrated in small pockets of large cities. This nascent ecosystem is highly collaborative, backed by a reputable player *Impact Hub*[9], socially-oriented and motivating talent and start-ups which can be modeled and scaled to elsewhere in Honduras.

Ability to impact the drivers of migration. The entrepreneurship sector holds medium to long-term potential to address the drivers of migration, as employment-heavy sectors such as value-added agriculture, light manufacturing and tourism experience higher growth rates as a result of increased access to finance and business services that better respond to MSME needs. Strengthened entrepreneurship services also opens pathways to economic opportunity for migrants to become potential entrepreneurs. There are inevitably other factors standing in the way of enterprise growth, beyond just entrepreneurship services, so the sector is also likely a necessary, but insufficient part of the equation.

Potential to raise incomes in DO1 and DO2 zones. Micro, small and medium-sized enterprises (MSMEs) account for more than 60% of total employment in Latin America[10] and are a vital ingredient of a healthy market system. MSMEs are noted as significant creators of value-addition and jobs, with the highest contribution in low-income economies[11]. Entrepreneurship services targets a subset of MSMEs[12] based on their growth potential. Few MSMEs can overcome the barrier of lack of capacity and collateral to finance growth-enhancing capital to reach their potential. Low levels of business sophistication results from the absence of business and ICT services aligned with the concrete needs of MSMEs. All sectors analyzed by TMS require a suite of entrepreneurship services; including, information systems, e-commerce solutions, more tailored business services, and access to growth financing. There are further opportunities to apply ICT services to help MSMEs navigate the complexity of emerging legal and fiscal policies in Honduras, significantly reducing the costs of doing business. The scope of potential enterprises impacted by the entrepreneurship services is substantial with an estimated 80% of enterprises inadequately served with entrepreneurship services, with high potential to result in significant increases in sales and income. A more sustainable entrepreneurship services market targeted would serve as the heart that pumps dynamism into the Honduran economy.

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[9] Learn more of Impact Hub Tegucigalpa in their web page at https://tegucigalpa.impacthub.net/about-us/

[10] Gonzales, E., Hommes, M., & Mirmulstein, M. (2014). MSME Country Indicators 2014. Towards a Better Understanding of Micro, Small, and Medium Enterprises. *Analysis note. DECEMBER*.

[11] MSME Country Indicators 2014.

[12] Small Growing SMEs are referenced in more detail in the sections of the report dedicated to the Business Development Services and Financial Services Sectors.

Potential for promoting inclusive development. Strengthening entrepreneurship services can improve pathways for enterprise growth allowing for greater upward economic mobility. Enhanced economic mobility promotes inclusivity as it offers a leg-up for enterprises and populations which have historically been excluded. Reflecting a great potential for entrepreneurship in Honduras, which also represents innumerable opportunities for the ever-growing youth in the country who can´t find an appropriate job and would contribute more to the economy and development of the country by creating their own businesses. Lowering the cost of delivery, increasing the quality and appropriateness of entrepreneurship services will help to reach a more representative set of client segments. Minority-owned MSMEs furthermore tend to be disproportionately affected by the skills and financing gaps identified. Improving the alignment of entrepreneurship services to their needs, and a resulting improvement in business performance, should achieve a parallel gain in inclusivity. In many cases, this area requires a paradigm shift towards the orientation of entrepreneurship service providers. This can be hard to achieve and makes the potential for inclusive development more uncertain.

1. A STRONGER ECOSYSTEM ACCELERATES ENTERPRISES BASED ON TRUST AND RESULTS

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

A stronger ecosystem accelerates enterprises based on trust and results

A stronger ecosystem that is better able to target dynamic, opportunity-driven enterprises and accelerate them into high-impact enterprises that can grow quickly, create jobs, transform sectors and energize the Honduran economy.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

Entrepreneurial ecosystems connect high-growth enterprises and investors efficiently, allowing for more efficient investment deal flow. These networks also facilitate learning and adaptation as enterprises quickly explore and validate new venture ideas – strengthening **resilience** capabilities. The energy generated through such ecosystems is amplified as successes emerge and signal to other would-be entrepreneurs that a growth pathway exists, thereby generating more deal flow. As ecosystem actors gain experience and learning from the ecosystem, the **competitive**ness and quality of that deal flow continues to improve over time. Entrepreneurship is the heart of the market system - once beating, it pumps a sustain flow of dynamic start-ups into the economy. Entrepreneurship also provides innumerable **inclusive** opportunities for the large population of youth who cannot find an appropriate job and could contribute to the economy and the development of their country by creating their own businesses.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Ecosystem in Honduras is nascent and small given economy size and more recent public focus on entrepreneurship • Absence of entrepreneurship service providers in Honduras, due to perceptions of limited quality deal flow and the early-stage of ecosystem development • Norms are an ad hoc event focused entrepreneurship network that is highly informal, which limits its development into a more sophisticated market • Emergent entrepreneurship 'culture' is overly concentrated in highly educated, tight-knit, urban centers • There exists distrust among service providers due to unfair competitions between actors, linked to formalization • Lack of clear framework, national policy or institutional mandate for entrepreneurship in Honduras	• Strategic identification of business segments to serve and to strengthen relevant gaps in service provision • Strengthen collaboration through joint action and improved knowledge of service offers – avoiding duplication and allowing for more specialized service provision • Establish entrepreneurship monitoring system for local ecosystems based on identified priorities • Facilitate educational exchanges with regional entrepreneurship examples in Guatemala and Nicaragua • Link the Honduran ecosystem with regional hubs to achieve greater scale in deal flow and actors • Strengthen and broaden the number of 'focal points' such as incubators and hubs that anchor the sector • Buy-down risk for new incubators, accelerators and networks to initiate operations in Honduras • Bridge emergent entrepreneurship system and actors with more traditional MSME sector, especially in rural areas • Support local mentoring networks and grow the number of business angels and investors providing seed capital • Facilitate establishment of policy framework that is more conducive to MSME development –including a national policy that lays out entrepreneurship as a priority

2. ENTERPRISES ADOPT DIGITALIZATION AS A CRITICAL FACTOR TO REACH LOCAL AND INTERNATIONAL MARKETS

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Enterprises adopt digitalization as a critical factor to reach local and international markets

Fixing the misalignment between supply and demand will enable marketplaces for ICT services to function more effectively spurring the digitalization of Honduran enterprises and enabling them to pursue local and international markets.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

A better functioning market that connects enterprises to the right ICT solutions will catalyze higher levels of enterprise efficiency, productivity and growth. This will lead to increasing **competitiveness** of Honduran enterprises as they increase client outreach and sales and make it easier to establish effective alliances and for consumers to find their business. The increased access to information, networks and markets that ICT enables is an important **resilience** capability for market systems. The technology adoption curve for ICT solutions is anticipated to lead to significant levels of copying and imitation once successful solutions are demonstrated by early adopters with high anticipated **inclusive** impacts for microenterprises with limited resources due relatively low thresholds for adoption. Due to comparatively low levels of ICT usage, the adoption curve for such solutions may prove especially 'disruptive' to market systems in Honduras.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Disconnect between supply and demand – service providers do not develop products/services based on demand • Fragmented demand for ICT services MSMEs results in ICT market that is oriented towards larger enterprises • Significant levels of digital illiteracy within business sectors and lack of understanding of ICT applications • Regulatory barriers that either prevent or undercut competition in financial technologies that would increase access	• Inventory, disseminate and establish directories on available ICT services for key economic sectors • Introduce human-centered design principles to help ICT service provides tailor their services to clients needs • Support the development of digitalization and ICT literacy materials accessible for diverse MSMEs • Facilitate hackathons for identified private sector challenges to stimulate new ICT solutions • Support digital initiatives linking them international programs and facilitate private sector funding for them • Expand e-money agents to open-up options for e-payments and e-commerce

3. STRONGER BUSINESS SERVICE PROVIDERS SERVE A RESILIENT, COMPETITIVE AND INCLUSIVE ECOSYSTEM

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Stronger business service providers serve a resilient, competitive and inclusive ecosystem

The expansion of markets for business services that provide valuable services to specialized to enterprises across their evolutionary spectrum and to a range of productive economic sectors.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

The need for information systems, e-commerce solutions, and more tailored business services by MSMEs cuts across all economic sectors. Enterprises that are aware of their own needs in these areas and proactively act to remedy those gaps by seeking out relevant business services, will create **competitive** pressures that motivate enterprises to add value and differentiate to better compete. This 'race to the top' has a virtuous effect on economic growth by spurring innovation which in turn increases enterprise demand for advisory and other services. A functioning marketplace for business services can facilitate such innovation processes over a long-term promoting **resilience** at a system-level as an **inclusive** range of enterprises are able to sustainably access these services on a commercial basis.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Limited effective demand for business services despite vast unserved real demand due to perception that such services should be received freely by NGOs and others • Advisory services providers have oriented towards larger, established firms due to higher cost-benefit and lack of models to reach smaller entrepreneurs effectively • Limited human capacity among service providers to provide high-quality advisory support to MSMEs • Little differentiation of business services based on lack of data and knowledge of the market for services • Institutional weaknesses among BDS providers, notably business chambers, CDEs and NGOs in rural areas	• Support results-based advisory service models where payments are made upon achievement of KPIs • Introduce lean start-up and other innovative methodologies to make services provide better value for money • Facilitate links between universities and private sector to establish technology hubs for ICT-based industries • Capacity-building of service providers to strengthen quality of service offer to MSMEs • Increase associativity between service providers, ICT service providers and business chambers to 'bridge' clients

• The payment terms and performance incentives around advisory services are not results-based • Lack of awareness of MSMEs of own managerial deficits and need for advisory support	• Leverage ICT to expand access to business services at scale to wider geography of MSMEs • Invest in digital platforms that provide market and business intelligence services for MSMEs • Promote leadership forums and events to showcase business 'case studies' to raise awareness on needs • Support trade missions and exchanges for businesses to observe new technical and management practices

4. A DYNAMIC FINANCIAL SECTOR UNLOCKS SOURCES OF CAPITAL AND LEVERAGES NEW RESOURCES

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

A dynamic financial sector unlocks sources of capital and leverages new resources

Financial institutions change their lending habits with a reduced reliance on collateral and make informed capacity-based financing decisions. New sources of finance, which have a more risk-tolerant profile, further unlock capital available for growth-oriented MSMEs which have the potential to create many new jobs and contribute to economic growth.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

The introduction of mechanisms that change the rules of lending to the MSME sector represents a paradigm shift in how financial markets function with the potential to unlock up to $4 billion in excess liquidity to the 88% of MSMEs that are underserved by the current financial system. The productive sector is starved of the financial resources it needs to **compete** and create jobs and grow incomes. More **inclusive** access to affordable, flexible and longer-term capital due to better functioning financial markets would accelerate productive investments, allow MSMEs to realize new innovations and increase access to markets. It would further expanded resource flows provide a source of capital to recover from shocks and invest in transformative **resilience** capacities.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Excess liquidity in financial system that does not reach MSME segment is due to bottlenecks in overreliance on collateral for credit decision-making • Rigidity in Central Bank regulations and internal banking culture that prioritizes collateral over cash flow analysis • Low functioning of property registries heavily discounts the value of collateral accepted by financial institutions • Complacency and lack of competition in commercial banking sector dampens incentives to finance MSMEs • Information asymmetry due to limited transaction and credit histories reduces capacity-based lending • Financial institutions interpret regulations in a strict manner due to internal rules and culture within banks • Absence of impact and social investors with operations in Honduras due to country risk profile	• Attract new investors and lenders to Honduras with greater risk appetite for non-collateralized lending • Introduce new risk analysis and mitigation strategies to the marketplace that reduces reliance on collateral, such as credit scoring, movable guarantees, factoring, etc. • Facilitate emergence of online financial platforms and intermediaries that have lower transactional fees and techniques to assess risk to boost SME access to finance • Demonstrate new mezzanine, quasi-equity financial products such as variable payment obligations to the market • Improve property registration systems and develop credit information systems for credit scoring models • Support the Central Bank and commercial banks to better align the high conservative informal rules with the more flexible formal rules based on best practices • Disruptive mobile platforms for remittance payments open remittances as source of funding for MSMEs

SECTOR 4: BUSINESS ENABLING ENVIRONMENT

Ability to affect systemic change. Market systems thrive or stagnate based on their enabling environment. Honduras fares very poorly among 120 out of 137 countries in the World Economic Forum's Global Competitiveness Index (WEF GCI) with respect to strength of its local institutions and perceptions of rule of law. Some of the lowest scores are caused by the burden of government regulation (126), judicial independence (121), and diversion of public funds (115). WEF's Executive Opinion Survey 2017 also shows that among the top "most problematic factors for doing business" in Honduras are inefficient government bureaucracy, corruption, tax regulations, and policy instability. Moreover, the World Justice Project's Rule of Law Index (WJP RLI) places Honduras third to last among other Latin American countries (28 out of 30 countries), with its weakest scores in absence of corruption,

regulatory enforcement, and criminal justice. The MSME sector, which generates 70 percent of private sector employment, is characterized by weak market linkages, internally and externally, and low levels of sectoral cooperation, either for leading sectoral development or for promoting business friendly policies. Most of the employment in Honduras is informal, and that is partially the result of BEE policies that promote "*pequeñismo*" or the trend of keeping businesses small and informal. MSMEs in complain having to compete unfairly with informal firms for market share. An overly complicated and burdensome tax systems, as well as red tape for starting businesses are analyzed as key causes for this phenomenon. Despite the above picture, economy is expected to grow between 3.5 and 4.0 percent annually during the 2018-2020 period. The Honduran government is committed to a series of reforms to ease doing business by simplifying rules and processes. If this holds, TMS may perform its work within a growing economy going through a process of BEE-friendly policy adjustments. TMS can become an advocate and facilitator of positive and sustainable results by the strategic use of project resources, influencing changes to BEE and sectoral rules, strengthening public-private dialogue, and by helping leverage and transform strategic partners' roles. At the same time, these changes are likely fail or fall back to the status quo if there is no private sector demand and sustain reform. Strengthening the private sector to take a stronger leadership and represent a wider range of interests is core to the entire vision of TMS's role in promoting BEE reform.

Ability to impact the drivers of migration. BEE reform increases the formalization of MSMEs, expands access to markets, motivates investment and spurs enterprise start-up and growth. This increased business activity has a direct impact on expanded sales and job creation, therefore reducing the economic incentive of youth and other marginalized populations to migrate. Given the scale of impacts of BEE reforms, these magnitude of job impacts may be large. In addition, investment in productive infrastructure because of public-private investment promotion further enhances the availability of basic services such as electricity, water and sanitation. The expansion of these services, particularly to rural areas, is vital to creating a livable space for Hondurans reducing the need for emigration.

> *"There are few factors as fundamental to the ability of individuals to achieve their potential for economic self-reliance and resilience over time as the rule of law as implemented through clear, effective commercial law systems that align with international standards and best practice."* - World Bank 2018

Potential to raise incomes in DO1 and DO2 zones. Changes within the BEE will have economy-wide impacts and potential to bolster growth among large numbers of enterprises. There are other opportunities to bring the one stop shop regime to reduce the time and procedures, associated costs, and discretionary application of rules to construction and operating permits, tax registrations, and environmental certifications, as well as other government administrative requirements. A key element of this strategy will be to allow much wider use of e-payments and e-signature and increase access to the internet through municipalities, *mancomunidades*, associations, and business service providers. The expected impacts of these reforms, if successful are likely high. Comparable reforms in reforming entry regulations in a different country increased the number of monthly start-ups in the country by 17%.[13] In an economy like Honduras, from a roughly estimated baseline of 20,000 registered start-ups a year, these same assumptions would amount to increase of 3,500 registered start-ups or 14,000 new jobs in a year[14]. Given the faster pace of economic growth and the significant impediment of informality on

[13] Do Entry Regulations Deter Entrepreneurship and Job Creation? Evidence from Recent Reforms in Portugal - The Economic Journal, Volume 124, Issue 577, 1 June 2014, Pages 805–832

[14] As a comparison, Honduran start-up enterprises in such a scenario are likely to be more, but fewer in number of employees.

enterprise access to credit and markets in Honduras, these effects may be significantly higher.

Potential for promoting inclusive development. In Honduras there are laws, regulations, and policies that protect marginalized groups, however, these are not well enforced. BEE reform that is inclusive of the perspectives and needs of women, youth, persons with disabilities, ethnic groups, and returned migrants can meaningfully expand access to economic opportunities for marginalized groups. Specific reforms targeted by BEE include equal salary and compensation, strengthening support institutions for workforce-based learning opportunities, public promotion strategies to reduce biases, stigma and discrimination, and institutionalizing a policy process that actively engages marginalized groups. Greater use of sex-disaggregated data, the inclusion of special advocacy groups, more inclusive public-private dialogue and targeted impact analysis are essential to promotion of inclusive development via BEE. In addition, BEE reforms targeting rural municipalities reduces the urban-rural gap in BEE services. For example, enhanced business and property registration systems has already made progress in major cities, but many smaller municipalities lack the resources to carry out such reforms. Within business organizations there are opportunities to establish self-sustaining organizations of women entrepreneurs.

1. NATIONAL AGENCIES STREAMLINE AND MAKE EFFICIENT ADMINISTRATIVE PROCESSES

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

National agencies streamline and make efficient administrative processes

The bureaucratic processes with the greatest impact on the local business environment are: local business and property registries, sanitary and phytosanitary processes, and municipal business operation licenses. Streamlining and efficiency involves the reduction of time, number of procedures, associated costs, and discretionary application of rules covering environmental certifications, construction permits, business and tax registration, among others.

What is the potential impact of this change? Impact is **s**calable, sustainable and significant - ***systemic*** change

This change will result in increased administrative efficiency that will address key bottlenecks in the business enabling environment. This will lead to increased registration, greater investment, productivity, and job creation. Reforms will impact the commercialization of products and services across a range of sectors leading to greater market system **competitiveness**. This system change has the additional benefit of reducing the opportunity for discretionary application of rules by public officials resulting in more **inclusive** rules and norms for all MSMEs. The reduction of entry barriers that further opens access to markets for MSMEs results in greater market channel diversity with the potential to enhance market systems-level **resilience**. There are strong sectoral effects that can result from reform to processes related to sanitary registrations and phytosanitary export and import licenses, environmental licenses, connections for energy generation, transmission and distribution, municipal permits for festival and events, forest products and management plans certification, etc.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• There is limited interoperability between registries, resulting in redundant and inefficient processes • Municipalities are dispersed among many different locations with their own set of difficulties and idiosyncrasies • High centralization of processes by institutions with limited capacity and resources to effectively manage • Reliance on hard-copies and paper signatures leads to processing and approval delays of permits and licenses	• Strengthen the national online registry Mi Empresa en Línea (MIEL) for a one-stop-shop solution • Facilitate an environment for sharing resources and know-how between larger and smaller municipalities • Strengthen capabilities of smaller chambers and data collection of all chambers to take on registry functions • Promote digital and interconnected platforms; e-payments and e-signatures to facilitate data sharing • Reform property registry system and outsourcing of property registry capabilities, particularly cadasters • Outsource certification and inspection services of agencies to accredited individuals and third-parties

2. TAX SYSTEM ADMINISTRATION AND POLICIES IS MORE EFFICIENT AND PRO-GROWTH

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Tax system administration and policies is more efficient and pro-growth

A more efficient and pro-growth tax system ensures that taxes are proportionate and not arbitrary, and that the method of

paying them is convenient to taxpayers. Taxes should also be easy to administer and collect. The tax system should not be overly burdensome, which may promote informality and cause businesses to not invest to grow.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

A better tax system facilitates the formalization of MSMEs, attracts investment in new activities, allows enterprises to pay their taxes in a simplified and expedited manner, or in reimbursing collected taxes. However, as SAR is not championing proposed changes there is a higher risk to systemic change. In terms of interrelated sectors, all sectors noted the impact of tax rates and administration on their businesses – the systemic change would be high, even if feasibility is uncertain, on increasing the **competitiveness** of industries, strengthening **resilience** by reducing barriers to formalization and promoting the **inclusion** of a range of MSMEs relegated to operating in the informal sector as a result of the current tax system.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Tax rates have elevated from 39.4% to 44.4% and tax administration practices have become more punitive • Foreign debt has doubled since 2011 and interest rates put continued pressures on fiscal revenues for repayment • Tax filing is complex, requiring 48 payments (224 hours) per year and with limited electronic filing options. • High penalties exist for newly formalizing MSMEs that discourages formalization and tax compliance	• Reform the tax system to a consolidated single monthly payment (*monotributo*) that will considerably simplify tax payment and administration, based on cost/benefit • Facilitate a shift in mental models of tax authorities from penalty-seeking to economic growth focused • Promotion of Tax Ombudsman or Advocate to protect taxpayers from arbitrary tax penalty decisions • Interconnect SAR digital platform with other platforms to eliminate redundant steps in business registry, etc.

3. PUBLIC-PRIVATE MECHANISMS ENCOURAGE INVESTMENT IN PRODUCTIVE INFRASTRUCTURE

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Public-private mechanisms encourage investment in productive infrastructure

New and more transparent mechanisms are needed to attract local and international private partners for investing in sustainable productive infrastructure. Public private partnerships (PPPs) offer significant value and serve as an optimal solution for overcoming shortages of upfront capital and skills, or human capital, needed to expedite the development of efficient infrastructure projects by the Government of Honduras.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

Investments in electricity, water and sanitation, rural roads, agro-parks, tourism transport infrastructure and other productive investments related to the primary economic sectors would have a large effect on improving Honduran **competitiveness** across industries. Public-private investments through PPPs would close the infrastructure gap and provide **inclusive** access for enterprises across geographies and economic sectors to enhance the efficiency of production, transportation, and communication capabilities of enterprises to grow and create jobs. Investments in energy and water resource management will reduce vulnerability and increase **resilience** of enterprises to the effects of climate change and stresses to electric grid.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Perceptions that procurement process for infrastructure projects provides unfair advantages for incumbents • Few incentives for smaller PPP projects in rural areas and with MSMEs resulting in unequal distribution of projects • Low levels of private and public sector dialogue and evidence-based selection based on market needs	• Support due diligence and prioritization of infrastructure projects based on their economic potential, value-for-money and pre-feasibility analyses • Strengthen the investment climate with investment promotion agencies to attract new investors in sectors • Facilitate reform and modernization of procurement process for projects to be more transparent and inclusive

4. ASSOCIATIONS FACILITATE EFFECTIVE, LONG-TERM PUBLIC-PRIVATE DIALOGUE AND PRIVATE-SECTOR ADVOCACY

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Associations facilitate effective, long-term public-private dialogue and private-sector advocacy

Robust and inclusive engagement by the private sector facilitates business enabling environment reforms by marshaling support, creating momentum, and seeing the reform effort to the end. This effort is enabled by more effective public-private dialogue facilitated through stronger, representative business associations.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

Stronger private sector advocacy and public-private sector dialogue promotes transparency, good governance, the taking of a broader view by setting an example for rigorous cost-benefit analysis, and increased pressure for public scrutiny and debate. This results in better-designed policy solutions that are **inclusive** of a wider range of perspectives, including

marginalized groups. Further, it makes policy reforms more effective because when entrepreneurs understand what a reform policy package is trying to achieve, they are more likely to accept and rally behind the proposed reforms, succeed in making changes to it, or be better prepared to offer an alternative. This contributes towards a business enabling environment that supports the **competitiveness** of Honduran market systems. Stronger private sector representation in governance and policy processes further reduces vulnerability and increases **resilience** to political shocks.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Business organizations are relatively weak to defend the interests of key economic sectors or to act in a coordinated manner to address common policy issues • Proposals are brought to Congress without previous public debate or analysis, giving limited time for private sector organizations to put together an informed counterproposal • Lack of broad-based consensus around priority policy programs and underrepresentation of the views of MSMEs and marginalized groups in these programs	• Institutional strengthening of business organizations to conduct economic and policy research and to become a stronger advocate for private sector membership • Support cost/benefit analysis and other studies to strengthen the evidence-base for policy reform and prove the value of public debate and analysis • Facilitate effective communication between business organizations and their members

5. REFORMED LAWS AND REGULATIONS INCREASE ECONOMIC COMPETITIVENESS

What is fundamentally different? Systems-level change that contributes to competitiveness, inclusion and resilience

Reformed laws and regulations increase economic competitiveness

Specific BEE related areas are targeted for policy reform; including, tax administration law, e-permitting regulations, insolvency law and regulation, financial inclusion strategy, contract enforcement laws, workforce development system, *orange economy* legal framework, digital economy law among others.

What is the potential impact of this change? Impact is scalable, sustainable and significant - ***systemic*** change

The adoption of technologies, such as e-permitting, putting in place mechanisms to prevent premature liquidation of businesses, or establishment of improved mechanisms for contract enforcement can unlock new opportunities for enterprises to secure the permits, finance, services and markets they need to **compete** to grow and become more **resilient** in the face of shocks. The explicit engagement of civil society organizations in the reform process, will provide avenues to advocate for stronger enforcement of cases of discrimination and to greater consciousness of **inclusion** issues at the national level.

CONSTRAINTS to inclusive, competitive and resilient growth *TMS targets root causes and binding constraints*	**OPPORTUNITIES for inclusive, competitive and resilient growth** *TMS targets high leverage opportunities*
• Laws are implemented without adequate private sector input, reflecting a lack of analysis and public discussion • Policy processes tends to be top-down and there are few bottom-up initiatives from the private sector • Apathy and lack of political will to reform and enforce laws due to low consciousness of their impacts • Enterprises are not aware of laws and policies and the potential implications that they have on them	• Support efforts by private sector to conceptualize new laws and regulations based on bottom-up approach • Improve evidence-base for informed policy-making through economic feasibility studies, etc. • Support communication strategies that increase awareness of laws and regulations and their impacts • Leverage current political will to change norms about public sector engagement with the private sector • Ensure the engagement of civil society organizations representing marginalized groups in the policy process

BEE DIAGNOSTIC OVERVIEW

TMS conducted a specialized BEE diagnostic analyzing shared sets of measurements regarding the time, cost, and number of procedures it may take to undertake a certain regulated action. This exercise leveraged primary information gathered through one-on-one interviews and workshops, as well as available reports on related measurements from credible international institutions, such as WB's Doing Business (DB) and the World Economic Forum's (WEF) Global Competitiveness Index (GCI), among others. Further findings from BEE diagnostic are incorporated within the Rules section of each of the economic sector analyses (see Annex).

ENTERPRISE INPUTS

Enterprise inputs have a direct impact on the decision to start a new business. It has been widely studied that there is a direct link between the quality of governance, enforcement of contracts, and protection of property rights in increasing business activity, increasing employment, and reducing poverty.

Real Property

International benchmark. Having straightforward, accessible and credible property regulations and records are key to an economy's well-being and dynamism. This is so because having valid property rights and the availability to transfer property or use it as collateral increases investment, facilitates access to credit, and permits national and/or local government to assess and collect property taxes. To improve property regulation, international best practices include[15]:

- One-stop shops and e-permitting, including e-signatures and e-payments.
- Increased transparency, such as online property transfer filing and registration (includes information on liens on property).
- Lower transfer taxes and fees, including reducing notary fees or using a differentiated approach based on property value.
- Requiring property registrations to be carried out in a specific time, decreasing uncertainty or opportunities for officials to pressure for additional filings or bribes.
- Use of GPS, mapping, and high-quality imagery technology to link related information to create easy accessible final documentation.
- Establish a land dispute mechanism or make disputes easier to file and follow online.

Honduras performance. Honduras currently ranks a middling 91 out of 190 countries in the DB 2018. If compared to Costa Rica's ranking in this topic (49), the country needs to improve the number of procedures and times, as well as reduce the cost of registering property. Fortunately, Honduras is working to improve the situation. The Property Law of 2014 created a sole public property registry under the supervision of the Property Institute (IP). The new system digitalized most processes (but not all) and made the public registry and cadaster available online. However, the new system's key weakness is coverage. Most of its benefits only impacts Tegucigalpa and San Pedro Sula/Cortes, while the digitalization of public registries and cadaster in smaller cities and rural areas lags significantly behind. This dual system puts smaller towns and rural areas at a clear disadvantage. As of 2018, only 40 percent of the national territory is covered by IP's digital database, much of it urban. Another weakness is the lack of alternatives for the resolution of conflicts, which overloads the judicial system, already overwhelmed by administrative delay.

Moreover, inadequate land title procedures have led to numerous investment disputes involving foreign nationals who are landowners. Title insurance is not widely available in Honduras and approximately 80 percent of the privately-held land in the country is either untitled or improperly titled. Resolution of disputes in court often takes years. There have been claims of widespread corruption in land sales, deed filing, and dispute resolution, including claims against attorneys, real estate companies, judges, and local officials. Although some progress has been achieved, particularly in the Bay Islands, the overall property registration system remains unreliable and represents a constraint on investment. In addition, a lack of implementing regulations leads to long delays in titling in some regions.

[15] World Bank, *Doing Business 2018*.

Electricity

International benchmark. Inadequate access to electricity ranks fourth among the major obstacles in doing business in most countries evaluated by the World Bank. Similar to property regulation, this topic usually has distinct urban and rural features. For example, urban priorities may include administrative red-tape in obtaining a connection, making connections automatic with construction or business operation permits, investing in additional sub-stations, and organizing rapid response squad to restore services after an outage. On the other hand, rural electrification priorities usually deal with less service coverage due to low consumer density or a lower income client base, which requires exploring alternative investments, such as promoting public-private participation in smaller energy generation projects involving local agricultural cooperatives, *mancomunidades*, municipalities, and regional energy generators.

Honduras performance. Honduras fares poorly in this area despite advances in energy generation and private sector investments. On the one hand, a new legal framework was executed in 2014 aimed at promoting a new electricity market, and opened the door to privately-owned service providers. This has enhanced competition, grown investment in renewable energy sources (now 70 percent of total generation and $3 billion investments). Nonetheless, the country still worsened its ranking from a low 125 out of 189 countries in DB 2014 to 144 out of 190 in DB 2018, mostly due to the time to get an electric connection and its cost (as percent per capita), which is 4.6 times higher than neighboring Costa Rica.

A probable explanation for these weak results after the partial liberalization of the sector is that, although generation is now in private hands, the National Electric and Energy Company (ENEE by its Spanish acronym) retains the monopoly of distribution and transmission through a concessionaire, *Empresa Electrica de Honduras* (EEH). Publicly mandated social subsidies and low energy rates have financially depleted ENEE and left it unable to modernize and expand the distribution system, including rural areas that required a subsidized investment. Even the urban areas are affected by low levels of necessary investment and maintenance services, as private sector suffers from significant productivity losses due to frequent service interruptions and brown-outs.

Very recently (October 2018), ENEE, EEH, the Electric Energy Producers Association (AHPEE), and the Banking Institutions Association (AHIBA) signed an agreement to open the energy market in Honduras. Under the agreement, generating companies can now sell electricity directly to the GoH or any private user, which is expected to increase competition, investments and coverage and, thus, reduce costs and rates. The Electric Energy Regulatory Commission (CREE) will regulate and supervise the more competitive system.

Labor

International benchmark. Even publicly discussing labor laws reform can turn controversial in many countries. But given the overall impact of labor regulations in the business environment and in creating adequate conditions for job generation, it is also unescapable. Some international best practices can be applied that offer flexibility for an economy to adapt to innovation and changes brought by technology and other economic realities. Some of those best practices include changes in hiring rules and probation periods, flexible working hours, easing redundancy rules and costs, and reforming legislation regulating worker protection and social benefits.

Honduras performance. In Honduras labor and economic policies have worked to promote (inadvertently) job informality on a large scale. For example, its minimum wage is adjusted upward on

a yearly basis and is already the second most expensive in the region after Costa Rica. This was cited as a contributing factor to informality, especially among MSMEs. The WB estimates over 70 percent of employment in the country is in the informal sector. Honduras ranks very low in WEF GCI 2017/2018 with a score on Labor of 124 out of 137 countries, most due to its scores in redundancy costs (123), female participation (117), effect of taxation on incentives to work (116), and flexibility of wage determination (102)[16]. By attempting to raise wages by fiat regardless of sectoral productivity and by prioritizing the protection of current permanent workers over creating opportunities/incentives for new hires, the GoH is making the local labor market overtly rigid.

In local interviews, the biggest complaint, however, had more to do with the ability of businesses to hire adequately trained manpower, as the local business climate is hampered by low education levels. On vocational and technical training, most interviewees pointed at the National Institute of Professional Training (INFOP by its Spanish acronym) as inadequately suited to address this issue. INFOP receives substantial local resources (about $40 million) through a tax on businesses. So even though, USAID/Honduras estimates that there is currently over $185 million of combined donor investment in workforce development activities in the country, local business leaders feel INFOP is wasting valuable local resources that could be put to better use.

Currently, COHEP is spearheading an initiative, together with other private sector groups, such as ANDI, to create a new system that will include INFOP, as well as other local vocational training institutions, but led by the private sector. Specifically, the new initiative is looking to adapt training curricula and technical certifications based on the real market demands, add new training partners (thus breaking INFOP monopoly in public funded training), and include a post-graduation monitoring to measure training's impact and validate/change training approaches accordingly and in a timely manner.

STARTING A BUSINESS

There is a strong correlation between easing start-up regulations and reducing informality, poverty and income inequality. This also requires improving the overall business environment, not just facilitating procedures, to have a real impact.

Company Registration

International benchmark. There are simple rules to improve business registering that can be summarized as 1) reducing number of procedures, 2) time involved, 3) associated costs, and 4) discretionary application of rules. To address these four factors, DB has identified the following best practices:

- Set up digital platforms and allow for e-signatures and e-payments. All payments should be known in advance and made online, with no need to pay in person or using an intermediary.
- Abolish requirements (ex. redundant requests, such as requiring digital and paper copies of the same documents).
- Consolidate processes, such as tax, social security, and licensing registrations in one step.
- Streamline post-registration procedures (ex. eliminating general business license requirements or company seal).
- Reduce or eliminate minimum capital requirements, which Honduras has already done.
- Create and implement clear/transparent and well disseminated rules. All information should be made available online.

[16] However, "redundancy costs" has by far the biggest value on Honduras' Labor overall score with 30.3, compared to a range of 0.5 to 4.5 for the three others.

Honduras performance. Although Honduras ranks very low in DB 2018 in Starting a Business with a score of 150 out of 190 countries, it has made progress through its new company registration service "*Mi Empresa en Línea*", which currently only works in the chambers of commerce of Tegucigalpa and Cortes (CCIT and CCIC). This new service reduced the time of registering new businesses from 3 months to 3 days. However, it is not a completely virtual solution since it still requires that users attend in person to other agencies, including the national tax authority (SAR) to obtain the Tax Registration Number (RTN). Moreover, it has limited coverage and should eventually include all other 43 chambers of commerce, which according to the Federation of Chambers of Commerce and Industry of Honduras (FEDECAMARA), operate in 17 departments and group about 20 thousand companies, mostly MSMEs.

Tax Administration

International benchmark. A good tax system ensures that taxes are proportionate and certain (not arbitrary) and that the method of paying them is convenient to taxpayers. Taxes should also be easy to administer and collect. A burdensome system may cause businesses to not invest to grow or inadvertently promote "*pequeñismo*" as companies prefer staying small rather than attracting unwanted attention from tax authorities. According to DB 2018, best practices include:

- Electronic filing for profit, value added, labor taxes, and all other mandatory deductions (El Salvador).
- Tax audits applied only to larger firms, no MSMEs.
- Time limits for processing tax refunds, including VAT's.

Honduras performance. Honduras has actually retreated in this topic having ranked 144 out of 189 economies in DB 2014 to the current 164 out of 190 in DB 2018. Not only total tax rates worsened from 39.4 percent to 44.4 percent, but most local businesses, small and large, loudly complain on how the tax system is being currently administered. Also, Honduras has not made any improvements in the number of payments (48) and time dedicated to pay taxes (224 days), while other countries have made necessary reforms.

Business Licenses

International benchmark. There are many types of business licenses beyond the actual registration itself and, depending on the country, they may span different levels of authority, from the national to regional to local. These may include utility connections, construction and operating permits, tax registration, environmental certifications, as well as other depending on economic activity. Facilitating business-related permits rely on the same elements as discussed for starting a business, namely reducing time and procedures, associated costs, and discretionary application of rules. Also, best practices to address them are the same:

- One-stop shop facilities. Incorporate tax, utility, and operating permits, among others, in one application.
- Make requirements, timelines, and costs widely available. This will also increase transparency and reduce discretionality. All payments to be made online.
- Whenever possible, reduce fees.

Honduras performance. Honduras has made some progress on simplifying its business-related regulations since enacting the Law of Administrative Simplification of 2002. However, though advances in the use of automation, such as allowing registrations to be processed online, businesses are

still required to visit in person several institutions. Just as was the case with the business registration progress described in a previous section, many of these improvements are mostly available in large cities, such as Tegucigalpa, San Pedro Sula and Cortes. Businesses located in smaller towns or rural areas still face a very different situation regarding where to go to resolve permitting issues (many must travel to larger cities), the time involved, and higher costs, such as hiring local legal representatives. Fortunately, the current government, through Executive Decree No. PCM 038-2018, created the Office of the Presidential Advisor for Administrative Simplification (OPAAS), to formulate, implement, and follow up an administrative simplification strategy. Also, the private sector, through the initiatives of the CCIT and ANDI, show a strong inclination to work with OPAAS to further reduce red-tape and push for more administrative efficiency.

ACCESS TO FINANCE

International benchmark. Adequate access to finance is a key ingredient of a healthy and prosperous business environment. In places where business financing becomes too expensive or exclusionary, with only few key actors, economic activity is either curtailed or only benefits few sectors or stakeholders. Best practices to improve access to finance, particularly among new actors and MSMEs, include:

- Introduction/strengthening of credit bureaus and registries to improve sharing credit information.
- Allow utilities to report to credit bureaus, thus expanding sources of credit reporting.
- Create a collateral registry for mobile property, such as crops, farm animals and equipment, cars and machinery, etc., with clear description of assets that can be used as collateral.
- Promote secured transactions encompassing functional equivalents to security interests and creating, modern, searchable collateral registries, which are accessible online for the registration, modification, and cancellation of those interests.
- Promote efficient bankruptcy regimes. Efficiency in this matter is associated with increased access to credit for firms and on better terms, since allowing firms to reorganize instead of liquidating them reduce their credit risk.
- Create tribunals exclusively dedicated to business related conflicts, such as enforcement of contracts and unpaid debts.

Honduras performance. Honduras enjoys a strong international ranking when it comes to the stability and strength of its banking sector. It ranks 12 out of 190 countries in the DB 2018 and 38 out of 137 countries in the WEF 2017/2018. The banking sector does most of its current business in consumer spending and property mortgages. Despite its system's stability and liquidity, it is too expensive and restrictive for MSMEs, particularly in rural areas. Specifically, Honduras has one of the lowest financial inclusion rates in the region. Less than one third of the adult population has a banking account[17]. There are actors that cover micro-finance in specialized sectors, such as Banhprovi and Lafisse in tourism, and Fundación Covelo in micro-industry. The banking system lacks equity investment and incubators/investment angels to develop new businesses in value added sectors.

Although the interest rates for commercial loans are higher in Honduras than in the rest of the Central America, this has not been a particular deterrent for medium and large companies. Successive legal reforms in the financial sector have improved the quality of financial services. Nevertheless, the financial sector, despite its competitiveness, remains highly concentrated and overregulated, which

[17] https://globalfindex.worldbank.org/

leads to sustained high interest rates over time, the concentration of credit in certain regions and sectors, and limited financial services targeting MSMEs.

ACCESSING MARKETS

To successfully access markets, an economy must improve on two key issues: 1) adequate transport infrastructure to facilitate trade and 2) a streamlined administrative process for export and import compliance. On the latter issue, best practices include improved electronic submission and processing documents for exports and imports. The DB 2018 ranks Honduras 115 out of 190 economies in ease of trading across borders.

Transport infrastructure

Honduras performance. Honduras currently ranks 81 out of 137 countries by WEF 2017/2018 in road infrastructure. It has made significant investments in key transport corridors through public private alliances (PPPs) managed through COALIANZA and INVEST-H. The latter plans to improve 1,500 km of rural roads throughout the country ("*Caminos de la Finca al Mercado*") during the 2019-2021 period. These efforts to improve secondary and tertiary road infrastructure is attracting national and foreign investment interest. On the other hand, Honduras freight transport sector is plagued with informality, outdated equipment, theft/contraband, and rigid formal costs (ex. US dollar pegged fees).

To address many of these issues in a comprehensive manner, Honduras recently launched a "National Logistic Strategy 2018-2030" (Strategy) sponsored by the Inter-American Development Bank (IDB) to promote economic growth and more inclusive social development. This strategy calls on the GoH to focus efforts to strengthen relevant institutions, improve the conditions of productive and access to market infrastructure, broaden the coverage and quality of education, and promote technological upgrades. The Strategy also seeks to achieve greater productivity, stimulate the business climate, increase the country's overall competitiveness, and strengthen the country's position vis-a-vis its neighbors. A recent result of this initiative is the creation of a National Logistics Board.

Sectors that the Strategy identified as needing further public and private investment are: energy, agriculture and agribusiness, light assembly, textiles, technology services, construction and housing, mining, forestry, tourism, and infrastructure. In the agribusiness sector, the Strategy highlighted the lack of cold chain storage and transport services. This significantly affects local fruits and vegetables producers. In addition, the country lacks a comprehensive network of centers of collection/consolidation close to areas of production. The existing ones are mostly located in Comayagua. There are also collection centers in urban areas.

Information, Communications, and Technology (ICT)

International benchmark. Information and Communication Technologies (ICT) are currently a key element for any well-functioning economy. The national and foreign companies can customize their programs according to their clients' needs and provide upgrades and maintenance at very competitive costs, making access to these technologies affordable to both large companies and MSMEs. However, to have a significant impact it requires a digital culture among the business community and its willingness to invest in ICT.

Honduras performance. In Honduras the most visible and publicized ICTs are those that facilitate access to bank accounts and financial transactions, including e-payments and e-purchases, whether between financial institutions or among other international online shopping websites. Outside the

private sector, Honduras enjoys several successful ICTs ventures, such as the renowned "National Observatory of Violence" managed by the National Autonomous University of Honduras (UNAH), the HONDUCOMPRAS website, which is an important effort to make public contracting and procurement more accessible and transparent. Also, IP and CENTREX are good examples of the use of ICT to increase ease and efficiency to administrative processes and procedures.

There has been advances in the key use of e-signature in the public sector. The BCH became the first e-signature certification agency in the country in April 2017. The *Direccion General de Propiedad Intelectual* (DIGEPIH) is the agency responsible to provide accreditation to e-signatures service providers. So far, SAR, IP, CENTREX, and the Deputy Directorate of Customs Revenues (DARA) are operating with e-signatures. Despite this progress, there is no private company registered in Honduras as a certified provider of electronic signatures services.

MIGRATION OVERVIEW

The number of unaccompanied alien children (UAC) apprehended at U.S. borders grew from 16,067 in 2011 to 68,500 in 2014, and in 2015 and 2016 were 39,970 and 59,692 respectively. Youth from El Salvador, Guatemala and Honduras, or the 'Northern Triangle,' make up more than 70 percent of total UACs (DHS Border Apprehension Statistics). Honduras continues to confront acute problems in terms of poverty, inequality, inequitable access to assets and insufficiency in basic health services, education and justice. These deficiencies have created conditions of economic and social inequality for the majority of the population. It is here that emigration emerges as an alternative to survival.

There are further trends in the demographics of the typical Honduran migrant[18]:

- *Gender:* Ninety-one percent of recent (2017) Honduran migrants returned by U.S. authorities are men, compared to 86 percent of those returned by Mexican authorities.
- *Age:* adolescent or young adults, especially males, are the most likely to migrate. This is a shift from the past when male head of households were the most likely to migrate.
- *Education*: the typical Honduran returned by the U.S. has acquired a secondary level of education or higher, while the typical child returned by Mexico had a primary education.
- Geography: More than 70 percent of the Honduran migrants returned by U.S. and Mexican authorities were returned to non-urban locations in 2017, an increase from previous years.

In Honduras there is also a strong internal migration which, in the last three decades, has been directed towards urban areas, highlighting large and medium cities of attraction for immigrants, such as Choloma, Tegucigalpa, San Pedro Sula, El Progreso, La Ceiba, Comayagua and Choluteca. Fifty-four percent (54 percent) of Hondurans live in urban areas. According to projections, the percentage of the population living in urban areas will continue to grow rapidly (INE, 2015)[19]

There are no universal demographic characteristics that define Hondurans who choose to migrate. There are, however, trends across demographic categorizations[20].

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[18] USAID/Honduras. September 2018. Monitoring and Evaluation Support for Collaboration, Learning and Adaptation (MESCLA) activity under the Report: "Migration Study: Who Migrates" from DHS Border Apprehension Statistics.

[19] Dirección de Investigación Científica y Posgrado de la Universidad Nacional Autónoma de Honduras (UNAH). (2016). Migración en Honduras 1998-2015. Tegucigalpa, Honduras. Retrieved from : https://dicyp.unah.edu.hn/investigacion-cientifica/becas-i-d-i/proyectos-especiales-de-investigacion-científica/migracion-en-honduras-1998-2015/

[20] Nearly all of this research was based on interviews with individuals about the 'likelihood' that they will emigrate and interviews with returned individuals from the U.S. and Mexico. No other primary data sources on emigration were used.

FIGURE 5 Summary of Demographic Trends in Emigration Based on Returnees from the U.S.

	Pre 2016	Post 2016	2016-Present[21]
Gender	Male	Male	Increasing
Age	Head of Household	Youth / Adolescent	Increasing
Level of Education	Primary	Secondary (Increasing)	Increasing
Rural/Urban	Rural	Rural	Increasing

DRIVERS OF MIGRATION

The most commonly-cited and agreed-upon events that drive persons to illegally migrate are to:

- Search for jobs
- Escape from violence
- Reconnect with family

Search for jobs. The USAID/Honduras Local Governance Activity[22] found the highest migration intention to be jobs-related. This is supported by evidence from the World Food Program which found that the primary motivator for migration to be the search for work.[23] Fifty-one percent (51 percent) of the population is classified as underemployed with incomes below the minimum wage in force in the country.[24] In Honduras, for 2016, an estimated 500,000 young people between 15 and 25 years old did not work or study. The recent study entitled 'Ninis in Latin America', published by the World Bank (WB), confirms that Honduras is the country with the highest rate of "ninis" in the region (26.8 percent).[25]

Escape from violence. The USAID/Honduras's MESCLA Activity found that homicide rates are strongly correlated with migration.[26] A study by Vanderbilt similarly found victimization is the main driver of migration from Central America.[27] New USAID-commissioned research "…finds that one additional homicide per year in the region caused a cumulative total of 3.7 unaccompanied child apprehensions in the United States" (Clemens, 2017). There is no doubt that violence is one of the main causes for the country's emigration. Honduras, behind El Salvador, has one of the highest homicide rates in the world with 56.5 homicides per 100,000 inhabitants in 2016 (seven times the world average). This rate however has dropped by more than a third since 2011.[28]

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[21] Clemens, M. (2014). "Does Development Reduce Migration?" CGD Working Paper 359. Washington, DC: Center for Global Development. Retrieved from: https://www.cgdev.org/sites/default/files/does-development-reduce-migration_final_0.pdf

[22] USAID Honduras Local Governance (HLG) Baseline Survey Report (August 15, 2018)

[23] The WFP study found the search for jobs accounted for 79% of reasons why people migrated, while the escape from violence and desire to reconnect with family accounted for 8% and 2% respectively. The remaining 11% were reasons due to loss of crop to draught or lacking water for irrigation. Water is a hidden, yet important driver as well. Source: World Food Program. Hunger without Borders.

[24] An approach to the policies of attention to deportees in the countries of the Northern Triangle of Central America, Honduras. Ciudad Guatemala December 2016. Study and publication was carried out with the collaboration of the Konrad Adenauer Foundation of the Federal Republic of Germany (KAS).

[25] Ninis in Latin America, World Bank (WB), 2016.

[26] USAID Honduras MESCLA Activity. What Drives Migration Briefing. September 2018. Activity however found that Hondurans with the highest number of Unsatisfied Basic Needs (UBNs) tend to have lower migration rates. The implications from this study is however that the poorest citizens likely do not have the means to migrate. Further analysis of DHS data from 2017 by MESCLA identifies that the overall link between poverty and migration is more complicated.

[27] Lasusa, M. (2016). Crime, Violence Driving Migration from Central America: Reports. Retrieved from: https://www.vanderbilt.edu/lapop/news/030216.AB-InSightCrime.pdf

[28] United Nations Office of Drugs and Crime. Intentional Homicide Victims. Retrieved from: https://dataunodc.un.org/crime/intentional-homicide-victims

Reconnect with family. MESCLA found that citizens were more likely to emigrate from municipalities where large populations have already left the country. It is estimated that thousands of Honduran children and adolescents have also been left behind by parents who migrated to Mexico or the United States. Members of the extended family tend to take care of children in this situation, but nobody is legally responsible for them. In the absence of support structures, these vulnerable children and adolescents are targeted by gangs. Parents living abroad reportedly pay *coyotes* or other intermediaries to bring their children to them.[29]

MIGRATION DYNAMICS AND ROOT CAUSES

Migration is complex - there is no simple answer as to what causes it, nor a simple solution to remedy it. The Honduran researcher Vladimir Lopez Recinos notably argues that migration is a product of multiple causes, is complex and multifaceted.[30] While violence, jobs and family reunification explain the immediate drivers of migration, they are incomplete explanations. It is necessary to dig deeper to understand what the 'root causes' are for migration and to consider how these issues are interrelated.

Climate change is impacting job opportunities in rural areas

Climate change is jeopardizing the jobs in rural areas. The effects of climate change impact an estimated 60 percent of Hondurans living in rural areas (INE). In 2014 Honduras experienced the most severe drought in decades with a resulting food insecurity that had a strong influence on outmigration.[31] The so-called "dry corridor" suffered significant crop losses, which took away the income and economic and food security that agriculture traditionally provided in the area, particularly for vulnerable populations, subsistence farmers and wage laborers.

There is a surge in the number of youths entering the workforce

The youth population relative to the total population is higher than ever and many so called "ninis" are no longer in school but cannot find work. A report from the Honduran Secretary of Labor reveals that of the 291,048 unemployed in 2016, 61.3 percent were young people under 25 years, 47 percent had secondary education and the unemployment rate of university graduates was 8.9 percent.[32] The inability to find a job, progress through education, or support themselves through self-employment or farming, forces many young Hondurans to leave their homes and communities.

Youth and other vulnerable groups are marginalized from jobs

Youth reportedly lack necessary basic and soft skills to qualify for positions. Companies that provide on-the-job training tend to be larger, while smaller companies are less likely to do so.[33] The TMS GSI Analysis found evidence of discriminatory practices by employers such as reported rejection based on years of experience versus technical qualifications or unfair dismissals. There is further evidence of

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[29] Childhood and migration in Central and North America: causes, policies, practices and challenges, February 2015

[30] López Recinos, Vladimir. Causes and consequences of the migration of Hondurans to the United States. I study in two shelters of the Mexican Northeast. Final report of the contest: Migrations and development models in Latin America and the Caribbean. Regional Scholarship Program CLACSO. October 2007 Available at:
http://bibliotecavirtual.clacso.org.ar/ar/libros/becas/2005/2005/migra/lopez.pdf

[31] Source: World Food Program. (2015). Hunger Without Borders.

[32] Report of the Labor Market 2016, Secretary of Labor Honduras.

[33] USAID Empleando Futuros. (2018). Labor Market Study Honduras.

discrimination against women who are single mothers, LGBTI people, and youth from at-risk communities for potential ties to gang violence.

The economy is growing too slowly and too unequally

The transition from low to middle income status is often correlated with significant increases in inequality.[34] In Honduras, while GDP per capita grew from $3,770 PPP in 2007 to $4,986 PPP in 2017[35], migration increased rather than decrease. Honduras is the most unequal country in Latin America and the 6th most unequal globally. New jobs created are offered in low productivity sectors and the probability of exiting out of poverty is extremely low.[36] No job opportunity is a driver for both crime and external migration.

Proliferation of organized crime and domestic violence with impunity

Honduras is home to several regional branches of transitional crime organizations which engage in trafficking of illegal drugs, arms, stolen vehicles and money laundering.[37] Community-level crime exacts so-called *war taxes* on local businesses, hurting economic growth, and recruiting unemployed youth. In the period from 2004 to 2016, Honduras experienced 64,096 homicides, which translates to an annual average of 4,930 victims, a monthly average of 410 cases, that is, a daily average of 14 violent deaths.[38] Violence extends to the home as well - many women and children reportedly migrate as a result of domestic violence.[39] Honduras ranks among the top countries with highest levels of impunity (12th highest globally).[40]

Changing social structures and safety-nets

Prior migration has also changed family dynamics as children grow up in the custody of relatives without direct care of parents. Many of these families remain dependent on remittances from abroad. In 2017, remittances totaled $4.3 billion or 19 percent of the GDP. One-in-five families in Honduras benefit from remittances and of those recipients 34.5 percent report remittances as the largest source of income.[41] These factors influence where people look for a safety-net for support or relief i.e. abroad and not at home.

Looking at these root causes or dynamics, it is evident that many are interrelated:

- Prior migration of family members shifts social and support structures, which appears to pave the way for future migration as family members move abroad.
- Perceptions of youth from criminal neighborhoods spur employer-based discrimination, further marginalizing youth who become susceptible to gang recruitment.

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34 Brueckner, M. and Lederman, D. (September 2017). Inequality and GDP per capita: The Role of Initial Income. Retrieved from: http://pubdocs.worldbank.org/en/755201504498011731/inequality-and-growth-3-september-2017.pdf

35 Clemens, M. (2014). "Does Development Reduce Migration?" CGD Working Paper 359. Washington, DC: Center for Global Development. Retrieved from: https://www.cgdev.org/sites/default/files/does-development-reduce-migration_final_0.pdf.

36 World Bank Group. (2015) Economic DNA Honduras.

37 Insight Crime. (2018) Retrieved from https://www.insightcrime.org/honduras-organized-crime-news/honduras/

38 National Autonomous University of Honduras (UNAH) and the University Institute in Democracy, Peace and Security (IUDPAS). (2017). Bulletin January to December 2016, Special Edition No.53 May 2017

39 Childhood and migration in Central and North America: causes, policies, practices and challenges, February 2015

40 University of Americas Puebla, UDLAP Jenkins Graduate School and Center of Studies on Impunity and Justice. (2017) Global Impunity Index.

41 Migration International Remittances and Financial Inclusion in the case of Honduras, 2017 Center for Latin American Monetary Studies (CEMLA)

- Crime taxes businesses which in turn grow slower and contribute less in terms of taxes for government, which in turns undermines government capacity to enforce laws.
- A lack of jobs in rural areas spurs migration to urban areas, which, overcrowded, offer scarce job opportunities and security, in turn facilitating greater external migration.

MIGRATION TAKE-AWAYS

Each of the root causes and dynamics articulated above can be further explained by a range of other contributing factors. TMS is focused principally on the transformation of the Honduran economy to grow faster and more inclusively. We believe, and evidence supports, this is a core underlying cause for migration and a key contributing factor to other root causes and drivers of migration. However, this change alone is unlikely to result in a sustainable and significant shift in patterns of irregular migration. The TMS Activity's use of a market systems development approach explicitly recognizes how these issues are complexly interrelated. Acting in concert with other initiatives to reduce stress points in the market system, such as those related to youth skills or tackling impunity to violence are necessary for success. This report is the first step in active collaboration with other interested stakeholders in the effort to make a sustainable and positive change in the life circumstances of persons prone to migrate.

GENDER AND SOCIAL INCLUSION ANALYSIS

While markets matter for everyone, they are especially significant for the marginalized and vulnerable as they can provide a direct means to improve their economic standing as either producers, employees, traders, and/or consumers.[42] In Honduras, women, youth, persons with disabilities (PWDs), ethnic and indigenous minorities, LGBTI, and returned migrants, are among the most marginalized groups in the social, political, and economic spheres. Because of their often reduced social location and power, these groups experience barriers to accessing economic opportunities, a lack of agency to fully act upon these opportunities, and as a result, experience less benefits because of their lack of inclusion within market systems. This is not to suggest that these groups are not economically active, but rather, they are often operating in the informal sector in tenuous occupations with low quality of job satisfaction, security, and pay. This report integrates gender and social inclusion considerations within each of the economic sectors. Below are the themes related to gender and social inclusion that emerged across sectors.

GENDER AND SOCIAL INCLUSION THEMES

Economic participation. Marginalized and vulnerable groups are economically active, but often operate in the informal sector with a lower quality of participation, resulting in lower job satisfaction, a lack of security, and lower pay, among other things. Informal work is often less visible, less profitable, and perceived to be less valuable. Several sectors analyzed noted a general lack of market actors that belonged to marginalized and vulnerable identity groups such as logistics and light manufacturing. While TMS has identified potential opportunities for inclusion of marginalized actors in these sectors, the current snapshot of the sector shows very little participation of these groups, and where they are engaged, it is often within the lower end of the value chain and in less profitable functions. In contrast, several sectors currently employ many marginalized and vulnerable groups and groups have the opportunity to take advantage of opportunities in these sectors. These sectors include value-added agriculture, tourism, lodging, food services, whole-sale retail trade and arts and entertainment. For example, while women often predominately work in the production of high value fruits and vegetables, there remain opportunities to further enhance their participation in commercialization through value-

[42] The Springfield Centre. (2015). *The Operational Guide for the Making Markets Work for the Poor (M4P) Approach.* 2nd edition funded by SDC & DFID.

addition, processing, and marketing. This would also result in higher incomes for women as they are able to take on new and higher-value functions within the value chain. Similarly, for ethnic and indigenous populations, there are opportunities to expand beyond production and focus on upgrading their sales and distribution of cultural food and artisanal products.

Wage Disparities. Across sectors and sub-sectors, marginalized and vulnerable groups reported often being paid less than their counterparts despite performing the same job and level of effort. These wage disparities are most pronounced for women, ethnic and indigenous minorities, and persons with disabilities. For example, women reportedly earn less than men in similar roles and sectors, with men earning an average of 1.15 times more than women. As we begin to look at rural areas, we see even greater wage disparities, where rural women earn only 46 percent of the total income received by women employed in urban areas, only 75 percent of the total income received by males in rural areas, and only 36 percent of the total income of males in urban areas. [43] Some of these wage gaps can be attributed to discrimination, paying certain groups less for the same work because of internalized biases and perceptions about the value afforded to one groups' work over another. Other reasons for wage disparities are reported to be differences in education and skills development that result in higher or lower skilled labor. In some cases, especially for people with disabilities, these could also be perceived differences in skill levels based on internalized attitudes about the capacities of those with disabilities. For females especially, their role in the care economy disproportionately affects their ability to participate in the formal economy, as they take gaps in employment when they get pregnant, care for children, and care for the sick, or turn down certain types of opportunities because of a lack of flexible working conditions, including hours, childcare services, etc. Based on focus group discussions and interviews conducted as a part of the GSI analysis, men reported spending 1.6 hours more on productive work per day than women, and women reported spending more than six times the amount of time than men on domestic unpaid care work per day. Women's role in the care economy impacts their ability to generate equitable incomes and often results in wage disparities.

Market-relevant skills. For all groups and across all sectors, a major constraint is the lack of capacity, especially market-relevant skills. In the GSI analysis, the effects of a lack in skills was felt most acutely by youth, who found it difficult if not impossible to obtain formal employment because of their lack of qualifications. These skills include technical, business, language, and soft skills. For example, in the tourism sector, there is a need for English and other language skills, technical knowledge, and financial and accounting skills. In addition, all groups need soft skills to effectively work in a sector with a customer service orientation. Education and workforce development initiatives that are equipping youth with skills need to be demand-driven and aligned with the prioritized sectors. One critical element of this is building feedback loops between employers and the education/skills sector, so that as labor market demands change, change is triggered in skills-building programs. Across sectors, there are also very few market actors that employ work-based learning opportunities for marginalized and vulnerable groups to "skill up" on the job.

Access to resources. Across sectors, a general lack of access to productive resources, including land and finance, precludes most marginalized groups from enhancing their positions in economic sectors or value chains. As investigated in the GSI analysis, limited access to finance was mentioned by all groups, with respondents noting that financial products and services often did not consider their needs, including collateral requirements and repayment terms. Lack of access to finance was reported by almost every group as a key impediment to creating or growing a business. While this theme has broad

[43] CEM-H. (2018). *Informative Bulletin on women's situation* .

application for all of the investigated sectors, it will most notably impact the wholesale-retail trade sector, value-added agriculture, and the subsector related to food and restaurants within the tourism sector as those are the areas, which can have job creation and growth opportunities for women- and minority-owned MSMEs.

Identification and belonging. One interesting conclusion from this assessment, was the ability of some sectors to create opportunities for positive identity shaping and social belonging among historically marginalized and vulnerable groups. Creating inclusive market systems afford marginalized and vulnerable groups an opportunity to engage in spaces where they previously were excluded. It also is an opportunity to influence and change these systems to better reflect their needs and realities as well as slowly change discriminatory attitudes and perceptions. For example, the tourism, lodging, and food services, the value-added agriculture, and the arts and entertainment provide opportunities for ethnic and indigenous populations to preserve cultural traditions while simultaneously earning a livelihood from it and sharing their culture with others. This, in turn, could be an excellent tool to motivate youth to stay in their communities. Currently, Garifuna youth report[44] that they cannot stay in their communities due to a lack of education and a lack of economic opportunities. When they do secure employment outside of their community, their quality of life is diminished, and they lack motivation because they are often disconnected from their culture and way of life. Through promoting sectors that have opportunities for inclusive growth for ethnic and indigenous minorities, TMS could have positive spillover effects in a range of other systems related to feelings of belonging and positive identity.

Infrastructure. In addition to the discrimination that people with disabilities face, there is also a lack of investment in infrastructure and assistive technologies that could better promote the inclusion of persons with cognitive and non-cognitive disabilities.

Rules and norms. As investigated in the GSIA report[45], formal and informal rules are major barriers to the economic inclusion of marginalized and vulnerable groups in Honduras. Despite the fact that there are legal protections afforded to marginalized groups in Honduras, all groups reported that these laws, policies, and regulations were often not enforced or upheld. In cases where groups or individuals tried to advocate for their legal protections, they were often met by corruption, a justice system that either delays cases or disregards them, and a lack of power to influence decision-making. Discrimination is also reproduced within institutions, resulting in discriminatory hiring practices, workplace harassment, exploitation, and abuse, which transects sectors. Similarly, informal rules, including cultural norms and beliefs, are prevalent in reproducing and reinforcing gender inequality and social exclusion across and within sectors. These norms and beliefs permeate society including households, communities, government, education, and economic systems. These norms dictate which roles are appropriate for different groups of individuals and limit the types of relationships that are socially acceptable. Social norms can further dictate who has access to and control over resources and who makes decisions over what aspects of the political, economic, and social spheres. Often when individuals do not conform to what is socially deemed appropriate, they are subjected to some form of discrimination and violence.

DESIRED SYSTEM-LEVEL CHANGES

[44] Based on findings from Gender and Social Inclusion Analysis, draft submitted to USAID July 13, 2018

[45] ACDI/VOCA, Gender and Social Inclusion Analysis Report submitted for approval to USAID on July, 2018 Information shared during the Pause and reflect meeting held in September 2018.

The analysis focused on identifying the underlying root causes that result in economic exclusion and to identify new pathways to increase inclusion of marginalized and vulnerable groups. To this end, TMS identified five system changes directly related to gender and social inclusion.

Companies hire more vulnerable people, offering more fair and equitable salaries and protecting employee rights. As stated by vulnerable groups, employer-based stigma and discrimination represent a major impediment to either securing employment or obtaining a fair salary. There are significant wage gaps noted between indigenous population throughout the sectors. For example, Maya-Chorti women reportedly received less than the minimum wage while working in hotels in the Copan area. There are also reported cases of discrimination against LGTBI community members. For example, interviewees indicated that gay youth who have a more feminine appearance find it hard to find employment.[46] Indigenous populations and Garifuna sometimes are seen by the mestizo and white population as lacking capabilities to learn and are discriminated against simply because of the color of skin and their appearance. Employers reportedly reject youth that come from neighborhoods that are considered of high crime/violence thinking that they belong to a gang, will steal from or extort them. Women are perceived as less qualified when having to take time off from work to have children and care for them. Women often bear the brunt of caring for other sick family members. Companies reportedly that they do not see women as a major contributor to their bottom line or want to invest in them because they have domestic responsibilities that makes them less "dependable" than men.

While some forms of discrimination were certainly overt, others appeared to be more unconscious or implicit biases. It was not always obvious that biases were recognized. Partnerships with the private sector to increase their awareness of their implicit and explicit biases and take positive actions would create more inclusive hiring practices. There is a lack of knowledge about capabilities and economic contributions of vulnerable population in general. Building the business case for marginalized groups such as women, people with disability and youth, and increasing awareness of enterprises about the benefits of diversity could motivate enterprises to be more proactive in reducing workplace-based discrimination. This would benefit companies to increase competitiveness as they recruit and retain new, diverse, and skilled labor. There is a lack of resources on the part of employers to develop inclusive hiring practices e.g. assistive technology or infrastructure for persons with disabilities could be perceived too costly by employers. The limited mandate/policy from the public sector (government) that requires and enforces non-discrimination and decent work conditions from employers, limits incentives for employers to take these actions. To create positive pressures for companies to promote inclusion, certification of companies that adopt standards may help to motivate inclusive practices. At the same time, there is a need for a stronger public mandate, including enforcement, against discriminatory practices. Other practices such as applying tax incentives could further strengthen inclusion initiatives. These incentives could revolve around equal pay for women, provision of maternity and paternity leave, or establishment of childcare centers at work, etc. The current law protects PwD states the number of that should be employed in every company depending on the total number of employees.

The feasibility around these changes is uncertain but have a potentially high impact. Potential partners in these interventions would include COHEP, Associations of PwD, indigenous populations, women, youth migrants, LGTBI, Secretaries of State, other USAID activities (HLG, Unidos por la Justicia), civil society groups, *mancomunidades* and municipalities. There may be preconditions to these changes

[46] ACDI VOCA, Gender and Social Inclusion Analysis Report submitted for approval to USAID on July, 2018
Information shared during the Pause and reflect meeting held in September 2018.

– notably stronger constituencies of marginalized persons to be able to generate pressures that will motivate consumers and public agencies to implement these measures. A more elemental strategy, see below, would be to strengthen associations of vulnerable groups, to be an interlocutor to help in the implementation with initiatives such as the seal of social inclusion. There is a more fundamental need to work with civil society to demand the enforcement of laws that favor inclusion at the workplace that encourage equal opportunities for a decent employment.

Companies offer work-based learning opportunities to young people to acquire necessary skills. Most vulnerable persons have access to basic educational centers in their communities. These institutions often do not equip them with quality education or skills to succeed. For example, young people acknowledged a lack of soft skills and work readiness skills as a limiting factor to securing employment. Specific skills noted by youth that could improve their opportunities for employment include: job interview techniques, public speaking, team work, conflict resolution, and professionalism.

"*As young people we have to empower ourselves before the person/company that is going to hire us; if we do not express ourselves in the best way, we will not convince the person who interviews us." – female youth, San Pedro Sula*

In the absence of receiving these necessary skills in the education system, employers can provide workplace-based learning opportunities. For example, in Honduras some of the large fast food franchises have set-up vocational training programs to provide a set of skills that their employees need to be successful at work achieving the goals of the companies. These jobs become stepping stones for young people to acquire soft skills that are not taught in high school or college. Such examples demonstrate that there can be a dual benefit for companies to invest in work-based learning given the potential efficiency gains. Most companies reportedly look inward in the promotion of talent, often looking towards friends and family networks. More effective vocational skills building may help companies to look more outward. From an inclusion perspective, this would potentially involve young people, who are currently discriminated against due to low soft skills, there is a need for a curriculum reform.

Interviewed companies however suggested that they do not see the value of providing training or that it was not their responsibility to undertake it. Others did not trust the quality of professional training by vocational institutes and consider it to be worth the investment. Developing the business case for the value of training, in terms of reduced turnover or better performance, would make the private sector realize that such work-based learning is worth the investment. Training centers and formal education are also reportedly not teaching market-relevant skills. There is a disconnect between educational centers and private sector businesses. Partnerships with the private sector would enhance training content to specifically meets their needs**.** Engaging the private sector to work more closely with training centers to adapt curriculum to their needs and/or as a part of CSR or shared-value work having them teach a skill they use in their work, would expose students to different career paths, and benefit the company because they are investing in the future workforce. For smaller companies that cannot afford the investment costs of developing a curriculum adapted to their needs, it is possible to work through chambers or associations to develop curricula that meets needs of members.

There are USAID and other donor Activities working precisely on this area, (in the DO1 zone), such as the USAID Empleados Futuros Activity, and ProJoven implemented by Swiss Contact. This high leverage opportunity is noted because of its significance, and the potential for the TMS Activity to coordinate with those workforce development programs and other private and public entities to

strengthen private sector investment in this systemic area. It is especially relevant for DO2 where there is not a strong presence of donors assessing training content and curriculum more market-relevant and building the business case for private-sector are clear areas for synergistic intervention.

Inclusive communication strategies are implemented with both the private and public sector to reduce biases, stigma and discrimination against vulnerable groups. Negative cultural norms and beliefs are learned, reinforced, and reproduced in a variety of systems whether households, schools, communities, or workplaces. Both males and females teach and reinforce norms and belief within the household telling young men or boys "*to stay out of the kitchen, don´t wash your plate, that´s for girls…"* To have an impact in this behavior area, it is necessary to improve the public and private perception of stigmatized groups in multiple systems or domains. Gender norms for example are learned at home and from peers at school. If these norms are not refuted in public, they become societal standards and institutional practices as well. For instance, women are also looked over when applying for non-traditional jobs, for example, in agriculture:

"I am an agronomist, trained at the university level, and I have had the door closed on me because I am a woman. It is difficult because it´s a career that promotes machismo, and the women look less qualified" – female interviewed in La Paz

In the case of PwD, discrimination is often based on lack of information about what these people can do and their needs. There is a general lack of culture and understanding of disability in the country, many people do not know how capable PWD are or could be while working in different productive sectors. Men, too, can be constrained by gender expectations. In Honduras, where there is a mutually reinforcing link between toxic masculinity and violence. Men, especially young men, can be at risk if they do not conform to gender expectations. Men are the gatekeepers for gender equality and should be targeted and included in efforts to promote gender equality and reduced discrimination in society.

There is an opportunity to engage men to create new forms of gender-equitable and non-violent masculinity, leveraging entertainment and media to model new masculinities and provide another source of information beyond family, friends and school. Such an initiative would be part of an integrated Social Behavior Change Campaign (SBCC) bringing together public and private stakeholders, as well as societal influencers to message more inclusive norms.

Perceptions are difficult to change and may take years to do, but when they change they tend to prevail. These changed perceptions can also pass through family and peer networks. There are a variety of partnerships possible with other USAID activities that have started SBCC campaigns such as Unidos por la Justicia to develop and reinforce these messages. The contribution from TMS Activity could include bringing private sector leaders into the conversation to lend credibility and weight to messages.

New and more inclusive services for women-, youth- and minority-owned entrepreneurs are established. Entrepreneurship is an alternative pathway that provides opportunities for marginalized groups that cannot secure formal employment. Youth and women entrepreneurs, either as first-time entrepreneurs or as existing microenterprises that have a growth-opportunity, also contribute to broader economic growth. Women-, youth-, and minority-owned enterprises at the microenterprise level notably lack finance and better market linkages with other market actors. Women-owned firms tend to be smaller and are at the lower end of the value chain functions e.g. primary processing and local market distribution and retailing. Women reportedly have less access to finance to grow their business because they have less collateral - they own less property and assets and might also have weaker credit

histories than men. This helps to explain why they are concentrated in less capital-intensive firms.[47] This situation does not allow them to expand or diversify their services. Strengthening the connectivity of these enterprises to more advantageous market actors suppliers, buyers, financial institutions, BDS firms, etc. would likely have a significant impact and improve their relative position in the market system.

The entry requirements for supply and distribution chains of large companies are high for microenterprises, particularly vulnerable-person owned microenterprises. There are opportunities to develop alliances with companies such as La Colonia or Walmart, or input supply companies to identify opportunities for young freelancers, agents or franchisees with companies to engage in the supply and distribution chains. Example opportunities for entrepreneurs might be i) the establishment of plantain and cassava peeling operations ii) honey production iii) pig fattening operations in alliance with meat processors iv) organic egg production for retailers v) resin and other non-timber forest products in alliance with buyers vi) tortilla production with local restaurant chains vii) recycling businesses with municipalities. There is a need to establish the template for such replicable business models (such as manual and corresponding support services) that would allow youth, women and minority entrepreneurs to learn a specific business with lower risk and with more minimal investments. Partnerships with local business services entities such as CDEs to train and certify these businesses to be able to participate in supply or distribution functions. In addition, there is a lack of social capital gained through advantageous business relationships and capacity among marginalized group-owned enterprises. Potential solutions to the lack of social capital - gained through advantageous business relationships - include tailored capacity building and technical assistance from local BDS and other service providers. Promoting women business networks or youth business networks could help these entrepreneurs to access technical support, advice, and build connections within a supportive and familiar environment offer strong potential since they will have related to a more open network of information. Finally, working with the financial sector to better meet the needs of female and other marginalized groups interested in creating or growing their own MSMEs would potentially alleviate financial constraints for youth- women- and minority-owned microenterprises. There is potential to train financial institutions to better understand their client base and develop female- and youth- friendly financial products.

Young people are often positioned to take on these entrepreneurship roles (or self-employed) as they tend to be highly mobile, motivated and with a relatively high-level of education. There are a wide variety of partners willing to participate in this intervention. If a model is proven, there is a high potential for copying. Potential partners are large companies such as La Colonia or Walmart, as well as CBDs that may be positioned to provide training. Other partners could include USAID activities, such as MERCADO, as well as a large number of NGOs dedicated to providing assistance to these farmers.

Municipalities support inter-sectoral processes through public policy that foster the inclusion of vulnerable groups into market systems and political areas. In Honduras there are laws, regulations, and policies that protect marginalized groups, however, these are not well enforced. At a local and national level, public policy needs to be strengthened. For instance, for women, youth, and PwDs, the law of municipalities states that they should allocate 5 percent of the budget to carry out activities for these populations, however, this is not specifically met for any of the groups. One women's rights

[47] How does gender affect the participation of SMEs in international trade? 2016. Retrieved from http://www.intracen.org/news/How-does-gender-affect-the-participation-of-SMEs-in-international-trade/

activist expressed frustration that there was often no gender-based budgeting, leaving national and local gender efforts resource-constrained. There is no entity to monitor compliance and therefore there are no sanctions for municipalities that do not comply with the provisions. Although the Labor Code establishes the equality of labor rights, there are no rules that protect specific cases, including denying women work because of marital status or pregnancy. There is policy on incentives companies can receive as a part of Corporate Social Responsibility where they employ a percentage of people from excluded groups, but often this is not enforced or taken advantage of.

For example, in Ocotopeque, one participant noted:
"According to the law of equity and development for people with disabilities under Article 35, each public or private institution can have 4 disabled in the company, but in Ocotepeque, this is not practiced…the only one that meets with Article 5 is the mayor, because they have 4 people with disabilities working there." – male respondent, Ocotepeque

The justice system either delay cases or ignores such cases due to apathy and a lack of political will to enforce the law. Overall, there is a lack of consciousness about the importance of inclusion at the municipal and national levels. There is an opportunity to strengthen civil society organizations which are weak to better advocate for enforcement of cases of discrimination. There is a need for these organizations to be trained and strengthened through capacity building, agency and leadership, so that they can demand the enforcement of the different laws that protect their rights and, proposed new public policy adapted to their community/municipality. In some cases, marginalized groups are not aware of laws and policies that protect their rights. To address the lack of information, compliance and respect to human rights, it is necessary to create SBCC campaigns to promote law enforcement.

There are opportunities to develop alliances with other USAID activities that are currently working with municipalities, transparency and law offices such as Unidos por la Justicia, Honduras Local Governance and others. Other partners include AMHON and Secretary of Human Rights to provide training on law enforcement in a continuous manner. There is some uncertainty as actors have their political agenda and interests, and maybe inclusion and strengthening civil society organizations is not a priority for them. The ability to make progress in this area is important however to reducing the culture of impunity and ensuring protection of vulnerable and marginalized groups.

NETWORK ANALYSIS

ANNEX I NETWORK ANALYSIS

INTRODUCTION

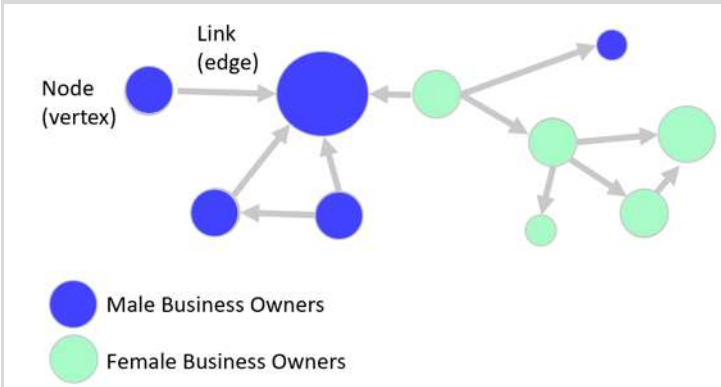
Social Network Analysis (SNA) quantifies, visualizes and analyzes the frequency and type of relationships between a given set of actors. The objective of this SNA is to better understand the environment and support services available to enterprises across the sectors analyzed by TMS. Enterprises surveyed are those that participate in the market systems analysis interviews. The survey asked each enterprise to list up to three current or recent (within the past six months) service providers in the following eight categories:

- Accessing finance (credit, insurance, etc.)
- Managing business processes (HR, accounting, advertising, etc.)
- Launching new products or services (R&D, market intelligence, etc.)
- Making strategic decisions (business advisory, consulting, etc.)
- Finding buyers or business contacts (networking, trade fairs, etc.)
- Training staff (vocational institutions, etc.)
- Engaging in advocacy (lobbying, policy engagement, etc.)
- Securing a permit, license, etc. (institutions, etc.)

Respondents were asked follow-up questions for each service provider listed including the organization type, their perceived value to the business on a scale from 1-5 (one representing minimal value to the business and five being critical to business operations and/or success), as well whether reasonable and accessible alternatives existed for each provider. For any business value responses of 1 or 5, respondents were also asked to explain why those providers were perceived as more or less valuable to their organization than others. The survey was deployed to 196 enterprises via SurveyMonkey. Attempts were also made by phone to contact any enterprise for which an email was not available, and to conduct follow-up with those who were emailed but did not submit a response. Responses were then aggregated for all 10 sectors and uploaded to the visualization platform Kumu where the relationships among and between sectors are displayed as navigable network maps as shown in the results and findings sections below.

Figure 6 How to read a network map

Network Maps. Network maps display the different entities in a network – called nodes or 'vertices', and the relationship between them called links or 'edges'. Nodes are often colored differently based on characteristic of the node called 'attributes' – such as blue for male business owners and green for female business owners in the example network to the left. In addition, nodes can be sized differently depending on their position in a network. The sizes are determined by different 'metrics' – statistical measures calculated for each node in the network. In the maps below, nodes are sized by *'in-degree'* or the number of incoming connections reported (times respondents indicated that the entity provides a service to their enterprise) for each. A node which the network depends more on



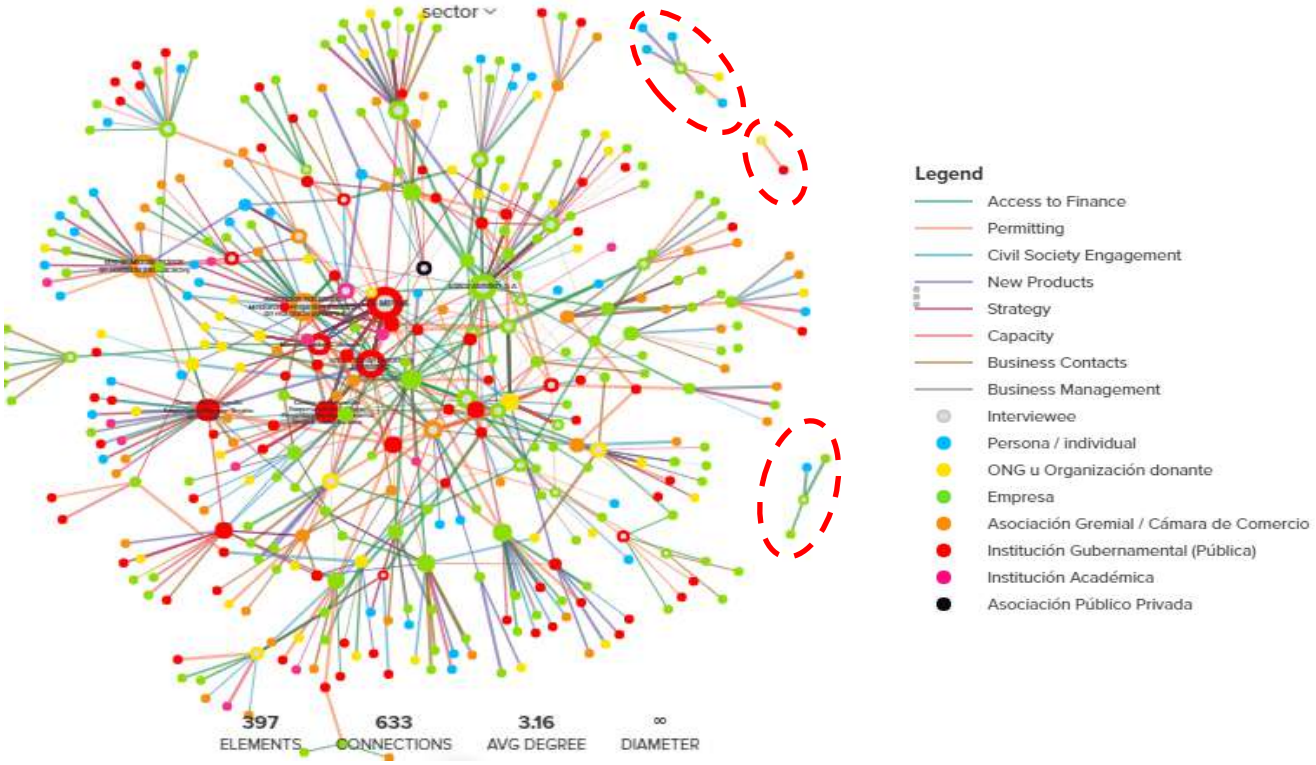
can be displayed as being "larger" than others. Network maps displayed in this report show nodes – the circles in the map, which each represent an organization or individual (those with a grey dot in the middle represent survey respondents, also referred
The maps are automatically generated by the online systems mapping platform, Kumu.io, using a standard layout algorithm. The position of nodes in a given map varies depending upon the purpose of the visualization and generally does not reflect distance of specific actors or groups from each other. Ungrouped maps tend to position the largest nodes (those with the highest number of connections) at or near the center, while those with the fewest connections tend to be at the periphery. The coloring scheme for each of the nodes is based on the organization type of the enterprise or service provider according to the colors shown below and the edges are colored based on the type of service being provided. All maps contain directionality (arrows), although this is generally difficult to see in highly populate. *Note: We do not suggest utilizing maps alone for interpretive purposes, especially those that are the largest and most complex. We suggest referencing the tables and metrics provided within, and included in this report, when conducting in-depth analysis on specific actors. This also includes utilizing the links provided below each map to view and navigate the full-sized maps on Kumu.*

RESULTS

There were 72 across all 10 sectors. The 72 respondents reported a cumulative 631 connections with 325 external actors (397 nodes). It should be noted that 22 of the 72 survey respondents were also cited as service providers by others. The network analyses revealed a number of surprising and interesting findings within and between the selected sectors. The first of these being what is known as the 'small world' phenomenon. This refers to the fact that although respondents did not select service providers from a pre-defined roster, the resulting network is almost fully connected. In this network, 69 of the 72 respondents have at least one service provider in common with at least one other enterprise surveyed. The three unconnected components in Figure 1 below represent the three respondents that did not indicate shared connections with any other enterprise.

Figure 7 Responses by Sector	# Responses
Arts and Entertainment	12
Value Added Agriculture	11
Financial Services	9
Tourism	8
Wholesale and Retail	8
Water and Sanitation	7
Business and ICT Services	6
Productive Infrastructure	4
Light Manufacturing	4
Transport and Logistics	3
TOTAL	**72**

Figure 1 - Full 'Small World' Network (unconnected components circled)



In exploring the 'small world' phenomenon further, it is clear that there are a several key service providers / provider types responsible for connecting the network, the most prominent of these (based on unique connections) being banks. Both the network analysis and feedback from TMS project staff indicated that there are only a handful of banks that provide the majority of the country's banking services, most notably: BAC (n=9), Banco de Occidente (n=9), Banco Atlantida (n=9), and Ficohsa (n=5). Second to financial service providers, government institutions focused on economic development are also highly central, as defined by number of in-degree connections. This includes the Centro de Desarrollo Empresarial (CDE- MIPYME) (n=6) and the Secretariat for Economic Development (n=5).

Across the sectors there are also a number of structural similarities across that will be highlighted in the subsequent sections of this report. A few of these cross-sectoral patterns include:

- Expansive government presence
- Lack of market-based support for new product development / innovation
- Low perceived value of business associations
- Limited use and availability of professional training and capacity building services
- Limited connections between private sector and academic institutions

The following sections outline findings by service provider type, service category, and by sector. Colored cells in the tables provided correspond to high or relatively high figures (green), low figures (orange), and potentially interesting or surprising figures (yellow).

FINDINGS BY SERVICE PROVIDER TYPE

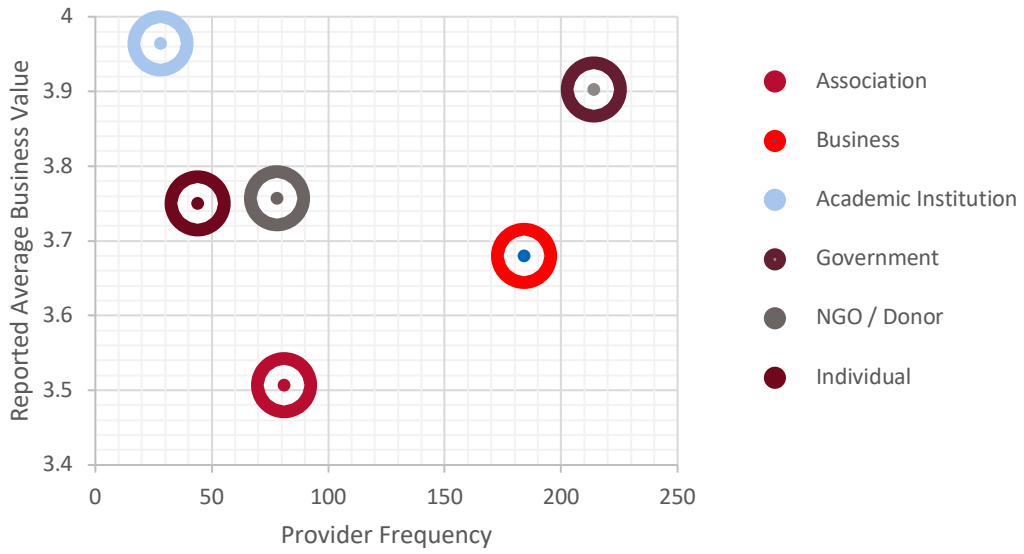
Overall, businesses (n=127) and government institutions (n=80) dominate the network of service providers. Academic institutions have the smallest representation (n=12).

Figure 8 Number of each service provider type, respective connections, and average business value

Provider Type	# of Providers	# Connections	Average Value
Business	127	184	3.68
NGO / Donor	43	78	3.76
Association / Chamber	53	81	**3.5**
Government Institution	80	214	**3.9**
Academic Institution	12	30	**3.97**
Person / Individual	38	44	3.75
Other	1	2	4

On the other hand, academic institutions have the highest average rating for perceived value of services provided (3.97). In contrast, associations and chambers of commerce (n=53) have the lowest average business value score (3.5) of any service provider type.

Figure 9 Perceived value vs. provider frequency



FINDINGS BY SERVICE

The most commonly cited services are access to finance (n=120), permitting (n=105), and business management / operations (n=83). Least cited were launching new products or services (n=54) and strategic decision-making (n=55).

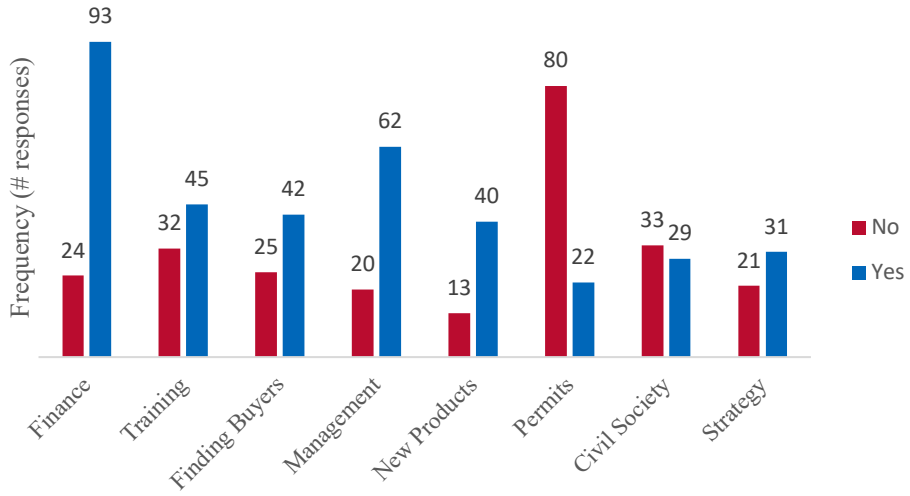
Figure 10 - Number of each type of service reported, number of entities providing and receiving the service, and average business value

Service	# Enterprises Using Service	# Service Providers	# of Connections	Average Value
Access to Finance	49	60	120	3.9
Business Operations	42	68	83	3.67
Licensing / Permitting	52	48	105	**4.0**
Capacity Development	41	43	80	**3.45**

Identifying Business Contacts	32	50	69	3.7
Strategic Decisions	32	42	57	3.6
Civil Society / Advocacy	32	49	59	3.8
New Product Launch	29	36	53	**3.89**

Respondents reported that reasonable, accessible alternatives exist for 364 of the 631 connections. Relationships for which alternatives *do not* exist have a higher average business value (4.1) than those for which respondents indicated the availability of alternatives (3.55). Of the 'no alternatives' group, service providers given a business value of either 1 or 2 (minimal or below average) (n=22) corresponded largely to two services: obtaining permits, licenses, or other legal requirements (n=8) and capacity building / training (n=7). For all relationships of minimal or below average business value (n=87), 21 are associated with capacity building / training services (more than any other service type).

Figure 11 Availability of alternatives by service type



FINDINGS BY SECTOR

In the following section, the network analysis findings are broken down by sector. The analysis for each sector includes a quantitative breakdown of the services used, service provider types, and the perceived business value of reported relationships. Because of low response rates in the Productive Infrastructure, Transportation and Logistics, and Light Manufacturing sectors, the findings from these have been grouped into a single section.

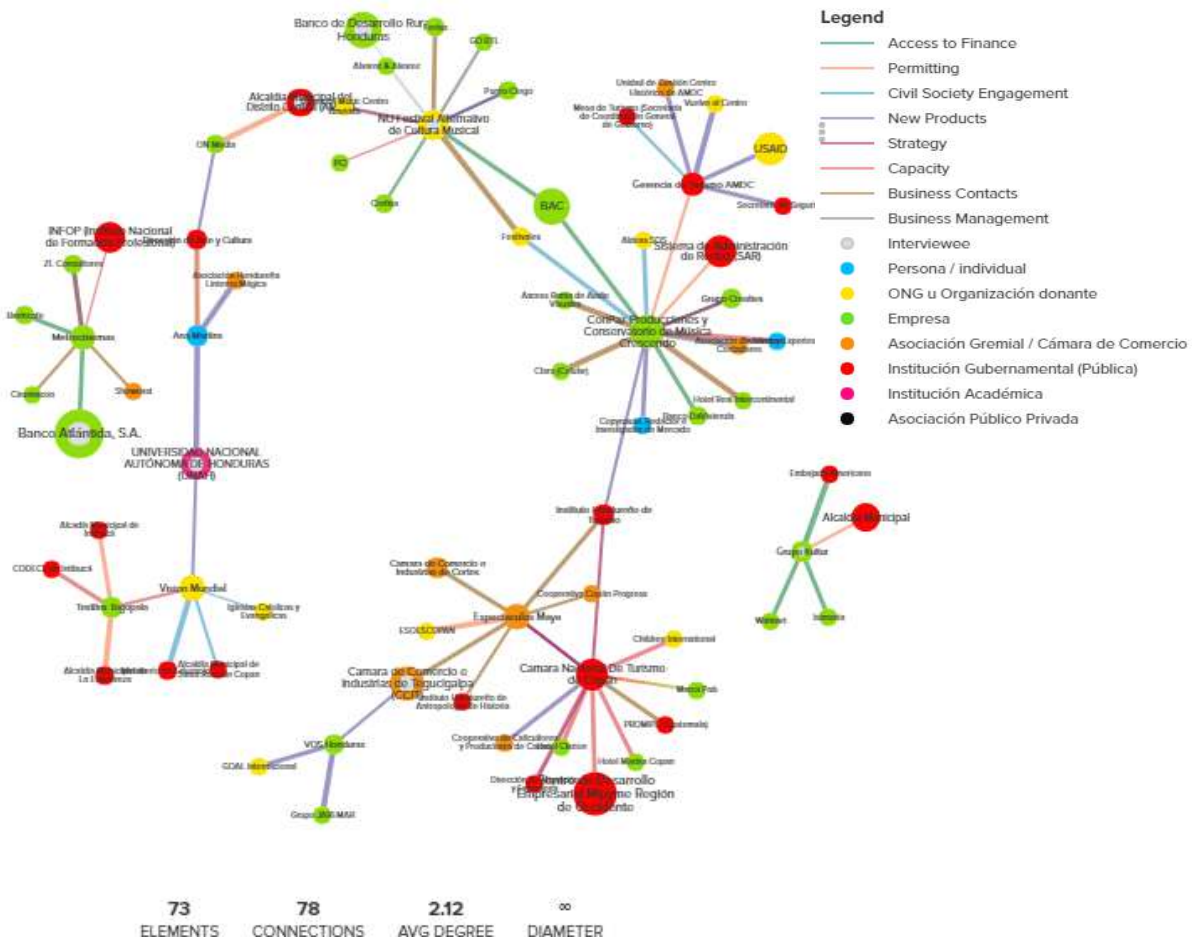
Arts and Entertainment. 12 respondents (the most of any sector) reported 78 connections with external service providers. More connections corresponded to support services for 'launching new products / services' (n=16) than any other service category. All six provider types are represented in this service category with associations and chambers of commerce being indicated only slightly more often (n=5) than others. The most frequently cited service provider types were businesses (n=27) and government (n=25). The average perceived value of the services provided to enterprise respondents by both businesses and government institutions is 3.56, falling below the overall network average of 3.76 and the sector average of 3.69. For services provided by business entities, the lowest average value (2.8) was reported in the category of business management processes. For government institutions, services supporting participation in civil society / advocacy activities were rated the lowest with an average perceived value of 3. Service providers listed by more than one respondent in

the sector include: Instituto Hondureño de Turismo (n=3), Alcaldia Municipal del Distrito Central (AMDC) (n=2), UNAH (n=2), World Vision (n=2), and the Dirección de Arte y Cultura (n=2).

Figure 12 Service provider types and corresponding services provided to enterprise respondents

Services (Arts and Entertainment)	Association / Chamber	Business	Academic Institution	Government	NGO / Donor	Person / Individual	TOTAL
Access to Finance		9		1	1		**11**
Capacity Building		4		3	2	1	**10**
Finding Buyers / Contacts	4	5		3	1		**13**
Management Processes	1	5					**6**
Launching New Products / Services	5	2	2	3	3	1	**16**
Permits / Licensing / Legal Requirements				7	1		**8**
Civil Society / Advocacy				5	3		**8**
Strategic Decision- Making		1		3	1		**5**
TOTAL	**10**	**27**	**2**	**25**	**12**	**2**	**78**

Figure 13 Network map Arts and Entertainment

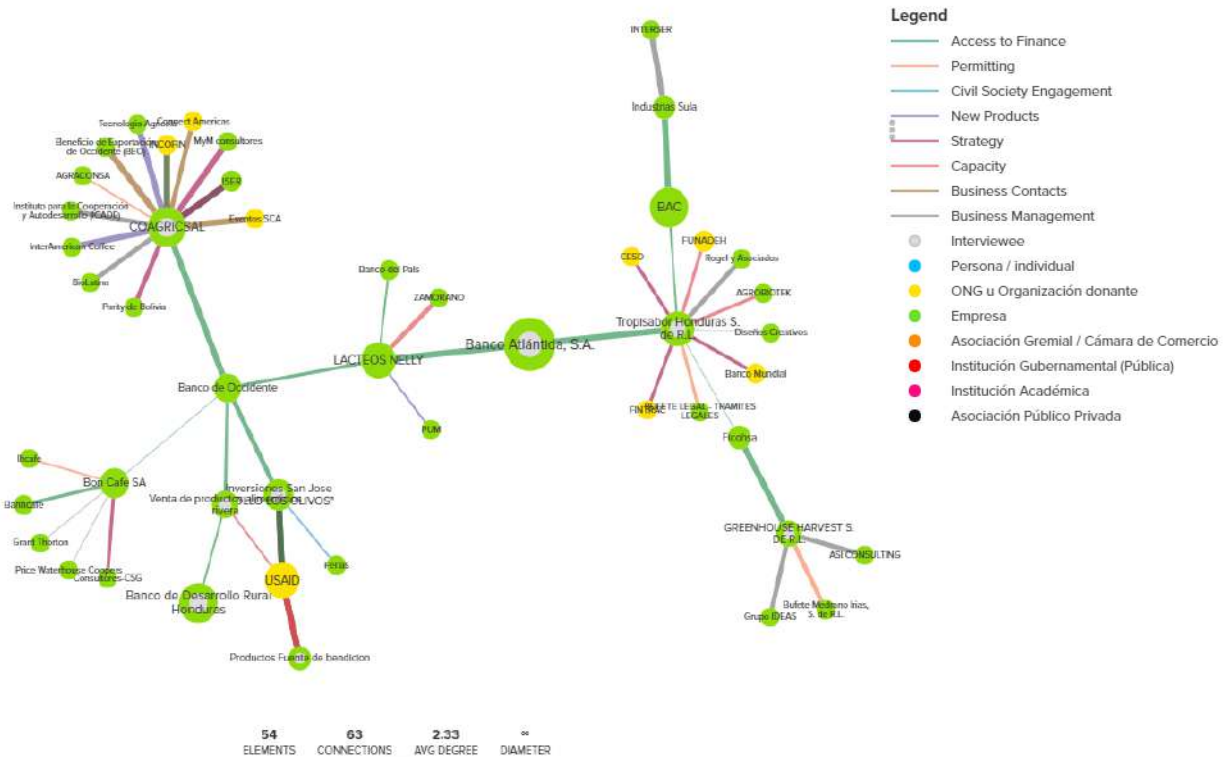


Value-Added Agriculture. In VAA, 11 respondents reported a total of 111 relationships with external service providers. NGOs and donor organizations have the most significant presence in the sector (n=21) compared to the other sectors analyzed. The most common service provided by NGOs and donor organizations is strategic decision-making support. The average reported business value of strategic decision-making services by VAA enterprises is 3.3 – lower than the average value of all services in the VAA sector (3.55). Use of external capacity building / training services also accounts for a significant number of connections (n=15) and is second highest among VAA respondents compared to those in other sectors. However, the average business value attributed to capacity building services in the sector is only 3.3. A less frequently cited relationship type service is support for launching new products or services (n=7). As a service provider, academic institutions are only cited once. Service providers reported in the VAA sector with the most unique relationships include SENASA (n=5), Banco de Occidente (n=5), Secretaria de Salud (n=4), and USAID (n=3).

