

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

ARGENTINA

**SOCIAL ENTREPRENEURSHIP PROGRAM
EXECUTIVE SUMMARY**

CONSOLIDATION OF FIS EMPRESA SOCIAL S.A.

(AR-S1004)

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CONTENTS

I.	BASIC PROJECT INFORMATION	1
A.	Borrower	1
B.	Amount and source of financing	1
C.	Terms and conditions	1
D.	Statement of no objection	1
E.	Problem to be addressed	1
II.	THE PROJECT	6
A.	Objectives	6
B.	Description	6
C.	Sustainability and results of the financial analysis	7
D.	Credit risk for the Bank	8
E.	Expected outcomes and benefits	9
F.	The Bank's strategy	9
G.	Cooperation with other donors and international agencies	10
H.	Summary of the environmental and social review	10
I.	Special conditions	10
J.	Reports, evaluations, and audits	11
K.	Project risks and mitigating factors	12
L.	Exceptions to Bank policies	13

ANNEXES IN THE PROJECT TECHNICAL FILE

Annex I	Performance indicators
Annex II	Logical framework
Annex III	Institutional analysis and execution of the operation
<i>Appendix 1</i>	<i>Financial statements and financial analysis</i>
<i>Appendix 2</i>	<i>Projections and financial analysis</i>
<i>Appendix 3</i>	<i>Calculation of the project's operational and financial stability</i>
Annex IV	Market analysis
<i>Appendix 1</i>	<i>Comparative information on performance for selection of FIS</i>
Annex V	Plan of operations for the technical-cooperation component
<i>Appendix 1</i>	<i>Itemized budget</i>
<i>Appendix 2</i>	<i>Terms of reference for the technical-cooperation component</i>
Annex VI	Detailed CESI recommendations
Annex VII	Summary of the project's financial terms and conditions
Annex VIII	FIS Credit Regulations
Annex IX	Stockholders, financiers, and other partners of FIS S.A.
Annex X	Agreement between El Ceibal Asociación Civil and the founders group of FIS Microcrédito, to establish FIS Empresa Social

ADDITIONAL INFORMATION IN THE PROJECT TECHNICAL FILE

Document 1	Legally recorded articles of incorporation of FIS Empresa Social S.A.
Document 2	Approved Profile
Document 3	Annex to Approved Profile
Document 4	Addendum to Approved Profile Sent to the Italian Fund
Document 5	Conditional Approval of the Profile by the Italian Fund
Document 6	Evidence of relationships between FIS and its financiers
Document 7	List of activities ineligible for financing due to their adverse social or environmental impact

ABBREVIATIONS

BCRA	Central Bank of the Republic of Argentina
CESI	Committee on Environment and Social Impact
CGAP	Consultative Group to Assist the Poorest
FIS	FIS Empresa Social S.A.
FONCAP	Fondo de Capital Social S.A.
Italian Fund for Microenterprise	Don L. Sturzo Trust Fund for Microenterprise
MFI	Microfinance Institution
NGO	Nongovernmental organization
REM	Forecast of Market Expectations

I. BASIC PROJECT INFORMATION

A. Borrower

1.1 FIS Empresa Social S.A.

B. Amount and source of financing

	IDB	Local	Total
Reimbursable financing:	US\$500,000	US\$2,000,000	US\$2,500,000
Technical cooperation:	US\$ <u>250,000</u>	US\$ <u>0</u>	US\$ <u>250,000</u>
Total:	US\$750,000	US\$2,000,000	US\$2,750,000

Source: Don L. Sturzo Trust Fund for Microenterprise (Italian Fund)

C. Terms and conditions

Execution period:	36 months
Disbursement period:	42 months
Amortization period:	15 years
Grace period:	5 years for principal
Interest rate:	11.8% for the first twelve months of execution, adjustable annually beginning in the second year of execution
Currency:	Argentine pesos

The grace period will apply to the repayment of principal only, not to interest. The loan will be denominated and repaid in local currency. The interest rate will have a fixed component of 1% and a variable component corresponding to the Consumer Price Index (CPI) forecasted for the following 12 months by the Central Bank of the Republic of Argentina (BCRA), which appears regularly in the BCRA's "Forecast of Market Expectations" (REM). The REM of 3 November 2005 indicated a forecasted rate of 10.8%.

D. Statement of no objection

1.2 The Government of Argentina stated its no objection to Bank financing for the project in a letter dated 24 October 2005.

