



APPRAISAL REPORT

CAO Appraisal for Audit of IFC

CAO Compliance

CI-R6-Y08-F095

June 17, 2008

**Mahindra ShubhLabh Services Limited (MSSL), Project 11230
India**

Cases of

Mahindra ShubhLabh Services Limited (MSSL)

Office of the Compliance Advisor/Ombudsman (CAO)
for the
International Finance Corporation (IFC)
Multilateral Investment Guarantee Agency (MIGA)
Members of the World Bank Group



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About the CAO

The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

The CAO (Office of the Compliance Advisor/Ombudsman) is an independent post that reports directly to the president of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the two private sector lending arms of the World Bank Group: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about the CAO, please visit www.cao-ombudsman.org



1. Overview of the CAO Compliance Appraisal Process

When the CAO receives a complaint about an IFC or MIGA project, it first refers it to the CAO Ombudsman, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If the CAO Ombudsman concludes that the parties are not willing to reach a facilitated solution, the CAO Vice President has the discretion to request the compliance arm of CAO, CAO Compliance, to appraise the concerns raised in the complaint for a compliance audit of IFC or MIGA. Alternatively, a compliance audit can be initiated by request from the President of the World Bank Group or the senior management of IFC or MIGA.

A CAO Compliance appraisal is a preliminary investigation to determine whether the CAO should proceed to a compliance audit of IFC or MIGA. Through CAO Compliance appraisals, the CAO ensures that compliance audits of IFC or MIGA are initiated only for those cases with substantial concerns regarding social or environmental outcomes.

A compliance audit is concerned with assessing the application of relevant policy provisions and related guidelines and procedures to determine whether IFC and MIGA are in compliance. The primary focus of compliance auditing is on IFC and MIGA, but the role of the sponsor may also be considered.

A compliance audit appraisal, and any audit that ensues, must remain within scope of the original complaint or request. It cannot go beyond the confines of the complaint or request to address other issues. In such cases, the complainant or requestor should consider a new complaint or request.

CAO compliance appraisal will consider how IFC/MIGA assured itself/themselves of compliance with national law, reflecting international legal commitments, along with other audit criteria. The CAO has no authority with respect to judicial processes. The CAO is not an appeals court or a legal enforcement mechanism, nor is the CAO a substitute for international courts systems or court systems in host countries.

The appraisal criteria are set forth in CAO's Operational Guidelines. The criteria are framed as a series of questions to test the value of undertaking a compliance audit of IFC or MIGA. The criteria are as follows:

- Is there evidence (or perceived risk) of adverse social and environmental outcomes that indicates that policy provisions (or other audit criteria) may not have been adhered to?
- Is there evidence of risk of significant adverse social and environmental outcomes that indicates that policy provisions, standards, guidelines, etc., whether or not complied with, have failed to provide an adequate level of protection?
- Is there evidence (or perceived risk) of significant adverse social and environmental outcomes where policy provisions, standards (or other audit criteria) were not thought to be applicable but perhaps should have been applied?



- Is there evidence that the application of some aspect of a policy, standard, guideline or procedure resulted in adverse social and environmental outcomes?
- Can the cause of adverse social and environmental outcomes not be readily identified and corrected through the intervention of the project team without a detailed investigation of the underlying causes or circumstances?
- Could a compliance audit yield information or findings that might better inform the application of policies (or other audit criteria) to future projects?

During appraisal, CAO Compliance holds discussions with the IFC or MIGA project team and other relevant parties to understand the validity of the concerns and to explore whether an audit would be warranted.

After a compliance appraisal has been completed, the CAO can choose only one of two options: to close the case, or to initiate a compliance audit of IFC or MIGA.

The CAO will report and disclose the findings and decision of the CAO compliance appraisal in an appraisal report in order to inform the President of the World Bank Group, the Boards of the World Bank Group, senior management of IFC or MIGA, and the public in writing about its decision.

If the CAO decides to initiate a compliance audit, as a result of the compliance appraisal, the CAO will draw up a terms of reference for the audit in accordance with CAO's operational guidelines.



2. Background and Concerns that Led to the Appraisal

1. Between March 2007 and February 2008, the CAO Ombudsman was engaged in negotiations between parties involved in four separate complaints regarding the Mahindra ShubLabh Services, Ltd. (MSSL) project. IFC supported the project in 2002 with a \$2.2 million equity investment for development of 180 Agricultural Service Centers (ASCs) in India, to be developed over a four-year period.