Figure 14 Service provider types and corresponding services provided to enterprise respondents

Service (Value-added Agriculture)	Association / Chamber	Business	Academic Institution	Government	NGO / Donor	Person / Individual	TOTAL
Access to Finance		14		3	2	1	**20**
Capacity Building	2	3		5	5		**15**
Finding Buyers / Contacts	4	2		1	4		**11**
Management Processes	1	11		1	1	1	**15**
Launching New Products / Services		3		2	2		**7**
Permits / Licensing / Legal Requirements		4		20	1		**25**
Civil Society / Advocacy	4	1		1			**6**
Strategic Decision- Making		4	1		6		**12**
TOTAL	**11**	**42**	**1**	**33**	**21**	**2**	**111**

Figure 15 Network map Value-added Agriculture

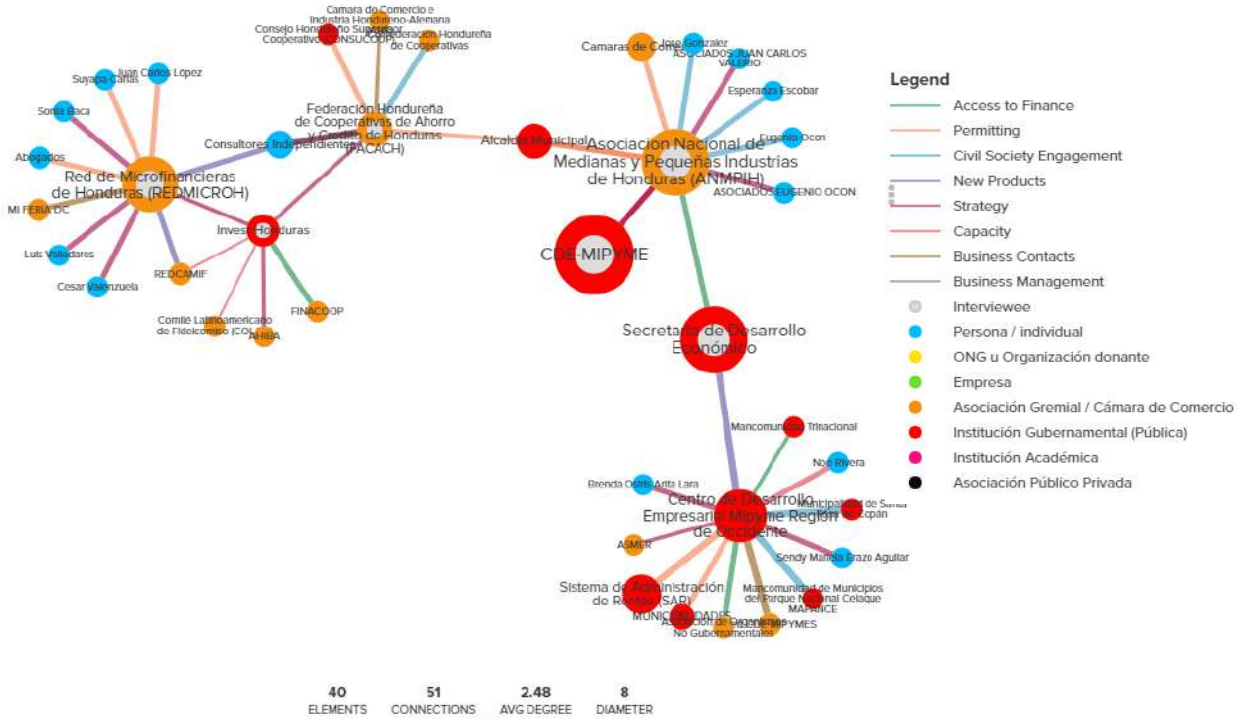


Financial Services. In financial services, nine respondents reported a total of 127 relationships with external service providers (more than any other sector). Most interesting in this sector is the high instance of support services being provided by individuals (n=24), which are mostly lawyers and consultants. Strategic decision-making is the third most reported service type (n=16), with 10 of the reported 16 service providers being individuals. Average value provided to the business by individuals across all services, however, is only 3.67, with strategic decision-making services averaging even lower at 3.6. Both scores are below the overall network average of 3.76. The financial services sector also reports utilizing training and capacity building services at a higher rate than the other sectors studied (n=19). The organization type cited most as providing these services in the sector is Academic Institutions (n=6). Perceived business value of the services provided by Academic Institutions averages to 4.67, which is significantly higher than both the overall network average (3.76) and the sector average (3.92). It is worth noting that the financial services sector's total connections with Academic Institutions exceeds that of any other sector, as well (n=9). Non-financial service providers reported in the sector by more than one respondent include the Universidad Tecnológica Centroamericana (UNITEC) (n=2), Alcaldias Muncipales (non-specific) (n=3), and Camaras de Comercios (non-specific) (n=5).

Figure 16 Service provider types and corresponding services provided to enterprise respondents

Services (Financial Services)	Association / Chamber	Business	Academic Institution	Government	NGO / Donor	Person / Individual	TOTAL
Access to Finance	3	14		5	3		25
Capacity Building	4	2	6	3	2	2	19
Finding Buyers / Contacts	7	1	2	1	2	1	14
Management Processes		12			1	2	15
Launching New Products / Services	2	3	1	2		3	11
Permits / Licensing / Legal Reqs.	2			9	2	3	16
Civil Society / Advocacy	2			5	1	3	11
Strategic Decision-Making	4	1		1		10	16
TOTAL	24	33	9	26	11	24	127

Figure 17 Network map financial services



Tourism. Eight enterprise respondents in the tourism sector reported a total of 77 relationships with external service providers. Responses indicate that the tourism industry relies on government institutions more than any other sector for support services (n=41) spanning all eight service categories. Perceived business value of relationships with Government service providers averages 4.12 making it higher than both the overall network average (3.76) and the sector average (3.84). Government institutions dominate capacity building / training services in the sector (accounting for 8 of 9 relationships), though the average corresponding business value associated with these services (3.5) is lower than the Government's overall average in the sector.

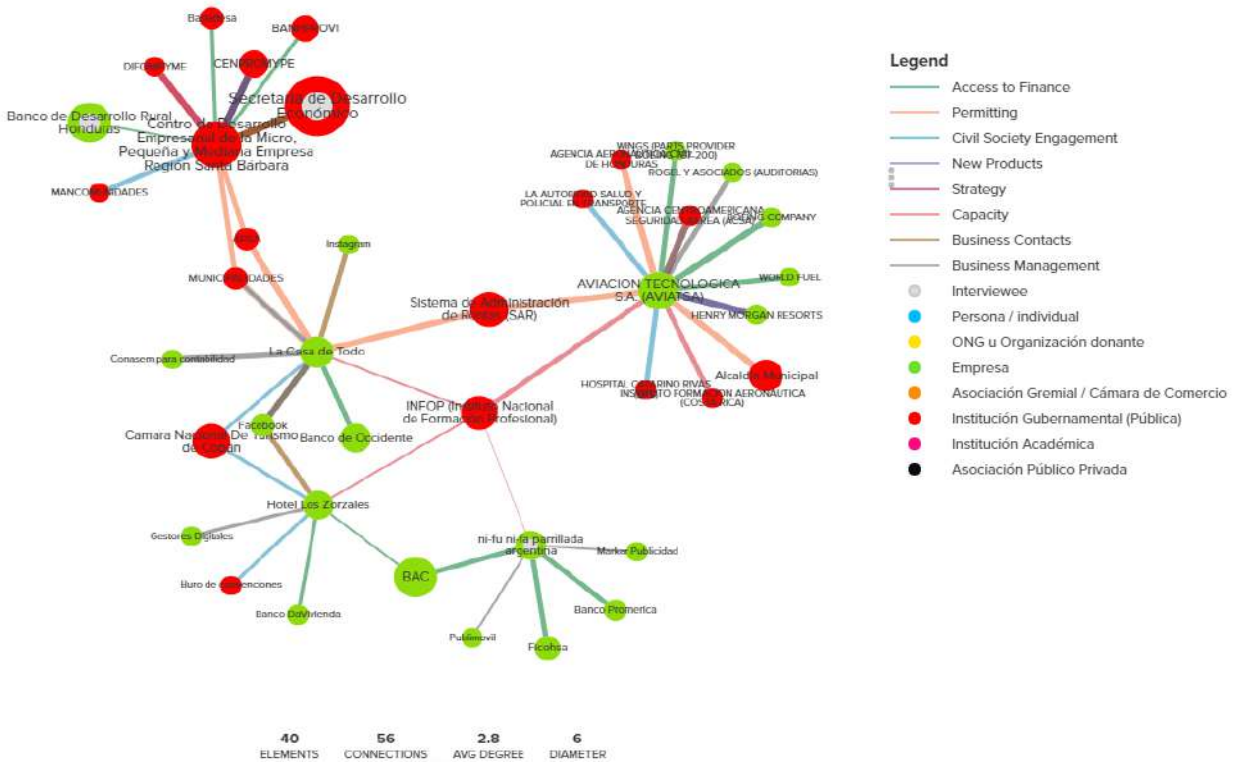
Though you might expect associations and chambers of commerce to have a similarly prominent role in the tourism industry, there is low reported engagement with this group of service providers (n=5). For those relationships that do exist with Associations and Chambers, the value they provide to enterprises in the industry averages only 2.8. Service providers in the sector reported by more than one respondent include INFOP (Instituto Nacional de Formacion Profesional) (n=5), ARSA (n=2),

BAC (n=2) and Facebook (n=2). Though INFOP was cited by five separate organizations, the average perceived value provided by INFOP to enterprises in the sector is only 2.6.

Figure 18 Service provider types and corresponding services provided to enterprise respondents

Services (Tourism)	Association / Chamber	Business	Academic Institution	Government	NGO / Donor	Person / Individual	TOTAL
Access to Finance		12		3	1		16
Capacity Building				8	1		9
Finding Buyers / Contacts	1	3		2			6
Management Processes		7	1	4			12
Launching New Products / Services		1	1	4			6
Permits / Licensing / Legal Reqs.				10		2	12
Civil Society / Advocacy	3			8	1		12
Strategic Decision-Making	1			2	1		4
TOTAL	5	23	2	41	4	2	77

Figure 19 Network map tourism



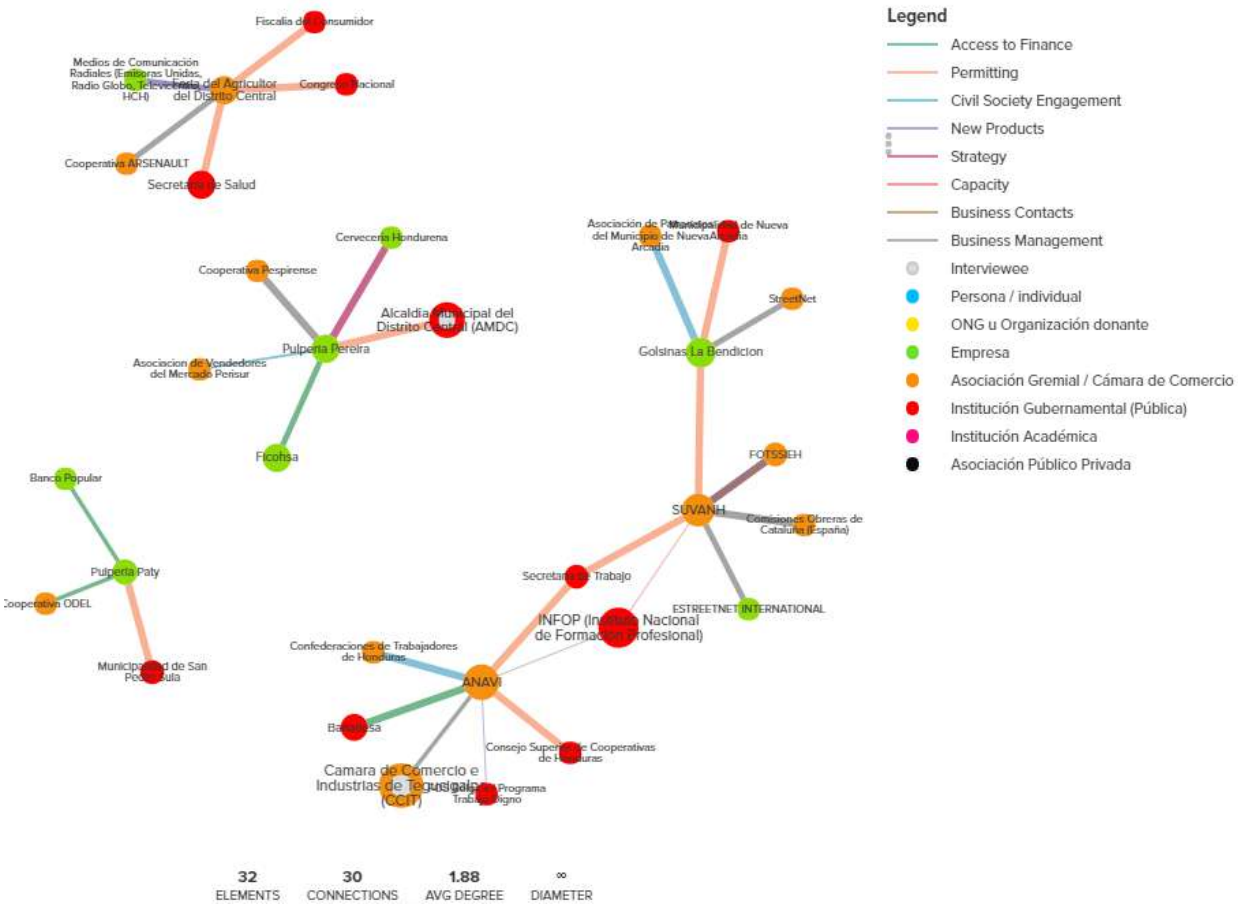
Wholesale and Retail. Eight enterprise respondents in the wholesale and retail sector reported a total of 39 relationships with external service providers. Compared to other sectors, wholesale and retail enterprises reported much fewer relative relationships with financial services providers (n=5). Respondents also reported a surprisingly low number of relationships with business service providers (n=5) and only two (2) relationships with external providers in support of launching new products or services. Operational / business management services is the most frequently cited service category (n=11), while government institutions (n=13) and associations and chambers of commerce (n=12) are the most commonly reported service providers in the sector. INFOP was also reported as a service

provider by two separate organizations in the Wholesale and Retail sector. In both instances, respondents rated the perceived business value provided by INFOP as 1 (minimal). The Secretaria de Trabajo is the only other organization in the sector with more than one unique citation (n=2). Most significantly in the sector, there are no reported connections for finding buyers or business contacts.

Figure 20 Service provider types and corresponding services provided to enterprise respondents

Services (Wholesale-retail)	Association / Chamber	Business	Academic Institution	Government	NGO / Donor	Person / Individual	TOTAL
Access to Finance	1	2		1	1		5
Capacity Building	1		1	1	1	1	5
Finding Buyers / Contacts							
Management Processes	6	1		1	3		11
Launching New Products / Services		1		1			2
Permits / Licensing / Legal Reqs.	1			9			10
Civil Society / Advocacy	3				1		4
Strategic Decision-Making		1			1		2
TOTAL	12	5	1	13	7	1	39

Figure 21 Network map wholesale-retail trade



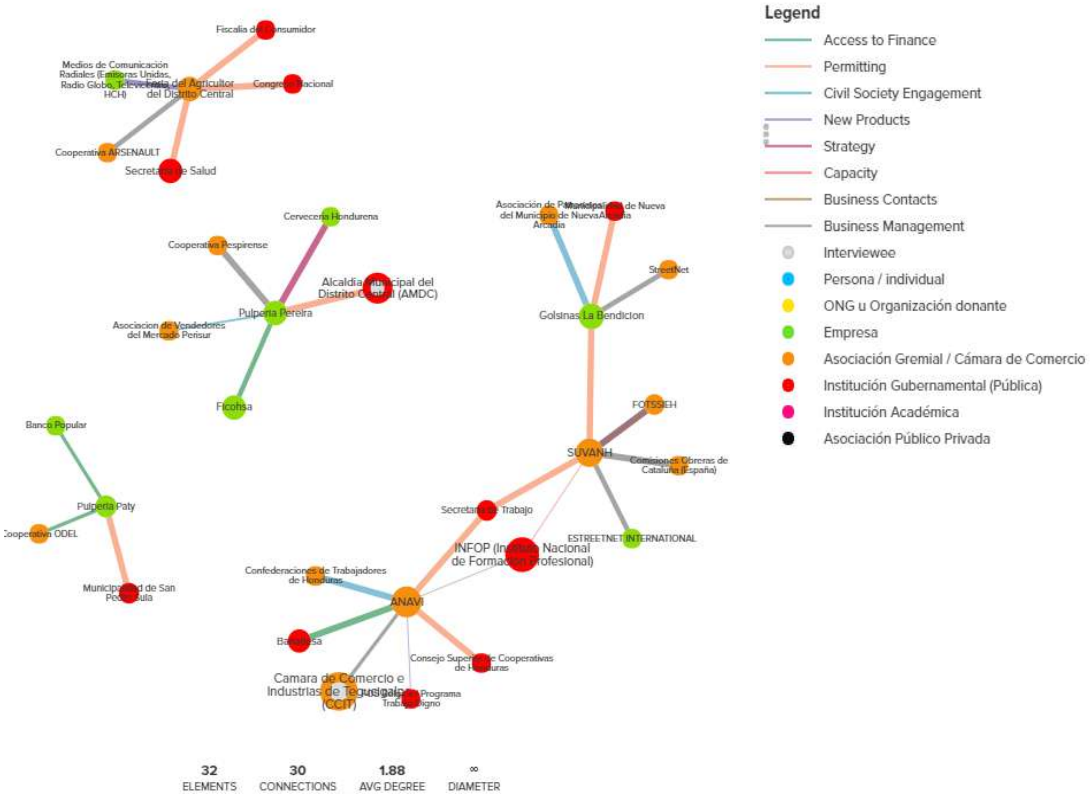
Business services and ICT. In business services and ICT sector, six respondents reported a total of 77 relationships with external service providers. Relative to the number of respondents (n=6), usage

of external service providers for civil society engagement and advocacy efforts is high (n=8), though the average business value associated with these services is relatively low at 3.38. Business and ICT enterprises also reported the second highest number of connections with academic institutions (n=8) of the 10 sectors surveyed. The eight reported connections correspond to four institutions: Centro Universitario Tecnológico (CEUTEC) (n=1), UNAH (n=1), UNITEC (n=2), and the University of Texas San Antonio (UTSA) (n=4). UTSA was listed in four different service categories by CDE-MIPYME and was rated as providing critical business value (5) to the organization in all four. The three local universities were reported as providing capacity building / training services (n=4) and all received business value scores of 3 or less, with a combined average of only 2.25. Government institutions also play a noticeable role in the sector (n=28), accounting for more than one third of all reported connections. To be expected, the most common service provided by government is obtaining permits, licenses, or meeting other regulatory requirements (n=11). Only two of the 28 connections indicate the availability of alternative service providers. Despite a lack of alternatives, the average business value of services provided by government institutions in the sector is 3.82.

Figure 22 Service provider types and corresponding services provided to enterprise respondents

Services (Business and ICT)	Association / Chamber	Business	Academic Institution	Government	NGO / Donor	Person / Individual	PPP	TOTAL
Access to Finance		10		4				**14**
Capacity Building	2	1	5	4	1			**11**
Finding Buyers / Contacts	3	4		1				**5**
Mgmt Processes		5	1	2	1	1		**10**
Launching New Products / Services		1	1	2				**4**
Permits / Licensing / Legal Reqs.	2			11				**11**
Civil Society / Advocacy	1			2	4		1	**7**
Strategic Decision-Making		3	1	2		1		**7**
TOTAL	**8**	**24**	**8**	**28**	**6**	**2**	**1**	**69**

Figure 23 Network map business services and ICT



Water and Sanitation. In the water and sanitation sector, seven respondents reported a total of 33 relationships with external service providers. Only one academic institution was listed (University of Cornell) and there were no reported relationships with NGOs or donor organizations. Of the eight service types, civil society engagement and advocacy support was most frequently cited (n=9). The relationships in this category have an average business value score of 4. No service providers are cited by more than one respondent in the Water and Sanitation sector. There were also no reported relationships corresponding to launching new products or services.

Figure 24 Service provider types and corresponding services provided to enterprise respondents

Services (water and sanitation)	Association / Chamber	Business	Academic Institution	Government	NGO / Donor	Person / Individual	TOTAL
Access to Finance		6		1			7
Capacity Building		1	1				2
Finding Buyers / Contacts		3					3
Management Processes		1				2	3
Launching New Products / Services							
Permits / Licensing / Legal Reqs/				6			6
Civil Society / Advocacy	2			6		1	9
Strategic Decision-Making				1			3
TOTAL	**2**	**11**	**1**	**14**	**0**	**3**	**31**

Remaining Sectors. Eleven combined respondents in the Productive Infrastructure (n=4), Light Manufacturing (n=4), and Transportation and Logistics (n=3) sectors reported 91 relationships with external service providers. Of the 19 relationships reported in the transportation and logistics sector,

six were with individual service providers – the highest proportional number of individual providers of any sector. In the productive infrastructure sector, 15 of 34 indicated relationships are with NGOs or donor organizations. Light manufacturing respondents cited government institutions with the highest frequency (20 of 39 total connections).

SUMMARY

Although the 10 MSA sectors represent markedly different areas of technical expertise, there are a number of structural similarities across the sectors related to the kinds of service provided (or not) and who is (or is not) providing those services.

- *Expansive government presence:* Government institutions play a large and significant role with respect to market actors. Obtaining permits, licensing, and fulfilling other legal requirements also accounts for 1/6 of all relationships in the overall network.
- *Lack of integration between market and academic / research institutions*: Academic institutions are hubs for innovation and technical support but their reported connections (n=28) to market actors in Honduras are few and far between.
- *Lack of market-based support for new product development / innovation:* There are very low rates of enterprises reporting use of support services to launch new products or services (n=53), suggestive of low rates of innovation across all sectors.
- *Low value-add of business associations*. While cited with relative frequency, associations and chambers of commerce seem to provide inconsistent service options / resources to market actors and are the provider type with the lowest average business value overall (3.5).
- *Limited use and availability of professional training and capacity building services*. Professional and organizational development services were only cited 79 times overall and have a reported business value average of only 3.45.



VALUE-ADDED AGRICULTURE

ANNEX II VALUE-ADDED AGRICULTURE

SECTOR OVERVIEW

Agricultural jobs are at risk and there is high likelihood to increased migration. Agribusiness is one of the priority sectors for the GoH and included in the Honduras 20/20 strategy. An incredible seventy-one percent of the total value of exported goods by Honduras are agricultural products. However, Honduras remains in lower value-added, fresh and lower grade processed products like coffee and bananas which has put the economy in more volatile markets. For example, recent coffee price trends have sent a shock to the industry. Despite the job and GDP contribution of this sector, many of these jobs are at risk. The analysis identified the need to shift into higher value-added products, which bring with it the possibility of job creation, export markets and foreign investment critical to achieve the scale and speed needed to create new jobs and reduce migration.

Strong end-market signals trigger a weak supply-side response. All product areas analyzed for this sector report (i.e. processed and/or transformed fruits, vegetables, poultry, coffee, cacao, dairy, beans, plantains, potatoes, and sweet potatoes) are experiencing growing demand, in Honduras and/or abroad. The strongest up-surges are domestic opportunities for packaged fruits and vegetables, mainly at supermarkets, for plantains and potatoes as snack foods, and for coffee to satisfy the emergent coffee culture and expansion in the number of coffee shops. Demand, across all product areas however, is generally for higher quality products that meet increasingly stringent grades and standards, for more diverse and innovative product lines and attractive packaging, and for greater volumes and reliability. The sector is characterized by end-market signals that often fail to influence farmers' production decisions, the activity of aggregators, or investments in upstream processing like post-harvest cleaning and sorting or washing of coffee cherries or fermenting of cacao beans.

Some leading agroindustry players are now pushing this status quo by rolling out new supply chain models. Companies are integrating to aggregate and package fruits and vegetables for their supermarket outlets (Walmart). Some are investing in upstream, pre-processing facilities to support producers and ensure reliability and quality of supply of plantains for snack-foods (Inalma). Others provide quality inputs and technical services to producers for coffee (COHORSIL) to align production with client demand. Others are also integrating their own production operations with small-scale producers to augment volumes of, for example, fresh vegetables (Farm Fresh and Fresh Greenhouse Harvest). However, these promising efforts remain the exception and even these backward integrations struggle to get suppliers to meet higher grades and standards more reliably.

Geographic dispersion, social norms and informal market channels continue to create pressures towards the status quo. The principle challenges for end-market buyers or processors to develop reliable sources of supply are three-fold. One, the wide geographic dispersal and generally small size of farmers complicates and increases the cost of outreach to farmers and aggregation of crops. Two, farmers' predominant practice of deciding what to produce without ascertaining end-market demand is likely embedded in strong social norms that are expensive to shift. Lastly, the business strategies of the most common rural intermediaries, *coyotes*, are mainly successful for competing in spot markets where price matters more than quality but are not conducive for aligning incentives between producers and processors in value-added markets.

Improving the application of sanitary and phytosanitary regulations and the performance of the responsible government agency has motivated key stakeholders. The Servicio Nacional de Sanidad

e Inocuidad Agroalimentaria (SENASA) is roundly criticized by sector stakeholders as ineffecient, under-staffed, and overly bureaucratic. The agency's deficiencies become a hindrance to, for example, actors' access to export markets that require timely and accurate quality control certifications or the emergence of new businesses or product lines that require licensing by the agency. The agency is also seen as an impediment to the formal registration of businesses where informal business owners perceive the hassle of adhering to SENASA's regulations as more costly than beneficial. The actors most negatively affected, and most motivated to improve the situation, are active in the fresh fruit and vegetable, dairy, and meat and poultry subsectors. Led by the Federación Nacional de Agricultores y Ganaderos de Honduras (FENAGH), key stakeholders have already put forth several initiatives and ideas to improve the agency's performance.

There is a growing innovation and performing gap within the sector. Limited access to R&D and extension to take informed decisions have increase the gap in innovation and performance resulting in low yields, difficulties to adapt to climate change, higher cost of production and limited competitive advantages. Local universities are not doing R&D neither providing extension services. Private and public-sector funding is limited, and researches do not have access to benefit from new patents and developments. Market system analysis identify that engaging academies to deliver R&D and extension services for agricultural enterprises could have a great impact in the industry.

INTRODUCTION

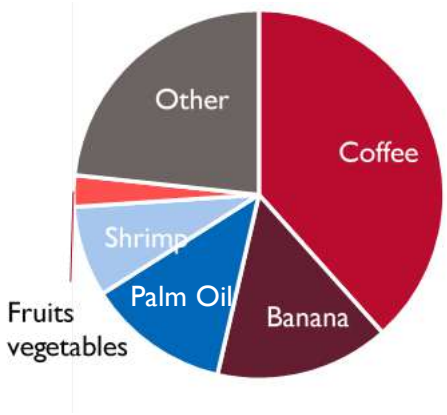
The nontraditional agribusiness sector in Honduras has grown significantly since the 1980's. Melon, shrimp, tilapia, and high-value vegetable export sectors comprise nontraditional agriculture success stories. Some of USAID funding for cooperatives in different regions of Honduras at the time gave rise to the leading exporters of 2018. These lessons from the past provide several hints for the recipe for success in the future. This includes a focus on smallholder farm associativity anchored to the supply chains of value-added operators e.g. packhouses and processing facilities which cooperate with U.S. and international buyers. These structured supply chain relationships have proven to successfully drive skills transfer, technical assistance and access to finance.

Agribusiness is one of the priority sectors for GOH included in the Honduras 20/20 strategy. Seventy-one percent of the total value of goods exported by Honduras are agricultural products. Agriculture comprises an estimated 20 percent of GDP and 33 percent of total employment.[48] Yet numerous, disperse subsistence farmers do not necessarily see agriculture as a business. Their low efficiency indicators are a result of high production costs as well as limited access to markets, skills, extension services, and finance. Facilitating lead agroindustry businesses to take the lead in innovation to reach new markets and address their own resource challenges will position the sector to more sustainably pursue competitiveness, and inclusion of vulnerable groups through supply chains.

[48] Banco Central de Honduras, "Honduras en Cifras, 2015-2017", 2018.

In recent years, market modernization in Honduras resulted in a shift to centralized distribution systems, specialized wholesalers, selected producers, increasingly stringent private standards and labels, and the rising use of international suppliers. The lack of coordination between actors, limited vision of entrepreneurs, and low investment capacity results in lost market opportunities for Honduran food processing companies and value-added operations (farm and off-farm). There is high potential for systemic change within the agribusiness sector to change the way large, anchor-firms do business through win-win alliances with vulnerable actors. This is the fastest way of reaching thousands of smallholder farmers and creating a massive number of jobs in rural areas. Proving business models will ensure that these changes 'stick' within the agricultural sector.

Figure 25 2017 Ag Exports Honduras



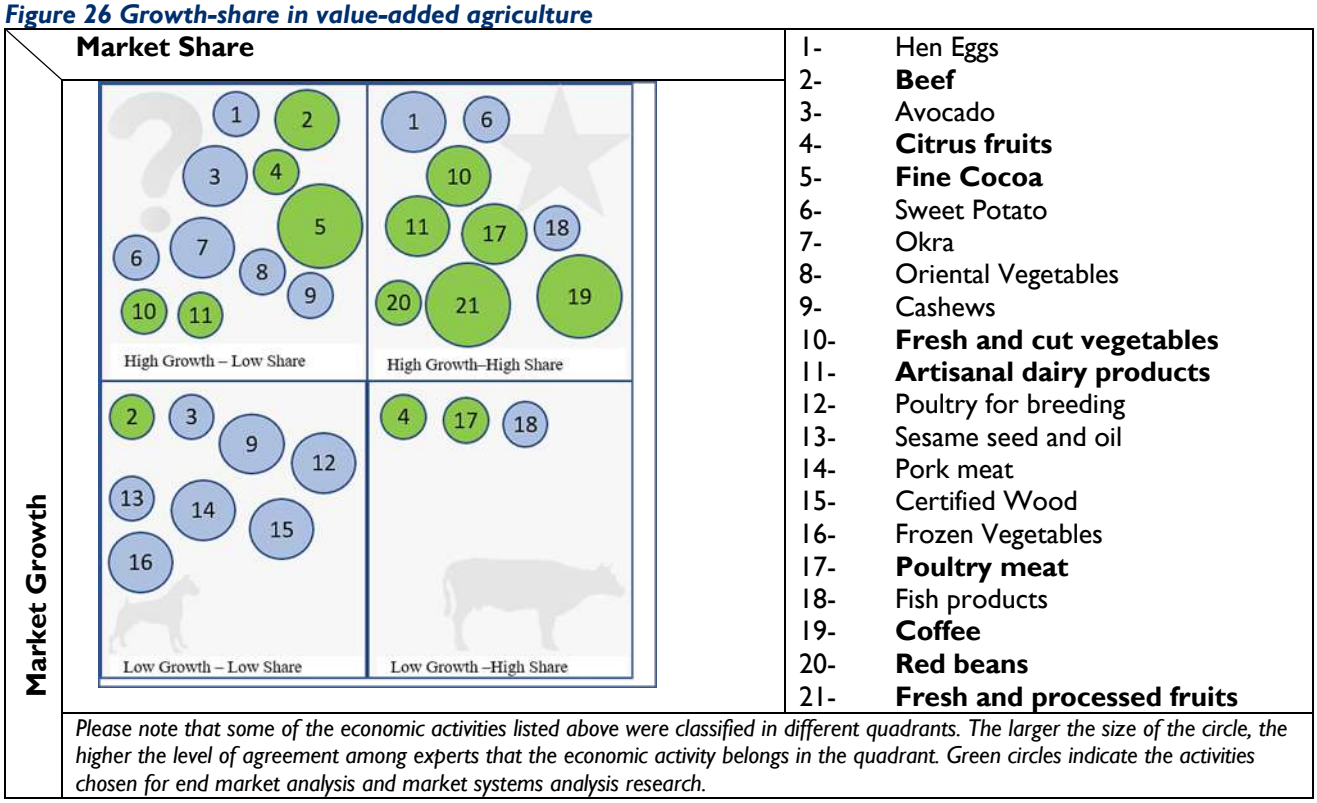
TMS selected the following subsectors: (1) processed fruit juices (2) fresh and cut vegetables (3) snack foods (4) processed beans (5) beef and poultry meat (6) dairy (7) coffee and cocoa based on the input of expert focus groups and looking at data on the leading agricultural exports of 2017, and considering that palm oil based on manageable interest, and that melon, watermelon, shrimp, and lobster production occurs in southern Honduras (outside of the DO1 and DO2 geographical areas).

There are opportunities for fresh packed and fresh-cut fruits and vegetables, fruit juices (pulp, single strength, and concentrates), and snacks (frozen and fried) for the local and export markets. In many cases, fresh produce exported from Honduras ends up being used as an ingredient for further processing into fresh-cut salads and vegetables, fried snacks, frozen products, or canned products. For example, fresh gherkins exported from Honduras are canned in the US and Canada to be preserved as pickles; colored bell peppers are used for fresh cut ready to eat salads; and sweet potatoes are used to produce frozen and fried snack products.

The fresh produce export sector is mature with access to state-of-the-art technology, protected and precision agriculture, and geared toward the U.S. export market during the winter months when demand increases. Added value provides an alternative channel that could create thousands of jobs and substantial investments in Honduras. Most enterprises discard rejected produce from fresh export operations, but an increasing number of exporters are adding value instead. For example, fresh sweet potato exporters process rejected products into flour, snacks, and animal feed. There is a need for stronger alliances within value- added; help to develop new products from concept to market; upgrade existing processing plants; automate processing lines; design and layout new facilities using sanitary design concepts to comply with international food safety and quality standards; facilitate access to new markets; and create new out-grower programs that could benefit thousands of smallholder farmers (SHFs), create jobs, and generate new investments.

TMS hosted a focus group of experts to help identify priority sub-sectors for analysis. The growth-share matrix presented below reflect the findings of this workshop.

Figure 26 Growth-share in value-added agriculture



Please note that some of the economic activities listed above were classified in different quadrants. The larger the size of the circle, the higher the level of agreement among experts that the economic activity belongs in the quadrant. Green circles indicate the activities chosen for end market analysis and market systems analysis research.

The study focused on the primary and secondary processing of agricultural products, given the mandate of the Activity to complement, not duplicate the efforts of other USAID and donor activities which are engaged at the farm level. The study explores roles from the perspective of the processor with an evaluation of their material inputs from a resource and relationship perspective. Given the diversity of end markets and actors between subsectors of value-added agriculture, the initial analysis of markets, actors, roles and functions is divided according to subsector or product.

Relevant subsector actor definitions are as follows:

- Intermediaries (formal and informal) – aggregators, consolidators, coyotes, wholesalers
- Supermarkets – large grocery retailers with traceability systems, quality standards, and the ability to accept credit card payments
- Farmers markets – open air, cash-only markets, which still move the largest volumes of produce in Honduras; bargaining and socializing, as well as security issues such as robbery are common
- Convenience stores – such as those in gas stations
- *Pulpería* – small neighborhood retail windows selling food and other household goods
- Mini markets – small supermarkets
- Institutional markets – restaurants, hotels, food service, franchises, and catering
- Micro, small, medium, and large enterprises – defined based on the number of employees.[49] Micro (1 – 10), small (11 – 25), medium (26 – 150), and large (151+)
- Smallholder farmer – farms on 0.3 – 3 hectares of land
- Artisanal processor– cottage industry home kitchens

[49] A forthcoming law in Honduras will define enterprise size based on gross sales revenue

- Semi-industrial processor – small dedicated area for processing foods with basic equipment, more labor intensive than an industrial processor
- Industrial processor – large, automated, expensive equipment with three to hundreds of employees depending on the process

As a note, the focal geographical areas include Development Objective 1 (DO1) - security and DO2 - food security zones of influence. Namely, the five DO1 cities of La Ceiba, Tela, San Pedro Sula, Choloma, and Tegucigalpa as well as the six DO2 departments in western Honduras: La Paz, Intibucá, Lempira, Copán, Ocotepeque, and Santa Bárbara.

SUBSECTOR 1 PROCESSED FRUIT JUICES

There are large juice processors near San Pedro Sula that export certified organic pineapple juice to the E.U. market. Organic certification is one way in which farmers can add value and benefit from sustainable production systems. However, one juice processor interviewed reportedly operates at one-third of its installed capacity. Helping develop new products such as aseptic sweet potato puree or aseptic passion fruit juice has the potential to increase their production capacity and create new jobs at the field-level through contract buying from SHFs. Honduras is primarily a raw material or commodity exporter, but its processing industry has significant potential.[50] The Central Bank of Honduras (Banco Central de Honduras – BCH) reported that in 2017, fruit juice comprised 20 percent or $13.6 million of the total value of processed fruit and vegetable exports ($67.3 million) (Harmonized tariff # 2009).

Value-addition Artisanal and semi-industrial processors operate throughout Honduras. Artisanal or small cottage industry processors of frozen fruit pulp often operate out of home kitchens and sell their products in small retail establishments. Semi-industrial processing plants have small processing facilities including basic equipment such as open kettles to pasteurize and/or concentrate juices that are hot fill and sell to institutional buyers such as restaurants, hotels, and franchises. Large manufacturers have inline closed automatic equipment including heat exchanger pasteurizers, concentrators, and aseptic fillers. Large processors sell to the export market and mainstream local retailers (supermarkets). As such, large, semi-industrial, and artisanal processors compete for buyers within different market segments.

Fruit juice processors include Lacthosa (Empresa Lácteos de Honduras S.A), LEYDE (Leche y Derivados S.A.), ALCOSA (Alimentos de Cortés S.A.), and Farm Fresh. Others comprise Alimentos Maravilla, Zamorano, Tropisabor, and APRAL. Several companies offer both dairy- and fruit-based drinks under a variety of brand names for domestic, regional, and export markets. Processors reported investing in their own cultivation or working with local producers to improve the reliability and quality of supply. Farm Fresh, for example, works with local growers groups, including over 100 farmers to introduce organic agricultural practices and support farm sustainability. However, no processing companies reported working with producers on a large scale.

Material supply. Much of the raw material for processed fruit comes from fruit rejected from the commercial plantations of multinational companies. According to BCH, banana, melon, pineapple (which comprise the majority of fruit exports from Honduras), remained stable between 2014 and 2017. Honduras has a diverse production base for fruit including pineapple, citrus, rambutan, and coconuts in the northern zone; mango and guava in the central zone and Comayagua; as well as

[50] Análisis de Coyuntura del Cultivo de Frutas en Honduras SAG-USAID

melon and watermelon in the southern zone. Other fruit trees such as papaya are scattered throughout the country. Orange trees often provide shade for intercropped coffee plants in the highlands and as a result of their altitude produce a balanced acid/sugar ratio for the high-quality fresh squeezed juice purchased by supermarkets.

Figure 27 Raw material pricing fresh fruit

Raw material prices are an indicator of how well local processors can compete in global markets. For example, when producers can meet the domestic demand for fresh fruit with a low priced surplus available for local processing, the competitiveness of processed exports increases. For example, Honduras and Guatemala are both large exporters of fresh bananas, which results in large amounts of rejected fresh fruit for the local market. However, high consumer demand for green and ripe bananas in Honduras means that processors have difficulty buying enough fruit at a reasonable price to compete in the export market for processed banana products such as banana puree and frozen slices. In contrast, green and ripe banana consumption in Guatemala is low, meaning processors in Guatemala can purchase rejected fruit from fresh exporters at competitive prices. Honduran banana processors import fruit from Guatemala to ensure availability. The processed fruit juice industry will develop with fresh fruit exports from Honduras because as the volume of fresh fruit exports increases, so does that of rejected fruit used for fresh local consumption and processing. A related example is that of the large export volumes of fresh honeydew melon from Honduras. Domestic consumers prefer cantaloupe to honeydew meaning processors need only pay transport for all rejected honeydew.

Market Opportunity: Fruit juices for the domestic market. The annual value of juice imports to Honduras is $1.7 million (BCH 2017). Domestic market opportunities include with institutional (restaurant and hotel) and supermarket buyers as consumers seek ready-to-drink, prepared, and freshly squeezed juices. The local market for processed fruit juices is saturated. Large, semi-industrial, and artisanal local processors meet market demand for nectar and chilled juices.[51] BCH reported that juice imports from Guatemala and Costa Rica were worth $1.7 million in 2017. Restaurants, cafes, pulperías, and other retail stores market domestic artisanal or industrially-produced single strength and concentrated fruit juices. The local processors interviewed reported that approximately 80 percent of their market is for such juices. Domestic processors tend not to sell directly to supermarkets given their slow payment process (60 to 90 days) as well as the difficulty in maintaining a reliable supply base due to limited cold chains, reliability in the productive base, and other constraints. However, Lacthosa, the largest juice processor in Honduras, has an orange concentrator in Colón that processes pineapple oranges grown by coastal lowland smallholders into juice products sold in supermarkets.

Market Opportunity: Fruit concentrates and single strength not from concentrate (NFC) juices for the export market. Honduras is a small producer of puréed fruit, concentrate, 100 percent juice, NFCs, and juice mixes which are reported growth areas in export markets. Superfruit is a marketing term which refers to fruits that have exceptional nutritional quality: acerola, acai, blackberries, blueberries, and raspberries, among others. The E.U. is the largest world market for superfruit juices with an estimated share of more than 40 percent of total world imports. The Netherlands is the largest re-exporter of superfruit juices and superfruit juice ingredients, while France, the UK, and Germany are the most innovative countries with the largest number of superfruit applications in fruit juices and fruit-based drinks. The main suppliers of fruit juice to the E.U. and the U.S. are Brazil, Peru, Poland, and Chile.

Developing superfruit juice export value chains in Honduras is a long-term endeavor (two to three years for blackberries, raspberries, and strawberries; greater than five years for blueberries). It is also

[51] The U.S. Food and Drug Administration defines nectar as a diluted juice beverage that contains fruit juice or puree, water, and may contain sweeteners.

difficult for countries in Central America to meet global market requirements for 100 percent juice products due to the low reliability and the seasonality of supply, constraints that countries such as Thailand manage to their advantage.[52] In Honduras, for example, pineapple production is seasonal (May-August), and processing plants shut down in the offseason. Furthermore, export market requirements for reliability and safety involve stringent, complex certification requirements that are difficult and expensive for processors and exporters to meet. However, Farm Fresh is exporting certified organic aseptic single strength pineapple juice to the Netherlands.

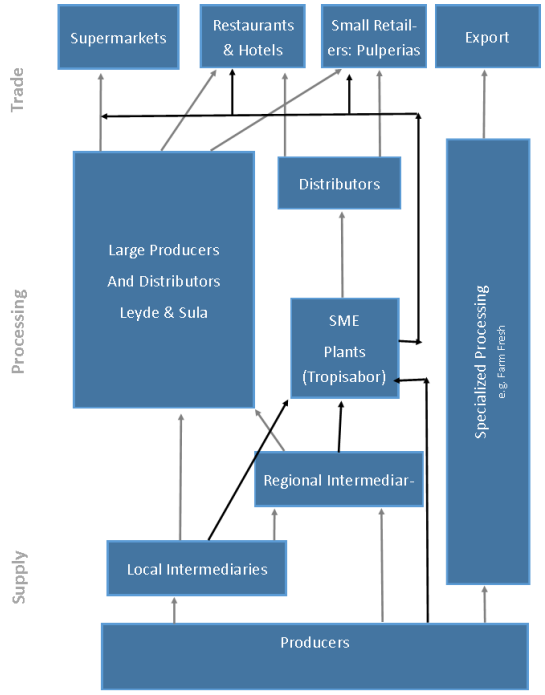
Fair-trade and organic fruit products for the export and domestic market. International demand for organic and fair trade products is increasing, but in Honduras, consumer awareness and willingness to pay for organic juices are less known. Organic farming is slowly moving from organic by default to organic by conviction. But SENASA controls the certification process for the local market, which is costly and inefficient. Grower cooperatives and smallholder farmers are the only producers eligible for fair trade certification in the fruit sector, but their lack of organization impedes certification. Honduras has the capacity, particularly as production increases, to offer a wide range of varietals that are well suited for the niche organic market such as Perspire mango, cashew apple, wild blackberries, and Sugarloaf pineapple.[53] Farm Fresh is an example of a Honduran company working with producers in Santa Bárbara to export certified organic single strength pineapple juice to the E.U.

Sub-sector competitiveness. Local consumption of fresh fruit is high, and fruit availability is low, which inflates fruit prices and reduces the competitiveness of local processors. One of the main constraints for local processors to compete in international markets is the low volume of fruit available for processing. Niche export market opportunities include the ingredients for international organic buyers to blend single strength juices not from concentrate (NFC). Local demand determines which rejected fruit goes to fresh consumption versus processing. Buyers purchase nearly all rejected green bananas for fresh local consumption due to high demand. In contrast, buyers purchase a portion of rejected pineapple and cantaloupe for fresh local consumption while processors purchase the rest to make pineapple jams, jellies, and juices as well as fresh cut and frozen cantaloupe products.

[52] https://ageconsearch.umn.edu/bitstream/245199/2/Article%207.pdf)
[53] Perspire mango (*mango perspire*) is a popular locally grown mango variety in Honduras.

Planting fruit exclusively for processing is not feasible due to high domestic and international demand for fresh fruit. In addition to purchasing rejected fruit, processors seeking low prices could buy fresh fruit not currently for export with limited Honduran consumption such as wild blackberries. The estimated annual production of wild blackberries in the highlands of La Paz (native variety is red) is 4,536 MT per year, 3,856 MT greater than the estimated 680 MT consumed in Honduras each year. Berry production is labor intensive and thus has the potential for job creation but the fruit requires strong market demand (such as that in Costa Rica) and a cold chain. The organic fruit juice market pays a price premium, meaning it is one of the few international markets in which Honduran processors can compete because they pay higher prices for fresh fruit than Thai and other international companies.

Figure 28 VC Map Fruit Juices



Developing the productive capacity to export into lucrative foreign markets and compete well domestically will require improved logistical capability (cold chain), production (machines, processors), and marketing. The development of long-standing partnerships and the identification and pursuit of niche market opportunities will also be critical for success.

SUBSECTOR 2 FRESH AND CUT VEGETABLES

The fresh vegetable subsector plays a vital role in income and employment generation in the agriculture sector. In 2016, producers reported cultivating over 17,000 hectares of vegetables in Honduras, which represented less than 1 percent of all land under agricultural production.[54] However, due to high land productivity and intensive labor demand, vegetable production contributes an estimated 5-8 percent of employment in agriculture.[55] Furthermore, vegetable production has a substantial multiplier effect on employment, affecting downstream and upstream value chain actors. For example, tomato production has an estimated multiplier effect of 1.8 on jobs and income at the production stage, and 2.2 at the first step of processing.[56] Namely, every job generated at the production level generates 1.8 jobs in production-related areas such as input supply, equipment maintenance, and land preparation. Each new processing job creates 2.2 jobs in associated areas such as transportation and packaging.

Value-addition. In the Honduran market, Hortifruti and El Consorcio have established different mechanisms to ensure product supply and incorporate many producers into their supply chains. However, these companies still struggle with quantity, quality, and variety. The Walmart Group of retail stores, which encompasses Walmart Supertiendas, Paiz, Despensa Familiar, and Maxi Despensa, is one of the few groups that integrated vertically downstream, establishing the company Hortifruti, to ensure quality and quantity of produce supply. Hortifruti supplies packed fresh

[54] FAOSTAT, 2016
[55] J. Dürr, Eur. J. Hortic. Sci. 82(6), 311–318 | ISSN 1611-4426, Center for Development Research, University of Bonn, 2017
[56] "Let's Work: Value Chain Based Job Creation", Global Development Solutions, 2016

vegetables to its 106 stores, representing an important market opportunity for produce suppliers. El Consorcio Agrocomercial de Honduras, a partnership of eight small producer-based organizations supplies the second largest supermarket group, La Colonia (24 stores). El Consorcio plays the sole interlocutor role, buying produce from non-affiliated producers, another market opportunity for fresh vegetable producers.

The export market requires packing operations, which are one of the basic ways to add value and create jobs through grading and other post-harvest activities. At present, most sector actors work separately, but increasing the level of coordination among actors will ensure access to markets, greater bargaining power, and increased investment capacity. It is for example necessary to rebuild the Honduras exporter association based on the Guatemalan Exporters Association (*Asociación Guatemalteca de Exportadores* – AGEXPORT) model; and coordinate action plans between exporters, small growers, and buyers.

The processing of fresh vegetables is regulated by the Servicio Nacional de Sanidad e Inocuidad Agroalimentaria (SENASA). SENASA provides the official licenses required to operate any fresh vegetable processing plant. Licensing is slow and tedious because of centralized service provision in Tegucigalpa. Having independent accredited inspectors could help speed up this process. Support services for processing fresh vegetables are not a constraint, and the supply of packing material is well established due to use in other industries such as fast food. However, electricity, water, and sanitation are often barriers to developing processing plants in peri-urban and rural areas.

Material supply. Although most fresh vegetable exports originate in the Comayagua Valley, the vegetable subsector is particularly important for job creation in western Honduras. For example, the potato value chain (a key crop for the Lenca community) in Intibucá and Ocotepeque, pepper and tomato in Copán, onions in Ocotepeque, plantain and sweet potato in Santa Bárbara, and temperate climate vegetables such as carrots, cabbage, broccoli, and lettuce in La Esperanza and Marcala. Furthermore, high-value fresh vegetables are short-cycle (45 to 120 day to harvest) crops, which means producers can enjoy quick returns compared to long-cycle crops (harvested once per year or less).

Honduran horticultural production includes two groups of producers. One small group of producers with access to high-quality inputs, utilizing technology, and linked to export markets. The second group, the vast majority, with limited access to inputs and technology and connected to unreliable markets. However, the dichotomy presents a significant opportunity to develop the market for agriculture inputs and services for small producers. Low levels of associativity and education, as well as grower dispersion, result in limited offerings and volumes as well as inconsistent quality, the most significant challenges within the segment. Most producers do not utilize production plans to guide decision-making and have limited access to inputs and services, which reduces production quality and quantity. Although there are many advantages of working with SHFs, large fresh produce exporters reported being afraid of outsourcing part of their volumes with smallholder farmers because of food safety and certification control issues. There is a need to create a strong business case, and the quality assurance mechanisms, that provide greater confidence for exports to source from local SHFs.

Market Opportunity: Exports to U.S. and regionally. Honduras can increase its market share in two fresh vegetable export markets: the east coast of the U.S. and regional buyers like El Salvador, Nicaragua and Costa Rica. The high-growth U.S. fresh-cut market reportedly presents an attractive export opportunity for Honduras. A low-volume specialty item 15 years ago, the fresh-cut category

today generates over $10 billion in annual sales and represents over 10 cents of every U.S. dollar spent on fresh fruits and vegetables at the retail grocery level. New market opportunities in El Salvador as well as in new regional markets including Nicaragua, Costa Rica, Panama, Jamaica, and those countries where Honduras has an FTA. For example, the new free customs union agreement (*unión aduanera)* between Honduras, Guatemala, and El Salvador presents the opportunity to re-activate regional export investment, but it will take time to operationalize the agreement.

Walmart and PriceSmart opened distribution channels between Central American countries and Mexico that could also be an excellent opportunity for regional exporters. There is a potential to develop the business case for exporters to outsource their raw material through organized and inclusive grower groups in Honduras to increase agropark processor competitiveness. Strengthening the pool of exporters and value chains of export products; creating a set of key efficiency indicators, and; building upon existing platforms will help TMS to identify the business cases for private sector input suppliers and buyers to include vulnerable groups.[57]

Market opportunity: domestic market. There are import replacement opportunities for fresh vegetable and fresh-cut segments. The value of fresh or chilled vegetable imports to Honduras increased 172 percent from $523,000 in 2013 to $1.42 million in 2017. Further, the value of fresh or chilled vegetable imports to Honduras in 2016 was $1.13 million or 2.76 percent of the value of processed vegetables imported in the same year. In 2016, Honduras imported over 37,000 MT of processed vegetables valued at $41 million or $1.08/kg. As a reference, the wholesale price for a kilogram of lettuce is $0.5/kg, which demonstrates the high value of the processed vegetable segment. At the local market, the main buyers for fresh vegetables with added value are supermarkets, and according to a manager from one of the largest retail chains in the country, the added-value segment represents 2-3 percent of their vegetable sales. But they would like to increase the added-value segment to at least 10 percent. The same source indicated that the added-value segment will continue to grow because supermarket clients appreciate the convenience, safety, and quality that packed produce offers.

Many supermarket owners prefer to buy fresh vegetables from Guatemalan suppliers that provide a one-stop shop for their produce purchases. Guatemalan consolidators such as La Carreta bring their products to Honduras to sell to supermarkets and other buyers. This an opportunity for the private sector to analyze the feasibility of having Guatemalan buyers source some of their fresh vegetables l in Honduras, including the possibility of exporting Honduran products to Guatemala to inform changes in the supplier business models of companies like La Carreta.

The fresh vegetables with added value portfolio for supermarkets, hotels, and restaurants includes at minimum tomato, lettuce, carrots, onions, and cucumber. Institutional buyers such as hotels, restaurants, and franchises are growing. For example, the new Hyatt and Aloft Hotel in San Pedro Sula are looking for suppliers that can provide a one-stop shop for their produce needs. Developing and expanding collection and processing systems and capacities along the value chain will be critical to meet growing demand and expand the domestic market share.

[57] Vulnerable groups are those excluded due to poverty, ethnicity, gender, and/or migration status, among others.

All stakeholders interviewed agreed that the demand for processed fresh vegetables (chopped and packed) will continue to grow. As supermarkets expand (the Walmart Group reported 40 new stores in the last eight years) the demand for processed/ready-to-eat vegetables will also keep growing.

Sub-sector competitiveness. Reducing production and transport costs will be critical for export and domestic market opportunities, but competitive advantages for Honduras include the following.

- Wide range of growing conditions and micro-climates which permit the efficient cultivation of many of the most important fruits and vegetables used in the fresh-cut sector including butter, iceberg, romaine, red leaf, and green leaf lettuce; radicchio; red and green cabbage; broccoli; cauliflower; carrots; cantaloupe; honeydew; and watermelon.
- Extensive experience in the production of these crops
- Human capital at the manual, supervisory, and managerial levels to meet the challenges of producing crops for the fresh-cut sector that meet quality and efficiency standards and that can compete with international producers

Significant gains in efficiency and profitability can be made by market actors in aggregation, selection, grading, packing, and trading. Supermarket buyers demand produce with the following characteristics: cleanliness, presentation, convenient packaging, and the timely and consistent provision of large volumes of a variety of produce. Buyers require consistent, year-round supply of tomato, lettuce, potato, onion, cucumber, and carrots. In-demand packaged produce includes tomatoes in foam trays, mini potatoes in mesh, heads of lettuce in bags, bagged carrots, baby carrots in foam trays, and peeled carrots. The development and growth of the packed fresh vegetable segment is likely to have positive spillover effects in terms of employment, especially if the segment is managed as part of a value chain portfolio approach. Outsourcing has advantages including produce delivery and traceability. There is an opportunity to connect MSMEs from the interior part of the country with large players in the main cities including Pyflor and Tropisabor that have access to institutional clients. According to Fresh Green House Harvest, a small/medium sized hydroponic production company based in Choloma, there is a growing market opportunity for lettuce and aromatic herbs produced with the technology driven by hotel, restaurant, and supermarket demand.

Aggregators. An improved business model for aggregators is needed to solve supply constraints. Aggregators are well-positioned to incorporate small producers into the supply chain. In addition to aggregating the produce and providing initial added-value (sorting/grading), aggregators could also provide advisory services and set production plans for a group of producers. For instance, a seedling producer could easily play the aggregator role by ensuring the quality of vegetable materials and proper planting planning. Intermediaries, also known as coyotes, are local leaders that play a key role in the value chain, filling gaps in the system such as financing, technical assistance, and input supply. These actors take risks and have access to relevant international markets like La Tiendona in San Salvador, which moves large volumes of produce. The fresh vegetable market segment could benefit from a network of “professional coyotes”.

Agroparks. Because some international buyers process much of the fresh produce exported from Honduras, there is a potential opportunity for Honduran exporters to install value-added processing facility agroparks. Back in the early 80’s, the textile maquila industry developed a viable industrial park model where the real estate developer builds and manages the park and leases infrastructure tailored to the specific needs. Potential food processor investors could be local or international such as processors from Mexico, Guatemala, Chile, and Peru already export value-added agricultural products that would look to expand to locations to split the risk due to climate change; investors from

South America (Chile and Peru) could have the opportunity to expand their seasonal production windows; Guatemalan and Mexican companies can find better conditions in terms of water and labor availability. Additionally, special attention would be given to those export markets where Honduras has free trade agreements: Canada, Chile, Costa Rica, the Dominican Republic, El Salvador, the E.U., Guatemala, Nicaragua, Panama, Peru, Taiwan, and the United States.

SUBSECTOR 3 SNACK FOODS

Existing root and tuber (plantain, cassava, malanga, potato, and sweet potato) snack and frozen ready-to-eat processors for the local and export market need additional raw material to meet demand. Expanding fresh exports of plantains and cassava could make raw material available for processing at competitive prices, replace imports from Nicaragua and Guatemala, and facilitate the creation of peeling hubs in rural areas. Introducing special potato varieties with high dry matter content for processing could also be a high-potential intervention. The availability of raw material at competitive prices will allow for the development of gluten-free flours (plantain and cassava), suited for artisan operations near producing areas to supply local bakeries and sausage manufacturers.

The estimated global snack food market, defined as a "small amount of food for light meals or for eating between meals that does not require preparation," was $280 billion in 2016.[58] According to Euromonitor International, retail sales of packaged food products in Honduras was $569.3 million in 2016, a 15.2 percent increase from 2012. The organization forecasted 36 percent growth by 2021 driven by the following: urbanization; the expansion of supermarkets in urban areas (El Progreso, La Ceiba, Choluteca, Comayagua, and Danlí) and in the tourist resort areas of the Bay Islands; a developing hotel, restaurant, and institutional sector; and increasing demand for baked goods. In Honduras, snack consumption is growing from 'at least once a day' to two to three times a day and even replacing traditional meals such as breakfast.[59] The country imported $135 million in snacks from regional competitors based in Mexico, El Salvador, and Guatemala (Gain FAS USDA 2017 Retail Foods Report).

Value-addition. Large processing companies and SMEs supply most of the domestic snack market as well as the export market to the U.S., Central America, and the Caribbean. Large companies use state-of-the-art technology and machinery for processing and packing including automatic slicers, continuous fryers, and weight, fill, and seal machines. While SMEs use hand slicers, open batch kettle type fryers and manual packing in plastic bags. Barriers to entry include cumbersome and costly legal requirements and procedures for new business installation as well as high initial investment requirements due to capital-intensive transformation (imported machinery/equipment that is not produced in country) and the lack of non-collateral financing. All processors, small and large firms alike, reported recurring shortages of the principal raw materials: plantain, cassava, and potato. Processors have a direct buying relationship with raw material farmers in Honduras ranging from micro and small informal enterprises (5,000 kg per week) to SMEs (1,250 MT per week).

Figure 29 Honduras potato and plantain imports ($ thousands)

Product	2013	2014	2015	2016	2017
Fresh or frozen potatoes	1,935	4,242	4,822	7,434	7,839
Plantain, including fresh or dried	4,097	5,896	6,061	7,597	8,252

[58] Euromonitor International. Packaged Food in Honduras report. December 2017.
[59] Euromonitor International. Packaged Food in Honduras report. December 2017.

Source: Comtrade.un.org

The leading ready to eat pre-fried frozen plantain, cassava, and sweet potato processor is Inalma, located in San Pedro Sula. Industrias Sula, also based in San Pedro Sula, processes banana and potatoes. Corporación Dinant, based in Tegucigalpa, is the largest fried snack product processor in Honduras. The company has 18 well-positioned brands comprising corn-, banana-, potato-, and seed-based snack foods sold primarily through supermarkets and wholesale club stores (PriceSmart). Dinant's domestic market share is 52 percent, and Central American market share is 40 percent. To meet demand, processors import a significant portion (if not all) of their raw supply. Processors interviewed sought to source more local supply but had difficulty finding sufficient quantity. Some processors have reportedly identified and conducted field trials for new varieties, such as potatoes, with limited successful. In addition to large companies, over the last decade, small and medium processors competed fiercely to supply the domestic market through small grocery stores, schools, and other vendors. These SMEs reportedly supply an estimated 48 percent of the local snack market.

Market Opportunity: Savory snacks from roots, tubers, banana, and plantain for export and the national market. Savory snacks include salted, extruded, and otherwise processed items along with nuts, seeds, and cheese products. Experts indicated that Honduran consumers prefer savory snacks, especially those made with corn and tubers (cassava, potato, taro, and sweet potato), as well as plantain and banana (both raw and green). Eighty percent of the population between 18 and 60 years old reported consuming snacks regularly; 52 percent of them prefer corn-based products; 23 percent prefer products derived from potatoes or cassava; 18 percent from bananas; and 17 percent from nuts.[60] Demand for potato snacks in Honduras increases 30 percent annually. Growth opportunities identified by processors include peeled plantain and potato-based products. Other growth categories include processed savory snacks, sauces, dressings and condiments, ready meals, and processed fruits and vegetables.[61]

There is also a growing international market with high volume potential. Honduras exports 90 percent of national banana snack products to the U.S. market. The value of processed potato exports increased 121 percent from $4.3 million in 2013 to $9.5 million in 2017. The U.S. market for sweet potato and malanga snacks has an export potential of more than $10 million.[62] Exporters project that growth in the U.S. market will be driven by Hispanic consumers that prefer products made with plantain, potato, and cassava.

Figure 30 Processed potato product imports and exports, Honduras ($ thousands)

Other prepared or preserved vegetables (except in vinegar or acetic acid), not frozen, other than goods of heading 20.06	Potatoes	Year	2013	2014	2015	2016	2017
		Imports	3,574	1,159	2,022	893	1,490
		Exports	4,382	5,920	8,063	10,003	9,502

Source: Banco Central de Honduras (BCH)

Market Opportunity: fried snacks and pre-fried frozen ready to eat foods. Honduran chips and frozen ready-to-eat products (local and export) involving plantain, cassava, malanga, potatoes, and sweet potato comprise an established market. There are already successful linkages between these processors and producers that could be expanded (Inalma, Dinant, Industria Sula, Honduchips). The

[60] Euromonitor International. Packaged Food in Honduras report. December 2017.
[61] Euromonitor International. Packaged Food in Honduras report. December 2017.
[62] http://www.radioamerica.hn/exportacion-de-snacks-de-camote-y-malanga/

market is stable and growing, and the increasing volumes demanded can benefit thousands of growers. The synergy with fresh exports of plantains and cassava, along the supply chain, has likely multiplying effects (increased exports of fresh plantains and cassava means more rejected product available, used for processing snack foods at a competitive price). Fresh sweet potato exporters have begun to process the rejected sweet potato for animal feed, snacks, and frozen pre-fried foods.

Market Opportunity: gluten-free flour and nutritious snacks. There is also rising demand in the local, regional, and international market for gluten free flours and nutritious stacks. Burgeoning niche markets include the following.

- Single-serve small portion (less calorie)
- Natural fruit flavors
- Certified organic
- Diverse tuber options (beetroot, carrot, parsnip, and turnip)
- Combination packs (different products in one package, used as a meal replacement)
- Gluten free

Gluten-free flour alternatives could replace wheat flour (targeting 10-20 percent) in the local bakery industry as well as potato starch in processed meat products (sausages). The cost of machinery and equipment is low, processing is easy, and the necessary volumes of raw materials are available. Thus, investments in processing infrastructure are worth exploring for further analysis.

Market opportunity: sweet snacks from chocolate and fruit for national and regional markets. Sweet snacks include confectionary items, bars, baked items, and fruit-based products. Most consumer demand for sweet snacks is in the baked goods category, particularly those filled with or combined with fruit-flavored spreads, jams, and marmalades.[63] The preferred fruit flavors in Honduras are blackberry, grape, pineapple, apple, orange, and strawberry, and to a lesser degree guava, peach, and cherry. Interviewees reported that high growth categories in Honduras include sweet biscuits, snack bars, and fruit snacks. Changing lifestyle habits continue to drive increased snacking, including the demand for nutritious snacks. Proximity to other Central American countries and the U.S. as well as CAFTA-DR benefits offer opportunities for Honduras to export sweet snacks. But there are limited opportunities to export artisanal sweets like *dulce de leche* and chocolate coated fruits to the U.S.

Competitors. Guatemala (39 percent), El Salvador (29 percent), Mexico (11 percent), and the U.S. (9 percent) are the main countries of origin for imported snack foods. The principal international suppliers of snack foods in Honduras are Frito Lay and Productos Alimenticios Diana.

Figure 31 Snack food imports to Honduras

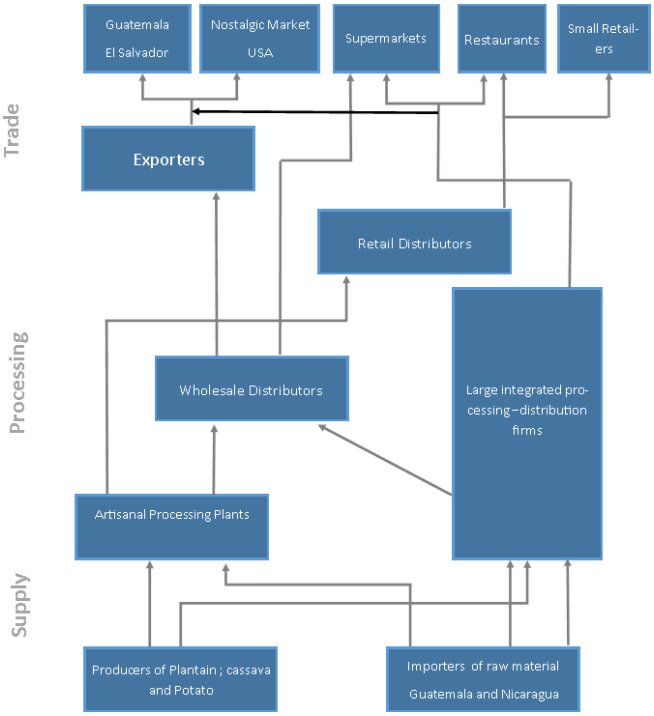
Product	Major Suppliers	Supplier strengths	Advantage/disadvantage of national suppliers
*Net Imports 67,773 MT *Total Imports: $135 million *Imports from the U.S.: $12 million	1. Guatemala: 39% 2. El Salvador: 29% 3. México: 11% 4. U.S.: 9 %	A. Free trade agreements with El Salvador, Guatemala, and Mexico B. Competitive prices C. Brand recognition	National supply is exclusively focused on covering demand for plantain and potato chips.

[63] According to a 2011 study conducted by sector specialist Julio López per capita consumption of churros (long, fried dough filled with dulce de leche or chocolate and sprinkled with sugar) in Honduras is 6.72 kg per year.

Source: Honduras Retail Foods. 2017 USDA Foreign Agricultural Service, Global Agricultural Information Network

Frito Lay is the snack division of PepsiCo Inc, and the leading company in salty snacks in the world, controlling 35 percent of the world market and 60 percent of the U.S. market. The company's well-known brands such as Lay's, Ruffles, Doritos, Tostitos, and Cheetos generate annual sales of over $1 billion each. In Honduras, all Frito Lay brands are well positioned and have good market acceptance. Productos Alimenticios Diana is a Salvadoran company dedicated to the manufacture of savory and sweet snacks, ice cream cones, and cookies. With a variety to choose from under each product category, Diana has a presence throughout Central America, the U.S., and Australia. In Honduras, Diana's leading products in order of importance are banana, cassava, and tortilla chips; peanut, cashew, and pumpkin seeds; and extruded snacks of various flavors.

Figure 32 Snack Food VC Map



Sub-sector competitiveness. There is a developing industry for snack food processing that requires high volumes of raw material with stable quality and price parameters. The lack of raw material (plantain, cassava, and potato) availability in Honduras pushes raw material prices upward and makes it difficult for local processors to compete, especially at the international market level where Columbia and Ecuador dominate. For example, raw material prices in Honduras range between $ 0.06 – $0.07/kg compared to $0.04 – $0.05/kg in Ecuador. Honduras has an estimated 2,000 hectares of plantain compared to 200,000 hectares in Ecuador. Replacing imports is one of the best opportunities to create jobs through growing and peeling operations in rural areas to supply large processors. Facilitating partnerships between exporters/processors and independent pre-processing facilities such as banana and cassava peeling centers in rural areas has excellent inclusion possibilities for women, youth, and vulnerable populations.

SUBSECTOR 4 PROCESSED BEANS

The bean (*Phaseolus vulgaris L*) is a grain that plays a dominant role in food security in Honduras, given that it is one of the cheapest sources of protein and calories, a perfect combination with corn tortillas and of high nutritional value due to its iron and Zinc content. Beans are also part of the national identity and of high cultural relevance, much like coffee in Colombia, corn in Mexico, or Beef in Argentina. Changing consumer trends include convenience, price, and taste. More and more, people do not have time to cook beans at home and look for ready to serve products. The GOH regulates the price of beans and in practical terms, does not permit bean exports. Price controls and restricted access to export markets reduce the incentives for local growers to increase production. Most beans processed by large firms are imports from Nicaragua. Growers in Honduras are losing the growing market opportunity to export beans to El Salvador and the U.S.

Value-addition. At least 12 companies including small, medium, and large processors are in the main cities: Cheff (Danlí), Campechanos (Comayagua), Juanita (Juticalpa), CORINA, El Zamorano, Tolupan, Manjar, La Rosa, and MARVISA. These processors commercialize frozen and shelf stable (standup pouches) whole and refried beans, mainly in supermarkets, small markets and pulperías of their respective cities. Example products are pureed beans, whole beans, blanched beans, refried beans, homemade chorizo, and chicken flute tacos. MARVISA, which supplies institutional clients such as hospitals, factories, and the military. APROINY, a small indigenous enterprise in Yoro, sells packaged whole beans to supermarket chains. CORINA packs and markets raw cleaned and polished whole beans to markets in Honduras, the U.S., Spain and Central America under the brand *Rojitos.* Inversiones Doña Lila mainly sells to pulperías located in the departments of Copán, Santa Bárbara, Lempira, and Ocotepeque. MSME processors depend on intermediaries for their bean supply but also purchase directly from independent producers and producer organizations. Large companies purchase from producer organizations, large intermediaries, and grain exporters from Nicaragua. According to one interviewee, large bean processors import bean supply from Nicaragua because the beans cost less than those produced in Honduras. DINANT with its Issima brand, UNILEVER with Naturas, and JAREMAR with Campo Fresco package and market fried beans in standup pouches that do not require refrigeration.

Market opportunity: Fresh or processed beans for export. The main market opportunity is with the export of fresh or processed red kidney beans to the U.S. ethnic market either directly from Honduras or through Salvadoran distributors. But a change in law is required to open the export market for bean producers. A free and open market for beans would also engage large processors in Honduras to buy locally produced beans instead of those imported from Nicaragua. Red kidney beans are popular with Hondurans, Salvadorans, and Nicaraguans living in the U.S. In contrast, consumers in Guatemala, Costa Rica, and Mexico prefer black beans, which presents an opportunity for export diversification within the subsector. According to the competitiveness study of the bean chain prepared by the SAG, nostalgic and ethnic markets in countries such as the U.S., Canada, and the E.U. are in a continuous growth stage. Free trade agreements also make these export destinations of interest.

Market opportunity: Domestic market. Per capita consumption of beans varies depending on the social stratum, consumption in urban and rural areas, and other variables.[64] According to COHEP, the aggregate demand in the bean sector was 302,000 MT in 2016. The council found that per capita consumption grew at an average annual rate of 2.2 percent during the same period, increasing from 76.9 kg per person in 2010 to 87.5 kg in 2016. Imports comprised 8.6 percent (26,000 MT) and domestic production 92.7 percent (276,000 MT) of total consumption in 2016. The bulk distribution channel is the largest although supermarkets also buy and repackage beans. Demand continues to increase for processed beans packed in 1,400 g plastic bags, for sale under different brand names, mainly in supermarkets. An estimated 48 percent of sales in Tegucigalpa occur in supermarkets but less than 15 percent in San Pedro de Sula.[65] Bean consumers in Honduras prefer red beans and consider the following attributes: grain size, flavor, and cooking time. Frozen and standup pouches of Refried beans are the most common packaging option for supermarkets. They require less food preparation time and are also popular with institutional buyers such as hotels and restaurants. Institutional buyers value the following attributes of the product: quality (consistency and

[64] Situación Actual de los Granos Besicos en Honduras, Consejo Hondureño de la Empresa Privada (COHEP).
[65] Situación Actual de los Granos Besicos en Honduras, Consejo Hondureño de la Empresa Privada (COHEP).

standardization), freshness (soft grain and seasonal), price (higher than the competition), type of packaging (plastic bag).

Competitiveness. Regulatory barriers have closed the export market for bean producers, which has hurt the potential of the sector. Processors reported imported as cheaper than locally produced beans. Significant technical assistance requirements are required at the producer-level in order to strengthen local supply. Bean production in Honduras is also vulnerable to drought; however, Zamorano and SAG will be releasing the new Rojo Chortí and Tolupán Rojo seed varieties, which are drought tolerant and angular spot tolerant, which may open up greater opportunities for the sector.

SUBSECTOR 5 POULTRY AND BEEF

Poultry. Poultry meat is one of the cheapest protein sources for Hondurans. The poultry subsector GDP represents 4.3 percent of total agricultural value added. The estimated annual production of poultry meat is around 158,757 MT. At least 200 specialized poultry farms and an undetermined number of small farms that join the value chain as "fattening" contractors. The poultry subsector generates an estimated 15,000 direct jobs and 160,000 indirect jobs.[66] On the importance of the poultry subsector, President Juan Orlando Hernández, within the framework of the XXV Central American and Caribbean Poultry Congress Honduras 2018 stated, "The intention of the Honduran government is to grow the poultry sector, which represents 45 percent of the diet of Hondurans and 12.5 percent of the basic basket. This would be done through the Honduras 2020 program, which seeks to create more than 600,000 jobs through six economic sectors, with agro-industry being one of them."

Poultry meat industry. It is estimated that producers in Honduras supply 95 percent of all poultry meat consumed in the country. The most common business models for poultry processing companies include fully vertically integrated operations including the following combination: (1) process and market chicken produced by company-owned farms; and (2) process and market chicken fattened by an exclusive supplier network. Experts noted the three largest fully vertically integrated poultry companies, Cargill, CADECA, and Cortijo, form an oligopoly, controlling volumes and prices, which distorts the market and impedes free market competition. There are 48 other poultry processing and production companies. Inversiones San José de San Nicolás, Copán (medium company) slaughters up to 18,000 chickens per week obtained from an exclusive network of 35 feeders. Another activity directly linked to the poultry segment is the production of live chicks for fattening. Large companies own most hatcheries to ensure the supply of chicks, which they then sent to broiler farms for further processing. In the peak production periods, only companies dedicated to fattening can purchase chicks, resulting in chick smuggling from nearby countries. Chick smuggling generates a high level of risk for the industry due to the possibility of "importing" sick animals.

Markets for poultry meat. Per capita consumption in Honduras is 21 kg whereas that in the wider Latin America region is 40 kg per capita, which presents the opportunity to multiply domestic demand for chicken and expand the industry. The 7 percent annual growth rate in the sector will continue to be led by vertically integrated multinationals. Broiler chickens are of great potential for small producer expansion to meet national demand.[67]Supermarkets, grocery stores, and distributors are the main outlets for poultry meat products including fresh, frozen, and marinated as well as whole and in pieces, nuggets, and other presentations. Large retail companies operate throughout the

[66] *http://www.elsitioavicola.com/poultrynews/32539/industria-avacola-de-honduras-produce-350-millones-de-libras-de-carne-de-pollo*
[67] http://www.elheraldo.hn/economia/1118972-466/consumo-de-pollo-en-centroamérica-subió-a-259-kilos-por-persona

country while small and medium establishments cover departmental and regional markets. Fried chicken is popular in Honduras, and multinational companies now own fast food restaurants such as Pollo Campero. In urban markets, it is estimated half of consumers buy fresh poultry meat sold mainly in supermarkets, fast food establishments, and restaurants. The other half purchases frozen chicken in supermarkets and other markets. In rural markets, nearly all of the chicken sold is frozen.

Beef. Honduras exports most of its cattle live to feedlots in Guatemala and Mexico, losing the opportunity to add value. There are two USDA approved facilities in Honduras for beef exports to the U.S. and a new free trade agreement opened up the E.U. market for Honduran beef. The political crisis in Nicaragua, which is the largest beef producer in the region, is also an opportunity for Honduras to increase beef exports. Local processors such as Del Corral and ProgCarne upgraded their facilities and equipment to produce cured soft meat and new cuts for the domestic market.

Production contributes an estimated 5.8 percent to agricultural GDP, generating approximately 68,757 direct jobs (Reyes Puerto et al.). Beef production in the rest of Central America fell in 2012 and has not yet recovered. International market prices for beef are also high, which benefits Honduran exporters, but also resulted in an increase in the number of illegal beef exports. Despite beef sector growth, Honduran cattle graze 1,700,000 ha, a smaller land area than before. The number of cattle farms also decreased by approximately 48 percent, from about 96,000 farms to 50,000 (Osorio and Guevara Pinto, 2014). Sixty percent or 30,000 farms are small producers.

Beef industry. The beef sector involves various actors including cattle breeders, cow-calf producers, finishers (grass-fed and feedlots), intermediaries, importers, brokers, industrial processing plants, and municipal slaughterhouses (*rastros*). The industry is stagnant due to the low supply of finished animals for processing. The fresh meat processed in formal slaughterhouses retails fresh and refrigerated. In Honduras there are four private slaughterhouses that process around two-thirds of the meat of the country. Due to the lack of supply, they reportedly operate at 40-60 percent of installed capacity. There are also 10 small municipal slaughterhouses, which supply meat to Tegucigalpa, San Pedro Sula, Progreso, La Ceiba, Choluteca, Juticalpa, and Santa Rosa de Copán. Companies sell the best cuts to buyers for the consumer market and process the rest into sausages (Ordóñez Tercero et al., 2007). To continue operating, processors buy a portion of cattle from national producers and intermediaries and import the rest from Nicaragua. The processing companies believe that supporting the development of national livestock is critical for beef sector growth. There are very few feedlots and grass-fed finish operations in Honduras. Feedlot buyers from Guatemala and Mexico pressure the market for live animals, causing scarcity for local processors.

Markets for beef. Production is estimated to go 80 percent for the domestic market, and 20 percent for export to El Salvador, Guatemala, and Taiwan. Hondurans are not accustomed to buying frozen beef cuts (which is not the case for pork and poultry) and prefer “hot” or recently slaughtered beef. Cured beef cut imports are becoming popular although local processors are now also offering these products. The local beef industry in Honduras does not produce enough products to satisfy its demand. Local production serves supermarket chains and wholesale distributors, through which their products reach food chains, restaurants, hotels nationwide.

Feed supply. Companies such as Cargill, Alianza, and NICOVITA dominate the animal feed sector and import most of the raw material such as corn and sorghum to produce feed for the aquaculture, poultry, and livestock industries. To make domestic raw material for animal feed producers a viable option, medium to large vegetable exporters could adopt corn and sorghum as rotational crops with

proper storage technology, and silo bags to weather price fluctuations. A similar business model is working well with peanut producers in the Pacific region of Nicaragua. The model could also include cooperatives with access to flat land in Santa Bárbara, Copán, and Ocotepeque.

SUBSECTOR 6 ARTISANAL DAIRY PRODUCTS

Experts interviewed estimated the dairy sector generates 540,000 direct jobs and $ 200 million in annual sales. Reportedly, artisan cheese makers process an estimated 65 percent of milk and 70 percent are not registered with SENASA. El Salvador is the closest dollarized market for the artisan processors located in DO2 areas. Salvadorans have developed distribution channels for the ethnic and nostalgia market in the U.S. There are several milk collection and cooling centers (*centros de recolección y enfriamiento de leche* - CREL's) in the region that could be used to upgrade and diversify the sector. Ethnic consumers in the U.S. market prefer Honduran dairy products, as do CAFTA-DR FTA region consumers including those in Nicaragua and El Salvador.

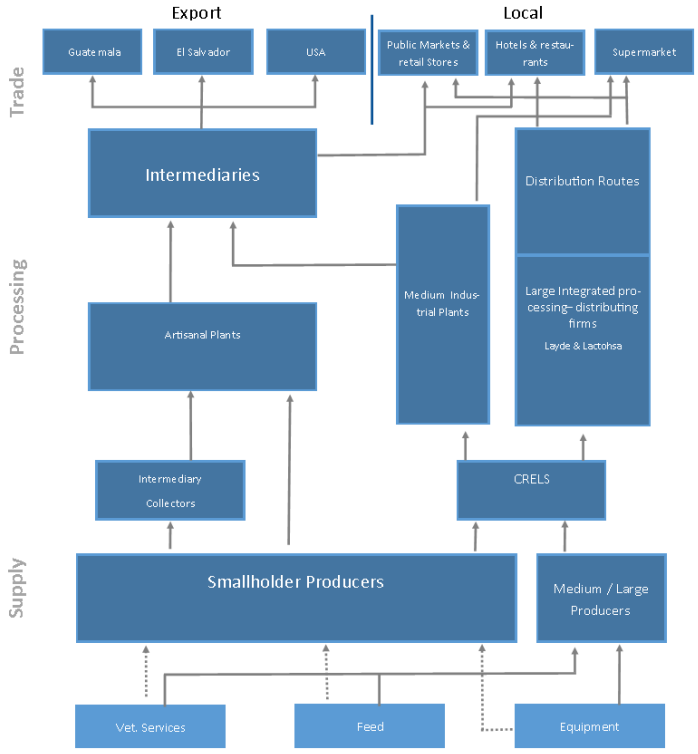
Value-addition. According to the dairy sector analysis document prepared by the Commission for the Defense and Promotion of Competition (*Comisión para la Defensa y Promoción de la Competencia* - CDPC), the Honduran dairy processing sector is divided into two major groups: (1) large industrialized plants that have technology and the sanitary permits required by the government, and (2) small artisanal industries that may not have all of the registrations and sanitary requirements in place. The large industrialized plants (including multinational companies) may process 16,000 to 316,000 liters of milk per day, whereas the artisanal enterprises (majority family owned) typically process between 1,800 and 16,000 liters of milk per day. However, large industries process 30 percent of milk production and artisanal plants, 70 percent. According to TechnoServe, the dairy production industry generates approximately 540,000 direct jobs and annual sales of $200 million. The dairy sector is the largest employer and a large income generator in the rural areas of Honduras.

Lacthosa and Leyde, the two largest industrialized plants, have a processing share of 21 percent, minor industrial processing plants comprise 19 percent, and artisanal dairy milk processors (*empresas de procesamiento artesanal de leche* - PALs) account for 60 percent. PALs also process most of the estimated 89 percent of milk in Honduras that becomes cheese and cream (FENAGH/CAHLE). It is estimated there are 470 to 500 PALs in 12 departments around the country that process between 500,000 to 600,000 liters of milk per day. Forty-two percent of all PALs are in the department of Olancho. Although the variety of products is limited, 62.9 percent produce semi-hard cheese, 48.7 percent butter, 44.1 percent fresh cheese, 24.4 percent ricotta quesillo, 24.4 percent cottage cheese, 13.1 percent dry cottage cheese (cuajada), and 2.1 percent smoked processed cheese.[20] The PALs have varying degrees of formality, investment, and technology; some offer training for their milk suppliers to improve good agricultural practices (GAPs) and guarantee the availability of feed. The National Federation of Farmers and Ranchers of Honduras (*La Federación Nacional de Agricultores y Ganaderos de Honduras* – FENAGH) and the centers for milk collection and cooling (centros de recolección y enfriamiento de leche - CREL) are the primary groups that along with *Alimentos Concentrados Nacionales S. de R. L.* (ALCON) cooperate to improve the feed supply for the dairy sector. Other participants include the Sula Farmer and Rancher Association (*Asociación de Ganaderos y Agricultores Sula* - AGAS), Honduran Chamber of Milk (*Cámara Hondureña de la Leche* - CAHLE), National Service for Agri-food Health and Safety (*Servicio Nacional de Sanidad e Inocuidad Agroalimentaria* - SENASA), and the Chamber of Commerce and Industry of the South (*Cámara de Comercio e Industria del Sur* - CCIS). PALs market themselves through FENAGH, promoting the federation even if they have their own brand or packaging. In return, PALs benefit from expert guidance in processing, marketing, and sales.

Processors that have certification of quality control (sanitary registration), packaging, and branding can charge a premium price. However, the process to obtain the registration is slow and cumbersome. Supermarkets demand products with all the legal and sanitary requirements. The terms of payment are on consignment. There is also not an established system for selling under concession. Most of the sales contracts are informal and leave artisanal producers at a disadvantage. Supermarkets face competition from informal producers who compete on price (even though the quality is inferior).

Material supply. According to the Honduran Chamber of Milk (*Cámara Hondureña de la Leche* - CAHLE), the country produces 1.8 - 2.4 million liters of milk daily and up to 900 billion liters annually, of which artisanal and semi-industrial plants process an estimated 70 percent and large industrial plants process 30 percent. Average yields are 4.1 liters per day per cow (National Agricultural Survey 2002-2008). Milk producers generally supply the following four entities: (1) directly to an industrial processing plant such as Lacthosa or Leyde, (2) indirectly to the closest CREL, which then supplies the industrial plant and sells the milk rejected by the industrial plants to the artisanal plants, (3) directly to the artisanal plants, and (4) indirectly to an intermediary, who usually collects milk on the farm and then sells it to the industrial or artisanal plants. Yields vary according to the season, peaking in the wintertime (December through February). According to the Central bank of Honduras, in 2017 the country imported $46.5 million in dairy products and exported only $29.4 million (HST Codes 0401 to 0406). Seasonality affects the price of milk, ranging from an average of HNL 6.00 per liter during the winter to HNL 12.50 per liter during the summer. The industrial processing plants have two classifications for the quality of milk they receive: type A for automated milking, cold milk, no water, and specific lower bacterial counts, and; type B for milked by hand and non-refrigerated milk, with an average price of $0.50/L (HNL 12.00/L). Of an estimated 90,000 production units, 85,500 or 95 percent also produce meat, among other activities. There are 139 centers for milk collection and cooling (centros de recolección y enfriamiento de leche - CREL) that group about 2,959 farmers, 470 artisanal processors, and 15 industrial processors. But two dominate the market. The sector generates approximately 30,000 direct jobs (FENAGH, Leopoldo Durán). Lacthosa reported that 70 percent of the fluid milk distribution occurs through pulperías. Input resource limitations are the primary cause of low-quality raw milk. The sector will need to address issues including the inconsistent availability of milk, poor management practices, and the practice of diluting milk with water to achieve its potential. Economic resources are also required for the investment in new technologies and training skilled labor to run the dairy plant efficiently. Furthermore, slow bureaucratic processes to register and obtain sanitary certifications hinder competitiveness. Applying as a group through FENAGH, for example, for

Figure 33 VC Map Dairy



registration, certification, and operation permits has the potential to ease the administrative burden of individual PALs.

Market opportunity: Dairy for local market. Although Honduras is not a significant player in the dairy sector at the regional level, national demand for dairy products increased by 50 percent from 80 liters per capita in 2007 to 120 liters per capita in 2011. Annual consumption increased by 15 percent between 2011 and 2017 to 138 liters per capita. In 2017, Honduras imported powdered milk to compensate for the lack of high-quality domestic supply. Experts estimate *pulperías* account for 70 percent of fluid milk distribution. Artisanal products are available for sale in supermarkets, small grocery shops, restaurants, and individual stands throughout the country. PALs also export informally to markets in Guatemala and El Salvador. Artisanal processors are aware that consumers value product quality and diversity. They note increased demand, not only for artisanal cheese but also by-products such as skim milk, buttermilk, and whey.

Market Opportunity: Cheese for Export. The most attractive dairy sector market opportunity is in the export of pasteurized products such as *quesillo* (a type of soft melting cheese similar to mozzarella used in the preparation of *pupusas* and tortillas with quesillo), sour cream, and cured cheeses to the U.S. and El Salvador. Honduran cheese is not only in demand but well known and recognized domestically and abroad for its taste and quality. Thus, stakeholders expect that artisanal processing plants will gain market share. The main constraint is to fulfill the food safety requirements of the intended markets. Strong demand as well as increases in production, including for export fuel dairy sector growth. The value of cheese and cottage cheese exports increased by 25 percent - more than any other dairy product – from $13.2 million in 2013 to $16.5 million in 2017. Data from the National Statistical Institute (*Instituto Nacional de Estadística* – INE) indicates that although milk and its by-products represent less than 1 percent of the country's exports, there was a 133 percent increase in exports from $3 million in 2015 to $7 million in 2017. Moreover, the unit value of exports increased by 56 percent from $ 0.81 to $1.26 per liter (*Boletín INE, Ene-Mar* 2014-2018). Around 80 percent of the dairy exports are to Guatemala and El Salvador, and the majority of these are artisanal cheeses produced by Lacthosa (316,000 L), Leyde (110,000 L), Alcosa (7,000 L), Zamorano (4,000 L), and Fondita (3,500 L). Additionally, the Fortuna plant (owned by Lacthosa) exports dehydrated milk (140,000 L). According to the Secretariat of Central American Economic Integration (*Secretaría de Integración Económica Centroamericana* – SIECA), over 78 percent of dairy exports in the region are among Central American countries. The competitors for Honduras are Nicaragua and Costa Rica.

Figure 34 Dairy product exports and imports ($ thousands)

Product		2013	2014	2015	2016	2017
Milk and cream, not concentrated, without added sugar or other sweetening agents	Imports	4,694	3,968	4,746	4,007	3,156
	Exports	6,818	7,686	6,953	5,557	6,133
Milk and cream, not concentrated, with sugar or other sweetening agents	Imports	15,088	20,212	24,809	16,001	15,570
	Exports	-	859	2,094	2,373	2,671
Buttermilk, milk and cream, yogurt, kefir	Imports	4,816	4,605	4,813	5,411	5,668
	Exports	1,749	1,651	1,774	1,848	1,780
`Whey, whether or not concentrated or containing added sugar or other sweetening matter	Imports	1,060	1,848	1,679	1,143	1,324
	Exports	85	135	71	3,374	67
Butter and other milk fats; dairy spreads	Imports	956	983	1,119	956	884
	Exports	2,849	5,295	2,085	14,338	2,335
Cheese and cottage cheese	Imports	21,921	18,556	19,796	17,104	19,997
	Exports	13,199	14,074	13,358	6,133	16,455

Source: Banco Central de Honduras (BCH)

SUBSECTOR 7 COFFEE AND FINE CACAO

Coffee and cacao beans are both long-term, semi-annual crops produced within shade grown agroforestry systems in DO2 (western Honduras) and DO1 (near La Ceiba, Tela, and Choloma), respectively. However, the Honduran coffee sector is far more developed than cacao in terms of volume, value, and organization as well as international and domestic recognition.

Coffee value-added. Honduras is the fifth largest coffee producing country in the world and the largest in Central America.[68] Coffee comprises 30 percent of the agriculture GDP and 4 percent of the GDP, equivalent to an average of $1 billion annually. Annual production in Honduras in 2017 was 456,000 MT comprising 410,000 MT of green coffee beans for export and 45,600 MT for domestic consumption. There are an estimated 120,000 coffee producers in 15 of 18 departments with a total production area of 293,579 ha. The department of Comayagua has the highest production and yields. At 1,141.23 kg/ha, average yields in Comayagua are 57 percent higher than the national average of 725.75 kg/ha. The maximum recorded yield in Honduras is 1,369.40 kg/ha.

Approximately 700 intermediaries, 54 exporters and 14 industrial roasters that participate in the market system. Coffee generates one million annual jobs, energizing the rural economy.[69] In 2017 Honduras exported 255,889 MTs of coffee valued at $ 860.6 million. Seventy-five percent of Honduran coffee exports go through the producer-intermediary-exporter market channel. Of the remaining 25 percent, cooperatives export 15 percent, producers to export companies, 4 percent, and direct producer exports, 1 percent. Honduras exports approximately 71 percent of its coffee to Europe and 21 percent to North America. The export price of Honduran coffee is 20 percent below the price received by Guatemala and up to 30 percent below the price received by Costa Rica. Local roasters process about 27,216 MT for domestic consumption, sold primarily through supermarkets and coffee shops.[70]

In terms of primary processing, according to IHCAFE, 90 percent of producers use the washed method, which typically creates a cleaner and more uniform coffee attractive to larger buyers, whereas the other methods are often sold in smaller lots to small-batch roasters. These activities are carried out on farms or centralized facilities with equipment for pulping, washing, and drying. Drying is where coffee most often loses quality through poor practices, resulting in mold or other defects. The drying process takes place mostly on concrete patios, some individual producers or cooperatives use raised dying beds or solar dryers. A minority of cooperatives have mechanical dryers. There are outstanding coffee cooperatives at DO2 including Coagricsal, Capucas, and Cocafelol. These cooperatives that have diversified their income sources with cocoa, allspice, honey, and tourism. Supporting them to develop new products with value-added is also an opportunity. For example, testing blueberries, which require the same ecological conditions as coffee could open up a new production chain.

[68] USDA GAIN 2018 Honduras Annual Coffee Report HO1802
[69] Ruben, R., Menenes, N., Ponsioen, T., Sfez, P. (2018)
[70] Heifer, PNUD & IHCAFE (2017)

Figure 35 Value-addition in coffee

There are two principal ways to add value to coffee: (1) improving or maintaining green bean quality through selective harvest and post-harvest handling, and (2) roasting, grinding, and packaging. If producers harvest ripe coffee cherries, the objective is to maintain the inherent quality of the coffee bean through proper processing, drying, and storing. The three main processing methods include natural, semi-washed (honey), and washed.

a. Natural is when the cherries are dried shortly after harvest; the fermentation is within the cherry, once dried the cherry (hull) are stored until hulling. Naturally processed coffee can create very rich and interesting flavors, but it takes longer to dry and so there is higher risk of off flavors from over fermentation and mold.
b. Semi-washed or honey process is when the coffee cherries are pulped, dry fermented and then dried with the mucilage, and stored in parchment.
c. Washed process, the most common in Honduras, is when coffee is pulped, fermented with enough water to cover the beans for 12-24 hours, washed to remove any remaining mucilage, and then dried.

The transformation of coffee through roasting, grinding, and packing adds value by creating a consumable product. Proper roasting is critical for creating a quality product. The roast type is also a way to differentiate the product; lighter roasts have become more common and popular as they allow the unique flavors of quality coffee to reveal themselves. Common roasts include dark (French, espresso), medium (city), light (blonde). Whole bean or ground coffee are sought out based on how the coffee will be prepared. Whole bean coffee maintains its freshness longer than ground. The different grind is used based on the preparation method, espresso, pour over, French press, cold brew, siphon, etc. Packing is used to preserve the freshness of the product and to market it to consumers. Packaging needs a valve to allow CO2 to escape. Nitrogen flushing extends the shelf life of coffee. Packaging is the first interaction the consumer has with the product, and it's the opportunity to explain the quality of the contents and story of the coffee.

For roasted and packaged coffee, the packaging might include the roast type, origin, elevation, quality, the producer story, sustainability and social certifications or other environmental or cultural story. For the local market, certifications are of little importance, whereas the origin, quality, social and environmental story are growing in importance. Price point remains a significant market and marketing factor, with peoples purchasing power often determining their willingness to purchase higher quality and more expensive products.

Depending on what is being marketed, either green beans or roasted and packaged coffee, there are different marketing approaches. Common approaches for both include highlighting the country and often growing region within the country (Honduras has six growing regions according to differences in microclimates and soil composition), coffee quality (based on the cupping score for specialty coffee and a simpler quality grading system for conventional coffee), and sustainability and social certifications (which often form part of the marketing and buyer requirements of green beans).

The Honduran Coffee Institute (Instituto Hondureño del Café – IHCAFE) in addition to its production, productivity, and R&D services, offers quality control training, financing, and facilities for roasting, grinding, and simple packaging to micro and small enterprises. The Association of Coffee Roasters of Honduras (Asociación de Tostadores de Café de Honduras - TOSCAFEH) includes 14 affiliates registered with IHCAFE. Other producers, cooperatives, intermediaries, and exporters not registered with IHCAFE engage to a lesser extent in TOSCAFEH activities. The Cup of Excellence (COE) coffee quality competition and green bean auction began in Honduras in 2004 and helped transform Honduras from a conventional coffee producing country to a specialty coffee producing country. It is estimated that Honduras sells 40 percent of its beans to the differentiated markets. High-quality coffee producers have alliances with importers from several countries that pay premium prices for coffee based on the sensory and flavor profile. These specialty importers develop relationships with cooperatives or estates and often facilitating credit and training to ensure the coffee meets quality requirements. In 2005, Honduras established the Geographical Indication: DO Marcala Coffee. They also developed a collective brand, Honduran Western Coffees (HWC).

The coffee sector in Honduras is extremely well-organized, below are several key institutions:

Figure 36 Coffee sector associations and institutions

The Honduran Coffee Producers Association (AHPROCAFE) supports technical, financial, management, and marketing aspects. The association also facilitates productive, social, educational and economic development opportunities for coffee producing communities including an exemplary training program for young leaders. The National Association of Coffee Producers of Honduras (ANACAFEH) similarly supports coffee producers. Through their business development activities, these organizations established alliances with several farmers to roast and market coffee on a small scale under a collective brand name. AHPROCAFE has 16 micro-enterprises contributing to its brand. Members represent their cooperatives in the two main federations: Federation of Honduran Coffee Cooperatives (CCCH – La Central) and the Federation of Honduran Coffee Cooperatives (UNIOCOOP) - both of whom are members of IHCAFE. These federations provide technical and financial management assistance and guidance. The Honduran Association of Coffee Exporters (ADECAFEH) supports the interests and concerns of coffee exporters, including addressing child labor concerns from client buyers by supporting the establishment of child daycare centers. Private and public associations form the Technical Coffee Board where the sector is analyzed, and decisions are made to improve its technical, financial and marketing performance. The board sets goals for increasing productivity, quality, and other aspects of the sector while IHCAFE and others implement. Institutes, councils, and committees. The Instituto Hondureño del Café (IHCAFE) a not-for-profit organization that has alliances with different public and private institutions, academe, NGOs, and international cooperation projects to manage and channel technical, social, financial, enterprise development, and marketing support. IHCAFE contributed tremendously to the significant transformation of the Honduran coffee sector over the last 15 years and is instrumental in the oversight and implementation of regulations. The National Council of Coffee (NCC) is the highest regulatory authority in the Honduran coffee sector. NCC is the specialized institution that works in all aspects of coffee production, harvesting, and exporting.

Cacao value-added. Despite the agroeconomic potential of cocoa, current production is low. The cacao subsector comprises 3,700 producers, of which 3,182 (86 percent) are men and 518 (14 percent) are women. Ninety-six percent or 3,552 producers are small and medium enterprises (0.7-3.5 ha) located in Mosquita, Olancho (Patuca area), the Atlantic Coast (Tela and Omoa), and Northwest (Copán and Santa Bárbara). Cacao production spans 10,000 ha with average yields of 240.4 kg/ha. These low yields are due in part to poor quality planting material. Most cacao producers also lack the appropriate good agricultural practices and infrastructure for on-farm processing (fermentation and drying). Cacao bean processing includes fermentation, drying, and roasting to produce cocoa. There are three principal ways to add value to cacao: (1) improve bean quality through harvest and post-harvest handling, with an emphasis on fermentation and drying (currently only 20 percent of beans are fermented); (2) processing the beans into cocoa liquor and butter; and (3) transforming the beans directly into artisan chocolate through roasting, grinding, and packaging. However, fine cocoa comprises only 20 percent of production. The remaining 80 percent is conventional unfermented cocoa, which is of lower quality and price. In 2015 there were 29 collection and post-harvest handling centers, roughly one for every 127 producers. Cacao bean production in 2015 was 768 MT, of which Honduras exported 60 percent (461 MT) valued at $1.72 million to Europe, the US, El Salvador, and Guatemala. In contrast, Honduras imported $17.5 million worth of cocoa liquor, butter, sweets, and other cocoa products in 2015, which represents a negative trade balance of $15.8 million.

The most relevant importer is the Swiss company Chocolates Halba which has established an alliance with APROCACAHO, cooperatives, and associations to buy cacao. The company pays producers based on quality parameters, thus creating a price incentive to improve quality. Once Chocolates Halba sells the cacao on the international market, they pay back the price differential to the producer. The company is interested in purchasing large quantities of cacao and has been effective in encouraging increased production and quality.

The limited availability of cacao due to low production and productivity is the most critical constraint for the sector. There isn't enough supply for interested buyers, and the volumes are too low to attract new buyers. According to the Association of Cacao Producers of Honduras (Asociación de Productores de Cacao de Honduras – APROCACAHO), there are plans to increase cacao production

by 10,000 ha. Producers already planted 50 percent or 5,000 ha and expect to increase yields by 0.5 MT/ha to produce 1.0 MT/ha. High-quality planting material (high-yield varieties, clones) available through well-managed nurseries, technical assistance, training on good agricultural practices, and access to inputs will be critical for achieving high yields. Marketing varies for beans and chocolate liquor products, but common approaches for both include the following: marketing the country of origin and often the growing region within the country, environmental and social certifications, and participation in local, regional, and international fairs and competitions. There are limited business services for entrepreneurs interested in starting a cacao processing enterprise.