2. According to IFC, the service centers were intended to provide farmers with a one-stop shop that would supply (i) appropriate inputs such as seed, fertilizers, and pesticides, (ii) rental equipment, (iii) information on agriculture techniques and market information, (iv) contractual farm input application and advisory services, and (v) access to crop finance from commercial banks.

3. In its August 2002 Streamlined Procedure Board paper, IFC states that the project will “improve farming profitability and sustainability by increasing agricultural yields, and reduce production costs and chemical pest control dependency.” IFC further states that the development impact will be an increase in productivity and farmer’s income through integrated crop management, increased local employment by every ACS hiring up 100 local employees, and that in addition there will be a demonstration effect that is likely to attract additional players from established companies in the agribusiness sector. Moreover, the project will benefit the health and well being of farmers and the environment by promoting integrated pest management, non-chemical methods and informed management of chemical products.

4. The four complaints filed by signatories of franchise agreements to run ACSs, claimed that MSSL;

- did not train or educate farmers about the use of eco-friendly pesticides and fertilizer
- promised eco-friendly and organic farming, but only provided traditional agriculture products
- did not, as committed, possess specialized knowledge in agriculture to improve farm productivity, resulting in losses for both farmers and franchisees
- offered no knowledge or technical expertise to increase productivity for the farmers, and that they, and the franchisees, suffered heavy losses as a consequence.

5. The complainants further state that when presented with the franchise agreements and project concept, they put great comfort in the fact that the World Bank in the form of IFC, was a partner, giving them a high degree of confidence in the project’s viability, and in the published income projections. They further state that they are in no position to pursue any of their claims through the local legal system due to their financial inability to support such a process.

6. As stated in its report made publicly available in March, 2007, the CAO Ombudsman found the following during its assessment; the original IFC-supported project sought to establish ASCs in 180 locations around India. Soon after its launch, an estimated 55 people who purchased ASC franchisee agreements closed their shops. The IFC does not refute that the project failed to meet its intended goals. In an effort to recoup its losses and keep the company afloat, MSSL said it abandoned the ASC concept and re-established itself as a marketer and distributor of pesticides and other agrichemicals.



3. CAO Findings

7. CAO's concerns in the context of a Compliance appraisal of the issues raised in the complaints are (i) any possible adverse environmental outcome as a consequence of agrichemical use, and (ii) any loss of livelihood for farmers as a consequence of the project.

8. IFC states that it made all reasonable efforts to assure itself of elimination of retail sale of WHO class Ia and Ib chemicals, and that it is assured that the desired environmental and social outcomes in regard to pest management were met. IFC further states that it has not received any indication that excessive or wrongful use of pesticides caused farmers to lose their livelihood as a result of pesticide induced land degradation.

9. IFC states that under the revised business model now in place, pesticides are sold by Mahindra Branded Pesticides through appointed dealers. IFC states that MSSL provides adequate assurance that it does not procure WHO Class Ia and Ib agrichemicals.

10. IFC states that the decision regarding agrichemical selection and application are ultimately made by the individual farmer, and it is not possible to draw conclusions as to how well systems and procedures addressing safe handling and application of agrichemicals at the individual farm level were implemented at any given time.

The appraisal finds the following:

11. CAO finds that the originally suggested business model relied on information and training at local level to increase the likelihood of local farmers making informed decisions on more sustainable agrichemical use. The possibility that this level of ability to make informed decisions was not achieved at the local level does not constitute an adverse environmental outcome, it constitutes a failure to deliver on the anticipated outcomes.

12. The complainants raise the issue whether IFC made reasonable efforts to assure itself that, in their view, the added credibility of IFC promoting the project was not misused, and whether IFC assured itself that the small-scale investors fully understood the commercial implications, in order to make an informed decision to enter into the franchise agreements. It is, however, outside the mandate of this compliance appraisal to address how careful IFC was in the use of its leverage.



4. The CAO Decision

The CAO concludes the following:

13. Failure to deliver the anticipated profits for the ASCs in this case can not be defined as loss of livelihood in the context of adverse social development impact.

14. Failure to deliver on the development outcomes promised to the Board, or a change of the anticipated outcome, does not in this case constitute a violation of any IFC policy provisions or criteria, neither is it indicative of potential adverse social or environmental outcomes.

15. There are no indications that farmers lost their livelihood due to pesticide induced land degradation as a direct consequence of the project IFC invested in.

Based on the above, CAO will close this appraisal with no further action.