The cacao sector in Honduras is also well-organized, below are several key institutions:

Figure 37 Cacao sector associations and institutions

Cooperatives and associations consolidate the cacao of their members for quality control and volume marketing which allows for better prices for member farmers. Provision of training and technical assistance in crop management, certification, and processing. COAGRICSAL is one of the most relevant as it has good productive, organizational, and export capacity. *National associations, unions, and federations*. Cooperatives and farmers' associations established the Cacao Producers Association of Honduras (*Asociación de Productores de Cacao de Honduras* – APROCACAHO) which provides technical and management support, marketing and financing to its members. APROCACAHO through the National Cocoa Council has alliances with FHIA, CATIE, UNAH, PRONAGRO-SAG to channel training, technical and financial assistance to producers. Government and parastatal entities such as the National Committee on the Cacao Value Chain (CNCC), Fundación Hondureña de Investigación Agrícola (FHIA), and Cacao Tourist Route promote cacao and its transformation. Most added-value cacao entrepreneurs initiated their enterprises with their own resources after receiving business services and training from a donor-funded project or government entity such as FHIA, APROCACAHO, and the Ministry of Agriculture and Livestock (Secretería de Agricultura y Ganadería - SAG). SAG regulates the cacao sector through the Cacao Competitiveness Framework Decree, which establishes the National Committee on Cacao, made up of processors, producer associations and federations, government representatives, academics, and international organizations, among others. The committee sets standards and sector objectives.

Market Opportunities for Coffee

Green Bean Specialty Arabica for Export. Over the last 15 years, there was steady global growth in specialty coffee consumption driven by retail chains and small batch roasters in the United States, Europe, Asia, and Oceana, along with increased demand in producing countries. Exporters, importers, and direct buyers evaluate specialty coffee based on quality attributes and flavor profile using the Coffee Quality Institutes Q system. Coffee quality is the most important differentiator, but buyers also consider the country and region of origin, social story or benefit, and organic, fair trade, and sustainability certifications from organizations such as the Rainforest Alliance and UTZ. The price paid depends on coffee quality, uniqueness, and certifications and is determined outside of the New York Stock Exchange (NYSE) C futures price, which helps to stabilize the effects of market price fluctuations. Buyers purchase containers, micro lots, and in some cases, nano lots. Direct trade is also increasing through electronic platforms such as Cropster Hub (https://www.hub.cropster.com) that connect producers directly with roasters.

Green Bean Conventional Coffee for Export. Conventional or commodity coffee is the largest market for coffee producers in Honduras. Conventional coffee is not differentiated by its quality or uniqueness but rather its consistent flavor, reliable supply, and low price point compared to specialty coffee. Arabica or mild conventional coffee pricing is based on the NYSE C futures price and is subject to volatile price swings. In coordination with local exporters, trading companies such as ECOM and OLAM conduct transactions on behalf of their clients, which range in size from large firms like Kraft and P&G to medium-sized enterprises such as Farmer Brothers, which also buy specialty coffee.

Locally Roasted Whole Bean & Ground Specialty Coffee for the Domestic Market and Export. Currently, less than 6 percent of coffee production goes to domestic consumption. The primary demand driver is young people (age 15 to 35 years old) consuming specialty coffee drinks and unique high-end coffee at a variety of establishments such as coffee shops, gas stations, supermarkets, offices, tourist venues, and retail spaces.[71] Increased consumption and appreciation of specialty coffee by the demographic is opening markets for retail and wholesale specialty coffee, representing an opportunity for new roasters. The expansion of domestic roasting capacity will result in new export opportunities such as nitrogen flushed roasted coffee in airtight packaging.

Locally Roasted and Ground Conventional Coffee. Traditionally, Hondurans, especially those in the middle and lower income brackets consume El Rey, Café Maya, or Café Indio, low-price, non-differentiated products that are heavily roasted and have a bitter flavor profile. Low income and elderly consumers accustomed to these products will likely continue to drink them.

Figure 38 Coffee market segments

Market Segment	Market Attractiveness	Barriers to Entry	Productive Capabilities
Green Bean Specialty Arabica for Export	**Attractive.** -Growing worldwide recognition of Honduran specialty coffee (Cup of Excellence) -Increasing global demand and a doubling or tripling of current annual world production by 2050 -Growth of specialty coffee sector leads to more direct sourcing and better prices	- Certified production increased to 30% of total exports. Many buyers of specialty coffee want environmental and social certifications, but the cost of certification for the producer is often higher than the price differential buyers pay for certified coffee. -Limited access to credit and financing for inputs for increased productivity and upgrading equipment for improved quality - Existing debt	-Increasing productivity will be more important than expanding production area. -IHCAFE, cooperatives, and associations provide important information and services for increasing productivity, quality, and market opportunities, which need to be extended to non-organized farmers.
Green Bean Conventional Coffee for Export	**Unattractive.** -Price volatility and decline -In Honduras, coffee production is labor intensive but labor is limited, and costs are increasing.	-Conventional coffee prices, governed by the New York Stock Exchange, are very volatile -Current low coffee prices -High production costs, due to increased pests and diseases, especially rust. -Low volumes from smallholder producers require a consolidator.	-The production not sold as specialty can supply the market. -Increasing productivity rather than expanding production area will be vital.
Locally Roasted Whole Bean & Ground Specialty Coffee for Internal Market and Export	**Attractive.** -Increasing appreciation and consumption of specialty coffee both domestically and abroad -Non-volatile price structure -Increased revenue stays within Honduras and is often invested back into the domestic enterprises transforming the sector	- Cost and access to the necessary equipment and supplies (roaster, grinder, packaging) -Certified processing space for HACCP, and other health and phytosanitary requirements for internal retailing and export.	-Specialty coffee that is not exported can be consumed domestically. -Other high-quality coffee (that doesn't reach a specialty coffee score) could potentially supply less discerning consumers
Locally Roasted and Ground	**Unattractive.**	-Local roasters (Maya, Indio, Rojo) have the market covered and may begin to upgrade into	-Conventional coffee that is not exported can fulfill this market.

[71] http://gcrmag.com/profile/view/honduran-health-report

Market Segment	Market Attractiveness	Barriers to Entry	Productive Capabilities
Conventional Coffee	-The conventional market segment will begin to contract as the specialty market expands. -Conventional roasters could shift into the specialty segment.	specialty coffee based on shifting consumer preferences.	

Market Opportunities for Cacao

Conventional and Fine Flavor Fermented Cacao Beans for Export. International niche buyers including XOCO and MarieBelle from Europe, East Asia, and North America have a long history of buying Honduran cacao because of its flavor. Currently, the most significant buyer of Honduran fine flavor cacao is Chocolates Halba, which has an annual demand requirement of 500 MT of certified (fair trade and organic) fine flavor cocao. But Honduran producers provide less than 150 MT/yr, 30 percent of the required volume. To meet demand, existing and new cacao producers could expand productive areas and yields through improved planting material, inputs, and good agricultural practices. But the cacao must also be fermented to meet the desired flavor profile for Chocolats Halba and other fine flavor buyers. More than 70 percent of the cacao produced in Honduras is not fermented, which means it cannot be sold for a price premium but presents an opportunity to add value.

Unfermented Conventional Cacao Beans for Export. Unfermented conventional cacao is a non-differentiated product typically used for cosmetics, cocoa butter, and low-quality liquor and chocolates. The chemical processes in fermentation generate the chocolate flavor, and so unfermented cacao has minimal flavor attributes (although there is some natural fermentation that occurs while the cacao beans are being prepared for drying). Local exporters buy unfermented conventional cacao beans at discounted prices for processing.

Bean to Bar, Bonbons, and Other Chocolate Candies for Internal Consumption and Export. The number of local processors transforming cacao into chocolate bars, bonbons, and other chocolate candies is reportedly increasing. Demand drivers include rising discretionary income, consumer appreciation for locally made products, and regional and international tourism. The local consumer, as with specialty coffee, is likely between the ages of 15 to 35 years old, has a willingness to pay a price premium for high-quality chocolates, and wants to support the local economy. Tourist and foreign buyers appreciate quality, sustainability certifications, and the story behind the product, especially those of women or family-owned enterprises, cultural recovery or discovery, and environmental conservation.

Cocoa Liquor Imported for Bars, Bonbons, and Other Chocolate Candies. According to the U.S. Food and Drug Administration, chocolate liquor (cocoa liquor) is pure cocoa mass in solid or semi-solid form. Imported cocoa liquor buyers in Honduras range from large candy and chocolate manufacturers to small chocolatiers or confectioneries. These local enterprises purchase imported cocoa liquor to manufacture chocolate bars, bonbons, and other chocolate candies, marketing the products they produce as locally made using imported ingredients. Product quality and price depends on the target market and ranges from high-priced, high-quality to low-priced, low-quality, mass-produced products. These manufacturers could include local cocoa liquor in their product line but imported cocoa liquor is cheaper.

Figure 39 Cacao market segments

Market Segment	Market Attractiveness	Barriers to Entry	Productive Capabilities
Market Segment 1: Conventional and Fine Flavor Fermented Cacao Beans for Export	**Semi-Attractive** -Honduran cacao is award-winning and sought after by international buyers -The availability of fine flavor varietals differentiates Honduran cacao from its competitors.	-Many cacao buyers want sustainability or social certifications, but often the sales price differential isn't enough to cover the cost of certification -Low volumes make it difficult to attract buyers and achieve desired volumes	-Existing and new cacao producers can expand production through increased productive area and yields through improved planting material, inputs, and good agricultural practices. -Institutions are weak but could be strengthened using the coffee sector as a model
Market Segment 2: Unfermented Conventional Cacao Beans for Export	**Unattractive** -Unfermented cacao prices are discounted.	-Low volumes -Low quality -Low price -Minimal buyers	-As the production and productivity of cacao increases, the producers that don't have the appropriate infrastructure to ferment and dry all of their production can sell unfermented cacao.
Market Segment 3: Bean to Bar, Bonbons, and Other Chocolate Candies for Internal Consumption and Export	**Attractive** -Increasing appreciation of locally made, high-quality products -Growing disposable income -Lucrative tourist and export market for artisan products	-Cost of equipment to process cacao beans into chocolate properly (roaster, winnower, conche, grinder, melanger, tempering, molds, refrigerators, etc.) -Availability and cost of proper packaging -Certified processing space for HACCP and other health and phytosanitary requirements for domestic retail and export	-Current production could supply internal demand
Market Segment 4: Cocoa Liquor Imported for Bars, Bonbons, and Other Chocolate Candies	Semi-Attractive -Increasing appreciation of locally made, high-quality products -Growing disposable income	-Cost of equipment to process cacao beans into chocolate properly (roaster, winnower, concher, grinder, malanger, tempering, molds, refrigerators, etc.) -Availability and cost of proper packaging -Certified processing space for HACCP and other health and phytosanitary requirements for domestic retail and export	-Imported cacao liquor may be more cost-effective than local cacao liquor

Coffee: The recommended coffee market segments are (1) Green Bean Specialty Arabica for Export, and (2) Locally Roasted Whole Bean and Ground Specialty Coffee for Internal Market and Export.

Cocoa: The recommended cocoa market segments are (1) Conventional and Fine Flavor Fermented Cacao Beans for Export, (2) Cocoa nibs, butter, liquor and powder for local market and, and (3) Artisan chocolate and cocoa products for local market

The export market segments offer growth prospects providing the international demand for specialty coffee continues to grow, and the market for high-quality fermented cacao remains stable. Likewise, the domestic market opportunity for locally roasted coffee and locally made chocolate products is favorable if the Honduran economy continues to grow along with consumer incomes.

The experience and lessons learned in the coffee sector for increasing production and quality could be applied to the cacao sector, albeit on a smaller scale. The Honduran coffee industry (a sleeping giant)

changed dramatically between 2000 and 2007 through the creation of the specialty coffee subsector. Coffee exporters learned how to speak the language of buyers, cupping by attributes and no defects. Sector actors learned to achieve consistent quality and as a result, avoided NYSE stock exchange penalties. Specialty coffee buyers are now among the best ambassadors for Honduras. Similarly, improving the access of cacao sector actors to market information in fine cocoa buyer tastes and requirements, for example, could be part of the formula for increasing the sector-wide pursuit and capture of buyer-driven market opportunities in VAA.

The experience and lessons learned in the coffee sector for increasing production and quality could be applied to the cacao sector, albeit on a smaller scale. The Honduran coffee industry (a sleeping giant) changed dramatically between 2000 and 2007 through the creation of the specialty coffee subsector. Coffee exporters learned how to speak the language of buyers, cupping by attributes and no defects. Sector actors learned to achieve consistent quality and as a result, avoided NYSE stock exchange penalties. Specialty coffee buyers are now among the best ambassadors for Honduras. Similarly, improving the access of cacao sector actors to market information in fine cocoa buyer tastes and requirements, for example, could be part of the formula for increasing the sector-wide pursuit and capture of buyer-driven market opportunities in VAA.

RELATIONSHIPS (VAA)

Producer association. In Honduras, producer organizations are the primary mechanism for producer cooperation. These organizations make bulk purchases of inputs, engage in collective marketing, and facilitate access to advisory and financial services. Some also take-on value-added functions and others hire technicians to provide technical support to members. ASOPRANO, for example, is a producer organization that received technical assistance and support from Funder to develop a processing facility for beans. Producers organized into coffee cooperatives or associations have access to shared facilities to process and dry their coffee if they are not carrying out these activities on their farm Some cooperatives and associations have roasting, grinding, and packaging equipment and the capacity to market a value-added product. The management of cooperatives and associations varies based on the education, experience, and skills of the leadership; from the board of directors to the manager, employees, and members. In the fruit juice sub-sector, organic fruit juice grower cooperatives and smallholder farmers are eligible for fair trade certification in the fruit sector, but their lack of organization impedes certification. There are many examples of donor-supported producer organizations which received technical assistance and grant support for value-addition. Oftentimes, cooperatives lack the capital and know-how to make these investments upfront. Most associations has been fostered by GOH or donor projects. Coffee is one of the most organized and largest sub-sectors and yet, less than 30 percent of farmers are associated, excluding forced affiliation to one of the 4 national federations which control sales and exports. Cooperatives and associations are more or less effective, depending on a number of factors; including, its governance.

Processor-supplier relationships. Agro-processors are overall interested in exploring new ways to develop supply bases for producers through technical assistance, contracting, implementing grades and standards, and improving access to finance and inputs. Although there are many advantages of working with SHFs, exporters for example, reported being afraid of outsourcing part of their volumes with smallholder farmers because of food safety and certification control issues. There are positive examples, for example, Fruit juice Farm Fresh is an example of a Honduran company working with producers in Santa Bárbara to export certified organic single strength pineapple juice to the E.U. Walmart Supertiendas, Paiz, Despensa Familiar, and Maxi Despensa, is one of the few groups that integrated vertically downstream, establishing the company Hortifruti, to ensure quality and quantity

of produce supply. Hortifruti supplies packed fresh vegetables to its 106 stores, representing an important market opportunity for produce suppliers. The PALs have varying degrees of formality, investment, and technology but still offer training for their milk suppliers to improve good agricultural practices (GAPs) and help to guarantee the availability of feed. These opportunities, however, remains significantly limited. El Consorcio Agrocomercial developed an effective model whereby the organization supplies processed fresh vegetables to La Colonia Supermarkets through eight producer associations that aggregate over 1,400 producers. Many processors report the transaction costs of dealing with many disperse producers is too high – it is often easier, and cheaper, to simply import production. In many cases, donors have stepped in to fix these problems. The Rural Competitiveness (*Competitividad Rural* – COMRURAL) project, an initiative of the Secretariat of Agriculture and Livestock (SAG) and the World Bank, facilitates the establishment of contracts between commercial entities and smallholders, providing support in areas such as technical services and business planning. FUNDER's *Recursos para Mi Tierra* project includes a strategic alliance between La Colonia and producer organizations. There is however a need to create a strong business case based on more cost-efficient supply chain models with the quality assurance mechanisms, that provide greater confidence for exports to source from local SHFs. This would allow for more sustainable scaling of these models.

Retail-processor relationships. The relationships between supermarkets, hotels, and restaurants with their providers are typically non-exclusive, meaning buyers can purchase from different providers if their customary provider cannot fulfill the demand. Many retailers request a minimum of 30 days to process payments. The standard rule of payment after 30 days for institutional markets generates barriers to participation, particularly for SMEs and producers selling directly. Fruit Domestic processors tend not to sell directly to supermarkets given their slow payment process (60 to 90 days) as well as the difficulty in maintaining a reliable supply base due to limited cold chains, reliability in the productive base, and other constraints. For example, in the domestic market, supermarkets appreciate the convenience, safety, and quality that packed produce offers, but will prefer to buy fresh vegetables from Guatemalan suppliers that can provide a one-stop shop for their produce purchases that meets these needs.

***Intermediaries* or aggregators** including wholesalers, or *mayoristas*, and small traders, or *minoristas* play a vital role in agriculture in Honduras. Intermediaries are also referred to as coyotes or middlemen, negative terms that signal a predatory relationship between buyer and seller. However, studies and stakeholders confirm that informal intermediaries are the single most important market channel for small producers and many value-added processors depend on them to meet their supply requirements.[72] For example, an estimated 50-75 percent of grains go through intermediaries. Individual producers often sell directly to minoristas through a verbal agreement whereby the minorista pays cash and facilitates transport services. Few minoristas provide technical assistance or facilitate access to inputs. Minoristas often sell to mayoristas, local markets, convenience stores, and pulperías. Producer associations sell to minoristas or mayoristas, depending on volumes. Many mayoristas perform essential functions such as sorting, cleaning, grading, and re-packing foods into plastic bags to sell to small markets and supermarkets. It is important to untangle the reasoning and logic behind the current intermediary-producer dynamic to build a business model focused on a long-term, win-win relationship. Changing incentives could be part of the response, and the working

[72] https://www.agrilinks.org/sites/default/files/resource/files/FIELD%20Report%20No%2014%20Sustainability%20in%20the%20Informal%20Honduran%20Market%20System_final.pdf

capital of all actors in the value chain impacts their ability to perform and expand their roles but building the capacity and skills of intermediaries from a human resources perspective will be vital for increasing agricultural competitiveness.

RESOURCES (VAA)

Raw materials. Honduras produces and/or has the potential to produce a large variety of raw materials such as apple, banana, beef, blackberry, cassava, cherry, cocoa, coffee, dairy, guava, grape, potato, orange peach, pineapple, poultry, strawberry, sweet potato, taro. The diversity of raw materials for value addition is an advantage for value-added product development. However, limited access to and use of inputs results in low productivity. Furthermore, the lack of year-round availability in the absence of calendarized production, poor postharvest handling practices, and fractured trade and marketing within the supply base result in costly inefficiencies and variable quality, which impede competitiveness. Hundreds of thousands of smallholder farmers with less than one manzana (0.7 hectares) produce the majority of raw materials in Honduras. Production technology varies. For example, an estimated 90 percent of bean farmers use recycled seeds, resulting in low germination rates. Recycled seeds do not include drought-resistant varieties, which also impedes productivity. Similarly, fertilizer and herbicide or insecticide rates are less than 50 percent.[73] The irregular supply and the inconsistent quality of milk. Because of the seasons, milk is not always available in the same quantities, and because it is not always properly handled, there is no traceability, giving rise to poor quality and inconsistent expected quality.

Cold chain. Lack of cold chain infrastructure limits the ability of producers and intermediaries to transport raw materials from rural areas to processors. Inadequate cold chains also restricts the ability of processors to secure supply and negatively impact the cost-effectiveness and quality of fruits, vegetables, dairy, and meat inputs for processing. Fruit processors, for example, indicated that one of the main issues that prevented them from sourcing fruit locally was the lack of cold chain to secure the fruit quality needed for high value export markets. Cold storage services in rural areas could allow producers to improve quality, reduce losses, and negotiate better prices. Likewise, developing processing plants near rural producers would increase efficiency. Limited water, energy, and sanitation services in rural areas are deterrents to establishment of processing plants in rural areas.

Research and development (R&D). Reportedly R&D for the agricultural sector is inadequate and has a systemic impact on the ability of enterprises to make evidence-based decisions. Example information needs include a national inventory of cattle farms, cattle genetics research to improve feed, a survey of milk processing factories to define standards, consumer studies for vegetables and fruits, and research into sustainable productive practices. A significant number of organizations in Honduras engage in R&D for agriculture such as the Zamorano Agricultural College, Honduran Foundation of Agricultural Research, Direction of Sciences and Agricultural Technology (DICTA), Tropical Agricultural Research and Higher Education Center (CATIE), and Honduran Coffee Institute (IHCAFE). Low private sector investment in R&D reflects a limited sense of value as well as the fear that new information could leak to competitors. Market validation of new technologies is also challenging. The market for new technologies and innovations in Honduras is small, which negatively impacts the cost-benefit and market feasibility analysis. Spurring local innovation systems will require a concerted effort between agribusinesses, GOH, NGOs, academia, and donors. Local entrepreneurship support programs can also help validate R&D ideas. For example, Green Technology won Honduras's 2018 Digital Challenge for the creation of a technology platform to

[73] Proyecto Red de Innovación Tecnológica, RED SICTA. IICA l

develop maps and images from drones for agriculture. While the Center for Innovation and Entrepreneurship (*Centro de Innovación y Emprendimiento* - CIEZ), at Zamorano University created the drought resilient "Chorti" red bean variety.

Extension services. Extension services are limited for smallholder farmers that supply inputs for value-added processors. A 2017 study on extension systems in Honduras found that national and international NGOs delivered 43 percent of extension services, educational and research institutions (18 percent), cooperatives (14 percent), the private sector (14 percent), and public sector (11 percent).[74] While a significant portion of extension services in Honduras are donor supported, some cooperatives, such as APROCACAHO and IHCAFE in the cocoa and coffee sectors provide extension to their members. In other cases, input dealers provide extension. The quality and reliability of private-sector provided extension is noted as an issue. Private sector companies also report that in many cases the cost of providing extension services is not worth the benefit it provided to their business, in terms of increased supplies or sales. Public or donor funding is likely to be a long-term requirement, particularly for extension provision to smaller farmers. A focus on streamlining diverse efforts and establishing public-private models, bolstered through an enhanced public-sector extension framework could have an effect, although most current models focus on health and infrastructure. FHIA has an effective public-private extension model that delivers technical assistance while generating revenues from contract-based research.[75] Increasing the effectiveness, affordability, and impact of extension would increase uptake by the private sector. Content delivery for the provision of agribusiness information supported by a social and behavior change communication (SBCC) approach and the use of ICT including video and apps to reach entrepreneurs limited by a lack of formal education, engage youth, and integrate other vulnerable populations.

Financial resources. Stakeholders across the sector report that financing is generally available but often not accessible. They describe a consistent lack of products and services tailored to the agricultural sector. Specifically, most actors lack the collateral necessary to secure long-term, flexible financing, which is also the primary reason the banking sector is less interested in agricultural financing.[76] Notable exceptions include the state-owned Mutual Guarantee Fund Trust and Banadesa. Among 15 banks, 12 report having agro-related portfolios, except Banco Honduras, Lafise, and AZTECA. Of 10 micro-credit banks, half have agro-related portfolios (CREDIMERSA, CREDI-Q, FINSOL, FINCA, and ODEF). The current coverage of agro-related loans within the national financing system is US$657million or only 5.2 percent. It is difficult to obtain credit to buy land in rural areas. Rural properties are taken as collaterals by half the value in the market. The GOH is non-compliant with mandated allocation of L.100 million per year for a period of 5 years to put into operation the Agricultural Fund for Reciprocal Guarantee (FAGRE). Finally, regulation for finance institutions doesn't allow the use of risk mitigating instruments like purchase-sale contracts for future delivery and mobile guarantees. As a result of the absence of the formal banking sector, supply chain actors such as processors, input suppliers, intermediaries, NGOs, microfinance institutions, social lenders (Root Capital), and informal lenders (*cajas rurales*), either directly provide or facilitate agricultural finance. The Honduras Recursos para Mi Tierra initiative is a successful agricultural financing partnership model between Fundación para el Desarrollo Empresarial Rural - FUNDER (a local NGO), La Colonia supermarkets, and Ficohsa bank. While these alternative providers crowded

[74] https://pdf.usaid.gov/pdf_docs/PA00TB9Z.pdf
[75] http://ebrary.ifpri.org/utils/getfile/collection/p15738coll2/id/129194/filename/129405.pdf
[76] Further discussion of collateral is in Rules under Financial Services.

in around the gap in agricultural finance, the vacuum left by the bank system, in terms of volume of assets, is too high.

Land distribution and tenure issues are well documented in Honduras and a focus of USAID- and donor-funded activities. A small percentage of the population owns a large percentage of the land. Agricultural producers tend to be land insecure and have small estates, or *minifundistas*. Land tenure issues are linked to an inability to meet collateral requirements to qualify for loans. Women, who hold less than a quarter of land, and indigenous and minority ethnic groups are particularly susceptible to land grabs.[77] More must be done to upgrade the existing land registry records (70.9 percent) stored at INA and municipalities, but which it may not yet been digitalized, mapped, and linked to GPS technology. Also, an additional 7.6 percent of agricultural producing land is going through the registration process. It is believed that increasing titling will increase investment, land transfers, and access to credit. Insecure land tenure is aggravated by growing climate volatility and land degradation. Land issues are interlinked with water resource management and deforestation tied to logging. Strengthening the equitable distribution, tenure, and protection of land resources would have a significant impact on the performance of value-added agricultural by establishing a secure supply base from which to grow. A substantive land issues investigation is not within the scope of the current analysis but will be necessary to inform stakeholder action for positive change.

Water. Water resource pressures are exacerbated by inadequate water resource management and climate change which results in decreased water recharge rates of groundwater and springs as well as reduced soil moisture. The Intergovernmental Panel on Climate Change (IPCC) model consensus strongly asserts that significant drying due to a 10-20 percent decrease in precipitation and close to two degrees Celsius of warming will characterize the regional climate by the year 2050. Parts of Honduras, especially western Honduras, are expected to become hotspots of climate change stress.[78] It is estimated between 5-6 percent of production is irrigated. Honduras needs to increase its irrigation network because producers that rely on just rainfall face lower productivity, quality issues, higher costs, and are more susceptible to plagues, diseases, droughts, etc. Fortunately, INVEST-H is planning new irrigation networks investments (in yet-to-be-selected rural locations) in the near future to address this need. For more information on water resources, see water and sanitation sector analysis.

Specialized services. Rising cost of energy, water, and transport logistics are affecting the sector's competitiveness. As examples, electric rates are among the highest in the region and recent legislation has pegged freight cargo rates to the US dollar. Storage facilities are a problem among MSME producers and there are no publicly available services for cold storage, as existing units are for the exclusive use their owners. Moreover, the supply of refrigerated freight transport is also limited. National firms engage in little consumer demand research to inform product adaptation. SMEs rely on radio, newspapers, and the internet for market signals (prices, buyers, requirements, grades/standards, and trends). Whereas international companies with significant market share extrapolate information based on international research and regional trends, particularly those in Mexico. With the influx of digital technologies for data capture, identifying specific, differentiated market signals should be standard practice. Yet even universities and research organizations are

[77] https://www.land-links.org/country-profile/honduras/#1528466934567-fd17cef6-5782

[78] See USAID Report, Vulnerability and Resilience to Climate change in Western Honduras, 2014 and https://www.crs.org/sites/default/files/tools-research/tortillas-on-the-roaster-full-report_0.pdf

absent from the landscape of market information providers. MSME's also require specialized support services in the areas of food safety, sanitary management, and quality processes, among others. Entities such as SENASA, El Zamorano, and FIDE provide specialized support services for MSMEs including for the importation and installation of specialized stainless-steel equipment and packaging. Stakeholders noted that high taxes on imports of machinery and process automation discourages the development of value-added products for the local market.

RULES (VAA)

The 2004-2021 State Policy for the Agri-food Sector and Rural Areas and the 2014-2018 Government Strategic Plan (*El Plan de Todos para una Vida Mejor*) targets employment and poverty reduction and guides the agricultural system. For example, the documents contain a decentralization policy to modernize the public sector through the strengthening and capacity building of municipalities, allowing them to provide goods and services to communities. By 2038, at least 40 percent of public investment will be channeled through the municipalities, according to GOH projections. The policy provides a favorable regulatory framework for agricultural extension at the local level. Policy implementation could counteract low MSME participation, which is due to lack of organization and is not reflective of their willingness to coordinate with the government.

There are a number of public institutions responsible for implementing

- *Secretaría de Agricultura y Ganadería* (SAG) is responsible for the coordination and execution of agricultural policies and represents the sector. The ministry emphasizes competition, integration, smallholder development, and gender equity.
- SAG oversees the *Servicio Nacional de Sanidad e Inocuidad Agroalimentaria* (SENASA), responsible for certifying agro-sanitary and safety processes.
- The *Agencia de Regulación Sanitaria de Honduras* (ARSA) regulates, authorizes, surveys, and inspects establishments, services, and products to protect consumer health through effective management that reduces exposure to health risks and that in turn contributes to an improvement in the business climate and the country's competitiveness.[79] ARSA is also responsible for granting, renewing, modifying, suspending, or canceling registrations, permits, licenses, certifications, and other health authorizations (*Decreto PCM-032-2017*).[80]
- The National Council for Agricultural Science and Technology (CONACTA) supports a national plan for food technology in coordination with the National Center for Technical Innovation in Agri-food (CENITA) and the Fund for Agricultural Technology Development (FONTEC).
- The *Secretaría de Desarollo Económico* – SDE is in charge of implementing trade policy and is responsible for export and investment promotion.
- The SDE's *Centro de Trámites de Exportaciones* (CENTREX) is responsible for centralizing all the procedures related to exports through the *Sistema Electrónico de Comercio Exterior de Honduras* (SECEH).[81]
- The *Dirección Adjunta de Rentas Aduaneras* (DARA) facilitates trade, revenue, and security through efficient control.[82]

[79] http://www.arsa.gob.hn/mision_vision.html
[80] http://www.arsa.gob.hn/quienes.html
[81] https://portalunico.iaip.gob.hn/archivos/SecretariadeDesarrolloEconomico/Estructura/Descripcion%20de%20los%20Servicios%20Prestado/2015/Requisitos%20para%20Exportar%20CENTREX%202015.pdf
[82] http://www.dara.gob.hn/mision-y-vision/

- The *Consejo Nacional Supervisor de Cooperativas* (CONSUCOOP) is a constitutionally mandated institution that is responsible to control, monitor and supervise the cooperative entities of the country and to safeguard the interests of the affiliates.[83]

High operating costs in transportation, energy, importing equipment and machinery, tax regulations, and customs procedures for exporters, hinders investment and contributes to informality among small farmers. Key institutions such as SENASA have the potential to unburden the system if they increase their efficiency and levels of technology. To simplify and streamline administrative processes and procedures for business operations, the GOH issued the *Administrative Simplification Law Executive Decree 255-200)* so that all relevant state actors regulate industry with speed, efficiency, and respect for economic norms. However, the law has not resulted in any significant benefits for enterprises.

Government controls and regulations can produce adverse effects. For example, price controls on food basket products such as beans and dairy distort the market and incite speculation.

Government price controls on food basket commodities such as beans discourage production by reducing profit margins. The Honduran Institute of Agricultural Marketing (*Instituto Hondureño de Mercadeo Agrícola* - IHMA) is the state entity that regulates bean purchase-sale prices for national food security.[84] The Ministry of Agriculture and Livestock (*Secretaría de Agricultura y Ganadería* - SAG) regulates the dairy industry per ministerial Agreement No. 656-01, dated July 9, 2001, which includes milk processing standards. But there are a lack of traceability and monitoring policies in place to ensure physical, microbiological, and chemical norms that would allow for the categorization of the dairy end products sold in the market and promote good dairy farm management practices. The Federation of Agro Exporters of Honduras (*Federación de Agroexportadores de Honduras* - FPX) is interested in promoting certifications that contribute to improved product quality as a mechanism for increasing producer access to export markets. The GOH authorizes powdered milk imports based on a quota when the internal supply is not enough to cover the demand of the industrial sector. But as a result, powdered milk imports reduce dairy prices each time a stressor affects domestic milk supplies, resulting in a disincentive for producers. In 2013, by Decree 143-2013, the GOH created the National Fund for the Competitiveness of the Agriculture and Livestock Sector with a tax of HNL 0.03 on each liter of milk to support the competitiveness of the dairy sector. But the impact of the funding is unclear.

Agro-industrial companies are required to comply with a complex sanitary regime for proper operation, thus one of their biggest barriers is the web of permits, such as sanitary registrations and inspections, import/export licensing, environmental certifications, etc., which can take up months. These requirements may also require expensive legal assistance, since many of the documentation must be delivered or transactions carried out in person in Tegucigalpa. The National Service of Agricultural Health (SENASA) is the primary agency responsible for maintaining the safety of all agricultural production, including those with export potential, through inspections, certifications, and licenses. This agency is institutionally weak, thus creating a bottleneck for agro-exports to meet international mandated sanitary and phytosanitary requirements. Moreover, producers find SENASA's services inconsistent, unreliable and of poor quality. Also, ARSA centralizes sanitary registrations for food and beverage products in Tegucigalpa. It takes between 3 to 6 months to obtain a sanitary registration needed to comply with food labeling to access formal markets (ex. supermarkets, etc.)

Some producers for the local market complain of unfair competition by both formal and informal actors. For example, the poultry and dairy industries complain about illegally operating farms and

[83] http://web.consucoop.hn/somos/mision
[84] Análisis Rápido Cadena de Valor de Frijol. SAG, Honduras 2011.

processors that sell products at lower prices that don't meet the sanitary requirements, which could impact the health certification for the whole sector. Meanwhile, producers of corn, rice and pork feel threatened competition from US farmers and find CAFTA as a threat to their business. New SAR invoicing requirements are driving non-formalized micro- and small-producers to sell to "*coyotes*" (informal middlemen) outside the formal market. Many of these producers don't have the approx. L.30,000.00 lempiras (US$1,250) to formally register their businesses. Staple foods are exempted from the 15 percent Value Added Tax (VAT) but with new tax regime many inputs used in their production have to pay duties which reduces profit margins. Price control and restriction on export permits on staple foods like beans and corn disincentives production and reduce profit margins.

RESULTS

The depth and complexity of the structure of actors involved in agriculture offer many opportunities for entrepreneurs, employees, consumers, and suppliers to be part of growth opportunities in the sector. Agriculture is a resource-intensive industry, but agriculture in Honduras is in a state of resource-crisis. Almost all processors interviewed cannot find the reliable, quality supply they need. Stakeholders report climate change and other pressures are further jeopardizing water and land resources to be able to sustain agricultural growth. Bottlenecks to resource flows include land tenure, credit allocation, and import tariffs on productive inputs, which significantly reduce investment in the agricultural sector. Markets are imposing increasing quality and certification requirements, necessitating even greater resource investments by industries. These multiple factors compound the need for investment in resources such as technical assistance, finance, etc. The question faced is who provides these resources, and who pays. Sustainable public funding for extension and other services as well as a renewed focus on lowering transaction costs within supply chains would have a positive impact in unlocking investment and create a more enabling environment for sectoral growth. To catalyze a more private-sector driven approach to agricultural development requires market modernization and a shift away from predominate supply chain models which require third-party intermediation which require continued donor-funding.

One notable constraint is that local exporters are too small to generate scale to take full advantage of the market opportunities. The sector requires foreign and domestic direct investment to thrive and grow. Agroparks, or similar infrastructure, would attract local and foreign investors as well as existing exporters willing to expand their operations. The development of agroparks would off-set the risk of investment in fixed assets such as land and infrastructure for processing facilities. Assistance would be required to conduct feasibility studies and work with responsible investment promotion agencies to conduct outreach to foreign and domestic investors and facilitate joint ventures with local exports. The rebuilding of the exporters federation, or creation of a new guild of exporters, could play a prominent role in helping to promote Honduras as a destination for investment. Potential food processor investors could be local or international such as processors from Mexico, Guatemala, Chile, and Peru already export value-added agricultural products that would look to expand to locations to split the risk due to climate change; investors from South America (Chile and Peru) could have the opportunity to expand their seasonal production windows; Guatemalan and Mexican companies can find better conditions in terms of water and labor availability.

New supply chain mechanisms are required for agro-processors to reliably source materials from SHFs. Prospective models could take a role to 'professionalization' of more traditional intermediaries or 'coyotes' to play for value-additive roles. For example, these intermediaries could assist in advisory services or helping to set production plans that align with the calendars of processor raw material needs. An alternative could be acceleration of medium-size farms, which can establish

outgrower or nucleus-farm relationships with SHFs, ensuring traceability and standards are met, while delivering reliable supply to exports. The development of a leadership development program for burgeoning 'middle-market' agribusiness SMEs that can intermediate more effectively at the right scale with SHF on behalf of larger agro-processors would help to streamline the structure of commodity chains to be more efficient and effective. This thread of opportunity ties to the need for business and financial services, or entrepreneurship support, for agricultural SMEs.

Support service systems impose significant resource bottlenecks on the agricultural sector. Further discussed in the financial services sector analysis, more flexible requirements for collateral and the expansion of factoring, longer-term loans or fintech would provide important resources to fuel sector growth. Further, stronger relationships with academic institutions to prioritize R&D, pilot and implement new and innovative technologies. The disconnect between agricultural sector players and support providers requires rules that foster greater trust – whether a shift in collateral rules with lending, or in intellectual property for R&D. Greater market information, provided through partnerships with COHEP for MIS such as SIMPAH and INFOAGRO can help supply the data required for support service providers to tailor their offer, right-size technical assistance, and for agro-enterprises to make better decisions regarding where and how to invest.

Lowering the hurdles to accessing new markets is an urgent priority for the sector. In particular, addressing sanitary and phytosanitary permitting process is a much-needed change. This can be enabled through the creation of a new online platform to speed up the process and have better transparency in registering inputs such as fertilizers, pesticides, and food safety equipment.
The development of a new regulatory framework to accept the services of accredited technicians and decentralize SENASA operations from Tegucigalpa to other areas would also open up market access. Finally, there remains opportunity to leverage e-commerce and expand direct to consumer marketing, particularly for high-value products such as roasted coffee, or other products.

The VAA sector has the potential to provide job opportunities to women, youth, returned migrants, LGTBI, Indigenous and Garifuna Populations and PwD. Women could participate in the different functions, from planting to commercialization. For youth without land, many subsectors such as coffee and cocoa, processed meat, dairy products, high value crops and animal feed provide off-farm opportunities. For example, in coffee, there are opportunities as *tasters*, *administrators, quality systems and sustainability managers and technical assistant.* Returned migrants often have acquired skills abroad in agricultural jobs that can be applied locally as well in agricultural and livestock production as well as agroindustry. VAA also employs the most people with disabilities (57 percent), offering opportunities in the areas of harvest and post-harvest for people who have disabilities including intellectual, blind, auditory, visceral and motor, depending on what type of motor disability is involved. Many crops identified have extensive coverage with Indigenous and Garifuna Populations such coffee, fruits and vegetables: potatoes, yuca, strawberries, mushrooms, coconuts and bananas, in addition to processed food as jellies, pickles, preserved fruit, cassava, banana chips, coconut sweets and wines.



ARTS AND ENTERTAINMENT

ANNEX III ARTS AND ENTERTAINMENT

SECTOR OVERVIEW

The arts and entertainment sector has proven to be both resilient and dynamic, despite on-going regulatory uncertainty and a lack of political support for the sector. Music production has grown, particularly through festivals and the spread of local music via news media; local film production is emerging in prominence; artisinal crafts have begun to specialize and generate higher quality offers; and urban and street art is gradually shaking off its traditional stigma, and is slowly being seen as a catalyst for social impact and non-violent messaging. New technologies are also providing a platform for the wider socialisation of arts, making it more available to mass media. For example, it is now cheaper to produce music and films of all types- and there is still an online market for it. The latest edition of the Festival Icaro film festival included 21 Honduran productions. However, while the sector is rich in creativity and cultural value, it is extremely diverse, dispersed and informal, and as a result, its economic potential remains largely unfulfilled.

An increase in the number and size of festivals and fairs over the last five years demonstrates the renewed dynamism of the arts and entertainment sector. These events provide an important forum for all types of art, from music and film to urban art and arts & crafts, and in turn lead to increased demand and increased production. Particular high points include music festivals such as Festival NU, the Guacamaya Fest, RockFest and Jazz Festival, multi-disciplinary festivals such as Gracias Convoca, film festivals such as Festival Icaro, and design "ferias" such as Auge Boga. The majority of these festivals are the result of private initiatives (with funding coming from commercial sponsorship). Their economic impact is significant, as they involve a range of goods and services, including accommodation, food and complementary activities. The rise in festivals has led to an increase in both international and particularly domestic tourism, although comprehensive data is difficult to access. At the same time, international festivals have helped raise the international profile of Honduran music at events such as the Garifuna Festival in New Orleans and the festival of Les Cultures du Monde in France.

There are strong opportunities for collaboration between the tourism sector and the entertainment sector in artisinal crafts. Crafts in particular hold significant potential for bolstering the tourism economy, as do the various festivals on offer. There is a demand for quality, handmade and local crafts by international and domestic tourists and by the middle-high class. However, this demand remains largely unmet, due to the informal and low-quality nature of production. Nevertheless, there has been significant investment in the artisinal crafts sub-sector in recent years, through capacity-building of artisan groups. Traditional cultures have a rich history and there is a strong tradition of artisanal production, such as the pottery of the Lenca. Honduras has many excellent designers of artisan products, but their products lack differentiation, while intellectual property rights and ease of replication pose a challenge to developing high value products.

There has been a significant increase in film production in recent years, despite it being a relatively new industry. Feature films and documentaries are on the rise. Most Honduran film productions are shown exclusively in Honduran cinemas, although some have been screened at international festivals, and a very few (two) have been shown on international TV. For example, Guacamaya Films produced *Expedientes Criminales*, available on Netflix. New talent, though still lacking, is coming from Hondurans who have studied or trained abroad as well as home-grown talent with graduates of

UNITEC, a Honduran university that now offers courses in Audio-visual Communication and Advertising.

The sub-sector that has seen most radical change over recent years is urban art. The stigma traditionally associated with urban and street art is gradually evolving, and it is slowly being seen as a catalyst for social impact and non-violent messaging. Several new artists have emerged, and a number of associations have been established, although they remain weak. Numerous festivals are including spaces for urban artists to create, develop and showcase their work.

Lack of political support for the arts and entertainment sector, with little recognition of the social and economic possibilities of the creative or orange economy continues to dog the sector. In 2012, the Secretaria de Arte was "downgraded" to the Direccion de Arte. Although several legal initiatives have been launched to support the industry, through both sector-wide legislation (Ley Marco de Arte y Cultura is only in draft form) and more specific sub-sector legislation (particularly in the case of the film industry), the regulatory framework continues to be insufficiently effective. A number of associations have emerged in the arts sector; though they remain small, and lack the skills and capabilities for effective policy advocacy. They include two associations of film makers, an association of musicians and composers, and a number of artisinal craft cooperatives. With a more enabling environment, the sector would have greater potential to expand, generate higher quality products, and create quality jobs for more people.

Poor coordination is prevalent in various sub-sectors, including the film industry, while urban art, for example, suffers from an absence of coordination. Those entities that exist, such as the Asociacion de Autores, Compositores, Interpretes y Musicos de Honduras (AACIMH), are weak, and have limited ability to engage in policy advocacy or dialogue e.g. to identify spaces for urban artists and their graffiti. Among artisans, there is a lack of association, leading to constraints in reaching markets in a coordinated and efficient manner. Knowledge constraints exacerbate this lack of coordination. There is a clear lack of capacity among artists and other industry players to manage the business aspects of their sub-sectors, particularly when it comes to marketing and distribution. At the same time, there are limited formal opportunities for technicians to learn about business, as well as a lack of business support services for producers or managers.

Lack of information within the sector and among the wider public has led to limited visibility and understanding of the orange economy in Honduras. There is limited information about events and festivals being organised, and data on the economic impact of the sector is not easily available. Artists themselves face a lack of information and understanding of the myriad requirements involved in organising an event, leading to reluctance and difficulty in expanding their activity. This is exacerbated by the large number of permits and approvals from various government entities required to stage live events, with application procedures being inconsistent and often prohibitively expensive.

INTRODUCTION

Creative industries are at the core of today's information and services economy, in which innovation and imagination are fast becoming powerful engines that can drive economic growth.[85] Culture should be viewed as an asset that has the potential to generate employment and reduce poverty.[86]

[85] International Trade Centre. (2004). Position paper- Challenges and opportunities in export development of Creative Industries: ITC's future technical assistance for the product sector. Retrieved from: www.intracen.org/WorkArea/DownloadAsset.aspx?id=55506
[86] UNESCO. Cultura y Desarrollo. Obtenido de: http://www.unesco.org/new/es/culture/themes/culture-and-development/

There is growing evidence for this viewpoint in the recent literature on the *Orange Economy.*[87] The arts and entertainment industry is also a very inclusive sector, which creates a greater sense of identity and belonging for its actors, increases critical spirit and solidarity within communities, and serves as a tool to motivate youth to stay and work in their country. Art and culture can create a unique and inimitable tourism offer that can differentiate experiences to attract diverse and new visitors. In this context, the creative economy is currently one of the fastest growing sectors in the global economy.[88]

In 2018, Ivan Duque, the President of Colombia stated that,

> *"Culture is an engine of innovation, is a source of economic and social development and is an antidote against violence."*[89]

In Honduras, arts and entertainment have proven resilient to changes in reforms and political regulations. Despite a fair degree of neglect from public and private actors, the sector has continued to create and innovate. The potential for the sector, if provided a more enabling environment, would have a strong effect in opening greater creative outlets to generate higher quality products and provide decent jobs. This has a profound implication for Honduras' development.

The study identified clear links between the arts and tourism sectors. There are strong opportunities for collaboration between the tourism sector and the entertainment sector. Arts and crafts hold significant potential for bolstering the tourism economy. At the same time, there is also evidence and rationale for why the sector should stand on its own, as it does in other countries. It must be noted that there is a dearth of research and secondary data on this sector in Honduras. We hope this study is one of the first of several that will continue to strengthen the evidence base and highlight the social and economic potential of this unfortunately hidden or ignored sector in Honduras.

The arts and entertainment sector is diverse, dispersed, and informal. The expert meeting included 26 representatives from the sector. The experts recognized that the sector is rich in creativity and cultural value but agreed that their economic contribution is not well documented. The segmentation also showed a high correspondence to tourism. Of the 24 economic activities identified by the experts, none were considered *cash cows*, suggestive of the nascent development of the sector. Cultural festivals and fairs are becoming increasingly popular; these often celebrate community themes and gain national and regional recognition. Audiovisual production, including movies and TV, reportedly has potential, and although there are few producers in the country, it generates a lot of job opportunities. Music production and concerts are also growing and have an international market, but promotion and distribution are weak points among national artists. All experts agreed that artisanal goods are a key activity but noted that the creativity and diversity of products needed much improvement. TMS included these sub-sectors for its analysis. The tourism sub-sector included gastronomy, meetings, recreational, cultural and eco-tourism, and meetings, incentives, conferences and exhibitions (MICE). Theater production, performing arts, and fashion were not selected.

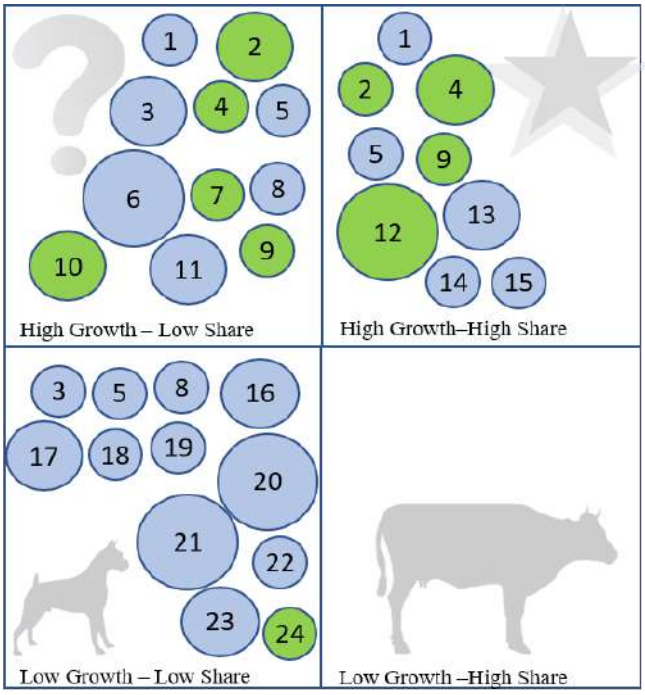
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[87] Restrepo, F.B, Marquez, I.D, and IDB. (2013). The Orange Economy: An Infinite Opportunity. Retrieved from: https://publications.iadb.org/bitstream/handle/11319/3659/La%20economia%20naranja%3a%20Una%20oportunidad%20infinita.pdf?sequence=4&isAllowed=y

[88] Oxford Economics, British Council, Inter-American Development Bank, Organization of American States. (2014). The Economic Impact of Creative Industries in the Americas. Retrieved from: https://publications.iadb.org/bitstream/handle/11319/7747/The-Economic-Impact-of-the-Creative-Industries-in-the-Americas.pdf?sequence=1

[89] Ministerio de Cultura de Colombia. (2018). "La cultura será protagonista en nuestro Gobierno": Iván Duque. Obtenido de: http://www.mincultura.gov.co/prensa/noticias/Paginas/La-cultura-sera-protagonista-en-nuestro-Gobierno-Ivan-Duque.aspx

Figure 40 Growth-Share Matrix from Expert Workshop



1- Recreation Tourism
2- **Cultural Festivals**
3- Paint and art expos
4- **Audiovisual-Movie Prod.**
5- Fashion
6- Theater-Production
7- **Concerts**
8- Education workshops
9- **Music Production**
10- **Audiovisual-TV Prod.**
11- Cultural and Eco Tourism
12- **Artisanal Goods**
13- Gastronomical Culture
14- MICE
15- Performing Arts
16- Cultural Consulting
17- Art Galleries
18- Traditional Games
19- Music distribution
20- Private Museums
21- Theaters (infrastructure)
22- Editorial
23- Orchestra/Choirs
24- **Cultural Centers**

Please note that some of the economic activities listed above were classified in different quadrants. The size of circles reflect the level of agreement among experts, a large circle would indicate a total agreement on that quadrant. Green circles are the activities chosen for EMA and MSA research.

As noted, the creative economy is becoming more widely recognized from an economic point of view including in the recently published Inter-American Development Bank (IDB) report denoting its ability to generate wealth, create jobs, and have a social impact.[90] In Honduras, this sector has grown dynamically in the past decade despite limited engagement or support from the government. This sector has relatively low prioritization nationally. In 2012, the *Secretaria de Arte* was "downgraded" to *Direccion de Arte*. Despite this, each selected sub-sector has been growing, with its own opportunities, challenges and success stories. A description and the recent history and trajectory of these sub-sectors are as follows.

Artisanal Goods. In Honduras, artisanal goods are tied to a cultural identity that is passed from generation to generation. For example, the Lenca people, which dates back to the sixteenth century, are currently using their pottery to maintain their culture, while making a profit.[91] Most of the production of artisanal goods is done in the poorest departments of Honduras such as in Intibuca, Lempria, La Paz and Valle. Handicrafts present relatively more export opportunities than other arts sub-sectors - the major market served in Honduras is domestic and foreign tourists. Top products are pottery and ceramics, weaving & basketry (natural fibers) and clothing/fashion (textile), although types of crafts also produced are jewelry, handbags, leather craft, woodwork carvings, paintings, metal work, photography, fabric printing, and stone sculpting. There are opportunities for value

[90] Restrepo, F.B, Marquez, I.D, and IDB. (2013). The Orange Economy: An Infinite Opportunity. Retrieved from: https://publications.iadb.org/bitstream/handle/11319/3659/La%20economia%20naranja%3a%20Una%20oportunidad%20infinita.pdf?sequence=4&isAllowed=y

[91] Roatan Tropical Vacations. Lenca People. Retrieved from: http://www.roatan.ws/honduras/lenca-people.html

addition in the textiles. Many textiles have complex patterns that differ by region and by cultural background of the producer. This however does not mean that producers cannot merge patterns, increase their quality in the design of their textiles, or diversify how the textiles are used. For example, there has been an increased use of Lenca textiles to produce ready-to-wear clothing, such as shoes, sneakers or wallets. There is room for innovation and creation of colorful patterns with natural fiber. Innovation is a major challenge for the handicraft artisans. The future development of this sector therefore will require collaboration with export traders to foster better access to creative new designs. Demand for quality, handmade and local crafts by international tourists and middle-high class remains unmet as production volumes of artisanal goods in Honduras are low.

Music. The musical panorama in Honduras includes a range of genre including popular music, classical music, rock music, and world music which often converge. Artists such as Hibriduz Jazz blend multiple influences to appeal to both local and international listeners.[92] Their live shows, such as the local festival *Lago Fest*, draw thousands of local and international tourists.[93] This suggests that there is a potential market for local bands, including those that exemplify local indigenous sounds and culture. The music industry includes employment from production, live events and related sectors, such as tourism. In the last 10 years, the music industry has presented notable growth from production to demand within Honduras. The sub-sector has led to recent change in how music is presented to the consumer; such as the development of a festival showcasing live music to young people. Additionally, there is a large amount of music being created by emerging artists who are showcasing their music in smaller venues such as bars, restaurants, cultural centers, and private events. Music has been mainly distributed at the national level through festivals such as *Guacamaya Fest*, *RockFest,* and *Jazz Festival*. There has also been an increased presence of Honduran music in the international scene through events such as *Sound Garifuna* and the festival of *Les Cultures du Monde* in France.

The jazz band called Hibriduz Jazz originally from Tegucigalpa founded in 2004, mixes different genres such as Latin-Jazz, trova-jazz fusion. In 2014, this band played bossa-jazz at a festival in collaboration with Brazilian singer and guitarist, Sander Pinheiro and the Nicaraguan trombonist, Iván Guevara. In 2016, the band collaborated with the Japanese musician Shota Lee, and together with Big Band Jazz created the innovative PuntaJazz mix; this inspired their second album that is currently being produced. This is an example of the diverse styles offered by Honduran musicians and their ability to diversify, evolve and be resilient.

Audio-visual Productions. This nascent sub-sector has only recently developed in Honduras over the past ten years. The sector emerged largely due to returned Hondurans who received education in other nations and from more recent graduates of UNITEC's Communications and Publishing program.[94] There is currently an emergence of film production in Honduras, especially in comedy. The comedy, *Quien paga la cuenta,* which was released in 2013, was produced by Guacamaya Films and has broken national sale records with 107,306 tickets sold[95]. However, this market is underdeveloped and cannot currently compete with other international productions. For comparison, this movie had approximately 2.5 percent of the sales of average comedy value in the United States that year. [96] This sub-sector has a high potential for social inclusion and has allowed marginalized people, such as the LGBT community, to tell their stories and share their view through short-films.

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[92] Hibriduz Jazz. Obtenido de: http://hibriduzjazz.com/tienda/?orderby=price

[93] Hoy Cierra el Lago Fest con un desfile de Carrozas Acuaticas en los Naranjos. (2018). *La Prensa*. Obtenido de: https://www.laprensa.hn/honduras/1204103-410/cierra-lago-fest-desfile-carrozas-acuaticas-los-naranjos

[94] Unitec. Obtenido de: http://www.unitec.edu/

[95] See Figure 2, below

[96] The Numbers. Domestic Theatrical Market Summary. (2013). Retrieved from: https://www.the-numbers.com/market/2013/summary

Many women reportedly hold managerial positions such as producers and directors, allowing them to access better salaries and influence change by being role models for the next generation of women. In recent years, there has also been a significant increase in the production of Honduran feature films and documentaries following the return of national experts trained in Cuba. These are mostly shown in Honduran theatres, although some are entering international film festivals. Currently, only two have made it to internationally commercial channels. Guacamaya Films has produced one show available on Netflix called *Expedientes Criminales*, and Sin Fronteras is now producing *Café con Sabor a Mi Tierra* with a 100 percent Honduran production team, which is set to film in both Honduras and Spain. The way that these movies have been able to take off is through private sponsorship and support, such as the *Instituto Hondureño del Café* (IHCAFE). The local investment in movies is partly to cover the company's corporate social responsibility, but it also is a strategic manner to attract, showcase, and promote Honduras to tourists.

Urban Art. Graffiti is a form of self-expression that is intended to be unregulated and free for the consumer. This makes it a complex sub-sector to analyze from the perspective of a market systems analysis. There are many policy barriers which restrict this form of expression and its artists. There is a common sentiment in Honduras that the population that engages in graffiti are vandals. An exception to this is Rei Blinky, who has turned this into a profession, doing commissions for local businesses or private individuals to paint murals and trucks. While philosophical and legal questions around urban art being commercialized, there is no debate around the inclusive potential of this sub-sector. Urban arts help to create acceptance of youth by their communities. There are currently 30 urban artists in Honduras, who are working with NGOs to invest on urban art to create community, self-expression, and an escape from violence for at-risk youth through projects like the One Drop Project.[97] These projects provide a safe space for young people and give them hope and a voice, even in the most dire of environments, through a medium of art that is conducive to discussion. Over the past several years, the stigma associated with this sub-sector is slowly evolving to be perceived as a catalyst for social impact and nonviolent messaging. As a result, new artists have appeared, and several associations (although remain weak) have been established. There are numerous festivals in the country that are opening spaces for artists to develop their art, such as the Urban Art Festival of the Museum for National Identity, Festival of the Sun (San Pedro Sula), Guacamaya Fest, Hip Hop Festival, The Art of the Street, Graffiti Festival, The Art of the Streets, National Festival of Urban Arts, and Without Borders. Most of these festivals are the result of private initiatives and funding coming from commercial sponsorship. They have had a significant economic impact by generating a demand in accommodation, food and other complementary activities. These festivals have also driven the growth in national tourism by attracting national and international consumers, although statistics remain scarce around profit, if any, for the urban artists that showcase in the festivals.

Figure 41 **Transfiguraciones by Rei Blinky[1]**



[97] ONE DROP. Retrieved from: https://www.onedrop.org/en/project/honduras/

Figure 42 Non-selected Sub-sectors

The sub-sectors discussed below were considered, but not selected for further research within this market systems analysis based on feedback from the SME meeting.

Performing Arts. It is not common in Honduras for people to go to the theater. When they do go, plays are typically free for the customer and are mostly subsidized events. Experts evaluated the market demand for performing arts and found that it is not sufficient at this point. Additionally, there are large financial barriers to production, and there is only one school of performing arts in Honduras. It was noted that some performing artists from the school have chosen to go abroad to further pursue career opportunities. Although performing arts is a pivotal form of self-expression and can be a powerful form of social identity in Honduras, it currently is not profitable and has less opportunities to create decent jobs, especially for the economically marginalized communities.

Visual arts and museums. There is a limited number of artists who produce art and are few galleries and museums in Honduras that exhibit visual art. There are 21 museums in Honduras; 18 are government-owned and managed and three are privatized. Most government-owned museums depend on a very small budget financed by low-ticket revenues e.g. the average entry cost is 10 lempiras (less than 50 cents). In 2010, the museum *Villa Roy* was closed to the public due to poor maintenance and infrastructure oversight, despite numerous warnings.[98] There is potential to strengthen funding sources for museums through the private and public sector, but absent this, this sub-sector does not offer strong employment potential.

Literature. This sub-sector was not selected as it was deemed difficult to analyze by the TMS team. In Tegucigalpa, there are four book stores, and these tend to be faith-related. There are few well-established writers in Honduras. The sub-sector of written literature suffers from low demand and the availability of reading materials through online sources. The release of a national book is sporadic; new Honduran novels and poems are only released every few years.

History and trajectory. The arts and entertainment sector includes a dynamic set of people that could have a positive and significant effect on job creation. Many marginalized individuals are attracted to this sector as a creative outlet that is driven by passion and culture; however, there are certain groups that are more prevalent in each sub-sector. For instance, in the music sub-sector, youth, women and ethnic minorities (especially Garifuna) are strongly engaged. In the artisanal goods sub-sector, rural ethnic minority women have been sharing their culture as an alternative income source, while continuing to celebrate tradition. The LGBT community has found their voice in showcasing their stories through short-films to bring awareness to the challenges they face in Honduran society. The urban art sub-sector creates a safe environment and sense of community for at-risk youth to escape from violence and pursue an alternative path to gang-related activities.

The art and entertainment sector is also a stigmatized sector. Culture is often viewed as a luxury that is secondary to more pressing economic sectors, like manufacturing and agriculture. Although this sector has been growing recently, the growth has been uneven and actors tend to business in silos with minimal collaboration. Many are in this space because art is their passion, yet art continues to strengthen cultural identity through practice. In addition to shifting the general perception of the Honduran population towards art, producers themselves need to shift to see themselves as entrepreneurs, and to acquire the skills and capacity needed to make art a business. This shift will help to make the art and entertainment sector more economically viable in Honduras.

MARKET OPPORTUNITY

Artisanal crafts for tourists. Tourism markets place a higher value on items that are authentically crafted and imbued with the cultural element of the destination. Therefore, the presence of tourists

[98] García, A. Villa Roy, una histórica mansión que se derrumba. (2017). *Proceso Digital.* Obtenido de: http://www.proceso.hn/portadas/10-portada/villa-roy-una-historica-mansion-que-se-derrumba.html

provides a significant market boost to the arts and crafts business.[99] The national tourist is a major consumer of artisanal goods. Markets are typically concentrated in higher tourist destinations where tourists purchase crafts in production centers, pavilions, and souvenir store fronts. The demand for these products is typically associated with decorating the household of people who feel cultural proximity to these products and have a desire to showcase the crafts in their homes.

Artisanal crafts for export markets. The global artisan economy is a $34 billion per year industry.[100] Countries in the developing world have a competitive advantage in this sector because of their rich cultural traditions, diverse artisanal skills and unique raw materials. developing countries today account for 65 percent of handicraft exports around the world.[101] For example, there are more than 100,000 ethnically identified Lenca people in Honduras[102] that have been successfully selling their pottery in the United States and Europe for home decoration purposes.[103] While these figures are significant, the artisan sector in Honduras still has a long way to go to reach its full potential.

Figure 43 **Pottery with traditional Lenca design being sold online to the European market for approximately $35.**



International festivals and fairs. According to UNESCO,[104] international artisanal fairs offer a strategic market for producers to share culture and widen the market for cultural products. They also ensure quality and price standards that protect both buyers and sellers. Additionally, international fairs allow the producer to be more aware of the regional market, and allow buyers to form links with producers. An example of an international fair that offers a market for the Honduran producer is the *2018 Festival de Malaga Cine en Español* (FMCE)[105] in which the documentary *Negra Soy* by Laura Bermudez was featured and won an award. Laura Bermudez produced the film herself with the support from private companies including local hotels and airline companies. Sponsors are motivated by the exposure they can get from successful films that showcase to wide audiences.

Domestic festivals and fairs. Festivals help sell a wide range of art content including music, dance shows, film, fine art, literature and poetry, in addition to visual arts.[106] Festivals in Honduras feature mixed programs that allow consumers to be exposed to multiple actors and mediums of art. Festivals range from being as short as one day to lasting over a month. They provide a market for all four sub-sectors analyzed. Festivals are important as they are an entry-point for new artists to be discovered and serve as ways to generate buzz and to increase demand for artist products. An art fair is a

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[99] Ministerio de Cultura de Colombia. (2018). "La cultura será protagonista en nuestro Gobierno": Iván Duque. Obtenido de: http://www.mincultura.gov.co/prensa/noticias/Paginas/La-cultura-sera-protagonista-en-nuestro-Gobierno-Ivan-Duque.aspx

[100] Indego, A. How artisan sector can change the world. (2016). Retrieved from. https://www.one.org/us/2016/05/13/how-the-artisan-sector-can-change-the-world/

[101] IBID.

[102] Honduras Arts. Ceramica Lenca or Lenca Pottery. Retrieved from. https://hondurasarts.com/ceramica-lenca-or-lenca-pottery/

[103] La Esperanza Intibuca, Honduras. Retrieved from: https://laesperanzahn.wordpress.com/art-and-lenca-culture/

[104] 2001 reference in the Milestone 2 of the MSA – however, there is no actual bibliography

[105] Murillo, L.A. (2018). El Documental "Negra Soy" de Laura Bermúdez gana premio en Festival de Málaga. *Estilo.* Obtenido de: https://www.revistaestilo.net/tendencias/1171603-444/el-documental-negra-soy-de-laura-berm%C3%BAdez-gana-premio-en-el-festival

[106] *Korza, Magie, Bacona, Fiscella and University of Massachusetts. (1989).* The Arts Festival Work Kit*. Arts Extension Service. Retrieved from: http://www.worldcat.org/title/arts-festival-work-kit/oclc/21158611*

subgenre of arts festival focused on visual art. Local art fairs provide a market for a range of artists, art dealers, collectors, and curators who buy or sell artwork in a venue, or gallery, that is open to the public. Some items for sale include photography, paintings, drawings, metalwork, handcrafted items and pottery. An example of an art fair is *Hecho en Casa Saturday Bazaar*[107] in Tegucigalpa and San Pedro Sula, which is sponsored by Banco Ficohsa as an initiative to support MSMEs.

Live performances. Live performances incorporate not just audio and visual arts but also the use of production equipment and services such as staging, scenery, mechanicals, sound, lighting, video, special effects, transport, packaging, communications, costumes and makeup. In Honduras, the *Gracias Convoca* concert is comparable in attendance, complexity and quality to international music festivals. This weeklong event reportedly has over 100,000 attendees, attracts a high-level of sponsorship with public and private actors collaborating to showcase a variety of regional performers. Festinal NU is another cultural event, which showcases emerging alternative music from Central America. The live performance segment of music provides a platform for artists to showcase their work and promote albums to increase sales of their product. Live shows such as concerts are also programmed in cultural spaces such as cafes, bars, and music circuits. Private companies such as BAC, CLARO, TIGO, Televicentro, among others have also promoted live performances.

Films for local and international markets. The main obstacle of this sub-sector is the lack of demand from local consumers that still perceive Honduran films as subpar in comparison to what is available in the international market, such as Hollywood movies, or even regionally produced television programs coming from Brazil. National movie theaters project film projects produced nationwide. Films are distributed by MetroCinemas (national), Cinemark (USA) and Cinepolis (Mexico). Most Honduran films are shown in MetroCinemas. It can be difficult for locally produced films to showcase in movie theaters, as there is reportedly low appreciation for local movies due to perceptions of a weak market. This creates a vicious circle whereby this decision by theaters influences the ability of the end consumers to see Honduran movies, which in turn limits their demand for Honduran films. Additionally, the market for Honduran films in theaters is likely limited due to competition from international films and Honduras' small overall market.

Content for digital users. New technologies are allowing for socialization of art, making it more available to mass media. It is now cheaper to produce films, shorts and music. Although quality is lower than professional standards, there is still an online market that can be reached (e.g. the last edition of Festival Icaro included 21 Honduran productions).

Among these market segments, artisanal crafts for tourist and domestic and international fairs exhibit the most immediate potential. Artisanal crafts are an important aspect of tourism, and given the size of the tourism and export market, it could provide tangible job opportunities if quality is sufficiently high and Honduras can differentiate its products. Both domestic and international fairs provide a way for producers from multiple sectors to find new consumers. These events also provide producers important feedback to be able to continue to evolve their art and improve product quality.

ROLES

Artisanal Craft Production. This sector is largely occupied by family businesses which have inherited the cultural traditions for crafts from prior generations. These are mostly informal businesses run by women. There are several cooperatives engaged in production. For example, in El Cacao Rio Grande

[107] Banco Ficohsa. Obtenido de: http://www.hechoencasa.com.hn/

there are five textile cooperatives EMATE, EPROSIL, COMIPAL, Locos El Cacao and Alianza. Honduran artisans primarily sell direct to local individuals and/or foreign visitors though locally owned stores, fairs, trade shows, and hotels, and through distributors that deliver products to retailers in cities like Mercado Guamilito in San Pedro Sula, or the *Feria* in Valle de Angeles. A smaller share of artisinal crafts are sold through souvenir shops, online stores and social media.

Actors in this sector experience a range of limitations. For instance, there are limited markets for artisanal producers. Artisans are typically located in rural and remote areas; however most of their consumers are tourists concentrated in the cities. This is a barrier for many artisans that typically have limited mobility. There is also a difficulty in access to supplies, as many artisans have limited sources of income and cannot afford to save to invest on their production. This problem is exacerbated by low level of access to finance, access of MSMEs to international markets and lack of government support to facilitate their business ventures. Craftmanship is largely taught through families and it is seen as a talent, not a workable skill that can be improved. There is limited training provided to artisans, which has implications in terms of the ability to innovate and diversify designs.

Organizers. Organizers include private actors such as music production companies, movie theaters, and cultural centers, as well as public and private sponsors and NGOs. Effective organization is critical to putting on festivals, fairs, bazaars, and live events. Organizers are responsible for the overall production of the events and make decisions on design and formats of the festival or show including; identifying and setting the line-up, finding technician, and managing the budget. There are approximately 20-30 event producers in Honduras, but interviewees considered only 3-5 to be professional and profitable. Due to the limited budget for most events, the artist often also takes on the organizer role. NGOs also play an important organizational role. The initiative called *Arte Que Mueve,* which is funded by USAID and other donors, targets dangerous neighborhoods through street art in violence-prone areas, in order to get people off the streets.

Production companies. There are 10 film producers in the country that make films, shorts and videos. The most important producers are HTW Honduras This Week, Guacamaya Films and Sin Fronteras. The average cost of putting together a movie production is $45,000- $50,000, and the most expensive film produced in Honduras was *Morazán*. This movie was co-produced by the Francisco Morazán Pedagogical University and Guacamaya Films, and cost approximately $125,000. Production companies reported issues recovering investments because of challenges regarding the distribution and marketing of the films, which is a problem common to the entire sector. Given low market penetration in, and low returns, for cinema, production companies tend to also produce other types of commercial videos for private companies and institutional campaigns. There is little knowledge on how to submit proposals to clients and financers of their projects. This is associated with the lack of a "business case" for nationally produced films. Currently, local movies are presented as ways in which to showcase culture, rather than a profit-driven effort.

Sponsorship. Another cross-cutting actor is the sponsor. The role of the sponsor is to help pay for production and content distribution. Many companies prefer to provide corporate sponsorships for specific services such as audio, lighting, lodging, food, transportation tickets, logistical support. Local Chambers of Commerce, Chambers of Tourism, the *Instituto Hondureño de Turismo* (IHT), and the Honduran Institute of Anthropology and History (IHAH) also sponsor and organize fairs and festivals. The two main drivers of sponsorship are to either advertise their own product, or to demonstrate their corporate social responsibility criteria, allowing them to have tax benefits.

RELATIONSHIPS

The arts sector in Honduras is self-described as disorganized, with a multitude of actors operating independently, often informally and unaware of what is happening within the industry. The inability to articulate a unified vision or value for the sector has broad consequences. Urban artists require space for graffiti, but often they are unable to express the value of their medium of art to their community. Despite having unique and valuable designs, artisans remain fragmented and unable to reach better markets due to inefficient coordination. There is a common tendency to work in silos rather than collaborate with colleagues who are perceived as competitors. This is problematic because cooperation and collaboration are at the heart of what allows creative industries to grow and mature.

Artistic collaboration. In arts, collaboration can be artistic in nature, as it stimulates new patterns and innovations in design and quality. Collaboration and influence are essential to creativity, as you can see from examples such as Hibriduz Jazz which blends the different musical genres of Latin and jazz into something that is uniquely Honduran. Collaboration can be done in an informal manner where established artists and emerging artists come together to share knowledge and experiment with new genres that enrich the country's art scene. Because of these collaborations, demand has grown at the Central American regional level, where different local bands are invited to exhibit their work. Creative clusters occur in urban areas where there is a high concentration of cultural activities, giving rise to agglomeration effects such as knowledge-sharing, developing markets, and specialized support services. In Tegucigalpa, for example, there is evidence of an emerging cluster involving local co-working spaces, cafes, museums and cultural centers that sponsor events and promote local artists. These relationships and alliances tend to be effective, however nascent. However, there are also examples of ineffective competition- in artisanal crafts, it is not uncommon for copying of designs, due to lack of legalization of designs or intellectual property - this dampens the incentive to innovate.

Formal associations. The arts and entertainment sector is weakly engaged in policy advocacy and dialogue. This is largely because actors do not see themselves as formal economic players. This is most obvious in the urban arts. Given its potential for violence prevention, it would be a seemingly obvious sub-sector for public support, and one that has a greater relationship with the international community. In the last five years, there have been several movements and associations that have strengthened urban graffiti, such as Arte de las Calles, Warriors Zulu Nation HND, Artilleros del Micrófono y EscenaHH. However, there is still limited public tolerance, much less support, for urban art. There have been recent growth associations within the sector, such the *Asociacion de Autores, Compositores and Interpretes y Musicos de Honduras* (AACIMH), and several arts and crafts cooperatives. For example, together with the Ícaro Festival, AACIMH has provided a series of workshops and talks on different aspects of the production process of music. However, the associations remain small and lack the skills and financial capacity for efficient policy advocacy.

RESOURCES

Venues for arts and entertainment. Interviewees reported a need for venues and areas for artisans to produce and sell their products. In the crafts sub-sector, as many artisans work from home, it is difficult for potential customers to locate artisans and their products. Public infrastructure is important to the development of creative clusters. Given the micro-scale of production, artisans usually cannot afford commercial space in shopping malls and other high visibility areas. Similarly, interviewees noted that spaces for live performance shows are limited. Many festivals, fairs and live shows improvise with whatever existing space they can book, such as gyms and restaurants. These present sub-optimal conditions in terms of acoustics and facilities which hurt the audience experience. The high cost of booking results in the few existing venues, such as Chochisosa Stadium

and the Colosseum of National Engineers, primarily cater to international artists. In some cases, local bands get together to afford the costs associated with these larger bookings. Overall, Honduras does not have specialized venues that only cater to live events. Venues are generally multi-purpose and lack the necessary equipment for shows, such as acoustics, access for handicapped people, bathroom capacity and good security. These factors discourage consumers from attending live shows.

Inputs, equipment and services. Locally available indigenous materials are the most widely used by artisans. However, some raw materials and machinery that are not produced in Honduras must be imported to increase the scale of production. Imported materials include fabrics, paper, wire, brushes and leather. There is reportedly a large gap in the technology and services available for artisans. Many artisanal producers are located outside the main cities and have very limited access to technology, which makes it hard for them to deliver such services. Similarly, access to capital is noted as important for supporting access to equipment and inputs. Improved access to artisan resources and support services would strengthen the economic development of the sub-sector. Live events require audio, stage and lighting equipment. There are currently around six large suppliers of this necessary equipment in Honduras. Equipment rental is considered expensive by the national artists, many of whom prefer to acquire their own equipment or reduce the technical rider to lower costs. Similar equipment issues are noted in the urban art sectors. High quality aerosols and masks are supplied by only two local suppliers. This leads to a distortion in the market prices for these products with local prices tending to be much higher than abroad. Artists noted buying supplies from El Salvador to reduce their costs of production.

Specialized workforce. There are advancements in technical expertise and qualifications to better compete and meet market demands. Honduras has a solid base of professional experts for musical production and in the film industry, some of whom have studied abroad and returned. In addition, the degree of Engineering in Film and Television was started at the Polytechnic University of Honduras in September 2018. This is the first time that this degree has been offered and provides an avenue for students to develop their expertise in a variety of audiovisual processes. However, a lot of progress must be made in this space. For example, *El Paletero* did their post-production in Puerto Rico and the United States, which is progress in the right direction but should be expanded. This is also applicable to artisans who have received some training but must have a cultural shift to see themselves as businesses. This is necessary in order to make this sub-sector profitable by going beyond the technical expertise and making producers see their craft as profitable source of income.

RULES

There have been two notable legal proposals to provide support to the industry. The *Ley Marco de Arte y Cultura* seeks to promote, protect and safeguard the different creative processes and cultural assents in Honduras. Also, the *Ley de Fomento a la Industria Cinematografica* has the objective of setting standards for the production and quality of movies in Honduras. These proposals lack public support, and consequently have not moved beyond working drafts. This lack of political engagement within the arts and entertainment sector is exemplified by the fact that the Art and Culture Directorate was downgraded from a Ministry to a Secretary, to its current status as a Directorate which has reportedly been associated with significant budget reductions.

This lack of governmental support and investment has created numerous barriers to the growth of the sector. These barriers range from formalization challenges and understanding the tax framework to significant reported red tape to obtain permits. At the municipal level, processes regarding permits for musical events are not clear and are often delayed. It can take up to 60 days for an application to obtain a permit, which can discourage actors from hosting events. Interviewees reported that some

public entities discouraged of artistic expression. For instance, many municipalities have created regulations to discourage graffiti and often require graffiti artists to have permits, even for private walls. These issues are compounded by a lack of statistics on the sector and a weak contribution by various stakeholders on the social and economic impact of the sector. This is an unregulated sector that could benefit from a legal framework that promotes the activity and defines the roles of the public and private players. Improved intellectual property rights protections, including assisting GoH's entry in the international IPR Agreement, would provide important protections to artists and have the potential to encourage greater creativity (if designed properly).

These regulatory issues must be addressed through the combined efforts of actors, such as the Department of Arts and Culture of the UNAH, which has been identified as a potential leader and unifier of the sector, the IDB, and the GoH as well as inclusive of the artists themselves.

RESULTS

Arts are widely recognized as powerful forms or self-expression and communication, inclusive of the viewpoints of a variety of people. Investing in arts is connected to investing in culture and the unique and valuable things that set Honduras apart. The arts and entertainment sector currently occupies a fringe status in Honduras, but, as noted in the urban arts interviews, that fringe status is also part of it appeal. Mainstreaming arts and entertainment is not about diluting that fringe appeal, but rather about broadening the audience, helping all to become more creative, and rewarding Honduran artists.

There is uncertain potential for change within the sector, but significant impacts would be possible if achieved. As noted in the Orange Economy literature, the development pathways for lower and middle-income countries are more uncertain than ever. Culture and entrepreneurship are important avenues for Latin American countries to forge their own development pathways. This requires legal, economic and behavioral changes within the arts and entertainment industry in Honduras.

There was surprisingly little secondary data and evidence to build off for this study. An obvious area to start, so simply creating a directory of cultural assets, building a reliable source of information for events and festivals being organized, and collecting data on the economic impact of the sector. This would provide a baseline to measure against in the future and provide evidence for public and private support. Eventually, the industry needs to be elevated and protected. Operating informally brings with it a host of risks to its actors. While the sector has proven resilient and has grown despite its low visibility and absence of public support, this is not an optimal growth scenario. Many of the seen results of the sector reflect an overall lack of unified vision or ability to brand itself to the external audience or market. Many of the creative businesses maintain a homemade status, not growing to create meaningful job opportunities or quality and scale to appeal outside of niche markets.

From a policy or BEE perspective, the limited capacity of the *Direccion de Arte,* as well as the lack of a Secretariat within the GoH to represent this sector has been a significant contributor to this issue. As a fringe sector, there has been limited enforcement or creation of regulations for a sound institutional framework that could motivate the sector's development. The development of *Ley Marco de Arte y Cultura* or *Ley de Fomento a la Industria Cinematografica* would be important steps in the right direction to correcting this. There are also risks to formalization, such as the risk of being exposed to a new legal framework and implementing institutions, without adequate representation to ensure the arts community is treated fairly and equitably. The need for intellectual property enforcement for example, in the protection and design of artisan crafts, music and film production could also create unfair barriers to entry and an uneven playing field. Likewise, there are large

numbers of government entities and permits required to organize an event, however the information is not commonly available or known by the actors within this sector.

The arts and entertainment sector, as mentioned, is an inclusive sector that generates a greater sense of identity and belonging, critical spirit and solidarity at the community-level which is a potential lever to motivate youth to stay in Honduras. It is also a sector that enhances and adds value to tourism products and destinations. Women, youth, LGBTI, PwDs, returned migrants, indigenous and Garifuna populations are well-represented in the sector. There are opportunities in painting, acting, cinema, theater, dance, music, painting, handicrafts, video production, urban art, live shows, native cuisine, textiles, and myriad related activities that express culture and identity. Lenca textile and pottery for example is something unique only to Honduras and for which there is potential international demand, in addition to production of articles made from natural fibers, if product quality and innovation can be enhanced and market channels strengthened.

There is ample reason for optimism in this sector. The GoH asked the IDB support to promote the creative industry (Orange Economy) in Honduras. The IDB is designing a pilot project with FOMIN funds to support the sector including a component of institutional strengthening, which includes drafting a law of creativity, like the ones in Colombia and Chile, and its regulation. There is a strong potential role for TMS to play in helping to facilitate the BEE and institutional reform process, as well as strengthening entrepreneurial support services for creative and artistic enterprises. Moreover, the engagement with municipalities and private sector actors to promote local arts as part of its destination management strategy can help bring the arts to new markets.



LIGHT MANUFACTURING

ANNEX IV LIGHT MANUFACTURING

SECTOR OVERVIEW

Markets are demanding more local and higher quality materials. The existing and potential end-market pull for construction materials and forest product offer potential to transform the overall light manufacturing sector. The construction sector grew by 7.8% in 2017, the strongest in Central America, fueling strong demand for stone, mainly cement block, products; wood products for forms, supports, and finished materials; and metal products such as those for doors and railings. The demand for Honduran wood products (e.g., sawn timber and finished products like furniture) is driven in part by the construction sector but also appears to have grown as the supply of Honduran raw material has shrunk, due in part to the damage caused by an infestation of weevils and to the low productivity of suppliers. Trends are similar in both subsectors, namely, steady improvements in product quality and downward pressure on prices. For example, local manufacturers of construction materials struggle to compete with international suppliers where lower-cost products may be made of stronger composite materials or come as prefabricated components ready to install. As such, Honduran manufacturers have the best chance of competing—in the short-term—where raw materials like wood, stone, and sand are obtained locally. For wood products, suppliers also compete with imports of lower-cost, quality products, which are often more aligned with evolving consumer tastes. In addition, while Honduran wood has an attractive international market, these customers are sensitive to products made from illegally logged forests, which, unfortunately, is on the rise in Honduras.

Larger firms have historically realized most advantages, but pathways for small firm growth are appearing. The preponderance of Honduran micro and small-sized businesses in the sector, who predominantly operate informally, are increasingly at a disadvantage to larger, formal businesses and international suppliers of similar or better-quality products. Not only are larger businesses better able to acquire resources, they tend to have access to better quality machinery and facilities allowing them to produce items of consistently uniform quality. Large businesses can also offer clients immediately available merchandise and accept 30-day payment terms. Informal businesses often need an advance in time and money to complete an order. Perhaps most importantly, clients buying materials from unregistered, informal businesses are unable to claim these purchases as business expenses, which increases their tax burden. In responding to end-market growth and requirements, large businesses have generally proven more adept at securing market share. For example, approximately 80% of Honduras' cement blocks are supplied by three businesses. Nevertheless, some alliances between businesses have emerged to enhance mutual competitiveness. For example, some small businesses acquire raw materials under the license bestowed on a larger firm (e.g., excavation of sand). In other alliances, materials suppliers acquire the services of artisans to tailor materials to onsite specifications (quarried marble). In addition, cooperatives or cooperatives-of-cooperatives have emerged, especially among extractors and processors of forest products, to improve economies of scale and upgrade machinery (e.g., FEHCAFOR and CENCATMO). However, the system's overall response appears anemic and has seen a steady rise in competition from imports.

Supply constraints and red tape have curbed sectoral growth despite market pull. Manufacturers of construction materials and forest products are plagued by difficulties getting raw materials, especially those that fall under the permitting and regulatory purview of the Instituto de Conservación Forestal (ICF) (e.g., wood, and non-timber forest products). Sector experts and businesses routinely point to ICF's inefficiencies as the chief cause of delays and a burden on manufacturers' production costs. It

is unsurprising, with demand for forest products largely unmet and the cost of operating in accordance with regulations, that illegal logging is on the rise.

Stronger intermediation is required to unlock resources and reverse policy disincentives. For many unregistered light manufacturers, formalizing their businesses offers few rewards. For one, few such businesses are inclined or able to grow and paying taxes seems like an unnecessary additional expense. For another, the current tax regime applies the same tax rate for most all businesses regardless of size or income, which is a disadvantage for newly registered, small businesses. In addition, local manufacturers pay higher duties on imported, unfinished production materials than do importers of finished products, which represents a significant disincentive for businesses like construction contractors or furniture sellers to buy products locally. Lastly, there is generally a low-level of inter-connectivity between businesses in the sector and with external public, private, and academic organization. There is also a general weakness among the sectors' industry organizations to play the role of network hub, facilitating interactivity and exchanges among members. These phenomena are a pervasive pattern across Honduras and not limited to this sector. As a result, many actors are isolated and miss out on important resource flows, especially information about on trends, opportunities, and potential partners. To illustrate, one construction contractor quipped that it is easier to find international suppliers than local ones because international ones are online.

INTRODUCTION

Internationally, light manufacturing is considered as small and medium-scale industries that usually are less capital-intensive than heavy industries and typically producing thousands of smaller consumer goods and/or products. In Honduras, light manufacturing is typically referred to the transformation of materials or components into manufactured products around eight specific segments including furniture, wood products, building materials, electronic equipment, auto parts, small machinery, packaging, and cosmetics.[108]. The sector has great economic impact given that it comprises many MSMEs. The potential to integrate new technologies and mainstream MSMEs into global supply chains in this promising sector offers strong economic growth and inclusion potential for Honduras. In 2017, the light manufacturing sector generated an estimated $114 million in exports[109]. Light manufacturing further represents a significant import substitution opportunity with an estimated $57 million in timber and furniture.

The light manufacturing sector in Honduras is interlinked with other analyzed sectors. For example, the country's growing productive infrastructure—e.g. roads, schools, airports, hospitals, energy systems—depends on the output of the construction materials and forest products subsectors, for key supplies like cement blocks, bricks, ironworks, wood beams, and furniture. Similarly, the growth of Honduras's tourism sector—through the construction and furnishing of new hotels—is tied to the light manufacturing sector. In addition, construction materials and forest products offer non-farm economic opportunities for rural producers in Western Honduras, as well as for youth in major cities such as Ceiba, Tela, San Pedro Sula, Choloma, and Tegucigalpa. The light manufacturing sector

[108] Honduras 20/20 even comprises the sector to exclusively auto parts, differentiating it from textiles and apparel and food processing. For this analysis, electronic equipment and auto parts were excluded (see Economic sector selection). Further, food processing and natural fiber products are included in the value-added agriculture and art sector analyses respectively.

[109] Honduras 20/20 Light Manufacturing Webinar, downloaded September 26, 2018. from: http://honduras2020.com/key-sectors/light-manufacturing/. The Webinar document (dated November 2017) estimated the 2017 export value at $740 million. The 2016 export value was calculated at $646 million and the 2015 export value at $690 million.

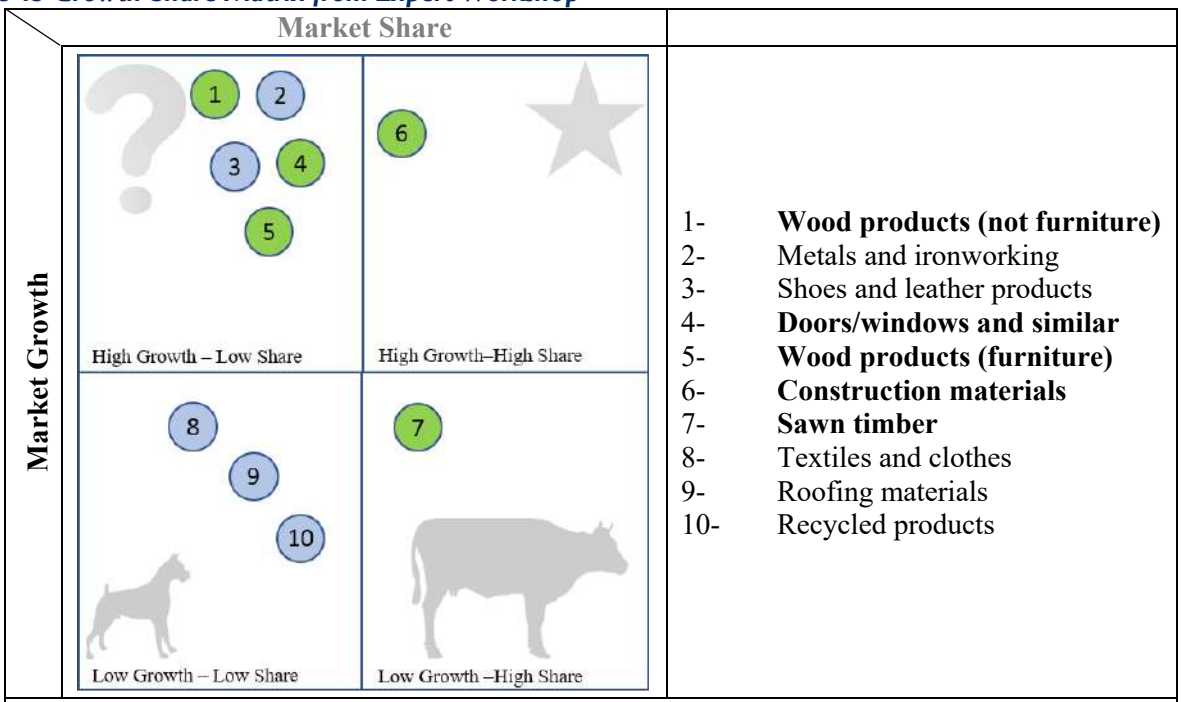
offers an opportunity to increase economic complexity and open-up opportunities for rural employment, semi-skilled labor, and generate diversification opportunities for the broader economy.

Figure 44 Light manufacturing segmentation

Sub-sectors	End Market Segments	Types of Products
Construction Materials	- Construction companies - Hardware stores	- Cement blocks, pavers - Tile and brick - Ceramics, granites, terrazzo - Ironworks
Forest Products	- Construction companies - Woodworking companies - Furniture stores	- Finished wood products (furniture, toys, broomsticks, pallets, matches, handicrafts, particleboard, fiberboard, plywood, doors, flooring) - Sawn wood products (beams, planks) - Resins, essential oils, rubbers

Subject Matter Expert workshops identified 10 sub-sectors and activities. Only one product was considered high growth and share - construction materials such as cement blocks, pavers, and bricks. Sawn timber, such as beams and planks, were considered to be more mature markets. Wood products such as finished furniture and toys, pallets, and handles were considered to have high growth potential, but low market share. The high quality of Honduran wood, quality craftmanship, and off-farm employment potential make it an attractive sub-sector, if complicated by increasing regulations to prevent illegal logging. The production of doors and windows—related to construction —was considered another strong opportunity.

Figure 45 Growth-Share Matrix from Expert Workshop



Please note that green circles represent the activities chosen for EMA and MSA research.

Two subsectors—construction materials and forest products—were prioritized under the light manufacturing sector for TMS consideration.

Construction Materials. The construction materials sub-sector consists of the transformation of national or imported natural resources into secondary products for use by the construction sector. Made from natural or synthetic inputs, the products can include concrete blocks, pavers, brick, tile, ceramics, granites, terrazzo flooring, and ironworks. The construction industry represents 5.8 percent of the GDP and grew by 24.5 percent between 2015 and 2017.[110] It also employs over 200,000 people.[111] The Banco Central de Honduras highlights that the construction sector is one of the key sectors that will drive the country's economic growth.[112] According to subject matter experts, key growth opportunities include prefabricated and environmentally sustainable materials, both of which are market niches characterized by increasing market demand and offering job creation potential. This subsector was selected given its medium-high competitiveness compared to imported goods, potential for increased inclusion of women, and medium potential for market transformation.

Summary issues identified by experts within the construction sector include:

- A ***lack of sector standards*** regarding professional certifications and product quality certifications within the sector. Honduras does not currently have specification standards for the construction materials sector, which constrain competitiveness on national and international markets.
- ***Increased public investment in social housing projects***[113], which increases demand for construction materials and presents strong opportunities for local supply of construction materials by MSMEs. The Cámara Hondureña de la Industria de la Construcción (CHICO) estimates there are $202 million in products underway to build nearly 9,000 units of affordable housing during 2018.
- Local demand is influenced by ***European and US design trends*** (particularly in kitchens). In addition, CHICO noted that project developers are starting to prefer ***prefabricated materials*** given the reduced construction schedules and ease of installation.
- Firms like Ecomobilia and AVANTI are promoting the use of **environmentally sustainable construction materials**—such as tamped earth floors, adobe-cement walls, green roofs, bamboo, solar panels—for affordable housing as well as ecotourism hotels and accommodations. These alternative materials offer competitive potential for Honduras, which can diminish construction costs, reduce imports, and alleviate pressure on forest resources[114].

Forest Products: Timber and Non-Timber Forest Products. The forest products subsector includes timber and transformation into finished wood products (furniture, toys, broomsticks, pallets, matches, fiberboard, particleboard, plywood, doors, and flooring), sawn wood products (beams, planks, and mulch), and non-timber forest products (NFTP), such as resins, rubbers, essential oils, coal, and seeds for national and international markets. Almost half of Honduras's territory (48 percent) is covered by forest.[115] Sustainable forest management is essential to sustain this resource

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[110] Banco Central de Honduras. (2018). Honduras en Cifras. 2015-2017. Tegucigalpa, Honduras. obtenido de: www.bch.hn/honduras en_cifras.php

[111] Cámara Hondureña de la Industria de la Construcción (CHICO).

[112] Bessy, L. (2018). Construcción en Honduras, la que más crece en Centroamérica. *La Prensa*. obtenido de: https://www.lprensa.hn/honduras/1184018-410/construccion-honduras-crece-inversion-centroamerica

[113] The subsidies come from a range of platforms, including the Régimen de Aportaciones Privadas (RAP), Consejo Nacional de la Vivienda (Convivienda), Banco Hondureño para la Producción y la Vivienda (BANHPROVI), and private banks.

[114] However, according to AVANTI, the market is still nascent as consumers lack of awareness of their benefits and still prefer traditional materials. This barrier is reinforced by financial service providers that discount collateral of prefab homes and do not consider financing for homes made with ecological materials at all.

[115] "El mapa forestal de Honduras", accessed September 27, 2018. Obtenido de: https://www.hondurastips.hn/2018/01/09/el-mapa-forestal-de-honduras-datos-interesantes-de-los-bosques/. Thirty-nine-and-a-half percent (39.5%) of Honduras's forest is concentrated in the country's 91 protected areas.

and its long-term economic benefits. Forest products require an environmental management approach to sustain a source of income for local communities that depend on and live in forested areas.

Honduras has yet to meet its full potential in harvesting forest products, as yearly logging caps are not yet being reached.[116] In 2016, forest products exports were valued at $82 million, with high potential for economic growth by 5 percent[117] given local availability of the required natural resources and related supply chain. Existing trade data only quantifies the subsector by its exports, resulting in a low representation in national GDP (0.82 percent) employing approximately 9,000 people[118], the subsector has high potential for increased inclusion of women, indigenous communities, and other marginalized populations. In addition, given its high potential for market transformation and medium-high competitiveness, this subsector was selected for TMS consideration.

Summary issues identified by experts within the forest product sector include:

- The **weevil plague** that decimated Honduran forests affected 33 million cubic meters of wood in 2015 and 10.72 million in 2016, resulting in a 17.1 percent reduction in Honduran supply during those years.[119] To contain the plague, the GoH's ICF eased restrictions and allowed for intensive logging of large swathes of infected forest.
- The plague flooded the domestic market with cheap infected wood, which has had lasting impacts. Domestic consumers have become accustomed to viewing Honduran wood as cheap, while preferring imported 'high-quality' finished wood products. The industry also consolidated with larger private companies able to secure their position by better competing for forest resources and maintaining presence in the European and U.S. markets.
- Most smaller companies have reverted to the national market, downsized, diversified, and invested in efficiency measures. For example, after losing international contracts, pine exporters reduced personnel and diversified to supplying molding, flooring, and roofing to the national market. Sawmills increased production of pallets and broomsticks, and distributors increased supply of furniture made from plastic, metal, or recycled pallets.[120]
- Additional pressures from ***illegal logging*** threaten the sustainability and competitiveness of the industry. In June 2018, Honduras was the first Latin American country to sign the ***Voluntary Agreement of Association (AVA-FLEGT)*** committed to export only timber products that are verified as coming from legal sources to the E.U. The AVA-FLEGT opens the door to new export opportunities in the E.U. in the coming years.
- Public and private entities are beginning to take steps to adapt to new verification and traceability requirements. The ICF approved new laws and regulations—including the *Ley contra la tala*

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[116] Instituto Nacional de Conservación y Desarrollo Forestal, Áreas Protegidas y Vida Silvestre (ICF), Anuario Forestal 2017. For example, for 2016, only 77.2% of the annual cap of broadleaf and coniferous tree logging was reached (i.e. 505,274m^3 logged of the 654,674m^3 cap).

[117] Instituto Nacional de Conservación Forestal, Áreas Protegidas y Vida Silvestre (ICF), 2017. Anuario Forestal. Obtenido de: http://icf.gob.hn/wp-content/uploads/2017/11/Anuario-Estadistico-Forestal-2016.pdf

[118] Instituto Nacional de Conservación Forestal, Áreas Protegidas y Vida Silvestre (ICF). Approximately 8,745 equivalent employments (using ILO quantification norms) are generated annually in planting, extraction, production, protection, and transformation.

[119] Instituto Nacional de Conservación Forestal, Áreas Protegidas y Vida Silvestre de Honduras (ICF), 2017. Anuario Forestal. Obtenido de: http://icf.gob.hn/wp-content/uploads/2017/11/Anuario-Estadistico-Forestal-2016.pdf

[120] In addition, the Cooperativa Agroforestal Palizal Limitada invested in equipment and logistics personnel to improve efficiency, increase value-add of transformed wood, and ensure cost-effective transportation logistic. The Federación Hondureña de Cooperativas Agroforestales, Ltda. (FEHCAFOR) built a new sawmill to process the high volumes of second- and third-rate quality wood. The Central de Negocios de Cooperativas Agroforestales y Transformadores de la Madera de Oriente (CENCATMO) organized input suppliers to improve efficiency in its furniture-making business.

ilegal, Normativa para el aprovechamiento de subproductos forestales y no maderables, and the *Normativa de cadena de custodia*—to combat illegal logging and standardize logging and distribution chain standards. Unions such as FEHCAFOR[121] are supporting bills that promote trade under the AVA-FLEGT and are putting regulatory pressures on firms to adhere to new standards.

- ICF's approval of ***Forest Management Plans*** take up to one year in some cases, resulting in cooperatives shutting down operations after losing national contracts. Interviewees consistently indicated that the forest sector is overregulated, and that bureaucratic procedures need to be simplified to promote competitiveness.[122] The ***forest sector cooperatives law*** (Decree 65-2013) requires forest sector cooperatives to obtain legal status ('*personería jurídica'*), but interviewees indicated that it was costly and difficult to obtain.

Figure 46 Non-selected subsectors in Light Manufacturing

As noted in the Economy to Sectors section, textiles, auto parts, and electrical parts were not considered for analysis. Characterized by low competitiveness as compared to imported products, the metal goods, packaging, cleaning products, cosmetics and perfumes, and leather goods subsectors were not selected for TMS consideration; sewing and screen printing were not selected given their minimal contribution to the Honduran economy.

Cleaning Products, Cosmetics and perfumery. This subsector is related to cleaning products, perfumes, and cosmetics. It was originally not selected due to its low size and the subsector is comprised of a limited number of mostly informal private enterprises. National regulations and certifications provide a disincentive for new firms to enter this sub-sector and quality requirements are generally high. Almost all oils used in Honduras' cleaning products are imported. There is potential for a small industry that extracts oil for sale in in local cleaning products. If this industry proves successful, and producers are able to produce top-grade aromatics and oils, then there is a path by which the small industry could shift into cosmetics and perfumes. The starting point would be more basic grades. Given non-timber forest product (NTFP) sub-sector is inclusive of essential oils, a key ingredient for cosmetic manufacturers, there is potential to create opportunities within this subsector through interventions in the NTFP more broadly, but was not included in the analysis

Metal Goods. The metal goods subsector includes industrial machinery and supply parts made from metal and iron alloys. While this subsector was initially selected for analysis, the TMS team determined that the sub-sector was uncompetitive. Most metal equipment and parts are currently imported. Given tax benefits on imported metal products, high local production costs, limited national metal and iron alloy resources, and low productive capacities, it was determined the sub-sector did not meet TMS criteria. The need for high levels of specialization and technological innovation in this subsector would require significant investment, making the importation of metal goods more attractive to meet local demand.

Packaging Materials. The packaging subsector refers to goods and merchandise packaging—principally made of plastic, paperboard, and cardboard—designed to contain, protect, and/or preserve the product during transport, storage, and delivery to the end customer. The national demand for packaging is currently unmet, resulting in the importation of packaging from neighboring countries. While this subsector was initially selected for analysis, the TMS team found that input supplies are not locally available, presenting challenges for the competitiveness of this subsector. For example, Honduras does not have a local paper pulp industry to produce paper and cardboard, and it is not an oil-generating country, needed to produce plastic. And while there is potential to integrate recycled material into packaging, that intervention area would be a spin-off of the waste management and recycling sector (see water and sanitation sector).

Further, **leather goods** because of the strong competitiveness of imported goods, both in terms of price and quality (perceived brand, etc.) and unlikeliness that Honduras could secure a competitive advantage in these sub-sectors given current and likely future productive capabilities. TMS also excluded **sewing** and **screen printing,** as it is a too small a subsector to generate jobs required.

[121] Federación Hondureña de Cooperativas Agroforestales
[122] Experts noted that Guatemala and Costa Rica are countries where forest regulation functions effectively.

Contribution to Economic Complexity. One of the noted advantages of the light manufacturing sector is the ability of the sector to open-up new pathways for development by contributing to economic complexity. The Harvard University's Atlas of Economic Complexity indicates that Honduras has a competitive advantage (RCA) in wood products[123]. If we look at its primary connections, we see the potential to leap into wood carpentry for construction. Wood carpentry for construction, however, has a much higher product complexity index of 0.0746 compared to wood products -1.25. Further, we see in the product complexity map the potential to leap from wood carpentry through its primary connections into furniture, plywood/laminated wood, tiles, packaging, etc. all of which have higher product complexity indexes.[124] For example, the ability to grow in furniture is a $95 billion market with myriad connections to other product groups. Light manufacturing is not only strategic from its potential income and jobs potential, it is a sector which can contribute to the economic complexity of the Honduran economy.

Figure 47 Economic Complexity Wood Products



Summary. The light manufacturing sector has great potential to drive Honduras's economic growth in the coming years. The construction materials and forest product subsectors are highly interconnected, providing critical inputs to build and furnish homes, apartment buildings, businesses, commercial centers, and other projects. Construction is at the heart of Honduran urban development of major cities like Tegucigalpa and San Pedro Sula. With a population that is 57.1 percent urban and an annual rate of ***urbanization*** of 2.75 percent,[125] Honduran urban development can fuel inclusive economic growth, generating jobs for rural and disadvantaged populations through the light manufacturing sector. However, this trajectory of rapid and uncoordinated urbanization can potentially devastate local ecosystems, cause biodiversity loss, and displace marginalized communities, including indigenous populations. ***Unsustainable resource extraction*** and the ***associated environmental threats*** are likely drivers of migration and harm other economic sectors, including tourism and agriculture. The heart of the challenge for Honduras will be to balance growth of construction and linked light manufacturing sectors, while ensuring environmental sustainability and prioritizing investments in renewable resources and environmental protection to ensure inclusion and protection of marginalized peoples who are most vulnerable to environmental degradation.

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[123] Atlas of Economic Complexity. "What did Honduras export in 2016". Retrieved from http://atlas.cid.harvard.edu
[124] Ibid.
[125] The World Factbook, accessed on October 2, 2018, at: https://www.cia.gov/library/publications/the-world-factbook/geos/ho.html

MARKET OPPORTUNITY

The following captures important customer characteristics of the analyzed end market segments.

Construction companies. In 2017, Honduras imported $31,7 million and exported $16,7 million in cement, stone, tiles, and related products (UN Comtrade). Imports consist of an array of products, many of which Honduras does not produce. Honduras does however produce cement blocks, exporting very little but importing about $6 million worth in 2017, mostly from El Salvador. There are 1,037 registered construction companies in Honduras, with almost 90 percent located in Tegucigalpa and San Pedro Sula.[126] As for company size, 3 percent (or 27 firms) are large, 10 percent (or 108) are small- or medium-sized, and 87 percent (or 902) are microenterprises.[127] In 2017, the construction industry employed 216,796 people, of which 74 percent were employed by the private sector, 24 percent by the public sector, and 2 percent unremunerated.[128] Construction companies generally indicated preferences for:

- Mid to low market, solid, decent quality products
- Prioritize timeliness, reliable logistics routes that enable fast delivery
- Prefer to purchase locally rather than imported, given reduced logistical costs
- Require solid quality, with certifications when needed
- Price is lower priority as compared to timeliness and quality

In 2017, Honduras's construction industry showed the greatest growth (7.8 percent) in Central America, as compared to Guatemala (5.3 percent), Nicaragua (3.1 percent), El Salvador (1.83 percent), and Costa Rica (-6.4 percent). Construction projects were 56.4 percent residential, 22.1 percent commercial, 17.8 percent services-related, and 3.7 percent industrial.[129] Competitor countries, however, are characterized by having higher levels of sector industrialization, more advanced technology, and more competitive prices.

Woodworking companies. Honduras consumes an estimated 495,000 m^3 of wood annually, of which approximately 15 percent was imported in 2016.[130] Wood has great transformational potential; at several points in the value chain, it becomes an input resource for another transforming market until the wood is burned into energy. Woodworking companies stated preferences for good log quality, length and thickness, and considered other factors such as extraction, delivery logistics, the state of the roads and the final price. Product categories, such as sawn wood (beams, planks) and finished wood products (particleboard, fiberboard, plywood, doors, flooring, etc.) have greater competition from countries with more organized industry and better forest management, advanced technology, such as Guatemala. It was also noted that the competitor countries had weaknesses, such as higher costs, including freight, taxes and longer delivery periods and, in the case of the U.S. and Chile, lower quality of its pine wood.

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[126] Honduras Instituto Nacional de Estadísticas (INE). The geographic distribution of the registered construction companies is as follows: 52% Cortes, 35% Francisco Morazán, 13% divided among the seven departments of Atlántida, Choluteca, Comayagua, Copan, Olancho, Yoro, and Santa Barbara.

[127] Instituto Nacional de Estadisticas (INE). Obtenido de : http://www.ine.gob.hn/

[128] Bessy, L. (2018). Construcción en Honduras, la que más crece en Centroamérica. *La Prensa*. obtenido de: https://www.lprensa.hn/honduras/1184018-410/construccion-honduras-crece-inversion-centroamerica

[129] Ibid.

[130] Organización de las Naciones Unidas para la Alimentación y la Agricultura (FAO) y Fundación Vida, Informe de aportes al fomento del mercado de productos forestales en Honduras (2017). Lineamientos para una propuesta multisectorial de políticas públicas. Tegucigalpa, Honduras. obtenido de: http://www.fao.org/3/a-i7995s.pdf

Furniture stores. Honduras is home to both national and international furniture and department stores. With an estimated 300 points of sale across the country, some furniture or department store chains have more than 50 stores nationwide, while others might have one or two storefronts in a specific department. Stores sell furniture that is made from 100 percent wood, some combination of wood and wood-composite, and 100 percent composite. Furniture stores have seasonal demand (April-May, June-July, November-December), with spikes around holidays like Mother's Day and Christmas. Their customers prioritize access to credit, followed by price and design. Furniture produced in other countries is highly competitive in terms of price, quality, and variety of products. In particular, those interviewed noted that El Salvador and Guatemala are strong furniture competitors; China maintains its competitive presence given its wide variety of furniture products.

Figure 48 Market Targeting Strategy Light Manufacturing

Market Segment	Market Attractiveness	Barriers to Entry	Productive Capabilities
Construction companies **Products:** - Cement blocks - Sawn wood - Finished products (fiberboard, particleboard, doors, floors, etc.)	**High** The construction industry is growing and provides a stable market for a wide variety of products. There is potential to replace imported products with locally produced products to satisfy demand.	**Some barriers** Solicitation requirements of construction companies often require five years' experience which limits new entrants or small actors. Materials require certification which is hard to achieve. ***Cement blocks*** is a quasi-monopoly: few companies dominate 80 percent of the market ***Wood products*** involves a difficult process to obtain operational permits.	**Intermediate to Strong** The resources are available locally and know-how is easily transferrable. Honduras benefits from low-cost labor. Further, competitive advantage relative to imported products given quicker delivery windows (essential in construction schedules). There is a risk of deforestation without sustainable forest management; need to ensure implementation of reforestation laws
Woodworking producers and exporters **Products:** - Sawn wood - Finished wood products - Other forest products (rubber, resins)	**Medium** There is both local and international demand for products. Honduran products are reportedly well-perceived in international markets. There is great transformational potential; as you can transform 100 percent of the resource into wide variety of value-added products. Timber prices lowered after weevil plague and have yet to normalize to pre-plague prices. International demand is willing to pay high prices for quality, and substitute products are of inferior quality.	**Medium** There is a scarcity of certified/high quality inputs, with significant investment required for certification. The principal producers have dominated the market for 20+ years, limiting entry to new actors.	**Intermediate** Honduras has a low-cost labor advantage. Knowledge can be learned as a skilled trade. There is a low current availability of high-quality timber, given the GoH's permits to log large swathes of forest with weevil plague. In addition, there is a long renewal cycle of timber stocks (10-15 years) with uncertain growth over the next five years. Without sustainable forest management, there is a high risk of deforestation; the GoH needs to ensure implementation of reforestation laws. In addition, there is limited technological innovation.
Furniture stores **Products:** - 100 percent wood furniture	**High** There is a high local demand which is being satisfied by imports. The local market is stable and growing. There are over 300 national points of sale, many of which offer	**Some barriers** The principal barrier is access to finance for furniture producers as they often sell on consignment to stores of logistics and distribution	**Intermediate** Artisanal furniture makers offer low cost but low-quality furniture. This requires significant investments to build technical and managerial capacity to take on more complex furniture

- Furniture made of combination of wood and wood-composite - 100 percent wood-composite furniture	consumer credit (market can grow). Substitute products (plastic, metal) have clearly differentiated clients. There is competition from high-quality, *used* furniture imported from U.S. (50 percent of original cost), and a lack of regulation on this importation.	channels for international or new national markets.	operations. This market is linked to sustainable forest management and renewal of forest resources. In addition, knowledge must be learned as a skilled trade.

ROLES

Extraction

Construction materials. Sand and gravel miners require concessions from the GoH and mayoral permission to extract sand and gravel stone from river channels and stone quarries. Concessions are mostly limited to large companies with the financial and legal capacity to request a concession as well as the technological and equipment capacity to then effectively mine sand and gravel. Identified needs include creating MSME extractor associations and linking them to processors and exporters to stabilize the supply chain. There tends be a lack of land management planning for mining in rural areas with river channels and quarries, and local communities are often excluded from this process. Several companies interviewed perform extraction, as well as other functions within the construction materials subsector, including design and production/construction of concrete products, prefab concrete structures, homes, and buildings. Large companies own mining equipment, such as density classification machines that use vibration to separate sand and gravel by size and density, while MSMEs use rudimentary equipment, such as shovels and mesh nets, to manually perform the extraction and separation.

Forest products. ICF identifies 178 agroforestry cooperatives as of 2016 that extract timber and NTFP, of which 148 were marked as 'active'. Loggers sell timber either to primary processors that transform into planks, or the loggers do primary processing themselves and sell planks directly to secondary processors. The type of equipment needed for modern primary processing includes mobile sawmill trucks, while MSMEs utilize rudimentary equipment such as chainsaws for logging and oxen for transporting. In general, the logging is in the departments of Francisco Morazán and Yoro, located near the secondary processing companies to reduce transportation costs. The principal barriers that limit extraction include i) the difficulty and cost of employing a skilled forestry technician to develop a Forest Management Plan to obtain the annual permits for resource extraction, or ii) the ICF's process capacity for permit requests.[131] In 2015, the ICF granted 75 year-long permits. In 2016 they granted only 49. These permits cover only 27 percent (62,000 hectares) of Honduras's total productive forested land (278,719 hectares). Interviewees noted that ICF can take anywhere from 15 days to one year to grant a permit. This uncertainty leads to contract delays and cancellations. It is also challenging if the permit is granted during the Honduran winter season, as the climatic conditions increase costs of extraction and reduce the profit margins of the extractors.

Processing

[131] ICF's inefficiencies and weak capacity include: a) diverse interpretations of the guidance on how to develop a Forest Management Plans (for example, measurements or sampling system) between the skilled forest technicians (certified by the ICF) that develop the plans and the ICF personnel who approve the plans, and b) the plans are all centralized and processed in the ICF's headquarters in Tegucigalpa, creating a bottleneck.

Construction materials. Companies who process sand, gravel, and other construction materials purchase materials locally or import it to produce finished products like molding, windows, metal structures, etc. Processors interviewed tend to produce several products. One interviewed produces natural stone like marble, granite, travertine, and quartz. Another produces cement and cement products, while another which produces sustainable construction materials like tamped earth floors, adobe-cement walls, and green roofs. Most MSME processors lack the financing to maintain their inventory. CHICO noted an absence of specialized labor with requisite training to do higher-value processing and an absence of certifications for quality of products. Quality control and standardization is needed to advance the industry. This will pose challenges as many processors are informal enterprises.

Forest products. Primary processors interviewed, typically cooperatives, transform timber into sawn wood and planks. These processors tend to lack access to financing to purchase the raw material from the extractors, and are forced to sign contracts with buyers with payment cycles greater than 30 days. This presents a perpetual cash flow dilemma that is aggravated by the fact that cooperatives lack title to forested land and, therefore, are unable to qualify for bank finance. Most lack modern primary processing equipment, such as mobile sawmill equipment, that performs basic processing and transports the product to transformation points.[132] In addition, access to chippers (to process branches into mulch or wood chips) and pelletizers (used to compress sawdust into pellets to make coal) would promote product diversification and better use of all forest products. Secondary processors provide greater added value to the primary products through higher levels of transformation and finishing, for example types through furniture, cabinets, window frames, and doors. These companies are mostly located near the principal sources of primary transformation, such as Olancho, Francisco Morazán, and Cortes. Data collected by the Banco Central de Honduras identified that most furniture makers and carpentry businesses are family-owned and make-to-order for local sales. Given the absence of larger orders, which would require international markets, there is no mass production. The secondary transformers are mostly independent and are not organized in unions or associations. These actors require technical assistance and training on forming associations, organizational strengthening, and competitiveness to then be able to negotiate as a group and strengthen their role in the supply chain. For these reasons, there is a negative trade balance for wood furniture, even if there is high potential to locally produce greater quantities of wooden furniture. In addition, a potential innovation would be to equip the furniture makers with wood drying equipment; currently, the furniture makers lack the capital to purchase this type of equipment and resort to buying cured wood at higher costs than if they purchased untreated wood and performed the drying themselves.

Distribution

In both analyzed subsectors, many companies take on both secondary processing, as well as distribution, including import and export functions. In construction materials, one company interviewed, due to its size, capital, and business relationships, has successfully built its own vertical wholesale and retail distribution channels for concrete products and prefab structures. On the other hand, another family-owned business distributes its products (e.g. brick, tile) on consignment through relationships with small, independent retail stores. The limiting factor for the latter's distribution model is they do not have the capacity to distribute their products on credit, and the retail stores lack access to financing; therefore, sale volumes are limited. In instances where the distribution function

[132] Small extractors in the Honduran logging industry still use rudimentary logging techniques that rely on chainsaws and oxen for transport. Meanwhile, the larger firms have invested in mobile sawmill equipment that conducts primary transformation at the logging site and transports it to the secondary transformation site.

was not owned by processors, interviewees reported the limited formal alliances between distributors, processor, and miners as their recourse to the lack of financing mechanisms that facilitate transformer-distributor contracts with payment cycles greater than 30 days. In forest products, distributors trade in both semi-finished and finished wood products through various distribution models. One company interviewed for example distributes and exports through the distribution networks of other companies. Another distributes wood furniture (among other home goods) through its own stores in Western Honduras (Copan, Lempira, and Ocotepeque). A third, distributes nationally to wholesalers (e.g. Larach, Lady Lee). The interviewees observed weak alliances between furniture makers and furniture distributors; one of the foremost challenges limiting these relationships is the lack of financing mechanisms available to furniture makers.

Export

Construction materials. According to the 2018 directory of exporters[133] developed by the Fundación para la Inversión y Desarrollo de Exportaciones (FIDE), 28 companies export construction materials to the international market. One exporter interviewed exports marble, granite, travertine, and quartz to North and Central America, while another exports sand and gravel to El Salvador, Guatemala, and Nicaragua. Exporters noted the supply of quality construction products from local processers and raw material providers is low and the need to develop more integrated supply chain alliances with suppliers. In addition, they noted the lack of standardization of cement blocks and pavers as an obstacle to reduce imports of foreign-made goods and increase exports of locally made goods.

Forest products. Private-sector companies and associations export principally unfinished and semi-finished wood, and to a lesser degree, finished wood products. According to Banco Central de Honduras, the country exported $81.4 million in wood and wood products in 2016. This assessment identified 15 large, high-capacity forest products exporters, with logistics centers located in duty free zones in the cities of Tegucigalpa, San Pedro Sula, Chamelecón, Villanueva, and Choloma. One sawmill interviewed produces unfinished and semi-finished wood products, such as sawn logs, planks, pallets, etc. 80 percent of which is exported. Another company exports cured wood to Central America and Germany. A furniture-making association exports furniture - though several large businesses that used to be members of the association have closed operations within the last few years.[134] Again, most of the exports reported were lower-value products. The lack of availability and reliability of quality and quantity of supply prevents them from stepping-into higher value markets.

Import

Ten (10) companies were identified as importers of construction materials for national distribution. These are mostly private-sector companies located in Cortes. One importer interviewed imports granite and terrazzo, a second imports porcelain and ceramics from the U.S., Europe, and Brazil, and a third company imports clay products like brick and tiles, principally from Spain, Guatemala, and Colombia. Several other companies imported metal products. Most importers take on distribution functions as well – one, for example, imports and sells aluminum products from its network of national stores. A lack of confidence in the quality and reliability of national products is a key reason why importers do not prefer to source locally. There is potential to strengthen the supply chain between extractors and importers, facilitating access to financial products for this subsector, and developing certification programs for local producers, to ensure quality and limit imports. Importers

[133]FIDE. (2018). Directorio de Exportadores. Obtenido de: http://fidehonduras.com/wpcontent/uploads/2018/03/Directorio_Exportadores_2018_FIDE.pdf

[134]These closed businesses include DERIMASA (closed their factory after a fire), Wellington Hall, and five others.

in the forest products subsector import timber to either distribute as unfinished product or transform into finished products and then distribute. For example, the leading companies that distribute wood furniture for home and office principally sell imported goods.

RELATIONSHIPS

Supply Chain Alliances are structured to improve coordination between buyers and suppliers to secure reliable, quality products. These include both formal and informal alliances between resource extractors, producers, distributors, and exporters.

In the construction sector, larger construction projects tend to maintain longer-term buying relationships with suppliers. These stable contracts reduce the time and expenses compared to individual purchases. Other construction firms prefer to negotiate each sale. This is effective for lower volume sales but inefficient as companies seek larger or more regular supplies. It was reported difficult and costly for construction firms to find reliable suppliers. Supply chain alliances appear overall limited, despite the fact that many are organized together in the CHICO. Experts identified a potential partnership between CHICO (on behalf of the construction firms) and the GoH's Centers for Enterprise Development (CDEs) to formalize and certify more MSME suppliers. For example, developing a database of local construction material suppliers would reduce search time and transaction costs. Greater online presence or e-commerce are other potential avenues that would allow for greater participation of MSMEs. Given that finished products are sold in urban areas while raw materials such as wood, sand, clay, stones, are produced in rural areas, there is a lot of potential to enhance supply chain alliances to strengthen cooperation agreements between rural producers, urban buyers, and local authorities that could mainstream rural MSMEs into local and export markets, to enhance inclusion opportunities in both urban and rural areas.

An example of an effective alliance for construction materials is in the municipality of Ojo de Agua in Comayagua. PRODECOM (a large private-sector business that is dedicated to building roads) needs sand, but does not have a concession. Local extractors have the concession to extract sand, but lack the machinery. Extractors supply sand to PRODECOM's plant, which separates the sand by quality level. High-quality sand is purchased by PRODECOM for use in their infrastructure activities, while the lower-grade sand is returned to the local extractors for commercialization in the local market.

Competition in the construction materials sector has led to stronger rates of innovation and diversification. Several companies identified have made technology investments to improve the quality and design of products. One, for example, invested in new factories to produce prefabricated materials to acquire important State contracts. Innovation and diversification rates are higher for larger companies than MSMEs. For example, small cement block producers located near the El Salvador border see the need to invest in improved machinery to reduce competing imports from the neighboring country but have yet to make the investments required to better compete. Competition becomes more ineffective when it comes to state procurements, which tends to be limited to a few large national or international firms given the steep requirements for these tenders. One company, for example, is the leading, and perhaps only, provider of prefabricated materials for public projects. Small firms simply are unable to compete for these contracts without the guarantees and financial backing given that the State often is delayed in its payments. Another firm seems to have acquired a quasi-monopoly as the only national firm with permission to import aluminum and galvanized metal.

In the forest products subsector, the forest product subsector suffers from similar high search time and transaction costs. A cooperative interviewed had an agreement with a processing company in San

Pedro Sula. The cooperative logs the wood and conducts primary processing, selling to the processor in San Pedro Sula which provides the final finishes and exports the wood. Having a guaranteed buyer establishes a sense of confidence to the cooperative and processor. These relationships tend to be built on trust, which is developed over the long-term. Not all processors have these relationships. For example, a wood processor located only 70 km from the cooperative indicated that it was unable to find the quality wood supply it needed. In other cases, supply worked through more indirect marketing chains. For example, a large distributor interviewed buys timber from a smaller distributor. They buy at a higher price due to a lack of knowledge of primary timber suppliers and concerns over quality of timber. Terms and conditions of contracts is another feature limiting alliances. For example, a furniture-maker identified had signed a contract with a department store. The department store required a 90-day payment while the furniture maker had to pay cash up-front to its suppliers. This payment mechanism proved non-feasible and the department store imported furniture instead.

CENCATMO groups 14 agroforestry cooperatives and a processor to extract and process approximately 9,000 m3 of wood annually, transform into finished wood products (furniture, doors, crafts, coffins, cribs, among others), and then distribute nationally to wholesalers. Under CENCATMO, the members have coordinated the production allowing them to invest in shared mobile sawmill equipment, and promoted value-added products and product diversification.

Competition can best be described as highly ineffective or a zero-sum game in the forestry sector. Similarly, pricing for logs reportedly varies significantly within the sector, depending on the negotiation capacity of suppliers. The root cause seems to be competition over natural resources, which has motivated collusive, anti-competitive behavior. Secondary processors reportedly compete intensely over resources and will artificially distort pricing by purchasing greater quantities of natural wood to block new processors from acquiring raw materials to keep them small, sabotage an order, or keep out of the market. Forestry companies reportedly have lost contracts and clients due to inability to source high-quality raw materials. Instead of cooperating with other processors to divvy up the order, they would prefer to lose the contract entirely rather than share information with competitors. Similarly, in the pine resin sector, companies have informally divided up territories to lower competition than to compete based on quality and innovation in the same zones. When the barriers to entry are broken, you see positive results. For example, the entry of a new processor into the cured wood market has forced diversification and innovation into new products. Other companies have invested in ISO certifications to start to enter markets. An evolution in market governance is a necessary requirement to making the competitive field more dynamic and equitable.

Unions and Advocacy Alliances serve as an intermediary for members and businesses to leverage their collective bargaining power to advocate for sector interests and influence policy. The light manufacturing sector are supported by several private-sector non-profit associations and cooperatives that represent the business interests of its affiliates, including the Consejo Hondureño de la Empresa Privada (COHEP), ANDI, CHICO, FEHCAFOR, and CENCATMO.

- Founded in 1967, ***COHEP*** constitutes the highest-level private-sector organization in the country. Representing 74 organizations (including ANDI and CHICO), COHEP is the technical-political arm of the Honduran business sector and seeks to represent business interests through the publication of reports on market trends, business transactions, and international trade agreements.
- ***ANDI***, founded in 1958, represents the Honduran industrial sector. With two offices and 15 staff, ANDI advocates for sector interests on political and legal issues such as social security, energy, minimum salary, electoral reform, among other topics. ANDI provides training and disseminates information on quality certifications as well as best practices on manufacturing, the environment, and occupational safety to its affiliates. In addition, ANDI seeks international cooperation funding

to implement development programs to benefit sector interests and members; funding from the US, Germany, Taiwan, and Turkey, for example, have funded initiatives in biodiversity, improved industrial equipment, professional training, and technical visits by international experts.

- Established in 1968, ***CHICO*** groups over 750 companies in the construction sector, including public and private construction companies, building materials producers and distributors, and service providers. CHICO provides best practices training and business advisory services to its affiliates, though it is also (erroneously) perceived as a construction workers' union, job placement agency, and assignor of construction contracts.
- Since 1974, ***FEHCAFOR*** is a second-level cooperative in forest products that provides multi-purpose services, including: technical assistance and marketing support to member organizations; extractor (with saw mill), supplier, and exporter of sawn pine logs nationally and to the Central American region; and facilitator/intermediary in the wood, resin, and coal supply chains.
- Created in 2016 with support from the EU-funded PAPSFOR (Programa de Apoyo Presupuestario al Sector Forestal de Honduras), ***CENCATMO*** groups 14 agroforestry cooperatives and one transformation company to facilitate production and national commercialization of finished wood products, including furniture, doors, crafts, coffins, cribs, among others.

Union and advocacy alliances are generally effective in the light manufacturing sector, with a tendency to be stronger in the construction materials compared to the forest products sub-sectors. ANDI's union representative has proven effective in negotiations of minimum salaries. This alliance has reportedly worked well for the last three years, allowing public and private investors to standardize their labor costs. ANDI is also member of international associations[135] with the aim of researching market tendencies and opportunities for Honduras and disseminating the information to its member companies. Specifically related to the construction sector, CHICO conducts advocacy to promote efficiency and transparency in State bids and contracts in the construction industry.

RESOURCES

Natural and Material Resources

Construction materials and forest products subsectors are both defined by access to natural resources. The construction materials subsector uses natural and material resources such as sand, cement, gravel, clay, wood, metals, and stone. The forest products subsector requires access to coniferous and broad-leafed forests to harvest timber and resins. In both sectors, access to natural and material resources is highly influenced by a company's size and their associated financial and legal capacities. Large companies are more likely than MSMEs to have the financial and legal capacities to obtain a concession for resource extraction. For example, among interviewees one large concrete company would not have difficulty accessing sand due to a large concession, while a smaller business without a concession must travel further downstream to obtain sand in unassigned zones. Similarly, private forestry companies reported greater ease in forest concessions, as they are better positioned to overcome the legal bureaucracy and costs for permissions. Indigenous communities on the other hand that live in or near forests face significant barriers (financial, operational, equipment, market access, etc.) to obtain concessions and legally harvest timber. Furthermore, there are significant economies of scale in light manufacturing as large companies are more able to negotiate wholesale discounts or access imported goods. MSMEs on the other hand purchase locally and in smaller quantities, limiting variety or increasing per unit cost post distribution. Sustainable natural resource management is a fundamental need to ensure the needed resources are not depleted and that Honduras's ecosystems

[135] Federación de Cámara de Industria de Centroamérica y la República Dominicana (FECAICA), the Asociación de Industriales Latinoamericanos (AILA), and the Alianza Latinoamericana Anti-Contrabando (ALAC)

and biodiversity are protected. Global Forest Watch estimates that nearly 937,550 hectares of forest with a canopy density of >30 percent were lost between 2001 and 2017.[136] Sustainably produced forestry products require engaging local communities in conservation and forest resource management, in partnership with forestry companies and guided by internationally-recognized standards.

Financing Mechanisms

Characterized as 'indispensable' by sector experts in both analyzed subsectors, financing is required to purchase costly input supplies and machinery, ensure sufficient and immediately available inventory, and diversify products to new markets. Operating costs are extremely high in the light manufacturing sector. For example, cooperatives reported requiring $54,000 to purchase 1,000 m^3 of timber. Their facilities have the capacity to transform 4,000-5,000 m^3 but they were unable to meet their operational capacity due to lack of financing. Access to financing is limited, especially for MSMEs. The lack of collateral—or in some cases owning resources that banks do not consider collateral—severely limits access to credit. Large companies are able to use larger contracts as collateral, which aids their access to finance. Smaller producers often do not have these contracts to quality for bank financing, and their needs often well exceed what a microfinance institution would offer. The issue of finance is more complex though. As small extractors do not own land and operate on concessions, they necessary lack collateral that would be considered acceptable by a bank. Local furniture-makers on the other hand sell on consignment to stores, assuming the risk if their product does not sell. The absence of supply chain financing within the sector imposes significant financial constraints on primary and secondary processors. In other words, the ways in which transactions are structured in the chain aren't conducive to commercial financing. Supply chain relationships are likely standing in the way of expanded financial resources.

Information Resources

Both subsectors require expanded technical, business advisory, and certification services. Experts perceived that the lack of training, technical, and business advisory services severely limits growth. There was a repeated expectation that needed services should be provided by the CDEs. There was little evidence of reported business advisory support from elsewhere. This is compounded by the fact that many primary processors are in rural areas and those services in urban areas aren't provided to the industry. The ICF's has a department to provide technical training support to MSMEs but is under-resourced to do so effectively. In the construction materials subsector, experts noted the importance of receiving continuous information on innovation, materials and consumer trends but that this information was generally unavailable. Finally, both subsectors remarked on the difficulty in hiring skilled professionals to develop Forest Management Plans and Annual Operational Plans. In fact, in the forest products subsector, though it is the producer's responsibility to seek the approval of a Forest Management Plan, the associated costs create such a high barrier that often the wood buyers will pay for it to ensure a supply of wood.

Skilled Labor

Light manufacturing requires diversified and skilled labor to continue growing, though access to labor differs between the two analyzed subsectors. With limited entities that provide training and certification services, skilled labor for the construction materials subsector is in low supply. It is even more difficult for MSMEs to obtain skilled labor, given the professionals' high salary expectations. On the other hand, labor is a highly available resource in the forest products sector—with a strong

[136] Global Forest Watch. Accessed October 2018. Retrieved from: https://www.globalforestwatch.org

potential for inclusive employment, especially in rural, disadvantaged communities living in or near forests. It is important to note, though, that the forest sector is not widely perceived by communities—and especially youth—as a stable source of employment, as production is often seasonal.[137] However, experts noted that improved organization of the forest products system could seek to match the continuous demand and supply of labor and thereby reduce youth migration.

RULES

Interviews in both sectors routinely cited the challenges around the enhanced enforcement of more demanding national tax policies, and slow and bureaucratic permit procedures and seemingly arbitrary application of rules and regulations.

Forest products. The *Ley Forestal* establishes the technical and administrative guidelines to approve the permits for the exploitation of forest resources, which are centralized in Tegucigalpa. It is estimated that cooperatives and associations hold the 45 percent of the legal forest permits, but interviews consider them to be expensive and take long time to get approval. Forest management plans for NTFP needs to be separated from timber plans, which duplicates efforts and disincentives NTFP activities that are in high demand and could be highly inclusive. **The permitting process by the ICF has a systemic effect on the sector**. ICF is granting fewer permits and these permits take longer to get (up to a year). Requirements around Management Plans (PM) and Annual Operating Plans (AOP) that require legal certifications, licenses, and permits represent a considerable barrier to doing business. Enterprises report an absence of technical staff knowledge in the preparation of sustainable forest management plans. The implementation of AVA FLEGT certifications[138] will further increase pressure. The changes in the Law of the Forest Sector (modification of the Decree 65-2013, article 47), which required forestry cooperatives to update their legal status, has also proven a difficult task due to low levels of training, difficulty paying for procedures requiring legal representation, and overall lack of awareness of the new requirements. This has impacted many cooperatives which have had their operating permits challenged. In turn, this has made it difficult for many to operate formally and had additional consequences in terms of access to banking services or joining the national tax system. The inefficiency of the public permitting system has led to the escalation of illegal logging practices. This has been to the detriment of indigenous and impoverished people who tend to live in forest communities and depend on forests as a principal source for livelihoods. Regulations such as Prior Consultation and the National Community Forestry Strategy law, which mandates that 50 percent of the net profit must be shared with local communities where forest is located, seem to have had the unintended effort of reducing the interest of cooperatives and associations to stay in business and expand in a legal way.

The GoH is aligning its national development planning system with the Agenda 2030 and the Sustainable Development Goals (SDG) through the "Forests-Water-Soils" Master Plan as a national policy that integrate climate change mitigation and adaptation programs, including the countries' efforts to reduce emissions from deforestation and forest degradation, and foster conservation,

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[137] For example, a furniture maker interviewed previously had skilled cabinetmakers among its personnel. However, since production (and therefore income) was not constant, many cabinetmakers preferred to emigrate.

[138] Honduras has become the first Latin America State to reach a bilateral agreement with the European Union, on a voluntary basis, confirming that timber products exported to the European Union are sustainably produced. This Voluntary Partnership Agreement (VPA) on Forest Law Enforcement, Governance and Trade (FLEGT) has been recently signed (June 2018) as a strategy against Illegal Logging of Forest. The agreement will help improve forest governance, address illegal logging and promote trade in verified legal timber products. The VPA is the first between the EU and any country in the Americas.

sustainable management of forests, and enhancement of forest carbon stocks. The AVA FLEGT represents another step towards tackling the urgent issue of illegal logging and associated trade. These comments further strengthen the commitment to positively engage indigenous peoples and their communities in sustainable forestry management. This agreement also stipulates compliance with Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES).

Figure 49 Forestry Policies, Laws, Regulations and Implementing Institutions

Forestry Policy, Laws and Regulations	Implementing Institutions
• Ley Forestal • Estrategia Nacional de Forestería Comunitaria • Acuerdo Unión Europea con Honduras Certificaciones AVA FLEGT • Plan Maestro de Agua, Bosque, Suelo • Ley de Cambio Climático (Decreto 297-2013) • Estrategia Nacional sobre Cambio Climático • Poder Legislativo Decreto No. 53-2015 • UUNN Convention 169	• Instituto de Conservación Forestal ICF • Federación Hondureña de Cooperativas Agroforestales FEHCAFO

Construction materials. The construction materials sector has few direct regulations. There is reportedly a large gap due to the lack of national standards and quality certifications This translates into barriers to access high end priced markets. Public infrastructure work is regulated through the Ley de Contratacion del Estado, which opens competition for local and international contractors, but due the large number of requirements, reduce the participation to only large firms. The prevalence of closed bidding processes, or not bidding at all, has significantly affected the participation of MSMES for government construction contracts. Under the Law of State Contracting the requirements imposed on companies in terms of certification requirements that only large companies are able to maintain. The lack of quality control for domestic products, in compliance with the contracting requirements, has also increased demand for imports as MSMEs face challenges in obtaining certifications.

Figure 50 Construction Policies, Laws, Regulations and Implementing Institutions

Construction Related Laws	Implementing Institutions
• Código Hondureño de la Construcción (Decreto 173-2010) • Ley del Fondo Social para la Vivienda FOSOVI • Ley de Beneficios para la Construcción de Vivienda Social (Decreto 93-2015)	• Comisión Nacional de Vivienda y Asentamientos humanos (Convivienda):

RESULTS

A significant appeal of the light manufacturing sector is its ability to contribute to complexity in the Honduran economy. The challenge will be how to successfully leap into higher-value products – no easy feat in a competitive global economy. Honduras has the natural resource base and there is both domestic and international market demand that should drive sector growth and diversification. The fundamental question is why Honduras has not been able to take a natural advantage and turn it into a competitive one.

One of Honduras's competitive advantages is the availability of untapped raw material for timber and non-timber forest products. The reputation of Honduran wood for its high quality makes it a resource for home and office furniture for domestic and international markets. There seems to be ample opportunity for commercial partnership to make this vision a reality. The list of potential partners is

long and includes, among others, Honduras Playwood, Wood Mizer Industries, SERMA, TRACOMA, SANSONE, Mayan Resin, Barh Industries and EFI SOLUTIONS, Yodeco, Distribuidora La Occidental, Naco Sawmill, GENTEC, INTRAMAR and MAYDEQ. All these companies operate in TMS zones. These businesses have installed capacity in processing plants to be positioned to make this leap, the issue that must be addressed is why this is not happening.

The light manufacturing sector bears several less-desirable features. There is a prevalence of monopolistic tendencies among larger firms, which has stifled competition and innovation. We analyze these as largely reflective in the competition for limited resources. The legal frameworks and institutions responsible for implementing laws to manage these resources are unable to do so. This divide between policy design and implementation crop-ups a grey economy. Operating in this grey area also makes smaller businesses extremely vulnerable. The weevil plague of 2015 and 2016 had a lasting effect on MSMEs and has led to consolidation within the industry. Significant changes must be made to how enterprises within the sector cooperate and compete.

Two areas stand out to promote competitive pressures and innovation. The first is streamlining public permitting processes through ICF and public procurement processes to be more inclusive of MSMEs. The implementation of a more mobile and decentralized structure for ICF and improved efficiency in administrative procedures would lessen incentives for unfair competition for resources. This would make for a more even competitive playing field. Improved supply chain alliances would improve cooperation between actors across the chain, from cooperative extractors to primary and secondary processors, and the wholesale-retail segment would make the sector attractive for new entrepreneurs and investors. Some interesting ideas include support to ICF and SDEs to establish a business portal for the industry so that businesses can more easily identify and establish commercial relationships.

There exist other opportunities to promote secondary industries in the research and design for the use of by-products generated in the production chain, such as: sawdust and log edges. The development of resin production also offers alternative source of income or to generate added value by producing briquettes and pallets. Accompany is payment initiatives for ecosystem services for the link between primary forest producers with current management plans, and entities linked to the use, distribution and water use in the middle and lower forest basins. Our analysis shows more limited opportunities in the construction material sub-sector, despite the investment climate in new housing projects. The challenge remains the significant barriers for smaller enterprises to enter the market. The construction sector is likely to generate jobs by nature of its current trajectory, and in response to other economic factors with limited potential influence from the Activity.

The GoH's commitments made as part of AVA FLEGT show that there a compelling international market that will reward more inclusive through engagement of indigenous communities and sustainable with reduced illegal logging. There is ample opportunity to engage vulnerable population groups in the more efficient use of forest resources which could quickly incorporate them into the production value chain. The light manufacturing sector requires diversified and skilled labor to grow but is limited by entities that provide training and certification services. Likely opportunities for youth and returned migrants would be in the transformation of material into manufactured products, furniture, wood, and cement blocks, furniture finishing, etc. While the light manufacturing is less inclusive of women (it was hard to obtain a reliable statistic, but interviewees estimated that less than 20 percent of the workforce is female), it is inclusive of youth and indigenous communities, for example, in sustainable forest management or the establishment of a growing industry with

accompanying skills development would have a significant impact on jobs for youth, indigenous and in rural areas.

The light manufacturing industry opens-up new doors for economic growth in Honduras. This requires a more competitive and innovative industry is required. However, to ensure these benefits flow to the most marginalized, TMS should work in collaboration with other activities. The European Support to Honduras Forestry Sector Project, Canada-Honduras Value-Added Agroforestry Project (CAHOVA) Project, USAID Gobernanza en Ecosistemas, Medios de Vida, y Agua (GEMA) Activity and the FAO/Canada Empowerment of Women for Climate Action in the Forestry Sector are all strong collaborators with whom the TMS Activity could work. Opportunities in particular, to strengthen workforce development in this sector would ensure this growth impacts the right populations. Models such as Campamento, Olancho, where a network of carpenters has engaged the hardware industry in Tegucigalpa and San Pedro Sula to supply ready to install doors, shows this path and leap into new opportunities is obtainable when actors work together in the right ways.



TRANSPORT AND LOGISTICS

ANNEX V TRANSPORT AND LOGISTICS

SECTOR OVERVIEW

The logistics and freight transport sector in Honduras has enjoyed positive growth and considerable public support since 2013. Further development of the sector will now be key to making the Honduran economy more competitive, given the sector's symbiotic relationship with the agricultural and manufacturing industries, in particular for export markets. Since 2013 the GoH has been implementing the "Honduras Logistic Center of the Americas" initiative, with significant investment in roads, ports, airports and logistics corridors. As a result, Honduras is starting to play a more important role in regional (and global) integration, providing a logistics infrastructure for Central America that includes a regional logistics corridor for Mesoamerican chains of coffee, palm oil and paper. The port at Puerto Cortés now operates as a hub for Atlantic trade, channelling imports and exports from Honduras, El Salvador and Nicaragua. Its new Pier 6 facility is the largest, most efficient pier in CA–4, and will be a catalyst for improving the competitiveness of the country. Nevertheless, the contribution of the logistics and freight transport sector to the national economy remains low compared to other regional hubs such as Panama, where it represents 14 percent of GDP.

The 2017 Customs Union agreement between Honduras and Guatemala (with El Salvador expected to join at the end of 2018) has created the conditions for the sector to reach its full potential. The agreement will create new opportunities, from transporting goods around the region to creating new logistics centers that will improve the efficiency of extended supply chains (particularly in the agriculture sector). However, to fully benefit from these trade facilitation opportunities, it will be important to incorporate new processing technologies, as inefficiencies in the current systems for external trade far too frequently lead to delays. A recent example of a successful new processing technology is the electronic system implemented since March 2018 for cargo between Honduras and Guatemala (along the borders of Agua Caliente, El Florido and Corinto in Occidente). This has already had a massive impact on reducing the time for crossing the border (from several hours to 15 minutes) and on incentivizing bilateral trade (which increased by 9 percent last year).

Road transport services do not allow for the efficient movement of goods within Honduras or across the region. Transport services in Honduras can sometimes take two to three times longer than similar routes in other countries, due to the poor condition of the roads, particularly in the western part of the country, allied to an obsolete fleet and frequent traffic jams and city crossings. Honduras has one of the lowest road densities in the region, so there are insufficient roads, and of these, only 24% are paved. In addition, poor road maintenance further impacts transportation times, and increases the risks for carriers. These low levels of productivity are confirmed by IADB's Regional Observatory for Freight Transport and Logistics. For example, transport in Honduras mobilized 7.9 million tons in 2013, compared to 24 million tons in Guatemala and 10.1 million tons in El Salvador. Average tariffs in Honduras are around US$0,07 t/km, which is among the highest in the region. The transport sector is also highly fragmented, and there is an oversupply of services. There are approximately 20,000 legal cargo transport companies, deploying 60,000 trucks whose average age is 18 years old. In addition, there is a large informal market, estimated to account for a further 40,000 trucks whose average age is even older. The only exceptions are a few large companies that have specialized fleets (e.g. transport of containers for export and import, and transport of inflammable liquids). The great majority of companies, however, have fewer than five trucks, and struggle to differentiate their services from those of their competitors. As a result, micro and small companies compete by offering lower fees, and by using units that are usually in precarious conditions, generating unfair competition in the market.

Distribution centers and warehousing facilities are limited, in particular for cold refrigeration systems. Such facilities are essential for ensuring that products are safely stored and rapidly redistributed, either to other locations or directly to the customer. Distribution centers and warehousing facilities are predominantly located around free economic zones and industrial parks close to commercial cities (Tegucigalpa and San Pedro Sula), as well as close to the busier border crossings. These facilities are mainly owned by large firms such as Walmart, or by international firms that specialize in managing large distribution centers, such as RANSA. The cost of accessing such centers is prohibitive for smaller and medium-size firms, who are not able to benefit from their services, and therefore suffer in terms of productivity and competitiveness.

Innovation is limited, making it difficult for firms to provide differentiated services. One of the key challenges faced by the private sector is the lack of certainty regarding returns on investment, due to high operational risks. This leads to lack of innovation, which reduces specialization of businesses and makes it difficult for them to differentiate their services. Price differentiation becomes the only factor, leading to a race to the bottom. Whatever technology is available, there are few incentives to use it, as firms do not really see added value in its services, and are solely concerned with price.

The new law for the transport sector is a step in the right direction, but further work is needed to develop the overall logistics regulatory framework. The new transport law created in 2016, together with the creation of the *Instituto Hondureño de Transporte Terrestre* (IHTT), aims to address key challenges in the sector. However, there remain significant gaps, as its regulations have not yet been fully developed. For example, there is no registration system for national carriers, only for international carriers; there is no mandatory liability insurance; and there is no driver certification system. Even in those instances where regulation exists (e.g. maximum cargo weights), limited enforcement means that overloading is the rule, putting carriers at risk and deteriorating the road infrastructure. This lack of regulation translates into very low barriers to entry in the sector, which promotes informality.

A long term vision for the sector is needed. Despite the new transport law, Honduras still lacks a national logistics policy that defines its strategic guidelines and how it should be organized. As a result, the development of logistics operators (i.e. transport firms that offer added value services such as storage, management of inventories or packing) is very limited. There are only a few large private transport companies, for example TRANYCOP, that are actually able to provide such added value services, while the large majority of firms simply provide transport services, and show little differentiation between one another. Overall, the lack of a long term vision also deters entrepreneurs from investing in and/or innovating the sector.

Fragmented institutional coordination continues to limit the impact of new logistics investments. Due to its cross cutting nature, this sector has a multiplicity of stakeholders, both in the public and private sectors. This segmented institutional context generates significant challenges to the sector. For example, the increased capacity of Puerto Cortes means that there will be more heavy road transport services, which will have an effect on congestion levels around key urban areas. The National Logistics Council was established in May 2018 to provide a space for dialogue between the public and private sectors. However, further coordination is required to ensure prioritization of projects that will have the greatest impact on productivity, logistics and urban mobility. There is also a need for improved prioritization and articulation of public-private partnerships.

Limited access to finance and poor entrepreneurial skills limit the ability of the sector to transform itself. The high average age of the transport fleet reduces the competitiveness of the country, as transfer times are longer and more expensive due to inefficiencies of the fleet. However, small and medium-sized entrepreneurs are unable to access appropriate finance to improve their fleets. Only larger firms, with exclusive contracts with importers and/or exporters that can be used as guarantees, can access suitable finance. Finally, most transport company managers lack relevant entrepreneurial skills, and tend to make decisions on a short term basis.

Security issues remain an underlying constraint for small and medium-size carriers becoming more competitive, as it increases their costs and reduces their efficiency. Road transport services are particularly affected by current insecurity, due to theft of goods and equipment, extortion (e.g. trucks trying to access specific routes) or bribery (e.g. payment to enforcement officials to allow a cargo to be moved). Similarly, the limited number of secure rest and parking areas for long-distance drivers significantly increases costs and time of moving cargo.

INTRODUCTION

An efficient transportation and logistics system is a key aspect in the economic growth and security of a country. Transport and economic development are closely linked - development increases the demand for transport and the availability of transport stimulates development through trade and economic specialization (González, 2016 and Khan, et al, 2007). The GoH began implementing the "Honduras Logistic Center of the Americas" initiative in 2013, investing in ports, airports, and logistic corridors. There have been a number of positive developments since, such as the development of the Customs Union with Guatemala in June 2017. The implementation of the Customs Union resulted in a reduction in the average border crossing time between Honduras and Guatemala from 15 hours to less than one hour, according to Honduras' Secretariat for Economic Development.[139] The recent addition of El Salvador to the bloc increases the aggregate expected commercial impact to $117 million in trade benefits.[140] These investments align with the vision to turn Honduras into a logistics hub. Honduras has an important role to play in regional and global integration through logistics corridors that facilitate Mesoamerican trade in coffee, palm oil and paper to Puerto Cortés, and a hub for Atlantic trade that mobilizes imports and exports from Honduras, El Salvador and Nicaragua. At the time of writing this report, 11 percent of all exports leaving Puerto Cortes are from its regional partners, led by Nicaragua (7 percent), El Salvador (3 percent), and Guatemala (1 percent)[141].

The negative impact of high transport costs on international trade in Latin America far exceeds the effects of high customs tariffs or unfavorable exchange rates. Recent studies estimate that the positive effects on export volumes of a 10 percent reduction in transport costs in Latin America would far exceed the effects resulting from a 10 percent reduction in tariffs.[142] High transport costs increase cost of imports, decreases cost-competitiveness of exports, exacerbates inflation, raises local

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[139] SDE. *Con la unión aduanera entre los tres países.* August 21, 2018. Accessible via https://sde.gob.hn/2018/08/21/con-la-union-aduanera-entre-los-tres-paises/

[140] CISION PR Newswire (2018)

[141] https://www.laprensa.com.ni/2018/03/07/economia/2387412-mejoran-eficiencia-de-puerto-cortes

[142] Mesquita M., C. Volpe, J. Blyde (2008) "Unclogging the Arteries: The Impact of Transport Costs on Latin American and Caribbean Trade". Special Report on Trade and Integration. Inter American Development Bank.

production costs and puts a drag on economic growth. All of these results in lower levels of employment and competitiveness.

In 2018, Honduras ranked 93 in the Index of Logistic Performance, ahead of Guatemala (125) and El Salvador (101) but behind Panama (38) and Costa Rica (73). This ranking reflects the commitments and actions of the government authorities to strengthen the sector with a recognition of the benefits this sector provides. Lingering challenges still remain related to multiple issues such as high costs of fuel, difficulties in accessing credit, high security cost, long travel times, empty returns (backhauls), limited road transport services, limited access to centers of distribution including cold facilities for perishable goods and delays at border crossings due to process inefficiencies.

The government has worked primarily to strengthen the sector by working together with the private sector through national PPP initiatives with the Honduras Logistics Center for the Americas, Honduras 20/20 and the National Logistics Council. They have also established relevant regulatory frameworks such as the Transport Law in 2016 and the Fiscal Reform in 2017. Nevertheless, there remains a noted gap by stakeholders for an integrated framework and strategic vision for the logistics sector to better regulate cargo and transport insurance, weight and dimension controls, and security and safety.

There are a range of national and regional initiatives together with GoH's investments in *logistics infrastructure* projects that are already underway to support the modernization of ports, airports, roads and corridors. *Logistics services* that support the connections of transport modes and foster the provision of door-to-door services accompany these infrastructure investments. An efficient and inclusive network of collection and consolidation centers that are near to production areas, border crossings, and truck centers for example can greatly enhance market access for small and medium enterprises. There are projects currently in place – and in planning - to strengthen this feeder network using both national and IADB financing. Finally, additional efforts to modernize land border crossings cannot be limited to the streamlining of procedures if real savings in times and costs want to be made; it must also include port infrastructure and logistical improvements as discussed in this section.

Maritime transport services: Most of foreign trade in Honduras in both value and volume is carried out by sea. In 2017, maritime transport represented 47 percent of imports and 62 percent of exports excluding free trade zones[143]. Puerto Cortes is a key logistics hub for Honduras and within the region. Significant investment is happening in this port, that is about to open new dry and cold storage facilities and double its capacity. This will likely have a systemic impact across the region as Puerto Cortes will become the largest commercial regional port and will be very competitive. Yet, the sea connectivity of the Honduran maritime transport is low compared to that observed in the region (Guatemala, Costa Rica and Panama). Among the problems confronting this transport mode are the high cost due to low volumes of cargo and its seasonality, the lack of integrated maritime and land transport for the provision of door-to-door services; and the lack of agreements of collaboration for the negotiation of maritime freights among producers.

[143] Instituto Nacional de Estadistica. Secretaria del Despacho de la Presidencia. Transacciones Comerciales de Bienes 2014-2018 http://www.ine.gob.hn/images/Productos%20ine/Boletines/Comercio%20exterior%202018/boletin%20comex%20ene%20mar%202014%20-%202018.pdf

Road transport services: Road transport is the second most important mode in Honduran commerce, following maritime, moving about 37 percent of the merchandise in terms of value[144] and representing in 2016 an average of 3.94 percent of GDP.[145] The Honduran highway infrastructure has 16,415 km of roads of which only 23 percent are paved,[146] and the road density (0.15 km/km^2) is the lowest in Mesoamerica - part of the reason being the extensive coverage of the country's forests. Although Honduras is currently investing heavily in road infrastructure, the country does not have an established planning system that optimizes transportation in an integral manner and thus the road network has not evolved according to the population and productive growth. A stronger enabling environment is required to allow transport operators to deliver high quality services that are safe and affordable. Currently, small and large transporters compete with price and quality even though the government has established a minimum fee of $1.24 per kilometer traveled (the highest fee among its neighbors), which is reportedly widely ignored due to informal actors' competition. Micro and small companies compete with lower fees by offering units that are usually in precarious conditions. An efficient and modern freight transport infrastructure is key to make the entire logistic system work appropriately. It directly impacts the movement of goods for all internal products and internationally traded goods. It is also important to ensure inclusiveness of micro- and small enterprises and that other sectors of the economy, particularly agri-business, can access the improved logistics network.

Air transport services: Air transport share in Honduras trade represents only one (1) percent of exports in volume. The increase of supply and competitiveness of this mode is conditioned by the high costs of airfreight and the demand of services. In the case of Honduras, only few products use this transport mode in a dedicated way including tilapia and flowers. Products such as shrimp only do so exceptionally. Because of low volumes, most airfreight services for other items excluding tilapia and flowers are currently provided in passenger flights. Given the low airport share in trading and the high costs of airfreight, it is unlikely that Honduras could become a hub for air cargo as other regional competitors are better positioned. For this reason, the sub-sector was not selected for analysis.

Railway transport services: Honduras has a non-operational rail network. In its peak development, it reached 1,300 km and played an important role for the communication between San Pedro Sula and Puerto Cortés, as well as for the transport of bananas. By 1996, the network had only 666 km in which 70 percent corresponded to the National Railroad of Honduras. The Government Plan 2014-2018 contemplated the realization of technical studies for the construction of an interoceanic railway to connect Puerto Castilla (on the Caribbean coast) with Amapala (in the Gulf of Fonseca). The original purpose was to manage up to seven percent of the commercial trade between Asia and America, as well as to serve the surrounded agricultural areas. Since there are no operational railway services in Honduras currently, this sector was not selected.

Distribution Centers and Warehousing. These are designed to store products that must be rapidly redistributed to another location or directly to the customer. It is the foundation of a supply network

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[144] Instituto Nacional de Estadistica. Secretaria del Despacho de la Presidencia. Transacciones Comerciales de Bienes 2014-2018 http://www.ine.gob.hn/images/Productos%20ine/Boletines/Comercio%20exterior%202018/boletin%20comex%20ene%20mar%202014%20-%202018.pdf

[145] Memoria Banco Central de Honduras 2016. https://portalunico.iaip.gob.hn/archivos/BancoCentraldeHonduras/Finanzas/Presupuesto/Informe%20Anual/2016/memoria_anual_2016 20170330135615.pdf

[146] Honduras en Cifras 2015-2017. Banco Central de Honduras. http://www.bch.hn/download/honduras_en_cifras/hencifras2015_2017.pdf

as it allows a single location to stock a vast number of products. Storage supply in Honduras is limited and centralized. The free economic zones and industrial parks available are mostly situated close to the commercial cities of Tegucigalpa and San Pedro Sula and to the busiest border crossings. Honduras has six Free Trade Zones (ZOLIs), six Industrial Processing Zones (ZIPs) and Zones under the Temporary Importation Regime (RIT) and 17 industrial parks with a total of 280 companies of which 63 percent are foreign owned mainly from the U.S., Korea, Guatemala, and El Salvador. The country needs to plan for a balanced network of collection and consolidation that is inclusive to all production areas, border crossings, and truck centers. Warehouse and distribution centers around the country will allow shippers and logistics service providers to operate efficiently extended supply chains. There are also strategic activities to generate employment, stimulate economic activity, reduce urban congestion, and, critically, leverage limited public-sector capital expenditures through public-private partnerships.[147] For these reasons, this sub-sector was selected.

Seaport infrastructure: Honduras has four maritime cargo ports administered by the National Port Company (ENP). Puerto Cortés been the most important in the country and one of the most important on the Atlantic side in Central America. In 2017, this port handled 11,239,510 MT of general cargo representing 35 percent of total imports and 53 percent of total exports.[148] Puerto Cortes has adequate equipment for cold storage and is currently going through an extensive expansion and modernization phase that will increase its operational capacity by 50 percent.[149] Despite the efforts, the country still needs to invest and modernize other seaports to strengthen its capacities and become a regional and international logistics hub.

Airports infrastructure: The country has four international airports of which Villeda Morales, located in San Pedro Sula in the Cortes Department, is the main logistics center for cargo air transport. In 2016, Honduras moved a total of 17 thousand metric tons of air cargo, 55 percent through Villeda Morales and 45 percent through Toncontín. Villeda Morales currently has more than 16,500 m2 of loading facilities that include warehouses for general cargo, miscellaneous, hazardous materials; and cold storage and container facilities. The airport infrastructure is of high quality and well valued by the international indicators (GCI). However, there is a lack of a clear strategic plan for future development, including a new comprehensive institutional model, and its location makes it difficult to serve the center and south of the country. As air transport services were not selected based on their limited competitiveness, airport infrastructure was similarly not selected for analysis.

Land ports infrastructure: The Customs Union between Honduras, El Salvador, and Guatemala is already supporting the harmonization and simplification of border procedures and the training and capacitation of border authorities, and more is expected to be done in the next years of implementation. But heavy investment in land border crossing infrastructure is critical to support the new modalities under the customs union (aduanas perfiericas vs puestos fronterizos integrados) to ultimately reduce the time and cost of moving goods. In Honduras, most border crossing infrastructure has been directed to Puerto Cortes. However, the Customs Union with Guatemala and El Salvador and recent improvements to the road network including the investment to logistic

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[147] Integrated Logistics Centers. Experience from North America and Options for China. The World Bank, Washington, D.C. https://openknowledge.worldbank.org/bitstream/handle/10986/23494/Integrated0log0d0options0for0China.pdf?sequence=1

[148] Instituto Nacional de Estadística. Secretaria del Despacho de la Presidencia. *Transacciones Comerciales de Bienes 2014-2018*

[149] Operadora Portuaria Centroamericana. http://www.opc.hn/operadora-portuaria-centroamericana-inaugura-nuevo-muelle-6-de-puerto-cortes/

corridors is increasing regional travel and trade. Growing trade makes efficient border procedures a key economic contributor to the nation and to the Northern Triangle.

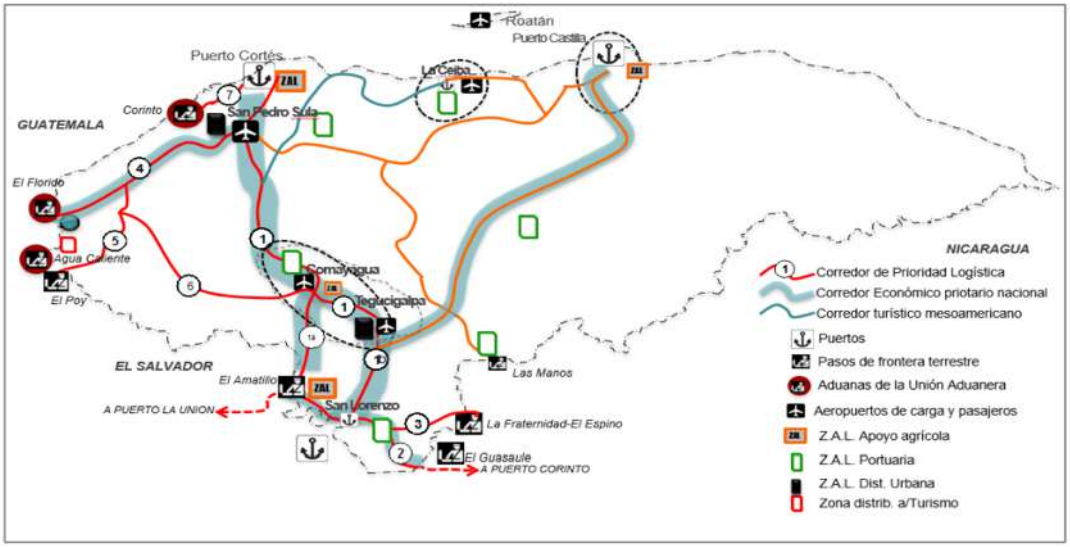
Logistics corridors: Honduras has recently earmarked public investment resources for major rehabilitation and maintenance of the primary and secondary network. The 2010-2014 Strategic Road Plan (*El Plan Estratégico de Carreteras*) includes the expansion and improvement of the logistics corridor (Tegucigalpa-San Pedro Sula section of CA-5 Norte), agricultural corridor construction (Gualaco-Bonito section), and tourism corridor concession (La Barca-Ceiba section and connection Progreso-San Pedro Sula). With the Customs Union with Guatemala and El Salvador, Honduras plans to invest in logistics corridors to optimize the times of moving goods within the country, improve connections between modes to support door to door services, and reduce logistics costs. Provided the large ongoing investments and plans to invest even further in this sub-sector, it was not selected for analysis.

History and Trajectory. The GoH's commitment to become a regional and international logistics center has been visible with the establishment and implementation of key reforms to policies and regulations, key financial investments and a strong regional integration. By working as a block, the three members have created a market of 28 million people, with the full implementation of the Customs Union, the Northern Triangle is expected to become the eighth largest economy in Latin America. The union reportedly brings considerable advantages including greater bargaining power as a region. Honduras has already made major strides in modernizing its main port, Puerto Cortes; streamlining border procedures; and building a substantial road network including logistic corridors. However, logistics operators still need to offer improved storage, inventory management, and packaging services for the sector to become more efficient. Since 2016, the National Logistics Council has provided a space for public-private dialogue and served as facilitator for technical discussions between the logistics chain actors. This promising development offers an important avenue to engage industry in the planning for investments and drafting laws and regulations. The 2016 Transport Law established the Honduran Institute of Road Transportation maintains protections for registered, formal firms, due to high costs of registration for new market entrants. A Road Transport National School is in the process of being established. Transport services however note that limited access to financial services; expensive fees for registration; a lack of road security and safety; and extortions and bribes continue to dampen performance of the sector.

The groundwork for a more competitive transport and logistics sector is being laid by the substantial investments and major trade agreements made. Momentum will continue to be build. INVEST-H for example will manage a new trust for secondary and tertiary roads maintenance for approximately 1,500 km of rural roads. IADB just approved a $90 million loan to Honduras to support Honduras's Transport and Logistics Sector Reform Program and contribute to the cargo logistics and transportation.[150] Efforts by GoH to attract private investment will continue with new concessions such as Henecan Port on the Pacific Coast. A new international airport is under construction in Palmerola. Experts believe that there is potential to reactivate the Plan Puebla Panama which will further enhance the connection between the south of Mexico and Central America. Multinational logistics company Ransa installed a new logistics center in Tegucigalpa and some of largest nationwide manufacturers and distributors like Bimbo have started to outsource services. In sum, all the momentum is in place to carry the transport and logistics sector into a next generation of

[150] https://www.iadb.org/en/news/honduras-boost-competitiveness-logistics-and-transport-sector-support-idb

development – the question is whether Honduras will be able to execute this investment in an inclusive manner to benefit local industries and firms.



Source: *National Logistics Plan, 2017*

ROLES

Road transport is the second most important mode of transportation in Honduran trade, representing approximately 31 percent and 29 percent of the value of imports and exports, respectively.[151] Transporters are key players in the logistics chain for trade in cereals, oils (e.g. palm), coffee, sugar, and construction materials, among other goods essential to the Honduran economy. According to the Institute of Land Transportation (IHTT) census, there are more than 20,000 cargo carriers operating legally, most of them are independently run. Many domestic transporters operate informally due to a lack of carrier registration regimes (international carriers must register with the Ministry of Finance) and no mandatory liability insurance and driver certification regulations. The country has a fleet of some 55,000 vehicles used for road freight transport with an average age close to 20 years.[152]

Large transport companies often have their own tariffs to negotiate transport fees, depending on the length of the section, destination, state of the road, etc. Several transport companies in Honduras including Tranycop, TranSport, Transportes Hispanos and Transportes los Andes supply an important share of the market, these companies offer value added by including services such as container terminals, pilot schools, logistic hubs, GPS technology, equipment to handle hazardous or oversized cargo and cargo security. Large transporters in Honduras are well known for their power to paralyze the country when they are not in agreement with increased costs (gas and parts) or regulations. The risk of contracting with uninsured and unregistered firms incentivizes sea cargo transporters to do business with larger firms that can absorb those additional costs, cutting SMEs out of this market.

SMEs in the road transport services sector compete in the market by offering lower prices than those allowed by the government. This is largely due to the limited quality of services while the large enterprises offer lower prices by negotiating the number of freights. There is a bill to penalize those

[151] ALG Study for the Improvement of Cargo Logistics in Mesoamerica, 2011 data
[152] Sanchez, M. *Caracterización del Transporte y Logística de Cargas de Honduras*

who pay or accept as payment lower rates but enforcement is limited. Even if the sector is not currently at its full potential, it is a source of livelihood for a significant number of people and it can only grow with the full implementation of the Customs Union and the commitment of the government to become a regional and international logistics center. This sector includes individual drivers, driver-owners and small-scale trucking companies (1 to 8 trucks) as the main clients and beneficiaries. Specific needs of SMEs are for greater regulations (e.g. on transport security and transport management), capacity building (e.g. the establishment of the Road Transport National School) and access to financial investment for SMEs so that driver owners and small-scale trucking owners can absorb impacts and maintain and update their vehicles to ultimately become more competitive. According to the *Empresa Sostenible del Consejo Hondureno de la Empresa Privada* (COHEP), 85 percent of the SMEs in Honduras fail in the first three years.

That the average fleet age is close to 20 years suggests that the capital costs of replacing vehicles impedes service improvement.[153] This obsolescence of the country's fleet poses a danger to road safety, an issue compounded by increasing roadside insecurity and a lack of regulations. The threat of robbery plagues the sector's transport corridors, forcing firms to pass the costs of increased insurance, GPS tracking systems, and security escort firms on to their consumers. In an effort to maximize efficiency, firms are incentivized to overload their vehicles with cargo, a practice that is dangerous for road safety but currently allowed due to the absence of weight control regulation. A high percentage of idle returns (estimated at nearly 50 percent, based on statistics from similar contexts) results in low fleet utilization during long-distance trips, consequently affecting service costs.[154] Limited availability of refrigerated vehicles put perishable agricultural products in danger of post-harvest loss if transported too far, resulting in hyper-localized markets. According to interviews, the absence of adequate (or affordable) cold storage facilities in Honduras also contributes to this outcome.

Despite multimillion-dollar investments, long-distance transporters infrequently encounter rest areas or overnight parking lots that can handle the size of large vehicles, forcing drivers to park on the (thin) roadside margin, or in the traffic lane. In fact, only one parking area was identified during research, for already nationalized cargo, near Taulabe. These practices impede non-commercial traffic flow, but also poses a security risk for drivers and their cargo from parking overnight in non-lighted, non-monitored areas. Shorter, domestic routes are burdened by the absence of urban commercial traffic planning, especially in congested urban areas, which increases the time required for a product to reach consumers.

The safe and cost-efficient capacity of moving goods from production to consumption through its various levels is the key to competitive international trade and economic development, road transport services are critical to the logistics chain. The sector is fundamental to market integration and relevant to job creation. Efficient transport services determine the cost of transactions for trade agents. Estimates for Honduras show that transport costs are about 50 to 60 percent of total logistics costs. Over the last three years, the sector has contributed an average of 3.9 percent to GDP. Better road transport services will support multiple sectors including trade and tourism, connect urban and interurban routes (including small farmers), and connect modes in order to provide door-to-door services.

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[153] Sanchez, M. *Caracterización del Transporte y Logística de Cargas de Honduras*

[154] Statistic was estimated based on similar data from Costa Rica and the Dominican Republic, as no data are available for Honduras.

Customs Brokers

According to the 2018 Doing Business Report, Honduras has the worst score for the Trading Across Border indicator which measures the time and cost (excluding tariffs) associated with three sets of procedures—documentary compliance, border compliance and domestic transport—within the overall process of exporting or importing a shipment of goods. The implementation of the Customs Union brings critical infrastructure and logistic requirements in Honduras and its neighbors, including the establishment of the new modalities: *aduanas perifericas* versus *puestos fronterizos integrados*. The current and future investment to improve land border crossing facilities will make a significant impact on the time and cost of moving goods to small and large enterprises. There still remains a way to go in terms of promoting cross-border trade.

Country 2018 WB Doing Business	Trading Across Border Indicator
El Salvador	43
Panama	54
Costa Rica	73
Nicaragua	74
Guatemala	79
Honduras	115

On the matter of documentation compliance, customs brokers in Honduras provide customs paperwork processing on behalf of the private sector. By law, persons with both "natural" and "legal" status can provide broker services.[155] According to the National Federation of Honduran Customs Brokers (FENADUANAH, for its Spanish acronym), there are approximately 260 firms currently operating in Honduras. Interviewees noted that some brokerage firms engage in underbidding costs for services to undercut competition, which has resulted in a decrease in aggregate consumer demand for brokerage services. Honduras' customs service recently introduced innovation in service delivery with the introduction of SARAH 2.0, a user-friendly, online customs platform that allows importers and exporters to file paperwork with respective government agencies without an intermediary broker. This change may incentivize more firms to discontinue outsourcing this process, resulting in the decline of this industry.

Warehousing and Distribution Centers

Warehousing and distribution centers are critical to support the safe and cost-efficient capacity of moving goods from production to consumption, the sector has become a key part of large companies' commercial strategy. Moreover, efficient and cost-effective centers of distribution will support Honduras commitment to become a regional and international logistics center. However, the sector still needs significant improvements to meet customer expectations for cost, service and localization to support the timely distribution of products around the country and within the region. Due to the current limited facilities, many large production companies carry out product selection and packaging processes in their own facilities and organize transportation logistics. Moreover, some of them have built their own facilities to avoid paying high costs (i.e. Walmart, DIAPA and DINANT).

Centers of Distribution (Supply their own store)	**Large Distributors** (Supply their own customers)	**Trusties**	**Logistics Operators**
Diunsa	Cervecería Hondureña	Cargo Express	Cropa
Lady Lee	Grupo UNO	Rápido Cargo	Hondumares
La Colonia	Unilever	Expreco	Coalsa
Walmart	Diapa	Ultra Entregas	Aimar
Intur	Embotelladora de Sula (Pepsi)	DHL	Enlace
Larach&Cía	Embotelladora La Reyna/CBC (Pepsi)	UPS	Aldesa

[155] Decree 212-87; Regulations of the Central American Uniform Customs Code (RECAUCA, for its Spanish acronym).

>100 employees*	>100 employees*	15-30*	10-30*

Leading warehouse and centers of distribution such as Ransa (Peruvian multinational), and the Honduran Coalsa, Hondumares and Aldesa offer quality and differentiated services. Their strengths include installed capacity, process systematization, cargo security, and scope of distribution. This sector has limited participation among SMEs due to the investment required and the lack of access to finance, in addition to limited know how. However, there are a few successful examples of distributions centers owned by small businesses, including Enalce, Caribex and Ofibodegas. Most of these enterprises employ 20 to 30 people and offer simple storage, packing, and transport services without value-added.

Ransa is one of the leading logistics operators in Latin America is currently expanding its presence in Honduras to meet the growing demand of the country and the region in general. The multinational serves retail, mass consumption and textile sectors (manufacturing) and offers storage, repackaging, deposit, transport, distribution and document management services. Document management services include the administration, management, custody, digitization and digitization of documents; inventory of assets; as well as destruction of documents. *Hondumares*, founded in Honduras in 1955, currently provides services in Tegucigalpa and San Pedro Sula and represent FedEx in the country. The company is also expanding and will soon open a facility in the Amarateca Valley. Hondumares offers the latest technology, 24-hour security, in-house customs personnel, and in-house banks representations.

The expansion of this sector inside and outside Tegucigalpa and San Pedro Sula is key to market integration and job creation. Honduras lacks collection and distribution centers close to production zones and has a very limited supply of cold facilities/vehicles making a challenge the competitive trade of perishable goods. In spite of recent investments in road infrastructure, some roads such as the ones leading to the West have not been equally benefited in the establishment of warehouses and distributions centers. As a result, supply is short and the few available facilities are expensive. To become a logistics hub and continue to be a central regional player in trade facilitation, Honduras requires investing in an efficient and inclusive network of collection/consolidation centers located close to all production areas, border crossings, and truck centers.

Logistics operators coordinate supply chain services for consumers, including warehousing and cold/dry storage, inventory management, and transportation and distribution, among others. This actor is relatively new in Honduras, but demand for outsourcing these value-added services is increasing—value added services reached approximately 4 percent of GDP in 2016.[156] As more warehousing and distribution firms enter the market and create economies of scale, manufacturers and buyers will seek to capitalize on the savings from outsourcing these services. Services provided by these actors can be organized into three packages: 1PL includes only transport services; 2PL includes transport services and storage; and 3PL includes warehouse management.

Transport services and warehouse/distribution centers are part of the logistics operator supply chain. The services provided by logistics operators include storage, management of stock, transport, and distribution. In Honduras, the services provided by logistics operators are limited and value-added services such as packing, labeling, encoding, and inventory management are mostly done in-house. Depending of the services presented, logistic operators can be divided in:

- 1PL. Transport of merchandise.
- 2PL. Transport plus storage of products.

[156] Banco Nacional de Honduras. *Honduras en cifras 2015-2017.*

- 3PL. Transport, storage, transport operations coordination and storage management. Agreements between users and 3PL are normally long term.

Per their variety and requirements of skills, logistics operators have the capacity to provide inclusive jobs. Their expansion around the country would require intense labor at multiple operational levels including drivers, guards, stevedore, packers, palletizers, movers, cleaners, technical workers and managers.

Regulation

Responsibility for developing, regulating, and overseeing the transport and logistics sector is shared by several government institutions, creating a complex public sector landscape. Such a fragmented institutional context generates significant coordination challenges. To simplify this landscape, the GoH has recently centralized responsibilities for the logistics sector within the Secretariat for Economic Development (Secretaria de Transport Logistico - SDE). As a cabinet-level institution, its core mandate is to facilitate investment within Honduras and international market access for Honduran exporters. SDE has now been tasked with regulating customs procedures and controlling the registration and licensing regimes for economic operators. In addition, the SDE is responsible for authorizing the Central American Unified Customs Form (FAUCA, for *Formulario Aduanero Único Centroamericano*), and the registration, incorporation, and modification of Free Zones and the Regime for Temporary Importation (*Régimen de Importación Temporal*). The SDE, however, works with a number of institutions that have more specific responsibilities within the sector:

- The Secretariat for Infrastructure and Public Services (**INSEP**) develops and maintains shared multimodal transport infrastructure, including key tourism and commercial transport corridors, roads, and ports. It is multi-sectoral, governing Honduras' infrastructure policies and representing Honduras before the Secretariat for Economic Integration in Central America (SIECA). It is considered to be sufficiently resourced, although due to multiple new entities created under INSEP, its budget has been splintered. The Secretariat is an overly bureaucratic entity, and there is a disconnect between INSEP's vision of Honduran logistics, and that of the government.
- The Honduran Institute for Land Transport (**IHTT**) was created in 2016 from the now-dissolved General Department of Transport (*Dirección General de Transporte*). IHTT is an independent entity under INSEP, with its own budget and mandate—to calculate and implement new tariffs for passenger and cargo transport. Recently, it has also introduced a law that provides tax benefits for transport firms that make capital improvements to their fleet. This law remains unknown to transporters in the informal sector however, and there are issues related to implementation of the law. IHTT has offices in Tegucigalpa, San Pedro Sula, La Ceiba, and Choluteca.
- The Joint Department for Customs Revenue (**DARA**) is principally responsible for assessing and collecting customs tariffs at Honduras' border points. Like many customs organizations, it also plays a role in maintaining secure borders by controlling imports and exports, and in facilitating trade by providing border services to the private sector. Importantly, DARA manages the Automated System for Customs Revenue (SARAH), an online portal for customs procedures. Despite recent donor improvements to equipment, DARA remains understaffed and under-resourced from an equipment standpoint.
- The International-Regional Organization for Agricultural Sanitation (**OIRSA**) is an intergovernmental institution with support from nine Central American and Caribbean countries, including Honduras. OIRSA's role in Honduras is to provide technical and financial assistance to sanitary and phyto-sanitary (SPS) measures implemented at the border. Notably, OIRSA provides this assistance to SENASA.

- The National Service for Agrofood Health and Safety (**SENASA**) is the domestic authority responsible for regulating and oversight of agrifood SPS standards in the Honduran market. SENASA is active at border points and inland processing centers to inspect and certify compliance for imports and exports of goods destined for human and animal consumption, and for planting within Honduras. The perception of SENASA among key sector actors interviewed was that its regulations are strong and comply with international standards, but that it is weak in its ability to provide effective and efficient inspections for agro producers and exporters. SENASA also charges for its services, providing a steady flow of income. However, it has low administrative capacity to create the strategies it needs to grow, due to the loss of technocratic employees.

Additional public sector institutions are responsible for maintenance and expansion of the roadway system. As of May 30, 2018, principal responsibility for strategic planning and management was appointed to Strategic Investments for Honduras (**Invest-H**), a Millennium Challenge Account entity. The Department for the Conservation of Road Heritage (**DCPV** for its Spanish acronym, itself a continuation of the legacy institution, "*Fondo Vial*") acts as the implementation arm, executing Invest-H's maintenance and strategic expansion portfolio.

RELATIONSHIPS

Associations. The fiercest competition in the sector is between associated and independent transporters, and several powerful private sector associations' efforts are largely focused on impeding new firms' entry into the market. According to interviewees, transport associations have previously used their platform to lobby the government for stricter registration requirements for independent newcomers to the market (i.e. non-members of transport associations), to raise minimum income requirements. This would essentially prohibit independent SMEs' participation in the industry. Other tactics include artificial price setting to decrease competition with SMEs to drive them out of the market. This practice is more frequently reported among transporters of imported second hand goods and general auto parts. In more specialized market segments, such as the transport of the African palm fruits (*fruta de palma africana*), larger firms can offer discounts to clients based on transaction volume or the economies of scale in the size of fleets, which smaller transporters cannot match. In other instances, larger associations have also absorbed some of the official duties of the government, essentially placing the responsibility for public service provision into the hands of the private sector. For example, the Honduran Council of Private Enterprise (COHEP) holds a concession to issue some official export documents and other requirements to transport firms.[157] Among these was a tamper-proof security seal for cargo containers known as a "*marchamo*" that was designed to increase import/export controls. Although the concession was criticized in 2016, the concession has been in effect for two decades.[158]

Some of the main logistics-related associations in the country include:

- ***Honduran Chamber for Cargo Transporters*** (CATRACHO, for *Cámara de Transporte de Carga de Honduras*) represents over 2,000 transporters in the north, an important region for transport due to the proximity to Puerto Cortes. This association is reportedly controversial, owing to its influence and ability to negotiate with the government and shipping companies.. CATRACHO is a member of the Land Transport Advisory Council and will organize the meeting of the Latin

[157] http://www.latribuna.hn/2016/03/11/gobierno-analiza-retomar-la-venta-marchamos/
[158] Ibid

American Transport Chambers in 2019. Many transporters choose to be independent, not associating with CATRACHO.

- ***National Federation of Honduran Customs Brokers*** (FENADUANAH, for *Federación Nacional de Agentes Aduanales de Honduras*), founded in 1995, has over 260 member firms. According to interviews, the decline of the customs broker industry will force the federation to absorb and represent the interests of a similar profession, logistics operators, to maintain its membership base. They also represent shipping companies in the country, so their membership base is already expanding into the transport industry and sometimes placing them at odds with the Honduran Chamber for Cargo Transporters.
- ***Honduran Association of International Freight Forwarders (***AHACI, for *Asociación Hondureña de Agencias de Carga Internacional*) has 39 active firms in its membership; the association is also a founding member of the Central American Federation of Freight Forwarders and Logistics Operators (FEDECARGA) and the Federation of Associations of Latin American Freight Forwarder Professionals. This association is perceived to be very influential due to their international backing and the president of the association is a member of the National Logistics Council. The association is currently creating a logistics school specializing in the transport of dangerous goods in Honduras. Their influence allows them to encourage their membership to work only with registered firms.
- ***National Association of Honduran Couriers*** (ANACH, *Asociación Nacional de Courier de Honduras)*, a relatively small organization with only three known firms. However, this association is important for the strategic vision of transport in the country, with the anticipated rise of e-commerce.

Public-private coordination. Public and private actors have also worked together to create higher level successful alliances, such as the National Logistics Council (*Consejo Nacional Logístico - CNL*). The CNL is comprised of key public and private sector logistics stakeholders in Honduras, and is mandated to develop a long-term vision for the sector to attend in an integral way the problems that prevent full the logistic development of Honduras. Most specifically, it aims to facilitate technical discussions between all actors of the logistics chain to promote the efficient use of infrastructure investment as well as the drafting of laws and regulations. The CNL was only constituted in May 2018, so even though it is still early, the interviewees had a positive opinion of the CNL.

Subcontracting. Many burgeoning alliances in the sector are formal subcontractor relationships. With the introduction of the logistics operator role, actors within this industry have begun to develop contractual relationships to broaden their market or diversity their services. For example, domestic logistics operator serves as a subcontractor to an international logistics operator, allowing the international firm to prepare post-clearance storage for a client's goods on arrival. These relationships can evolve between two domestic actors, too—allowing one operator to access unoccupied storage in a transporter's cargo hold reserved for another domestic actor. Though untested, if this is the case, logistics coordinators can play a pivotal role in decreasing the rate of idle returns on extended international journeys, connecting foreign merchants and transporters with common interests.

Other barriers to entry affect the integration of women and vulnerable populations into transport and logistics services. For women, barriers to participation are largely based in perception. One interviewee commented that women's participation in the sector is high, since there are many women in administrative positions. However, there is a general lack of understanding that the diversity of jobs occupied by women is an important indicator of overall sector participation. Non-administrative jobs in warehouses can be seen as too physically demanding for women, while jobs as cargo truck

drivers are too risky due to the security situation. Changing the perception of jobs women can occupy is likely a necessary precondition to increasing overall sector participation.

RESOURCES

There are five key resources required for the growth of the logistics cross cutting sectors.

Security. Security remains a top concern of transporters in Honduras due to pervasive roadside robberies, bribery and extortion, and unsafe vehicle operation practices. To mitigate these concerns, transporters must invest resources in security escorts, GPS tracking systems, and costly insurance, passing these costs on to the consumer. Interviewees estimated that in the last three years, the average aggregate security costs have increased by nearly 20 percent, reaching nearly five percent of the total transport price. While the costs of long-term investments in GPS tracking systems can be absorbed over many transactions for larger firms, the costs of security for SMEs in the sector must be borne by a smaller client base and a longer amortization period. The absence of regulations mandating maximum weight limits, adequate parking facilities, and enforcement of speed limits along transport corridors all contribute to the risk of transport, endangering the cargo, driver, and other commuters. Combatting roadside robberies and extortion requires government investment in enforcement mechanisms, increasing the human resources available to police along critical transport corridors. The decrease in bribery requires more complex and long-term institutional change, to instill an ethical law enforcement workforce and a strong reporting and disciplinary system. Regulatory action could entice actors to lessen their cargo loads to a safe weight, drive within the speed limits, and obey safe driving practices, but again enforcement resources is a constraint to their effectiveness.

Finance. The high average age of the transport fleet reduces the competitiveness of the country, as transfer times are longer and fuel costs are higher due to inefficiencies of the fleet. Small and medium-sized entrepreneurs, however, are unable to access appropriate finance to invest in new vehicles, other necessary equipment or maintenance services. Their only source of credit are some financial institutions such as Cofisa or Rapicredito that offer loans using the vehicle as guarantee, but interest rates are excessively high. Banks are also a source of credit, but they require higher levels of collateral or, alternatively, that firms hold valid transport contracts with large companies such as Walmart or Chiquita. The high cost of credit and high risk of operating in Honduras leads to most trucks being bought second hand, which limits the ability to renovate the fleet. The low level of association has also meant that transporters have not been able to negotiate with banks with one voice and get them to develop adequate financial products.

Road infrastructure. According to interviewees, transport in Honduras can take sometimes 2 to 3 times longer than similar stretches in other countries. This is principally due to poor road condition (mainly in the western part of the country), frequent traffic jams (caused by few rest stops and little overnight parking), and the absence of traffic management plans for urban areas. Longer transport times results in higher operating costs comparative to other areas in the region, which are passed to consumers. Cargo traffic management plans are required to facilitate movements in the interior of the country, especially in urban areas where there are traffic restrictions (e.g. San Pedro Sula). Only about a quarter of roads in Honduras are paved, leading to slower maximum speeds for cargo trucks. The roads that are paved are likely to lack the density needed to absorb the impact of large vehicles; Honduras has one of the lowest road densities in the region. Low density and high volumes of heavy traffic (especially overweight cargo loads) can cause divots and potholes, which further reduce transport speeds. The scarcity of overnight parking and rest stops along transport corridors result in transporters parking in the traffic lane or on the margins of the road, further hindering traffic flows.

There is a need for continued investment in road to address these issues and reduce the time and cost of transport. Further, by investing in the expansion of roadways into hard-to-reach areas, Honduras can connect its rural producers to transport networks, and by extension, expands their market opportunities. This is especially important for producers of perishable goods, for whom faster transit from farm to market can mean less post-harvest loss. Investments through Public-Private Partnerships can further create employment opportunities and leverage private sector capital for public benefit.

Technology. According to the IABD[159], in Latin America every year about 30 percent of agricultural production is lost due to logistical problems. The use of new technologies allows for increased interconnectivity and traceability, fostering innovation and competitiveness. The reality in Honduras, however, is that only the very large firms are currently able to use some of these technologies when providing transport and logistics services. Most of these technologies, however, are too expensive for small and medium firms, who also lack understanding of their benefits and face resistance to change. Some recent changes from DARA like the introduction of SARAH Web 2.0 are steps in the right direction, but technology at border crossings is still scarce and the digital gap is still significant.

Training. Capacity is limited at all levels of the supply chain to develop and deliver innovative logistics and transport services. To become a competitive logistics hub, the sector in Honduras needs greater product innovation and strategic marketing, delivered in an equitable and non-affiliated manner. Due to uncertainty regarding returns on investments for product differentiation, firms are reluctant to invest in new processes or technologies. This leads to little product differentiation, leaving firms to differentiate their services on cost alone, with little benefit to the consumer. Therefore, the inclusion of market analysis and consumer profiling is a necessary component of product development training. Currently, some university programs focused on logistics and supply chain management exist, however technical training is mostly delivered on-site by employers.

RULES

There are multiple ongoing efforts and institutions supporting the modernization of the logistics sector in Honduras. Some of these efforts are being led with a regional perspective and others a national perspective. In either case, there is a clear commitment from the GoH to support the logistics sector, but coordination challenges are significant. The two key regional initiatives that provide strategic direction for the sector:

- *The Central America Customs Union*: the recent establishment of the Customs Unions impacts and will continue to impact policies, procedures and regulations in the logistics sector. In the case of Honduras, the country has to catch up with its neighbors in enabling the regulatory environment and modernizing its services and infrastructure. As part of its commitments to the Union, Honduras is already in the process of investing heavily in roads infrastructure, in ports and land borders infrastructure and technology, and in streamlining of border procedures which has already reduced the time and cost of moving goods. However, these efforts have to be accompanied with quality and efficient logistics services including transport and collection and distribution centers. The Ministry of Economic Development, Customs and COPRISAO in Honduras are the institutions responsible of the establishment of the Customs Union.

[159] Inter-American Development Bank "Honduras: Programa de Reformas del Sector Transporte y Logistica de Carga". Propuesta de Prestamo. October 2018.

- *National Freights Logistics Plan (PMRML - Politica Marco Regional de Movilidad y Logistica)*: the Central American Integration System (SICA) approved in December 2017 the PMRML and established the members' commitment to address in a coordinated manner the needs of infrastructure and regional connectivity under a comprehensive and shared vision. This encompasses different modes of transport in six sectors: maritime - port, aeronautical - airport, rail, land, coordinated border management, and urban logistics. The objective of the PMRML is to make the movement of goods and people more competitive, efficient, fast, reliable and safe. To implement the PMRML in Honduras, the Inter-American Development Bank (IDB) approved in October 2018 a $60 million loan for Honduras. The program features reforms in the regulatory, institutional, planning and commercial assistance areas, laying the foundations for the use of technology, inter-operability and process digitalization.

The "Honduras Logistics Center of the Americas" initiative has been in place since 2013. The plan aims to invest $1.3 billion to infrastructure projects in roads, ports, airports, and logistic corridors. The new veins of the national economy will be the Dry Canal, Tourism Corridor, Pacific Corridor, Agricultural Corridor, Western Corridor and Lenca Corridor, alongside the remodeling of airports and seaports. The projects are in different stages of development. Several laws have been approved to attract foreign direct investment including the Law for the Promotion of Public-Private Partnerships, Law for the Promotion and Protection of Investments, National Law for Hourly Employment and the Law for the Special Zones of Economic Development. As a result, international companies have expressed their interest in expanding operations or investing in the sector.

The most noticeable aspect, however, is the absence of a ley-marco for the logistics sector. The lack of this legal framework is a serious limitation for the development of the sector. At present, the main law regulating this sector is the 2016 Transport Law (*Ley de Transporte Terrestre*), which establishes the administrative and functional structure for the development and implementation of the road transport sector, including the creation of the Honduran Institute of Land Transportation (IHTT), which came into force to replace the National Transportation Directorate. The law contemplates the development of additional regulations, including requirements for mandatory liability insurance, and the control of weights and volume. Both these elements are still under development but are key to improve the security and efficiency of the sector. The law also establishes the creation of the National School of Road Transportation (*Escuela Nacional de Transporte Terrestre*) and the creation of a driver certification system that applies to the whole territory. Another important aspect of this law is that it includes fiscal incentives to promote the renewal of the fleet. Overall, the law aims to incentivize the formalization of transporters, although there are still high costs of doing so.

In terms of informal rules and norms, women's participation this sector is low. A report by the Inter-American Development Bank[160] states that women's participation in physical work or equipment and machinery handling activities is limited, with less than 15 percent. The absence of a national government training perpetuates the informal learning that is passed through predominantly male networks. Gender diversity in a company can improve customer orientation, promotes a higher level of employee satisfaction, reduces conflicts, improves collaboration and loyalty and promotes creativity and innovation in the resolution of problems. Encouraging women's participation also contributes to increase family income. Another informal norm impacts that participation of former immigrants in this sector. Many of the immigrants that are sent back from the U.S. to Honduras are

[160] Inter-American Development Bank "Honduras: Programa de Reformas del Sector Transporte y Logistica de Carga". Propuesta de Prestamo. October 2018.

discriminated by locals thinking that they are all related to gangs such as the Maras. The same happens with people with visible with tattoos.

RESULTS

The GoH is making significant investments to position Honduras as a main logistics center in Central America which will benefit a multiple of supply chains, particularly in the agriculture sector. These investments position Honduras to play a greater role in regional and global integration which are likely to bring significant increases in exports, incomes and jobs. To fully benefit from these new and expanded trade opportunities, greater levels of innovation are needed within the sector.

New processing technologies are also needed to reduce delays. A recent example is the electronic system implemented since March 2018 for cargo between Honduras and Guatemala (along the borders of Agua Caliente, El Florido and Corinto in the western border), which has had a massive impact on reducing the time for crossing the border (from several hours to 15 minutes) and on incentivizing bilateral trade (which increased by 9 percent last year). There are necessary investments in transport fleets to replace aging trucks to reduce transfer times. These will be hard for SMEs to achieve which are unable to secure commercial financing and face increasing barriers by larger firms. There is a need for information to inform the effectiveness of investments based on sound sectoral statistics and information systems. A challenge will be ensuring that these are available to all.

An improved enabling environment and stronger set of support services are needed to fully realize these opportunities by opening up innovation and motivating enterprise growth. Professional training to motivate new talent in marketing, management and leadership among a diverse population, including women, are urgently required to help companies grow smartly. The creation of the *Instituto Hondureño de Transporte Terrestre* (IHTT), aims to address this challenge. There is a need to make sure that its curricula and training are oriented to the needs of private sector companies. Support services oriented towards SMEs, notably finance and business advisory, are important to help foster entrepreneurship, differentiation and specialization among logistical services.

Ineffective competition is a further deterrent to sector growth and innovation. For example, only larger firms, with exclusive contracts with importers and/or exporters that can be used as guarantees, can access suitable finance. The National Logistics Council established May 2018 can serve as a space to facilitate more inclusive dialogue between the public and private sectors. Ensuring the council is transparent and represents the interests of the sector as a whole, not just its largest and most influential players, is important to ensuring the prioritization of projects that will have the greatest impact on productivity, logistics as well as mobility of actors in the sector. It is also a mechanism to streamline coordination and establish a more coherent institutional context for the sector.

Honduras still lacks a national logistics policy that defines its strategic guidelines and how it should be organized. The establishment of such guidelines could assist the development of logistics operators (i.e. transport firms that offer value-added services such as storage, management of inventories or packing) since the supply is very limited. There are only a few large private transport companies, for example TRANYCOP, that are actually able to provide such added value services, while the large majority of firms simply provide transport services and show little differentiation between one another.

Security issues remain an underlying constraint for small and medium-size carriers becoming more competitive, as it increases their costs and reduces their efficiency. Road transport services are

particularly affected by current insecurity, due to theft of goods and equipment, extortion (e.g. trucks trying to access specific routes) or bribery (e.g. payment to enforcement officials to allow a cargo to be moved). Similarly, the limited number of secure rest and parking areas for long-distance drivers significantly increases the safety costs and time of moving cargo.

Given the set of investments already being made in the logistics sector, the role of TMS would be as a facilitator to help enhance the effectiveness of those investments. This includes coordination with the new IADB and USAID RTMA projects to facilitate and coordinate specific activities for trade facilitation, legal, regulatory and institutional framework.



TOURISM

ANNEX VI TOURISM

SECTOR OVERVIEW

Honduras has a wealth of underdeveloped tourism assets and potential. These include a UNESCO's world heritage Maya Site of Copan, pristine beaches such as Arrecife Capiro in Tela, and natural parks such as Pico Bonito or Celaque. Such sites make Honduras highly competitive with respect to other Central American countries in terms of the relative strength and diversity of its offer. Honduras's proximity to the North American market and existing tax incentives for investment practically pave the way for tourism development. The reality is that these outstanding natural and cultural assets are not well-incorporated in tourist itineraries are not developed to provide an attractive visitor experience. There is little to do beyond the short visits to these sites and many natural assets are poorly-maintained. There are few entertainment activities offered and the quality of lodging and services is sub-standard and difficult to find. Costa Rica, El Salvador, Guatemala Nicaragua and Panama have demonstrably outcompeted Honduras in delivering a quality, wholistic tourism experience, and have been rewarded with substantial increases in tourism exports over the past decade Since 2007 the number of international tourists visiting Honduras has remained largely constant, while the other countries in the region experienced average increases of up to 34% between 2010 and 2016. Honduras is measurably the lowest performing tourism destination in the Central American region.

The tourism sector has been identified by the GOH plan Honduras 2020 as one of the six key sectors to support economic growth. It is currently the fourth largest source of income for the country, representing around 6.4% of GDP in 2016 and employing around 250,000 people (56% women). Over 60 percentage of the two million tourists that visit Honduras annually are cruise passengers who spend a few hours in the country. Looking at the 880,000 tourists that spent at least one night, around 45% come from Central America and 40% come from USA and Canada.

There is a growing innovation and quality performance gap. The market in Honduras has shifted towards a greater focus on domestic tourism. This has been an important source of resilience in the tourism industry but has shifted competitive pressures away from innovation for the international market, resulting in comparatively high prices for services to this segment, relative to quality of what services are provided elsewhere. Neighbouring countries offer cheaper and better services suited towards international segments. Private and public sector initiatives struggle to be able to maintain quality of service but markets are not rewarding those quality investments. Hotel operators for example noted the difficulty finding staff with the right skills, despite initiatives by INFOP and CANATURH to strengthen the workforce. Noted skills deficiencies are in destination and hospitality management, especially marketing and customer service. Efforts to improve standards of the industry such as the Sistema Integrado Centroamericano de Calidad y Sostenibilidad (SICCS) are important but early markers for increased quality in the hotel industry. Few businesses are seeking business support services, and as a result, few provide tailored support required by the industry. Data is almost completely unavailable for the sector. This makes it hard for institutions to make informed decisions These challenges are not static but growing. As regional neighbors continue to innovate and compete their offers, Honduras will fall farther and farther behind in the competition for international tourism.

Significant investments are being made but results are not showing yet. The launch of the Plan Honduras 2020 marked the start of a new phase for the tourism industry. The Plan included significant investments in road infrastructure such as the new road between Copan and Gracias, and the Corredor de Occidente. It included a new regulatory framework for the industry - the Ley de Fomento al Turismo which was approved in November 2017. It included a focus on promoting national tourism, which has allowed the survival of the tourism industry in a period when political unrest. However,

despite having four international airports, poor road infrastructure make access to major tourist destinations such as Copan Ruinas difficult and tiresome. The private sector too has also been able to develop new and inclusive offerings such as the Ruta del Café and the Ruta Lenca[161]. The organisation of festivals such as Gracias Convoca build off emerging development of the creative or orange economy[162] in Honduras to showcase rich cultural assets. Alternatively, more innovative actors such as Guatemalan tour operators have developed such packages that have benefitted Honduras e.g. Copan Ruinas is part of their Mayan Experience packages, but these mostly consist of day visits.

Coordination failures undercut the effectiveness of tourism investments. Weak coordination and limited capacity between public and private sector to develop and promote tourism in Honduras has translated into low demand from tourists. There are four entities doing some of the same branding and marketing efforts: Marca País, 2020 Honduras Plan, Pro-Honduras, and IHT. This multiplicity of actors playing a similar role leads to uncoordinated marketing efforts and inefficient use of resources. Efforts by the private sector, such as Ruta del Café and Sociedad Civil Marcala fall short of expectations due to poor cooperation with public bodies, which are not able to provide a more enabling environment for their successful development. Tour operators have interacted weakly with meetings, incentives, conference and events (MICE) industry actors to develop new destination packages that could encourage business tourists to extend trips or visit nearby sites. Instead they tend to prioritise their well-established sun & beach circuits in the Bay Islands. There are models for effective coordination that seem to have paid off for the development of new destinations such as Gracias Convoca (building on the orange economy) and OGD Atlántida.

> The Organizacion Gestion Destino (OGD) Atlantida is a network of tourist firms that jointly promote sustainable tourism to the Atlantida region in Honduras. Importantly, increasing the tourist offer is done in a very inclusive manner, working through the local communities to develop new offers. Its dependence on the regional tourist chambers, however, limits its ability to self-finance and growth further.

Low capacity underlies the leadership potential of key institutions. Many of the above-noted dynamics are shaped by the limited institutional capacity of key industry institutions responsible for promoting and advancing tourism in Honduras. The promotion of tourism products that have limited sustainability e.g. cruise ship stop-overs, and limited international promotion reflects a disconnect in priorities between these institutions and the private actors they represent. Despite having an "Estrategia Nacional de Turismo Sostenible" there appears to be little coherent coordination between institutions responsible for developing the industry such as IHT, Marca Pais, CANATURH at national and regional levels, the municipal-levels. There are notable capacity and financial constraints noted in the Instituto Hondureño del Turismo or Marca Pais that are contributors to limited promotion campaigns in the international markets, insufficiently focused in North America. However, the root causes appear to stem from a top-down (versus bottom-up) orientation to priority-setting that has reportedly dissuaded membership and contributions in key associations such as CANATURH. The international tourism segment requires public-private alignment and a blend of resources to effectively compete.

Poor reputation and low visibility continue to drive weak international tourist flows. Finally, Honduras is still perceived as a highly "violent" country, although security in the country has improved substantially in the last few years. Recurring economic and political instability has further exacerbated this image. This affect has been compounded by a focus on internal campaigns to promote national tourism. Experts routinely identified the real growth opportunity is in the international tourist market,

[161] https://www.frommers.com/destinations/la-ruta-lenca/introduction
[162] https://www.iadb.org/en/news/news-releases/2017-07-13/orange-economy-innovations-in-lac%2C11841.html

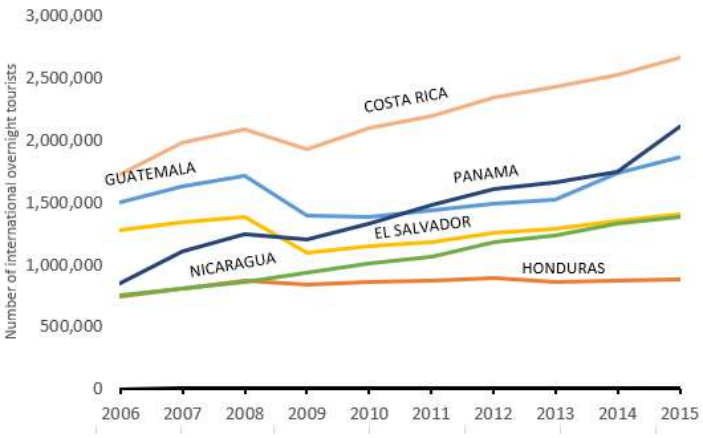
in particular flashbackers and nature/cultural tourists. Bloggers and influencers are playing an increasing role in destination promotion. However, even the more adventurous and dedicated tourists find it nearly impossible to source online comprehensive and up to date information to develop an itinerary. The dearth of information coupled with Honduras's lingering image as a "violence" country (reinforced by security guidance from entities such as the US State Department) will continue to make Honduras an unlikely destination for international tourists.

INTRODUCTION

The market potential for tourism is high in Honduras. Honduras has an abundance of natural beauty with a diversity of wildlife, a rich and preserved ancient cultural heritage, and a warm and inviting climate. If promoted and managed sustainably, these resources could unlock a wealth of export revenues from visiting tourists for decades to come.

Despite its potential, growth in Honduras' tourism sector has stagnated while those of its regional peers have benefited from significant growth over the past decade. In 2017, Honduras attracted over 880,000 international tourists, while neighbors Guatemala and El Salvador attracted nearly 1.5 and 1.4 million, respectively.[163] The is disparity has only worsened in the past ten years, especially among competitors outside of the Northern Triangle; as its regional peers continue to improve their tourism environment, the tourist arrivals gap continues to widen.

Figure 51 International overnight tourists Central America



The economic activity resulting from Honduras' tourism inflows tends to be highly concentrated in the northern part of the country, yielding few benefits for poor communities further inland. It is estimated that the majority of tourists that visit Honduras arrive by cruise-ship to the port of Roatan, an island off the northern coast. The tourists that do visit inland tend to be backpackers, volunteers, missionaries, or visiting friends and family, all segments of the market that tend to effect fewer or less expensive transactions, and thereby generate less economic impact in local markets.

Although the sector's performance has stagnated, tourism-related industries in Honduras remain an important contributor to the country's overall economic health. Official government statistics place tourism exports as the fourth largest source of foreign currency inflows for the country, after remittances, manufacturing, and coffee exports. These exports contributed $585.1 million, or 6.4 percent, of the GDP in 2016. The sector is also a significant source of employment in the country. In 2016, an estimated 250,000 Hondurans worked in the tourism industry representing 6 percent of its labor force (or 2.7 percent of the population).[164] If indirect effects are considered, total direct and indirect contribution of the tourism sector to employment is projected to reach as high as 680,000

[163] World Economic Forum. (2017). The Travel & Tourism Competitiveness Index 2017: Paving the world for a more sustainable and inclusive future. Retrieved from: http://www3.weforum.org/docs/WEF_TTCR_2017_web_0401.pdf
[164] Honduran Tourism Institute. 2016. Tourism sector employment. World Bank. Total labor force and total population.

jobs by 2028, or 15.5 percent of estimated total employment[165]. Moreover, Honduras' tourism workforce is predominantly female and offers opportunities to advance gender and social inclusion objectives, promoting women's leadership, entrepreneurship and empowerment.

The GoH prioritized the tourism sector as part of Honduras 20/20, providing an incentive structure for corresponding investments in tourism infrastructure. Examples include the revitalization of the Corridor del Occidente and the construction a new, modern data center in Tegucigalpa, by private sector investor Tigo Honduras. Honduras' National Congress also approved a new Law on Tourism Promotion in 2017 providing an incentive framework to further boost domestic and foreign investment in the sector. The National Strategy for Sustainable Tourism (ENTS, for its Spanish acronym) is an instrument representative of this commitment to ensuring that the longevity of natural resources and cultural heritage is preserved for future generations—particularly important when considering Honduras' burgeoning birdwatching and nature tourism products.

Despite Honduras' natural advantages and the increased promotion of the sector by the GoH, there are significant challenges for the tourism industry. Political unrest and travel warnings have dissuaded foreign tourists from visiting Honduras. The perception of Honduras as a safe destination to visit will take time and effort to change. To-date, the tourism sector has marketed its products to the less demanding domestic and foreign consumers. Tourism enterprises will have to invest in the quality of their offer to compete for more tourists. While tourism is a significant employer, it also depends on higher skilled workforce to meet consumer expectations.

Figure 52 Global Tourism Rank Central America Countries

Country	Global Rank	Business Environment	Safety & Security	Health & Hygiene	Human Resources	ICT Readiness
Panama	**35**	**4.9**	5.3	**5.1**	4.4	4.5
Costa Rica	38	4.5	**5.4**	5.0	**4.9**	**5.2**
Guatemala	86	4.4	3.7	4.6	4.1	3.8
Honduras	90	4.2	3.5	4.6	4.3	3.4
Nicaragua	92	3.5	5.4	4.6	4.2	3.3
El Salvador	105	4.0	3.0	4.9	4.2	3.7

Source: World Economic Forum, The Travel & Tourism Competitiveness Index 2017

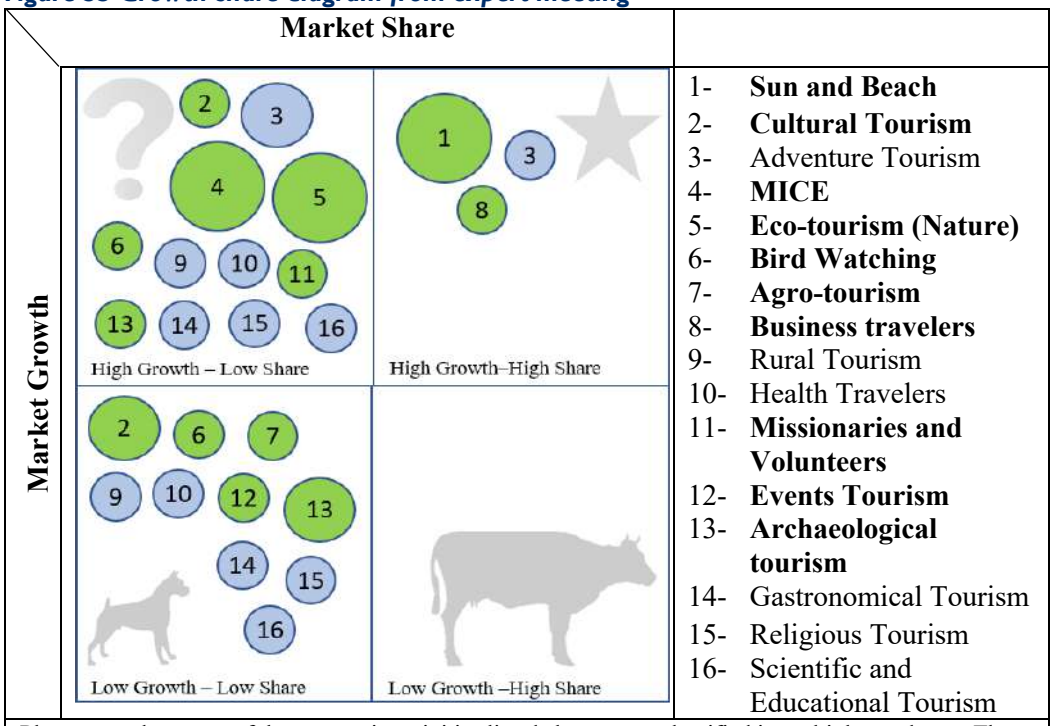
During the Subject Matter Expert workshop, experts identified a total of 16 economic activities in tourism, but disagreed on the share and growth potential of each. Points of view were divided between types of tourism per activities and types of clients or their purpose for travelling, and which to promote. Even official documents[166] published by the IHT, Pro Honduras and the National Strategy for Sustainable Tourism, all present different classifications and number of sub-sectors. This itself is reflective of a lack of coordinated vision for tourism in Honduras. All experts agreed that sun-and-beach is a star segment, they also agreed on classifying archaeological tourism and the conventions and events segment (or MICE by its standard acronym) as a question mark. Even though many activities have growth potential, their growth wasn't realized. This is consistent with the view

[165] It is worth noting that the Council's Travel & Tourism Economic Impact 2018 report for Honduras posits that the tourism sector directly contributed fewer jobs in 2016 than the Honduran Tourism Institute. The former report posited that the tourism sector contributed 183,600 jobs in 2016, whereas the IHT's estimates were significantly higher. This discrepancy was not studied as a part of this paper.

[166] IHT. Retrieved From: http://www.iht.hn/wp-content/uploads/2015/10/CatalagodeProyectosIHT2015.pdf or Pro Honduras. Retrieved from: http://www.prohonduras.hn/index.php/espanol/por-que-honduras/somos-en-el-mundo. breakdown from 6 to 11 sub-sectors to analyze tourism in Honduras.

that Honduras has a lot of unexploited tourism assets. The four sub-sectors detailed below incorporate the most agreed-upon opportunities for Honduran tourism. These include: Sun and Beach, Cultural Tourism, Nature Tourism, and MICE.

Figure 53 Growth-share diagram from expert meeting



Please note that some of the economic activities listed above were classified in multiple quadrants. The size of circles reflect the level of agreement among experts, a large circle would indicate a total agreement on that quadrant. Green circles are the activities chosen for EMA and MSA research.

Figure 54 Highlight Findings from Tourism Expert Focus Group

To improve the sector´s competitiveness, experts indicated that better training of human resources is needed, but the institution responsible for providing the service (INFOP) has no training centers in the most important tourist regions and is not offering a tailored package of programs that can fit the sector´s demand. Experts highlighted the slow, complex and expensive environmental around permits. It was noted that procedures for the tourism sector have not been regulated accordingly or considering the size of investments for SMEs. Even local procedures, which should be expedited by municipal authorities are entangled with the environmental permits. Municipal zoning of bars and night recreation businesses in residential areas was noted as an issue. Pricing of commercial passenger flights to Honduras is high. The country´s aeronautic authorities are still unable to certify national companies to fly into the USA. The most important improvement noted by the sector experts is to invest in the promotion of the country, to recover the flow of foreign tourists which fell dramatically after the political crisis in 2009 and since has not been the same. Hotels outside the two mayor cities of Tegucigalpa and San Pedro Sula remain with occupancy levels as low as 30-40% and the numbers of foreign visitors to popular destinations like the Mayan archaeological city is only 30% of what it was in 2008. A reported challenge is that the current budget for promotion is a quarter of its neighbors and is broken up between four different entities, each following its own agenda and do not work under the umbrella of the official Tourism Institute (IHT). The advice given by experts was that the IHT should establish a strong presence in all important tourist destinations and working close to the private sector, establish a unified and openly administrated campaign to promote the country.

The end market and market systems analyses conducted by research partners identified key market segments and enterprise types active within the Honduran tourism sector. The research focused on destinations within TMS' geographic intervention areas. Sun and Beach focused on Tela and La Ceiba, as those cities were identified by the National Strategy for Sustainable Tourism as high-priority zones with incipient development initiatives with possibility for successful scaling. Within the Cultural Tourism sub-sector, researchers identified that the DO2 departments had existing tourism products which could be scaled-up or innovated upon to attract additional market share. Analysis of the Nature Tourism sub-sector was limited to agricultural and rural areas in the west of the country. The MICE sub-sector analysis focused on San Pedro Sula as the city with the most developed MICE infrastructure and product offerings. However, it also considered Tegucigalpa, Tela, Ceiba and Copan Ruinas as markets in development.

Sun and Beach tourism refers to travel for the purpose of sunbathing, swimming, snorkeling or scuba diving, and other beach- or ocean-based activities. Honduras's sun and beach tourist attractions are concentrated along the country's northern coastal areas. This includes TMS intervention areas Tela and La Ceiba. All-inclusive products are popular within this sub-sector which offer tourists an ease of experience by purchasing lodging, transport, meals and drinks, and excursion packages in a single transaction with the hotel or travel agent. Research indicated several hotels, such as Villa Telamar and Indura in Tela or Palma Real in La Ceiba, have begun to offer all-inclusive packages, but this is still uncommon in the market. One of the advantages of Tela and La Ceiba is that they are also short distances from national parks and wildlife refuges. This differentiates some of the packaging of the sun and beach offer.

Nature tourism is travel for the purpose of exploring the destination's natural ecosystems and biodiversity. In Honduras, this sub-sector includes activities such as birdwatching (avitourism), hiking, kayaking and rafting, mountain biking, canopy tours, and visiting working coffee or banana farms (agritourism). Honduras has two promising product offerings in particular in avitourism and agritourism. Its diversity of wildlife, including more than 770 registered bird species across national parks and protected wilderness reserves, such as Pico Bonito and Cuero y Salado near La Ceiba, and Azual Meambar Park at Yojoa Lake in Cortes Department, make Honduras an ideal ecosystem for birdwatching products.[167] Additionally, Honduras' rich agricultural history in coffee production, as well as its abundance of working and accessible coffee farms, hold promise for developing the proposed "Ruta del Café." Due to the rural geographic locations of destinations within this subsector, it has a high potential to include the surrounding populations in tourism supply chains.

Meetings, Incentives, Conferences, and Events (MICE) tourism includes people visiting destinations for professional purposes. The market for MICE tourism requires adequate conference infrastructure, including large event spaces in hotels or conference centers, fast and reliable ICT, high-quality lodging and catering services, and, particularly for international MICE, proximity to major airports. San Pedro Sula has made major investments in MICE facilities, hosting event spaces to accommodate up to 5,000 people (at the El Copantl Hotel).[168] Other cities have potential to also attract MICE tourism. Tegucigalpa's Honduras Maya Hotel can accommodate conferences for up to 2,000 participants, Copan's Hotel Marina is investing in an event center near the Copan ruins, Tela and Ceiba are targeting the segment of national events. Notably, this sub-sector has the opportunity to

[167] Gallardo, R. J. (2014). Guía de Aves de Honduras.
[168] While the conference center was recently renovated, lodging offerings—a complementary product of importance for the business consumer—is still an area for growth.

integrate product offerings from other sub-sectors, to create a package for the business traveler that would like to take advantage of "free time" to further explore the city or different parts of the country.

Cultural tourism involves experiences that immerse tourists in the heritage, language, cultural norms, gastronomy, and art of a destination. Honduras has very strong offerings in this sub-sector. These include the ancient ruins at Copan —a UNESCO World Heritage site — the unique culture of the Lenca ethnicity around Intibuca through the Ruta Lenca, and a variety of museums and nightlife available in the urban cultural hubs of Tegucigalpa and San Pedro Sula. It is also worth noting that MICE infrastructure—especially large event spaces and adequate lodging—can also attract non-professionals to Honduras under the guise of cultural tourism.

Figure 55 Sub-sectors not included in analysis
Wellbeing or Spa Tourism is travel focused on rejuvenation, wellness, and personal care, and is principally concentrated around destinations with product offerings such as spas, hot springs, yoga or other exercise retreats, and world-class medical facilities, among others. This sub-sector was not prioritized; although locations like Luna Jaguar Spa in Copan and hot springs in the west of Honduras exist, it is not well-developed enough to be sufficiently attractive to compete with other countries in the region.

History and Trajectory. International tourism to Honduras began to decline in 2009, after a political crisis that replaced then-President Manual Zeyala. The U.S. Department of State has had a Level 3 Travel Advisory since 2012 due to high levels of crime. Honduras' tourism sector has yet to recover and falls far short of the performance of neighboring countries. Greater Central America enjoyed a nearly 34 percent increase in tourism flows between 2010 and 2016, while in Honduras the increase was a mere 5.3 percent over the same period. Expert interviews and subsequent desk research indicate that the perception of continuing instability, combined with inadequate promotion and infrastructure, limited business development services, and an undertrained workforce continue to hinder the future potential of the sector.

Among international tourists, perception of instability is propagated by continuing travel warnings and news outlets covering post-election violence, despite demonstrable improvements in the country's security situation. To this day, the governments of two of Honduras' largest international tourism export markets—the United States and Canada—recommend that their citizens reconsider travel or exercise a "high degree of caution" due to crime, and to avoid all travel to some areas near San Pedro Sula. Though homicide rates in the Northern Triangle remain some of the highest in the world, the country has made significant improvements in the past few years. Honduras, just behind El Salvador, has one of the highest homicide rates in the world with 56.5 homicides for

Figure 56 Major Tourism Destinations in Implementation Zones



100,000 in 2016 (7 times the world average). This rate, however, has dropped by more than a third since 2011.[169] Even among citizens of Honduras, perceptions of Honduran tourism initiatives remain highly politicized. The government institution responsible for promoting Honduras' brand and image, *Marca País,* is not seen as having been successful in attracting foreign tourists. The Honduran Institute for Tourism (IHT), the government institution responsible for promoting the growth of the sector, currently suffers from the lowest levels of funding in the past decade. Institutions' resources are often inefficiently allocated due to the lack of a unified government strategy. In light of falling international tourism flows, previous government initiatives have focused on attracting regional and domestic tourists, and developing tourism products for cruise ship passengers passing through day-time ports of call in Roatan. For example, interviewees stated that Copan Ruinas reportedly welcomed 200,000 tourists in 2008 of whom 70 percent of which were foreigners, but by 2017 it had changed with reportedly seventy percent of its 140,000 visitors were local Hondurans.

There are currently significant investments underway to develop road infrastructure, service standards, and new product offerings to meet the eventual demand. In road infrastructure for example, a revitalization of the Corridor de Occidente promises to facilitate greater tourism flows through western parts of the country. Service standards and workforce development have increasingly become the focus of competitiveness improvement efforts to adapt to evolving consumer preferences that demand a higher standard of culinary experiences in restaurants and hotels. Honduras is part of the Integrated Central American System for Quality and Sustainability (SICSS), and some firms in the tourism sector are already certified as compliant with standards set forth under this regime. ProParque, a USAID program in Honduras partly focused on economic growth of tourism-focused MSMEs, developed of a quality standards manual for the hotel industry in particular. Workforce development, especially among hospitality industry management is critical to improve service standards of an increasingly diversified and high-end market and there are ongoing successful actors providing workforce development programs like Hotel Escuela Madrid and Escuela de Hoteleria Los Sauces in Tegucigalpa and Mairin project in Zambrano.

Honduras 20/20 and the recent legislature enacted incentive structures that are encouraging the development of new and inclusive product offerings in the sector, like the Ruta del Café. However, challenges still remain in attracting tourists into these rural areas from MICE epicenters in Tegucigalpa and San Pedro Sula, or Sun and Beach destinations such as the Bay Islands. A subsequent challenge for tourist development is ensuring that the benefits of tourism flows positively and impact poorer surrounding communities and don't further exacerbate inequality, or economic and social exclusion. Although instability and insecurity remain a challenge for the country, there are other popular tourist destinations, such as South Africa and Colombia, which in the past or more recently have managed successful tourism campaigns and mitigated the heightened security concerns of tourists. While, continued progress in reducing insecurity situation should open the country up to more tourists, industry actors will have to innovate to develop and market destinations, improve product offerings and invest in their workforce to meet Honduras 20/20 goals.

MARKET OPPORTUNITY

The end market analysis identified and evaluated the following segments. This segmentation is informed by consultations with key actors within the tourism sector:

[169] United Nations Office of Drugs and Crime. Intentional Homicide Victims. Retrieved from: https://dataunodc.un.org/crime/intentional-homicide-victims

Coffee tourists that visit Honduras are likely drawn to purchase quality, small-batch coffee products. This consumer is likely to be a North American millennial that wants their commercial habits to have a positive impact. Enterprises that adopt sustainable farming methods to produce their coffee and use recyclable, reusable, or biodegradable packaging or that support vulnerable populations (e.g. a percentage of the proceeds are donations or that employ marginalized groups) are likely to be popular with this tourist segment. With this segment, sustainability and low ecological footprints, fair treatment of labor are also important aspects of demand the Ruta del Café is intended to attract this segment and should incorporate sustainability efforts and worker fairness initiatives are a part of their attraction.

Backpackers are a price-sensitive and young consumer profile. Due to the typically extended nature of backpacking trips and low travel budgets, this traveler profile is unlikely to spend money on food and drink, and tend to choose low-cost lodging alternatives, such as hostels. This segment does tend spend more on bars and adventure products (e.g. rafting on the Rio Cangrejal in La Ceiba). They are more likely to choose public transportation or shared-ride services, which is also part of the experience of the everyday life as a local. Backpackers are adept and comfortable with social media and are known to share their experiences with friends and other travelers on blogs, social media accounts, or other travel sites. Their tendency to choose communal lodging when traveling also facilitates word-of-mouth referrals to travelers with similar interests.

Business tourists are attractive from a revenue-perspective. Tourism budgets for this market segment are much higher than the average consumer, as the sponsoring company of business travelers tends to pick up travel-related expenses. Lodging is particularly important to this segment especially if conferences are held at hotels - where room blocks, catering and large venue management services including conference planners and audio-visual teams are required. This tourist profile generally travels to MICE-centric destinations—in the Honduran context, San Pedro Sula and to a lesser extent, Tegucigalpa—but does not generally venture outside of these markets.

Cruise ship stop-over tourists to Roatan represented 62.4 percent of the international tourist inflows to Honduras in 2016[170]. This segment contributes little to sector growth and revenues. Cruise ship stop-overs only at the port in Roatan and last for several hours only, before tourists board in the evening and travel to the next destination. The economic activity for this segment is concentrated at ports of call - strict itineraries do not permit tourists to venture inland. However, in terms of raising awareness of Honduran tourism products, the stop-over allows exposure to Honduras to facilitate outreach to tourists whose positive experiences may entice them to return to the country as a principal destination. There is little evidence to support if this is the case, but is a possible outcome, especially as Honduras develops its all-inclusive hotel supply. Given the similar all-inclusive nature of cruise ship vacations, all-inclusive hotel products are likely to be of interest to this market segment.

Flashpackers are generally more mature travelers who travel for less time, usually one or two months at the most. Flashpackers may have been backpackers when they were younger, but now are several years into their careers are willing and able to spend more for privacy or comfort. Flashpackers are likely to travel alone or with their partner. So, they are likely to seek to develop relationships with other travelers or Hondurans along the way. While flashpackers may choose to stay in hostels for the social experience, they are more likely to purchase private or semi-private rooms.

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[170] Banco Central de Honduras . (2018). Honduras en Cifras 2015-2017. Obtenido de: http://www.bch.hn/download/honduras_en_cifras/hencifras2015_2017.pdf

Sharing economy products such as Uber and AirBnB for lodging are alternative transport and lodging services that satisfy the desire for social networking, while offering a low-to-mid-range price point service. While there is no Uber or similar ICT-based ridesharing service in Honduras, there are a growing number of listings on AirBnB, principally concentrated in the Bay Islands, and to a lesser extent, Tegucigalpa, San Pedro Sula, La Ceiba, and Tela.

Hondurans on holiday have bolstered the tourism sector as of the last couple years, providing reliable revenue streams in the face of falling international tourists. The Honduran government, looking to promote domestic tourism, deemed Morazanica Week in October a national holiday. This has given rise to a new wave of domestic tourism consumer. This week along with Easter week remain peak travel periods in Honduras. The downside is that while this has peaked tourism in two weeks of the year, the remainder of the year is more flat in terms of domestic tourism and travel. .

Voluntourists travel to volunteer their time for community service-type activities in the interests of the local population. In Honduras, this is most commonly high school or college-age travelers but can also include highly-skilled volunteer labor, such as dentists or medical professionals. In general, these tourists travel to impoverished parts of the country and spend relatively little compared to other market segments. This segment's demand for tourism products has proven resilient to shocks from increased insecurity or violence. This segment's current spending patterns include transactions with lodging and restaurant establishments in impoverished parts of the country, providing short-run capital inflows and stimulating the local economy.

Visiting Friends and Relatives (VFR) is comprised of tourists that have existing familial or close social ties among residents of the destination, and are often the source of remittance flows into Honduras.[171] As such, VFR tourists do not usually consume lodging products, instead choosing to stay with friends or family. In 2017 the United Nations estimated that 722,430 of Hondurans—8 percent of total population—live abroad.[172] Further, the U.N. estimates that 93 percent of the Honduran diaspora reside in the United States, Canada, or other Central American countries (major tourism export markets), creating a significant opportunity to market tourism products to the diaspora community.[173] Tourism to Honduras for this segment establishes important ties that can be leveraged to grow demand for other services and products. VFRs tend to be attracted to local cultural and heritage destinations and consumers of 'nostalgia' products. The market segment is appealing in its potential to serve as a market for Honduran food products and artistic items, purchased not only as souvenirs for themselves but for friends and family in the larger diaspora abroad.

Cultural Tourists. Cultural tourists are motivated to gain an understanding of the culture, history, gastronomy, and everyday life of a destination and its people. In Honduras, this would also include tourists who travel to visit archaeological sites in Copan and colonial villages in the west of the country. Museums and galleries are particularly attractive to this market segment, as repositories of historical, artistic, and cultural artifacts and information. Architecture is also of interest to this

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[171] Remittance flows into Honduras represented 18.81 percent of Honduras' Gross Domestic Product in 2017, as estimated by the Federal Reserve Bank of St. Louis. World Bank, Remittance Inflows to GDP for Honduras [DDOI11HNA156NWDB], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DDOI11HNA156NWDB.

[172] United Nations, Department of Economic and Social Affairs. (2017). Population Division. Trends in International Migrant Stock: The 2017 revision (United Nations database, POP/DB/MIG/Stock/Rev.2017). Retrieved from: http://www.un.org/en/development/desa/population/migration/data/estimates2/estimates17.shtml

[173] Ibid.

segment, and guided walking tours of cities designed to offer a "local's" look at the destination's historical and noteworthy buildings and monuments will likely be popular.

Nature Tourists. Nature tourists are motivated by adventure and outdoor activities, notably birdwatching, hiking, camping, and zip lining. Birdwatching is particularly popular among older generations of tourists with greater access to financial resources and a demand for knowledgeable, hospitable tour guides. This may offer opportunities for high-end small group or private guided tour products to target this sub-segment. Other sub-segments are motivated by more adventurous activities, like zip lining. While the thrill of these activities is attractive, consumer safety records are important to maintaining this consumer.

Sun and Beach Tourists. This segment is motivated by relaxation, recreation activities focused on the ocean and beach, and scenic beauty. Consumers in this segment are influenced by environmental aspects of their destination, such as the water quality and absence of litter, as well as the crowdedness of beaches or pools and the quality of private and public facilities (e.g. beach chairs, umbrellas, etc.). This consumer is likely to be interested in all-inclusive packages.

Figure 57 Market Targeting Strategy

	Market Attractiveness	Barriers to Entry	Productive Capabilities
Backpackers	**Medium-Low.** Backpackers have low spending power, so they have more limited impact on job creation. On travel they tend to stopover in multiple destinations in-country. They also may return for travel if they have good experiences, even later in life as flashpackers. Backpackers share travel experiences with each other through social media and word-of-mouth. This provides "free" publicity for Honduras.	**Few Barriers.** Backpackers are a resilient segment inclined to travel despite restrictions or travel warnings. Risks in public transport (crime, etc.) are a potential deterrent to this segment as backpackers tend to rely on this form of transport given price-sensitivity.	**Medium-High.** Backpackers require relatively little resources for accommodation. There are sufficient number of decent hostels in Honduras and plenty of 'undiscovered' (i.e. less frequented) destinations which offer rich cultural, nature and sun/beach experiences in Honduras for this more adventurous segment.
Business travelers	**High.** Business travelers' high budget makes them an attractive segment. The willingness of business tourists to leave venues can however limit the flow of benefits from this segment outside of larger hotel chains. This limits the benefits of this market to a limited set of enterprises in San Pedro Sula and Tegucigalpa.	**Some barriers.** Honduras is at a disadvantage relative to its competitors in the region due to increased safety concerns among travelers to Honduras and the higher cost of international travel. In other word, Honduras does not register as the obvious choice for an international conference of meeting.	**Medium.** There is new emerging business lodging and events infrastructure in Honduras. There is relatively easy (if expensive) access to U.S. consumer markets with direct flights to both MICE target destinations. There are tax incentives also for U.S. companies to hold events in Honduras. There is a need to expand add-on tourism products to enhance the appeal of hosting a conference in Honduras, to further differentiate from safer countries that have cheaper flights and better facilities overall.
Cruise stop-over tourists	**Low.** Cruise ships stop at ports of call in Honduras for day visits only, not allowing tourists to stay the night or adequate time to take advantage of multiple tourism products.	**High barriers.** Short, non-extendable stays in ports of call make it unlikely for cruisers to visit the mainland or take advantage of more	**Medium.** High number of tourists already visiting the country, but low possibility of changing cruise patterns to allow cruisers to spend more time at port, which would allow greater exploration of more of the country

		than one short-period tourism product	
Flashpackers	**Medium-High.** Flashpackers are adventurous, making Honduras an attractive destination given nature and cultural offers. Flashpackers have relatively higher spending power than backpackers, making them a more lucrative market segment	**Some barriers.** This market tends to heed travel warnings. Honduras an unlikely destination without increases to safety and security. Variable standards in lodging facilities also pose barriers for more remote destinations where there are attractive offers.	**Medium.** Honduras' relatively low numbers of current tourists make it an attractive destination for flashpackers, who desire locations with strong cultural tourism products that haven't been overrun by tourists (yet). Tourism infrastructure needs to continue to improve with corresponding increases in service quality.
Hondurans on holiday	**Medium.** Hondurans have shown increased confidence to travel within the country and are expected to do so. This market segment travel is limited to extended holiday seasons in Honduras, including Semana Santa, Semana Morazanica, etc.	**No barriers.** There are no notable barriers for this market segment in Honduras.	**High.** The tourism industry has realigned around domestic tourism offers with attractive packages and marketing geared towards Honduran tourists.
Voluntourism	**Medium-Low.** This market segment travel is largely concentrated in the summer months, coinciding with schools' summer vacation in North America. There is no reason to believe that significant growth in this sector will occur in Honduras.	**No barriers.** A relatively high number of voluntourists already visit the country and are generally interested in advancing the development of Honduras or other faith-based objectives. Demand for travel among some members of this segment is less affected by travel warnings.	**Medium.** Lodging, restaurants, and transport firms already provide services to this market segment.
VFR	**Medium.** This market segment as a rule spends less on accommodation and restaurants/ bars than counterparts, but provide excellent word-of-mouth promotion.	**Some barriers.** Attractiveness of Honduras to this market segment is affected by the perception of danger and insecurity.	**High.** Existing infrastructure is sufficient for attracting the VFR segment, since many may choose to stay with friends and relatives and eat at their homes
Cultural tourists	**High.** Copan Ruinas is a UNESCO World Heritage Site with a history of success in attracting cultural tourists, many of which travel from nearby Guatemala.	**Some barriers**. Security risks, no air access, and relatively poor highway infrastructure to Copan Ruinas may dissuade this segment from travel to this cultural site. Existing museum, hotel, and restaurant infrastructure and a new convention center under construction provide adequate facilities for tourists once in Copan Ruinas, however tourists' arrival remains a challenge.	**Medium**. Copan Ruinas' location near many colonial villages and coffee production sites creates incentives for tourists to journey to the western parts of the country.
Nature tourists	**High.** Honduras' Pico Bonito, Celaque, and PANACAM parks provide access to over 770 different registered birds for birdwatchers, and many outdoor adventure activities like hiking and	**Some barriers.** Trails need to be forged, and public-use restrooms and birdwatching observation decks within the parks require improvements to meet consumer expectations.	**High.** Honduras' peers in the Northern Triangle have not yet developed service offerings for this market segment, offering a chance for Honduras to lead in this sub-sector. High potential to integrate products

	canopy tours.[174] Nature tourists are likely to be incentivized to visit Honduras' coffee regions, especially during the Marcala Coffee Culture Festival in March (near the end of the harvest season), offering an additional income stream for producers in the west.	Tighter regulations on consumer protection and strengthened training on safety standards for zip lining are required to instill confidence among potential consumers.	from this sub-sector with others in the same geographical area, e.g. with sun and sand products near parks in the north, or with Copan Ruinas for parks and coffee production sites in the west.
Sun and Beach tourists	**High**. Roatan's popularity as a cruise destination raises awareness of Honduras as a sun and sand destination among this segment, and creates opportunities for other destinations along the northern coast to diversify product offerings in the sub-sector.	**Few barriers.** The quantity of hotels on the northern coast is sufficient to attract tourists, and have begun to adapt business models to respond to changing consumer demographics and preferences. Workforce development remains a challenge, particularly the strengthening of management and consumer-facing roles in the hospitality industry.	**High**. The growth of all-inclusive hotel models in La Ceiba and Tela can integrate excursion packages from other sub-sectors into its business model, providing incentives for the segment to venture inward towards Honduras' nature parks, coffee plantations, or cultural heritage destinations.

ROLES

Restaurants and Bars. IHT estimates that employees in the nearly 1,400 dining establishments in TMS' zone of influence comprise nearly 62 percent of the total tourism sector labor force.[175] A 2012 USAID survey of the industry estimated that 80 percent of all dining establishments in Honduras were microenterprises, which combined grossed nearly $11 million in revenue per year.[176] The market is structured now to adequately serve the tourist influxes to Honduras during the low season, but any increases in demand would require additional investment in restaurant expansion. There is potential then for significant employment increases in restaurants and bars with greater influx of tourists. Menu offers and pricing are reportedly oriented to more price-oriented local clientele. International demand would drive up service expectations, understandably food prices will rise. As a frame of reference, the average price of a meal costs around $5.45 per person for a meal typical of the area; diversity in menu items among restaurants in Honduras is low compared to other international destinations.[177]

Lodging. According to IHT estimates, there are 1,080 private and chain-affiliated lodging establishments in Honduras, over half of which are located within TMS' zone of influence, most with varying degrees of service quality and amenity offerings.[178] Interviewees estimated that these hotels on average operate with occupancy rates between 30-40 percent. The highest concentration of hotels in the country is around San Pedro Sula, Honduras' MICE epicenter. The second most hotel-dense area is the department of Atlántida, which is home to 154 hotels and Sun and Beach destinations La

[174] Gallardo, R.J. (2014). Guías de Aves de Honduras.

[175] Honduran Tourism Institute. (2018). Tourist establishments directory. Tegucigalpa, Honduras. Retrieve from: http://www.iht.hn/

[176] USAID ProParque. (2013). Analysis of The Tourist Economy Hondureña With Regional, National and Local Destinations for Project Focus.

[177] Ibid.

[178] Honduran Tourism Institute. (2018). Tourist establishments directory. Tegucigalpa, Honduras. Retrieve from: http://www.iht.hn/

Ceiba and Tela. Ranked third, with 119 hotels, is Tegucigalpa and the surrounding area.[179] While the majority of Honduras' hotels are owned by local businesspeople, especially in the western and more rural areas of the country, some are owned by investment banks. This is the case for the Hotel Honduras Maya in Tegucigalpa and the Hotel Villas Telamar in Tela, both of which are owned by Banco Atlántida.

Hotels in the north and west of the country have an increasingly varied consumer base. In the west of the country, hotels cater mainly to nature and cultural tourists, and are equipped with only the basic amenities. However, interviewees stated that this is largely due to a reported lack of demand among domestic consumers for more complex service offerings. It is not evident if the resources and will to meet consumer preferences will not prevent them from meeting that demand in the future. In contrast, hotels in the north of the country cater to the sun and sand tourist, and are already beginning to diversify product offerings—such as all-inclusive packages—to meet the unique preferences of this customer base.

International chains are also present in Honduras' major cities. Choice Hotels International's Clarion Hotel and Marriott International's Marriott Hotel both have locations in Tegucigalpa, while IHG's InterContinental has locations in Tegucigalpa and San Pedro Sula. Hilton maintains a Hilton Princess in San Pedro Sula and has branched into the Sun and Beach market by offering a high-end beach and golf resort in the outskirts of Tela, as a part of its Curio Collection. These international chains strive to protect their brand by maintaining a high standard of services and amenities provided to guests in their locations across the globe; this consistency is attractive to international tourists familiar with the brand, especially MICE tourists. However, according to experts interviewed, the hospitality workforce exhibits relatively low levels of educational attainment and unfamiliarity with hospitality management and customer service principles, making quality control difficult.

The ***Museum of National Identity***, located in Tegucigalpa, attracts tourists who wish not only to learn about Honduras' national history and modern-day culture, but also those who enjoy beautifully preserved Spanish Colonial architecture. Built in 1882 as the General Hospital of Tegucigalpa, it was renovated six decades later and converted into the Ministerial Palace. It currently hosts rotating exhibits on Honduran culture and concerts, film festivals, and children's workshops

Transport and Vehicle Rental. There are estimated to be as many as 145 interurban transport companies in the country, 75 percent of which are located within TMS' geographical area, according to IHT's directory.[180] However, it is worth noting that not all of these firms offer products or services that cater to tourists—the majority are designed to transport local personnel traveling between defined cities on a pre-planned route, without a tourism agenda, and hence may not make stops at locations convenient to tourism zones. Most transportation firms are members of the union in Honduras, which staunchly protects their interests in new product development or changes in workforce development. Interviewees stated that tour guides generally prefer to contract with firms that exclusively provide transport for tourists, given differences in consumer experience between firms with domestic and foreign end markets.

[179] Ibid.

[180] Honduran Tourism Institute. (2018). Tourist establishments directory. Tegucigalpa, Honduras: Retrieve from: http://www.iht.hn/

Cities with international airports, including Tegucigalpa, San Pedro Sula, and La Ceiba, often have a selection of car rental enterprises, which offer a wide selection of cars and price points from which tourists can choose. Insurance against personal and property damage in case of an accident however is still rare within the market—only one major rental company, Hertz, offers complete coverage packages to consumers. Other firms only offer partial coverage. For business travelers with corporate rates or consumers who wish to do business with a well-known international firm, international brands Econo Rent-a-Car, Hertz, Avis, and Alamo all operate within Honduras. Other local options such as Xplore also have diverse ranges of cars and prices to fit varying traveler's budget.

Museums and Galleries. IHT estimates that a total of 22 museums exist in Honduras, half of which are concentrated in Tegucigalpa. Four museums exist in Copan, three in San Pedro Sula, and one each in La Ceiba, Tela, La Paz, and Gracias. Three museums are the most popular: the Museum of National Identity in Tegucigalpa, the Museum and Archaeological Site El Puente, and the Museum of Mayan Sculpture. The Museum and Archaeological Site at El Puente and the Museum of Mayan Sculpture, both in Copan, are estimated by experts to attract nearly 130,000 tourists in 2016 but approximately one-third were international tourists. In the Mayan cultural hub of Copan, tour guides are licensed, bilingual, and fluent in their knowledge of Mayan history, which can be an asset for those foreigners seeking to broaden their understanding of the culture.

Artisan Shops. There are an estimated 119 artisan shops, 45 percent of which are located within TMS' areas of influence, according to IHT.[181] Approximately 10 percent of artisans export their products, although it is estimated that less than 10 percent of those comply with export requirements, and less than 5 percent possess the appropriate certifications.[182] Export markets also have been found to be more demanding, requesting a quality standard that as of recently, local artisans have been unable to deliver. An interviewee in Copan Ruinas noted that on occasion artisans sell goods at the popular tourist site, actually source those goods from Guatemala and El Salvador due to the improved quality. The majority of products sold at artisan markets in Copan include textiles, ceramics and wood carvings, and masks. Unfortunately, until local producers begin to improve the quality of locally-made products at prices that can compete with foreign suppliers, this supply chain is unlikely to change. Artisanal crafts are discussed further in Arts and Entertainment.

Tour Operators and Travel Agents. There are an estimated 106 travel agents and tour operators operating in Honduras, which charge a sales fee to producers that utilize them for the marketing or promotion of products.[183] Tour operators operate mostly in business-to-business markets, while travel agents in business-to-consumer markets. Travel agents package itineraries for consumers tailored to the consumer and then pass the coordination role to the tour operator, which manages the relationships with individual service providers. Tour operators coordinate and contract lodging, transport, restaurant packages, tour guides, and excursions that conform to the ideal negotiated with the consumer by the travel agent, and then passes on this bundle of reservations and contracts to the travel agent, who gives it to the consumer. The consumer ultimately pays the cost of the bundle, but also the fees for each level of service. The market for this service is rapidly shifting. E-commerce and increased travel savviness of consumers mean that many tourists now go online to book their travel.

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[181] Honduran Tourism Institute. (2018). Tourist establishments directory. Tegucigalpa, Honduras. Retrieve from: http://www.iht.hn/

[182] USAID ProParque. (2013). Analysis of The Tourist Economy Hondureña With Regional, National and Local Destinations for Project Focus.

[183] Honduran Tourism Institute. (2018). Tourist establishments directory. Tegucigalpa, Honduras. Retrieve from: http://www.iht.hn/

This poses challenges for the Honduran industry given its extremely low online visibility. The limited accessibility of information and presence on popular travel websites leaves this function poorly filled.

Destination management. This function relates to the work by businesses and other stakeholders to develop and market destinations – both reportedly weak in Honduras. The text box below provides examples of companies that are engaged in the development and promotion of destinations around bird watching, coffee tours, or adventure activities. In general, interviewees noted the difficulty of destination managers in developing 'experiences' of multiple products that lasted long enough to motivate tourists to visit, much less overnight in locations. Destination marketing is similarly weak. There is little use of technology by destination managers and attention to online marketing. This is described in greater detail in the Resources section below.

Figure 58 Destination Management Examples

Avitourism. While relatively nascent in the region and publicly-maintained facilities are underdeveloped, the private sector has found an opportunity in avitourism. The Macaw Mountain Bird Park, opened in 2001, is a bird rescue and rehabilitation center hosting 350 birds from over 30 bird species from Honduras and Central America.[184,185] Its 10 acres offers a variety of products for nature tourists, including a coffee roaster and coffee production educational center and natural springs. Nature trails that surround the property are well-developed and wheelchair-accessible, amenities not commonly found in publicly-maintained parks. The park also offers discriminatory pricing for un-packaged tickets based on nationality and age, with prices ranging from $2.50-10 per ticket.

Coffee tourism. According to the Honduran Institute of Coffee, there are eight large coffee plantations that offer tours or eco-lodge experiences throughout the country's six coffee producing regions.[186] Márcala coffee producers in 202 villages along the Montecillos mountain range in Honduras' La Paz, Comayagua, and Intibucá departments benefit from an appellation of origin (a more restrictive type of geographical indication, referred to as *denominación de origin* or "DO"), the first of its kind in Honduras. Producers that cultivate and process coffee according to the norms and regulations of the DO have access to promotion and marketing support from the DO Regulatory Council, including access to the annual Márcala Coffee Culture Festival, in March.[187] On its webpage, the regulatory council promotes tours from two Márcala coffee producers, Los Catadores and Vishnu Coffee, both in La Paz. These producers offer tours and coffee cuppings from HNL 50-150, depending on age and nationality.

Canopies. There are five zip line operators in TMS' area of influence, which offer cable networks of up to 4 kilometers in total distance, designed to reach speeds of up to 140 kilometers (or 87 miles) per hour, as high as 350 meters (appx. 1,150 feet) above the forest floor. Prices for these excursions range from $20-45 per person. The Canopy Extremo, near La Campa in Gracias, charges HNL 700 for international tourists and HNL 500 for domestic tourists. Some operators have chosen to offer packaged tickets also, combining canopy activities with other outdoor activities in the same geographical area, such as birdwatching. Honduras Canopy Tour near Copan Ruinas includes admission into the adjacent Macaw Mountain Bird Park (*Parque de Aves Montaña Guacamaya*).

Tourism Sector Promotion. Several public entities are engaged in the promotion of the tourism sector:

- **Honduran Institute of Tourism (IHT).** This government institution has increased in relevance and priority with the development of the Honduras 20/20 initiative and has been elevated to a cabinet-level institution under the **Secretariat of Tourism**. Its mandate is to promote tourism as an economic sector within the country. Although its budget is a fraction of what it used to be before the decline of tourism in 2009, it is funded by a sales tax equivalent to 4 percent of tourism transactions. Firms within the sector have been quick to criticize this additional tax, and

[184] Cámara de Comercio y Turismo de Ruinas de Copan. (2017). Macaw Mountain Bird Park. Obtenido de: http://copanhonduras.org/en/macaw-mountain-bird-park/

[185] Macaw Mountain Bird Park and Natural Reserve. Retrieved from: http://www.macawmountain.org/en/bird-inventory/

[186] Instituto Hondureño del Café. Obtenido de: https://www.ihcafe.hn/

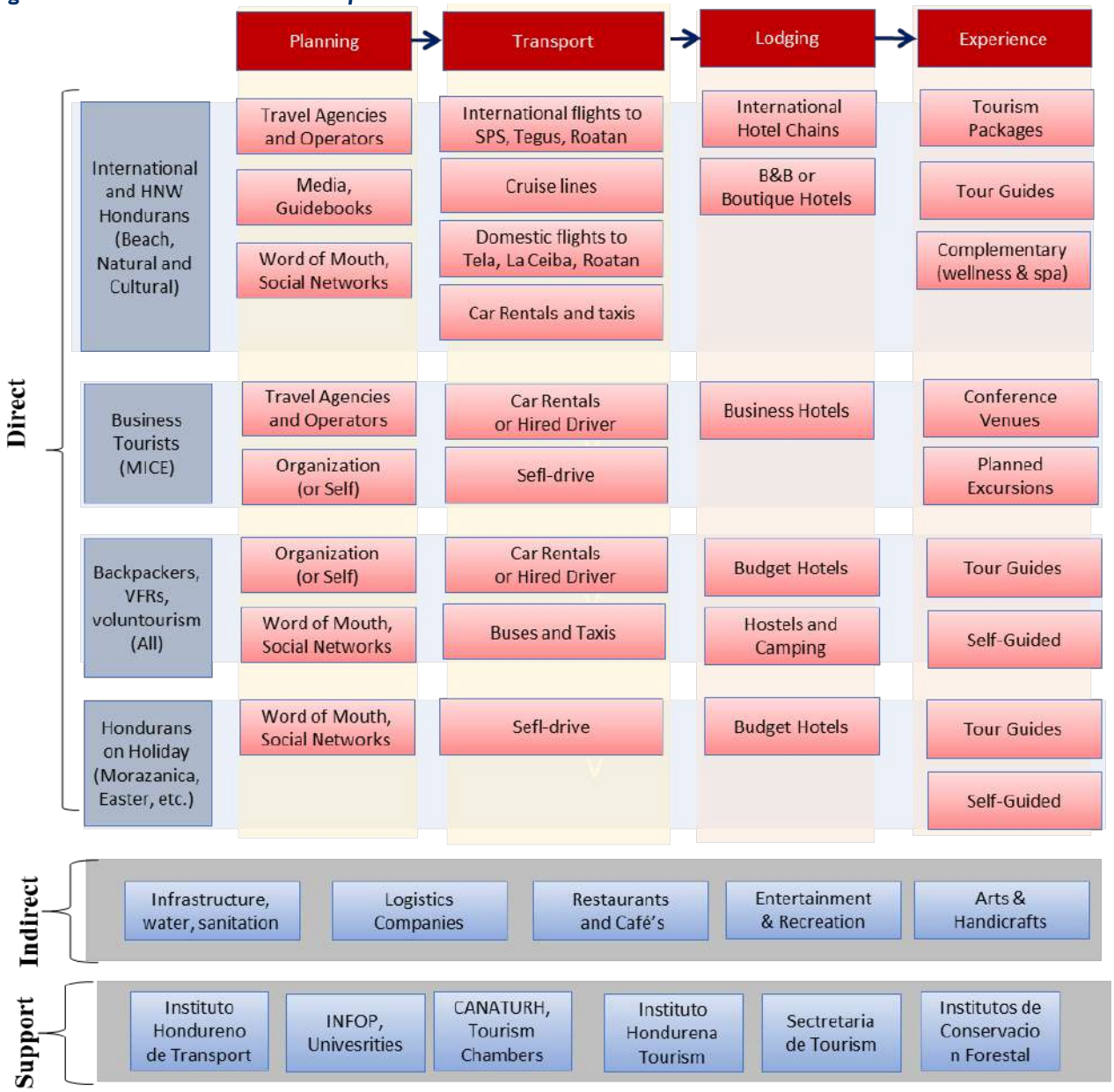
[187] International Training Module. (2007). Geographical Indication: A way forward to local development. Prangings, Switzerland. Retrieved from: http://www.fao.org/fileadmin/templates/olq/documents/documents/formationIG%20agrideacirad2007.pdf

interviewees desired greater transparency in how the funding is used. There is reportedly a lack of long-term strategies or policies to accomplish its mandate that outlast changes in administrations. Partially tied to its limited funding, is a sense of limited technical capacity within the organization to assist with product development, standards and interagency coordination. This theme – in sufficient coordination between government institutions responsible for promoting tourism – was repeated in multiple interviews with firms.

- The **Institute for Forest Conservation (ICF)** is responsible for the regulation and supervision of laws related to the protection of wilderness reserves, either through direct intervention in enforcement or via co-management. The perceived effectiveness of this institution and its success in ensuring sustainable management of natural resources, is reportedly low. Much of this is attributed to budget and human resource constraints that have rendered the institution unable to effectively carry out its mandate, causing enforcement responsibilities to go unmet.
- **Honduran Institute for Coffee (IHCAFE).** IHCAFE is a network of extension agents located in the six coffee producing regions of Honduras that provides technical assistance to farmers in the production, harvesting, and exporting of coffee. It also promotes Honduran exporters of coffee through its website and coffee expositions abroad in cooperation with the **Secretariat for Foreign Relations** and foreign **Embassies of Honduras**. Each October, with other coffee-producing countries in Central America and the International Organization of Coffee in London, it hosts events for International Coffee Day, promoting Honduran varietals.
- Other entities responsible for promoting the sector include Honduras 20/20, *Marca País* and The National Institute for Professional Training (INFOP). There is noted duplication of efforts between Honduras 20/20, *Marca Pais* and IHT and inefficient use of public resources. ***Marca País*** is the main promotional and branding arm of Honduras' tourism sector. It has partnered with over 70 companies, including Oro Lenca Honduras, Cerveceria Honduras, and Televicentro to promote their products. Its mandate includes attracting more tourists, build national pride and share Honduras's cultural influence with the world. Tourism companies reportedly see this as a highly politicized entity. **INFOP** holds occupational workshops and technical trainings to develop the workforce – it was noted the curriculum is not well-suited to the needs of tourism enterprises (discussed further down).

Municipalities also play an important role in granting operating permits to companies. Several municipalities have their own municipal tourism and environmental units that support destination management functions. There is a high degree of variability in the performance of municipalities. Some municipalities, with particularly dynamic mayors have been effective in promoting tourism.

Figure 59 Tourism Value Chain Map



RELATIONSHIPS

Associations. There is a high level of associativity within the private sector in the tourism industry. Some of the notable associations are as follows:

- **The National Chamber of Tourism in Honduras (CANATURH) and its regional chambers** lobby on behalf of tourism-related businesses and promote private sector investments in tourism. Businesses belong to regional CANATURH chambers and pay a membership fee, which is managed by the regional chambers' own personnel with little administrative or managerial support from the national headquarters. Despite membership income, several do not have the technical capacity to deliver capacity training to its members. Many regional tourism chambers feel that the national chamber no longer represents their interests, but instead those of large hotels in Honduras' main two cities and the beach resorts in the Bay Islands. This has dissuaded firms from affiliating

and reduced membership-based income flows. However, regional chambers are well regarded as seen as active stakeholders in trying to develop their regional destinations.

- **Tour Operators of Honduras** (*Operadores de Turismo Receptivo de Honduras,* OPTURH) is an organization of tour operators with its principal offices in Tegucigalpa. Like the other professional associations, their main objective is lobbying on behalf of, and strengthening, tour operators. It has approximately 25 members, most of which are based in Tegucigalpa and San Pedro Sula.

- **Small Hotels of Honduras** (*Hoteles Pequeños de Honduras,* HOPEH) is an association of 80 SME hotels (the majority with less than 50 rooms), which has developed shared standards, operations, and best practices. HOPEH has become the largest chain of independent hotels in the country; each hotel maintains its own unique design and business model. It is commonly cited as dynamic organization that has an active voice in promotion and development of the sector.

- **Tour Guide Association of Copan** (*Asociacion de Guias Copan)* regulates prices and quality of guide services throughout Copan. This association offers tour guides with local and regional expertise in archaeology, nature and ecotourism, local culture, and colonial art. The Copan association is widely seen as the most successful due to the number and quality of its tour guides. There are other local guide associations in the country, but they are weak. A key limitation, however, is that they are not organized nationally, limiting their ability to influence, for example, the guide certification processes that are implemented by IHT.

- **National Convention Bureaus** *(El Buró de Convenciones Nacional)* and the San Pedro Sula Convention Bureau promotes Honduras as a destination for national and international conferences, events and conventions. The bureau takes a role also in developing a culture around events in Honduras, working with private companies to create or attract international events.

- Other noted associations: *Asociación de Restauranteros* and *Asociación de Gastronomía*

In addition to these formal associations, there are also a number of more informal alliances that occur between different stakeholders in the sector. They include:

Destination Management —Atlántida (*Organización de Gestión de Destino Atlántida*, or OGD-Atlántida) is a network of tourist firms that jointly promote sustainable tourism to the Atlántida region in Honduras. Atlántida is a department on the North Coast, encompassing Tela and La Ceiba. It is an example of how different municipalities and private sector companies can come together to develop and manage a packaged tourism experience. Atlántida incorporates 4 national parks, including Pico Bonito National Park which offer hiking, birding, white water rafting. Tela and El Porvenir offer attractive Sun and Beach locations. La Ceiba is a nightlife destination. Atlántida is further connected to Roatan through daily ferries – scuba diving is highly accessible. The experience of Atlántida has reportedly been done in an inclusive manner, working through the local communities to develop new offers, notably highlighting Garifuna Culture which has been declared UNESCO Intangible World Heritage. Despite investments, Atlántida does not feature strongly in international tourism offerings despite its domestic market appeal. Its limited ability to self-finance, consolidate and represent its offer to broader markets reveals it to be a low visibility destination.

Public-Private Alliance for Vocational Training. INFOP, CANTURH, and the Honduran Institute for Tourism (IHT) have developed an alliance that has the mandate to develop training programs to

ensure quality control among the tourism labor force in Honduras. CANATURH recruits trainees from its member organizations; IHT provides financing for the training programs; and INFOP designs curriculum and delivers training. In many respects, this alliance is considered by interviewees to be dated and no longer responsive to current consumer trends and needs. Tourism enterprises reported courses to be too theoretical in a trade that is more operationally-oriented. The capacity of INFOP to effectively deliver these trainings has also been called into question, with interviewees citing it lacks qualified instructors with tourism industry experience, and that courses are only delivered in Tegucigalpa and San Pedro Sula. The disconnect between private sector needs and public sector offer is emblematic of much of the feedback from interviewees, and perceived as reflective of how representative organizations that do not adequately represent the interests of members.

Private sector cooperation. Many of the interviewees reported varying degrees of mostly informal alliances between private sector businesses. For example, hotels may coordinate with a transport service. A model for an effective alliance happened in 2014 when a flight company Transat developed charter flights between Montreal and Roatán across a nine-week period. Canadian tourists stayed a week – versus a half-day cruise-ship stop-over. The alliance reportedly ended nine weeks later because of lack of coordination and political issues on the Honduras side. Though it didn't succeed, this type of alliance could be hugely impactful in terms of bringing in tourists to Honduras.

There is more limited but generally effective cooperation between hotels, restaurants and tour providers. Hotel concierge desks may recommend restaurants to guests based on association or reputation. However, interviewees reported fearing that a poor experience at a recommended restaurant may merit a poor review for the concierge, hotels are typically conservative in their recommendations. There is a level of trust that needs to be established between restaurants and tour operators and hotels, based on a more mutual recognition of the value of enhancing the tourism experience. The verification of the quality of services based on review sites like TripAdvisor can lend credibility to tourism operators and create confidence to cross-sell opportunities. In general, information availability and marketing is characteristically weak among all tourism enterprises and discourages the creation of more effective alliances between tourism enterprises.

RESOURCES

The Honduran tourism sector's ability to compete with its regional international peers depends on the ability of its private sector to provide innovative products that deliver upon increasingly sophisticated consumer expectations. Honduran firms have proven themselves willing to create alliances, diversify product offerings, and change business models to become a world-class tourism destination across multiple sub-sectors. However, firms cannot develop in an environment devoid of resources. The private sector requires accessible infrastructure, favorable financial products for growth and expansion, and a well-trained and dedicated labor force to deliver the best of Honduras' services.

Workforce development. Multiple firms interviewed mentioned that the current formal curriculum does not equip students with the practical skills required to compete on an international level, especially in the areas of marketing or customer service. In the rural parts of the country, where educational systems are weaker and tourism salaries are lower, employment is further complicated by the informality of many enterprises. Other firms also mentioned the lack of vocational training in support service areas as an issue. For example, in rural areas maintenance personnel were often unknowledgeable on how to repair or perform routine maintenance on industrial laundry or kitchen equipment. This knowledge and skills gap is further complicated by the inaccessibility or noted limited effectiveness of INFOP vocational programs. Even in main tourist destinations, the hospitality industry suffers from poorly-trained job seekers for restaurant waiter, bartender, and chef positions when consumer preferences are shifting to become more demanding. Instead of meeting this demand, INFOP's curriculum and facilities remain unchanged. Management capabilities for highly-skilled jobs such as management positions in restaurants and hotels are also weak. UNITEC's university degree in tourism is cited as too theoretical. Several hotels reportedly recruit internationally for these positions.

Hotel Escuela Madrid

Founded by the Spanish Canovas del Castillo foundation after a similar school in Madrid, Spain, this hospitality vocational school in Tegucigalpa offers a practical approach to learning skills required to work in the hotel and restaurant industries. Its curriculum includes courses on culinary arts and bartending, kitchen management, hotel reception and concierge, and housekeeping. Although the school is currently inactive, the building remains well-outfitted with an industrial teaching kitchen with spots for 15 students, and a classroom-style space for conferences and other learning events. CANATURH is considering converting the space into offices for tourism sector associations, while maintaining the hotel school classrooms and kitchen for workforce development initiatives.

Access to finance. Hotels, tour operators and restaurants routinely expressed that they cannot grow due to lack of funding to investment in infrastructure for remodeling, expansion, parking, purchase of equipment, etc. Investments are also needed in generators, particularly in the north, to mitigate erratic public services such as electricity outages. Although relevant financial products are available in the market, their uptake is low among MSMEs due to high interest rates and relatively short repayment periods. In the western parts of the country, credit cooperatives have serviced as alternative source of capital, but often mandate high collateral contributions, guaranteed revenue, or credit history, and amounts loaned in this model tend to be too small to finance significant expansion. The Ministry of Finance has established a fund for the tourism sector, managed by the Honduran Bank for Production and Housing (BAHNPROVI), but it is reportedly insufficient to meet demands.

Information services. There is an opportunity for growth in developing Honduras' service offerings in marketing and consumer outreach, revenue and reservation management, and e-commerce platform and strategy development. Among international consumers, travel agents have largely been replaced by websites such as Yelp and TripAdvisor, which offer platforms for prior guests to rate and share their experiences with future potential guests; and other social media, which brings "word of mouth" referrals into the e-commerce age. Online third-party reservation sites such as Expedia and Hotels.com offer bilingual and secure reservation transactions with instant confirmations, and often provide users with incentives for booking through their platform. The use of these online tools is reportedly low which lowers the visibility of Honduran destinations – even awareness of their importance is unknown -only one interviewee could articulate the benefits of these platforms. In a similar thread, the relevance and access to business services for the tourism industry remains a challenge, particularly impacting MSMEs. Business support services reportedly tend to be generic, focused on more traditional aspects of the businesses such as accounting, financial and legal aspects. Business services lack a more detailed understanding of the needs of the industry. This is particularly

the case in marketing and ICT. For example, few providers are supporting enterprises on how to make the best use of online platforms like TripAdvisor, Booking.com, Expedia, Facebook, Google, Instagram and Twitter; managing revenue generated via e-commerce and online platforms; or leveraging consumer content to market their own businesses.

Air connectivity. Copan Ruinas is the only regional Mayan archaeological site that has no direct air connectivity. The runway doesn't meet international standards for safety, so it can't be certified for international flights. The Roatan runway also requires an extension to allow for more of flights. There is a CA4 regional agreement signed by Honduras, Guatemala, El Salvador, and Nicaragua that states that all flights originating in any of these countries are considered local and should not go through migration but is not being implemented in practice. This agreement is a great opportunity to generate a greater volume of tourists. However, new biometric screening used at points of entry are delaying access and providing a bad experience for visitors.

Natural resources. The ICF is responsible for the country's protected areas, in some cases has delegated these responsibilities to environmental foundations, which work with funding from international NGOs. There is a notable lack of employees and a low budget for safeguards of natural designated parks. There is a lack of awareness or local appreciation of the value of natural areas and the potential to use these resources to generate economic value. Tourists visiting natural parks will frequently experience a lack of maintenance to facilities and litter in parks.

RULES

To support the sector's development, the GoH enacted the Tourism Incentive Law of 2017, which provides generous tax incentives, such as no sales tax and income taxes for 15 years, net assets tax exemption, and prioritize issuance of environmental licenses. It also created an $100 million tourism investment fund (FITUR) together with the IDB. The law applies to new investments and investments made after January 2014. Companies must register and be validated by the Honduran Institute of Tourism (IHT). Much hope is riding on this new law, which anticipates the creation of 250 thousand new jobs in addition to an estimated 8 indirect jobs for each direct one generated.

There is a lack of transparency in how tourist taxes are being used. The GoH uses fiscal policy to directly finance the IHT and its tourism marketing and promotion initiatives. Tourists are taxed four percent of the total transaction value from lodging, payments to tour operators, and on car rentals. In addition, airlines pass on a $5.00 tax on each airline ticket to the country, funds which are ultimately divided between IHT and the Honduras 20/20 initiative. Actors in the tourism sector have repeatedly called for more transparency in how these funds are being used because the agreement when these levies where instated was that funds should be fully devoted to marketing activities. However, the budget for promotion of tourism is just $2 million, compared to $8 million in Nicaragua. The reality is that, at present, most levied funds are likely used to pay for the running expenses of the IHT, including salaries - which should be financed from the government's budget.

Regulations specific to the tourism sector are delayed and unevenly enforced. The permitting environment for tourism development projects is highly centralized, resulting in long delays for approval of plans and the issuance of permits. Obtaining environmental permits from Mi Ambiente for tourism projects, for example, is reportedly slow, cumbersome and expensive. There are no environmental regulations specific to the tourism sector, so in many cases even small tourism businesses are required the same administrative processes that apply to mining, refineries, etc. Municipalities also require the environmental licenses to grant operating permits, which in many

cases can take 90-120 days. Alternatively, cruise ships are unrestricted in their environmental practices in Honduras, which could have long-term effects on coral reef and waterway management. Main tourist attraction for nature tourism, including zip line operators in Honduras have poor safety records.[188] A dearth of supervisors to inspect and certify firms' compliance with these new regulations impact enforcement and weaken consumer safety.[189] Enterprises also indicated SAR is having issues on how to apply the new Tourism Incentive Law. The political economy for policy and regulatory reform is a limiting as many local chambers of tourism feel that the national association, *Camara Nacional de Turismo* (CANATURH), no longer represents their best interests.

A welcoming and accepting environment in the tourism sector also applies to tourism consumers. Although the penal code in Honduras protects against discrimination based on sexual orientation and gender identity, prejudices are still widespread. In 2017, the U.S. Department of State cited eight violent deaths of LGBTI persons in central Honduras in their Human Rights Report, and multiple reports of assault and discrimination. These incidences affect the diversity of tourism flows into Honduras. Anti-harassment training for staff of tourism actors that includes sections on LGBTI rights and professional treatment of all guests may be successful in providing more hospitable environment.

RESULTS

Honduras benefits from a diverse array of tourism resources that provide it a uniquely diverse offer. These include a UNESCO's world heritage Maya Site of Copan, pristine beaches such as Arrecife Capiro in Tela, and natural parks such as Pico Bonito or Celaque. A recurring problem has been that there is little to do beyond the short visits to these sites, and many natural assets are poorly-maintained. Efforts to establish more packaged offers such as Ruta del Café, Ruta Lenca, Gracias Convoca, and OGD Atlántida have not seen significant upticks in international tourists visiting to justify further investment. Part of this is reflective of the greater focus on domestic tourism and cruise ship stop-overs by the institutions responsible for promoting the sector, such as IHT, Marca País, 20/20 Honduras Plan and Pro-Honduras.

There is a growing disconnect between Honduras and its peers. Costa Rica, El Salvador, Guatemala Nicaragua and Panama have demonstrably outcompeted Honduras and have been rewarded with substantial increases in tourism exports over the past decade. Honduras on the other hand has experienced a widening gap in the innovation and quality to compete in the international market. Hotel operators for example noted the difficulty finding staff with the right skills, tourists stopover at popular destinations such as the Copán Ruinas is short due to lack of complementary activities, and there are a limited variety of restaurants that appeal to wider culinary tastes of diverse international tourists. Honduran travel destinations and facilities are virtually absent from on-line travel media, such as Expedia, Booking.com, and Trip Advisor (with the exception of Roatan). A recent census made in La Ceiba found that almost 50 percent of the hotels do not have a website.[190] A dearth of

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[188] Schmidt, S. Tourists on honeymoon collide while zip-lining, leaving husband dead and wife injured. Retrieved from: https://www.washingtonpost.com/news/morning-mix/wp/2018/07/09/tourists-on-honeymoon-collide-while-zip-lining-leaving-husband-dead-and-wife-injured/?noredirect=on&utm_term=.ab16ba4b63da; https://thepointsguy.com/news/death-in-honduras-adds-to-growing-list-of-cruise-zip-line-accidents/

[189] Consejo Interinstitucional de Reglamentación Técnica, (CIRT), Comité Técnico de Trabajo (CTT), Instituto Hondureño de Turismo, IHT, Secretaría de Estado en el Despacho de Desarrollo Económico, (SDE). 2017. Reglamento Tecnico hondureño. Turismo de Aventura: Canopy, Cables y Tirolesas Requisitos. Obtenido de: https://sde.gob.hn/wp-content/uploads/2017/06/Reglamento-Tecnico-Hondure%C3%B1o-Canopy.pdf

[190] El Observatorio Universitario de Turismo Sostenible y Cambio Climatico located at the Centro Universitario Regional del Atlantico CURLA

travel information on Honduras to develop an itinerary, coupled with travel advisories, and a lingering image of 'violence' are a formidable disincentive for travelers to visit Honduras. A digital transformation of the tourism sector is required, which must be based on reliable and updated statistics and information systems, improving marketing plans and promotion

Perception of insecurity, poor aerial connectivity, climate change and infrastructure, notably water and sanitation services, stand out as significant constraints that will be difficult to address. The above-noted challenges requires significant levels of public and private sector coordination and investment to overcome. Despite having an "Estrategia Nacional de Turismo Sostenible" there appears to be little coherent vision for the industry. This appears to stem from a top-down (versus bottom-up) orientation to priority-setting that has reportedly dissuaded membership and contributions in key associations such as CANATURH. Improving information availability and statistics on the sector can help to provide evidence to strengthen coordination. Ultimately, there needs to be a coherent strategy in place and a better model for public-private coordination than move out of the status quo. At the national level, greater transparency and capacity of IHT to undertake promotion activities and unify promotional efforts in closer cooperation with private sector are required. This includes a strategy to improve international and local aerial connectivity between key regions and lowering the airfreight rates. There are ample ideas on how to take advantage of Honduran's advantage, the issue in the tourism sector appears to be effective execution of those ideas. Strengthened coordination, backed by evidence to inform that vision, is a major leverage point for the sector.

Tourism has the potential of providing an array of employment opportunities in TMS's zones of intervention. Likewise, there is ample opportunity for women, youth, LGBTI, PWDs and returned migrants as tour guides, customer service providers, interpreters, chefs, waiters, and as travel assistants. Employers interviewed noted the need for knowledge for greater knowledge in accounting, English, and having a positive and realistic attitude towards job opportunities. There are several famous LGBT chefs in Honduras, an significant portion of females are employed in lodging and food services (BOH), and wholesale-retail trade and restaurants represent 19 percent of employed PwD.[191] Indigenous populations, such as the Lenca in the west, the Maya-Chorti community near Copan Ruins, and the Garifuna culture in the north offer traditions and history that can enrich cultural tourism to the country and generate employment opportunities within the community. Despite the relatively high levels of engagement of vulnerable populations, there are reported wage gaps between groups despite doing the same type of work. More active inclusion in the tourism sector requires access to skills building opportunities through vocational institutes or through on-the-job learning opportunities. There is also a need to reduce employer-based stigma and discrimination which even in the tourism industry is an impediment to either securing employment or obtaining a fair salary.

[191] Discapacidad lucha por educación y trabajo digno en Honduras. (2018). *La Tribuna. Obtenido de:* http://www.latribuna.hn/2018/06/10/discapacidad-lucha-educacion-trabajo-digno-honduras/



WHOLESALE-RETAIL TRADE

ANNEX VII WHOLESALE-RETAIL TRADE

SECTOR OVERVIEW

Drivers behind the growth in formal retail outlets reduce prospects for traditional, informal market channels. Forty percent of Honduran consumers shop for foodstuffs and consumer goods at formally registered stores like supermarkets and convenience stores. Experts expect formal outlets to continue capturing more customers and for traditional channels of open markets, agricultural fairs, *pulperias*, and small shops to see their market share shrink and the purchasing power of their clientele get smaller. The key dynamics fueling this growth are aggressive investment in new store locations, perceptions that customers are safer shopping at formal stores, and the reliability of formal stores to offer diverse, quality, products. While most formal stores struggle to procure local products—a problem stores are intent on solving—they excel at importing finished goods and offering them at attractive prices. Meanwhile, a large portion of the workforce relies on the informal wholesale-retail sector as a means of self-employment when they have no other option. These enterprises are being squeezed from both ends: from the upper end from modern supermarkets and malls, and from the lower end a growing number of street sellers. For various reasons, informal sellers find their sales and circumstances getting worse. For example, most believe revenues have declined by 30% to 45%, most notably among sellers of locally made shoes and clothing, who also compete with imports of second-hand and lower-cost products.

The informal market channel still however maintains some advantages, but is extremely vulnerable. Every city has at least one open-air market Tegucigalpa has 12 and San Pedro Sula 17. Open air markets, fairs and farmers market are in every city. Consumers shopping at informal outlets are attracted by the lower prices, especially at open markets and agricultural fairs, the proximity of outlets like pulperias that serve small neighborhoods, and the ability to buy small, affordable quantities, even though the per-unit price may be 20% more than elsewhere. Although products typically cost 20% more than in formal stores, they are often sold in affordably small quantities. The purchasing power and available space to stock merchandise is extremely limited among pulperias. Given their client-base, their turnover of stock is generally slow. However, pulperias play a critical role among an often-underserved population. Consumers are also likely to get locally made, traditional products like processed meat and dairy whose manufacturers are predominantly artisanal and informal. The same safety issues that push more consumers to shop at formal outlets, leave informal sellers exposed and prone to abuse. Experts estimated that one *pulperia* closes every three days from extortion pressures. Informal sellers' inability to qualify for formal loans, leaves them open to abuses, and in many cases reported violence, from predatory lenders.

Many local and international suppliers thrive by distributing through pulperias. Rural and poorer urban markets are difficult to reach yet remain attractive segments for many businesses. Many international suppliers like Unilever and Pepsi tend to have a broad reach to pulperias across the country through, for example, local representatives, small-scale distributors, and, in rural areas, wholesale intermediaries. Local large-scale manufacturers and suppliers of, for instance, beer, coffee, and dairy products have similar operations with strong brand presence in these markets. However, other sellers, like artisanal dairies and local foodstuff makers, only reach sales outlets in a limited radius and rely on these *pulperias* for a significant percentage of their sales. While the buying and stocking power of most *pulperias* is small, some have taken advantages of opportunities for growth in demand for IT items like mobile phone accessories, which take up little shop space and have high turn-

over rates and in services like top-up of cellular service plans, battery charging for devices, or digital payment services.

INTRODUCTION

The wholesale-retail trade sector represents a key role of the Honduras' economy, one that spans many of the other sectors assessed by TMS. Contributions of the wholesale and retail sector to GDP are estimated by the GoH at just over 18 percent, employing more than 750,000 people and ranking as the second-highest sector of employment in the country, following agriculture. There is considerable informal – and largely unmeasured – activity in the retail sector consisting of sidewalk and street vendors, typically on the periphery of open-air markets and fairs. TMS research highlights this as a key constraint to sector growth, as the prevalence of loosely structured and informal trade channels limits economies of scale, legal competition and formal employment gains.

Honduras' retail food sector is dominated by three large supermarket chains: La Colonia, PriceSmart and Walmart (Paiz/Maxi Despensa). The construction of large shopping malls and other mixed-use commercial centers in strategic urban areas, as well as large retail stores and supermarkets such as PriceSmart and HyperPaiz (Walmart), are indicators of opportunities in the retail distribution sector. Honduras has fewer levels of distribution from producer or importer to retailer, and a limited number of specialty, chain, and department stores. Importers typically serve as distributors to retail markets and manage their own distribution networks and transportation. High forecasted growth categories include processed meat and seafood, savory snacks, sauces dressings and condiments, ready meals, processed fruit and vegetables, dairy products, sweet biscuits, snack bars and fruits snacks.[192]
The wholesale and retail trade sector is not a target sector of the Honduras 20/20 initiative, but it plays an important role, serving as the primary consumer outlet for retail products in textile and apparel, light manufacturing and agribusiness sectors. A focus group meeting with experts identified priority trade channels to include importers, wholesalers, supermarkets, franchise chains, mini markets, convenient stores and informal retailers. The characteristics, advantages and disadvantages of each sector evaluated by these experts are listed in table below.

Figure 60 Market segments wholesale-retail trade

Market Segments	Characterization	Noted Advantages	Noted Disadvantages
Supermarkets & Wholesale Clubs (Supermercados)	• Urban and rural, primarily middle- to upper-class shoppers. • All urban centers; strong growth trends.	+ Accepts credit card + Bargains and discounts + Tasting events + Greater variety + Cleanliness + Security + Convenience + Food safety and traceability + Nice and safe environment + Other services: ATM, Pharmacy, Fast Food	- Not always fresh

[192] Honduras Country Profile. Retrieved From: https://www.foodexport.org/get-started/country-market-profiles/central-america/honduras-country-profile

Neighborhood Grocers (Mercaditos)	• Primarily urban grocers, lower- to middle-class, with less disposable income and access to supermarkets. • Frequented by foot-traffic customers.	+ Pricing competitive with supermarkets + Regular customers may have credit from owner + Greater variety than mini-markets + Convenient locations + Fresh local produce + Bargains and discounts	- Lower security - No guarantees - No invoice provided - Traceability concerns - Cash only
Mini-Markets (Pulperías)	• Urban, suburban, rural, high-traffic locations, targeting shopper convenience and late-night service. • Fast and ready foods, plus high-quality imported snacks.	+ Easy access + Extended schedules + Convenient locations and extended hour service + Offer other services: pre-paid cell phone plans	- Prices 10-20% higher than supermarkets - Serve basic, high turn-over products (keep $500-$1,000 in inventory) - Insecurity issues - Traceability concerns - Cash only
Convenience Stores (Tienda de conveniencia)	• Fuel station convenience stores targeting travelers and 24-hour shoppers. • Primarily prepared foods and snacks.	+ Accepts credit card + Convenient locations and 24-hour service + Serve convenience needs, packaged and ready foods + Secure facilities + ATMs common	- Prices 10-20% higher than supermarkets - Not always fresh - Serve basic, high turn-over products
Public Open-Air Markets (Mercado) *Every city has at least one open-air market; Tegus has 12, San Pedro Sula, 17.*	• Supply centers where converge intermediaries and producers; includes stall sellers and street vendors. • Primarily lower- to middle-class shoppers. • Primarily fresh, local produce from rural areas. • Reported sales decreases of 30%-50%; footwear and clothing 50%; meat 30%; tortillas constant • Street vending increased 45% over last 10 years	+ Fixed days + Lowest prices for produce + Fresh local produce + Social interaction and cultural identity + Better customer service	- Poorly planned and congested - Facilities deteriorating - Congested/uncomfortable - Limited cold chain - Traceability concerns - Insecurity issues - Cash only
Fairs (Ferias)	• Weekend markets organized throughout the country; all shoppers. • Popular atmosphere with generally lower prices than supermarkets. • Market basket price monitoring.	+ Direct producer to buyer + Social and cultural aspects make fairs popular + Artisan products sold + Specialty products + Innovation and renewed municipal support + End prices competitive with supermarket prices	- Limited days of week - Limited cold chain - Traceability concerns - Difficult to access
Wholesalers and Coyotes	• Active participation in traditional distribution channel. • Provide crop financing to small farmers; • May or may not provide credit (importers and distributors generally do not). • Face challenges due to growth of supermarkets managing own supply chains		

Based on the subject matter expert meetings, TMS evaluated informal retail market segments, including open-air markets, as experts highlighted the need to transition from informal market channels. While the formal segment is more transparent, there is considerably less information on the informal segment and a need to develop a clearer, evidence-based understanding of these retail channels. The research strategy also intended to utilize informal market channels as a lens to evaluate the overall sector; thus, the team began by initially surveying informal retailers and then, through a "snowball" approach, identified formal and informal wholesalers connected to these informal retailers, and included them in the sample.

The team prioritized wholesale and retail trade in the following geographic regions: Tegucigalpa, San Pedro Sula, La Esperanza, Santa Rosa de Copan and Gracias, Lempira. TMS' MSA team conducted 25 interviews of retailers and grocers; vendors; warehouses; convenience stores; open-air market sellers; fairs; leading formal wholesalers of footwear and handcrafts; and informal wholesalers of meat, dairy and tortillas. Working under the guidance of experts, the team sought to better understand informal market channel dynamics to identify leverage points with broader benefits to all sectors. Issues seeking clarification include: Why do wholesalers and distributors import versus buy local? What are the preferences of local industry and manufacturers? How competitive are local products in distribution channels? What differences are there between distribution of intermediary versus finished products?

Supermarkets & Wholesale Clubs.
Supermarkets contribute the largest volume of sales of consumer-ready products, and their number continues to grow throughout urban areas of the country. Research indicated 205 major supermarkets currently operating in Honduras, dominated by three chains: La Colonia; PriceSmart; and Walmart and its affiliates Paiz/Maxi Despensa. Shopper preferences are increasingly trending toward supermarkets, due to comfort, convenience and variety and quality of goods, as well as their clean and secure shopping environment; ease of access and parking are also attributing factors, as well as access to other services. Interviewees reported consumers in Tegucigalpa and San Pedro Sula visit a supermarket at least once per month and approximately half visit at least once per week.[193] Supermarkets offer services such as banking, pharmacies, food courts and dry cleaning. The entry of wholesale discount clubs has pushed supermarkets to introduce more aggressive advertising and discount promotions, especially for imported products. The socio-economic status of consumers frequenting supermarkets reflects medium- to higher-income.

Grocery Stores (Mercaditos) Mercaditos include small to medium sized neighborhood groceries where customers can walk over the aisles and choose what they need that sell ready foods, basic food basket products, fresh produce and meats, personal necessities and other sundry articles. They serve residential neighborhoods and areas of heavy foot traffic, providing convenience and access to common household grocery needs, processed and packaged food, produce and essentials. Experts noted prices are generally 10-20 percent higher prices than supermarkets. They are frequented by nearly all consumers from low- to high-income for small and immediate needs. Convenience and proximity to home are driving factors, while higher-income consumers may favor supermarkets for large purchases. Because of the familiarity of the neighborhood grocery store, customers may have access to credit (payment period for goods purchased) by the owner.

[193] Villeda, A.E. (2013). Estudio sobre el Sector de los Supermercados en Honduras: Distrito Central y San Pedro Sula. Tegucigalpa, Honduras. Obtenido de: http://cderegion12.hn/wp-content/uploads/2015/12/Estudio-sobre-el-sector-de-los-supermercados.pdf

Pulperias. Pulperias are prevalent throughout Honduras, with nearly 41,000 establishments according to Honduras' National Statistical Institute.[194] Smaller than mercaditos, customers do not have direct access to products and it is served through a window or a counter, they typically offer consumer-ready food products; basics and essentials; quality imported snacks, limited produce; as well as fast food, including sandwiches, chicken, pizza and other fast food products. are generally located on main boulevards and street corners in urban areas and are typically the only stores that offer late-hour convenience. They seek to stock high-turnover products, offering ease and convenience to customers.

Convenience Stores (Tienda de conveniencia). Another growing segment of the retail industry consists of convenience stores (tienda de conveniencia) located at fuel stations and shopping centers, many of which offer 24-hour service and high-turnover products suiting their limited space. Like pulperias, they generally offer basic fast food and consumer-ready products and snacks; ATMs are also common. Customers reportedly pay 10-20 percent more for the convenience and security offered at these stores. They are often located at fuel stations and shopping centers, targeting travelers and 24-hour shoppers.

Wholesalers. These intermediaries participate in traditional distribution channels, primarily serving mercaditos and pulperias. Larger distributors, also serving as importers, serve larger outlets like supermarkets and local wholesalers, who in turn sell to the smaller outlets. The largest distribution companies are Codis, Dromeinter, Diapa, Café Maya, Distribuidora Solis and Kawas. In the food sector, there are five main food distributors: Diapa, Boga, Solis, Farinter and Dimerc. For nationwide distribution of imported products, Tegucigalpa and San Pedro Sula serve as the major distribution centers. Experts estimates that 60 percent of the distribution channel is "traditional," while the balance of 40 percent serves the supermarket segment. As supermarkets manage their own supply chains and networks – and are rapidly growing in popularity and sales – traditional food distributors reported that they believe that future trends will not be favorable for their businesses. The estimated operating margins for importers are in the 10 percent range while local wholesalers are 15-20 percent - noting these are volume-driven businesses.

Coyotes, often referred to as a "necessary evil" in the supply chain provide important services such as crop financing to small farmers, which is repaid through the sale of produce at seasons' ends. Coyotes also provide transportation services. They may also advance credit to the various mercaditos and pulperias; this is typically done in the form of advancing products and goods, with repayment made following sales of the goods. These arrangements are based on trust and may be limited to clients with longer relationships.

Public Open-Air Markets (Mercado). Traditional municipal open-air markets feature local produce and products. Every town in Honduras has at least one, and larger towns have them in all major districts of the city; San Pedro Sula has 17 and Tegucigalpa has 12. Marketed products are generally locally-produced fresh fruits and vegetables, grains, and meats brought in from rural areas. Products entering the markets are usually handled through wholesalers who buy from farmers and coyotes directly serving rural areas. Municipal authorities and sellers surveyed indicate declining sales in open-air markets. This is attributed to shifts in consumer preferences toward supermarkets and other convenience stores that offer better variety, quality and freshness, convenience and security.

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[194]Instituto Nacional de Estadistica (INE). (2018). Directorio de Establecimientos Económicos. Tegucigalpa, Honduras. Obtenido de: http://170.238.108.227/binhnd/RpWebEngine.exe/Portal?BASE=DEE1&lang=ESP

Nevertheless, *mercados* remain an important outlet for locally grown and produced goods and a traditional part of the Honduras retail sector. Going to the mercados and being able to bargain and socialize with other people is part of Honduran culture. In rural areas, farmers come to trade once a week normally during the weekends selling and buying what they need to take back home. Open-air markets primarily target lower- to middle-class shoppers but are also attended by all shoppers interested in procuring local produce, hand-picking quality, comparing prices and browsing offerings. In addition to rented municipal stalls, the open-air market segment also includes informal street vendors and hawkers. While these sellers provide additional buying opportunities, they also congest the markets – an issue related to heightened insecurity of consumers – and are a major part of the informal economy.

Fairs (Ferias). Weekend and holiday fairs attract variety of sellers and products. Buyers attend in part due social atmosphere. Interviewees indicate that fairs offer even more competitive prices than supermarkets, notably for locally-grown produce. Some of the permanent and most important fairs include the Farmers & Artisans Fair in Tegucigalpa and Bazar del Sabado in San Pedro Sula; My Fair, Feria del Ahorro Lempirita; and annual fairs commemorating Catholic patron saints in most communities. The Farmer Fair in Tegucigalpa, operating every Friday for the past 37 years, is one of the most important fairs, and is commonly used as a reference for market basket prices - a similar market Guamilito operates in San Pedro Sula. Annual fairs, organized around Catholic patron saints in most Honduras towns, offer food and non-food products, handicrafts and sweets, as well as a social atmosphere. Shoppers and attendees dress for the occasion. The Chamber of Commerce of Cortes has revitalized My Fair, aimed at supporting micro and small entrepreneurs. According to an interviewee, the fair has been successful in supporting e-business development, supply chain assembly work and connecting suppliers and sponsors. Each fair reportedly fills its 200 stalls with vendors, each of which averages revenues of 4000-7000 HNL ($160-$300) and is attended by over 6,100 shoppers.

History and Trajectory. The most impactful trend in the retail and wholesale sector clearly has been the rise in growth and popularity of supermarkets and wholesale clubs. This in turn has logically led to declining sales in other retail outlets and disrupted supply chains of traditional wholesalers. According to expert interviewed, the growth in supermarkets in the last year between 2017 and 2018 increased by more than 10 percent.[195] This trend is likely to continue, as shoppers seek the convenience, selection, quality, shopping comfort and conditions and safety provided by the supermarket atmosphere. This growth is further bolstered by the new construction of large shopping malls and other smaller mixed-use commercial centers in strategic urban areas, many of which are anchored by supermarkets. These centers provide convenience, selection, quality and security for shoppers.

Interviewees with mercaditos and *pulperias* reported declining sales in the range of 20-30 percent below former or traditional levels, as well as shifts in consumer buying patterns, although most retailers attribute declining sales primarily to poor economic conditions, rising unemployment and falling wages. In terms of buying patterns, declining sales of meats and higher-value dairy products were reported by several interviewees, as customers are forced to rely more on basic staples and lower-value dairy products; in some cases, meats have been completely discontinued. Shifting consumption patterns have also forced diversification within *pulperias* and mercaditos, with

[195] United States Department of Agriculture (USDA). (2017). Honduras Retails Foods Report. This is over the 176 supermarket and wholesale clubs identified in the USDA GAIN Report. Retrieved From: https://gain.fas.usda.gov/Recent%20GAIN%20Publications/Retail%20Foods_Tegucigalpa_Honduras_12-29-2017.pdf

interviewees citing items such as ice, juice and beverages in plastic bottles, pet food, snacks and churros for schoolchildren, and seasonal trinkets. Perhaps not surprisingly, but discouraging from a development perspective, are sales of phone recharges, which one *pulperia* says trumps almost everything.

Across the board, from vendors and hawkers, to unions, and municipal officials, interviewees report declining sales in open-air markets, complemented or exasperated by a range of factors. Declining sales on the order of roughly 50 percent below traditional levels are commonly reported for food, and slightly lesser declines in the range of 40 percent for clothing and footwear. In some cases, supermarkets have, perhaps shrewdly, positioned themselves near open-air markets, allowing them to exploit the proximity to gain sales. Additional factors contributing to declining sales are aging infrastructure, convenience and public access. Security was also cited by virtually all interviewees to one degree or another, although some interviewees indicated that insecurity is not as bad as it is often portrayed.

Despite sales declines, interviewees point out several issues that remain positive with respect to open-air markets. First, many vendors in all sectors – fruits and vegetables, flowers, organic remedies and others – report considerable customer loyalty to their products. Second, most of these products are locally grown and produced, of high quality, and fresh. The open-air markets are recognized and valued to some degree as supporting local producers and supply chains. Some of those interviewed who attribute declining sales to aging infrastructure believe that if the markets are renovated and modernized, and with visible, improved security, customers will return. Two interviewees reported significantly increasing sales at the weekend fairs, despite having similar issues as open-air markets. Increasing sales are attributed to proactive measures by fair organizers, such as improved marketing and consumer demand studies; cooperation between sellers through association; and "liberalization" of sellers' products. As noted, wholesalers interviewed reported declining sales and more challenging markets as the major supermarkets tend to manage their own supply chains. The table below evaluates the end market segments within wholesale-retail sector.

Figure 61 Market segmentation wholesale-retail trade

Segment	Market Attractiveness	Barriers to Entry	Supply Chain Potential
Supermarkets & Wholesale Clubs (Supermercado)	**High.** This is a growing segment due to strong and shifting consumer preference. It offers opportunity for distribution of a wide variety of goods. Increasing competition market, yet there remains room for future growth.	**High barriers.** Requires significant capital investment and cash flow for entry as retailer or supplier. Requires well-established and reliable supply chain networks.	**Medium.** Has resources to support local supply chains and networks and local workforce development. There is uncertain potential to support linkages to create markets for local production – high standards in terms of traceability and reliability from supply chain.
Grocery Stores (Mercadito)	**Medium-low.** This sector has a strong neighborhood presence and convenience which should ensure continued viability of segment. Established stores in most neighborhoods equate to little demand for new stores. It is a declining segment due to popularity of supermarkets.	**Few barriers.** Established local distributors and supplier networks for most products equates to ease of entry for new retailers in segment. Requires higher capital investment and cash flow for growth of store networks.	**Medium.** Some, albeit relatively limited, resources to support local supply chains and networks. Demonstrated ability to strengthen upstream and downstream linkages through credit offerings.
Mini-Markets (Pulpería)	**Low.** Strong neighborhood presence and convenience should	**Few Barriers.** Established distributors and suppliers for	**Weak.** Limited support of local production due to stocking of

	ensure continued viability of segment. It is a stable but saturated segment. Established mini-markets in most neighborhoods equate to little demand for new mini-markets.	most products equates to ease of entry. Minimal capital investment necessary.	prepared, high-turnover products.
Convenience Stores (Tienda de conveniencia)	**Medium.** Growth in malls and shopping centers create opportunities for convenience stores. Much of growth is likely covered and already planned by chain convenience stores.	**No Barrier.** Established distributors and suppliers for most products equates to ease of entry. Lower capital investment necessary.	**Weak.** Limited support of local production due to stocking of prepared, high-turnover products.
Wholesalers Coyotes	**Medium.** Provides avenue for supporting supplier and retailer development. Wholesalers report declining business due to supermarket popularity, which operate own supply chains. Require establishing supply chain networks.	**Some barriers.** Simple and established distribution channels. Large number of smaller retail outlets can provide opportunities for development of segment. Requires significant investments in transport and storage facilities.	**Medium-strong.** Can support local production and supply chain networks. Can create opportunities to strengthen suppliers and retailers, serving as supply chain hubs. Connotation and norms in channel tend to be extractive or win-lose.
Public Open-Air Markets	**Low-medium.** Established, traditional, publicly-managed facilities. Declining market segment, yet due to traditional stature is unlikely to cease. Declining infrastructure; new facilities require significant investment relative to a declining segment.	**Some Barriers**. Established supply chain and distribution channels. High number of vendors provide opportunities for development and outreach. Requires public investment to improve or reinvigorate.	**Medium.** Strong support for local production and supply chain networks. Opportunities to strengthen suppliers and retailers, serving as supply chain hubs. Limited in resources to invest in supply chain and there are high levels informality.
Fairs	**Medium-high**. Periodic nature of most fairs helps them retain social stature. Opportunities to market variety of local and imported goods. Steady market segment, with some recent efforts to reinvigorate. Offers potential for opportunities in innovation.	**No Barrier.** Minimal investment aside from space and organization. Large number of vendors provides opportunities for development and outreach.	**Medium.** Essentially open to all products and supply chain participants. Strong support for local production and supply chain networks. Periodic nature of fairs limits potential for long-term supply chain development.

On the surface, the trends in the retail and wholesale trade sector may appear rather bleak. Traditional retailers and supply chains are competing with the growth of supermarkets, malls and large outlets, which are predisposed to importation of products. However, importantly there are some innovative findings and ideas highlighted in interviews that might provide opportunities for certain retail and wholesale channels. Large-scale positive impact on local producers should in some way address supermarkets, and how local suppliers and producers can increase their stake and role in this most important and growing segment. However, there are many challenges: meeting and guaranteeing the demand for consistent quality and quantity; breaking into supermarket-controlled supply chains; competing with low-cost imports and vast economies of scale; and organizing local resources to deliver are just some of the challenges. There are some examples of success, including La Colonia's "Mi Terra" program. Mi Terra has reportedly benefited 7,300 people, generating 2,800 agricultural jobs and reducing vegetable imports by 86.5 percent.[196] Similarly, Walmart's Honduran-affiliated

[196] Supermercados La Colonia. "De mi Tierra". Obtenido de: http://lacolonia.hn/sobre-nosotros/rse/de-mi-tierra/

supply chain manager Hortifruiti has successfully sourced local fresh vegetables.[197] These alliances are explored in greater detail in the value-added agriculture sector. Expectations should be modest but tempered, regarding the degree these might be significantly expanded to larger groups of suppliers.

Another avenue may be to reestablish and modernize open-air markets, which are based on strong local tradition, loyalty, and quality and fresh local production. This concept or "*a return to tradition"* would necessitate a holistic approach to revitalize the spirit, energy and preference of Honduran shoppers to return to open-air markets. These markets remain an important and traditional segment of Honduran society. Similarly, weekend and patron-day fairs reportedly remain popular and even growing, providing tangential evidence that successes can be gained through their revival. This would require a strong customer-orientation to identify and understand what consumers are seeking in their needs and to enhance shopping experience; improving security, strengthening infrastructure, reducing extortion, and using innovative marketing to re-attract consumers.

ROLES

Wholesale-retail trade is a sector where many different actors converge, including importers and traders, large and medium distributors and wholesalers, formal retailers (pulperias and mini-groceries stores), non-formal retailers (mobile vendors, bodegas), municipal open-air markets and fairs (farmers markets), international and local franchises chains and supermarkets (Walmart, La Colonia, Colonial), along with a complete cross-section of the Honduran population. Furthermore, some urban retailers are beginning to sell online using e-commerce platforms like Sompopo or doing direct trade through social media platforms like Facebook. The sector includes large numbers of small formal retailers and informal retailers such as street vendors, hawkers and open-air vendors, many of whom suffer violence, extortion and lack of space and basic sanitary conditions. The informal segment is still estimated to be the largest market mass consumer market goods. This analysis focuses on the informal channel to better understand its dynamics to evaluate how it will fare under increasing formality pressures and identify ways to facilitate that its transition is inclusive and effective.

If you disregard the highly technological-enabled and advanced supply chain management practices of supermarkets and convenience store chains, there appears to be limited rates of innovation and technology adoption in the retail and wholesale sector. Interviews showed that retailers use mobile telephones to take orders and conduct other business with suppliers. There are some limited cases of internet sales reported, albeit with no quantified results, in more niche sectors like flowers, remedies and shoes. Efforts to enhance the open-air market experience have included music playing over a speaker system. Equipment upgrades tend to be relatively basic - one *tortilleria* for example reported upgrading from a simple gas stove unit to an improved cookstove.

There also appear to be limited cases of mobility within the retail and wholesale sector. Perhaps this is due in part to the sector's maturity and declining growth rates outside of the supermarket segment. For example, there doesn't appear to be appreciable examples from the research of open-air vendors graduating to pulperias, or pulperias growing to mercaditos. There is a sentiment generally the informal wholesale-retail sector is saturated. To give a practical example, of two *pulperias* interviewed, one was established in 2005 as a family business and has remained in consistent ownership in the same location; the second was established in 2015. Both serve their respective neighborhoods, and both reported declining sales and shifting buying patterns of consumers.

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[197] USAID. (2009). The Farm-To-Market Value Chain Approach: Linking Small Holders to Wal-Mart in Honduras. Retrieved From: https://pdf.usaid.gov/pdf_docs/PNADP047.pdf

There appears to be a high degree of entrepreneurship within the retail sector, considering the sheer volume of peddlers, vendors and small retail outlets, many – perhaps most – of sellers who likely sustain little more than their livelihoods and subsistence from their monthly income. These low-level retailers are taking entrepreneurial risk, albeit out of necessity versus opportunity. Mobile vending is referred to as a job-of-last-resort. People fall into it when they fall out of another job. In other cases, mobile vending provides supplemental income. In unfortunately too many cases, it seems that people get stuck in it with no option to get out. A core constraining feature of the informal wholesale-retail sector is the absence of credit, which is needed to grow inventory. Credit is limited to usurious 18-20 percent rates with payback periods ranging from overnight to one month. Non-repayment represents considerable risk, including of life and limb, as reported by interviewees.

Women tend to dominate the retail sector, especially venders and peddlers at open-air markets, with estimates of 60-70 percent of retailers being women. At the low levels of retail – vendors, hawkers and street sellers – retail is dominated by the poor. Due to the dire economic situation of the country, poor people are migrating to the cities from rural areas and have virtually no means to support themselves. They tend to then to illegitimate street selling. As more and more people migrate in, the problem continues to exacerbate, creating significant challenges for legitimate sellers, especially since the street sellers tend to establish around existing markets and other retail outlets. There is a reported uptick in youth venders – even those with higher education – as they seek out any available opportunity. There is reportedly little to no ethnic discrimination in the retail sector, neither among sellers nor in association membership and representation. Due to the general necessity for retailers to be mobile – and the lack of handicapped-accessible facilities and amenities – the participation of PWDs in the retail sector is estimated to be very low to virtually none.

RELATIONSHIPS

There are several levels of organizational relationships and representation in the retail and wholesale sector, both formal and informal.

Independent Associations of Sellers. There are numerous associations of retailers, sellers and peddlers, primarily at the local level, with efforts being made to organize them at a higher, national level. Membership in these associations is predominantly (or perhaps exclusively) voluntary, with members paying "symbolic" or nominal membership fees that support administration and other expenses, such as in some cases security, health services, day care or other services for the market sellers they represent. Street vendors have organized themselves into syndicates like the Free Sellers Union of Honduras (SIVELIH) and the National Federation of Honduran Autonomous Workers (FENTAEH). Open-air markets and Fairs have also organized and created boards, associations and cooperatives representing independent sellers. The table below identifies the main national associations of sellers in Honduras. There are also local associations organized by individual markets, many of which are affiliated or members with the national associations.

Figure 62 Associations in Wholesale-retail trade

Association	Services & Highlights
Free Union of Honduras Sellers (SIVELIH)	• Established in 1983 with estimated 2,000-3,000 members or more • Partners with FENTAEH. • Established day care and clinic services for members. • Provide advocacy efforts for passage of law, eight years awaiting. • Has cooperative offering credit to members; no daycare services.

Association of Autonomous Sellers of Honduras (AVENIH)	• Established in 2001 with estimated 500-900 members or more • Manage 5000-member cooperative providing credit to members. • Affiliated to Confederation of Workers of Honduras (CTH) • Associated cooperative offers loans to hawkers. • Manage unique, modern market with nursery and health clinic. • Have 56 M lempiras outstanding debt to BANADESA.
Dealers Association of Artisanal and Agricultural Health Fair Villanueva (AVANFAAS)	• Estimated to have 100 or more members • Association of Agricultural Fair Villanueva. • Incorporated 3 separate member cooperatives, with board of 2 members from each. • Offers health services in cooperation with Ministry of Health; provides private security • Surveys customer satisfaction and socio-economic situation of buyers and sellers.
National Federation of Autonomous Workers of Honduras Economics (FENTAEH)	• Established in 1983 with estimated 3,000-6,000 members • Apex association of: CONAVAH, SIVELIH, AVENAH, SINENZOBJ, ASOVIN. • Manage workshops with vendors to identify priorities. • Work with cooperatives providing solidarity loans of 3-4 members (unclear relationship).
National Trade Union of Authentic Honduras Vendors (SUVANH)	• Established in 1985 with estimated 9,000 members • Interested to expand to other economic sectors: taxis, sex workers, sand gatherers. • Cited challenges of "internal division" between vendor associations and organizations. • Do not offer daycare or credit services.

Other identified associations include the National Council Peddlers of Honduras (CONAVAH), Federation of Organizations of Workers of the Social Sector of the Informal Economy of Honduras (FOTSSIEH), Confederation of Workers of Honduras (CTH), Vendors' Union Boulevard Zone of Juticalpa (SINENZOBJ) and Association of Independent Sellers North (ASOVIN).

The mandates of these associations are generally built around ensuring the rights of, and providing advocacy for, members; providing social and education services and development; and advising members on legal and institutional issues. In those cases where membership is voluntary, they appear to be successful in attracting members. They also appear to be successful in mobilizing cooperation with other stakeholders, such as municipal administrations, police, health services and public institutions. Associations cite national advocacy initiatives, notably the long-delayed passage of the "Law of Social Inclusion & Labor for Autonomous and Self-Employed" which according to sources has been awaiting passage for eight years. In the instances where the associations and their cooperative affiliates and members provide credit services, they also appear to be viewed positively by members, as do the daycare and health services.

Associations interviewed also cited various degrees of relationships with municipal and other authorities, including police with respect to security provision. In some cases, the associations are credited for having successfully advocated for the municipality to exonerate them from utility expenses used by market vendors (although presumably utility expenses are at least in part recouped through vendors' rental payments for their stalls). Associations reported positive cooperation with municipalities on issues like assistance to vendors with utilities, security and occasional investment in markets. In other cases, however, municipalities were accused of enabling extortion and victimization of retailers and non-enforcement of laws regarding illegal street vendors. All vendors interviewed, from open-air market vendors to mercaditos reported circulating street vendors congregating around markets and other sales outlets, offering products at cut-rate prices, as one of the key challenges to their businesses. Many retailers also cited challenges with formal registration, and the unfair competition resulting from informal vendors not registering. The top priority for most retailers is access to financial services. Numerous associations and local open-air markets have established some

form of credit cooperation based on credit cooperatives and/or solidarity loans. In some cases, these appear to be official entities, while in others they are reported to be informal agreements between groups of vendors to either provide periodic credit to one another to access "solidarity" credit. In these cases, these favorable relationships can be viewed as win-win agreements.

Highlight: Agricultural Fair Villanueva & AVANFAAS Association
The Agricultural Fair Villanueva in Colonia Villaneuva is one example of how associations can be independently formed and function for the benefit of their members. Established in 1997, the fair operates weekly on Fridays and Saturdays and features 197 sellers weekly, offering local agricultural produce and products, including fresh fruits and vegetables, preserves, milk and dairy products, poultry and even pinatas. Original organizers include CARE, the Ministry of Health and the municipal government. The market itself belongs to three cooperatives and is thus, "almost a private institution," albeit with assistance from national and local government institutions. All of the sellers are members of the Dealers Association of Artisanal and Agricultural Health Fair Villanueva (AVANFAAS), to whom they pay a symbolic membership fee to cover administrative expenses, the right to sell their wares, security and utilities. While the fair admittedly started off "disorganized," it has gradually become increasingly organized. Initially, cooperatives were operating individually; then, with the introduction of AVANFAAS, they were consolidated into the association. The fair now boasts full-time administration and provides effective, permanent security for both buyers and sellers. The fair has introduced numerous innovations. They have established a permanent clinic and doctor, and they receive assistance with medicines from various health institutions. Fair administrators conduct annual customer satisfaction surveys; and socio-economic surveys of both buyers and sellers. In response to consumer surveys, they have introduced new products such as seafood including jumbo shrimp, Guatemalan tomato paste, and PROMDECA-stamped meats. The fair restricts access to intermediaries to maintain a direct link between sellers and buyers. They have ambitious plans for the future including expansion of parking, lighting improvements and extending the fair to Thursday. They hope to finance these with a combination of seller contributions and municipal government support.

Supplier-Retailer Relationships. Some products are commonly distributed to retail outlets by one or more distributors. In these cases, notably meat and dairy and other products that require refrigerated or special transport, there seems to exist stronger relationships. Suppliers are noted to sometimes extend credit to the retailers for these products. These relationships can also be viewed as win-win, as both sides are eager to maximize sales and are willing to go to some lengths to help the other. Supplier relationships with open-air vendors tend to be more transactional, as buyers seek to buy on a spot or transactional basis. They deal with small quantities of more accessible and less perishable supplies, such as fruits and vegetables, flour and wood for *tortillerias*, and new or second-hand clothing picked from different wholesalers. Even non-food sectors like clothing and shoes, are minimally integrated, with actors preferring to act more opportunistically to be aligned with the market. There is, perhaps inherently, little specialization in retail. Retailers from vendors to *pulperias* to mercaditos pursue products that provide them the best margins, highest turnover and minimal shelf space to maximize their profits; and are willing and ready to change products on short notice.

Select findings on buyer-seller relationships from interviews
For fresh fruits and vegetables, meats and dairy products, small retailers and local grocers were stocked directly by Honduran farmers and artisans. Processed products such as cleaning products, personal hygiene and higher value food products are provided by large distributors and wholesale companies such as Diapa, Unilever, Leyde, Lacthosa, Maseca, Compadre, Sula, Distribuidora Itsmania, Embotelladora La Reyna and Honduran Brewery. It is estimated that few small retailers purchase from supermarkets with the intention to resell, perhaps as low as 5%. Pulperias and mercaditos state that some products they purchase from wholesale outlets and transport to their outlets, while other products are delivered to their stores by distributors. Vendors of used clothing interviewed are buying from local sellers who have acquired bundles of used clothing from the United States; they also report personally traveling to Guatemala to purchase, although the origin of those goods isn't clear. Competition in the clothing sector is reportedly very high, including inexpensive new clothing imported from Turkey. A sewing workshop interviewed buys from a single supplier, based on selection and quality; she is pleased with the service and doesn't look elsewhere. A flower seller stated that all of their suppliers are foreign, including Costa Rican, Guatemalan and Ecuadorian; contacts are made electronically, and distributors also visit in Honduras. She indicates no domestic suppliers and wholesalers in the market where she procures.

Some basic information on the major formal supermarket and distribution chains can be acquired from the USDA Retail Report 2017.[198] This report highlights Walmart and its affiliates (Paiz, Maxi Despensa), La Colonia, and PriceSmart are the country´s biggest retailers in Honduras. It also references Texaco, Puma and Uno as major convenience stores. In addition to retailers listed in the USDA report, which also import and distribute. Other major distributors in Honduras include Almacén El Ahorro, Distribuidora Los Dos Hermanos, Multiflora Honduras and Distribuidora Flores. Distribuidora Universal (DIUNSA), Distribuidora Istmania, Distribuidora CODIS, Agencia Barret, Distribuidora BOGA are also wholesalers and importers, who are country representatives of diverse brands and products and own big distribution and logistics operations for nation-wide delivery.

RESOURCES

Credit & Financing: Almost exclusively, when asked about resources, interviewees in the retail and wholesale sector cite the need for reliable and affordable credit. While some street vendors and hawkers are able to access credit through cooperatives, these opportunities appear to be relatively limited, forcing them to rely on usurers and exploitative lenders and their 18-20 percent interest rates (loaned on terms ranging from daily to monthly). Some vendors and enterprises report having applied for credit from institutional lenders but have failed to meet the requirements. Some of the reports arising from the lack of credit and reliance on usury include violence, murders and suicides. Some of the quotes from interviewed enterprises reflect the degree of the challenges faced:

[198] United States Department of Agriculture (USDA). (2017). Honduras Retails Foods Report. Retrieved From: https://gain.fas.usda.gov/Recent%20GAIN%20Publications/Retail%20Foods_Tegucigalpa_Honduras_12-29-2017.pdf

Selected quotes from interviewees:

- "We need financing because we are not approved by institutions who don't believe in us despite we can repay. This is a resource that kills us because we have to get expensive credit. We need money daily."
- "One companion took financing from a cooperative but could not afford to repay. He gave an ultimatum for a week and she could not meet the demand or have another option. She committed suicide the day before we tried to help."
- "For me the most important resource to get is money, because no one wants to lend. I work with a cooperative that offers credit at 18% daily. But most of the market works with lenders at 20% daily or monthly."
- "Funding is most needed because if you take a loan with a moneylender … there have been killings for not being able to repay the loans. Sixty percent of the market works with usurers and it is expensive and dangerous money."
- "Financing is most difficult because we have no access to formal institutions. We work with Columbian usurers at 20% daily and unfair conditions. Sometimes we play with life."

Infrastructure & Security: Commonly-stated resource needs include improved infrastructure and security, both in markets as well as in neighborhoods. Specific infrastructure needs noted include parking, lighting, sewerage, bus stops and general market improvements. Improved security is also commonly stated. Some grocers and vendors state that security improvements have been made, but much remains to be improved. Markets are infiltrated by gangs who promise to protect vendors and eliminate extortion, only to turn to the same criminal practices as previous gangs. Resource investments in safe spaces to do business would reduce vulnerability of wholesale-retail venders.

Organizational Capacity. Peddlers, fairs, grocers and wholesalers are often organized under associations, unions and federation structures at local and national levels. This is a benefit because sellers have a structure to represent them and help meet their labor rights and demands. Their formal and legal status has allowed them to strengthen their management capacity and better represent their constituents. These associations and structures have evolved to provide several benefits, including cooperative and state financial aid, technical assistance and training, social development projects, legal assistance and advice, security for markets and sellers, and advocacy for passage of the "Law of Social Inclusion and Labor for Autonomous and Self-Employed." Continued capacity strengthening of these associations, in cooperation with Chambers of Commerce, municipal administrations and other partners, can help to introduce new offerings and services for their sellers, cultivate new partnerships, develop solidarity, facilitate access to credit organizations and cooperatives, and strengthen supply chains with rural communities could be effective instruments to increase incomes.

Human Resources: Some venders and sellers receive training and development activities, primarily through associations, and supported by the Ministry of Economy and some international donors and programs. Noted beneficial trainings and demands include in areas of food safety; marketing and promotion; internet marketing and sourcing; supply chain management; and financial, productivity and business management. Strengthening formal and informal training offers through vendor associations, Chambers of Commerce, NGOs and INFOP could help address the low mobility in the sector. Efforts in cooperation with the Ministry of Economic Development and SAR to integrate the informal sector into the formal sector through partnership facilitation and training, articulating the benefits of transitioning from the informal to formal sector would offer a dual benefit. Further training on the use of digital tools to facilitate trade can also be beneficial for women, children, disabled, elderly and ethnic groups. It was noted that as the majority of retailers are women, that issues of domestic violence and exploitation should be considered in the design of content. Lack of basic business skills is a cross cutting issue in the sector.

Technical training provision mentioned in interviews
All the major universities, including UNAH, UNITEC, UNICAH, UTH and others offer various programs which fit the sectors broad necessities. Soft skills training is in high demand and still not addressed by local academia actors. INFOP is charged with tending to these needs since all companies by law must pay 1% of salaries and wages for employee skill-building services. Experts state that, when available, courses are generally offered during peak sales hours, making them impractical for many companies and individuals; there is also some criticism related to relevancy of content. INFOP instructors are, however, highly rated; thus the institution should work to review their programs to better serve the needs of targeted sectors. Private institutions could also be engaged to provide informal or short courses to train the wholesale and retail sector workforce. There are also positive reports of some of the training provided by associations, Chambers of Commerce, and in some cases wholesalers. It bears mention that several development programs are mentioned in a positive light as having been of assistance to associations and, in some cases, individual companies or vendors; these include USAID CONVIVE, Better Life, Active Aging Project, and ILO (training).

RULES

The wholesale-retail trade sector is the intersection of many different policies and institutions. The National Service of Health and Food Safety (SENASA), Health Regulation Agency (ARSA), Agriculture Secretariat (SAG), Economic Development Secretariat (SDE), Environment Secretariat (Mi Ambiente), and the Health Secretariat are responsible for product distribution permits. The Honduran Transport Institute (IHT) is responsible for regulating ground transportation. The Rent Customs Management Office (DARA) is responsible for import permits, licensing and customs tax regulation. Experts cite that all these offices require more user-friendly processes, online access for users and a "single window" to simplify permitting and licensing processes. These institutions and policies are discussed in greater detail in the Rules section for respective sectors.

Other notable laws and policies which affect the wholesale-retail sector in particular are:

- Law No. 549, Official Register (La Gaceta) No. 22366, of December 7, 1977 entitled "Law on Agents, Distributors and Representatives of Domestic and Foreign Companies," includes a provision for penalties for wrongful termination that discourages exclusive distribution agreements. For new-to-market or new-to-export companies, authorized distributorship arrangements or renewable periods of representation are recommended over exclusivity contracts, unless the relationship has proven to be stable and profitable for both parties.
- Law on Electronic Commerce passed on January 21st, 2015. This bill was drafted in accordance to the model legislature put forth by the United Nations Commission for International Trade Rights. Honduras is one of the first subscribers of the convention for utilization of electronic communications and international contracts which entered into effect in 2013, under national law decree 149, but reportedly only the public sector has taken advantage of the law. In August 2014, a law on efficient and transparent purchasing through electronic media came into effect, under congressional decree number 36-2013.
- Law of Social Inclusion and Labor for Autonomous and Self-Employed**:** The law, currently a bill, aims for the Secretary of Labor and Social Security (STSS) to recognize and have legal status; fundamental rights including access to social security; and favorable environment for the formalization and development of self-employed persons complying with mandates.

Of particular note are the reforms to the tax code which have imposed significant burden on MSMEs, which have found it difficult to meet the requirements for tax filings. In essence, the current tax system reportedly penalizes firms that try to formalize. This has had the effect of encouraging MSMEs in the wholesale-retail sector to remain informal. The formalization of street vendors is also a commonly stated need among retailers and experts alike. The primary detriments, or reasons not to formalize, include the tax obligations if formalized, the low cost of street peddling, and the

unwillingness of street peddlers to pay ongoing taxes. Additionally, there are some potentially unintended negative consequences from formalization, such as the make businesses targets for extortion.

Further, discussions for example by interviewees of licensing of vendors could also have unintended consequences. Street peddling for example is already considered a "last-resort" job. Licensing or creating a barrier to access this last resort job could in turn trigger greater migration. In sum, a balanced approach to formalization and regulation of the wholesale-retail sector should be developed such that the benefits outweigh the costs. Potential ways to mitigate include reducing tax obligations, not reporting if revenues are below a certain level, and providing greater incentives for formalization, such as increasing access to financial and support services, accessing social security benefits or investments in market infrastructure to establish safe shopping spaces, promoting local fairs, etc. These could be part of a MSME Law developed in conjunction with the Economic Development Secretariat and the SAR to establish more inclusive rules for vulnerable people in the sector.

RESULTS

There are likely sectors of intervention that perhaps have greater transformative potential than retail and wholesale. Challenges facing the sector – some perhaps inherent and inevitable – are considerable, and the retail sector is being squeezed from both ends: from the upper end from modern supermarkets and malls, and from the lower end a growing number of street sellers. Caught in the middle are the traditional Honduran sellers facing declining sales to vendors and neighborhood grocers and small boutique shops. The wholesale-retail sector is a sector pulled and pushed by other sectors, yet it is also a vitally important sector given the number of people it employs, and it is the ultimate outlet for the sale of all locally produced, processed and manufactured goods.

A large portion of the workforce relies on the informal wholesale-retail sector as a means of self-employment when they have no other option. The ability to make this safety net more secure and less vulnerable to crime, extortion or violence would impact hundreds of thousands of Hondurans. The potential of the sector to provide a much-needed economic ladder to either move-up or move-out of wholesale-retail trade, in a country with low mobility might shift perceptions about future long-term aspects of staying in Honduras. In other words, the sector should be considered important not just from its direct contributions but its inclusion potential for the poorest and most vulnerable.

The retail sector as noted is where many women find the best way to obtain resources. Twenty percent of the population is employed in this sector in diverse activities many of which are increasingly represented by youth. The Chamber of Commerce and Industries of Tegucigalpa implements a project for returnees, providing spaces for the generation of income through microenterprises and to facilitate the insertion into the labor market of returnees from the United States to reduce the incidence of recourse to emigration in search of job opportunities. The sector opens on opportunities as well for PwDs in multiple roles such as auxiliary roles such as inventory and seller replenishment. The sector also necessary includes indigenous and Garifuna populations as well.

Municipal investments in market infrastructure and working with vendor and hawker associations to strengthen security and support services for informal and retail sellers as part of path to formalization can be a more inclusive way to integrate retailers into the formal economy. Notably, credit providers that serve informal sellers and associations that can represent venders in local and national levels are positioned to strengthen the status of the profession. Building on the strong open-air market tradition

and successes of fairs can help to keep consumers shopping for fresh produce in local markets. These venues can remain an outlet for locally produced goods and alternative to the supermarket segment. There is considerable energy and dynamism within this sector that can be better harnessed and should be considered an opportunity in whatever sector engaged in, whether as an end market for value-added products or as part of a cultural destination for visiting tourists. There are also opportunities noted to take advantage of digital transformation and e-commerce and support the development of new applications for delivery services such as Hugo Delivery https://hugoapp.com/. E-commerce could be enhanced marketing in mature sectors such as roasted coffee to be able to pursue direct to consumer marketing channels. Further, B2B platforms were identified in light manufacturing sectors as potential to help identify new suppliers.

The development of supermarkets retail segment will inevitably continue. There are necessary opportunities to expand the supply chains of industrial firms and supermarkets to better promote local products, and work through supply chains to improve quality and deliver quantities demanded. These opportunities are more sector-specific and explored in greater detail in the other sectors.



BUSINESS SERVICES

ANNEX VIII BUSINESS SERVICES

SECTOR OVERVIEW

The market for business services for MSMEs is underdeveloped which limits the sustainable supply of this vital service to support MSME growth. There is reportedly high willingness to pay for business services, among all sizes of firms yet these services are not reaching clients. It is estimated only 10-20 percent of MSMEs have received business services, and up to 44 percent expressed having no contact with a service provider ever. In general, the provision of of BDS by NGOs has contributed to a general perception by businesses that they do not have to pay for services. This market asymmetry has caused the current predicament, in which there is little effective demand among SMEs for BDS, yet there is a vast unserved real demand, despite the demonstrable value of these services to businesses. A lack of market signals limits the supply of new business services offers tailored to MSMEs, with many instead focusing on large commercial clients.

There has been a recent surge ICT adoption in Honduras, but with a notable gap to still bridge to catch-up with regional peers. There has been significant strides in ICT adoption as enterprises of all sizes implement ICT solutions. Micro- and small-enterprises for example are reportedly demanding solutions as basic as creation of a webpage, establishing email and Facebook accounts or development of simple accounting systems. ICT services tend to be concentrated in large cities and there still lingers a generalized mistrust of digital services among MSMEs. The market is however changing and clients respond positively to the convenience of easy automatization and low cost. Increased connectivity in Honduras is a positive signal, especially mobile (coverage at 91 percent) and broadband internet (coverage at 39 percent), although considered low for the LAC region, for future growth within this sub-sector. Increases of ICT usage is leading to greater appreciation of ICT by MSME clients. Digitalization of businesses paired with growing social media, are fostering use of digital marketing and the potential of e-commerce, which can enable more inclusive and innovative MSME entrepreneurship.

There are seemingly limitless opportunities for business service and ICT solutions to address constraints in sectors. All the sectors analyzed by TMS require information systems, e-commerce solutions, and more tailored business services, etc. There are opportunities to apply ICT and BDS to help MSMEs navigate the complexity of emerging legal and fiscal policies in Honduras, significantly reducing the costs of doing business. Solutions include digital transaction windows and the adoption of e-payments and e-signatures which eliminate the need for cash payments and visiting offices. In multiple sectors on-line directories were noted to lower search costs and help suppliers and consumers identify each other.

CDEs and chambers are opening-up business service provision to the MSME segment. In recent years (starting in 2014) the most significant development in this sub-sector has been the creation of the CDE network. This network has grown rapidly, integrating country wide an average 5,000 new micro-small businesses each year to their client list. This year the network reached total national coverage with 12 centers. CDE services are subsidized by GOH and cooperating entities but are shifting towards greater private-sector funding. Chamber of Commerce, notably for Tegucigalpa, San Pedro Sula, and Choloma have started to provide important business services. For example, the Chamber in Tegucigalpa for provides registration services, manages a mobile guarantees system, delivers communications, public relations, and graphic design and runs an incubation program for innovative startups (Honduras Emprende). Emerging relationships between CDEs and Chamber of

Commerce, such as the integration of processing windows in some CDEs mark the beginning of a public- and private- sector alternative for business services, which may be critical to make the lea pinto a more commercial market.

There is a lack of enabling environment for the business services ICT sector, including legal and regulatory frameworks. Many BDS and ICT providers believe the sector is overshadowed in national policy and there is a general sentiment that for the government the sector is of little importance. There is a lack of official statistics on the country´s ICT sector resulting in little recognition of its contribution to the economy. The sector as a whole, and in particular e-commerce, lacks a regulatory framework. The law for e-commerce and e-money (Decreto No. 149-2014) is still inapplicable, and while the Central Bank (BCH) and Regulations Commission (CNBS) are doing a better job with regards to e-money policies, no progress has been made for e-commerce, and both still lag behind international best practices.

INTRODUCTION

Business development services (BDS) and information and communication technology (ICT) are valued as cross-cutting services for micro, small, medium and large enterprises in all economic sectors with impact on structural features of company operations, and notably on their competitiveness. The digital economy is made up of telecommunications infrastructure, the ICT industries (software, hardware and ICT services), and the many economic and social activities that are facilitated by the Internet, such as cloud computing and mobile, social, and remote sensor networks. It is divided in three main components: the broadband network infrastructure, the ICT applications industry, and the final users. Depending on their degree of development and complementarity, these components determine the digital economy's maturity in each country. BDS includes services and products essential for skill transfer and advisory at different stages of development for a business. These services often require a deep of the segment being served, Topics include management consulting, business skill building, market research, advertising, collection agencies, credit bureaus, strategic planning and organizational development, office administrative services, auditing and the organization of trade shows, conventions and conferences. In Honduras, NGOs and international cooperation projects have filled the missing gap in services for MSMEs related to training, advisory, etc. Private sector actors are mainly present in providing legal, accounting, management, sales and ICT services for enterprises.

ICT encompasses vital services, like mobile communication, e-commerce, information systems, and technology applied to business systems and processes. In its economic reports, Honduras only shows Communications as contributing 3.2 percent of GDP, whereas Technology and Business Services are not listed. But data on Service Exports show communications generating $262.4 million (20 percent of total exports)[199] in 2017, with a growth trend of 3.6 percent for the last three years. The relevance of these sectors is also highlighted in the Global Competitiveness Index, presented as indicators for technological readiness, business sophistication and innovation. Honduras unfortunately has dropped by eight spots[200] in these indicators between 2016-2017 and 2017-2018 (ranked 88 to 96 out of 137 countries). See the table below for more details.

[199] BCH, "Honduras en Cifras 2015-2017"
[200] Klaus Schwab et al. (2017). The Global Competitiveness Report 2017–2018. World Economic Forum.

Figure 63 Honduras in GCI for three BDS and ICT-related indicators

Global Competitiveness Index 2017-2018 Best Performer in LAC versus Honduras	Technological Readiness	Business Sophistication	Innovation
	Uruguay Rank #36 Score: 5.3 Honduras Rank #99 Score: 3.3	Costa Rica Rank #35 Score 4.5 Honduras Rank #88 Score: 3.8	Costa Rica Rank #43 Score: 3.7 Honduras Rank #108 Score: 2.9

In 2017, internet connectivity was estimated at 3.6 million users, representing approximately 38.2 percent of the total population an increase of just over 33 percent from 2016 (IWS). With a population of over 9.4 MM inhabitants, the percentage of users active in social media represents 36.1 percent of the population with 3,400,000 active users of Facebook, Twitter and other social media applications (IWS)[201]. According to the Global Entrepreneurship and Development Institute (GEDI) in 2018 the Global Entrepreneurship Index (GEI) score for the health of the Honduran entrepreneurship ecosystem was 19 percent, ranking above Guatemala with 18 percent, El Salvador 17 percent and Nicaragua 15 percent, but below Panama 28 percent and Costa Rica 33 percent. As per the table below, the country with the best GEI index in LAC region is Chile with 59 percent.[202] According to the GEDI, the Central America region scored highest in the areas of Startups Skills and Product Innovation.

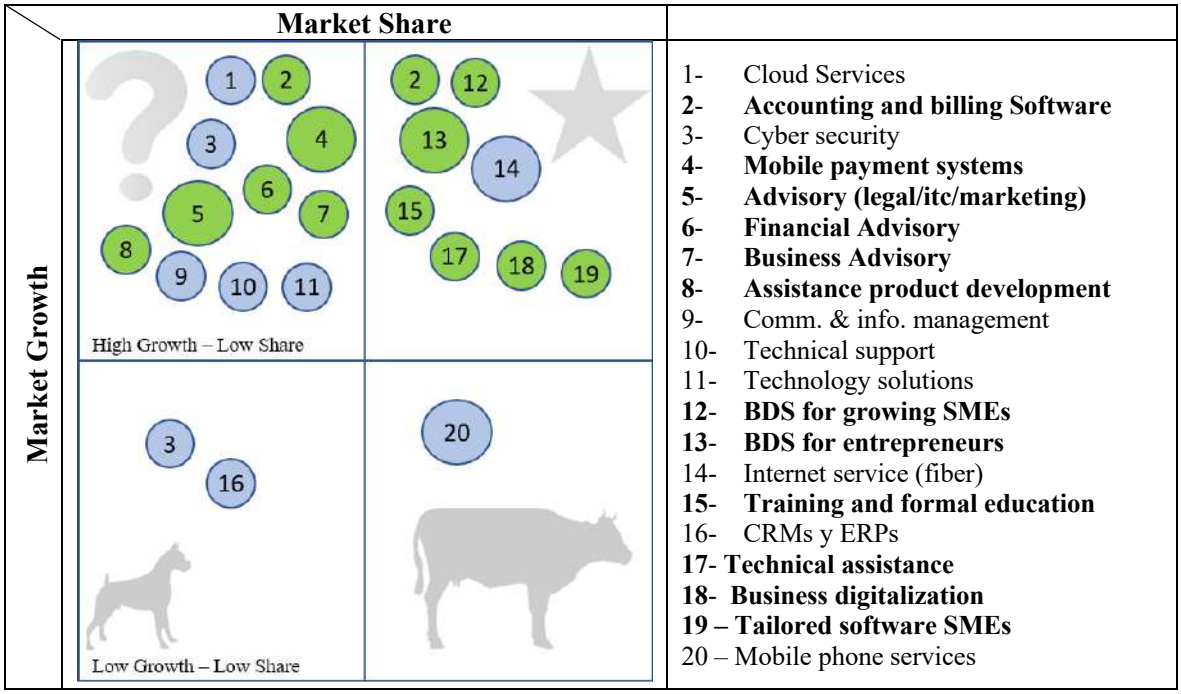
Figure 64 GEDI Central America

Country	Global Rank (137 countries)	2018 GEI Score
Costa Rica	56	33.3
Panama	70	27.7
Honduras	107	18.7
Guatemala	108	18.5
El Salvador	114	16.7
Nicaragua	122	14.7

TMS held an expert workshop[203] in which 25 experts participated from 21 different organizations. With these experts´ insight, five sub-sectors were identified that provide unique business services to MSMEs: Marketing and sales, Training and formal education, Advisory services, Digitalization and ICT services and Mobile Payment Systems. There is. There is an overlap in the five sub-sectors, both business-oriented and technology-based services, since ICT provides an invaluable tool for managing processes and communicating information at a low cost. Researchers then conducted in-depth 25 structured interviews with BDS and ICT organizations with different perspectives including public sector CDEs (5), private sector (13), NGO's (2), finance institutions (2), and academic institutions (3). The expert workshop identified a total of 20 relevant economic activities or services, 11 directly related to the ICT sector and 9 to BDS. Most of the activities possess a high growth potential. As shown in the growth/share matrix table below. Ten activities were classified as question marks and 7 considered stars. Because of the high growth potential, a total of 12 activities were chosen for further research and were grouped into the five sub-sectors. (i) marketing and sales includes marketing advisory and new product development, (ii) training and formal education, (iii) advisory services, (iv) digitalization and ICT, and (v) payment systems.

[201] https://www.internetworldstats.com/central.htm
[202] https://thegedi.org/countries/Honduras
[203] Go to section 2.1 for more detailed results of the Subject Matter Expert´s (SME) Workshop.

***Figure 65** Economic activities identified and evaluated for growth and share by the SME of Business Development Services (BDS) and Information Communication Technology (ICT)*



Please note that some of the economic activities listed above were classified in multiples quadrants. The size of circles reflect the level of agreement among experts, a large circle would indicate a total agreement on that quadrant. Green circles are the activities chosen for EMA and MSA research.

Marketing and sales. The marketing subsector includes products and services, which help enterprises to expand sales to new and existing clients. Types of business products and services within the marketing sub-sector include advertising, graphic design, market research, and marketing plan development. Micro and small enterprises make up 81 percent of businesses in Honduras - 48 percent of micro and 31 percent of small business reported using no media marketing at all. [204] Experts observe that when entrepreneurs decide to conduct marketing strategies on their own rather than seek advisory services, they often waste money on ineffective marketing strategies. There is limited realization of professional marketing services. As a result, there is a very small supply (five large local firms) of professional marketing research, almost exclusively used by medium and large enterprises. There is a need for greater provision of more technological, low cost solutions to tailor services to MSME demand.

Training and formal education. the mismatch of technical and vocational education and training (TVET) in relation to the needs of the private productive sector is perceived by experts to be a root cause for unemployment and underemployment, particularly affecting young people. Unemployment and underemployment particularly affect young people who generally have very limited or no training at all, since 44 percent of the population is under 19 years old. The country´s education system is reportedly in crisis. For informal microenterprises, just 8 percent of managers have high school education or higher, while formal micro enterprises report 28 percent and formal small-

[204] IADB 2013. "Diagnóstico Sectorial de la MIPYME en Honduras". Enero 2013

enterprises 51 percent.[205] Experts noted skills training suffers from low diversity, quality, and overall access. [206]

INFOP is the public/private organization created to lead labor training in the country but has the lowest budget in the CA region and the second lowest geographic coverage[207]. Private schools and universities are creating more technical careers but aim for high school graduates of medium to high income due to limited financing options. There is a variety of NGOs and international cooperation agencies investing in these areas. However, their scale is limited and programs are not sustainable after project funding ends. There is latent demand for more such training: in the latest enterprise survey conducted by COHEP, more than 75 percent of managers agreed that training is important for business development and stated that they would be willing to pay for the right skills and technical training[208]. It stands to reason that if public and private training and education centers tailor training design to MSMEs´ needs, greater demand and job opportunities will result.

Advisory services – Many MSMEs in Honduras lack management, planning and marketing skills, as well as technical skills for production activities. The supply of services has limited coverage and, as the 2013 diagnostic conducted by IADB[209] showed, only 20 percent of MSMEs receive any advisory service and up to 44 percent have no contact at all with a service provider. Several NGOs and cooperation agencies have set-up projects to assist entrepreneurs and provide technical assistance with donor's funds distorting the market to fill this gap and making it harder to establish a sustainable private sector driven service network.

Advisory services are mainly concentrated in urban areas and there is a gap for rural and agricultural MSME's enterprises. Several private sector trade associations, like IHCAFE and *Consorcio Agrocomercial*, have developed their own advisory services. There is a reported need to make these systems more cost-effective and streamlined to reduce cost and increase coverage. In recent years (starting in 2014) the most significant development in this sub-sector has been the creation of the Small Business Development Center network (CDE MIPYMEs). These were created under the Law for the Promotion and Development of the Competitiveness of Micro, Small and Medium Enterprises, but they operate independently from government management and with a mixed public-private model. This network has grown rapidly, integrating country wide an average 5,000 new micro-small businesses each year to their client list. This year the network reached total national coverage with 12 centers. [210] CDEs provide start-up and business growth support with a holistic methodology adopted from the Small Business Development Centers (SBDC) network from University of Texas in San Antonio (UTSA), but they also rely on subsidies to serve clients. CDEs are starting to create networks with donors, NGO's, private sector, financial institutions, academia, and other regional networks - this as a promising opportunity to build upon.

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[205] COHEP, "Encuesta Empresarial de Honduras 2017"
[206] Personal interviews to three different experts, August 2018. Juan Carlos Sikaffy, COHEP; Roque Rivera, AHIBA; and Patricia Lanza, INFOP.
[207] Juan José Llisterri, Nicolo Gligo, Oriol Homs y Domenec Ruíz-Devesa Educación técnica y formación profesional en América Latina. El reto de la productividad Retrieved from:
http://publicaciones.caf.com/media/38365/educacion_tecnica_formacion_profesional.pdf
[208] COHEP, "Encuesta Empresarial de Honduras 2017"
[209] IADB. Diagnosis of Non-Agricultural MSME Sectors in Honduras, "Diagnóstico Sectorial de la MYPIME no Agrícola en Honduras". January 2013
[210] Difomipyme. "Estrategia de apoyo Presidencial a la MIPYME, Centros de Desarrollo Empresarial", 2018.

Digitalization and ICT services. Businesses of all sizes are expanding the use of customized ICT solutions to be more competitive and enhance marketing and sales, cost control and efficiency. These solutions are supporting the growth of services from both ICT and BDS providers. Larger enterprises continue to appreciate the value of and be more willing to pay for ICT services than smaller firms. SMEs also are estimated to have twice and even four times more use of these services compared to micro enterprises.[211] A disadvantage for micro-, small- and rural- enterprises is that ICT services tend to be concentrated in urban areas. Large and medium size software and hardware service providers and distributors operate out of Tegucigalpa and San Pedro Sula. There is an estimated 95 companies, mostly Honduran, in this sub-sector. They tend to target both individual clients and wealthier corporate clients. According to experts, the most sought-out software products are for accounting, billing, human resource management, process automation, human resource capacity development, and online legal services. Digitalization is relatively easy and low cost for MSMEs with simple business operations and these demands can be met by small companies or freelancers. Reportedly, all CDE centers hire an ICT consultant to provide services for the center through simple solutions for clients, like creating a web page, establishing email and Facebook accounts, and developing simple accounting systems. These simple solutions have served to demonstrate the demand and potential for the market. Applications have even demonstrated their value for the agriculture sector, as demonstrated by the company Green Tech, which is creating technological solutions to manage fish production and field supervision with drones.

Mobile Payment Systems. Experts identified a nascent market for mobile payment services. Interviews with the largest mobile phone provider confirmed that in fact mobile payment systems generate less than 1 percent of all transactions in Honduras. Current regulations restrict the market and have prevented the uptake of e-commerce models which have been successfully developed in other countries. Efforts are however underway to remedy this - e-money is a key element to supporting e-commerce. The most important success factor however for this sub-sector is a strong mobile network service, which is already established in the country. In addition to data presented before, the technological association in Honduras reports that coverage with 2G and 3G technology is the highest with 100 percent of geography and 90 percent of the population. Statistics are less favorable for 4G and broad band internet coverage, dropping to 36 percent of geography (CA average is 61 percent) and 51 percent of population. [212] The latest data estimates that 39 percent of the population are active internet users, and 36 percent are active internet users through mobile networks. Despite these relatively low numbers, internet and mobile communication are promising channels to provide services and business opportunities to MSMEs and reach rural cities where leading companies don't exist.

History and Trajectory. The BDS sector has traditionally been the domain of donors and NGOs. The Aspen Network for Development Entrepreneurs (ANDE) entrepreneurship mapping of Honduras shows NGOs constituting half of all support service actors available for entrepreneurs. This is about 75 percent more than neighboring Guatemala and El Salvador, revealing a distinct gap of private sector actors in support service roles. But the entrance of CDEs (*Centros de Desarrollo Empresarial*) has marked the beginning of a public/private sector alternative. CDE services are currently subsidized by the government of Honduras and other cooperating entities, though with a more explicit intent to leverage private sector funding in the future. The provision of BDS by NGOs has contributed to a

[211] IADB. Diagnosis of Non-Agricultural MSME Sectors in Honduras, "Diagnóstico Sectorial de la MYPIME no Agrícola en Honduras". January 2013.
[212]https://digitalreport.wearesocial.com/download

general perception by businesses that they do not have to pay for services. This market asymmetry has caused the current predicament, in which there is little effective demand among SMEs for BDS, yet there is a vast unserved real demand due to lack of scalability of donor-supplied services. There is the opportunity to validate the business case on the ROI for these services. As an example, the Small Business Development Center in Texas reports that for every $1 invested in BDS a return of $8.91 is generated due to increase jobs, sales, financing and tax revenues[213].

TMS interviewed BDS, ICT, financial service providers, and academic institutions and their views of the challenges in growth for these sectors in the past five years are summarized in the figure below. The interviews also revealed that the most significant points of integration include use of ICT for improving efficiency and effectiveness of business systems and processes, customization of BDS and ICT products and services to meet customer / user needs, digital marketing and use of social networks to reach new markets and communicate directly with consumers.[214] There is already a trend to work with large, public, and private sector actors to renew and update software systems and platforms, which helps to improve business systems and processes, including financial management systems, such as QuickBooks, Unit 4, SAP, and others. The low cost of simple solutions that address the business needs of MSME sized companies is also growing as these smaller firms demand well-tailored solutions and mobility of applications. Some of the challenges perceived by interviewed experts also include the skepticism of clients that would be first-time users of technology, especially among MSMEs with limited resources to invest. But as some CDE center managers noted, the networking done through their centers reduces doubts for the new client and with a very low cost (sometimes subsidized) for basic services it makes it possible to break the ice and prove the value of ICT services to these new MSME clients. Other barriers include access to finance for BDS and ICT service providers, availability of qualified ICT and BDS professionals, including both technical capacity and domain of the English language - closely related challenges present in the current academic and educational programs offered by Honduran universities. Some of these are challenges that are still to be overcome in following years.

Figure 66 Challenges faced by BDS/ICT Sector in Past 3-5 Years



[213] https://sbdc.mccoy.txstate.edu/about-us/economic-impact.html
[214] Challenges were described by interviewees and the level of importance is measured in number of responses.

Digital transformation is growing rapidly in Honduras through e-commerce, information systems, and business systems and processes. Reportedly, a new generation of young Honduran entrepreneurs are developing ICT products and services, though this is not captured in official statistics.[215] In the public sector as well, ICT is being adopted as an efficiency enhancer and a means to improve quality, transparency and coverage of services. Centrex, SAR, and numerous financial institutions now online services – issuing export permits, submission of taxes, and billing, and ACH transfers through online processes are just some examples of how businesses are using online and mobile services in Honduras to improve efficiency of business systems and processes and delivery of services to customers and clients. But there remains much to be done. Many public and permit related processes are still to be digitalized. Interviews held with Honduras BDS and ICT product and service providers revealed a number of continuing trends and opportunities for expanding SME market for BDS and ICT services over the next 3-5 years. The most important challenges perceived by interviewed experts for the near future are summarized in the figure below.[216]

Figure 67 Challenges for Growth of BDS & ICT in next 3-5 Years



These trends are influenced by changes in both the global and national environment, which in many cases, influence customer preference, and levels of demand. The BDS market has had ample participation from international cooperation actors and academy, but experts feel that it is primed to shift to more sustainable and impactful private-sector-led models, which in turn would leverage the potential for systemic change and support for enterprise growth. Global evidence shows that BDS is positively correlated with increased investment, sales, and jobs. A systematic review of studies by the Kauffman Foundation found that business services demonstrate a positive impact on SMEs, with a pooled effect of 21.9 percent on sales performance, 9 percent job creation, 8.9 percent labor productivity as well as increases in exports and investment rates.[217] The CDE network in Honduras reports similar positive effects in the las three years of operations, creating and average 10,000 new jobs every year, and $4.8 million increased income[218].

A number of BDS and ICT providers interviewed highlighted a shift in market trends, from selling hardware and software solutions – such as Microsoft Office Software, local data servers, and intranet –to selling licenses, accompanied with services to meet customization needs. This has created new opportunities for these service providers through layered services provided through the life of a license, for example, continued adaptation and customization of the initial service, and even advising on business and ICT integration and expansion strategy. These BDS and ICT service providers are adapting business models to meet new demands and future opportunities resulting from this shift.

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[215] The GoH has not developed a specific code for exports of software products.
[216] Challenges were described by interviewees and the level of importance is measured in number of responses.
[217] Piza C, Cravo T, Taylor L, Gonzalez L, Musse I, Furtado I, Sierra AC, Abdelnour S. The Impact of Business Support Services for Small and Medium Enterprises on Firm Performance in Low- and Middle-Income Countries: A Systematic Review. Campbell Systematic Reviews 2016:1 DOI: 10.4073/csr.2016.1
[218] Difomipyme. "Estrategia de apoyo Presidencial a la MIPYME, Centros de Desarrollo Empresarial", 2018.

Another shift that was highlighted during the interviews is the increasing market for cloud-based software and services. One effect has been growing access to international BDS services and ICT solutions. This has both increased competition for Honduran providers, as well as opened new business opportunities for Honduran firms.

MARKET OPPORTUNITY

Market research noted differences in demand according to client size, where demand changes in ranges from micro to large. An interesting preference across enterprises is the for direct marketing channels versus traditional mass media. Enterprises reportedly rely mostly on traditional 1-on-1 marketing e.g. word-of-mouth, etc. as well as social media and networking to identify new clients. Advisory services, especially training, are heavily subsidized for micro-small businesses, and even for medium-sized clients. When delivered through the CDEs[219] these services, and even products such as tailored ICT software, is subsidized. The willingness-to-pay for this segment is less certain - demand is best described as incipient. It's important for the sector to take a stronger market-orientation and develop services that are scalable without the need for ongoing subsidies. ICT innovation is promising in that it can significantly reduce delivery costs and opens up new distribution channels for services under SDE

***Figure 68** Characteristics and development needs by type of enterprise.*

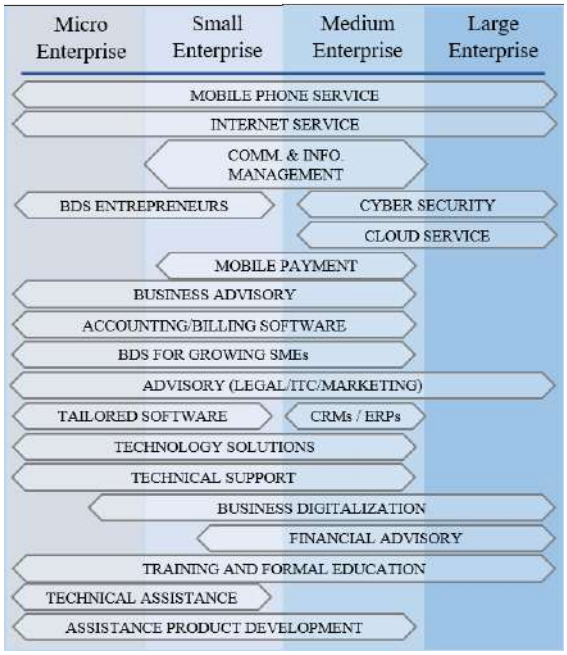
Type of SME	*Characteristics*	*Business Development Demands*
Necessity-oriented microenterprises	Pursue self-employment out of an obligation to supplement family-income or for their own survival versus the pursuit of an opportunity.	-Basic business management skills -Basic systems to improve efficiency e.g. bookkeeping -Buyer identification, some sales and distribution -Support to meet formalization requirements -Skills development, largely technical
Growth-oriented MSMEs.	Perceive an economic opportunity to expand their client pool and grow market share. Willing to commit resources and take risk in order to grow.	-Support to meet formalization requirements -Sales and marketing: new product development branding, trade shows, e-commerce, certifications -Business processes: legal, accounting and payroll, etc. -Skills development both technical and managerial -Business model validation and coaching/mentoring -Networking opportunities e.g. new buyers, patient capital
Established industry SMEs	Have an established customer base but are looking to expand their geographical area or open the possibility to offering new products to its customers	-New product development, business intelligence, data consulting, trade shows, e-commerce, etc. -Networking and innovation-seeking -ICT and digitalization -Lean manufacturing of processing and personnel e.g. middle-management to manage complex structures, and systems efficiency (HR, accounting, legal, digital) -Enterprise risk management e.g. climate-change
Large Enterprise	Tendency to focus on maintenance of market share - stable and small pool of large enterprises in Honduras.	-Greater supply chain or distribution channel efficiency -Innovation support e.g. new product development to maintain client base and share in market -Digitization, certifications (ISO), etc.

Microenterprises. Micro and small enterprises are more likely to use assistance from national and international service providers, such as international donor programs, CDEs, and university

Figure 69 BDS/ICT Demands by Enterprise Size

[219] CDE standing for Centro de Desarrollo Empresarial, Private/Public BDS centers in a network of 14 that have been developed with the help of the Secretary of Economic Development and the private sector represented by COHEP (Honduras Council for Private Enterprise).

programs/incubators. An estimated 13 percent of micro and small enterprises receive BDS, not including agriculture sector clients, which are served also by numerous NGOs and donor programs and sector associations. Microenterprises were reportedly interested mostly in identifying a specific buyer. According to CDE center´s experience, there is limited awareness by microenterprises on how to use digital media and the impact it can have for their businesses. A growing demand for digitalization among micro-small size enterprises was acknowledged by all interviewees, especially for accounting systems, human resource management software and mobile apps that help control staff, processes and stay in touch with clients. Micro and small businesses reportedly prefer tailored solutions that are low cost and hired through freelancers, which is oftentimes less inexpensive than off the shelf software.



SMEs. Small and medium enterprises tend to be more oriented than microenterprises towards exports and look to branding, marking, packaging, and stronger on-line presence. The trend for SMEs is not to use mass media, but rather investing in B2C (business to consumer) marketing, relying on digital marketing, customer loyalty, and social networks to generate new referrals. An SME Diagnosis conducted by IADB[220] to non-agriculture enterprises in 2013, showed that in fact only large-medium size businesses use traditional mass media and approximately 10-13 percent of SMEs use flyers, posters, and customer reference sheets. Business is reportedly growing for local graphic designers and digital printing services for SMEs. Both IADB and COHEP conclude that SMEs invest a larger percentage of their budgets in ICT (26 percent for micro enterprises, 53 percent for small ones and 75 percent at medium size enterprises).

Large enterprises. The SME Diagnosis conducted by IADB[221] to non-agriculture enterprises in 2013 shows that in fact only large and medium-size businesses use traditional mass media. Larger enterprises use more off the shelf software like QuickBooks and more powerful ERP and CMS software like SAP. But large enterprises are also increasing their use of local programmers for higher degree of personalization and customization. This in turn has increased the need for one-on-one, continuous service and support accompanying ICT related business solutions, creating more opportunities for BDS firms to layer-on additional support and services.

ROLES

This section highlights some of the significant findings and questions regarding the roles which TMS identified for these two market segments. Currently there is no good source for statistics on existing enterprises or their clients. Therefore, this analysis is based on first-hand information gathered through the sector interviews and several surveys and studies.[222] The array of service providers is ample, but at least 9 companies that provide marketing advisory can be accounted for, also 74

[220]Valenzuela, C. (January 2013). Diagnóstico de la Mipyme no Agrícola en Honduras. Retrieved from https://tuxdoc.com/download/diagnostico-sectorial-de-la-mipyme-no-agricola-en-honduras_pdf
[221]Valenzuela, C. (January 2013). Diagnóstico de la Mipyme no Agrícola en Honduras. Retrieved from https://tuxdoc.com/download/diagnostico-sectorial-de-la-mipyme-no-agricola-en-honduras_pdf
[222] MSME diagnosis conducted by IADB in 2013; and the enterprise surveys conducted by COHEP in 2013 and then in 2017.

registered financial and accounting firms, 187 technical schools, 19 advanced education institutions (including universities), and 95 ICT companies. The main roles and type of institutions are presented in the following table.

***Figure 70** Main actors by type of role*

Roles	Main Actors Identified
Marketing	• 5 Companies focus on Medium-Large Clients • 4 Specialized survey companies
Financial/ Accounting	• 74 registered providers
Training and Education	• 187 Technical Training Schools • 4 Technical Training Centers • 1 Public University • 14 Private Universities
Business advisory	• Highly atomized market, NGOs, independent, associations & more • Highlight CDE Network, with 38 service points and 152 staff
Software/Hardware Services	• 95 ICT Companies • 5 Large Software /Hardware Distributors
Mobile/Internet Services	• Private providers (TIGO & CLARO) 99% clients • 1 Public Provider (Hondutel)
e-money	• 2 Strong e-money operators (Tigo-money, and Tengo • All Banks are authorized to operate digital banking

The sections below describe the actors that are involved in the supply of BDS and ICT services:

Marketing. There are 9 large companies identified, but many more smaller exist, mostly marketing firms aiming for large to medium size enterprises. Market research firms do mostly market perception studies, branding, customer satisfaction, and opinion surveys for large, established companies. Some of the more recognized market research firms in Honduras are Unimerc, Mercaplan, Marketing Total, Espirálica, Insight Marketing Research and DELCO Marketing. The shift to digital marketing, particularly through social media (Facebook and WhatsApp, webpages are less common) is a general trend and the use of WhatsApp is particularly stronger in rural areas. Marketing and ICT firms noted that digital marketing helps SMEs to become more competitive as investment is cheaper compared to traditional methods like print marketing. Some interviewees indicated that in print media shops, providers often provide advice on use of products, but charge only for materials. Marketing support is also embedded in additional products/services. For example, a firm developing an online payment system may get strategy and business models advice on how to improve online marketing. Experts noted that a challenge for the marketing industry is the lack of available statistics and market intelligence data around which to develop strategies to reach new clients.

Training. The official labor training center in the country is INFOP, which is financed by the private sector. Some 8,000 companies with 5 or more employees are bounded by law to contribute an equivalent 1 percent of their payroll to INFOP[223]. Training programs reportedly do not meet the needs of the private sector and require more tailored content, better equipped labs, and training schedules that are suited to work schedules. INFOP has begun an online MOOC (massive open online courses) offer since 2016, but its limited and very basic. A recent request has been elevated by COHEP to begin a transformation process and change management of INFOP to the private sector. There are technical schools which are popular because their education programs prepare high school level students in mechanical, electrical, carpentry, and similar trades. Small cities and rural

[223] Figueroa, J. (2014, February 2). Revisaran aportes de empresas al Infop. *La Prensa.* Retrieved from https://www.laprensa.hn/honduras/tegucigalpa/461395-98/revisaran-aportes-de-empresas-al-infop

communities have limited access to formal education programs and on-line courses, though growing, are still very limited in their offer. Online courses from EDx, Coursera, Mx, and others are satisfying this educational gap, but more tailored programs from local institutions are required. Experts emphasized that another need is leadership skills training for new and existing entrepreneurs.

Figure 71 Technical Schools in Honduras

187 technical private and public schools in Honduras but the most popular are in the cities of Tegucigalpa and San Pedro Sula, mainly Centro Técnico Honduras Corea, Centro Técnico Hondureño Alemán, and Centro Técnico Sampedrano, Centro de Formacion Profesional San Juan Bosco are top of the list. Three other technical training centers are relevant in the market, but are much smaller than INFOP. These are Centro Asesor de Desarrollo de Recurso Humano (CADERH) in the city of Comayagua (the only one that delivers programs with an International certification), Centro de Crecimiento de Recursos Humanos (CRECERH)[224] and Red de Desarrollo Sostenible (RDS) which provides mostly web-based education. There are an estimated 19 accredited public and private institutions of higher learning in Honduras, but despite their variety, most of these are concentrated in the urban centers of Tegucigalpa and San Pedro Sula. In Honduras there is only one public university, the rest are private institutions and all of them (e.g. UTH, UNITEC, UNAH, UNICAH, UPNFM, UNCEM, UMH) have an academic offer for BDS and ICT sectors. Experts believe their training needs go beyond university degrees, like Computer Engineering or Telecommunications Engineering. They require short courses to teach specific abilities for their work force, like specific programming languages, UX – UI experience, hardware – software, among others.

Advisory services. Advisory services are composed of many independent consultants, NGO and donor-based projects (in most cases temporary) and some permanent institutions that provide services. The services are typically concentrated in the large cities and have a limited coverage, particularly to rural micro-small businesses. The most relevant actors in this segment is the CDE network, a public/private initiative created to promote MSME development (see text box below). COHEP´s MSME sustainability strategy[225] identifies the need for MSMEs to improve human capital, provide leadership training to managers, and formalize operations to fulfill legal requirements. There is a notable gap in service provision around entrepreneurship – a vital feature of an economy. In Honduras there is a notable absence of business incubators and accelerators to provide support to new entrepreneurs and enterprises including business strategy and startup. Only a handful were identified in SPS, Tegucigalpa and two of the largest private universities, which have incubation programs, but each of which work with a very small number of students each year. The Honduran Institute for Sciences and Technology (IHCIETI) for example supports the tech entrepreneurial community and have developed the biggest startup competition in the country, called Honduras Startup. This competition gives entrepreneurs the opportunity to compete for an incubation program and up to L.1 million in seed capital.

Figure 72* Centros de Desarrollo Empresarial *(CDEs)

CDEs have adopted the UTSA SBDC methodology to provide an holistic approach, giving services ranging from organizational support (legal, permits, planning, start-up), training and T/A (both inhouse and with external alliances), ICT training and service, business strategy and design, market analysis (just getting started), new product development, and finance (budgeting, costing and specially access to credit through alliances with FIs). The CDE approach is also developing larger networks with private actors to integrate market driven value chain development approach. Moreover, since the academy is mostly disconnected from the business world and are only recently running small incubation programs, CDEs are networking with universities and research centers, to provide proper training and innovation to their clients. This is a

[224] http://www.crecerh.com/wp-content/uploads/2017/12/Catalogo-Consultores-2018.pdf
[225] COHEP (2017). Estrategia de Empresas Sostenibles en Honduras. Retrieved from http://comunidadilgo.org/cohep/estrategia2.pdf

promising development but it´s still in early stage development, as just this year they achieved a full coverage of the country, but most centers are still highly dependent on government subsidies and are working with few staff.

ICT. There is a wide array of ICT service providers; including, national and international enterprises, on-line and cloud service providers, large telecommunication companies, and freelancers. SODISA, APPLAND, TECNASA, and UNIONPYME are several local software companies that have a portfolio of local and international clients. Several ICT enterprises interviewed indicated that they are adapting their business model from a product to service-orientation, layering additional services and products to help enterprises adapt to digital technology. However, it has also created opportunity for freelancers – both local and international, and foreign ICT firms that can compete against larger local firms, but with much lower operating costs. Startups and technological entrepreneurs are the new players in the ICT sector. They have a drive to expand and produce quality services and products by whichever means are available. Actors like Sube LA, Chekku, AUREM, Pixel Pay, Cloudbiz, ICOMS, among others, are offering ICT and BDS services to the public, targeting MSMEs and other entrepreneurs with affordable services. They have been in the market for over a year, and have established formal operations that are already generating revenues. A challenge to the growth of these actors are that many managers actually lack the data to analyze sales statistics, client satisfaction, KPI, and similar to make proper cost/benefit decision on ICT investments.

Mobile Money. Only two providers stand out, Tigo Money and Tengo (electronic payment system established by Banco Ficohsa). Tigo has one million users and Tengo has two million. Both offer the ability to transfer money between members securely and conveniently and pay to affiliated private and public service providers. Tengo has also partnered with money transfer companies like Xoom and Regalii so individuals who live in the United States can safely pay bills on-line. Experts noted that less than 1 percent of transactions in the country are done through electronic purses and according to the Center for Financial Inclusion, only 3.4 percent of Hondurans have a mobile wallet account.[226] The growth of on-line banking is very high, according to the Center for Interbank Processing (CEPROBAN) in Honduras is four-fold from 2010 to 2017. [227] And all of the largest banks and international banks like Ficohsa, Banco Atlantida, BAC, Lafisse Bank, Banco de Occidente, BANPAIS and DAVIVIENDA offer a full menu of on-line banking services. At the end of October 2017 carriers reported a total of 2,335,470 operated ACH transactions amounting to L.60 trillion. [228] There is enormous growth opportunity for mobile money. If we consider the country has one of the lowest levels of financial inclusion in Latin America (the 2016 Global Microscope[229] estimates below 30 percent of the population has a formal account at a financial institution), electronic financial services have strong potential to close this gap. There are several barriers to growth of this sub-sector. The first is the need for higher levels of technological literacy to foster greater confidence and use of fintech. The second has to do with e-money regulations (see Rules).

RELATIONSHIPS

Enterprises within the BDS and ICT sector are loosely organized, in part because of the diversity of actors and general levels of informal micro-small businesses and freelancers and also because a

[226] Serman, H. (February 10, 2016). Mobile Money and Honduras´ Financial Inclusion Landscape. Retrieved from https://www.centerforfinancialinclusion.org/mobile-money-and-honduras-financial-inclusion-landscape

[227] https://www.elheraldo.hn/economia/1072800-466/honduras-conozca-los-pros-y-contras-de-la-banca-electrónica

[228] https://ahiba.hn/ceproban-lanza-ach-pronto/

[229] Center for Financial Inclusion. (October 7, 2016). The enabling environment for financial inclusion. *Global Microscope, 2016*. Retrieved from https://www.centerforfinancialinclusion.org/global-microscope-2016

general low perception for the value of associativity predominates in all sectors. The most relevant relationships identified by TMS for these two sectors are described as follows.

Business Networks. Chambers of commerce are the most common and widely available network for businesses, but many are small and provide very little value to members. The chambers of commerce for Tegucigalpa, San Pedro Sula, and Choloma reportedly have stronger membership and a significantly higher supply of services. The Chamber in Tegucigalpa for example provides registration services for all new businesses in Francisco Morazán; manages a mobile guarantees system that facilitates access to credit, delivers a range of trainings, including communications, public relations, and graphic design; conducts marketing for members through their web page and magazine; provides an arbitration center; and runs an incubation program for innovative startups (Honduras Emprende). The Chamber in Cortes (San Pedro Sula), created their start-up and growth program called "Bazaar del Sabado", which provides BDS to MSMEs, which has been successfully replicated in other Chambers. Other services delivered include permitting windows created in association with municipalities and SAR and the on-line company creation service (Mi Empresa en Línea) – this so far only through the web pages of Tegucigalpa and Cortes Chambers. The *Asociación de Medianos y Pequeños Industriales de Hondura*s (ANMPIH) is an MSME association that is mainly focused on influencing policy, but does have a limited offer for training.

Public-private. CDEs have also established promising networks with 167 different institutions (25 public, 122 private, and 20 academic) across its network of 14 centers. Through these partnerships, CDEs increase the availability of training for their clients, integrate a roster of consultants available for specific SME needs, establish alliances with FIs to increase access to credit, and connect SMEs with markets. These are all recent relationships that have demonstrated potential and are beginning to create some results, but specific statistics are still not available. The CDEs are also integrating efforts and knowledge at a national and international level. The Honduras CDE network participates in international events and an annual congress held for CDE networks in the region. Relationships between CDEs and chambers of commerce have supported alliances with municipal and central government. Mainly the integration of processing windows in some CDEs and the on-line processing platform available in Tegucigalpa and San Pedro Sula Chambers of Commerce. Institutions like ARSA, IP and SAR provide paperwork and collaboration with the private institutions to speed up processing and give counseling when required. Through these relationships, public institutions also provide counseling and training about changes in permitting and recently relevant changes in taxation laws. Creating more windows that provide in-situ information for entrepreneurs and assure proper procedures when soliciting licenses and permits has a great value for development of the sectors.

ICT Associations. The newly created association ASETIC has the mission of representing ICT entrepreneurs and advocating for its members with other service providers, as an effort to share costs and possibly provide services to larger clients through its members. Examples of the cost sharing is purchase of software licenses that an individual SME cannot afford or hiring programming expertise (international mainly) to provide training or algorithms for several local programmers at a time. Another association, ASEMTECH, has in its members mostly MSMEs and five large foreign companies, creating a cluster that provides goods and services to small, medium, and large Honduran companies[230]. Some of the benefits to members include being listed in a roster of service providers, partnering among members to provide a wider range of service to larger

[230] http://asemtech.org/asociados.php

clients and scaling of costs. For these ICT associations, the most important goal is to develop a stronger ecosystem for services developed in Honduras and abroad. The Honduran market shows distrust, or lack of confidence in the performance benefits of ICT solutions, and pricing is sensitive to the low investment capacity of most clients. These associations are trying to improve these issues by establishing proper business profiles for clients, sharing investments to reduce costs, and developing skills certifications in the sector.

Academic Institutions. Technical training and formal education was generally perceived in interviews with experts, as not meeting the needs of businesses in BDS and ICT sectors and thus revealing a lack of relationships among institutions. No alliances were detected among universities and their partnerships with CDEs are new and many still weak. Besides permanent internship programs, the only interaction that stands out is in some private universities (UNITEC, UTH, and UPNFM) and the public UNAH, which have established small entrepreneurship centers. In these centers the efforts go straight to the incubation of student entrepreneurs who foster innovative solutions for real market problems or opportunities. This stagnant interaction with academic institutions is a reason why sectors like banks, maquilas, and call centers have created their own training centers to provide appropriate skills for their employees and at lower costs. A recent effort done by CEUTEC is the creation of a technical career for call centers, but it was sponsored by the Government Commission (CONATEL) and not directly with sector enterprises. For the public training center INFOP, the problems are the same. The highlight for INFOP is their newly improved online courses for SMEs and entrepreneurs in topics like business model canvas, web campaigns, marketing, finance and costing, entrepreneurial spirit, among others.

Contracting. Among sector competitors only two types of relations seem to be strongly embedded, sub-contracting and outsourcing. Companies in both sectors create alliances by sub-contracting competitors, to meet increasingly diverse needs from clients. This sub-contracting was more noticeable among interviewed advertising and marketing companies and software development companies. A common reason for sub-contracting among ICT enterprises is to use freelancers on a temporary basis, to meet rushed delivery schedules and other immediate needs. There is a growing trend among larger enterprises to outsource work, specially to MSEs and freelancers which can lower their operating costs. In the ICT sector, both TIGO and CLARO have outsourced all home and corporate installation and support services. Sector associations are a way in which companies access a larger pool of MSEs and freelancers, mutually benefiting with the diversity of resources and competitive prices for the larger companies and creating more work for the small actors. Companies cited instances in which subcontractors attempted to negotiate directly with clients, bypassing the firm and, more importantly, undermining the relationship. Another negative aspect of these relations is that large companies also use them to avoid paying labor benefits, which the smaller companies and/or freelancers are not able to provide for their employees.

RESOURCES

Human capital. As noted before, the ICT and BDS sectors consider that academic institutions lack the appropriate training programs to provide the technological skills required by these sectors. From a global perception, Honduras presents a general disadvantage in human resource quality when scored for the Higher Education and Training Pillar (WEF GCI 2017/2018), which is 3.6 on a 1-7 scale and it´s lower than the LAC average. Honduras scored even lower in the Technological Readiness Pillar

of the same global index, with 3.3 and also below the LAC average. [231] This lack of skilled talent reportedly makes it difficult to attract international investment. Since the ICT sector is already operating in a global market, they are clearly affected because Honduras is not perceived by international clients as a top destination offering ICT services. The young working population in the country is almost 60 percent and Honduras has one of the highest bilingual populations in the region - bilingual high schools graduate 10,000 new students every year. But because the potential in this human resource is underserved by an outdated education system and because BDS and ICT sectors require highly skilled professionals, this is viewed as a higher hurdle to overcome. Vulnerable population require more specialized training to actively participate in these sectors since both require a high level of skills and knowledge in technology, sciences, mathematics, etc.

Finance. ICT and BDS enterprises consider access to credit an obstacle for growth. Without a mortgage guarantee, many businesses in this field are unable to secure formal credit. For ICT enterprises securing new loans presents an additional hurdle due to the intangible nature of their product and inability to register it as collateral. There are few public alternatives available, but the largest source of funds is BANHPROVI and their second-tier loans through the banking system, where obstacles persist for MSMEs. Alternatives like venture capital or angel investor funds are not available. Micro-finance institutions and savings and loan cooperatives are more flexible and, in fact, have a stronger portfolio of MSEs, but they don´t have products related to BDS and ICT services, so the market remains very restrained.

Telecommunications Infrastructure. The strong synergy between BDS and ICT sectors shares a key resource: mobile communications. But services are concentrated in two companies and according to an IADB expert analysis[232], this is reducing competitiveness and pushing prices up for broad band services. The analyst also pointed out issues with CONATEL´s poor management of FITT funds, high wholesale tariffs and inefficient distribution of radio spectrum. In the global competitiveness report for 2017/18 Honduras scored low on two pillars closely related to Telecommunications and is actually among the worst 3 countries for internet access in LAC. In a 1-7 scale, Honduras scored 3.3 on Technological Readiness, and 3.2 on Infrastructure. Despite the bad scores, the country reflects a high growth tendency for internet access and mobile broadband and that means the situation has improve in recent years.

RULES

Many interviewed BDS and ICT providers believe the sector is overshadowed in national policy and there is a general sentiment that for the government the sector is of little importance. Many interviewees consider Honduras is not recognized as an international ICT hub because the government is not doing an effective promotion of the sector. Implicit in this perception is that it is the role of the government to promote the sector, create incentives, and attract investment and business. BDS and ICT providers did not seem to indicate or take on the challenge that they may play as leaders in this regard. Confounding this issue is the lack of official statistics on the country´s ICT sector in terms of revenue by category, contribution to GDP and inclusion of women, youth, ethnic groups, and other marginalized people. This may be aligned with weak leadership and the lack of coordination and organization. Only two organizations exist in the ICT sector, and hopefully the

[231] Schwab, K. (2018). The Global Competitiveness Report 2017-2018. Retrieved from http://alianciapas.sk/wp-content/uploads/2017/09/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf

[232] Mejia, O. (2018, April 30). Lenta agenda digital retrasa acceso a banda ancha. La Prensa. Retrieved from https://www.laprensa.hn/economia/dineroynegocios/1173867-410/agenda-digital-acceso-banda_ancha-internet-conatel

newly formed ASETIC association may possibly shift towards ICT providers organizing to influence policy. The most important policies and informal rules related to the BDS and ICT sectors are below.

ICT. This sector as a whole, and in particular e-commerce, lacks a regulatory framework. The law for e-commerce and e-money (Decreto No. 149-2014) is still inapplicable, and while the banks commission has done a good job in operating mobile payment regulations, no progress has been made for e-commerce. For example, no institution is currently responsible for regulating e-commerce and no tariff codes exist to register software and ICT exports, creating an information void for the sector. E-commerce companies have to operate and get permitted with regulations intended for traditional businesses. Another issue with permitting was noted by graphic design companies, because import permits for the industrial machinery they use is very strict and cumbersome. In addition, these permitting processes and regulations are not unified across municipalities. Experts suggested that the Orange Economy Law (*Ley Naranja*) in Colombia and statistical system used in Chile are benchmarks for examples that could be adapted in Honduras.

E-money. The Central Bank (BCH) and Banks Regulations Commission (CNBS) are responsible for regulations regarding e-money in Honduras and these existing regulations were created in 2016. The framework has been criticized for being restrictive, and even contradictory to international best practices.[233] Honduran regulations exclude small businesses, fintech SMEs and independent merchants (physical persons) from e-money networks. Agents and merchants have to be legally established businesses to join the network and agents that want to buy and sell e-money must also endorse a minimum capital of $1.25 million. Also, the ecosystem is limited to agents and merchants legally established in Honduras, excluding any international companies from affiliating, and clients have a cap of $830 per month in their e-wallet. Finally, agents managing e-money purses must report the trust account balance as an asset, becoming dutiable and creating an unfair cost to the operation. These regulations also impose unnecessary intermediation and additional costs to actors that are excluded from affiliating to the network.

E-signatures. There has been advances in the key use of e-signature in the public sector. The BCH became the first e-signature certification agency in the country in April 2017. The *Direccion General de Propiedad Intelectual* (DIGEPIH) is the agency responsible to provide accreditation to e-signatures service providers. So far, SAR, IP, CENTREX, and the Deputy Directorate of Customs Revenues (DARA) are operating with e-signatures. Despite this progress, there is no private company registered in Honduras as a certified provider of electronic signatures services.

Entrepreneurship. In Honduras the law for MSMEs Promotion was passed in 2008 (Decreto No. 135-2008) but it does not provide needed policies and incentives for entrepreneurship. El Salvador, Costa Rica, and Panama have entrepreneurship regulations, while in Guatemala this year an Entrepreneurship Law was passed. In Central America, Panamá, Belize and Dominican Republic there is a regional Entrepreneurship Strategy called "SICA EMPRENDE", it operates under the "Sistema de Integración Centroamericana" (SICA) initiative. The purpose is to create a homogeneous entrepreneurship environment in all the region. Honduras is modifying it´s law and the new bill, to be passed this year, was co-created with private actors and is expected to include the first Entrepreneurship Policy.

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[233] Frydrych, J. and Sanin, J. (September 21, 2016). Regulation in El Salvador and Honduras: On The Brink of Enabling. Retrieved fromhttps://www.gsma.com/mobilefordevelopment/programme/mobile-money/regulation-in-el-salvador-and-honduras-on-the-brink-of-enabling/

Contracting and bidding. Many BDS and ICT providers identify the bidding and tendering process as a challenge with both government and private sector actors. Many firms note that due to high competition, and weak mechanisms to enforce fair bidding, tendering, and contracting ICT firms characterize the competition as unfair. A lack of technological awareness and marketplace norms during the procurement process, contracting companies tend to overstate and misstate requirements. This results in increased operational and legal obligations and costs that bidding firms transfers into their price and creates an apparent limited pool of qualified firms operating on a price-based competition. Changes in procurement requirements or even awarding contracts that are later re-negotiated is frequent and this generates mistrust down the line. These processes discourage the participation of smaller companies, favoring more well-established firms. It has also led to a proliferation of freelance-based work which has further undercut the growth of smaller companies.

Taxation. The application of tax laws is a recurrent challenge for the Honduran industry and in the 2017/18 Global Competitiveness Report tax rates scored as the number one obstacle for doing business, while tax regulations scored fourth. Honduras reports the highest tax rate in CA, estimated by the ICEFI (Instituto Centroamericano de Estudios Fiscales) at 18.8 percent of GDP in 2017 and the average for CA is 13.9 percent. There are no current tax incentives for MSMEs in the ICT and BDS sectors and new procedures established by SAR with the purpose of reducing tax evasion have created cumbersome, expensive and time-consuming processes. These processes are also causing frequent non-compliance and its resulting penalization and while the penalties can be afforded by larger firms, many smaller ICT businesses were reportedly forced to shut down due to unpayable tax debt. Although the SAR has a digital office and on-line payment process, MSMEs also indicated a lack of support in seeking tax advice or when filling out forms.

Intellectual property rights (IPR). The legislative framework for IPR, which includes the Honduran copyright law and its industrial property law, is generally adequate but often not effectively implemented by the Property Institute (IP). The Honduran legal framework provides deterrence against piracy and counterfeiting by, for example requiring the seizure, forfeiture, and destruction of counterfeit and pirated goods and the equipment used to produce them. The law also provides for statutory damages for copyright and trademark infringement, to ensure that monetary damages can be awarded even when losses associated with an infringement are difficult to assign. But enforcement is weak and as a result intellectual theft and piracy is common in Honduras. For ICT service providers this is a more relevant issue regarding software development, but sector interviews also noted a significant lack of knowledge and advisory regarding IPR among MSEs.

Telecommunications. CONATEL (Comisión Nacional de Telecomunicaciones) is the regulator for all telecommunication activities in Honduras. CONATEL created the Information and Telecommunications Management Office (TICS) and the Investment Fund for Telecommunications and Information and Communication Technologies (FITT), which is managed by TICS. The FITT is funded with a 1 percent of mobile phone service gross sales reported by operators Claro and Tigo. This fund is relevant for the universal access and service of information and communication technologies in Honduras (Decree number 325-2013 Framework Law for the Telecommunications Sector). FITT also has the purpose of financing ICT infrastructure development nationwide, but no reports are published regarding the application of the policies and investments made with FITT.

RESULTS

BDS and ICT can be used together synergistically to develop a set of integrated tools that will help MSMEs to innovate and grow. Working with local providers and BDS providers, like CDEs, applications can be made to lower the cost of delivery of business services and better reach client segments. There are also important hurdles to overcome such as lack of market information and the need for a quicker process to test and validate these solutions. Incorporating an entrepreneurship lens to the sector will help to target innovations towards growth-oriented MSMEs with the greatest potential in terms of sales, jobs and broader system-level innovation.

A process of digital transformation at all levels through capacity building and pilot projects is require so private sector can fully engage into the digital world and benefit from a new digital economy. All the sectors analyzed by TMS require information systems, e-commerce solutions, mapping of actors and infrastructure to make them visible etc. so the opportunities are endless. International cooperation projects, central and municipal government could benefit from outsourcing baseline information, reliable statistics and monitoring and evaluation services.

An important area for innovation is in helping MSMEs navigate the complexity of emerging legal and fiscal policies in Honduras. Partnerships with public institutions such as ARSA, SENASA, IP and SAR offer potential to reduce the costs of doing business and create efficiencies that allow MSMEs to pursue new markets. Digital and physical transaction windows e.g. *Ventanilla Unica* facilitate the flow of information and reduce the paperwork burden and increase the quality of public services provided to MSMEs. Digitization of permitting and other processes by the above-noted public institutions could be part of the 'tool box' of solutions of an integrated BDS and ICT approach. These should include more widespread use of e-payments and e-signatures to eliminate the need for cash payments and visiting offices, which will lower the economic cost (ex. time wasted in permitting processes) improve transparency by eliminating or reducing opportunities for bribes and graft.

Increased outreach of advisory, training and education, and technical assistance for MSMEs is required to realize sector growth objectives. Demand for, and supply of, BDS and ICT solutions is dependent on the creation of a stronger market for those services. This requires greater awareness and education among MSMEs of different pathways they can take to improve skills and capacities. ICT can help to generate the data that will inform this *business case* for both the demand and supply-side. Increasingly investments by buyers and suppliers alike are required in the human capital to be able to adopt more complex technologies. The realities of the global information economy however increasingly demand these investments to stay competitive.

There are multiple potential ICT applications to solve issues noted in other economic sectors. These include more powerful portals/platforms to access information on-line. It was noted among multiple sectors that on-line directories are needed to find suppliers or to help consumers find their business (in the case of Tourism with TripAdvisor or Expedia.com). The CDE network presents a promising partner to help develop these information resources given their expanded coverage and success in partnering with private sector to deliver demand-driven solutions.

Like any system, such information systems are necessarily built on trust and ownership by an institution that can make a sustainable business case in providing needed services. Like many resources in Honduras, information is one that isn't widely shared between firms. Partnerships with trusted entities, such as CDEs or COHEP, are necessary for these information systems to function and for ICT solutions to take root. COHEP, for example, already plays a recognized role within the

industry in research and generation of market information. The strengthening of institutions like COHEP to perform this function in an inclusive and effective manner is critical to its sustainability.

There are other opportunities to provide tailored ICT/BDS solutions in sectors like agriculture, manufacturing, and tourism. Green Tech is a good example on how technological solutions can be tailored to solve supply chain issues around automatization and traceability. The market is increasingly demanding new and tailored solutions with regards to ICT and BDS. There are opportunities to draw from graduates of local technical universities to develop them. These efforts can also be enhanced through incubation programs – though the direct job effects may be minimal, the indirect effects on the business, or on stimulating a broader innovation system, can be larger.

Online B2C and B2B transactions present another promising growth opportunity. There are a growing number of providers within the BDS and ICT sector that can help enterprises to make the leap to e-commerce. The challenge is the regulatory framework which holds the sector back. Loosening restrictions on electronic payment and signatures would unlock a source of growth for a wide range of MSMEs. While there is an initial skepticism that would present an opportunity, consumer trends can change quickly and there will regional and international market incentives to drive this change.

The heart of the BDS and ICT sector is innovation and entrepreneurship. The absence of such an innovation and entrepreneurship environment is notable in Honduras and requires a fundamental paradigm shift. Innovation hubs like Campus Tec https://tec.gt/ in Guatemala is a good example of what is already happening in the region. Part of the strategy for the sector should focus on bringing in accelerators and incubators and develop greater partnerships between academia, financial institutions, chambers, ICT companies, etc. Moreover, the sector aligns strongly with the interests and institutional mandates of COHEP and SDE. The ingredients for a more dynamic and supportive BDS and ICT sector are present, it is a matter of finding the right recipe that will work in Honduras.



FINANCIAL SERVICES

ANNEX IX FINANCIAL SERVICES

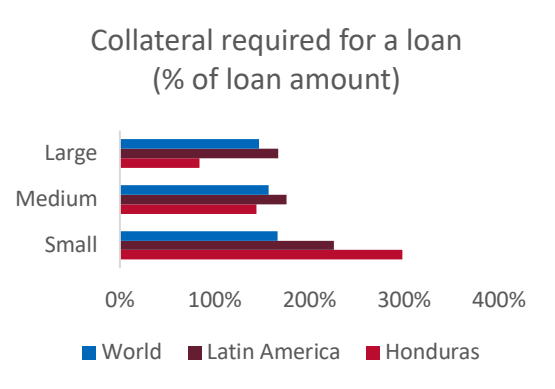
SECTOR OVERVIEW

The financial sector does not serve well the demands of 88% of firms. The majority of enterprises in Honduras cite access to finance as the biggest constraint to their business' growth. While the financial system has grown substantially over the past several years, from 34 percent of GDP in 2000 to 56 percent in 2017, banks manage 88 percent of total capital but serve only 12 percent of commercial entities, who have 25 or more employees, are highly formal, and have significant assets at their disposal. The remaining 12 percent of financial capital in Honduras is managed by non-bank entities such as cooperatives, OPDFs and MFIs. These FIs serve firms with less than 25 employees - constituting 88 percent of enterprises in Honduras. This 12 percent of capital tends to be expensive and short-term and not useful for growth-oriented enterprises of all sizes. There is also a high concentration of capital, as the 5 largest banks hold 76% percent of total assets. At the same time, there is *$4 billion in excess liquidity* that sits idle in these banks, equivalent to 35 percent of total value of current loans, and is significantly higher than the 25 percent regional average. Only 17 percent of the financial system´s lending capital is estimated to go to productive activities and MSMEs must then rely on trade credit, alternative and informal lending, which creates a vicious cycle of expensive capital that restricts growth.

Guarantee funds, specialized institutions and supply chain financing are increasing financial inclusion but with limited scale so far. New entrants into the market like BANHPROVI and Guarantee Fund CONFIANZA have facilitated increasing capital for the productive sector. Confianza for example grew from $2.5 million to $16 million, facilitating $93 million in loans for 27,623 clients. Over-indebted urban clients and violence that increases risk to the business, have had the unexpected impact of pushing micro credit lenders into rural areas, growing portfolio up to 55% with rural clients. There is a plethora of examples of value chain finance, such as input suppliers creating lending products for their clients and/or partnering with financial institutions and other value chain actors to facilitate credit to those with few credit options. There is a broader range of products and services today developed toward the MSMEs segment and a stronger trend is emerging to tailor products for the different economic activities. Again, this is from a low starting point, but some progress is being made that points to potential avenues for future growth.

Technology has the potential to disrupt the financial sector. As a whole, the sector has embraced technological innovation to expand geographic coverage and access. Service desks increased 4-fold and digital banking use grew 80% from 2013—2017, 29 percent of that growth in 2017 alone. This has improved service to existing clients but has not reflected greater credit coverage for 2017. The emergence of new online financial platforms and intermediaries –with lower transactional fees and new techniques and information sources to assess credit risk– will contribute to boost SMEs access to credit. Payment solutions and digital tools to obtain better business financial performance will not only promote digitalization and formalization, but also make the transaction history available to evaluate credit risks, helping to solve information asymmetries that currently restrict lending to MSMEs. All of this can generate a virtuous cycle by solving the persistent challenge of SME informality which poses an obstacle to financial access, impacts SME productivity levels - a fact confirmed by one out of every four Fintech startups in the region focusing exclusively on serving the small and medium enterprises.

The rules and norms around collateral are the single most constraining supply-side factor. There is an opportunity to place part of this $4 billion of excess liquidity into productive enterprises. This requires a paradigm shift in how financial intermediaries and regulators do business. Banks over-rely on collateral as the principal risk mitigation tool, with collateral requirements ranging from 84% of the value of the loan for large firms to nearly 300 percent for small firms, with collateral rates rising sharply as the size of borrower firms and loan request amounts get smaller. FIs may also interpret the regulations in a strict manner and hesitate to innovate or propose or pilot new methodologies. Informal rules, in the case of bank's internal policies and overrule less conservative formal rules, keeping collateral rates high. There is evidence from other contexts that bank consolidation tends to lead to higher collateral requirements – presumably as competitive pressures are lower, it is simply easier for banks to maintain restrictive requirements. The need to move towards 'non-collateralized' financial products emerged from interviews in every single sector among diverse cross-section of actors.



Significant gaps remain in real and perceived creditworthiness of potential borrowers, particularly among MSMEs and especially noteworthy in rural areas of the country. This contributes significantly to the reluctance of FIs of all kinds to extend more credit to viable borrowers. The productive sector is starved of the financial resources it needs to grow to create jobs and grow incomes. It also points to the need to design partnerships with financial institutions to improve the business services and ICT services to build clients' creditworthiness in the form of skills upgrades, business model innovation, with integrated ICT solutions, and higher levels of financial literacy. It also points to stronger alliances between the commercial banking sector and the system of OPDFs, MFIs and institutions serving that currently seek to serve 88 percent of enterprises.

INTRODUCTION

In Honduras less than one-third of the adult population has access to formal financial services. As of 2014, financial inclusion rates[234] were lower for Honduras than for either Guatemala or El Salvador. Women are less likely to have bank accounts than men, and men and women in the poorest 40 percent of households are even less likely. World Bank's 2016 Enterprise Survey revealed access to finance to be the top constraint for small enterprises. It is estimated that only 31 percent of enterprises have access to credit in Honduras, which is significantly lower than the LAC rate of 46 percent.[235] Access to credit is also the most expensive in the LAC region with nominal lending rates hovering around 12 percent (surpassed only by El Salvador and Dominican

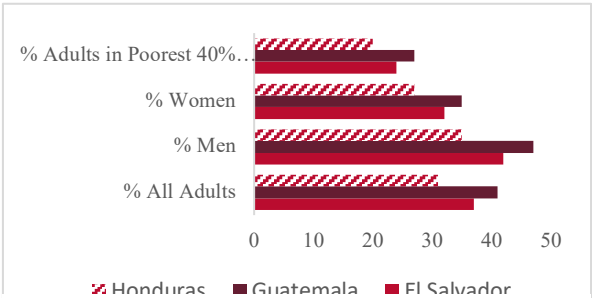


Figure 73 Financial inclusion rates

[234] Demirguc-Kunt, Asli, Leora Klapper, Dorothe Singer, Peter Van Oudheusden (2015) "The Global Findex Database 2014: Measuring Financial Inclusion around the World," World Bank Policy Research Working Paper No. 7255.
[235] World Bank Data. Data.worldbank.org.

Republic). [236] Experts across all sectors noted challenges with respect to accessing to finance. It is estimated only 26 percent of loans go towards production with just 5 percent of total lending going towards MSMEs which comprise more than 90 percent of the formal private enterprises. [237] Despite limited financial inclusion, the Honduran financial sector is growing steadily over the past five years. Domestic loans to the private sector grew from 34 percent of GDP in 2000 to 56 percent in 2017. [238] The total sector portfolio grew from $11.1 Bn in April 2016 to $12.5 Bn in April 2017. [239] The financial sector is also showing signs of increased stability, the Nonperforming Loan (NPL) ratio declined steadily from 3.93 percent in 2013 to 2.6 percent in 2017, and in the same period leverage ratio increased gradually from 9.1—11.1 percent [240], meaning the banks have more liquidity on hand which is a good sign of systemic resiliency.

Honduras' financial services sector is in some ways two different sectors operating in parallel. The core commercial banking sector is integrated by 15 Banks. This system presents high levels of concentration with 76 percent of total assets (reported in $21 Bn) held by the five largest banks[241] which manage 88 percent of the loan capital in the financial system. These banks predominantly lend to real estate/construction and consumers. Loans for production focus on commercial firms that have more than 25 employees, are overwhelmingly urban, and tend to be focused in services, commerce, manufacturing and agribusiness. Financing needs for these firms tend to range from $25,000 to millions of dollars. Banks require clients to provide sufficient financial information and possess ample assets to put up as collateral. All these conditions limit service to MSEs that are in many cases informal, have limited financial information and don´t have assets to pledge as collateral.

[236] Consejo Monetario Centroamericano. (June 2018). Informe del Sistema bancario de Centroamérica, República Dominicana y Pánama 2017 [data file]. Retrieved from http://www.secmca.org/INFORMES/12%20EFR/EFR2018.pdf

[237] Comision Nacional de Bancos y Seguros, CNBS. (2017). Reporte de Inclusión Financiera 2017. Retrieved from https://publicaciones.cnbs.gob.hn/boletines/Boletines%20de%20Inclusin%20Financiera/Reporte%20de%20Inclusi%C3%B3n%20Financiera%202017.pdf

[238] Data.worldbank.org

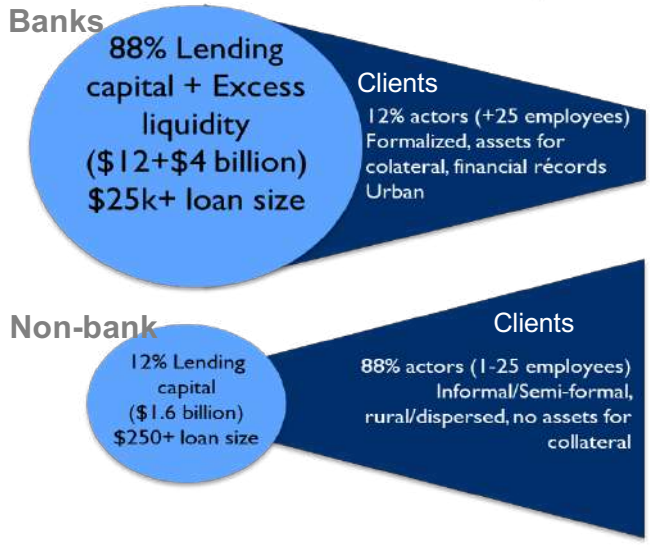
[239] CNBS data, at https://publicaciones.cnbs.gob.hn/boletines/Paginas/default.aspx

[240] IMF 2018 Article IV Consultation Press Release. Accessed 9/27/2018 here: https://www.imf.org/~/media/Files/Publications/CR/2018/cr18206.ashx

[241] Comision Nacional de Bancos y Seguros, CNBS. (2017). Memoria Anual 2017. Retrieved from https://publicaciones.cnbs.gob.hn/boletines/Memoria%20Anual/Memoria%202017%20.pdf

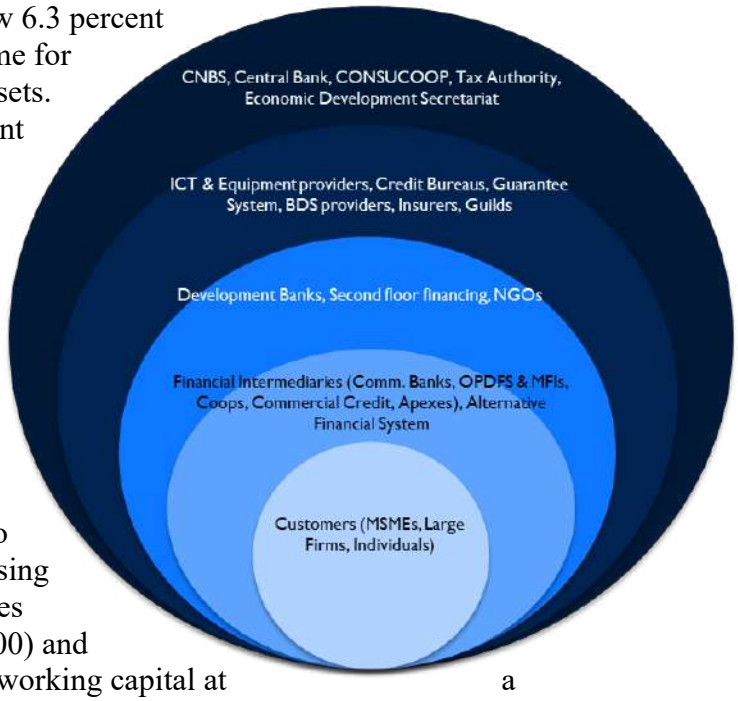
The other sector is comprised of a diversity of regulated and non-regulated financial institutions (FIs); namely, microfinance institutions (MFIs), private financial development companies (OPDFs) and Savings and Loans Cooperatives which manage an estimated 12 percent of total lending capital in the financial system. There are more than 450 operating institutions in this sector with disparate, if sometimes overlapping, focuses, clients, capacities, and mandates. Their clients tend to operate as semi-formal or informal businesses or as individuals. They possess limited assets, are geographically dispersed (e.g. rural Honduras) and with financing needs in the $100s up to $10,000's. Low levels of financial inclusion motivates client in this segment to trade credit, supply chain finance and alternative financing options as cooperatives and associations including *cajas rurales* (village banks). These providers lack the capital and range of financial products, along with competitive rates, to supply capital required to support MSE growth.

Figure 74 Honduran dual financial system



The research included 25 structured interviews across a cross-set of financial intermediaries. The table below provides a quick of the major financial products provided by these institutions to different client segments, segmented by size (household, micro-, small-, medium- and large-), location (rural-) and orientation (growth-, necessity-driven).

History and Trajectory. Overall, financial assets grew 6.3 percent in 2017 and loan portfolios grew 10 percent. Net income for the financial sector amounted to 1.9 percent of total assets. This is a higher profitability compared to the 1.6 percent average for Central America (CNBS), despite low levels of efficiency and rising credit costs. The sector also shows signs of increased stability with healthy levels of reserves and stable NPL indicators. Financial inclusion is however low, and the demands of the productive sectors are largely unmet. The GoH has made MSME development a priority - in response some banks are developing portfolios for MSME lending. Despite innovation in products and services towards the MSME segment, only 2 percent of the reported portfolio in 2017 went to MSMEs. The Honduran Bank for Production and Housing (Banhprovi) recently announced new financing facilities targeted towards SME tourism companies (max $34,000) and hotel companies (max $427,000) for construction and working capital at a concessionary interest rate of 10 percent.[242] But since these products are intermediated through FIs, strict requirements are applied that present insurmountable barriers for many MSMEs to access the



[242] https://www.centralamericadata.com/en/article/home/Financing_Facilities_for_Tourism_Companies

funds. Commercial banks, OPDFs, and MFIs still rely heavily on collateral as the primary risk mitigation tool for loans, with collateral requirements ranging from 84 percent of the value of the loan for large firms to nearly 300 percent for small firms.[243] Banhprovi is starting to assume a direct lending role which is expected to stimulate greater access for underserved MSME clients.

Trade credit presents an alternative to bridge the MSME finance gap. For example, agriculture producers often rely on working capital through input suppliers and large buyers. Several of which are also creating alliances with FIs to providing financing for their supply chains e.g. CADELGA and Consorcio Agrocomercial. The challenge to access to finance is not a liquidity one. Over the past three years, the Central Bank has increasingly absorbed excess liquidity. Banks net position with the Banco Central de Honduras (BCH) climbed from 25-35 percent of current loans from 2015—2018, equivalent to $4 Bn.[244] This is capital that is not being invested in MSMEs and productive sectors. Broader growth in the sector has also been marred by revelations of corruption and money laundering; including, in October 2015 the liquidation of Banco Continental, which held 3.2 percent of total system deposits. Although the CNBS conducted a transparent and effective liquidation process of the bank´s assets and portfolio, the aftermath created greater concerns about compliance risks and stronger controls for formal, semi-formal and informal firms of all kinds, raising barriers to finance providers. [245]

The Confianza-SA-FGR guarantee fund is the primary guarantee fund operating in Honduras and presents successful results - having grown from $2.5 million to $16 million (six-fold) in less than five years, enabling over $93 million in loans for 27,623 clients. This year the presidential office announced the launch of a coffee-sector specific guarantee fund of L6.7 million to facilitate up to L1.9 Bn in lending during the 2018/19 coffee season to offset low international coffee prices. Guarantee funds have proven to be an effective tool to reducing the barriers for specific sectors. Guarantees are however limited in the clients they can support, and of course increase the cost to the clients in the system. Another source of funds to sectors are the individual remittances, which have grown from $3.651 billion in 2015 to $4.331 Bn in 2017, equivalent to 19.5 percent of GDP. But remittances are most likely to access the banking system for remittance transfer and savings services[246] and FI have been unable to channel these funds to investment portfolios.

The financial sector has embraced technological innovation to expand geographic coverage and access; service desks increased 4-fold and digital banking grew 80 percent from 2013 to 2017, with a 29 percent growth in 2017 alone. This has improved services to existing clients but has not yet reflected greater credit coverage for 2017. The emerge of fintech has the potential to reconfigure the structure of the financial sector to better serve small and medium enterprises (SMEs).[247] New online financial platforms lower transactional fees and provide new ways assess credit risk. The growth of payment solutions, for example, can build transaction history and digital footprint for better credit

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[243] IFC Honduras Enterprise Survey data, 2010.
[244] Op. Cit. Ibid.
[245] Comision Nacional de Bancos y Seguros. (2015, October). INFORMACIÓN RELACIONADA CON LA LIQUIDACIÓN DE BANCO CONTINENTAL S.A. Retrieved from https://www.cnbs.gob.hn/files/avisos/aviso-cnbs-22-10-2015-01.pdf
[246] Endo, Isaku, Sarah Hirsch, Jan Rogge, and Kamil Borowik (2010). "The U.S.-Honduras Remittance Corridor: Acting on Opportunities to Increase Financial Inclusion and Foster Development of a Transnational Economy," World Bank Working Paper No. 177.
[247] Ketterer, J. A. (2017). FINTECH-Innovations-You-May-Not-Know-are-from-latin-America-and-the-Caribbean. Retrieved from https://publications.iadb.org/bitstream/handle/11319/8265/FINTECH-Innovations-You-May-Not-Know-are-from-latin-America-and-the-Caribbean.pdf

risk assessment. This can generate a virtuous cycle that contributes to solve the SME informality dilemma, by rewarding steps towards formalization with greater access to finance.

Figure 75 FIs interviewed, and selected products and client segments.

Sub-sectors (# interviewed)	Selected Products Non-Consumption	Demand (D) and Supply (S) per Selected Consumers									
		Necessity-driven MSE		Growth-MSEs		Established MSMEs		Rural self-employed		Medium & Large Ents.	
		D	S	D	S	D	S	D	S	D	S
Commercial Banks (9)	Working Capital	-	-	+	-	+	-	-	-	+	+
	Capex	-	-	+	-	+	-	-	-	+	+
	Leasing	+	-	+	-	+	+	-	-	+	+
	Savings/Deposits	+	-	+	+	+	+	-	-	+	+
	Insurance	+	-	+	+	+	-	-	-	+	+
OPDFs, MFIs (6)	Microcredit	+	+	+	+	+	+	+	-	-	-
	Savings/Deposits	+	+	+	+	+	+	+	+	-	-
	Microinsurance	+	+	-	-	+	+	+	+	-	-
Cooperatives (5)	Microcredit	+	+	+	+	+	+	+	+	-	-
	Savings/Deposits	+	+	+	+	+	+	+	+	-	-
	Microinsurance	+	+	-	-	-	-	+	+	-	-
Commercial (1)	Trade Finance	+	-	+	-	+	+	+	-	+	+
Apexes (4)	Guarantees Wholesale Credit Invest. Capital	These products for financial intermediation are oriented for Commercial Banks, OPDFs, MFIs, Savings & Loan Coops. and Commercial Lenders.									

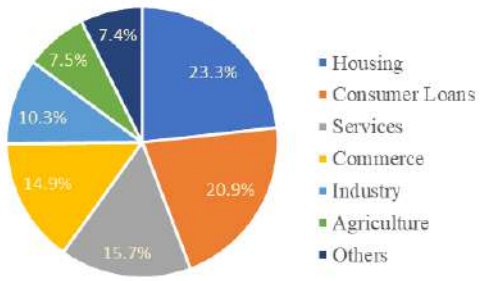
Based on feedback of experts, several products were excluded from analysis:

- *Corporate trade credit:* Experts reported that large firms did not have major issues securing trade credit and therefore there was little to evaluate within this segment,
- *Consumer credit:* Given the focus of the TMS activity on generating jobs as focusing on finance as a service for enterprises, consumer credit was not relevant to analysis,
- *Housing credit:* The sector selection committee excluded residential construction from analysis, so finance for this sector was not relevant for the analysis.

ACTORS

Commercial banks. Banks represent the majority of private sector finance in Honduras, with 15 registered commercial banks, seven of which are foreign. Banks reported assets totalling L503,470 million and a total portfolio of L.277,890 million at the end of 2017. Banks provide a mix of corporate, individual and housing financing. The larger banks also include MSME portfolios. No specialized investment banks operate in Honduras and there is no off-shore banking in Honduras. Banks offer the greatest variety of financial products including debt, insurance, savings/deposits, mortgage, leasing, and consumer credit services. Experts noted however their working capital products are not diverse and investment loans are limited to 7-year terms. The adjacent chart illustrates the sectoral allocation of banks. Agriculture for example employs 34 percent more of Honduras' workforce than industry (28.4 percent vs. 21.2 percent of all

Figure 76 % of Lending by Sector



workers, respectively), but receives 37 percent less commercial investment (7.5 percent vs. 10.3 percent, respectively).[248]

Apexes. Apexes provide wholesale financing to retail financial institutions and large commercial firms active in trade credit, which they evaluate for their intermediation capability and risk/return analysis of individual financing opportunities. There are three types of apexes in Honduras:

- Pension Funds: Public pension funds, including the Military Pension Institute (IPM) with 1,918 pensioners; Honduran Institute of Social Services (IHSS) with 252,886 pensioners; Institute for Teachers (INPREMA) with 16,371 pensioners; Civil Servants Retirement Fund (INJUPEMP) with 14,416 pensioners; and Employees Provident Institute (UNAH) with 1,410 pensioners.[249] These funds cumulative value is L3.1 Bn as of the end of 2017. Private pension funds include AFP Atlántida, BAC, West and FICOHSA.
- Central American Stock Exchange: The stock exchange could be a potential source of apex funding pending approval of Congress' Securitization Act, which has been pending for five years. Currently the exchange just trades bank and public-sector bonds. Historically, many traded firms had economic ties to the different business/financial groups represented as shareholders of the exchange, which has led to lax risk management practices and an enduring loss of public confidence in the institution.
- The public development bank, BANHPROVI that provides apex funding for the home loan market and several production sectors, especially agriculture.

Savings and loan cooperatives. These are community-based FIs with a strong focus on savings products, but they are also appealing because they provide an automatic loan product based on the affiliates savings. Cooperatives have a social focus and some actively promote women's financial inclusion. There are 1,020 registered cooperatives in Honduras, 434 production cooperatives and 586 Savings and Loans cooperatives (S&L Coops). At end of 2017 S&L Coops recorded L25.6 Bn in credit portfolio.[250] Cooperatives provide standard retail banking products for their members as well as microcredit, microinsurance, micro-savings/deposits, consignment deposits and loans, home loans, and consumer credit. As a sub-sector, their level of relationships and collaboration are better than the rest of FIs. S&L Coops established an ATM network and also created a united insurance broker called Equidad. The majority of cooperatives are concentrated in Francisco Morazan & Cortés departments, with 215 and 167 respectively. But in DO2 regions of La Paz and Lempira S&L Coops reportedly have the lowest coverage, with 16 and 28 coops respectively.

Microfinance Institutions (MFIs) and Private Financial Development Funds (OPDFs). OPDFs & MFIs focus on small ticket products such as microloans, savings/deposits, and microinsurance to low-income individual customers and MSMEs. There are five major OPDFs in Honduras: Fellowship of Honduras, FAMA, Vision Fund, PILARH and Credisol. Collectively they managed L.13.3 Bn in loans as of end of 2017.[251] These FIs fill geographical and sectoral gaps in commercial financing and cater to rural and informal clients. While only 23 percent of bank lending is rural, 59 percent of MFI investments are rural. [252] Trend are moving towards rural areas and agricultural sectors, but portfolios are still predominantly focused on non-farm sectors, with only 10 percent of lending in agriculture.

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[248] World Bank Data, data.worldbank.org.
[249] https://www.laprensa.hn/honduras/1198031-410/hondure%C3%B1os-pension-adultos-mayores-ihss-fondos-pensiones-
[250] Central Bank of Honduras, Honduras in Figures 2017. Page 87.
[251] Central Bank of Honduras, Honduras in Figures 2017. Page 75.
[252]Ms. María Elena Carías. Risk and Compliance Manager. Covelo Foundation. Interview August 14, 2018.

These FIs use microcredit methodologies which tend to have few requirements, with limited to no collateral, but offer only small sums of capital, short-terms and high interest rates. They also provide more interactive guidance and education to their clients.

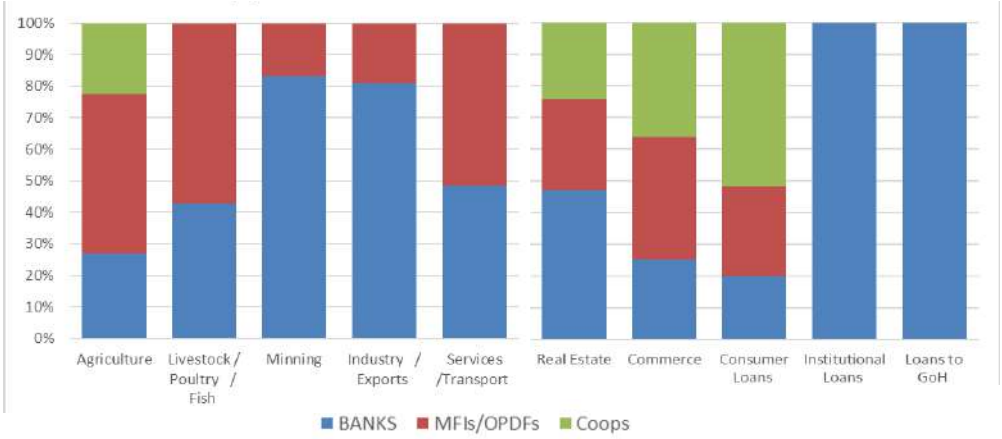
Commercial Credit. There are ten firms providing non-bank financing in Honduras linked to consumer loans. These firms specialize in trade financing and micro-credit. This category also includes embedded supply chain financing from large suppliers to buyers along supply chains, and other non-financial institutions that provide alternative micro-credit in rural areas, such as *cajas rurales* and *bancos comunales* among the most popular. For more information on embedded supply chain financing, please see the Relationships sector.

The Honduran financial ecosystem in practice often functions as two separate systems, where the majority of capital is disbursed and circulated through commercial banks to large, formal firms; while the majority of borrowers struggle to access smaller amounts of capital through a range of MFIs/OPDFs, cooperatives, commercial credit providers, and government-backed lending programs.

MARKETS

Different institutions serve different proportions of total lending by sector. Commercial banking, while present in all sectors, is primarily focused in extractives, industry and exports, services, and real estate, relatively to other sectors. MFIs/OPDFs are primarily involved in agriculture & livestock and services and transportation. Cooperatives provide the most consumer loans, a third of commercial loans, and a little over 20 percent of mortgage and agricultural lending. Note, this is current lending only.

Figure 77 Loans by Activity



Elaborated with data from BCH, financial reports 2017.

The table below highlights clients with easier or more restricted access to credit. Information for this table was gathered from interviewees and information provided in expert meetings.

Figure 78 Clients with easier and restricted Access to credit by economic sector

Economic Sector	*Clients with easier access*	*Clients with no access*	*Main Bottlenecks*
Tourism	• Large hotel and franchises • Food and tourism SMEs • Sector associations	• Rural hotels • Small restaurants • Micro business, especially independent (informal)	• Missing financial information • Seasonal sales cycles • Business informality • Lack of collateral
Value-added agriculture	• Agro-processors • Large-medium producers • Farmers in cooperatives	• Small-scale farmers • Not in producer group • Subsistence farmers	• Bad or no credit history • Lack of collateral • Missing financial information

		• Women farmers	• High risk farming (no T/A, etc.)
Light manufacturing	• Secondary processors	• Small-micro processors • Informal factories • Primary processors • Material extractors	• Missing financial information • Inventory not accepted as collateral • Delayed payments by buyers
Transport and logistics	• Large transportation and logistics companies	• Informal transport owners • Rural transport companies	• Down payments for lease • Vehicle insurance • Vehicles have low collateral value • Missing financial information
Wholesale-retail	• Formal MSMEs • Commercial stores • Wholesalers	• Small-micro retailers • Municipal market vendors • Street vendors	• Missing financial information • Inventory not accepted as collateral • No inventory insurance
Infrastructure and construction	• Large construction firms	• Small construction firms	• Limited cash flows • No collateral available • Machinery not accepted as collateral

Financial institutions are described in detail above. The table below provides the current range of product terms, APRs and ticket sizes of loans by FI. Regulatory functions are described in Rules.

Figure 79 Detailed description of loan options offered by OPDFs, MFIs and Banks

Types of FIs	Products	Terms (months)	Annual Percentage Rates (APR)	Ticket Size (HNL)
OPDFs & MFIs	Working Capital	Up to 24	32 to 36%	6,000 to 720,000
	Fixed Assets	Up to 60	11 to 18%	6,000 to 720,000
	Agriculture	Up to 9	24 to 36%	6,000 to 720,000
Commercial Banks	Working Capital	Up to 36	14 to 28%	Minimum 50,000
	Fixed Assets	Up to 84	11 to 18%	500,000 to 5,000,000
	Agriculture	Up to 12	14 to 28%	Minimum 50,000
Corporate Banking (working capital, fixed asset, factoring and other)		Preferential terms	Preferential terms	5,000,000 or more

Experts also noted different finance demands and access by client types.

Necessity-driven micro-enterprises tend to demand savings and deposits, small working capital credit, and insurance. They have limited to no assets for collateral, are typically informal and lack financial records. Most of them borrow through OPDFs/MFIs, or local loan sharks at predatory rates. Loan amounts cap at L.50,000 ($2,000).

Growth-oriented SMEs tend to demand savings and deposits, investment in real assets (capex) and working capital financing. Given growth-status, they have few if any assets to collateralize. They often are often pre-revenue or cash flow negative presenting high risk parameters. Most of them access financing through social networks (friends and family), have their own capital, or access special public development funds. Their needs vary widely depending on enterprise and growth phase.

Established SMEs tend demand savings and deposits, checking accounts, capex (both for equipment and infrastructure) as well as working capital. These SMEs tend to have more stable revenues, if in some cases cycle such as in tourism, etc. In many cases they are semiformal with limited financial records and lacking credit history. They tend to access finance from a range of non-bank institutions

due to collateral requirements which tend to be 300 percent of loan value. Their loan requests typically vary between L720,000 - L4,000,000 ($30,000 - $167,000).

Rural producers and households require mostly savings and deposits and working capital to cover seasonal cash flow imbalances e.g. agro-input financing. Small agricultural or other petty producers that are informal, possess little or no assets and often access loans through MFIs or local petty lenders, but paying predatory rates. Most cash needs below L50,000[253] ($2,000).

Large Companies require a mix of corporate financial products. This segment enjoys high access to financial services with average collateral requirements of 84 percent of the value of the loan. Only 8 percent of large firms ranked access to finance as a key constraint in the 2016 World Bank Enterprise survey, compared with 22 percent of SMEs.[254]

The table below provides an analysis of the different segments, considering how attractive that client segment is for financial suppliers, and the barriers and capabilities to reach the segment.

Figure 80. Analysis of six selected financial client segments that represent the productive sectors

Segment	Market Attractiveness	Supplier Barriers	Supplier Capability
Necessity-driven MEs	MEDIUM • There is significant demand that could be met at more competitive rates than provided by moneylenders. • Significant risk as clients have low returns and vulnerable / volatile to shocks or stressors • Potentially large number of clients offers scale of demand	HIGH • Dispersed customer base with limited connection to formal financial services. • Small ticket size = high transaction costs. • Significant financial illiteracy and capacity challenges for client-base.	MEDIUM • High volume, low margin products demonstrated through microfinance methodologies • Significant investments required in brick-and-mortar FI outreach • Financial technology can reduce transaction costs and enhance productive capabilities
Growth-oriented SMEs	MEDIUM • Firms tend to attract high capacity personnel and have significant upside to growth. • Number of firms is small but seems to be growing. • Assets are high risk, with limited collateral, unknowns on business revenues, etc. • Limited pathways for investor exit, limits upside potential	MEDIUM • Low (or lack) of collateral may make financing inaccessible under the current CNBS requirements • Longer periods of negative cash flow may misalign with underwriting standards	LOW • Few lenders with products and/or experience in financing growth-oriented businesses • Limited risk capital available • Lack of supportive entrepreneur system to provide accompanying technical assistance to loan • No functioning stock market or established mergers and acquisitions for exits
Established product-industry SMEs	HIGH • Large number of enterprises largely underserved by financial sector • Established market share and operations strengthens case for capacity to repay • Government support and and guarantees for specific sectors (e.g. coffee)	MEDIUM • Difficulty making credit assessment given the lack of verifiable information • Collateral/down-payment capital for loans are too low based on current underwriting standards	MEDIUM-HIGH • Banks have established products for SMEs already • Excess liquidity can deploy to reach this market • Limited experience in SME financing (bank culture, norms)

[253] Rodriguez, J. R. Personal Communication, August 16, 2018.
[254] Lopez, Z. Personal Communication, August 21, 2018

Rural producers and households	MEDIUM • Many organized through producer groups/cooperatives • Smallholders represent millions of currently un- and underserved customers • Proportionately high cost, low margin products for segment • High covariate risks • Buyer contracts and insurance can help to hedge risks	HIGH • Highly disperse, low value demand, no collateral • Limited literacy of clients • Demands are seasonal • Moral hazards	MEDIUM • Several cooperatives and specialized intermediaries focused on this segment • Product innovation, particularly for agricultural sector • Limited branch network
Large Companies	LOW • Saturated market, companies have established relationships in the banking sector. • Limited room for growth or expansion, as evidenced by the $4 Bn in excess liquidity	LOW • No noticeable barriers	HIGH • Banks have successfully demonstrated ability to innovate and grow to meet the demands of this client segment

RELATIONSHIPS

Associations. Financial institutions cooperate to advocate for and against new policy changes, and to build industry-wide understanding on common implementation of those rules. Commercial banks advocate through the Honduran Association of Banking Institutions (AHIBA), while OPDFs & MFIs cooperate through REDMICROH and Red Katalysis. Cooperatives representative association is the Honduras Federation of Savings and Credit Cooperatives (FACACH) and as well *Consejo Nacional Supervisor de Cooperativas* (CONSUCOOP). In practice, interviewees reported that many member FIs do not actively participate in these associations and there is limited learning and innovation-sharing.

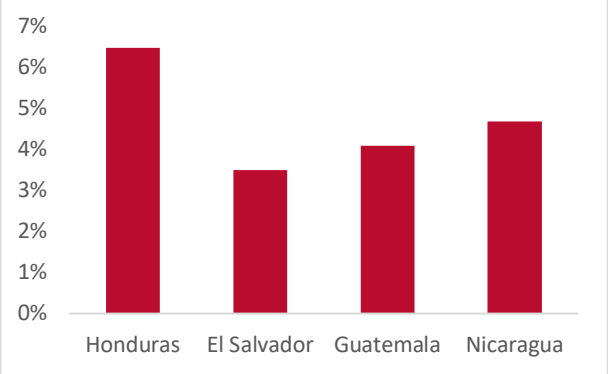
Supply chain finance. Several alliances provide embedded financing between suppliers and buyers ranging in size. An IADB study from 2014 found that input providers are responsible for the "bulk of lending, both in terms of number of borrowers, as well as value of loans" for finance providers with fewer than 25 loans.[255] These loans are really inventory credit for inputs. Sector-specific cooperatives and buyers also lend to producers for select crops, notable coffee and cocoa. Several MFIs/OPDFs and financial cooperatives lend to agriculture, relying on 'third party' guarantees to discourage side selling. For example, AgroBolsa is a certificate program clears outstanding debts for producers if they sell to the contracted buyer firm. There seems to be interest in experimentation and expansion of embedded supply chain financing through these forms of alliances, but they rely heavily on guarantees to offset side-selling or other risks.

NGO alliances. Many MFIs/OPDFs, cooperatives, and development banks partner with donors and NGOs to expand MSME lending. These alliances tend to form around capacity building of loan officers to be able to deploy improved due diligence processes as well as FI capacity building. A repeated weakness cited by respondents are low levels of financial literacy on the part of borrowers. Many FIs have launched financial education programs in conjunction with NGOs, but these tend to be limited in scale and fail to reach broader consumer segment.

[255] IADB, 2014. Financing Agricultural Value Chains in Latin America: Barriers and Opportunities in Mexico, Peru, and Honduras.

Competition. Several metrics are helpful to paint the picture of competition in Honduras. Honduras's loan rejection rate is 5.9 percent, nearly double that of world average (3.3 percent). Honduras' non-performing loan ratio is only 2.36 percent, significantly below the world average of 3.74 percent.[256] Combined, these numbers suggest that commercial banks have a conservative bias and are risk averse. 88 percent of lending goes to 12 percent of clients and there is $4 Bn in excess liquidity. This is despite access to credit being the number one constraint to growth reported by enterprises in Honduras. These figures imply that the demand of capital far exceeds the supply available on the market. It is further reflective of limited competitive pressure to compete 'down market' for small or less formal clients. Another indicator which suggests a lack of competitiveness is the sector's comparatively high administrative costs relative to neighboring financial sectors.[257] If commercial banks were competing effectively, these rates should likely converge with the benchmarks from neighboring countries. These features suggest that bank consolidation has not, intrinsically, led to greater efficiency through economies of scale. Rather, these indicators seem to imply that consolidation has reduced competitive pressures within the banking sector.

Figure 81 Average Administrative Costs (% of Total Assets 2012)



RESOURCES

Apex financing. Apexes provide most second tier or wholesale financing for retail lenders. Apex institutions include the Honduran Central Bank, Banhprovi, the ten pension funds listed above and international banks (Central-American Bank for Economic Integration, BCIE and the Inter-American Development Bank, IADB). Interviewees stated that many of these sources are underutilized because their lending rates are close to retail rates, leaving too little margin for intermediaries. There is potential to explore other sources of apex financing, but there are open policy questions that could potentially limit these investments—for further information in Rules below.

Figure 82 Apex Funding Innovations

There are opportunities to attract foreign capital to provide additional apex funding through structured syndicates or platforms, such as Variable Payment Obligations (VPO) developed under USAID's Partnering to Accelerate Entrepreneurship (PACE) Initiative in Nicaragua.[258] Remittances are another under-utilized source for apex financing, particularly for risk capital. MoneyGram and Western Union manage the majority of remittance transactions, handling the equivalent of 25% of the total loan portfolio of regulated FIs in 2017. Although most of the remittances goes to consumption, it is unknown what percentage is used in productive activities as working capital and capex (investment in real assets). A study made by Red Katalysis shows that 72% of remittance receivers are women, with an average age of 45 years and they have been receiving remittances in average for 7 years, 87% are discounted in commercial banks and only 27% have savings account. Services like PANGEA money, a growing mobile remittance payment platform in Honduras, could develop options for remitters to commit nominal (even as low as $1-5) amounts from remittances to MSME investments.

[256] World Bank data at data.worldbank.org.
[257] Millennium Challenge Corporation, 2013. Honduras Constraints Analysis. https://assets.mcc.gov/content/uploads/2017/05/Honduras_CA_English_withCover.pdf
[258] For further information the VPO model and its results in Nicaragua, see www.usaid.gov/pace.

Staff capacity. Human resource capacity, especially loan officers and managers to take on SME lending require necessary financial and sectoral acumen to evaluate credit risk and soft skills to articulate loan terms to potential borrowers clearly and succinctly. Interviewed OPDFs and MFIs in particular cited capacity building for their loan officers as a key gap. Across all sub-sectors, including banks, interviewees cited a lending culture that did not cultivate the capacity for innovation or problem-solving if a loan application was missing information or was otherwise disqualified. This capacity issue reportedly contributes to the over-reliance on collateral as loan officers will use collateral as a alternative to more rigorous due diligence and risk evaluation. with banks interested in building or expanding MSME lending segments. Interviewees reported developing specialized MSME lending segments, linked to technical assistance to bank executives, loan officers, and regulators as necessary can strengthen institutional capacity and develop in-house training programs for loan officers and credit managers.

Client information. Expert interviews with financial institutions across sectors consistently cite unreliable or missing financial information, lack of formal registrations and certifications (informality), lack of proof of tax compliance, and lack of clarity around ownership of real estate property used for collateral. Lack of client data make full due diligence difficult and necessitate alternative forms of risk valuation. Credit bureaus and credit scoring are growing as a risk management tool, particularly for individual consumers in the commercial banking sector. TransUnion introduced a consumer credit scoring system in Honduras in 2009, and the World Bank's Doing Business survey shows that 45 percent of Hondurans were covered by private sector credit bureaus in 2017.[259] Digitalized transaction data and sector-specific transaction and market data sets are increasingly being combined to develop novel predictive models that can supplement incomplete paperwork to enable lenders to adequately assess risk. Electronic banking opens up significant opportunities to build credit histories for previously underbanked populations, reduce transaction costs through automated payment systems that could enable banks to break up loans into smaller payments (mitigating risk through incrementalism), facilitate supply chain finance partnership, each of which would reduce the classic SME underwriting dilemma of too little verifiable information and too high cost to analyze.

Risk capital. Risk capital, often private, venture capital, impact, or philanthropic capital, is high risk and high reward capital that is an essential component of a functional financial services ecosystem. These actors provide a 'mirror image' to regulated FI's risk/return profiles, actively seeking early and growth phase companies without sufficient assets or traction to qualify for traditional debt. This capital is a critical resource to incubate and accelerate firms that will become clients of banks in the future. Currently this sector is extremely limited in Honduras; for further details, see the Entrepreneurship Analysis.

ICT/business services. ICT and business services for the financial sector range from basic operational software and management systems for financial institutions, managing transactions and capital stocks and flows, to innovations in mobile payments and fintech. Electronic money transactions (electronic wallet) represent a significant opportunity to increase access to financial services and penetrate regions where it is not feasible to have branches. Telecommunications companies Tigo, Claro, and other Banks are developing mobile platforms, but currently it only covers approximately 2 percent of transactions, and have to conform to standard transaction regulations (see

[259] https://www.indexmundi.com/facts/honduras/private-credit-bureau-coverage

'Rules' below). For further details, see ICT and business services sector. Innovations in this sector could be used to develop novel data sets of transaction histories, feeding the risk valuation data needs outlined above. The current credit bureau service provides has highlighted this as an avenue of opportunity, and are interested in active investment in this research.

RULES

Formal and informal rules govern how financial services are designed, as well as how they are delivered. Formal rules are often focused on prudential norms and in line with global standards and agreements such as the Basil accords, and are therefore less subject to major changes. On the contrary, informal rules include attitudes and banking culture (for example, attitudes toward risk and innovation) as well as official norms that govern how a particular FI decides to interpret a given regulation. These informal rules in the financial sector are more subject to evolution, though many FIs' internal culture is longstanding and thus also resistant to rapid change.

MSME Lending. Much of the legal and regulatory framework that influences lending to MSMEs in fact comes in the broader laws and regulations governing financial institutions, especially be defining collateral, capital adequacy and documentation requirements that limit lending to smaller firms. Aside from this, other laws are more directly relevant to MSME financing, such as the Law Regulating Private Development Organizations engaged in financial activities (Decree 229-2000); the Cooperatives Act (Decree 67-87); the Law on Social Sector of the Economy (Decree No. 193-1985) and the Law of Savings and Rural Credit (Decree No. 201-93.), among others. The framework law for the MSME sector in non-financial aspects is the Law for the Promotion and Development of the Competitiveness of Micro, Small and Medium Enterprises (Decree 135-2008). This decree provides funding and training and coordination services, including creating a database for MSMEs. One of the laws with the greatest impact for MSMEs has been the Mutual Guarantee Act, Decree No. 205-2011, which provides guarantees to companies with little capital or limited guarantees to obtain better financing conditions or investment. This has stimulated the emergence of entities such as Confianza, which has quickly managed to expand its coverage to 270 municipalities, especially by supporting rural entrepreneurs. This regulatory framework supports the MSME sector by reducing obligations e.g. in hiring labor; creating useful legal frameworks to support relevant financial products for MSMEs, including reciprocal guarantees, factoring, leasing, and digital systems; and creates institutions to facilitate microcredit such as OPDF, rural banks, cooperatives. But these policies have limitations: they are all consultative but have no enforcement mechanism, have proven difficult to implement, or require coordinated adjustments in other institutions/agencies beyond the purview of the Ministry of Economic Development. Factoring, leasing, and digital payment, while codified legally, still lack clarity from regulators on how to implement.

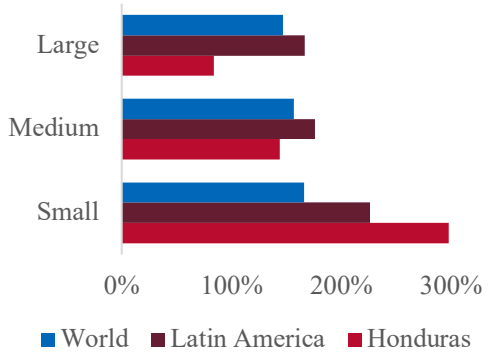
Mobile money transactions. Decree No. 01/2016 outlines parameters for mobile money transactions and sets two potentially challenging barriers to expanding financial inclusion through mobile money providers: first, agencies and authorized transaction centers (ATCs) must be fully formalized, and already fully functioning enterprises. Globally, mobile money agents have proven to be a highly effective and scalable enterprise model for micro-entrepreneurs, particularly in rural areas. By requiring high levels of formalization and existing operations, the potential pool of agents and geographies are limited. Additionally, the accord defines e-money as a tax liability for the mobile money provider,

meaning they can be taxed on money in customer accounts as assets.[260] Additionally, mobile money payments are limited to $800 per transaction, severely limiting the utility as a business-to-business payment system.

Credit scoring. Credit scoring companies rely on public availability of transaction histories to generate scores. There are currently two laws governing how credit bureaus access and handle end-borrower credit history. One is regulation for the Strengthening of Transparency, Financial Culture and Attention to Financial Users in Supervised Institutions (Circular CNBS 140/2012). The other one is the regulation for the Authorization and Operation of Private Risk Centers. The data protection and Habeas data law currently in discussion in Honduras could limit the functionality of these credit scoring systems, as it would set additional limits on what electronic data would be available to third-parties without user consent. The promise and potential benefits of improved credit scoring – the use of large amounts of data to predict willingness and capacity to repay based on criteria other than traditional ones like collateral – must be balanced against the need for privacy and consumer protection.

Collateral. There is a heavy reliance on collateral as a risk mitigation tool in Honduras. The World Bank's Doing Business survey found that in 2010 commercial collateral rates ranged from 84—300 percent the value of the loan, with collateral rates rising as the size of borrower firms and loan request amounts get smaller. [84] Interestingly, rates for large and medium firms are below the rest of Latin America or the world, but rates for small firms are significantly higher. Mortgages or other immovable assets as well as cash are the most accepted collaterals. Given the size of collateral requirements and the preference for mortgages, the lack of clear land tenure and the incomplete cadastral map, compound collateral requirements as a choke point.

Figure 83 Collateral required (% loan amount)



Formal Rules. The CNBS establishes reserve requirements based on the type of borrower (large commercial firms, small commercial firms, and microcredit), loan amount, credit standing, the bank's assessment of the capacity to repay, historical performance, and collateral/guarantees. Immovable assets, primarily real estate, are the preferred collateral type, as they are perceived as more easily recoverable, and have 0.25 percent lower reserve requirements. The 2011 Secured Transactions Law, however, expanded the list of approved collateral assets to include multiple tangible and intangible assets, including crop inventory and futures, equipment & vehicles, accounts receivable, and sales contracts. However, a 2014 IADB study found that just one of seven financial institutions interviewed had actively used and accepted collateral from the expanded list. This is an example of informal rules – a bank's internal policies or even its unwritten practices – overruling the less conservative formal rules, resulting in no change to high collateral requirements imposed on potential borrowers. See below for more on informal rules.

[260] https://www.gsma.com/mobilefordevelopment/programme/mobile-money/regulation-in-el-salvador-and-honduras-on-the-brink-of-enabling/

Informal Rules. As underwriting costs tend to be fixed, banks will increase collateral requirements along with other loan terms, such as interest rates, for smaller ticket sizes to recover these costs. There are no formal rules segmenting sectors by risk, banks have noted that regulators will informally advise them to treat agricultural loans as higher risk. In part this reflects fundamental risks of the sector such as climate & market risks, etc., and because agricultural enterprises tend to be smaller and less formal. It appears however that rather than apply these assessments on a case by case basis, they become a broad sectoral standard. The IADB study also noted that the Hurricane Mitch recovery response, which compelled banks to write-off large numbers of agricultural loans, led to huge contraction in agricultural lending and increased hesitancy to increase exposure to that sector in the future without substantial collateral. Collateral can also be used as a crutch by loan officers and institutions as a way to avoid or replace more rigorous due diligence procedures. While not a widespread observation, this tendency can be exacerbated by contexts where loan officers are not confident in their capacity to do full due diligence, or willing to stand by their supporting analyses.

Additionally, bank respondents highlighted two inter-related demand-side challenges that contribute to a heavy reliance on collateral as the primary or exclusive risk management tool. First, the majority of respondents highlighted the challenges of informality, limited record keeping, and other weak business management practices as key inhibitors in conducting sufficient due diligence. Banks will balance out those missing data points with increased collateral requirements. Second, several banks noted that the lack of an early-phase financing ecosystem also contributes to increased collateral requirements. Seed- and early-stage growth financing institutions act as critical market signals for later stage lenders. They ensure nascent enterprises develop sufficiently rigorous financials and other documentation to access later stage financing, but also act as a key informal gatekeeper, with their own relationships with commercial banks and the ability to act as trusted informal advisors and vouch for their invested companies when seeking loans. Without this feeder ecosystem, most SMEs are challenged to identify pathways to build social relationships with commercial banks critical to building willingness to develop less extractive collateral requirements.

Legal frameworks for Implementing institutions. Descriptions of the function of implementing institutions can be found above in section 3. The policy frameworks for these institutions are:

Figure 85 Legal Framework Financial Sector

- National Commission on Banking and Insurance (CNBS). *Shall exercise supervision, monitoring and control of banking institutions, insurance companies and financial by the National Banking and Insurance Commission* Decree No. 155-95
- CONSUCOOP (Co): Established in the Honduras Cooperatives Act and Regulations under Decree No. 174-2013, the Sovereign National Congress and published in the Official Gazette number 33.344 on 01 February 2014.
- Secretary of Finance SEFIN regards the formulation, coordination, implementation and evaluation of policies related to public finances and the General Budget of Revenues and Expenditures of the Republic, with regard to credit and public debt, public investment programming.
- Revenue Management Services (SAR) responsible for the tax administration
- National Bank and Insurance Commission Law (Decree Number 155-95) creates the bank and financial institution´s supervising entity (the National Bank and Insurance Commission).
- Financial System Law (Decree Number 129-2004) sets the requirements to create and authorize bank and financial institutions. It contains the legal framework that will govern all financial institution´s activities.
- Deposit Insurance Law (Decree Number 53-2001) creates a deposit insurance as a savings and protection system to guarantee the repayment or restitution of certain percentage of money deposits made by the general public in financial institutions in the event any said institutions is involved in a enforced or compulsory liquidation procedure.
- Monetary Law (Decree Number 51): contains the legal framework of the monetary system of Honduras.

- Honduran Central Bank Law (Decree Number 53) creates the Honduran Central Bank, empowering such entity with setting the country´s exchange and monetary policies. Also, it contains several provisions regulating currency, and bank and insurance institutions. Mobile money transactions are limited to a max of $800 per company per month. (Decreto 149-2014)
- Investment Law guarantees foreign investors access to foreign currency needed to transfer funds associated with their investments in Honduras.
- There are two regulations for the credit bureaus handling information on end-borrowers credit history.
  - Rules for the strengthening of Transparency, Financial Culture and Attention to the Financial User in the Supervised Institutions (Circular CNBS 140/2012)
  - Regulations for the Authorization and Operation of Private Risk Centers
- Fondo de Seguro de Depósitos (FOSEDE) guarantees the repayment of a certain percentage of clients' deposits, in financial institutions, in the event of liquidation. All members of the Financial System are required to contribute yearly sums to the FOSEDE (Decree 53-2001).

A key risk for banks is correspondent banking funding, particularly in light of the liquidation of Banco Continental last October 2015, which held 3.2 percent of total system deposits. All depositors received up to 208,680 Lempiras (about $9,400) the insured threshold of the Honduran deposit insurance fund. The CNBS conducted a resolution process involving purchase and assumption operations for almost all of BC's loan portfolio. The liquidation occurred after the U.S. Office of Foreign Assets Control accused the bank and other companies owned by Continental's controlling family of being involved in international drug trafficking and money laundering. Global financial institutions have likely become more concerned about compliance risks in Honduras, notwithstanding the passage in March 2015 of a special law to prevent money laundering.

RESULTS

The Honduran financial sector is blessed and cursed by strong fundamentals and solid profit margins for core intermediaries. This contributes to a positive business enabling environment and regionally competitive financing terms for large firms. But this symbiosis between large banks and large firms has led to products, actors, rules, and resources misaligned to MSME needs, suppressing the pipeline of potential future large firms that could propel development in productive sectors and catalyze Honduras' adaptation to changes in the global economy. Additionally, the highly consolidated nature of Honduras' financial sector, in which 10 banks hold 90 percent of the market, is itself a systemic risk. A structural threat to one of these banks could lead to significant cascading harms across the economy. Institutions of that size tend to lack the nimbleness to innovate and adapt quickly, particularly when the status quo is highly profitable.

But there are several emerging dynamics that provide opportunities to build financial inclusion and expand the financial ecosystem's access to and services for MSMEs. The GoH has signaled its commitment to MSME development, and the financial sector as a whole is committed in principle. Expanding and diversifying sources of capital from new domestic and international sources and helping banks, OPDFs & MFIs, and other lenders to develop new ways to evaluate risk can create a virtuous cycle, in which MSMEs are supported and financed appropriately, accelerating growth and profitability, and demonstrating their value to lenders. Over time existing and new lenders will cater to growing businesses, orienting business segments, products, and innovations to their needs.

Below we end by listing the major risk categories to the system, and the four recommended leverage points for future implementation.

Figure 86 Risks in the Financial Services Sector

Risk profile	Resilience Capacity

Political Insecurity	Low--Spikes in violence can lead to rapid disruptions/contractions in borrower cash flows and asset values, leading to significant risk for the financial system. There are limited mechanisms within the financial to mitigate this risk ahead of time, but more investment in reciprocal guarantees or innovation around insurance products for businesses that are negatively affected by violence could be further explored.
Domestic economic contraction	Low—the financial sector's increasing exposure to mortgage and consumer credit as a portion of their balance sheet amplifies exposure to domestic economic downturns. Diversification into productive economic sectors would serve to diversify risk and contribute to the long-term economic resilience of enterprises and jobs that pay for mortgage and consumer credit lines.
Global financial & commodity market volatility	Low - Medium: Honduras has minimal ability to respond to global market movements. Some policy actions, such as the rise of targeted guarantee funds, can function as productive counter-cyclical buffers, but politically pressured debt write-offs for agricultural borrowers increase overall risk exposure by FIs and depress future lending. Diversifying loan portfolios, investing in the long-term health of the overall productive economy, and deploying a better mix of insurance and blended financing sources will help increase resilience capacity.
Climatic Risk (for resource-based sector-lending)	Low—key value-added agriculture sectors are vulnerable to climatic risks, which present major long-term challenges to the health of the financial system as well.

The root cause of many issues in the financial sector is FI's heavy reliance on collateral due to regulations (or interpretation of regulations) as well as lack of confidence in the other "Cs of credit"[261]. There is a need to work with FIs to strengthen other forms of risk analysis and mitigation that rely less on collateral and are more suitable for companies looking to grow. Alliances with non-financial actors, such as buyers and suppliers, can contribute to this. To amplify the scalability of these partnerships, there is a need however to address the limited availability of reliable data to assess client capacity to repay. Credit scoring digital client records can drive greater data-driven decision-making. Potential partners include credit bureaus, Cofianza as well as first-adopter FIs which can model best practices, potentially catalyzing copying by other FIs assuming competitive pressures are adequate. Fintech in particular offers an avenue to push innovation in the sector by opening up the playing field to new financial providers and/or providing new channels for existing FIs to innovate. The launch of fintech however requires less restrictive regulations consistent with international best practice.

Other ways to expand financial inclusion is to deflect risk to third parties that are more able to absorb it, such as insurance, micro-insurance and guarantee funds such as Confianza. Reallocating part of the risk to these actors can have the effect of freeing up retail financial institutions to make credit decisions based on assessment of willingness and capacity to repay. Several policy-related improvements would have a positive impact in this regard. In particular, improving and modernizing the ineffective property registration system, and further developing credit information systems capable of providing useful data for credit scoring models.

Part of the challenge will be to address the informal rules and norms within the sector. There are strong forces driving the status quo for commercial banking sector. A deliberate approach to piloting and testing different product innovations is necessary to demonstrate the business case to banks, which should be done in coordination with CNBS to provide this evidence to regulators, while staying within the parameters of current law. The prize for success in this regard, if even unlocking a

[261] The five Cs of credit are character, capacity, capital, collateral, and conditions.

small fraction of the $4 Bn in excess liquidity into the SME sector, particularly for growth-oriented SMEs, would result in significant job creation and growth.

There have been studies and a lot of research into the potential to unlock remittance flows as a source of capital for productive lending and investments. The scale of remittance flows is massive (18.9 percent percent of Honduras GDP according to World Bank). There have been a growing field of mobile-platform remittance services, including PANGEA and Ria, which serve as potential partners. The likely avenue for engagement would be to develop a broader portfolio of remittance-based donation and investment options with these providers, where remitters are prompted to contribute or invest a portion of their remittance to a MSME development fund (as part of an apex funding source). These opportunities are no longer just hypothetical. Entities such as Homestrings have successfully launched such funds in other countries, offering diaspora bonds to migrants. In Guatemala, savings and loans cooperatives have had success in capturing remittances as savings – the first step in channeling such resources for investment.[262] Capturing just 1 percent of remittances would generate $43 million in MSME investment funding per year.[263]

There are other opportunities in the financial sector, such as *risk capital* (see Entrepreneurship section), digital financial education, and other technology and e-banking solutions. The financial services sector in many ways is ripe for a structural realignment. Opening the door to new technologies would have a transformative effect on the industry and make the financial services sector better serve the large and significant unmet demands of growth-oriented MSMEs.

[262] In 2007, US$246 million in remittances were transferred through the Guatemalan credit unions, according to the World Council of Credit Unions

[263] IADB remittance data.



WATER AND SANITATION

ANNEX X WATER AND SANITATION

SECTOR OVERVIEW

Water is a growing source of vulnerability for people and businesses in Honduras. Lack of access to water and sanitation services threatens to unravel the economic gains of Honduras. A growing misalignment between supply and demand is widely acknowledged. Municipalities reported being able to satisfy less than two-thirds of their current water demand. Increasing pressures of irregular rainfall from climate change, population growth, and wearing infrastructure are exacerbating these issues. In western and southern Honduras, there is a forecasted 10-20 percent decrease in precipitation by 2050. At the same time, less than one-tenth of available water in Honduras is being utilized. The GOH estimates that until year 2022 an annual investment of at least $314 MM in water and sanitation infrastructure to close the supply-demand gap and provide an acceptable coverage of service to meet future demand. The scarcity of water will impact jobs which depend on water, particularly agricultural jobs with about 5-6 percent of agricultural land irrigated. Industrial and manufacturing industries and tourism depend on water and sanitation services as well. Studies have linked the absence of water, specifically drought, as a significant driver of Central American migration to the U.S.

Demand signals are growing but supply is non-responsive. Honduras is a country with economic water scarcity, although there is no physical scarcity. Water and sanitation services largely remain a public good without a market mechanism to reconcile supply with demand, much less stimulate necessary investments to close the infrastructure gap. Water providers note that many instances of water unavailability often occur because pipes rupture- however, with a fragmented water fee collection system, most providers are unable to fix the piping system. In other words, the price mechanism for water and sanitation services is non-functional. Fixing this market to establish a more sustainable form of financing to support the sector has been identified since the 2003 General Framework Law of Water and Sanitation. This includes the basic water meters. However, progress stems on this front has been low due to a low appreciation of the value of water and coordination failures within the sector. Despite this, some demand pressures, particularly by industries, are having an effect as agencies are responding with laboratory analyses for water quality.

Responsibility without clear accountability is creating leadership dilemma in the sector. A holistic approach to water management is essential to ensure its long-term sustainability. Integrated water resources management is one of Government of Honduras' objectives in the Country Vision Plan (2010-2038) to reduce poverty and promote the overall economic development of Honduras and achieve SDG 6 targets. There has been policy momentum in the water and sanitation sector over the last decade. Multiple public agencies bear responsibility for the water and sanitation sector. These include at the national-level agencies such as CONASA, Mi AMBIENTE, ICF, CONAGUA, the Department of Solid Waste Management and ERSAPA. This lack of central leadership results in public sector actors interpreting laws and regulations differently which discourages private investment from entering the water business. There is considerable overlap and roles and responsibilities between these agencies which weakens effective coordination. This lack of coordinated leadership was nearly ubiquitously noted in interviews with sector actors as a root cause for many issues in the sector.

INTRODUCTION

Water and sanitation are indispensable resources and services for the productivity of a country and are interrelated to almost every economic sector. A 2012 World Bank study estimated the total economic cost to society of deficient storm management, sanitation, solid waste and water services in Tegucigalpa at $160 million per year, or close to 2.5 percent of Honduras' GDP.[264] Furthermore, evidence demonstrates that availability and quality of water has a direct effect on social stability and jobs, which when not achieved, can lead to greater migration. For example, research by the World Food Program suggests that environmental factors, specifically drought, has been a significant driver of Central American migration to the United States.[265] Globally, as climate change continues to affect the availability of water, jobs that depend on water will become increasingly more vulnerable, particularly agricultural jobs, which comprises 95 percent of water-dependent jobs.[266]

Honduras is considered to be a country with *economic water* scarcity although there is no physical scarcity. This is caused by a lack of investment in the development of water resources and collection and distribution infrastructure, resulting in incapacity to satisfy the demand for water. In Honduras, only an estimated 9.1 percent of available water is being utilized.[267] This gap is caused by the irregular precipitation, lack of collection and distribution infrastructure throughout the country, leading to scarcity problems and inability to meet demand for water, especially in the Pacific slope. There is conflicting data on the coverage of water and sanitation services, but a 2015 World Health Organization report estimated that 91 percent of the population had access to *improved drinking water sources* and 83 percent had access to *improved sanitation services*. Despite these high coverage rates, only 38 percent of water providers in urban areas and 10 percent in rural areas were providing purified or disinfected water, safe for human consumption.[268] Additionally, there is great variance in the reliability of services, where households may only have access to water for a few days a week and for a specific amount of time.[58] Improvements can be seen in the sanitation sector, with a majority of urban and rural households accessing improved sanitation services. However, it is estimated that at least 50 percent of the cities do not have wastewater treatment infrastructure and only 38 percent of the total collected wastewater is treated.[60]

The GoH estimated in 2014 that a total investment of $314 million would be required by 2022 for infrastructure in the water and sanitation subsectors to provide acceptable coverage of services and meet the 20/20 and 2030 country goals.[60] These investments are critical for economic growth. The agriculture sector obtains 80 percent of its water from freshwater sources, with only 5.6 percent of cropland being serviced by irrigated water sources.[269] Furthermore, the majority of industrial and manufacturing sectors rely on water and sanitation services, such as for cooling and transportation, producing steam or electricity, sanitation, and for producing outputs. Tourism relies on water and sanitation services to properly serve their customers.

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[264] World Bank. 2012. Integrated Urban Water Management Case Study: Tegucigalpa.
[265] A 2017 World Food Program study found that people living in the Northern Triangle's Dry Corridor region, which is prone to draught were food insecurity and during El Niño many migrants had left their country because of low yields as a result of drought. See World Food Program. 2017. Food Security and Emigration.
[266] Miletto, M., Caretta, M. A., Burchi, F. M. and Zanlucchi, G. 2017. Migration and its interdependencies with water scarcity, gender and youth employment. WWAP. Paris, UNESCO.
[267] Secretaría Ejecutiva del Consejo Nacional de Agua Potable y Saneamiento (CONASA). 2016. Segundo informe de monitoreo de los avances de país en agua potable y saneamiento – MAPAS II. World Bank.
[268] WHO/UNICEF. 2015. Joint monitoring programme for water supply and sanitation. Estimates of the use of water sources and sanitation facilities. Updated June 2015. Honduras
[269] World Bank. 2006. World Development Indicators: Honduras. World Bank.

SECTOR SELECTION

Water Resources. A holistic approach to water management is essential to ensure long-term viability. Integrated water resources management is one of the GoH's objectives in the Country Vision Plan (2010-2038) to reduce poverty and promote the overall economic development of Honduras and to achieve six of the Sustainable Development Goals. The role of managing water resources has characteristically been left to the central government, leaving many water service providers and municipalities to continue with the status quo and inability to meet demand. In some communities, water scarcity has become increasingly problematic due to lack of proper resource management and development of untapped water resources. For example, three out of four of the rivers completely dry up during the dry season in the city of La Ceiba. This leaves one available water resource to meet demand for the whole community, which is already heavily overstressed by the tourism industry. For the case of this study, water is used for two purposes, for human consumption and by businesses as a key resource in their production or business.

The World Bank defines **water resource management** as "*the process of planning, developing, and managing water resources, in terms of both water quantity and quality, across all water uses,"* further key components of WRM definition include a focus on harnessing its benefits for economic and social purposes but also managing its risks with a recognition of its complexity. Source: The World Bank.

Drinking Water.[270] In order to be deemed safe for human consumption, drinking water must meet the microbial, chemical, radiological, and acceptability characteristics according to the World Health Organization.[271] There is a high deficit in quantity and quality of services in both urban and rural areas, where many communities are forced to restrict the service, especially during dry season. Improvements have been made to the water sources in Honduras, with a majority of urban households receiving piped water. Nonetheless, the drinking water subsector faces constraints in both rural and urban areas due to ineffective financing mechanisms, where even the capital does not cover costs with water fees.[272]

The World Health Organization defines an **improved drinking water source** as "*piped household water connection located inside the user's dwelling, plot or yard" and/or "public taps or standpipes, tube wells or boreholes, protected dug wells, protected springs and rainwater collection"* and is what is counted when this case study reports on coverage of improved water sources. Source: The World Health Organization.

Wastewater Disposal. The wastewater system consists of structures and pipes that transport sewage from the site of generation, including that generated from households, institutions, and industries, to the site where it is treated for subsequent disposal. Eighty-three percent of households in Honduras have basic sanitation services, which means that households do not share sanitation facilities with other households. It however, does not mean that this wastewater is satisfactorily managed, treated, or disposed of. The majority of households access a sewage system (34.26 percent), followed by septic tank (34.35 percent), open pit latrine (15.04 percent) and improved, hydraulic latrine (6.21

[270] Drinking water can be viewed in terms of the system or set of subsystems that carries water from the accessibility point (surface water or groundwater) to the point of consumption or use, including the supporting infrastructure, facilities and systems for treatment and distribution, plumbing and maintenance services, financing and fee system, management, and monitoring and evaluation.
[271] World Health Organization. 2017. Guidelines for drinking-water quality: fourth edition incorporating the first addendum Geneva. License: CC BY-NC-SA 3.0 IGO.
[272] Organización Mundial de la Salud (WHO)., Fondo de las Naciones Unidas para la Infancia (UNICEF). 2017. Progresos en materia de agua potable, saneamiento e higiene: informe de actualización de 2017 y linea de base de los ODS [Progress on drinking water, sanitation and hygiene: 2017 update and SDG baselines]. Ginebra: 2017. Licencia: CC BY-NC-SA 3.0 IGO.

percent).[273] A large flaw of the sanitation system in Honduras is that waste collected from households and industry is rarely properly treated before being disposed into water bodies, which occurs in both San Pedro Sula and Tegucigalpa, which has led to the pollution of surface water. The segments in the wastewater subsector investigated for this analysis include both household and industry wastewater.

Figure 87. Population Coverage of Improved Water and Sanitation Sources/Facilities Honduras 2015[274]

Potable Water		Sanitation	
Rural	84%	Rural	78%
Urban	97%	Urban	87%
Average	91%	Average	83%

Waste Management. Waste management services include the collection, transportation, treatment, and recycling and disposal of non-hazardous and hazardous waste. According to the Regulation for the Integral Management of Solid Waste (created by executive agreement 167-2010), waste management should be undertaken to avoid risks to health and to the environment. In 2010, Honduras was ranked second to last in coverage of waste collection in Latin America, with 64.6 percent of the population covered with waste management services.[275] These figures can skew the picture of the delivery of services in rural areas, as the majority of the population is urban residing. When comparing across municipalities, which does not account for population, waste management service delivery looks starkly different. Across all municipalities, rural and urban, only 20 percent had waste collection services and 3.7 percent had infrastructure for final disposal as of 2008.[276] When services are provided, most providers utilize open-air dumps that pollute the soil, air, and water.

Bottled Water. Due to the relatively low interaction that the bottled water subsector plays with other market sectors (e.g., agriculture, light manufacturing), it was not selected as a subsector for analysis. However, because the bottled water industry is a large user of water resources, it should be considered in future analyses of water use and of the water resource management subsector.

Water and Sanitation Sector Organization Overview. The water and sanitation sector is largely a publicly financed and administrated sector, with few private sector companies involved. The National Water and Sanitation Council (CONASA) oversees water and wastewater subsectors, the Secretary of Energy, Natural Resource, Environment and Mines (Mi AMBIENTE) and the National Institute of Conservation and Development of Forest, Protected Areas, and Wildlife (ICF) oversee the management of water resources subsector, and Mi AMBIENTE and the Department of Solid Waste Management oversee the solid waste management subsector (see figure 14). The drinking water and wastewater subsectors are even further subdivided, by region. In urban areas, municipalities the services are often contracted with the private sector, which provides them with financial and administrative autonomy. In rural areas, water and sanitation services are largely dominated by the Water and Sanitation Boards

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273 Secretaría Ejecutiva del Consejo Nacional de Agua Potable y Saneamiento (CONASA). 2016. Segundo informe de monitoreo de los avances de país en agua potable y saneamiento – MAPAS II. World Bank.

274 UNICEF/OMS. 2012. Programa conjunto de monitoreo de los progresos en agua y saneamiento.

275 Espinoza, P., Arca, E., Daza, D., Faure, M., Terraza, H. 2010. Informe de la evaluación regional del manejo de residuos sólidos urbanos en ALC 2010. Organización Panamericana de la Salud (OPS), Asociación Interamericana de Ingeniería Sanitaria y Ambiental (AIDIS), el Banco Interamericano de Desarrollo (BID).

276 Organización Panamericana de la Salud (PAHO), Secretaría de Recursos Naturales y Ambiente (SERNA), Secretaría de Salud (SS), Asociación de Municipios de Honduras (AMHON). 2007. Analisis sectorial de residuos sólidos: Honduras. Organización Panamericana de la Salud (PAHO).

(JAAS), which are a function of the municipality and lack financial and administrative autonomy. Waste management services are similarly divided, but with less oversight and investment than the other subsectors. The municipalities are charged with the responsibility for waste management services; often contracting those services out.

Figure 88 Regulating Actors of Water and Sanitation Subsectors



History and Trajectory. There has been policy momentum in the water and sanitation sector over the last decade. The Vision of the Country (2010-2038) and National Country Plan (2010-2022) outlined national goals for rural water and sanitation and urban sanitation sectors. The National Water and Sanitation Plan (PLANASA), released in 2014, outlined strategies to increase coverage of water and sanitation services including investment targets to reach the National Country Plan 2022 goals. It projected $314.1 million would have to be invested until 2022 to close the gap in the water and sanitation sector and suggested greater investment from the Honduran government be made, as the GoH budget was projected to cover only a quarter of the necessary investments.

Over this period, demand for water and sanitation has steadily increased due to continued population growth (1.6 percent in 2017).[277] Municipalities and service providers are aware of the growing disconnect between supply and demand. For example, a municipality in Western Honduras estimated they were only able to meet between 55-60 percent of demand due to a lack of investment in water collection and distribution infrastructure. Key informants noted that financing this gap would require additional budget allocations from the central government, increased water rates for customers, and new financing mechanisms. To respond to growth demands, some water providers have increased the utilization of water meters to better enforce water rates and avoid water waste. To strengthen sector management, CONASA established COMASAs (municipal water and sanitation commissions) aimed at increasing capacity of service providers, particularly the water and sanitation boards in rural areas (JAAS). As of 2016, 48 percent of the municipalities in Honduras had established a COMASA. The Regulating Entity of Water and Sanitation Services **(**ERSAPS) established Local Units of Supervision and Control, independent from service providers and COMASAs, to help monitor and audit the water and sanitation services and water fee schedules. These units currently serve 41 percent of municipalities.[278]

In wastewater, the industry has increased their demand for laboratory analyses for water quality over the past half-decade. The Center for Study and Control of Contaminants (CESCCO) conducted

[277] Central Intelligence Agency (CIA). The World Factbook: population growth rate. OpenGov.
[278] Secretaría Ejecutiva del Consejo Nacional de Agua Potable y Saneamiento (CONASA). 2016. Segundo informe de monitoreo de los avances de país en agua potable y saneamiento – MAPAS II. World Bank.

approximately 6,000 analyses for private sector companies on water quality in 2017. This was cited as being due to the increased enforcement from the Directorate of Environmental Assessment and Control, a public institution, aiming to decrease environmental contamination of the water supply from industry. This shows positive strides in the reduction of untreated wastewater being dumped into bodies of water, which later becomes drinking water for downstream communities.

The solid waste management subsector has seen less momentum. The country hasn't seen a change in comprehensive regulation in the waste management subsector since the Management of Solid Waste Regulation in 2001. Furthermore, only 20 percent and 3.7 percent of municipalities provide waste collection and disposal services, respectively.[279] In key informant interviews, the Department of Solid Waste Management noted a lack of consumer awareness or concern for responsible waste management, which is a barrier to increasing demand, as it is not seen as a priority.

In the future, adaptation to climate change and watershed protection continues to be a priority issue, demand for water and sanitation services will continue to grow with population. Customers are expected to continue to demand higher quality, more reliable and accessible services. One water service provider noted "*every day the demand grows and not just for water, but for safe drinking water*." The water sector must modernize to meet this demand. More immediately, this includes the installation of water meters to effectively inform price setting and billing according to water usage. There is also a need to shift consumer mentality to put more value on water and willingness to pay a higher price for quality services. These services should be coupled with similar modernization of sanitation services with more viable consumer fee-based mechanisms to sustain investments. In the waste management subsector, campaigns to increase environmental awareness of citizens such as "Honduras without Garbage" reflects a similar need to educate consumers.[280] While the issues and demands are relatively understood, the prevailing sentiment is that the necessary investments aren't being made to meet increasing expectations and demands.

DEMAND

Drinking water for urban municipalities and consumers. Interviews with water providers indicated that urban customers consistently demand more reliable service, meaning they get water for the expected number of days a week and the number of hours per day, water safe for human consumption (filtered and purified), and low prices. Water provision is largely satisfied by water and sanitation boards (JAAS) at 60.7 percent, followed by municipalities (26 percent), SANAA (5 percent), especially in the larger cities, decentralized municipalities (4 percent), and public-private partnerships (2 percent) (MAPAS II). There are still gaps in most urban areas. For example, urban areas reportedly have an average of 10 hours of water per day, which is lower than rural areas at 14 hours per day. In the southwest some regions reportedly receive an average of five hours of water service a day. However, urban consumers have seen improvements in the water infrastructure, with increased

[279] Secretaría de Recursos Naturales y Ambiente (SERNA). Acuerdo No 378-2001.Tegucigalpa, M.D.C, 6 de Abril del 2001. República de Honduras.
[280] Organización Panamericana de la Salud. Serna y OPS lanzan primera fase de campaña Honduras sin basura. Tegucigalpa, Honduras.

access to improved water sources over the last two decades. As of 2012, 85 percent of the lowest wealth quintile had piped water, which was up from 75 percent in 1995.[281] A majority of urban consumers have access to improved water sources, yet still have unmet demand due to the availability of that water throughout the day. Increased coverage of water meters would help providers better finance their services with more accurate water rates, and increase the development of water resources to increase availability of water and consistency of service. As noted by a 2015 ERSAPS report, urban providers with water meter coverage of 70 percent or higher are able to offer continuous service (24 hours/day) because water meters have allowed them to better understand the demand of the customers, track water utilization patterns, and accurately collect water fees. There remains a lack of development of water resources and investments in infrastructure for collection and distribution. Experts reported the potential are joint venture opportunities between water service providers and municipalities in urban areas with underdeveloped water resources.

Urban Water Providers with < 70% water meter coverage

SANAA Tegucigalpa, Aguas de Choloma, SANAA La Ceiba, Aguas de Choluteca, Aguas del Valle División, Aguas de Danlí, Aguas de Siguatepeque, Aguas de Lima, SERMUCAT, SANAA La Paz, SERMUPAS, Aguas de Guaimaca, Aguas de Trujilo, Aguas de Marcala, Aguas de Santa Rita, Morazán Municipality, La Masica JAAs, Aguas de Teupasenti, Aguas de Tutule.

Source: ERSAPS. 2015. Agua potable y saneamiento en Honduras. Indicadores urbanos. Edición 2015. ERSAPS

Drinking water for rural municipalities and consumers. Service provision in rural areas is large provided by the JAAS boards. Rural consumers have an average water availability of 14 hours per day. Coverage of the population with piped water or other improved water sources in fact decreased between 1995 and 2012 – difference in coverage between the lowest wealth quintile is 50 percent, compared to the highest wealthiest quintile which is 74 percent.[282] There are barriers for investment in the development of water resources in rural areas. First, there is little investment from the community in water and sanitation due to low levels of funding from the central government, a lack of funds available from water fees and decreased population with rural-urban migration. Private sector actors do not typically invest in rural water infrastructure. There are some models where *mancomunidades* have helped manage and preserve water resources available from watersheds in their catchment area. An example is the Association of Municipalities of Montaña Celaque National Park does in western Honduras. Additional investments in infrastructure will be necessary to address infrastructural degradation and expand collection and distribution networks.

Water for agricultural use. Water for agricultural use has livelihood and food security implications for a large proportion of the population. In 2003, when the last water census was conducted, 54.4 percent of total water usage in Honduras was for agriculture, showing large stressors from agriculture on water resources. However, a 2014 report from the Secretariat of Agriculture and Livestock (SAG) reported that 400,000 hectares of land in Honduras is classified as easy to irrigate, of which only 115,000 is under irrigation, showing room for further investment.[283] The departments of Intibucá, La Paz, Lempira, Copán, Choluteca, and Valle, as well as the southern part of Francisco Morazán and Comayagua, which comprise the Dry Corridor in Honduras, a drought-prone area, are particularly vulnerable and could benefit from improved irrigation systems. However, they noted challenges include a lack of qualified people for the design and construction of irrigation systems, making it hard

[281] Secretaría Ejecutiva del Consejo Nacional de Agua Potable y Saneamiento (CONASA). 2016. Segundo informe de monitoreo de los avances de país en agua potable y saneamiento – MAPAS II. World Bank.
[282] IBID
[283] United Nations Programme for Development (UNDP). Secretaría de Agricultura y Ganadería (SAG). 2014. Programa de desarrollo agrícola bajo riego (PDABR). UNDP.

to introduce into communities.[284] Irrigation projects have largely been initiatives of the GoH, led by SAG, and other international donors. For example, the National Water Harvesting Project, an initiative of SAG, was launched in 2015 to build 27 reservoirs to provide irrigation for 128 hectares per reservoir.[285] Other investments in water for agricultural use is likely only occurring among larger, agribusinesses, rather than among smallholder farmers. Agricultural producer organizations could explore joint investment projects with the municipality, input suppliers and wholesaler purchasers, and SAG to improve irrigation coverage and practices.

Water for industrial use. Industry is limited in their ability to extract surface water because of the possible environmental impacts of construction, burdens on the ecosystem from over extraction, and the possibility of limiting water resources for consumers in the community. The General Directorate of Water Resources (DGRH) is charged with granting rights to explore and extract water according to guidelines in the General Water Law, which reportedly is laborious process, as stated from key informant interviews. As can be seen in Table 3, companies tend to cluster near specific watersheds. Some watersheds do not support industry because they are environmentally protected, as is the case for Lempa. Nonetheless, there is potential to investigate and develop watersheds that are not currently stressed from extraction.

Figure 89 Principal Characteristics of the River Basins of Honduras[286]

River Basins	Population	Water Availability (m3/inhabitant)	Industry (count)
Islas del Caribe	38,352	5,326	
Motagua	186,466	4,376	1
Cuyamel/Tulián	7,000	178,429	31
Chamelecón	1,219,488	1,332	781
Ulúa	1,777,972	5,597	210
Léan	194,413	21,748	11
Cangrejal	168,566	9,866	60
Lislis	61,892	26,966	
Aguán	409,310	15,062	9
Sico/Paulaya	71,188	80,870	
Plátano/Sucre	1,040	5,189,423	
Patuca	631,733	25,047	43
Warunta	14,347	632,467	
Kruta	6,313	365,120	
Segovia/Coco	33,343	135,111	1
Islas del Pacífico	2,313	16,861	
Lempa	368,851	9,725	
Goascorán	54,355	20,532	
Nacamoe	277,303	8,040	15
Choluteca	1,400,208	2,343	504
Negro y Sampile	72,497	5,096	

[284] Secretaría de Agricultura y Ganadería (SAG). 2011. Presentación: Marco del Programa Nacional de Fomento a la Agricultura Irrigada (PRONAGRi) de la SAG. SAG.
[285] Global Water Partnership (GWP). 2018. Honduras: Benefits of action and costs of inaction in agricultural reservoir project in Azacualpa (#490). GWP.
[286] Secretaría de Recursos Naturales y Ambiente (SERNA). Acuerdo No 378-2001.Tegucigalpa, M.D.C, 6 de Abril del 2001. República de Honduras.

Sanitation services for urban municipalities. Sanitation services are typically coupled with water provision services by the same provider. Improvements have been made in urban sanitation services as of 2015, with 84 percent of urban customers covered by basic sanitation services (up from 77 percent in 1995).[287] However, a majority of this wastewater is going untreated. A 2013 ERSAPS report found that of the 71 analyzed cities, 49 percent had sewage systems with treatment, of unknown efficacy, 28 percent had sewage systems with no form of treatment, and 23 percent did not have a sewage system.[288] Necessary investments, as forecasted by PLANASA, to meet the 2022 country goals, had urban sanitation needing greater investment than water systems, at $75.4 million for urban sanitation and $67.7 million for urban water. New infrastructure projects accounted for 63 percent of the budget, compared to 41 percent of the budget for urban water, demonstrating the lack in systems to effectively collect, treat, and dispose of wastewater.[4] For example, SANAA is the water and sanitation service provider for the Central District (Tegucigalpa and Comayagüela) for 250,000 customers, yet only treats wastewater for 120,000 customers due to the lack of sewage systems to meet these customers. In the case of San Pedro Sula, served by Aguas de San Pedro, 66 percent of households are connected to a sewer network, yet the provider lacks treatment capacity and the wastewater is disposed of in the Chamelecón River.[22] As can be seen in Table 4, which does not include metropolitan cities, investments are required to fill the coverage gap of sewage systems. However, because these systems largely serve households and not industry, developing a business case for private sector to co-finance infrastructure projects may be difficult.

Figure 90 Proportion of Cities with Sewage System and Treatment[289]

Population Range	N° of Cities	Cities with Sewer Network	% of Cities with Sewer Network	Cities with Treatment Facilities	% Cities with Treatment Facilities
> 30,000	16	16	100%	13	81%
20,000-30,000	6	5	83%	4	80%
10,000-20,000	18	15	83%	9	60%
5,000-10,000	28	15	54%	2	13%
All	68	51	75%	28	55%

Sanitation services for rural municipalities. Rural sanitation services are also coupled with services from the service provider for water. Rural municipalities have seen greater improvements in sanitation services, jumping to 75 percent of rural households being covered by basic sanitation services as of 2015, which is up from 50 percent in 1995.[290] Coverage of basic sanitation services does not account for the proper management, treatment, and final disposal of wastewater. Data on the type of sanitation facilities utilized and treatment of wastewater is not available for rural municipalities. However, investments for rural sanitation from the PLANASA analysis identified improved latrines and septic tanks, rather than sewer systems, as preferred sanitation facilities. This signifies that sanitation projects are typically completed at a household or individual level, rather than being supported by sewer networks, as is the case for urban municipalities. Interviews with water and sanitation service providers, for both rural and urban providers, revealed that customers rarely

287 Organización Mundial de la Salud (WHO)., Fondo de las Naciones Unidas para la Infancia (UNICEF). 2017. Progresos en materia de agua potable, saneamiento e higiene: informe de actualización de 2017 y linea de base de los ODS [Progress on drinking water, sanitation and hygiene: 2017 update and SDG baselines]. Ginebra: 2017. Licencia: CC BY-NC-SA 3.0 IGO.
288 Ente Regulador de los Servicios de Agua Potable y Saneamiento (ERSAPS), SEFIN, PROMOSAS. 2013. Indicadores. Sector agua y saneamiento en Honduras. ERSAPS.
289 UNICEF/OMS. 2012. Programa conjunto de monitoreo de los progresos en agua y saneamiento.
290 IBID

demand improvements in sanitation services, but are more focused on improvements in the provision of water services.

Sanitation services for industrial zones. As of 2013, 46 percent of industrial activity was concentrated in the Department of Cortés, where San Pedro Sula is located, and 39.3 percent were located in the Department of Francisco Morazán, where Tegucigalpa is located. Although regulations exist prohibiting the disposal of effluents into the sewage system or bodies of water from industry actors, it is still occurring. For example, according to a 2007 World Bank report, 90 percent of industry actors in Tegucigalpa are not treating their wastewater before releasing it into the city sewage system or into the Choluteca River.[291] However, interviews suggest there have been large increases in the volume of requests for wastewater lab analysis received over the last five years. This may demonstrate an increase in the number of industry actors trying to comply with the law and ensure their wastewater is with standards. However, it remains unclear as to why some actors may not be treating their wastewater (e.g., no enforcement, lack of technical capacity) and therefore hard to understand the barriers and unmet demand for this particular customer.

Waste management for urban municipalities. Waste management services are typically provided in urban municipalities, where large cities have coverage between 76-90 percent, medium-sized cities (40-82 percent), and small cities (<40 percent). Fortunately, there is higher coverage in the cities that produce more than 58 percent of the total waste in the country, including in Tegucigalpa, San Pedro Sula, La Ceiba, and Choloma. Similar to water and sanitation services, municipalities can also contract out the waste management services to private companies, form a public-private partnership, or provide the services themselves. According to the Department of Waste Management, the sector is becoming increasingly competitive, with around 50 companies operating in the country. More companies are entering this market, as municipalities continue to contract out the collection and disposal services through a private contract. Private companies face the possibility of increased enforcement in the subsequent years to appropriately dispose of solid waste, particularly hazardous waste, which may result in some companies failing to adapt and being pushed out. There are poor final disposal practices, with only 11 urban municipalities practicing adequate final disposal practices, which range from the lowest classification of adequate semi-controlled landfill (Santa Bárbara, San Pedro Sula, Tegucigalpa) to mechanized sanitary landfills (Puerto Cortes, Roatán, Talanga). There are environmental and human health impacts from lack of investment in this sector. This distresses human health by increasing risk of water-borne disease from consumption of contaminated water, which increases the risk malnutrition and economic losses from reduced productivity.[292]

Waste management for industries. Waste produced by industry is not intended to be disposed of in the same manner as household waste, despite being possibly dangerous or not. However, it has been reported that industry actors typically burn their solid waste and then dump it at the municipal landfill.[293] From a partnership between the Swedish Institute for Public Administration and the

291 World Bank. 2007. Republic of Honduras. Country environmental analysis. World Bank. A previously cited study was done by Gutiérrez J., Munguía L., Tarradellas J. 1992. Estudio de residuos industriales en Tegucigalpa. CESSCO, 1992. Contaminantes Químicos / Monografía 11 – 96. SEP which reported that 150 of the then 380 companies in the country produced problematic effluents and of the 31 food and beverage companies studied that produce possibly problematic effluents, 81.5% dumped their wastewater into the sewage system and 18.5% released it into streams or rivers

292 Pandey, P., Kass, P., Soupir, M., Biswas, S., Singh, V. 2014. Contamination of water resources by pathogenic bacteria. AMB Express.

293 Swedish Institute for Public Administration (SIPU). 2006. Solid waste management and the environment in Tegucigalpa: Final report.

municipality of Tegucigalpa, it was reported that industry actors showed great interest in learning more about the Cleaner Production (CP) strategy, which is a preventative and integrated strategy aimed at reducing environmental impact for all products and services and at all stages of production, to reduce raw materials, water, and energy and decrease production costs for the company. There may be opportunity for consultants to work with industry players in finding solutions to decrease their solid waste through improvements in production efficiency, while also improving the bottom line for the industry player. There may also be potential for waste management service providers for municipalities to contract their services for the proper handling, storage, and disposal of waste produced from industry actors in their catchment zone. This could also help waste management service providers operating in urban municipalities better finance their services and improve the consistency of their service for household consumers.

ROLES

This section describes the actors and their roles and functions in the water and sanitation sector in Honduras. Actors are divided by four main functions: sector leadership and enforcement, technical assistance, service provision, and input supply.

***Figure 91** Market Functions and Actors of the Water and Sanitation Sector*

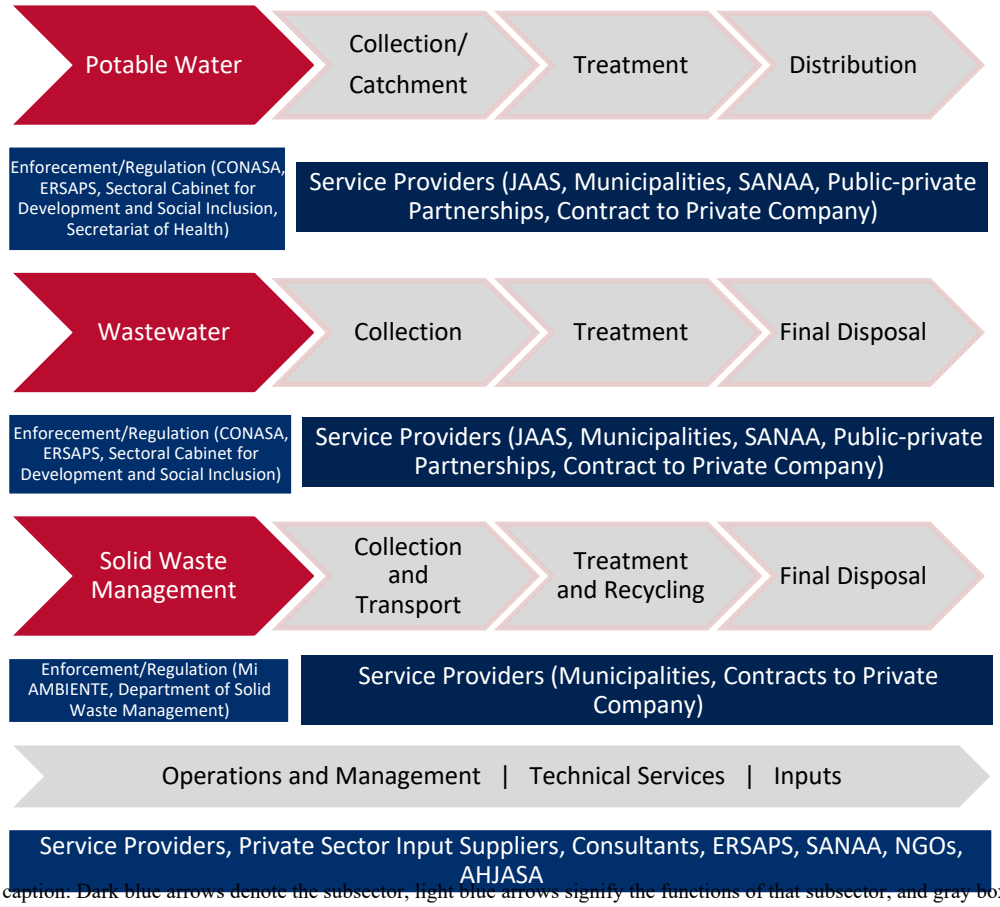


Figure 20 caption: Dark blue arrows denote the subsector, light blue arrows signify the functions of that subsector, and gray boxes contain the actors in that specific subsector.

The water and sanitation sector is highly regulated, with numerous actors charged with the creation and enforcement of policies and guidance. This section describes the actors from the three subsectors that are responsible for the regulation responsibilities in the overall sector.

Water Resource Regulation. The Secretariat of Energy, Natural Resources, Environment, and Mines (Mi AMBIENTE) and the General Directorate of Water Resources (DGRH) is charged with regulating natural water resources in the country. The DGRH has promoted the creation of regional water councils in areas where public and private entities share water from the same watershed. These councils execute programs and policies to promote the sustainable management of nearby water resources, develop and maintain necessary hydraulic infrastructure, and preserve the water resources. There are 33 water councils in Honduras and the DGRH works with them to develop their Water Plans. The DGRH also reviews and either denies or approves water permits, which are supposed to be required to start infrastructure projects to extract water. Interviewees noted there is a lack of enforcement to necessitate the approval of a water permit prior to extracting water and it was noted that there the DGRH does not have enough people or skilled labor to be able to appropriately review the permit applications.

Potable and Wastewater Regulation. Regulation of the potable water and waste water sub-sectors are principally managed by both CONASA and ERSAPS:

- **The National Water and Sanitation Council (CONASA**): Consejo Nacional de Agua y Saneamiento is the directing council that brings together different central government actors that work in water and sanitation with the purpose of setting direction and coordinating the different actors and activities. CONASA was established in 2003 under the Framework Law of Water and Sanitation with representatives from different public institutions. CONASA develops policy, guidance, and instruments to help steer water and sanitation service providers. As part of the decentralization efforts to support local water and sanitation service providers, CONASA promotes the creation of municipal water and sanitation commissions (COMAS). As of 2016, 144 municipalities had a COMAS established. CONASA leans on the network of organizations working in water and sanitation, including Honduran Association of Water and Sanitation Boards (AHJASA), Honduras Network of Water and Sanitation (RAS-HON), and the Association of Municipalities of Honduras (AMHON) to fill their gaps in setting the direction of the sector at the community level. A challenge in providing support to the COMAS and setting direction for the sector is the small operating budget and capacity of CONASA, which has reportedly decreased in the last five years from 1,700,000 to 1,400,000 lempiras, as reported during interviews with key informants. Challenge noted by interviewees include the lack of monitoring of the performance of the sector and thus their ability to advocate for an increased budget to the central government.

- **Regulating Entity of Water and Sanitation Services (ERSAPS):** ERSAPS is under the Secretariat of Health regulates and controls the provision of water and sanitation services, which is distinct from CONASA's responsibility as a planning and guiding agency. ERSAPS is charged with enforcing quality water service delivery, ensuring water fees are fair and within regulation, assisting municipalities in the decentralization process, and increasing service providers' access to information needed to make decisions. Similar to CONASA, ERSAPS promotes the creation of local entities to better reach the local service providers - Local Control and Supervision Units (USCL) – which are charged with observing and auditing the quality of water and sanitation services in the municipality. Most of these auditors are volunteers from the community and trained by regulation and control technicians and supported by regional and national ERSAPS technicians. ERSAPS as an institution remains underfunded and unable to fulfill their supervisory functions of the 123 USCLs in the country or carry out their other aforementioned duties. As ERSAPS' technicians also provide technical assistance, there have been attempts to charge communities (with 5,000 or more inhabitants) a fee when technical assistance is provided. This has received mixed feedback but suggests institutional desire to increase their services and funding mechanisms. Many

interviewees expressed a sentiment that ERSAPS' services are unnecessary, as investments in changes to the water and sanitation sector are rarely promoted or made, which is when ERSAPS' services would be potentially utilized.

Waste Management Regulation. Within Mi AMBIENTE, the Department of Solid Waste Management is charged as the regulating body of solid waste management and helps provide policy and strategy development and dissemination, technical instrument development, provides trainings and technical assistance to municipalities and service providers on the collection and final disposal of solid waste. There is not an Integrated Solid Waste Management Law for the sector, only a regulation, which limits the scope of the Department of Solid Waste Management due to the fact that the regulation does not afford power to the department to make policies or enforce a law.

Technical Assistance is delivered to service providers largely by public institutions but also by private organizations, like the Honduran Association for Water and Sanitation Boards. For the purpose of this case study, ERSAPS and CONASA are categorized by their function as leaders and enforcers in the water and sanitation sector, despite also providing some technical assistance. The providers described below perform technical assistance as their primary function, but may also provide additional services, like as a water and sanitation service provider, which is the case for SANAA.

- The **National Autonomous Service of Aqueducts and Sewage (SANAA**) is a technical unit for water and sanitation services within CONASA. SANAA previously served as one of the primary water and sanitation service providers in a quasi-centralized system prior to the 2003 Framework Law, when it was mandated to transition service delivery authority over to the municipalities. SANAA is still in the process of fully transitioning from their role as water and sanitation service provider for multiple urban areas, including in La Ceiba and Tegucigalpa. In their technical role to CONASA, SANAA serves as a capacity development tool for water and sanitation service providers. From key informant interviews with representatives from SANAA, it was reported that they have characteristically only been able to cover the municipalities who have requested their services, rather than systematically reaching out to all municipalities. SANAA offers laboratory services for service providers, through the National Information System of Water and Sanitation (SIASAR). SIASAR had registered and recorded water and sanitation provision data for 47 percent of the municipalities as of 2016 but reportedly continues to face obstacles in finishing baseline data and updating the information on a regular basis. The 2016 Monitoring the Advances of the Country in Water and Sanitation (MAPAS) II report described the lack of budget SANAA has to fulfill their role as the technical arm of CONASA and effectively develop the water and sanitation providers' ability to deliver quality water in a sustainable manner.

- The **Honduran Association of Water and Sanitation Boards (AHJASA)** is member-based organization that includes over 5,000 municipality water boards (JAAS). Municipalities pay a membership fee to AHJASA and receive services to become more self-sufficient providers. AHJASA stemmed out of the "necessity for a more streamlined and responsive technical body", as noted through key informant interviews. AHJASA is committed to keeping their catchment area lower for their technicians, which may provide for more timely and effective assistance.

In some cases, *mancomunidads* regulate and manage the water resources in a given area. One example of this is the Association of Municipalities of Montaña Celaque National Park (MAPANCE) is comprised of representatives from 11 municipalities (7 from Lempira, 3 from Copán, 1 from Ocotepeque). The association preserves and manages the water resources from the 50 micro watersheds, which serve 100,000 people, in their respective municipalities. MAPANCE receives funding from the central government. MAPANCE helps municipalities identify water

resources but does not help them extract or collect the water. As demand increases, they are expecting to see an increase in their services to the municipalities to identify additional water sources. MAPANCE serves as a technical assistance entity to the municipalities in helping them better provide delivery of water services to their communities and is an example of a functioning organization in the water resource management subsector. A significant advantage of having an association manage the area's water resources is that it is not as typically affected by political motivations, which sometimes happens at the singular municipal level.

Service Provision: Water and Sanitation Service

The municipalities have been appointed as the managing entity for the provision of water by law, which, in turn, replaced the National Autonomous Service of Aqueducts and Sewers (SANAA) of that function. Water and sanitation service providers are responsible for the identification and development of water resources to serve the water needs of the designated community, monitoring and evaluation of water quality, maintenance of water and sewer systems, and administrative responsibilities, such as setting and collection of the water fees. There are five main models of water and sanitation service delivery in Honduras, the JAAS, private companies through contracts with the municipality, mixed public-private providers, municipality providers, and SANAA. Municipalities are able to select the model which is best suited for them. According to the MAPAS II report, JAAS is the sole delivery model deployed in rural area, while there is a variation in models in urban areas. In urban areas, the JAAS delivery model is still the most common (60.7 percent), followed by municipalities (26 percent), and then SANAA (5 percent). Table 5 provides pros and cons of the different models, extracted from market systems interviews and the 2016 MAPAS II report. Similarly, during the market systems interviews, we heard similar barriers in providing quality service, including lack of funding and technical capacity of the labor force, regardless of what delivery model the interviewee represented.

Figure 92 Water and Sanitation Service Delivery Models

Model	Description	Pros	Cons
JAAS	The water and sanitation board, is a semi-independent function of the municipality that is comprised of elected officials who serve two-year terms that manage and oversee the water and sanitation services in the community. The municipality still holds the title to service delivery in the case of the JAAS model.	• Largely has administrative and financial independence from the municipality.	• Term for board members is only for two years and requires the continuous capacity building of new board members. • There is a a reported disconnection with the municipalities
Municipality	Municipalities can fill the role of service providers, often by having a designated department or staff within the municipality, to manage and oversee water and sanitation service delivery. Unlike with the JAAS model, this model is not separate from the municipality.	• It is an integrated system, with overlap with other parts of the municipality.	• Can be a bureaucratic process to make decisions and is affected by politics and elections • Earmarked money for water and sanitation can be sequestered for other municipality needs.
SANAA	SANAA was the primary water and sanitation service provider in the centralized system but transitioned the role of service provider to the municipalities (still provides services for 13 communities, as of 2015).	• Has financial and decision-making autonomy. • Hold institutional and technical knowledge specific to that community.	• Supposed to transition over responsibility for service provision to municipalities
Concession to other organizations	Municipalities have the option to contract the services out to private sector companies or civil society organizations to provide the	• Reduces the municipality's management burden.	• Reportedly is an anti-competitive bidding process, with companies holding contracts for 10+ years.

	water and sanitation services for the community.	• Provides financial and decision-making autonomy from the municipality.	
Mixed public-private partnership	In some instances, the municipality will contract the services out to a private provider but will still reserve the right to make larger decisions.	• Is largely independent from the municipality, but still allows for greater collaboration with the municipality for larger decisions.	• Can be impacted by politics with larger strategies.

A core challenge for water and sanitation service providers is ineffective price setting and collection processes for water fees. Prices are not set according to water usage and collection rates are low and most consumer aren't aware of their unpaid water bills. Service providers noted the urgency of adopting the use of water meters for households and businesses to better gauge water usage and bill accordingly. Water pricing and collection processes were listed as a priority action item in the 2016 MAPAS II report and even prior, in the 2003 General Framework Law of Water and Sanitation.

Another challenge water and sanitation service providers is infrastructure failure caused by a lack of funding to invest in necessary infrastructural improvements. Water providers note that the reduction in supply often occurs because pipes rupture, which results in a considerable loss of water. However, with a fragmented water fee collection system, most providers are unable to fix the piping system, which poses health risks from contamination for end users. Improvements in financing and payments for water and sanitation services is necessary to invest in new water and sewage systems to better meet demand. Larger cities, like San Pedro Sula, have outsourced to private sector providers like Aguas de San Pedro and have experienced streamlined bureaucracy nd improved efficiency. There are opportunities to promote the concession of potable water and sanitation services to private entities, or the creation of joint ventures (public-private partnerships), through inclusive and sustainable models.

Service Providers: Waste Management. Municipalities are charged with ensuring waste management service delivery provision. The majority of urban areas have elected to contract the services to private solid waste management service providers. According to the Department of Solid Waste Management, two large companies operate in Tegucigalpa and San Pedro Sula, and 50 smaller companies cover other urban areas. Companies face challenges in disposing of the solid waste, with only 11 landfills in the country. This leads to concerns about continued increase in waste and where it will be disposed of in the subsequent years. The Department of Solid Waste Management also called for an improvement in treatment and disposal practices, particularly for hazardous material. Private companies are working to expand into other areas but are having difficulty presenting the business case to municipalities that have traditionally lacked waste management services and do not see it as a necessary investment.

Input supply. Bombas y Motores of Honduras (BOMOSHA) is a provider of pumping equipment. Inversiones Diversas offers well drilling, construction of tanks for water storage, and conduction lines for water treatment. Green Base Technologies sells equipment for purification, wastewater, pumping and irrigation with solar panels, in addition to preparing feasibility studies and support in obtaining financing from financing institutions. Rotoplast is a supplier of water storage tanks and associated supplies. Lastly, water meter suppliers and lab testing services are provided by Agrobioteck, FHIA, and JordanLab. Suppliers have tried to diversify their client base to focus on industry and agriculture, housing development projects, and other large-scale projects. Equipment suppliers reportedly play an

important role in training of municipalities, or through separate maintenance contracts, but require assurance of pay from the municipalities, as noted during key informant interviews.

International Assistance. There is a variety of international aid and NGOs operating in the water and sanitation subsectors in Honduras, largely working in the development of water and sanitation systems. USAID has the Central America Regional Climate Change Program (RCCP) and the Governance in Ecosystems, Livelihoods, and Water (GEMA) activity. The NGO GOAL works in building latrines in Gracias a Dios and in drainage and water treatment systems in Distrito Central. *Agua Para el Pueblo* works in the design, construction, and supervision of water systems, water purification centers, and sewage systems. The Inter-American Development Bank has invested $525 million in Honduras, primarily working with rural water boards, to improve the infrastructure of their water and sanitation systems. Many international corporations and multilateral organizations have served as funders for projects mostly at the municipal level such as IADB, World Bank, CABEI, and KFW. Development organizations were perceived as a main source of funds for water and sanitation projects, rather than the central government, municipalities, or service providers. This has implications in terms of developing viable and sustainable solutions to for financing of water and sanitation systems in the longer term.

RELATIONSHIPS

The water and sanitation sector is characterized by an overlap in roles which results in uncertainty and weakens coordination between actors. The water and sanitation system is most easily defined and understood in terms of its individual actors. These actors are weakly interconnected resulting in a system that fails to generate desired results, such as fee collection, infrastructure investment and expanded services. Interviews showed there is a strong intend and desire among most actors to collaborate effectively; however, lack of clarity in roles undermines the realization of this intent.

Concessions to private companies. Some municipalities contract their water, sanitation and waste management services to private companies through public-private partnerships. These contracts have varying time lengths, ranging from renewable yearly to 20 years. Contracts are based on the State Contracting Law and the Budget Provisions of the Republic. In some cases, where they affect more than one municipality or are for an extended period of time, they must be approved by congress. Contracting out water and sanitation services reportedly streamlines delivery of such services. There were instances where competition for contracts was noted as unfair, due to the expansive periods of time that a company is able to serve as the provider. Water and sanitation services are however perceived as not lucrative to private sector companies due to the cap on fees set by ERSAP.

Aguas de Choloma is an example of a public-private partnership, where the municipality of Choloma and two cooperatives have provided water, sanitation, and waste management services for the zone of Choloma since 2004. Although the municipality has the majority of shares (97 percent) and is the directing body of the partnership, Agua de Choloma operates fairly independently of the municipality, which has helped decrease their bureaucracy and increase their efficiency. The provider is one of the few in the country that has updated the water fee schedule since the transition from SANAA, which Aguas de Choloma did in 2013. The provider also contracts ERSAPS for their services and pays them 2% of their total revenue through a formal partnership.

Input supply contracts. Water and sanitation providers have a variety of informal and formal contracts with input suppliers for equipment for water and sanitation systems (catchment, piping, pumping, etc.), maintenance of equipment, and technical assistance. Input suppliers provide the option to purchase with maintenance assistance. Some input suppliers reported training the service

providers on how to operate and maintain the equipment. In interviews with input suppliers, it was evident that although these contracts and transactions are important for them, they are not reliable given low levels of investment in overhauling current water and sanitation systems.

NGO-public sector coordination. The For Everyone, Forever Movement is a partnership between CONASA, ERSAPS, SANAA, and sixteen NGOs in the water and sanitation sector. The objectives of the movement are grounded in the Water and Sanitation General Framework Law, but ultimately aim to improve the management and provision of these services. This alliance serves as a platform for different NGOs and government actors to collaborate on projects, share research, and align approaches and objectives. For example, CONASA works with Para Todos Por Siempre to help train their staff and SANAA collaborates with them to provide technical assistance to 25 municipalities. The effectiveness of this partnership at providing better quality technical assistance to the central government and service providers is relatively unclear. However, it seems effective at decreasing geographic overlap and increasing the synergies in trainings provided to service providers.

Industry and water service providers. There is limited coordination between industry and the water and sanitation sector, particularly in the development water resources. For example, near the Choluteca River Basin there are 504 companies that utilize water for processing and production purposes to some extent. In that same area, water availability per inhabitant is one of the lowest (2,343 m3/inhabitant) in the country basins (see Table 6). The Administrative Water and Sanitation Board of Jesus de Otoro recognizes the potential private sector can play and stated, “private sector can help extend the supply networks to rural areas in which they operate”. Leveraging industry to help finance water development projects could be a win-win relationship. However, trust is fairly low in the water and sanitation sector, with most actors being skeptical of initiation or progress from other actors. The lack of trust may exist because of the segregation of the market, where actors rarely have to rely on each other. The promotion of formal public-private partnerships in the water and sanitation sector may help ease the sense of mistrust among industry actors and municipalities.

RESOURCES

Water. One of the most important resources for the water and sanitation sector is water, which is subject to changes due to rainfall patterns and climate change, deforestation, and other constraints to supply. The two of the largest watersheds are the Atlantic Watershed, which has 16 watersheds that feed into it, and the Pacific Sloping Watershed, which has five watersheds that drain into it. Most of the water used is from surface water sources, but groundwater is becoming increasingly more important, especially on the Pacific side. In western and southern Honduras, climate change poses significant risks and is expected to cause a 2°C increase in temperature and 10-20 percent decrease in precipitation by 2050.[294] Only 9.1 percent of available water in Honduras is utilized. However, water is not sufficiently available in many areas for service providers to consistently reach their consumers. The geographic variance in water availability can be seen in Table 7. Relying on the water resources of the river basins is insufficient, particularly on the Pacific Ocean side, and has resulted in PLANASA suggesting municipalities invest in drilling of wells to increase supply and better meet demand. Additionally, with climate change projections, Honduras is vulnerable to a decrease in water availability to between 2,000-5,000 m^3/inhabitant/year by 2050 and less than 1,700 m3/inhabitant per

294 United States Agency for International Development (USAID) Honduras. 2016. Country Development Strategy 2015-2019. USAID.

year by 2100.[295] To better serve populations and meet the increasing demand, investments in watershed protection, water harvesting infrastructure and extracting water from other sources, like through drilling of wells, will be necessary.

***Figure 93** Continuation of Water Service by Region of Development*[296]

Regions of Development							
Population Location	**1**	**2**	**3**	**4**	**5**	**6**	**Average hours/day**
Metropolitan	22	NA	NA	6	NA	NA	**14**
Large City	11	15	7	5	NA	NA	**10**
Intermediate City	15	17	7	7	5	12	**11**
Total Urban	16	16	7	6	5	12	**10**
Rural	19	22	5	8	14	NA	**14**

Financial Investment: Funding for the water and sanitation subsectors has been fairly limited from the public sector, largely due to the lack of prioritization from the central government and lack of clarity as to where funds are supposed to come from. For example, operation costs for maintaining the water and sanitation systems falls under the financial responsibility of the municipality, while the central government is supposed to cover technical assistance. To meet the 2022 water and sanitation coverage goals established in the National Water and Sanitation Plan (PLANASA), it was estimated that by 2022, $116.7 million, $154.1 million, and $43.2 million would be required for rehabilitation of current systems, repositioning current systems, and constructing new systems. During that same time, only $78 million has been planned from the central government, leaving an investment deficit of $236.1 million. Municipalities often do not have the funds to update or construct new water and sanitation systems, CONASA created the National Water and Sanitation Fund (FONASAN) in 2015 as a way to offer attractive credit opportunities to providers and share responsibility across stakeholders. The idea was that the central government would start the fund with 100,000 million lempiras and be matched with 400,000 million lempiras from the Honduran Bank for Production and Living (Banhprovi) with other local organizations, municipalities, or international organizations contributing. It remains unclear as to whether FONASAN has been established and is accessible to providers to make the necessary investments in their water and sanitation systems. From interviews, investing in maintenance or constructing new water and sanitation systems is seen as a priority, but the lack of funds or financing makes is difficult. Improving the water fee setting and collection system, as well as exploring ways to incorporate other stakeholders, like private sector actors, in investing in water and sanitation projects in a mutually beneficial manner will likely be necessary.

Technical Capacity: The National Information System of Water and Sanitation assessed the capacity of the service providers in 2015 and found that 71 percent received a B rating, which indicated they needed some improvements, like trainings, while 19 percent received a C, 8 percent received an A, and 2 percent received a D. These results were reiterated in the interviews with service providers, often stating that employees do not know how to maintain the equipment or systems, particularly

295 ECLAC/CCAD/SICA/UKAID/DANIDA. 2011. La economía del cambio climático en Centroamérica. Reporte técnico 2011 (LC/MEX/L.1016), Mexico City.
296 Adapted from Consejo Nacional de Agua Potable y Saneamiento (CONASA). 2014. Plan nacional de agua potable y saneamiento (PLANASA). República de Honduras.

among the water and sanitation boards. The challenge with the water and sanitation boards is that they turnover every two years, which results in loss of technical knowledge and momentum that was built over the previous term. A representative of SANAA is supposed to provide technical assistance to the new water board, but they are already functioning with a limited number of people making it difficult to ensure trainings are done in a timely manner. There is a need for a labor force with knowledge of water and sanitation to ensure systems are appropriately maintained and new projects can be effectively planned and executed. Honduras can draw from examples such as Galileo University in Guatemala, which has a specific track for the water and sanitation sector, which prepares engineers for positions in the field.

RULES

Water and sanitation represent a key cross-cutting sector indispensable to the competitiveness of the country, but such priority has not been reflected in successive GoH budgetary allocations. There are a range of policies and regulations within the water and sanitation sector (see table below). However, due to the lack of coordination and leadership and generally low budget prioritization, many of these laws and policies have yet to be fully implemented. The protection and management of the water resource with multipurpose approach (drinking water, irrigation and energy) should be prioritized.

A belief seems to persist among service providers, particularly the municipal providers, that the responsibility for improvement of the sector belongs to the central government. This lack of central leadership results in public sector actors interpreting laws and regulations differently ex. municipalities, MI AMBIENTE, SANAA, etc., which discourages private investment from entering the water business. There are no technical studies on water projects' economic valuation to assist decision makers to prioritize water investment planning. Since the sector has dispersed public actors and is regulated under multiple laws and regulations, experts agree that they should be centralized under an umbrella high-level Commission with its own budget. Experts also noted environmental licenses, municipal permits, certifications by COCAFCA, etc. must become more standardized and made more expedient as to reduce the procedures' costs and time.

A core challenge reported is the belief among customers that water is a public right, and not something that should be paid for – or if paid for, at the lowest possible price. Households are fearful of having water meters installed because they believe their water bill may increase. Providers stated that there is a lack of awareness of the value of water and importance of conserving it, which further makes it difficult to increase water rates for the consumers. In sum, everyone is affected by the water and sanitation sector issues, but no one appears to be accountable and responsible for fixing it.

***Figure 94** Chronological Reform of the Water and Sanitation Sector in Honduras*

Year	Chronological Reform of the Water and Sanitation Sector in Honduras
1927	National Waters Use Law
1961	Law of the National Autonomous Service of Aqueducts and Sewers (SANAA)
1990	Law of the Municipalities
1993	General Environment Law
2003	General Framework Law of Water and Sanitation
2005	Legislation of the Management of Waste
2006	Strategic Plan for the Modernization of the Water and Sanitation Sector (PEMAPS)
2009	General Water Law: Comprehensive Management of Water Resources
2010	Vision of the Country 2010-2038 and National Plan 2010-2022
2010	National Strategy of the Management of Watersheds in Honduras
2011	National Policy for the Water and Sanitation Sector and National Sanitation Plan (PNAPS)

2014	National Plan for Water and Sanitation (PLANASA)
2015	Financial Policy for the Water and Sanitation Sector

RESULTS

The status quo poses significant risks with the increasing pressure of climate change, population growth, and wearing infrastructure of the water and sanitation systems. If the sector continues to act in a segregated fashion, the growing misalignment between supply and demand will become an unmitigated crisis. The overlap in responsibilities between actors such as Mi AMBIENTE, CONASA and ERSAPS already results in a deficit of leadership which has systemic impacts on the sector to overcome its challenges. Water is a resource used by all, but seemingly valued by none. No one appears accountable for ensuring this resource is adequately managed. In the future, the availability of water per habitant will likely continue to decrease with climate change to levels of between 2,000-5,000 m3/inhabitant/year.[26] This will have significant impacts on the livelihood in many areas in Honduras and will relocate industries, jobs and drive external migration. These risks aren't hypothetical. It is researched and documented that jobs that depend on water will become increasingly more vulnerable, particularly agricultural jobs, which comprises 95 percent of water-dependent jobs.[297] The migration crisis in 2015 was attributed by the World Food Program primarily to environmental factors, specifically drought and its impact on food security.[298]

The GoH estimated in 2014 that a total investment of $314 million would be required by 2022 for infrastructure in the water and sanitation to provide acceptable coverage of services and meet the 20/20 and 2030 country goals (PLANASA). The water and sanitation sector is a highly regulated sector, with numerous actors charged with the creation and enforcement of policies and guidance. A more centralized, umbrella regulator that could reduce the overlap in roles and responsibilities between different regulatory agencies would help to streamline public investments in the sector. However, it is not clear or likely that pushing responsibility to the central government is a solution. The sector remains highly vulnerable to further budget cuts. Municipal service providers and JAAS providers rely on the services of SANAA and ERSAPS, which already face constrained by limited budgets.

Water can no longer be a public good, the costs of maintaining this resource should be borne by its users. Improving the fragmented water fee collection system is a necessary next step to improve investment. Public-private funding models are required. Aguas de San Pedro is a water and sanitation service provider in the city of San Pedro Sula that functions free of the administrative, budgetary, and political constraints of the municipality through a contract with the City of San Pedro Sula. The service provider distributes water for an average of 20 hours a day, supplying roughly 326 liters per person per day (lppd)[299]. Contracting can help to solve water and sanitation management issues. Industries depend on water resources as well are potential investors through public-private partnerships (PPPs) that develop water resources for productive use, while also improving availability to the community for household use is a win-win. These partnerships could engage food and

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[297] Miletto, M., Caretta, M. A., Burchi, F. M. and Zanlucchi, G. 2017. Migration and its interdependencies with water scarcity, gender and youth employment. WWAP. Paris, UNESCO.

[298] A 2017 World Food Program study found that people living in the Northern Triangle's Dry Corridor region, which is prone to draught were food insecurity and during El Niño many migrants had left their country because of low yields as a result of drought. See World Food Program. 2017. Food Security and Emigration.

[299] In comparison, SANAA, a government service provider in Tegucigalpa, sees frequent water shortages and provides an average of 180 lppd.

beverage companies, hotels and resorts, medium and large-scale agriculture operations, light manufacturers, etc. which depend on resources.

In particular, there are opportunities for the development of the business case where the private sector can increasingly take the lead for development of the water and sanitation sector, in partnership with municipalities JAAs and local chambers to identify more sustainable solutions to address issues related to waste disposal, access to potable water and water resource management. Input providers, such as water meter companies, chlorinators and storage tank suppliers are likely partners who are motivated to increase market share to meet this unmet demand. In particular, strengthening the base case for rural service provision could have significant implications for vulnerable persons. Building this business case could start simply with an update to the 2003 water census and working with GoH to bring to life the FONASAN fund which was originally established to provide loans to the sector.

There are opportunities for inclusive employment of marginalized groups in solid waste collection related to recycling, integrated water resource management as part of municipal management and in local water boards. Youth and women are also active in the waste management sector as garbage pickers and sorters. There are business models which can be introduced and scaled in Honduras, involving marginalized populations for collection centers for recyclable materials such as cardboard, PET, plastic, glass, metals. There are prototypes from elsewhere in Latin America to draw from to develop in Honduras, such as *Ciudad Saludable*.[300] Other opportunities noted include the construction of reservoirs or payment for ecological services, which would motivate better land use practices such as planting of trees for carbon sequestration. The water and sanitation sector warrants considerable attention from GoH, diverse donors and private sector alike - TMS's primary role in this broader effort would be to contribute to efforts to streamline policy and leadership as part of BEE reform. In addition, there is space to strengthen the business case for water and help to bring private sector industry to the table based on a recognition of the implications of a water crisis to the bottom-line and to contribute to efforts to strengthen investments in water and sanitation systems.

[300] https://www.ciudadsaludable.org/



INFRASTRUCTURE

ANNEX XI INFRASTRUCTURE

SECTOR OVERVIEW

Sizeable infrastructure gaps that translate into deficient services. Expensive and low-quality infrastructure in Honduras had been noted long before 1998, when Hurricane Mitch destroyed 70% of the nation's transport infrastructure. Today, Honduras has one of the highest industrial energy costs in the region, with costs 25% above the LAC average. Top barriers to growth in Honduras noted include inadequate infrastructure - leading to high transportation, electricity and telecom costs - as a key constraint to growth and competitiveness. Honduras requires infrastructure development at a grand scale. There is an estimated $3 billion investment gap (or more) and this gap is growing at $500 million (or more) a year based on current investment rates (ECLAC recommendations that LAC countries should invest 6.2% of GDP annually).

Private investment in PPPs has helped to close the infrastructure gap but has favored some types of infrastructure over others. Most financing and investment in new infrastructure in Honduras comes in the form of administrative concessions to private companies, local and international; public-private partnerships (PPPs) for large-scale energy, transport and telecommunications projects. Investment in the sector attracted US$3 billion and grew renewable energy sources participation to 75% of total generation. The private sector is now responsible for around two-thirds of power generation. Honduras has the highest private sector investment participation share in the LAC region for productive infrastructure. However, these partnerships however do not go towards smaller projects such as rural electrification and water, sanitation, waste management, hospitals or schools. but rather large-scale energy and transport projects, with more limited investment in water and sanitation.

Infrastructure prioritization is reportedly a top-down exercise. Interviewees routinely noted limited cooperation between the municipal government and the national government. Reportedly, projects are handed down to municipalities from the national government without necessary consultation or engagement with municipal authorities. This results in contracted projects that lack adequate analysis and are misaligned with municipal-level development goals and initiatives.

There is a lack of transparency in project contracting and execution. Current state contracting law in conflict with the law of complementary income which is used to avoid infrastructure bids generating unfair competition. The need for greater equity and transparency in bidding processes is a highly systemic constraint within in the infrastructure sector. It results in delays to project execution, contract addendums and change orders and escalation of project costs, while leaving smaller players excluded. The absence of sufficient levels of transparency results in frequent litigation marginalizes both qualified companies and small and medium sized actors in the sector. This helps to ensure that the pool of awardees is routinely comprised of the same parties, while creating openings underqualified companies to bid. Experts also noted it is also unclear the degree to which public funding through trust funds established by fuel and other taxes are being used for as public investment in infrastructure development.

INTRODUCTION

The fixed capital of Honduras is reflected in its infrastructure and productive facilities. This includes roads, ports, airports, bridges, dams, energy and other communication systems, schools, hospitals, etc., making the sector fundamental in driving the nation's economy and improving the economic wellbeing of its inhabitants.[302] Its physical installations and services allow for all formal trade, transport, social services and electrical and data transmission to occur. Infrastructure is the backbone of an economy and a critical input to every economic output. The condition of a country's infrastructure has a cascading impact on the nation's economy, impacting business productivity, gross domestic product (GDP), employment, personal income, and international competitiveness. Honduras has the lowest ranking for infrastructure in the Central American region. Honduras has 16,415 km of roads (23 percent of which are paved)[303], 4 international airports, and 3 seaports (on two oceans)[304], yet the competitiveness of its infrastructure is ranked within the bottom 75 percent worldwide.[305]

Figure 95 Infrastructure rankings of Central America[301]

Country Ranking Score	Infrastructure
Panama	37
Costa Rica	65
El Salvador	77
Guatemala	84
Nicaragua	92
Honduras	104

However, Honduras has sizeable infrastructure gaps that translate into deficient services. Expensive and low-quality infrastructure in Honduras had been noted long before 1998, when Hurricane Mitch destroyed 70 percent of the nation's transport infrastructure.[306] Today, Honduras has one of the highest industrial energy costs in the region, with costs 25 percent above the LAC average. Recent analysis on barriers to growth in Honduras noted inadequate infrastructure - leading to high transportation, electricity and telecom costs - as a key constraint to growth and competitiveness. ECLAC recommends that LAC countries should invest approximately 6.2 percent of GDP annually between 2012 and 20/20 in infrastructure.[307] Honduras is investing only 3.5 percent.[308] The underinvestment gap for Honduras over the past 5 years amounts to more than $3 billion.[309]

Infrastructure is fixed, unable to be exported. Yet all of Honduras' export goods, including its top four exports in general – knit goods, coffee, insulated wire and bananas – all rely on the nation's roads to move their inputs and final products, its electrical grid to power supply chains, its hospitals and schools to provide for its workers and their families, and mobile networks to facilitate it all. Of the nine other sectors examined in this report, all rely on productive infrastructure to function. Among all investment types, investment in infrastructure is one of the most crucial for growth. Infrastructure investment has the potential to impact growth positively in both the short- and long term.[310] The infrastructure sector provides the foundation for enterprises to grow and enables the connectivity between enterprises that facilitates trade and stimulates broad-based economic growth.

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[301] World Economic Forum. (2017). Global Competitiveness Report.

[302] Sanchez, Palma and Mouftier. (2017). Natural Resources and Infrastructure. Retrieved from : https://www.cepal.org/en/publications/type/natural-resources-and-infrastructure

[303] Instituto Nacional de Estadisticas (INE). (2017). Road network by type and Department. Tegucigalpa, Honduras.

[304] COALIANZA- obtenido de: http://coalianza.gob.hn/en/invest-in-honduras/modern-infrastructure

[305] World Economic Forum (WEF), 2017-2018. Global Competitiveness Index.

[306] Hernandez Ore, Marco Antonio, Liliana D. Sousa, and J. Humberto Lopez. 2016. "Honduras: Unlocking Economic Potential for Greater Opportunities." Systematic Country Diagnostic. World Bank, Washington, DC. License: Creative Commons Attribution CC BY 3.0 IGO

[307]The Economic Infrastructure gap and Investment in Latin America, bulletin FAL issue No. 332, number 4/2014

[308]Infralatam. obtenido de: http://es.infralatam.info/dataviews/226323/infraestructura-agregada-todos-los-sectores/

[309] Authors calculations taking the difference of 6.2% and 3.5% between 2012 and 2017

[310] Jiménez and Manuelito. (2014). Rasgos Generales de la Inversión. Santiago de Chile. Obtenido de: https://www.cepal.org/sites/default/files/events/files/1.7_jimenez-manuelito.pdf

Infrastructure reflects the ability of an area to sustain productive growth and competitiveness with strong effects on economic growth, job creation, and quality of life.[311]

This analysis breaks the infrastructure sector into 5 sub-sectors, which fall under 4 purposes:

Figure 96 Infrastructure Sector Descriptions

Purpose	Economic Development	Social Development	Environmental Protection	Access to Information and Knowledge
Description	Transport infrastructure, Energy, communications, WASH	Hospitals, schools, WASH, Unpaved roads	Parks, reserves, ecotourism circuits, protected areas, flood works	Cable TV, distance education, internet provision, mobile access, relay stations
Sub-sector	Road & Transport Networks	Community (or social) Works	Mitigation & Climate Change	Telecommunications Infrastructure
	Energy Infrastructure			

Sub-sector 1 - Road & Transport Networks -
This sector consists of the construction and maintenance of the nation's paved and unpaved road network, bridges, railroads, seaports, airports. This sub-sector is one of the most important for the promotion of the economy due to provision of the national and international mobility of passengers and commercial cargo, which are closely linked to economic growth. It provides access to communities via the road network, in combination with the construction and maintenance of bridges, causeways, culverts, and other works for public transport systems. It includes airfields and maritime ports (covered in more detail in the Logistics sector) making it an essential sub-sector for all other sectors as it enables commerce and the flow of goods and resources. The Social Forum on Foreign Debt and Development of Honduras (FOSDEH) referred to the sector in 2017 as the fundamental pillar in the productive development of the country, noting: "the State favors the conditions for economic growth and development, to the extent that it stimulates economic activity by facilitating to access roads and the circulation of trade in local markets (i.e., through the construction and maintenance of roads, etc.)".[312]

Sub-sector 2 - Community (or social) Works -
Public construction projects associated with various sectors make up the community works sub-sector. These are the structures necessary for the physical, academic and social wellbeing of a country's human resources and labor force. These projects support communities through the implementation of water projects[313] to properly convey drinking water, sewage, and rainwater. Most public vertical construction falls within this subsector, including schools, health centers, community centers, nursery centers, etc. Non-vertical public construction, includes the construction and maintenance of parks, roadsides and sporting fields, are also included here. Public investment in these areas through a proper investment strategy focused on factors that increase human capital (through

[311] Economic Commission for Latin America and the Caribbean (ECLAC), December 2010: A Regional Competitiveness Index for Country (pg. 80).
[312] FOSDEH, (2017) *Infraestructura Faraónica. "citando a* Torche, Cerda, Edwards, Valenzuela" (2009). Tegucigalpa Honduras. obtenido de: http://www.fosdeh.com/wp-content/uploads/2017/11/10.-Infraestructura-fara%C3%B3nica.pdf
[313] UNICEF. (2016). Strategy for Water, Sanitation. at: https://www.unicef.org/wash/files/UNICEF_Strategy_for_WASH_2016_2030.PDF

education and health) and productive capacity can have a positive effect on the productivity of private enterprises and increase economic growth.[314]

Sub-sector 3 – Mitigation Infrastructure to adapt to Climate Change -
As a cross-cutting element, mitigation infrastructure subsector supports local governments and vulnerable communities through training and implementation of projects for risk management, disaster prevention and climate change mitigation. It includes, flood protection projects, irrigation, drainage works, watershed protection measures and structures required to increase of agricultural productivity. Irrigation systems under this sub-sector serve to increase the profitability, competitiveness and relevance of the agriculture and forestry sectors in the international economy. They ensure a more efficient use of water resources and improve the welfare by increasing productivity.[315] Honduras - and Central America in general - is highly vulnerable to natural disasters (tropical cyclones, flooding, landslides, and earthquakes).[316] United Nations Development Program (UNDP) analysis of the post-Mitch[317] era, shows a lack of focused recovery strategies for sustainable sources of income and employment generation, contributing to the rise of poverty rates and the stagnation of human development in the country. It also shows a reactive approach towards public spending on risk management, weakening the country's resilience to disasters.

Sub-sector 4 – Energy Infrastructure
The energy infrastructure sub-sector consists of both renewable and non-renewable power systems that aim to solve shortages of electricity and improve the quality of energy supply. Energy infrastructure consists of elements related to the generation, transmission and distribution of energy.

Figure 97 Electricity Supply Quality in Central America[318]

Country Ranking Score	Quality of Electricity Supply
Panama	56
Costa Rica	37
El Salvador	73
Guatemala	42
Nicaragua	87
Honduras	104

The electrification rate for Honduras was estimated at 86 percent in 2012[319], attributed to a lack of resources and the isolation of certain areas in the country (primarily the northeast and southeast). Since the creation of the Social Development Fund (FOSODE), by the Framework Law of 1994, the GoH has the ability finance electrification projects, especially those of social interest. Although Honduras has the highest investment rate in the energy sub-sector in Central America still has by far the lowest quality of electricity supply in the region (see table above)[320]. Currently electrified areas witness high and consistent levels of service interruption due to the repair of the transmission lines. According to the Energy Company Honduras (EEH) this has a significant effect on the competitiveness of the business sector. After the establishment of the Electricity Regulatory Commission, electricity tariffs increased by 15 percent (2015 and 2017) resulting in considerable increase in the prices of processed and manufactured products. This was particularly hard-hitting for Honduran homes with incomes below the minimum wage. The ENNE is the state-owned company responsible for all transmission and distribution. It functions in an enormous deficit (1.8 percent of GDP, 2013) due to systemic inefficiencies and structural formation

[314] FOSDEH. (2017) *Infraestructura Faraónica."* Torche, Cerda, Edwards and Valenzuela (2009), citando Barro (1995). obtenido de: http://www.fosdeh.com/wp-content/uploads/2017/11/10.-Infraestructura-fara%C3%B3nica.pdf
[315] Directorate General of Irrigation and Drainage of the Secretary of Agriculture and Livestock (SAG)
[316] United Nations Development Program (UNDP). "Disasters, Risk and Development in Honduras, 2012".
[317] Hurricane Mitch (1998) is deadliest Atlantic Hurricane of the modern era, causing 7,000+ fatalities in Honduras
[318] World Bank. Govdata 360: Quality of electricity supply. at: https://govdata360.worldbank.org/indicators/ha7db856d?country=BRA&indicator=548&viz=line_chart&years=2007,2017#table-link
[319] National Electric Energy Company (ENEE).at: www.enee.hn/
[320] World Economic Forum. (2017). Global Competitiveness Report.

that lacks accountability. Only power generation has been opened to private business, who are currently responsible for around 2/3 of production. Between 2017 and 2018, renewable energy generation increased as a portion of total energy demand from 58.3 percent to 75 percent. These gains were driven by a 10.3 percent increase in hydroelectric generation, a 5.1 percent increase in wind generated electricity, and a reduction of 16.9 percent in the use of diesel and combustibles for generation.[321]

Sub-sector 5 – Telecommunications Infrastructure

The sub-sector for telecommunication infrastructure is composed of construction projects that improve access to mobile communication and information technology. Telecommunications systems and especially ICTs reduce the digital divide to increase innovation and competitiveness of companies, streamline government processes and generate education opportunities in remote areas. Honduras has the second lowest ranking after Nicaragua in technology readiness which is directly related with investments in telecommunications (see table 3).[323] The coverage and quality of service requires evaluation to determine its potential for improvement. As of Q1 2018, 90 out of 100 Hondurans own a mobile telephone line (vs. 5 out of 100 owning a fixed telephone line).

Figure 98 Mobile and Technology Scores Central America[322]

Country Ranking Score	Mobile-Cellular Subscriptions	Technology Readiness
Panama	6	63
Costa Rica	12	45
El Salvador	29	95
Guatemala	73	96
Nicaragua	58	108
Honduras	105	99

Coverage rates percentages for municipal capitals and population are as follows:

Service Type	Municipal Capital Coverage	Population Coverage
2G voice telephone	100%	91.92%
3G mobile internet	97%	75.91%
4G mobile internet	39.26%	47.75%

The average speed of Internet access is 2.9 Mbps for fixed service and 4 Mbps for mobile (equivalent to 3G). In Q1 of 2018, the international internet bandwidth of the grew 7.66 percent compared to the previous quarter[324]. Growth in the sector has been supported by large foreign direct investment inflows. The sub-sector, accounts for the largest share of FDI in Honduras[325].

Figure 99 Non-selected subsectors

Housing/Real Estate. This sector was excluded from TMS analysis during the ranking exercise with the SME's on June 18th, 2018. Housing and real estate have not been selected by TMS as a sub-sector for further examination within the Productive Infrastructure sector. In 2014, public interest to enforce the *Social Housing Funding Law* (FOSOVI) led to the Council of Ministers to approve the *National Commission on Housing and Human Settlements* (CONVIVIENDA), as a separate entity decentralized from office of the Presidency. The establishment of CONVIVIENDA was done to create and implement a national housing policy. This policy ensures programs and projects are designed to improve the living conditions of low-income Honduran families and that basic living

[321] National Electric Energy Company (ENEE) Generation of electricity by type. at: www.enee.hn/
[322] World Economic Forum. (2017). Global Competitiveness Report.
[323] IBID
[324] National Telecommunications Commission (CONATEL). (2018). Performance of the telecommunications sector. at: http://www.conatel.gob.hn/
[325] Hernandez Ore, Marco Antonio, Liliana D. Sousa, and J. Humberto López. 2016. "Honduras: Unlocking Economic Potential for Greater Opportunities." Systematic Country Diagnostic. World Bank, Washington, DC. License: Creative Commons Attribution CC BY 3.0 IGO

conditions for those in extreme poverty are being met. This move of CONVIVENDA from the office of the Presidency, effectively established Housing as an independent sector.

In the **past three to five years** there has been a stronger emphasis on municipalities and professional groups leading the planning processes for strategic local development plans and in infrastructure regulation. Infrastructure sector professionals have seen the need to strengthen their relationships through Associations and Guilds to pool their influence to advocate for stricter compliance with regulations.[326] This is in response to a lack of effective oversight which has led to instances where low quality projects with poor safety standards have been approved and implemented. Some of these instances have been due to a lack of proper regulation and compliance of Non-Governmental Organizations (NGOs) which execute construction projects. This level of coordination reflects a grassroots push for more a more fair and transparent bidding process and increased oversight over the execution of infrastructure projects by construction companies. The push for improving transparency and efficient use of resources is both a challenge and an opportunity moving forward. The political-economy of how stakeholders come together will impact the stability of the sector and whether institutions are strengthened to make more effective and binding decisions. This involves stronger follow-through on commitment between the GoH and local governments to adhere to technical working group prioritizations for transformative projects.

Infrastructure investments have been driven by donations, loans and public-private partnerships (PPPs). The national funds are complementary as well as the contributions of the beneficiaries when they are required. There has been a perceived imbalance between what is committed in public funding versus what is realized. The budget for public investment has been 4.3 percent of GDP but it has typically only been executed 2.61 percent. Private sector funding via PPPs has formed a vital source of funding for the infrastructure projects. Honduras has the highest private sector investment participation share in the LAC region for productive infrastructure.[327] These partnerships however do not go towards smaller projects such as hospitals, schools etc. but rather large-scale energy and transport projects, with more limited investment in water and sanitation (FOSDEH, 2017). Actors in the in the sector expect to see continued efforts to improve performance through use of strategic alliances; a change in views of public investment due to the exposure of corrupt practices; and basic sectoral working groups whose decisions are binding.

Recent years have also see noted differences in the infrastructure sector between the Northern and Western regions. Municipalities in the Northern Region do not feel they receive the same level support from aid implementors as Western municipalities. Northern zone municipalities have seen demand for larger investment in the road network, and social infrastructure services such as: landfills, garbage collection, schools, and river dredging. In the western region, municipalities have been organized and associated as "*Mancomunidades*" – a type of commonwealth or network of individual municipalities. This mechanism has proven effective in allowing them to secure greater access to financial support given they can pool technical resources more effectively to form, manage, and successfully execute infrastructure projects. Interviewees noted this new trajectory offers an opportunity to change the way actors cooperate, shifting emphasis away from one of "*asistencialismo*" - where problems are solved through external assistance – to one where solutions are structural and self-created. This involves a greater recognition of the value of decision making at the local government-level.

[326] Honduran Construction Code, Construction Regulations and Complementary Technical Standards, State Contracting Law, among others
[327] Infralatam. obtenido de: www.infralatam.info

Honduras is highly vulnerability to natural events requiring greater investment and innovation in climate mitigation infrastructure. An overview of the sector shows that Honduras has a lack of quality in it is infrastructure, high costs, and historic vulnerability to shocks and stressors. With 75 percent of the landscape of the country on a slope greater than 25 percent, combined with more frequent and more intense tropical storms due to climate change, the potential effects could be significant and ripple through the economy. The Global Climate Risk Index 2016 shows that Honduras was one of the three countries in the world most affected by extreme weather events during the 20-year period from 1995 through 2014. Public expenditure on risk management tends to be reactive. Looking forward, a growth in renewable energy is expected, with new players entering market. Infrastructure actors need to adapt or take advantage of these changes by resourcing young and qualified staff and betting on the implementation of cutting-edge technology that makes the market more competitive and resilient.

Infrastructure is a basic need for an economy. If that need is unmet, the rest of the economy cannot function. Infrastructure is meant to serve a single block - the entire population - and therefore its strengths and weaknesses affect the entire population. Infrastructure is however a tough sector to coordinate and reform, as any one of its processes involves a complicated array of actors. From the highest levels of the Honduran government down to common laborers including all the actors in-between: development banks, universities, the private sector, and international aid organizations, etc. If these actors do not act in harmony, then the infrastructure deficit will continue to grow and the Honduran economy won't be healthy enough to produce the jobs needed. This requires high levels of coordination and strong planning and leadership at the Central Government level, that is informed by bottom-up influence from the municipalities and communities served. Success in achieving this will be determined by the future growth, competitiveness and resiliency of the other sectors of the Honduran economy.

ROLES

Within the infrastructure sector, the actors serve four primary functions: **Contracting, Executing, Regulating**, and **Financing**. All of these functions are applicable to each of the infrastructure sub-sectors (transport, social, mitigation and climate change, electrical transmission, telecom transmission); however, the actors who provide them may differ between sub-sector.

The infrastructure sector represents a fairly generic model for supply and demand of services: a party (contractor) wants something built; a party (executor) is contracted to perform the work; someone monitors (regulator) the compliance of the work; and someone pays for it (financing). However simple this model is, what distinguishes infrastructure is the complicated array of *actors* engaged in each role. For large institutions, there are often sub-actors nested within them that can often interact as if dependent. Infrastructure is not a sector prone to mobility (i.e. actors are stuck in their roles), yet overlap is common, with the same actor performing multiple functions. This overlap can both provide efficiencies such as the case of both financing and contracting functions but can also lead to potential conflicts of interest such as entities that do both contracting and execution functions.

Function 1. Contracting - Central government, local governments, donors (national and international) and private investors contract out services related to infrastructure design, planning, installation, maintenance, etc. These are the actors responsible for the *development* of infrastructure projects. In comparing to general construction, this category of entities best aligns with *developers* - the ones who deem a project is required and contract the necessary parties to make it a reality.

Function	Actors			
Contracting	INSEP	Commonwealths	HONDUTEL	Townhalls (D and C)
	INVEST-H	COPECO	SANAA	Deputies
	SEDI	NGOs	COALIANZA	
	IDECOA	PRONADERS	Concessionaires	
	National Coffee Fund	ENEE	Private companies	

Contracting is performed by the GoH, its designated departments, secretariats or state-run entities, local government and by international aid or, in the case of concessions, by private companies. The larger the project, the higher-up the contracting entity. At the central government level**,** contracts are prioritized by the president and his council of ministers, and large/mega projects defined accordingly.

Actors performing the contracting function that are of special note include:

- The National Electric Energy Company (**ENEE**) which is a state entity that contracts out projects related to the electrical transmission subsector.
- Strategic Investment of Honduras (**INVEST-H**) which is the GoH's management unit for projects using international and national funds for road construction, maintenance and oversight of concessions; specifically, investments relating to the Millennium Challenge Corporation.
- The Commission for the Promotion of the Public-Private Partnership **(COALIANZA)** operates under the Law for the Promotion of the Public-Private Partnership. The commission is responsible for managing PPPs associated with the execution, development and administration of public works projects and utility services. It contracts large-scale projects, such as the road network, public buildings, ports, and electrical power under **INSEP** (The Secretariat of Infrastructure and Public Services).
- The Institute of Community Development, Water and Sanitation (**IDECOAS**) and its sub-agencies Honduran Social Investment Fund (**FHIS**), and National Program for Sustainable Rural and Urban Development (**PRONADERS**) contracts out basic services such as water and sanitation, roads and rural electrification.
- The **Rural Infrastructure Project (PIR**) is the executing unit of IDECOAS/FHIS that has been very successful in generating positive impact with projects developed with World Bank funding for rural electrification to reach very poor communities. The PIR serves the transport, social, energy sub-sectors, and leverages projects established by ENEE for rural electrification to promote solar and micro-hydro renewables. PIR manages solar energy subsides provided by the GoH for participants to finance renewable systems.
- **Permanent Commission of Contingencies (COPECO)** is an entity created to coordinate public and private organizations in response to natural disasters. It does so under the framework of the National Risk Management System (SINAGER)[328]. SINAGER is tasked with developing the capacity of Honduras to prevent and reduce risks from natural disasters, as well as prepare, respond and recover from physical destruction caused by natural or human activities. Its framework is inclusive of all sectors in the country regardless of organizational structure, membership, etc.[329]

At the **local government level**, municipalities and *mancommunidades* contract projects primarily for social and environmental infrastructure, often in collaboration with one of the entities listed above.

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[328] Formed under the Special Law of the National System of Risk Management.
[329] Honduras: Ley del sistema nacional de gestión de riesgos. obtenido en: https://www.preventionweb.net/english/professional/policies/v.php?id=21473

These projects are typically smaller-scale infrastructure such as: schools, bridges, pavements, fences, and any need for cadasters related to land use and tenure of the land offered to the community. *Mancommunidades* help to pool resources between individual municipalities to generate budgets, supervise project design, and form proposals to manage larger sums of resources from international donors and the GoH. Private investors and/or donors may take on contracting projects however, infrastructure requires large investments that often takes significant time, if ever, for an individual business to recoup profit[330]. Infrastructure projects tend not to be funded through private investment; yet some cases do exist. Communications Services of Honduras (Sercom Honduras) is one example of a private investment, whose local subsidiary of Claro, is the second largest mobile network operator in the county. Another example is the Nation Coffee Fund, a private association that maintains the entire road network (along with social infrastructure projects) within the 15 coffee growing departments to ensure the continued and improved production of the county's primary agricultural export. Both these private investors have determined that it is in their best interests (and profitable) to maintain or develop the infrastructure needed to sustain their businesses.

Function 2. Executing – This is work performed by service providers, be it construction firms or other "contractors", engineers, consultants, etc. This does not only include physical construction. Planning, design, studies, maintenance, and operation are all part of the executing function. Some of the same organizations and type of actors with a contracting function described in the section above are also active in executing infrastructure projects (i.e., NCF, NGOs).

Function	Actors		
Executing	Construction Companies Consulting Companies National Coffee Fund NGOs	Women's Associations Indigenous Associations Producer's Associations Community Organizations	Patronages Water Boards Master builders Bricklayers, plumbers, carpenters, electrician

In general, execution tends to be performed by large private sector construction and consulting companies. Interviewees noted that contracting entities tended to prefer larger organizations. There were comments as well regarding the transparency of competition processes and ineffective competition i.e. low-bidding by implementing executors, which has excluded small and medium-sized companies from executing contracts. In terms of entrepreneurship, there is no easy entry into this industry for new actors. Projects at this level of scale require capital and experience. While the sector may not lend itself to new entrants, infrastructure is certainly enabling of entrepreneurship in other sectors. On the other hand, *mancommunidades* and municipalities also serve in the executing function through the design and supervision of projects, as well as the services to support micro-enterprise development. This includes institutional strengthening; environmental impact studies; cadastral surveying; management of social service programs, such as daycare for children, youth, and the elderly; and the promotion of tourism, culture and heritage.

Function 3. Regulating – The regulation of sector activities includes permitting, studies, advocacy, legal representation, information sharing, and knowledge management, legislation, etc. These activities assure accountability and result in industry norms and practices, which like any, need to be maintained through action. The function is primarily performed by the state and civil society.

[330] A simple example – railway infrastructure. It is not feasible for a private business to develop a nation or state's railway system. However, once the track is in place, it becomes a conduit to efficient profitability for private companies like CSX, Deutsche Post, etc.

Function	Actors		
Regulating	CHICO Professional Associations Academia	Audits Electric Power Regulatory Commission (CREE) COPECO	CONATEL CCIVS The populous

The general population, through civil society organizations, should be the most important regulator, but are not active. The consequence of this lack of engagement is that the regulations and projects not reflective of local circumstances. As it happens, the onus is on the regulators to press for community participation in decisions that affect them in order to identify problems with the registry of public contracts, control of state bids, and law enforcement.

Regulation is, therefore, concentrated in few state entities. CONATEL, is the public regulator and growth promoter for the telecommunications subsector. When spectrum frequency are given out in concessions, CONATEL, handles the award (under Function 1). The same is true for the provision of cable television. The commission has a direct relationship with Congress to ensure telecom regulations are not disruptive to the market. However, market is currently controlled by a duopoly of Claro and TIGO, leading to controversy in how the sector is being regulated. COPECO is a public institution within the framework of the National Risk Management System of the Republic of Honduras and responsible for the coordination of public and private organizations to mitigate natural disasters. COPECO collects and shares data for planning and identification of sites where infrastructure interventions are required.

Influential Private Sector and Civil Society Regulator include:

- NGOs, such as the Social Forum of External Debt and Development (**FOSDEH**), have the objective of producing the most reliable accounting of Honduras' external debt and serves as a social auditor of the government's decisions. It validates the central government's official figures and generates alternative points of view. FOSDEH also produces academic technical articles as tools for decision making and offers studies for international organizations to improve their understanding of the economics and politics of Honduras' trade agreements.
- Trade unions, such as the Honduran Chamber of the Construction Industry **(CHICO)** and the College of Civil Engineers of Honduras (**CICH**), seek to protect the interests of industry personnel, while ensuring that projects are executed transparently and by qualified staff, resulting in safe, high-quality infrastructure. CHICO advocates for favorable conditions for workers and improving the enabling environment in the sector; free and transparent contracting; and political conditions favoring economic stability and growth. They serve as a forum for information sharing that includes training bodies, publishers, and other sectoral advocates. In this function they can supervise state bids and advocate for faithful compliance with the law (i.e., Honduran Construction Code, Construction Regulations and Complementary Technical Standards, State Contracting Law, etc.).

3. Financing - Most infrastructure projects are financed through development banks, international aid organizations[331], or government funds. Sources of financing include: The Inter-American Development Bank (IDB), The Central American Bank for Economic Integration (BCIE), World Bank, KFW etc. International missions to Honduras, such as the embassies of Japan, the US, Germany, etc., work in close relationship with the GoH to establish aid (non-reimbursable financial cooperation) for disaster risk prevention and social and transport development depending on their interests. Financing entities can perform other functions. For example, the Embassy of Japan, in its oversight of JICA, also exerts the executing function by providing Japanese volunteer technicians for direct project execution, while the National Coffee Fund secures financing for its activities through coffee cooperative memberships. Foreign direct investment plays a strong role in the financing of telecom infrastructure - this subsector represents that largest contribution of FDI in Honduras.

Function	Actors		
Financing	GoH External Aid Orgs	Development Banks Embassies/Missions	Local Governments

Figure 100 Functions and Actors by Sector

Sector	Function	Actors
Transport	Contracting	INSEP, INVEST-H, INSEP, IDECOAS, Municipalities, Commonwealths and National Coffee Fund.
	Executing	Construction Companies and Consulting Firms, National Coffee Fund, NGOs, Community Organizations, Boards of Trustees, Water Boards, Producer Associations, Indigenous Associations, Women's Associations, Local Contractors (Construction Masters, Bricklayers, Plumbers, Carpenters).
	Regulating	INSEP, Instituto Hondureno del Transporte, COPECO, CHICO, Professional Associations and Academia
	Financing	Central Government, Local Governments and International Cooperators, National Coffee Fund
Social	Contracting	IDECOAS, SEDIS, Municipalities, Commonwealths, NGOs
	Executing	Construction Companies, Consulting Firms, National Coffee Fund, NGOs, Community Organizations, Women Associations, Patronages, Water Boards, Producer Associations, Indigenous Associations, Local tradespeople
	Regulating	COPECO, CHICO, Professional Associations and Academia
	Financing	Central Government, Local Governments and international aid
Climate Mitigation	Contracting	COPECO, Municipalities, Commonwealths, NGOs
	Executing	Construction Companies, Consulting Firms, National Coffee Fund, NGOs, Community Organizations, Women Associations, Patronages, Water Boards, Producer Associations, Indigenous Associations, and Local tradespeople
	Regulating	COPECO, Professional Associations and Academia
	Financing	Central Government (Own Funds, Loans), Local Governments (Own Funds and Municipal Transfer) and international aid
Electrical	Contracting	ENEE, IDECOAS, Municipalities, Commonwealths

[331] USAID, the German Federal Government Agency (GIZ), German Cooperation Kreditanstalt Für Wiederraufbau (KFW), Japanese Agency for International Cooperation (JICA) were the agencies most mentioned, mainly in the western regions, that have direct relationships with both the central and local governments.

	Executing	Construction Companies, Consulting Firms, National Coffee Fund, Community Organizations, Women Associations, Patronages, Water Boards, Producer Associations, Indigenous Associations, Local tradespeople
	Regulating	CREE, CHICO and Professional Associations
	Financing	Central Government (Own funds, Loans), Local Governments (Own funds and Municipal Transfer), international aid (External organizations, Development Banks, Embassies), foreign direct investment
Telecom	Contracting	HONDUTEL, Sercom/CLARO, TIGO
	Executing	Construction Companies, Consulting Firms, Local tradespeople
	Regulating	CREE, CHICO and Professional Associations
	Financing	Central Government, Private (Bank, own funds, investors) and international aid

RELATIONSHIPS

Cooperation is an essential component in the successful coordination of the type of large-scale construction efforts that are typically seen within the infrastructure sector. The infrastructure sector overlaps with each of the other sectors examined in this report and others. A road project that transects several departments or municipalities, intersects with transmission lines, has runoff that affects surface waterways, brings commerce in and out, or sometimes around communities, provides unskilled laborers with job opportunities while also demanding highly-trained engineers, designers and managers - requires extensive cooperation between stakeholders. The construction, operation and maintenance of the electrical grid, or hospitals or the nation's telecom services is no different.

Partnerships and alliances help to facilitate the execution of infrastructure projects by securing supply and more efficient sharing of resources. They can also help to expose of new groups and individuals to training and learning opportunities they would otherwise not encounter, helping to improve the supply of qualified skilled human resources. This is the case with scholarship programs and exchanges as part of academic alliances. Alliances can also serve to bring increased visibility to projects that might otherwise be overlooked. *Mancomunidades* serve as a vehicle for local governments, smaller contractors and maintenance providers to showcase their more successful efforts which can leveraged to lobby contractors e.g. Rural Infrastructure Project (PIR)[332] to promote similar work. The scale of infrastructure projects and the array and diversity of actors involved, make the sector well positioned to employ various relationships and alliances to meet its goals.

Municipal-National Coordination. Interviewees routinely noted limited cooperation between the municipal government and the national government. Reportedly, projects are handed down to municipalities from the national government without necessary consultation or engagement with municipal authorities. This results in contracted projects that lack adequate analysis and are misaligned with municipal-level development goals and initiatives. This results in inefficiencies in spending for the development of rural infrastructure. Mechanisms that foster greater collaboration between local and national governments, as part of a more participatory, open and decentralized processes would result in greater efficiencies and impact, according to interviewees. An example would be working groups or other functional structures to facilitate dialogue to help governmental institutions at different levels, as well as aid implementers and community organizations to work together to develop and prioritize development agendas. This could be done according to

[332] The PIR in an alliance between the GoH and the commonwealths has created jobs for rehabilitation of rural roads, water and sanitation and electrification efforts

infrastructure subsectors, giving higher visibility to the ability of certain projects or initiatives to create job opportunities, or increase access to basic services or markets.

Mancomunidades. These are formally-structured alliances that allow municipalities to partner and to form, manage and execute projects of common interest within the infrastructure subsectors (with the exclusion of telecom). Under this arrangement the *mancomunidad* provides technical support and management capacity to the city hall with jurisdiction over the project. Municipalities may belong to more than one *mancomunidad* depending on the common interests of the populations they represent. There are 46 *mancomunidades* in operation in Honduras of which 29 are in the area of influence of TMS. Interviews with these entities have shown a strong ability to leverage resources by structuring formal alliances with other entities. For example, Mancomunidad Lenca Eramaní (MANLE) has a formal agreement with the Chamber of Commerce to improve the efficiency of business taxes and regulations implemented in its association. COLOSUCA has a similar alliance with CANATURH to promote their territory. MAMCEPAZ and MANLE have agreements with international aid organizations for the development of water and sanitation infrastructure and administration. Interviews with *mancomunidades* showed them to be successful advocates and facilitators of primarily small-scale, NGO-funded, social infrastructure projects (e.g. schools, health centers, etc.) Depending on the capacity of the *mancomunidad* involved, they could be supported, or their capacity improved, to address larger, more sophisticated infrastructure projects. The *mancomunidad* model can be viewed as a win-win alliance, for member municipalities and strengthening alliances throughout the infrastructure sector.

Interviewees noted that *mancomunidades* are well positioned to become an intermediary between municipalities and national governments. Depending on their capacity, *Mancomunidades can* carry out community-based assessments, develop pre-implementation studies, solicit constituent input to inform project design and planning, and serve as an interlocuter for feedback throughout contract execution, and later in operation. These forms of arrangement can further outline expectations for roles and responsibilities of different actors and have the potential to better leverage local labor and business as part of projects e.g. community workers that would maintain unpaved roads where machinery is unavailable or unfeasible. *Mancomunidades* are positioned to work with municipal governments to environmental protection measures against erosion and excessive runoff, through roadside planting, and maintenance of ditches and culverts. Such activities provide a double win for reducing unpaved road maintenance and reducing sedimentation and pollution of local waterways.

Funding agreements. These are partnerships between the GoH and multilateral banks and aid organizations that allow collaboration of technical and financial efforts. Note these are usually not applied under the telecom subsector. The largest hurdle for infrastructure development is finding and securing the funding for construction. To attract such funding, it is increasingly important to have the cooperation of the government to develop, apply and enforce transparency mechanisms to better compete for this funding with other countries. Global emphasis has shifted rapidly towards greater transparency in the financing of infrastructure development. Initiatives such as the Infrastructure Transparency Initiative (CoST) - of which the GoH is a member[333] - are working to improve transparency and accountability in public infrastructure. Strengthening transparency as part of BEE reform offers improved legal certainty and opens Honduras to potential new investment. Local government engagement in the infrastructure planning process is a core feature of transparency. The

[333] CoST: Infrastructure Transparency Initiative. (2018). at: http://infrastructuretransparency.gn.apc.org/where-we-work/cost-honduras/

channeling of community needs and information through cooperation is valuable not only in ensuring more relevant project planning and executing, but in improving local government capacity over time.

Contractors and Contracting Entities. Contracts are executed through a private or public bidding process or through direct contracting process without bidding. Interviewees suggested varying degrees of ineffective competition in this process. There is reportedly an emergence of underqualified NGOs, without demonstrated capacity or expertise in construction, implementing infrastructure projects that take advantage of the *Law of Supplementary Revenues in sub-rural and marginal urban areas* (see Rules). There are also reportedly a growing set of newly formed and underqualified companies that are successfully winning contracts – these firms in many cases reportedly prove unable to effectively execute projects. In other cases, proxies of larger companies, bid on contracts and then subcontract the work to the larger company, generating profit without performing all the terms of the agreement. These cases reflect ineffective competition, which has also created barriers to entry for small and medium-sized builders in the sector.

Alliances in the form of agreements and contracts require transparency to work. Unfortunately, a lack of transparency is common, and there are legal loopholes that allow for circumvention[334]. The need for greater equity and transparency in bidding processes is a highly systemic constraint within in the infrastructure sector. It results in delays to project execution, contract addendums and change orders and an escalation of project costs. It leaves smaller players excluded. The absence of sufficient levels of transparency and resulting frequent litigation will continue to marginalize both qualified companies and small and medium sized actors in the sector, ensuring that the pool of awardees is routinely comprised of the same parties, while creating openings underqualified companies to bid. This again limits competition and with it the need for innovation, and without proper regulation does little to ensure that the best (and technically sound) product is being obtained for the lowest price.

Despite the ineffectiveness of competition in the bidding process, there is also some degree of innovation and technology adoption among construction and associated companies that is positive. This is brought by pressures from working in a small undifferentiated market, but also one that is growing, which forces creativity and continuous adaptation to set them apart from competitors. Construction companies are rapid adopters of new technology and many invest in workforce development. There is a constant pressure to improve decision making and optimize strategies to exploit or create market diversification. Executing firms are cooperative with the actors in other roles though alliances or relationships in the form of formal agreements and contributions but tend to specialize in their core strengths. No exclusive relationships - that leave out the poor, women, youth, indigenous, PWD or LBGT - have been noted, however that does not confirm their absence. While involvement in the infrastructure sector can be seen as “needs-based” and employing democratic hiring processes, the sector is not immune societal biases and exclusion.

Academic Alliances and Letters of Understanding. These alliances enable cooperation between institutions for scholarship programs and cultural exchanges as well as the implementation of new technologies. An academic alliance through a letter of understanding exists between the Higuito commonwealth and the national Autonomous University of Honduras (UNAH). Such letters of

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334 Policies such as the Law of Transparency and Access to Public Information (2006) are meant for development and execution of the national transparency policy, as well as to ensure of the right of everyone to access public information. However, it is ineffective given it includes provisions that allow for the confidentiality of documents from public institutions at their discretion, thus handicapping its designed purpose

understanding occur between local governments and public or private universities to ensure that research processes are channeled effectively through *mancommunnidades*. This ensures that commonwealth partners are aware of university involvement at the research level.

Specialized Input/service suppliers and Contractors: Large contractors form alliance with specialized services providers to bid large projects. One good example of these specialized input/service suppliers is Lazarus & Lazarus.

RESOURCES

The infrastructure sector does not appear to lack availability of resources such as raw materials, equipment or machinery, so much as the ability to transform those resources into results due to a lack of the financing and skilled human resources needed to complete projects.

Raw materials

Infrastructure consumes a large amount of raw material resources. Take for example the nations road network: enormous amounts of gravel and dirt are needed for leveling, asphalt for surfacing, concrete and rebar for the construction of culverts, drainage channels, walls and barricades, bridges and overpasses, etc. Or in the case of vertical construction, schools and their components: concrete foundations and floors, brick or concrete block for walls, timber ceiling joists, tile or corrugated metal roofing. Most surveys conducted of enterprises acknowledged the importance of this resource, but there was only a single instance noted of difficulty accessing it. The supply of materials is discussed in greater detail under construction materials sub-sector in Light Manufacturing.

Human Resources

Human resources are just as important to the sector as natural resources. Skilled personnel to work at all levels - operate equipment, design and engineer projects, facilitate the contracting process, coordinate implementation - are required. Executors noted the importance of machinery and equipment to the work they perform in the sector. While this equipment is reportedly available, there is an absence of skilled, trained personnel to operate the equipment. Highly trained personnel in general, including this category of labor, was consistently observed as difficult to recruit and hire. A lack of skilled staff reduces potential for technology acquisition due to lack of operators. Most survey respondents were indifferent on the aspect of inclusion when asked. The sector likely leans to being more inclusive in its hiring than other sectors. The undifferentiated nature of infrastructure and its services provides results – physical works – for the use of all.

Qualified, skill personnel are nearly universally seen as lacking by interviewees. Groups, institutions and organizations surveyed noted that many companies choose to hire inexperienced personnel and train them internally. This method is reportedly risky and often doesn't often provide return. A reported problem is that many young people entering the labor market don't have the right technical training needed by businesses. Low income youth are unlikely to have university-level training and there is a gap in professional training programs. There seems to exist for example opportunities for alliances with universities to develop programs to train lower-income and people in rural areas to take on less skill-intensive functions, such as maintenance of local infrastructure projects. Few companies reported having access to administrative and operational certification processes that allow them to be more effective in vocational training. Free, or low-cost access to such programs is either not available or highly selective. This lack of access to advice and training hinders sector performance.

Financing

Given Honduras's limited ability to finance large infrastructure investments on its own, most financing and investment in new infrastructure comes in the form of administrative concessions to private companies, local and international; public-private partnerships (PPPs) for large – and some small – projects; multilateral donor assistance, such as rural electrification and water and sanitation; and foreign direct investment (FDI) on the energy and telecommunication sectors. There are also opportunities to leverage PPPs, donor projects, and inter-municipal collaboration to finance smaller, more inclusive infrastructure projects, particularly in rural areas. Notable examples include the National Coffee Fund, *mancomunidades*, discussed previously, as well as others.

Over the last decade, billions in US dollars have helped strengthen and develop energy, telecommunications, and road networks. Private concessionaires operate several key areas of Honduras economy, including its main port (Puerto Cortes), the management of energy transmission and distribution (EEH), and, in a smaller scale, the water, sanitation, and waste management services (Aguas de Choloma, Aguas de San Pedro). The GoH agency most involved in promoting the large-scale projects is COALIANZA, under the Secretariat of Infrastructure and Public Services (INSEP). Investment in telecommunications is fully covered with private financing, mostly FDI. There are only two dominant players, Tigo and Claro. Furthermore, the energy sector has been thoroughly revamped since 2014. New investment in the sector attracted $3 billion and grew renewable energy sources participation to 75 percent of total generation. The private sector is now responsible for around two-thirds of power generation. To deal with weaknesses in its power distribution and transmission networks, still in hands of a financially strapped ENEE, the GoH and representatives of the private sector signed an agreement in October 2018 to further open the energy market. Under the new agreement, generating companies can now sell electricity directly to the GoH or any private user, which is expected to increase competition, investments, and coverage, which in turn are anticipated to reduce costs and rates. Other infrastructure needs, such as air connectivity, an administrative concession, or another type of PPP mechanism, such as build-and-operate, could help Copan Ruinas improve its local airport by expanding its runway and improving its installations and services. This will require the GoH (COALIANZA) finding an interested private partner.

Not all concession mechanisms are considered effective. Puerto Cortes users, such as customs agents and shipping companies, complain that, although the port concessionaire has improved efficiency, it has done it at too high a cost. They see it as functioning as a monopoly with very expensive operating costs, particularly when compared with other ports in the region. For example, the costs in Puerto Barrios in Guatemala are 20-30 percent lower than in Puerto Cortes. Another roadblock for increasing PPPs in some key inclusive activities, such as rural electrification and water, sanitation, and waste management, are caps on fees set by government entities, such as EENE and ERSAP, which discourages private sector interest in participating in those efforts. Unless, utility rates regulation allows for a more reasonable level of profitability on those projects, private involvement could be curtailed indefinitely. Multilateral donors are also important players in infrastructure financing, particularly in rural areas. For example (and as mentioned earlier), PIR (World Bank) is funding rural electrification to reach very poor communities focusing on solar and micro-hydro renewables. Meanwhile, the IDB is funding through INVEST-H rural access roads and may do the same in cold storage infrastructure as part of its efforts to strengthen the logistics sector. INVEST-H is GoH's management unit for projects using international and national funds for road construction, maintenance, and oversight of concessions; specifically, investments relating to the Millennium Challenge Corporation. As part of INVEST-H upcoming efforts, it plans to improve 1,500 km of rural roads throughout the country ("*Caminos de la Finca al Mercado*") during the 2019-2021 period. These efforts to improve secondary and tertiary road infrastructure are attracting national and foreign

investment interest. The agency is also looking into increasing the rural irrigation network in the near future.

Information

There were several information gaps noted in the infrastructure sector. Access to transparent information for example was noted as lacking for an open bidding and contracting process. Reliable access to statistics is needed to improve the design of roads and other essential social services, as is digital access to information for works pertaining to the environmental protection in the face of climate change. *Mancomunidades* noted the importance of access to information to develop, plan, and manage projects. Technological innovation is seen as an option for institutions and companies to enhance access to information to improve competitiveness in the market. This includes advance software for project design and management; GPS systems for surveying; remote sensing application (such as LIDAR) for data collection to inform design; drone photography for topographic mapping use in the transport and mitigation subsectors, as well as to determine utility transmission paths. Unfortunately, the cost of technological innovation is high and access to it is low. Additionally, sector actors report that an added hurdle attached to acquisition of improved technology is a complete lack of technical staff able to employ it for the use of improved business development.

RULES

The institutions involved in administrating these laws were already described in the Roles section given the centrality of regulators and public actors in the infrastructure transaction process.

The **State Contracting Law** is the legal instrument that regulates contracting for the execution of works and the acquisition of goods and services by the GoH. This law is intended to ensure equity and the optimal use of state resources. The policy generates controversy in part in that it does not require concessions to include the participation of a national company or entity, such as the concession for the operation of CA-5 Highway. Perhaps more relevant is a desire by local companies for a more open process for companies with less experience to become certified so they can also participate in the bidding process either alone or in a consortium with other national or foreign companies.

Notably though, there is a perceived conflict with the State Contracting Law and the **2010 Law on Supplementary Income which** declares national priority on infrastructure investments that improve the income of rural populations and low-income urban zone by allowing those projects to be awarded without prior bidding or competition. Although this law doesn't have precedent or higher hierarchy than the State Contracting Law, it is being used more often than needed, in the opinion of several business leaders. Specifically, they complain that there are no longer openly bided projects, but that most are now awarded through this new law's uncompetitive mechanism.

The **Law on Access to Public Information** lays out a transparency policy, however, it is not strictly adhered to. Interviewees noted greater oversight from the Institute of Access to Public Information (IAIP)[335] is required in order to establish a habit of transparency across institutions dealing with public information. Specific needs cited include improved technology to manage information and

[335] IAIP is a decentralized public administration body, responsible for promoting and facilitating access to public information, and regulating and supervising the procedures of institutions engaging in the protection, classification and custody of public information.

certifications for transparent management processes. Further, the Administrative Career Policy, as part of the **Municipal Administrative Career Law (CAM),** is meant to ensure continuity of municipal technical resources. Political turnover in local government routinely causes the loss trained human resources needed to manage the project contracting process effectively. Stakeholders noted that an enforced CAM policy that generates greater continuity would strengthen the effectiveness of local institutions in contracting and regulatory roles.

Stakeholders interviewed, public and private, national and local, reported a positive willingness to move towards reducing bureaucracy, simplifying administrative processes, and making it easier and quicker to manage permits for infrastructure projects. This include moving to electronic application of permits and creating a more centralized administrative process between the different institutions currently involved. There is a real possibility for BEE reform in the above-noted areas if public, private, civil society and NGOs are able to work together in a more concerted manner. These reforms have a potential to lend credibility and transparency to infrastructure projects and will likely have a systemic impact in driving greater levels of competitiveness, innovation and potential inclusion.

RESULTS

Infrastructure, though often politicized and bureaucratic, yields concrete results. Large scale physical works are easy ways to point to the fruits of development, government investment, foreign aid, and/or a persistent electorate. Infrastructure plays a large role in measuring or comparing economic competitiveness. Roads, powerlines, hospitals, bridges, protected areas, and mobile phone penetration, among others are synonymous with progress. Honduras requires infrastructure development at a grand scale. There is an estimated $3 billion investment gap (or more) and this gap is growing at $500 million (or more) a year based on current investment rates. This sector will require considerable resources, including raw materials and skilled personnel to facilitate the logistics, design, coordinate, execute and maintenance of projects. Honduras cannot afford to defer investments in productive infrastructure. Strengthening infrastructure trust funds sustainably funded from user-generated fees and the motor fuel tax collected. TMS could facilitate three key interventions:

- Strengthen transparency to the fuel tax at the central government level which is intended to be used for road maintenance (original idea of the Fondo Vial) but at this moment is unclear how much and how is being used and support the creation of a pilot infrastructure trust fund supported by user-generated fees in strategic territories, similar to what INVEST-H does.
- Coordinate with CANAHTUR and local municipalities a pilot infrastructure trust fund with user-generated fees in key tourist cities like Copan Ruins and La Ceiba to close the gap and ensure proper infrastructure services with emphasis in water, sewage and solid waste.
- Work through CHICO, ERSAPs, Colegio de Ingenierios Civiles de Honduras the infrastructure super map, a web tool for decision makers highlighting and grading the status of productive infrastructure in each department and quantifying the needs of investment

The infrastructure gap is therefore both a challenge and a significant opportunity to generate economic growth and to enable and strengthen the competitiveness of other linked sectors. It is obvious the sector needs a better trained workforce, new technology, and a lot more financing. The question is why isn't this happening. These factors appear limited by their low effective demand - a result of lack transparency and competition in the sector. This lack of transparency limits outside investment, establishes barriers to SMEs, reduces competition, and potentially leads to low quality execution. It further discourages alliances between firms, which could stimulate more inclusive growth whether among national and municipal governments and *mancomunidades*; between

executing companies specializing to become more efficient in construction, design, etc. and international donors wishing to invest in Honduras; and between contractors and community members who could have a greater sense of buy-in and ownership to ensure project sustainability.

Transparency mechanisms could include:

- Greater engagement of trade unions and advocacy organizations such as CHICO and CHIC to advocate for transparency around project contracting and execution.
- Stronger engagement from the Institute of Access to Public Information (IAIP) to achieve more transparent bidding processes.
- Strengthen the Law of Transparency and Access to Public Information (2006) to ensure better public access to information.
- Improved information technology can further streamline and make transparent current administrative processes.
- Working with institutions to create certifications for contracting companies would reduce some of the unnecessary bureaucracy, while ensuring only qualified firms are bidding that can deliver cost effective, technologically sound, and resource efficient services.

Transparency is also built through a bottom-up process that engages community organizations, local governments, and project developers (GoH, or external aid organizations) to better prioritize projects in line with community needs. This has the dual purpose of promoting the population as a regulator and provide some degree of accountability. This could be facilitated by working with *mancomunidades* and institutions like COPECO to ensure that infrastructure is built and maintained in a sustainable manner that will last.

There are opportunities within each of the sub-sectors. Renewable solar energy for households and communities without access to the electrical grid is a sub-sector which offers growth opportunities for companies and individual service providers (ex. technicians and repair specialists), while contributing to the development to the poorest communities. The energy sector, however, is monopolized, currently restricted to a few companies. This offers fewer opportunities (and thus was not selected for consideration in the initial sector selection workshop). The growing demands of the transport sector will further increase the need to maintain secondary and tertiary roads. This presents opportunities for vulnerable communities to encourage micro-companies for the maintenance of community infrastructure, such as unpaved roads, culverts, etc. Fairer and more transparent contracting practices and reduction in monopolies and oligopolies within the sector would further open opportunities in other sub-sectors. The infrastructure sector is susceptible to a variety of risks both environmental and political. Climate risks will further exacerbate the need for infrastructure investments and increases the need for adequate mitigation infrastructure and planning. The planning process for infrastructure projects is vulnerable to be influenced by a dissatisfied electorate which fails to see their priorities reflected or their interests adequately represented.

Honduras' location and geography make it uniquely vulnerable to the effects of climate change and susceptible to earthquakes, and landslides. From 1997-2016 Honduras was the country most affected by climate risks, and - along with Myanmar - most affected by extreme weather events[336]. There is a significant risk to the sector posed by more frequent, more intense tropical cyclones. From 2000-2007, flooding and storm events have had more severe impacts. [337] In 2008, after months of drought, an unnamed tropical depression caused the country's worst flooding since 1998's Hurricane Mitch. The Central and Western regions saw widespread flooding and landslides as a result. Forty percent of municipalities experienced flooding, displacing over 50,000 people, destroying nearly half the country's roads. [338] More than 75 percent of the country exists on slopes greater than 25 percent, posing landslide risk to transport infrastructure from extreme rainfall. Hurricanes and storms cause high concerns for energy infrastructure in Honduras. Changes in patterns of storms could pose aggravated physical damage to dams and power lines. Seasonal rising river levels would increase due to increased rainfall variability and intensity during hurricane seasons. According to the World Bank climate change makes it imperative that Honduras diversify its energy supplies by investing in renewable energy to diversify domestic generation assets and reduce import dependency. [339]

There is opportunity to draw more inclusive human resources to staff various workforce gaps for high-level engineers and managers, technicians, regulators and administrators, equipment operators, and common laborers. While women are less represented, there is more inclusion of indigenous and Garifuna populations, youth, and returned migrants. Opportunities for PwDs are more limited. Infrastructure currently employs and has the potential to employ a lot more people. The infrastructure sector, in addition to providing a critical service to the poor and marginalized through investments that expand access to road networks, energy grids, water and sanitation facilities, etc. for these populations, is vitally important to increasing access and agency to participate in economic activities. Greater investment in technical training will open-up more inclusive opportunities. Career paths and professional training should align to equip youth and others with relevant skills.

[336] Germanwatch Global Climate Risk Index. (2018) (13th ed.). at: https://germanwatch.org/es/node/14987
[337] World Bank Climate Change Knowledge Portal – Honduras. at: http://sdwebx.worldbank.org/climateportal/index.cfm?page=country_historical_climate&ThisRegion=North%20America&ThisCCode=HND
[338] Honduras and Central America: Floods OCHA Situation Report No. 4 (Report). Relief Web. United Nations Office for the Coordination of Humanitarian Affairs. 2008-10-27. Retrieved 2013-12-07.
[339] World Bank Climate Change Knowledge Portal – Honduras. at: http://sdwebx.worldbank.org/climateportal/index.cfm?page=country_historical_climate&ThisRegion=North%20America&ThisCCode=HND

GLOSSARY

ANNEX XII GLOSSARY

Systems thinking and its associated concepts and tools seek to understand the dynamic processes of local systems to better design and implement interventions for sustainability. [340]

Systems practice is a way of seeing, analyzing, and acting through systems; including:
- *Listening* to the system to understand how it currently operates,
- *Engaging* the system to prompt change through targeted interventions,
- *Discovering* the actual effects of those interventions on the system, and
- *Adapting* interventions in response to discoveries. [341]

System is a set of elements that interact and affect each other. This set of individual interactions collectively result in emergent patterns that define a larger complex whole. Systems are defined by the function that elements collectively perform. In a system, the whole is greater than the sum of its elements. A system may be economic, ecological, political, educational, health, etc. Systems are dynamic - they constantly change. Changes in systems happen at the element- and the system-level. [342]

Elements are the parts of a system that are coherently organized in a way that together they achieve something – or perform a function. In a systems map, elements may be conceptualized differently, based on how the system is being modeled. For example, elements can be:
- *Actors* or agents which may include firms, households, etc.,
- *Behaviors* refer to visible specific actions performed by actors,
- *Stocks* which are measure of a quantity of something,
- *Conditions* or factors which influence an outcome,
- *Change* or a variable which is a factor that may vary or be changed,
- *Intervention* or actions done to influence change.

Interconnections are the interactions between the elements of a system involving the exchange of resources. Interconnections consider both connectivity and interdependence. [343]
- *Connectivity* describes the frequency or degree of interactions.
- *Interdependence* describes the degree of interrelation between separate elements.

In a systems map, interconnections can be conceptualized differently, such as:
- *Relationship* are ways in which two elements are related or connected,
- *Flows* rate or speed of movement of an element between stocks,
- *Cause-and-effect* is how one element results from another.

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[340] Shah, R.J. April 2014. Local Systems: A Framework for supporting sustained development. e.g. Washington, DC. Retrieved from: https://www.usaid.gov/sites/default/files/documents/1870/LocalSystemsFramework.pdf

[341] USAID, (October 2016a). The5RS Framework in The Program Cycle. Retrieved from: https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf

[342] Fowler, Sparkman and Markel (October 2016a). Disrupting System Dynamics: A Framework for Understanding Systemic Changes. e.g. Washington, D.C and Lusaka, Zambia. Retrieved from: https://www.marketlinks.org/library/disrupting-system-dynamics-framework-understanding-systemic-changes

[343] Colchester, J. (August 7, 2016a). Interdependence. Retrieved from: http://complexitylabs.io/interdependence/

Boundaries demarcate what is internal to the system and what is considered part of the external environment. Complex systems have *open boundaries* which means that systems draw inputs from and produce outputs to the broader environment. Within this environment exists other systems which may be interrelated to the primary system. [344]

Environment refers to where systems converge to provide resource inputs into or draw resource outputs out from. Systems influence the environment and the environment influences systems. Open systems interact constantly with the environment versus closed systems which are self-contained. The inflow of resources into open systems from the environment is critical to sustaining the system. [345]

Actor- vs. system-level refers to the levels at which change occurs in market systems. Actors in a system, such as firms, employees, households, etc. perform specific actions or behaviors. At the system-levels, the aggregate of actions and behaviors result in emergent patterns of behavior. Patterns may be conceptualized as norms, networks, etc. These emergent patterns in turn affect the behaviors of individuals, and vice-versa. MSD looks at both individual behaviors and system-level patterns. [346]

Emergence are patterns that happen at the systems-level as elements within a system self-organize to perform more complex functions. Emergence results in the whole system becoming greater than sum of its parts. Emergence can be unpredictable and unintended. The dynamic nature of emergence requires *complexity-aware monitoring tools* to be able to evaluate higher-level systems change. [347]

Market System is a dynamic space incorporating roles, relationships, rules, resources, and results in which actors collaborate, coordinate and compete for the production, distribution and consumption of goods and services. Market systems include interconnected firms, end markets, support services and the environment in which operate (socio-cultural, political factors, infrastructure and institutions). [348]

Inclusive market systems engage and benefit a range of actors including the poor, women, youth, ethnic minorities and/or other marginalized groups who are often excluded—or even exploited—by traditional market systems. In inclusive market systems, diverse people are able to acquire access to the opportunities, skills and resources to innovate and improve their capabilities to engage with and influence market systems, and to access the benefits that arise from the system.[349]

Market Systems Development (MSD) is an approach to private sector development that catalyzes a process in which the market system is able to adapt as needed over time to deliver a sustained flow of benefits to system actors, including the poor and otherwise disadvantaged or excluded. The MSD approach recognize the complexity of market systems and need for more routine analysis, piloting and engagement of stakeholders in a co-creation process. The desired result of MSD is a market

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[344] Colchester, J. (October 17, 2016b). System Boundary. Retrieved from: http://complexitylabs.io/system-boundary/
[345] USAID, (October 2016b). The5RS Framework in The Program Cycle Retrieved from: https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf
[346] Fowler, Sparkman and Markel (October 2016b). Disrupting System Dynamics: A Framework for Understanding Systemic Changes. e.g. Washington, D.C and Lusaka, Zambia. Retrieved from: https://www.marketlinks.org/library/disrupting-system-dynamics-framework-understanding-systemic-changes
[347] Colchester, J. (August 23, 2016d). Emergent Process. Retrieved from: http://complexitylabs.io/emergent-process/
[348] USAID (n.d) A Framework for Inclusive Market System Development. Retrieved from: https://www.marketlinks.org/library/framework-inclusive-market-system-development
[349] USAID (n.d) A Framework for Inclusive Market System Development. Retrieved from: https://www.marketlinks.org/library/framework-inclusive-market-system-development

system that is more competitive, inclusive and resilient. MSD is an approach toward private sector development that has been increasingly used by USAID, DFID, SDC and other donors. [350]

Dynamics refer to how elements interact, cooperate, transact and communicate with each other, which produces patterns of behavior in the market system. Dynamics are constantly changing as actors, systems and environment interconnect and interact. This change happens with or without the influence of an Activity. The objective of MSD is to facilitate the development of more inclusive, resilient and competitive dynamics that provide a foundation for broad-based, long-term growth. [351]

5Rs Framework helps to understand the dynamics of a system. It includes the five key dimensions of system dynamics: roles, relationships, rules, resources, and results. The 5Rs provide a useful guide for systems thinking and practice helping to focus on what is important to listen to, imagining a system "as is" versus "to be" and to prioritize a set of interventions to facilitate this change. [352]

Functions refer to how a system *transforms inputs* into *outputs*. The function is equivalent to a purpose of a system i.e. systems are defined by functions they perform. Transformation is the result of a series of actions or processes taken by the combination of elements and interconnections within a system. *Efficiency* or *productivity* describes the how effective a system is at transforming inputs into outputs and whether the transformed output has greater value than the input that went into the system. [353]

Roles refer to the actors in a system and the functions they perform. In other words, the *who* and *what do they do*. Actors and their roles are at the center of the system. The more important the role that an actor performs, the more central they are to system functionality. Actors can take on multiple roles and/or different actors can take on the same role. Roles vary based on the system being analyzed, but may generally include direct roles input supply, production, trade, consumption, or governance, as well as less obvious ones such as brokers, advocates or networkers. TMS utilizes will-skill matrixes as a tool to identify actors and prioritize their relative importance in performing roles. [354]

Innovation (or upgrading) refers to a new way of doing or organizing things, products, rules, norms, business models or networks that allow the system to operate more inclusively, efficiently and competitively. Innovation is part of a learning process by which actors acquire and translate know-how to add value. In a system, innovations are both introduced and diffused throughout a system. [355]

Diffusion refers to how innovations replicate between actors within a system and become part of the new status quo. Innovations are spread through the interconnections between actors through both

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[350] USAID, (October 2016c). The5RS Framework in The Program Cycle Retrieved from: https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf
[351] Fowler, Sparkman and Markel (October 2016c). Disrupting System Dynamics: A Framework for Understanding Systemic Changes. e.g. Washington, D.C and Lusaka, Zambia. Retrieved from: https://www.marketlinks.org/library/disrupting-system-dynamics-framework-understanding-systemic-changes
[352] USAID, (October 2016d). The5RS Framework in The Program Cycle Retrieved from: https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf
[353] Colchester, J. (October 17, 2016e). Functions. Retrieved from: http://complexitylabs.io/functions/
[354] USAID, (October 2016e). The5RS Framework in The Program Cycle Retrieved from: https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf
[355] O´Planick, K. (October 2016a). Case Studies Facilitating Systemic Change: A Synthesis of case from Ghana, Senegal, Zambia and Rwanda. Retrieved from: https://www.marketlinks.org/library/case-studies-facilitating-systemic-change-feed-future-synthesis-cases-ghana-senegal-zambia-a

strong and weak ties. Diffusion theory classifies actors as innovators, early adopters, early and late majorities and laggards. [356]

Mobility refers to how actors innovate and take on new roles in a system. The mobility of actors may be limited by barriers to entry take on certain functions. These barriers may be related to the other Rs -for example, significant resource investments, exclusive rules or norms or lack of networks. [357]

Entrepreneurship refers to the start of a new business or venture. This may be self-employment or part of a business organization. A new venture is inclusive of existing businesses which launch a new product or service. Opportunity-driven entrepreneurship refers to the orientation of the entrepreneur to increase their income based on an opportunity versus maintaining with no other option for work. [358]

Support services refer products and services that support businesses to better compete in end markets. Support services include finance, advisory, business process services, information and communications technology, technical advisory, information, or sector-specific such as veterinary services, repairs, etc. Support services may be supplied through markets via independent suppliers e.g. financial institutions or may be embedded within supply chain transactions. [359]

Relationships refer to the interconnections between actors playing particular roles in a market system. Relationships may be vertical or horizontal and consider connectivity and interdependence of actors. Relationships may be characterized as formal to informal, strong to weak, mutual to one-sided, cooperative to adversarial and productive to destructive. Effective relationships are associated with greater levels of competitiveness, inclusivity and resilience in a system. [360]

Self-organization also called in social sciences *spontaneous order*, is a process where some form of overall order arises from interconnections between elements of an initially disordered system. The process is spontaneous, not needing control by any external agent. This results in patterns and order that define the emergent characteristics of a system. In self-organization, elements self-organize into *networks* and *organizations*. The higher the degree of connectivity between agents within a system, the greater the degree of complexity in self-organized networks and organizations. [361]

Network is a large group of elements that are connected together to allow movement or communication between or along the parts, or between the parts and a control center. Networks play an important role in the dissemination of technologies, transfer of resources, levels of competition and cooperation.

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[356] O´Planick, K. (October 2016b). Case Studies Facilitating Systemic Change: A Synthesis of case from Ghana, Senegal, Zambia and Rwanda. Retrieved from:https://www.marketlinks.org/library/case-studies-facilitating-systemic-change-feed-future-synthesis-cases-ghana-senegal-zambia-aa

[357] Fowler, Sparkman and Markel (October 2016d). Disrupting System Dynamics: A Framework for Understanding Systemic Changes. e.g. Washington, D.C and Lusaka, Zambia. Retrieved from: https://www.marketlinks.org/library/disrupting-system-dynamics-framework-understanding-systemic-changes

[358] *How GEM Defines Entrepreneurship,* n.d. Retrieved from: https://www.gemconsortium.org/wiki/1149

[359] . *Supporting Market Overview* (n.d) Retrieved from: https://www.marketlinks.org/good-practice-center/value-chain-wiki/supporting-markets-overview

[360] USAID, (October 2016f). The5RS Framework in The Program Cycle Retrieved from: https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf

[361] Colchester, J. (July 15, 2014a). Self-Organization Far-From-Equilibrium. Retrieved from: https://complexitylabs.io/self-organization-far-from-equilibrium/

Network analysis models the relationships between elements or agents in a system.

- *Nodes* are the elements in a system and *edges* are the connections.
- The d*egree of connectivity* is the total number of edges divided by nodes.
- *Centrality* measures the degree to which an element is proximate all other elements.

Cooperation and Competition refers to how actors interact within a market system and the broader enabling environment. Cooperation and competition may be horizontal or vertical. Effective cooperation supports integration whereas ineffective cooperation is often collusive and anti-competitive. Effective competition drives innovation and value-addition through win-win strategies whereas Ineffective competition involves rent-seeking or zero-sum tactics. [362]

Horizontal refers to cooperation and alliances between like-firms involving interdependence, trust and resource-sharing to accomplish common goals. Horizontal cooperation is a form of integration that helps to reduce transaction costs, facilitate innovation diffusion and productive capabilities. Examples of forms of horizontal cooperation include cooperatives, associations, clusters, etc. [363]

Vertical refers to cooperation and alliances between firms at different functions of a system. Similarly, vertical cooperation includes interdependence, trust and resource-sharing which results in to reduced transaction costs, innovation diffusion and enhances productive capabilities. Example of forms of horizontal cooperation include contracting, licensing, mergers and acquisitions, etc. [364]

Win-win are mutually beneficial relationships between actors and may be horizontal or vertical. Win-win relationships encourage innovation by rewarding risk-taking and investment by actors. The opposite of win-win are zero-sum or ***extractive*** relationships, in which one party gains at the expense of another. These relationships lead to *ineffective* cooperation and competition. [365]

Integration describes how unified or 'whole' a system is. The greater the level of connectivity, the more integrated a system is. Integration enables a system to operate more effectively in its environment and/or as part of larger systems. Systems-level integration supports differentiation and specialization, which in turn facilitates greater system-level efficiency and productivity. [366]

Transaction costs explain why firms decide to produce goods and services themselves or source or from other firms. Specific costs such as search and information, bargaining and decisions, and policing and enforcement impact *make or buy* decisions of firms. Frequency, certainty and asset specificity also influence these decisions. Transaction costs play an important role in integration and specialization within the system. [367]

Specialization or differentiation is when actors focus on their core competencies and 'outsource' non-strategic or non-competitive functions to other actors. Collaboration depends on internal and

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[362] *Frameworks for Analyzing Relationships* (n.d) Retrieved from: https://www.marketlinks.org/good-practice-center/value-chain-wiki/frameworks-analyzing-relationships

[363] *Horizontal Linkage- Overview,* n.d. Retrieved from: https://www.marketlinks.org/good-practice-center/value-chain-wiki/horizontal-linkages-overview

[364] *Vertical Linkage (*n.d) Retrieved from: https://www.marketlinks.org/good-practice-center/value-chain-wiki/vertical-linkages-in-depth

[365] *Importance of Vertical and Horizontal Linkages to Foster Win-Win Relationships,* n.d. Retrieved from: https://www.marketlinks.org/good-practice-center/value-chain-wiki/importance-vertical-and-horizontal-linkages-foster-win-win-rr

[366] Colchester, J. (August 8, 2016f). Integration. Retrieved from: http://complexitylabs.io/integration/

[367] *Theory of the Firm (*n.d) Retrieved from: https://en.wikipedia.org/wiki/Theory_of_the_firm

external transaction costs. Specialization is associated with higher-levels of competitiveness of a system in the broader environment. [368]

Trust is the certainty or confidence that collaboration with another actor will not result in harm. Collaboration requires risk-taking, some level of trust is necessary to take different levels of risk. Frequency, reliability and transparency are associated with higher levels of trust, resulting in greater cooperation and specialization. [369]

Resources are the various inputs which are transformed in a system into results. Resources serve as the "fuel" to keep the system functioning. The sustainability of the system depends on continued inflow of resources into and throughout the system. Resources include natural, material, financial, human, information, etc. Resource considerations include differential access, sources of supply, flows and inclusivity. [370]

Stocks are the resources in a system that you can see, feel, count, or measure at any point of time. Stocks can increase or decrease like water or money. [371]

Flows are the rate at which resources change in a system. For example, if a stock is a water tank, the irrigation equipment would be the flow water out of the tank and into the garden. Flows are measured over some interval of time. [372]

Rules refer to laws, regulations and statutes and to the informal norms, incentives and expectations that regulate how actors behave and the entire system functions. Rule considerations include degree of participation in the rule-making process, governance structures, political economy, etc. Rules incorporate incentives which include financial and non-financial motivators for behavior change. [373]

Business enabling environment (BEE) includes norms, customs, laws, regulations, policies, international trade agreements and public infrastructure that enable or constrain the growth of enterprises, industries and market systems at national and local levels. In addition to formal rules, the BEE considers the social norms, business culture and unwritten rules that influence how actors behave. BEE reform is the process by which stakeholders engage in a policy process to strengthen the BEE. [374]

Governance is the power and the ability of actors to set, monitor and enforce rules and standards for other actors. Actors which establish the "rules" may include firms, chambers, public institutions, etc. Power refers to the relative strength of actors in setting and enforcing rules. Rules may be helpful by

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[368] Colchester, J. (August 5, 2016g). Systems Differentiation. Retrieved from: http://complexitylabs.io/integration-and-differentiation/
[369] Trust in Inter-Firms Relationships (n.d) Retrieved from: https://www.marketlinks.org/good-practice-center/value-chain-wiki/trust-inter-firm-relationships
[370] USAID, (October 2016g). The5RS Framework in The Program Cycle Retrieved from: https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf
[371] Colchester, J. (October 17, 2016h). System Dynamics. Retrieved from: http://complexitylabs.io/system-dynamics-models/
[372] Colchester, J. (October 17, 2016i). System Dynamics. Retrieved from: http://complexitylabs.io/system-dynamics-models/
[373] USAID, (October 2016h). The5RS Framework in The Program Cycle Retrieved from: https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf
[374] *Business Enabling Environment—Overview (*n.d) Retrieved from: https://www.marketlinks.org/good-practice-center/value-chain-wiki/business-enabling-environment

enhancing integration or may be harmful by creating barriers to entry. Market governance styles include: transactional, network or vertically integrated. [375]

Results are the outputs which result from transformation processes of the system. Results include observable events and hidden performance patterns that result from underlying dynamics. Results frame how systems practice is undertaken, by focusing attention on the root causes or dynamics responsible for producing them. [376]

Root causes are the underlying causes or reasons behind patterns of results. MSD approaches address the root causes, not the symptoms, for why market systems fail to generate competitive, inclusive and resilient results.

Patterns underlie the observable events of a system and are generated by underlying dynamics. Events are distinguishable from patterns. Events are 'what's happened.' Patterns are the trends that happen over time that allow us to anticipate what will happen. Looking at *history and trajectory* helps us to identify patterns. [377]

Feedback loops are the change pathways when a result leads back to its cause.

- **Reinforcing feedback loops** consist of actions that produce a result which influences more of the same action, either positive or negative. If a reinforcing loop is producing a desired result it is referred to as a virtuous loop, and vicious if it is producing a negative result. Strengthening reinforcing loops that lead to greater competitiveness, inclusiveness, and resilience supports scale and sustainability of impact
- **Balancing feedback loops** on the other hand, dampen change processes. An initial action causes a response which reduces the incentive for the same action. MSD activities may need to find ways to break or circumvent such systems. [378]

Status quo is the state of a system to which things will naturally gravitate. Because of self-regulation, actors with entrenched interests within the system will strive to maintain the current status quo. Negative feedback loops are a core mechanism for regulation.

Leverage points are places in the system that are amenable to change, where a small shift in one area can have a large effect in others (large impact). Leverage points are driven by feedback loops which compound or amplify a set of results. The stronger the feedback loop, the higher the leverage. Leverage points are typically areas in the system proximate to root causes where change is amenable. Feedback loops increase the rate of transformation of inputs into outputs by an exponential rate. Types of leverage points include changing rules, networks, power structures, or mindsets.

Systemic change are changes that have reached a level of scale and sustainability. 'Systemic' is a way of noting the degree to which change has happened. Systemic change refers to changes in the structure or dynamics of systems with significant impacts for system performance. Systemic change requires change at a systems-level - not just piecemeal change in a single part of the system. Systemic

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[375] *.Value Chain Governance—Overview (*n.d) Retrieved from: https://www.marketlinks.org/good-practice-center/value-chain-wiki/value-chain-governance-overview

[376]USAID, (October 2016i). The5RS Framework in The Program Cycle Retrieved from: https://usaidlearninglab.org/sites/default/files/resource/files/5rs_techncial_note_ver_2_1_final.pdf

[377] Colchester, J. (August 2, 2016j). Iceberg Model. Retrieved from: http://complexitylabs.io/iceberg-model/

[378] Colchester, J. (February 5, 2016k). Nonlinear Feedback Loops. Retrieved from: http://complexitylabs.io/nonlinear-feedback-loops/

change diverts a market system down a new evolutionary path. Desirable systemic changes result in a system that functions more competitively, resiliently and inclusively. [379]

Competitiveness refers to the ability of actors to innovate and add value to products and services in a manner that enables them to become increasingly productive and expand into domestic, regional and export markets. Sustained increases in income and employment require that businesses and industries become and remain competitive over market rivals in the same end market segment. Competitiveness is achieved by producing at lower cost, higher quality or offering a different alternative or substitute.

End markets are where final transactions take place in a supply chain. End markets may be local, regional or international and may provide opportunities to support economic growth. End markets are segmented based on the characteristics of customers (or their demands) defined by attributes such as quality, price, reliability, etc. [380]

Segmenting, targeting and positioning (STP) is a marketing framework for analyzing which market segments a business a business can develop a competitive advantage. TMS considers the attractiveness of a market, barriers to entry and *productive capabilities* to compete in a segment as part of its utilization of the STP framework in end market analysis. [381]

Value Chain is a narrow market system bounded by the series of actors and activities required to bring a single product or service from conception to the final consumer.

Productive capabilities refer to the tangible resources and intangible know-how of an economy to transform economic resources into sustained economic development. Based on economic complexity theory, productive capabilities are considered the 'building blocks' of economic complexity which is the economy to effectively compete and sell diverse goods and services into global markets. [382]

Knowhow is complex knowledge accumulated at a system-level for an economy to acquire the productive capabilities to competitively produce diverse goods and services. Some products are more complex than others. Produce complexity approximates the level of complexity of different products. Economic complexity evaluates the complexity of goods a country produces to approximate its overall knowhow or productive capabilities as a measure of potential for development. [383]

Path dependence considers how history and trajectory of a system establishes a pattern which establishes the context for future change. Path dependence can enable future growth, for example through a source for competitive advantage that becomes inimitable by others. It can also constrain

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[379] O´Planick, Mayo, Walker, Jacobstein and Tanburn (October 2016). Guidance for Monitoring, Evaluation and Learning in Market Systems Development. Retrieved from: https://www.marketlinks.org/library/guidelines-monitoring-evaluation-and-learning-market-systems-development

[380] *End Markets –Overview* (n.d) Retrieved from: https://www.marketlinks.org/good-practice-center/value-chain-wiki/end-markets-overview

[381] *Segmenting-Targeting-Positioning (*n.d) Retrieved from: https://en.wikipedia.org/wiki/Segmenting-targeting-positioning

[382] Hidalgo, C. & Hausmann, R. (June 30, 2009). The building blocks of economic complexity. e.g. Cambridge, MA. Retrieved from: http://www.pnas.org/content/pnas/106/26/10570.full.pdf

[383] The Center for International Development, (2013). Economic Complexity Briefing. e.g. Harvard University. Retrieved from: https://growthlab.cid.harvard.edu/files/growthlab/files/economic_complexity_briefing.pdf

future growth. As history is non-reversible, the path taken can strongly influence future potential paths and opportunities. [384]

Resilience is the ability of people, households, communities, countries, and systems to mitigate, adapt to, and recover from shocks and stresses in a manner that reduces chronic vulnerability and facilitates inclusive growth. It focuses on enhancing resilience capacities to meet longer-term development objectives in the face of shocks and stresses instead of just preparing and responding to shocks based on immediate needs. [385]

Shocks are acute events that have a severe impact on a system and its actors. Shocks may be chronic or infrequent. Example shocks include

- Economic shocks: market volatility e.g. price hikes, market gluts, etc.
- Political shocks: governance or political instability, etc.
- Environmental shocks: natural resource degradation, droughts, etc.
- Health shocks—health crises, malnutrition, etc.
- Conflict – crime, violence, etc. [386]

Vulnerability refers to how shocks impact actors differently based on demographic characteristics, industry type or other vulnerability criteria. [387]

Resilience capacities include the resources, processes and control systems that enable networks of actors to be able to absorb, adapt, and transform in the face of shocks and stressors. There are three major types of resilience capacities

- ***Absorptive***: ability to mitigate or resist the impact of shocks and maintain stability without negative impact on the basic needs of actors or market system functions,
- ***Adaptive*** is the ability of actors and the system to learn and adjust to shocks and stresses through incremental changes, to maintain flexibility, etc.
- ***Transformative*** is the ability to fundamentally change the structure of the system when the previous system is no longer sustainable as a result of severe shocks.

Resilience capacities include diversity and redundancy of market channels and buyers, networks and safety nets, productive capabilities to sell diverse goods and services, sound market and political governance, strength of support institutions, etc.[388]

Adaptation refers to continued adaption of actors and the system to changes in the environment. System-level adaptation is referred to as *evolution*. Adaptation results from actors in the system self-

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[384] Fowler, Sparkman and Markel (October 2016e). Disrupting System Dynamics: A Framework for Understanding Systemic Changes. e.g. Washington, D.C and Lusaka, Zambia. Retrieved from: https://www.marketlinks.org/library/disrupting-system-dynamics-framework-understanding-systemic-changes

[385] Irwin, B. & Campbell, R. (January 2015a) Market System for Resilience. Retrieved from: https://www.marketlinks.org/library/market-systems-resilience

[386] Irwin, B. & Campbell, R. (January 2015b) Market System for Resilience. Retrieved from: https://www.marketlinks.org/library/market-systems-resilience

[387] Irwin, B. & Campbell, R. (January 2015c) Market System for Resilience. Retrieved from: https://www.marketlinks.org/library/market-systems-resilience

[388] Irwin, B. & Campbell, R. (January 2015d) Market System for Resilience. Retrieved from: https://www.marketlinks.org/library/market-systems-resilience

organizing and cooperating to better respond to shifts in context and compete more effectively in the environment. [389]

Adaptive Programming is an implementation methodology that helps Activities to better and more effectively respond to evolving contexts. Adaptive programming allows flexibility to modify parameters -such as outputs, indicators and targets – to pursue adaptive, systemic change as an objective. Characteristics of adaptive programming are: co-creation processes, inception phase analysis, organizational strengthening, etc. [390]

Economic inclusion is the ability of a system to engage and deliver a sustainable flow of benefits to the poor and otherwise marginalized, as well as to society. Inclusive growth ensures that the gains from economic growth benefit vulnerable and marginalized groups whether as producers, service providers, laborers and/or consumers. Inclusivity includes reduced risks from economic engagement, such as the risk of violence, additional time burden or exposure to harmful practices. [391]

Business case for inclusion refers to the benefits that accrue to private enterprise through the inclusion of marginalized groups as employees, producers, and business owners, etc. There is a link between economic inclusion, firm profitability and overall economic growth that motivates private-sector actors to become change agents. [392]

Access and Agency are interconnected elements that lead to economic empowerment. Access refers to the capability to access productive resources, support services and markets. Agency refers to the ability to make one's own decisions to act on economic opportunities as well as ability to influence broader systems and environment. Access and agency refers to multiple levels: household, business and national government. [393]

Systems analysis is the process of decomposing a complex system into its parts to understand and prioritize dynamics to influence based on potential for leverage. Analysis includes synthesis to better understand the relations between the individual parts, and how the entire system performs also influences its individual parts function. Synthesis is a more holistic viewpoint of a system to describe its emergent features. [394]

Complexity theory examines uncertainty and non-linearity in complex systems. It considers concepts such as networks, adaptation, emergence, etc. Complexity emerges from the high degree of interconnectivity within a system, its environment and the diversity of actors in a system. The

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[389] Colchester, J. (July 15, 2014b). Evolution. Retrieved from: https://complexitylabs.io/evolution/
[390] Irwin, B. & Campbell, R. (January 2015e) Market System for Resilience. Retrieved from: https://www.marketlinks.org/library/market-systems-resilience
[391] Campbell, R. (July 1, 2014). A Framework for Inclusive Market Systems Development. Retrieved from: https://www.marketlinks.org/library/framework-inclusive-market-system-development
[392] Markel, Hess & Loftin (March 1, 2015). Making the Business Case: Women's Economic Empowerment in Market Systems Development. Retrieved from: https://www.marketlinks.org/library/making-business-case-womens-economic-empowerment-market-systems-development
[393]Markel, E. & Jones, L. (n.d.). Women's Economic Empowerment: Pushing the Frontiers of Inclusive Market Development. Retrieved from: https://www.marketlinks.org/library/womens-economic-empowerment-pushing-frontiers-inclusive-market-developmentt
[394] Colchester, J. (July 30, 2016j). Analysis. Retrieved from: http://complexitylabs.io/analysis/

Honduran economy is an open and complex system that interacts with social, political, environmental and global trading systems through the business enabling environment. [395]

Abstraction is the focusing-in at different levels of a system i.e. micro, meso and macro-levels to understand the essential dynamics to a question. The process of abstraction compresses the levels of detail to support comprehension. Abstraction is a necessary to be able to practically do systems practice given the complexity of systems. TMS *zooms-in* and *zooms-out* to move between different levels of abstraction. [396]

Objectivity refers to need to be aware of our inherent subjectivity in analyzing a system because systems are more abstract. Engaging diverse perspectives can help mitigate our biases. Be intentional about assumptions and routinely test them. [397]

Non-linear causality is where cause and effect can flow bi-directionally through feedback loops. E.g. A impacts B which in turn impacts A, sometimes moderated through C. Linear causality in where cause and effect flows in a single, linear direction. E.g. A may impact B, but B has no impact on A. Non-linear causality leads to self-reinforcing or amplification of results. [398]

Change pathways are a set of changes necessary to reach a desired outcome. In complex systems, there are multiple potential pathways for change. Different pathways may be more amenable to change and offer higher potential leverage for achieve systemic change. The complexity of change pathways, and the unintended consequences they lead to, require both a thoughtful analytical and pilot-adapt-scale approach.

Systems maps or *causal loop diagrams*, are models that organize understanding of a system. Systems maps have non-linear causality to explain the behavior of open systems in which feedback loops create cycles and there are multiple different pathways for change. The purpose of a systems map is to identify root cause dynamics and where there is leverage within the system to be able to generate systemic change. [399]

Results chains are models showing the chain of causality through which a program's activities lead to leverage points, systems change objectives and ultimately competitive, inclusive, and resilient systems. They illustrate the '*zoom-in'* to provide an appropriate level of abstraction to identify specific behaviors, intervention areas and activities that are linked to dynamics which are potential leverage points for broader systemic change. Results chains include well-defined assumptions to help evaluate the validity of the results chain and whether the logic holds true.

Significance is the focus on which effects are most critical to our understanding of how and why the system functions the way it does. In a complex system, everything influences everything else to one degree or another. To note, small effects can be amplified in the system to become significant effects through positive feedback loops.

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[395] Colchester, J. (October 15, 2016k). Complexity Theory. Retrieved from: http://complexitylabs.io/course/complexity-theory/
[396] Colchester, J. (July 31, 2016m). Abstraction. Retrieved from: http://complexitylabs.io/abstraction/
[397] Colchester, J. (July 24, 2016n). Systems Awareness. Retrieved from: http://complexitylabs.io/systems-awareness/
[398] Colchester, J. (August 2, 2016o). Nonlinear Causality. Retrieved from: http://complexitylabs.io/nonlinear-causality/
[399] Colchester, J. (October 8, 2016p). Engineering System Dynamics. Retrieved from: https://complexitylabs.io/technology-system-dynamics/

Validity refers to the soundness of causal logic in systems maps, results chains, intervention strategies and measurement. To test for validity, TMS gathers diverse *perspectives* to establish a more holistic and accurate understanding of the system. TMS deploys a mix of *sentinel and system indicators* and deploys *complexity-aware monitoring* to routinely evaluate validity.

Facilitation is encouraging local actors to adopt changes in their relationships and behaviors without direct intervention by an Activity in a system. By stimulating changes that are replicated by local actors throughout the system, facilitation leads to results that extend to more beneficiaries sustainably over a long period of time. [400]

Primary contacts are actors that interact directly with an Activity in interventions. Secondary contacts are connected through primary contacts. Deliberate facilitation strategies seek to reach secondary contacts as direct beneficiaries via direct primary contacts to achieve higher scale and sustainability of results. [401]

Indirect beneficiaries result from the amplication of results in a system due to:
- *Crowding-in* as other businesses not directly reached by Activity imitate the new, more inclusive business models that have been demonstrated by primary contacts;
- *Copying* as firms not directly reached by the Activity imitate the new products and production technologies of secondary contacts at the target beneficiary level. [402]

Exit strategy are the plans that facilitators should have to make their eventual withdrawal from the intervention as smooth and painless as possible.

Buy-in measures the degree to which actors have taken ownership over the new business models, technologies, practices and behavior changes that were introduced and/or supported by an Activity intervention. Examples of 'buy-in' include:
- Adaptation or innovation to the original, Activity-sponsored model(s),
- Continued, independent investment after program sponsorship ends[403]

Multiplier effects are benefits on individuals and businesses that are unrelated to the primary value chain, sector or system of intervention. Multiplier effects are generated through the circulation of additional money in local economies due to higher incomes. [404]

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[400] *Understanding Facilitation Briefing Paper* (January 1, 2012). Retrieved from: https://www.marketlinks.org/library/understanding-facilitation-briefing-paper

[401] O´Planick, Mayo, Walker, Jacobstein and Tanburn (October 2016). Guidance for Monitoring, Evaluation and Learning in Market Systems Development. Retrieved from: https://www.marketlinks.org/sites/marketlinks.org/files/resource/files/Report20No.205120-20Guidelines20for20MEL20in20MSD.pdf

[402] O´Planick, Mayo, Walker, Jacobstein and Tanburn (October 2016). Guidance for Monitoring, Evaluation and Learning in Market Systems Development. Retrieved from: https://www.marketlinks.org/sites/marketlinks.org/files/resource/files/Report20No.205120-20Guidelines20for20MEL20in20MSD.pdf

[403] Kula, White, Addo & MarketShare Associates (October 30, 2016) Case Studies on Facilitating Systemic Change in Feed the Future: A Synthesis of Cases from Ghana, Senegal, Zambia, and Rwanda. Retrieved from: https://www.marketlinks.org/library/case-studies-facilitating-systemic-change-feed-future-synthesis-cases-ghana-senegal-zambia-a

[404] Brown, Campbell & Downing (August 2014) Agricultural Transformation in Sub-Saharan Africa and the role of the Multiplier. Retrieved from: https://www.marketlinks.org/sites/marketlinks.org/files/resource/files/Ag_Transformation_in_SSA_and_the_Role_of_the_Multiplier_0.pdf

Spillover refers to externalities that occur in unrelated sectors as a result of actions in another. Spillover may be negative, such as waste or pollution, that goes from one sector to another. Spillover can be positive, such as the transfer of know-how or capabilities from one sector to another, innovation or business model copying, etc.

Interrelated refers to economic sectors, value chains or systems that share common dynamics. By improving these shared dynamics, results are amplified across a broader population. This leads to higher leverage from activities.

Portfolio approach is a selection methodology that intentionally selects a mix of sectors, systems and value chains which have different risk and return profiles to maximize expected returns considering exposure to a set of possible risks and shocks. A portfolio of diversified, yet interrelated, sectors, value chains or systems offers the greatest potential for developmental impact while building resilience capacities. [405]

Sequencing, layering and integration. Sequencing starts with interventions that address the initial binding constraints and then further interventions are later added. Layering refers to supporting the same actor with multiple interventions simultaneously. Integrating involves cross-sectoral support within the framework of one portfolio. [406]

Context refers to environment around systems and the impacts this has on how systems function. Complex systems impact environment and the environment can impact the system. To monitor the complexity of these interactions, *context indicators* are helpful to look at changes where the cause-and-effect linkage is so complex that causal attribution is hard to discern, and top-down impacts may be significant.

[405] USAID (February 1, 2016) Value Chain Selection in the Context of Inclusive Market Systems Development. Retrieved from: https://www.marketlinks.org/library/value-chain-selection-context-inclusive-market-systems-development
[406] Scott, Garloch & Shepherd (November 6, 2016) Resilience and Sustainable Poverty Escapes: Implications for Programming. Retrieved from: https://www.marketlinks.org/library/resilience-and-sustainable-poverty-escapes-implications-programming

METHODOLOGY

ANNEX XIII METHODOLOGY

Purpose: The purpose of the six-month Inception Phase, as defined by the TMS IDIQ, is to provide insight into the current state of the market systems, establish the theory of change, and identify methods for monitoring the progress of implementation. The Market System Assessment Report (MSAR) lays the analytical foundation of the Activity to answer strategic learning questions that inform the formative decisions that the Activity must answer to launch effectively:

- What are the priority economic sectors which offer inclusive growth opportunities, specifically the potential to create job opportunities for youth prone to migrate?
- What are the leverage points for intervention which offer the highest value-for-money in terms of results, while building the foundation for broad-based, long-term growth?
- Who are the partners most willing to engage with TMS that offer greatest potential to leverage capital, networks and expertise towards the achievement of its objectives?
- What are the risks and unknowns that TMS should continue to explore and monitor to avoid negative unintended consequences or other effects that may limit future impact?

Features: In the design and execution of the Inception Phase, TMS recognized and designed for the need to ensure that formative analyses took a systems-based approach and utilized a co-creation process, while building the capacity of key actors in the system, throughout formative stages to innovate and lead the analysis, strategy and intervention design process. This includes:

1. Taking a systems-based analysis approach. The multi-dimensionality and interconnectedness of the complex issues facing Honduras required the use of a systems analysis process. Systems analysis breaks-down a system into its components while simultaneously building them back-up to examine how the components function holistically (i.e. the concept of emergence). Systems analysis requires a multi-disciplinary team and regular touch-points between those teams to synthesize the findings between studies. The format these take in TMS are 'Pause and Reflect' sessions.

2. Setting wide boundaries and then zooming-in. The mandate provided to TMS in Task Order No. 1 to pursue the most promising economic sectors and leverage points required an unbiased, evidence-based approach. TMS set the boundaries of its analyses as broadly as possible at the level of the entire Honduran economy and applied a criterion-based approach to narrow-down or 'zoom-in' on the most promising opportunities based on evidence and stakeholder feedback. The intention of this process is to avoid overlooking promising intervention areas or jumping to conclusions based on an inadequate understanding of the broader system and environment.

3. Co-creation strategy with stakeholders. USAID/Honduras hypothesized, and the TMS Activity embraced, the importance of adoption of a co-creation approach. TMS integrated specific stakeholder-led decisions with regards to economic sector selection and leverage point prioritization within its formative analyses. The Activity used stakeholder consultation, notably subject-matter-expert (SME) workshops, to further inform the selection and sampling methodologies of its formative studies. USAID/Honduras's hypothesis for co-creation is:

> ***If*** *the USAID/Honduras Transforming Market Systems activity uses a co-creation process to the design of the Activity,* ***then*** *it will (1) increase sustainability of the actions and changes it will affect; (2) improve the appropriateness of its strategies, approaches, and intervention designs; and (3) increase processes to support innovation in the TMS Activity and among TMS stakeholders.*

4. Build local capacity through formative analyses: TMS employed a facilitative approach to its formative analyses, engaging local research and consultant providers to contribute to the analyses while simultaneously building their understanding of market systems concepts and expertise in the target sectors.

SUBJECT-MATTER-EXPERT MEETINGS

Objectives: The subject-matter-expert (SME) meetings gathered stakeholder perspectives and feedback on opportunities in selected economic sectors to identify promising areas for further exploration and inform the design of formative studies. Learning questions included:

- Who are the key influencers with the right combination of will and ability to support change?
- What are the business enabling environment factors that propel and constrain change?
- What are the markets that will support inclusive and sustained growth?

Method: TMS organized an SME meeting for each of the 10 priority economic sectors as well as additional meetings for inclusion and municipalities. The SME meetings included three roundtables (described in further detail below) that participants rotated between. Each participant participated in all three tables. The SME meetings preceded and informed the sampling and design of formative studies for each of the economic sectors. Roundtables included:

Key influencers. Participants applied the will-skill matrix to evaluate which actors within the sector had relatively high will and skill to partner to support systemic changes, and which actors lacked either the skill or capacity to support change but could potentially be influenced through the creation of a sound business case, or with strategic capacity building support to become change agents within the system. In this exercise, participants listed the private and public sector by business types, government institutions, associations, etc. that play an important role in the sector. Participants would write the name of that actor down on a post-it note and place it on a template on the poster. Resulting discussions were recorded as participants evaluated the will and skill. The results from this roundtable directly informed the selection of stakeholders to interview under the market systems analysis.

Business enabling environment. Participants prioritized issues related to the legal framework, implementing and supporting institutions and the social dynamics that enable or constrain sectoral growth. Responses were recorded in a table along these four areas and subdivided into enabling and constraining factors. Participants would discuss and vote on the issues within each category they believed to be most important to reform in order to facilitate inclusive economic growth. The results from this roundtable informed the issues explored under the business enabling environment (BEE) analysis.

Target markets. Participants differentiated and segmented the overall markets into specific sub-sectors, products or services and end markets segments. Specific segments were then placed on a growth-share matrix which rated segments based on market growth and market size. This subdivided sectors into its more established vs. nascent, stable vs. growing, and attractive vs. unattractive sub-sectors. Participants evaluated the most attractive sub-sectors to pursue using green markers. The considerations for attractiveness considered high growth potential, low levels of volatility, and ability to create economic opportunities at a scale. The results from this roundtable informed the sub-sectors selected for end market and market systems analyses.

Data Collection: SME workshops consisted of 25-35 participants on average for each economic sector. Each thematic workshop was held only once with participants travelling from different destinations within Honduras. TMS held workshops in Tegucigalpa, San Pedro Sula, Tela and Gracias.

END MARKET ANALYSIS

Objectives: The end market analysis (EMA) evaluated market demand for products and services for each economic sector. This resulted in a prioritization of target end markets and the development of a positioning strategy that considered competitiveness features such as end market requirements, barriers to entry and productive capabilities of Honduran industries. Learning questions included:

- What are the major market segments and defining characteristics (or attribute demands) of customers within those segments?
- What are the productive capabilities of Honduras that are relevant to reaching this target market and how do they compare vis-à-vis other competing countries?
- What target segments should Honduras pursue based on their competitive, inclusive and resilient potential?

Method: TMS contracted market research consultants, or contracted service providers (CSPs), with expertise in each sector to conduct EMA applying the *segment-target-position* (STP) framework, with a guiding outline to fill-out based on secondary market information. CSPs conducted data collection primarily between the first and second milestones, using guidance from the SME meetings to hone-in on secondary sources most relevant for identified segments. TMS met with market research consultants between each milestone to validate findings and progress analysis.

The *segment-target-position* framework considered primarily:
Segmenting of markets both domestic and international which offer value-added opportunities, i.e. not a commodity market, involving major products and service segments of a sector, that may incentivize investment by growing enterprises. Segmentation mapped the broad characteristics of consumers within the segment including defining requirements and preferences.

Targeting of segments considering external factors, notably competition and barriers to entry, as well as internal factors, notably productive capabilities to meet market requirements of segments at lower cost, higher quality of offering an alternative to external competitors. Internal factors were only cursory, as the market systems analysis explored these in much greater detail.

Positioning of Honduran industries within the targeted market segments and an articulation of a positioning statement to achieve a competitive advantage, emphasizing those advantages which are sustainable i.e. potentially valuable, unique and inimitable.

The EMA placed special emphasis in weighting the attractiveness of a market segment based on its potential to generate market opportunities for inclusive economic participation of youth, women and other marginalized populations. It also considered the degree to which those segments were vulnerable to shocks, such as trade barriers, demand swings or other resilience features.

Data Collection: TMS contracted one to two market researchers to work on each priority sector. Market researchers consulted secondary data sources such as available statistical databases like the U.N ComTrade and available market research studies. No primary market data was collected. Market

researchers conducted semi-structured interviews with an average of ten industry experts to gather additional perspectives on end markets and competitiveness factors.

MARKET SYSTEM ANALYSIS

Objectives: The market systems analysis (MSA) applied USAID's 5Rs framework to analyze the rules, roles, resources, relationships and results that drive market systems performance. The purpose of the MSA was to evaluate the underlying patterns, dynamics and root causes and identify leverage points for intervention that would lead to more competitive, resilient and inclusive performance. Learning questions included:

- What firms and actors play what function in the sector and what are the opportunities for actors to innovate to improve efficiency and adopt more value-added functions?
- What is the nature of relationships between actors and what are the opportunities to encourage more effective cooperation and competition within the sector?
- What is the state of resources e.g. technical, business and financial, and what are the opportunities to expand the provision and inclusive flow of needed resources?
- What are the policies, institutions and informal rules that govern or influence how the system operates and what is the political economy around opportunities to reform those rules?
- What are the root causes for low market system performance and what are leverage points that would lead to systemic change and more competitive, inclusive and resilient results?

Method: TMS contracted CSPs to conduct the MSA applying the 5Rs framework. TMS provided introductory training, standardized survey and reporting outlines to guide the MSA. CSPs included local experts from the sectors being analyzed. The MSA included secondary research as well as primary key informant interviews of a diverse sample of actor types across sub-sectors prioritized under in the SME meetings. MSA advisors worked with CSPs to develop the study plans, coach the CSP teams and provide continued mentoring, oversight and support to the sectoral teams in conjunction with the TMS market systems team.

Roles refer to the actors in the system and the functions they perform i.e. who does what. The more important the role that an actor performs, the more central they are to system functionality. Roles also considers the level of mobility of actors to take on new or value-added functions, the prevalence of business models, rates of innovation, the absence or saturation of roles, who is performing and underperforming, and what are the opportunities to improve performance.

Relationships are the interconnections between actors playing roles in a market system. Relationships may be vertical or horizontal. Important considerations include the degree of connectivity and interdependence of actors. Relationships may be formal to informal, strong to weak, mutual to one-sided, cooperative to adversarial, productive to destructive, etc. Transaction costs and cooperation and competition frameworks are used to analyze relationships.

Resources are the inputs which are transformed in a system into results. Resources serve as the "fuel" to keep the system functioning. The sustained inflow of resources into and throughout a system are critical to the sustainability and growth of the market system. Types of resources may include natural, material, financial, human, information, etc. Resource considerations include differential access, sources of supply, flows and inclusivity.

Rules include the formal laws, regulations and statutes and the informal norms, incentives and expectations that regulate how actors behave and the market system functions. Analysis of rules considers the degree of participation in the rule-making process, governance structures, political economy, etc. Rules include both financial and non-financial incentives that motivate behaviors.

Results are the outputs which arise from transformation processes of the market system. Results include both the observable events and hidden performance patterns that occur from underlying dynamics or Rs. The results frame how systems analysis is designed by focusing attention on the root causes or dynamics responsible for producing them.

Data Collection: TMS contracted two researchers to work on the MSA for each priority sector. MSA researchers consulted secondary data sources and conducted primary interviews with a sampling of actors within identified sub-sectors. The sampling strategy included a cross-section of actors taking on different roles within each of the prioritized sub-sectors. TMS MSA advisors developed the sampling strategy with the support of the TMS market systems team. Researchers used semi-structured interviews for 25 market actors per sector. The TMS MSA advisors and TMS market systems team coached researchers on how to ask appropriate probing questions.

SOCIAL NETWORK ANALYSIS

Objectives: The social network analysis (SNA) modeled the relationships between market actors and support service providers to evaluate the relative importance of relationships, identify prominent actors and identify gaps with service providers. TMS conducted SNA for the market actors interviewed as part of the MSA. Learning questions included:

- Who are the most important external service providers that actors go-to to fulfill specific business needs (accessing credit, launching new products, etc.)?
- How do these services rank in terms of the value they provide to the business?

Method: TMS provided e-mail surveys to all enterprises interviewed as part of the MSA. The SNA modeled the relationships of actors to support service providers to map support service network structures and evaluate access to resources at both the sectoral and market system levels.

Data Collection: TMS conducted SNA surveys for all enterprises surveyed as part of the MSA. The questionnaire will be administered online, utilizing an online network data collector.

BUSINESS ENABLING ENVIRONMENT ANALYSIS

Objectives: The BEE analysis prioritized BEE constraints most relevant to the identified economic sectors that offer greatest potential for reform. BEE delineated opportunities within the commercial, legal and institutional environment. This includes political economy considerations of the incentives, opportunities and roadblocks to BEE reform. The BEE analysis resulted in a preliminary BEE reform agenda, developed in conjunction with stakeholders, that outlined major BEE intervention areas. Key learning questions included:

- What is the legal framework that either enables or constrains business, how is the legal framework applied and what impact does this have on different stakeholders?
- What are the institutions that bear primary responsibility for implementing and enforcing the legal framework and how effectively do these institutions function?

- What other organizations are critical to the development, implementation and enforcement of the legal framework and how well do they work with implementing institutions?
- What is the political economy around reform and what implications does it have in terms of policy outcomes and in terms of marginalized groups?

Method: The BEE examined norms and customs, laws, regulations, policies, international trade agreements, and public infrastructure that either facilitate or hinder the movement of products or services within the priority sectors. TMS analyzed the BEE along five fundamental aspects:

- *enterprise inputs* which are critical for enterprises, including land, electricity, and labor;
- *starting a business* which are the conditions for company registration;
- *access to finance,* inclusive of banking, and microfinance;
- *access to markets* including transport infrastructure, e-commerce, etc.; and
- *competition.*

The BEE further examined the legal framework, implementing and supporting institutions as well as the political economy around BEE issues across these aspects.

- *Legal framework* considers the policy process of problem identification, policy development, enforcement and monitoring. The legal framework considers how accessible is the law, how well-positioned and informed are stakeholders and the extent to which the laws reflect emerging global standards and the commercial realities of constituents.
- *Implementing institutions* include ministries, regulators, registries and courts with primary responsibility for implementing the legal framework and enforcing laws and regulations.
- *Supporting institutions* include banks, business support services, business associations, professional associations, universities and training centers which may champion reform and play an integral function in how enterprises are influenced by and interact with implementing institutions and the legal framework.
- *Political economy* refers to the dynamics between legal structures, institutions and actors and considers the interests and incentives different groups face, their contribution to policy outcomes and extent to which poor and marginalized communities are included.

Data Collection: Data sources included the SME meetings, MSA surveys which highlighted BEE issues, as well as semi-structured interviews with key informants. The sampling strategy included a mix of public and private-sector actors across the sectors that are part of key implementing and supporting institutions identified as critical to prioritized BEE issues from SMEs and MSAs. The BEE analysis included a review of secondary sources and benchmarking of key BEE indicators.

GENDER AND SOCIAL INCLUSION ANALYSIS (GSIA)

Objectives: The GSIA evaluated specific inclusion issues that affect marginalized populations with special attention to youth, women and the poor. The GSIA analyzed the barriers, including stigma, that prevent vulnerable populations from participating in economic opportunities. The GSIA included the identification of gender gaps, gender-based violence (GBV) and inclusion issues that may affect TMS's ability to achieve results. The GSIA informed the identification of leverage points which are amenable to change, and high-potential intervention areas that can close inequality gaps and empower women, men, boys, and girls of all abilities, ethnicities, ages, and sexual orientations to participate in economic opportunities. Key learning questions included:

- What economic sectors and sub-systems have the potential to include and/or benefit vulnerable and marginalized groups?
- What are the laws, policies, regulations, and institutional practices that govern or influence how the system includes and/or excludes marginalized groups?
- What are the informal rules, cultural norms and beliefs that lead to greater risk of violence and exploitation against marginalized groups in the market system?
- What are the gender roles, responsibilities and time used of marginalized groups in the target economic sectors and what are opportunities to engage in profitable and secure employment?
- What are the constraints and needs of marginalized groups in accessing and having control over productive resources needed for economic participation?
- What relationships can TMS broker or enhance to shift patterns of power and decision-making to be more inclusive and provide greater opportunities for marginalized groups?

Method: The GSIA used the USAID ADS Chapter 205 Integrating Gender Equality and Female Empowerment in USAID's Program Cycle domains of analysis, including:

- *Laws, policies, regulations and institutional practices* to analyze who sets the rules that advantage and disadvantage and the policies that exclude or include marginalized groups. It included the extent to which governance structures reinforce exclusion, degree of participation in the rule-making process, and areas for partnership and opportunity to strengthen sets of policies and rules that would enable greater inclusion.
- *Cultural norms and beliefs* to identify dominant social norms which limit economic participation and inclusion and the private sector's perception of marginalized groups. It further considers the degree to which discrimination occurs and inequalities are internalized resulting in self-exclusion as well as the norms with regards to GBV.
- *Gender roles, responsibilities and time used* to identify the roles marginalized actors tend to play and transactions they are excluded from participating in. It considers the extent to which marginalized groups spend time on unpaid care and subsistence work and extent to which marginalized groups participate in other informal or hidden work.
- *Access to and control over assets and resources* to identify specific constraints and needs that marginalized groups face accessing and controlling services, products, information as well as the incomes that result from their work. It considers strategies employed to maintain control and skills and assets needed to open up access to economic opportunities.
- *Patters of power and decision-making* to identify the social capital of different groups and extent to which they are able to access necessary networks to advance. It considers who makes decisions at home, the impact this has on labor and the risk of crime and violence.

Data Collection: TMS brought on a headquarters-based GSI expert and conducted research, interviews and analysis with four members of the TMS GSI team. The team conducted research in all of the USAID DO1 cities and DO2 departments. Data collected included a literary review and secondary data collection including existing GSI assessments from USAID/Honduras. Key informant interviews included males, females and youth with efforts to include diverse males and females that identify as LGBTI, ethnic and indigenous minorities, returned migrants, and persons with disabilities. TMS worked with USAID implementing partners, the private sector, government, and/or civil society actors to identify key informants, while others came through referrals by other interviewees. The GSI team interviewed 137 key informants (56 percent female, 44 percent male) and conducted 13 focus

group discussions and 14 key informant interviews. Data was fed through a qualitative data analysis software and a code book developed to analyze themes related to distinct social groups and domains of analysis.