E. Problem to be addressed

1.3 **The outer suburbs of Buenos Aires.** The outer suburbs or urban area surrounding Buenos Aires comprises 24 administrative subdivisions and approximately 13 million inhabitants with a socioeconomic level far below the rest of the province of Buenos Aires. According to official data, at the end of 2003, 18% of households

and 23% of people in the outer suburbs were living below the indigence line,¹ and 43% of households and 54% of people were living below the poverty line.² The situation is more serious in the outer suburbs to the south, where shortfalls in housing (more than 40% in many neighborhoods), infrastructure, and formal employment is similar to the suburbs of the poorest countries in the region. More than 70% of the 900,000 inhabitants of Esteban Echeverría and Lomas de Zamora are living below the poverty line. Other neighboring administrative subdivisions, such as Almirante Brown, La Matanza, and Florencio Varela add another 2.4 million inhabitants in similar conditions.

- 1.4 **Importance of microenterprise in this urban area.** According to a recent study, more than 85% of the aforementioned administrative subdivisions in southern Buenos Aires are at the base of the pyramid, i.e. impoverished with high unemployment and dependent on social programs. In such a setting, microenterprises represent the greatest private source of employment and household income. It is reasonable to estimate that approximately 320,000 microentrepreneurs (60% women) operate in these administrative subdivisions, from informal merchants and the self-employed to numerous dynamic microenterprises with growth potential. Forty percent of the 3.3 million inhabitants depend on their ability to grow and generate economic activity and employment. However, their needs for growth are not being met.
- 1.5 **Limited access to credit for microenterprises in the suburbs.** According to a number of Argentine microfinance institutions (MFIs), between 40% and 50% of urban microentrepreneurs say they need credit for inventory, working capital, and investment in their businesses, the largest percentage being women. At the same time, the experience of FIS Empresa Social S.A. (FIS) has shown that nearly 70% of microentrepreneurs in the southern suburbs have no borrowing experience. Commercial credit—which was the largest available source of financing—has been scarce since 2001, while credit from various informal sources with daily payments is widely available, but effective monthly rates are 70% and delinquent borrowers are threatened with violence. This, combined with the difficulties of saving while in conditions of poverty, makes it hard for microentrepreneurs to invest in their businesses and generate growth in assets, sales, profits, and employment.
- 1.6 FIS Microcrédito has been offering microcredit in the southern suburbs since 2001, first as a program of the nongovernmental organization (NGO) El Ceibal, and since August 2005 as FIS Empresa Social S.A., an entity specializing in microfinance created as a “social enterprise” by El Ceibal. FIS seeks to use its products and services to make a substantial, sustainable, and measurable positive impact on the lives of people and communities where it works. It uses the same means as

¹ Indigence is a level of income insufficient to purchase a basic basket of food for US\$42 per month.

² Poverty is a level of income insufficient to purchase a total basic basket of food, clothing, transportation, education, and healthcare for US\$91.

for-profit companies: gains in efficiency, productivity, and profitability. This enables it to attract and ensure the optimum use of necessary resources (social investors) to achieve a social impact. With 2,440 total borrowers (1,500 in the aforementioned areas), an average balance of US\$187, and a delinquency rate of 1.01% (more than 30 days past due), FIS is the only credit option for most microentrepreneurs.³

1.7 Selection of FIS as executing agency. FIS's performance compared to other Argentine MFIs that operate without the Bank's support is presented below:⁴

Figures In US\$ (All data for other MFIs is as of June 2005)	FIS		MFIs not supported by the Bank				
	As of September 2005	Performance among MFIs not supported by the Bank	Alternativa 3	Fundación Pro Vivienda Social	Fundación Grameen Mendoza	Entre Todos	Fundación Progresar
Credit portfolio	455,315	1	50,000	21,865	74,155	23,113	14,355
Number of borrowers	2,440	1	350	188	713	500	170
Credits disbursed per month	584	1	N/A	23	185	100	66
Average balance	US\$187	-	US\$143	US\$116	US\$104	US\$46	US\$84
Delinquent portfolio (more than 30 days past due)	1.01%	2	N/A	N/A	0.80%	3.10%	1.40%
Clients per loan advisor	153	1	N/A	94	102	83	85

1.8 Likewise, a broader comparison of FIS with all Argentine MFIs (see Technical File, Annex IV, Appendix 1) shows that FIS, along with FIE Gran Poder, is one of the three largest MFIs, and one of the two with the best indicators.

1.9 The Bank selected FIS because: (i) it has a track record of sustained growth in its portfolio and client base, and solid performance in the last three years (see Technical File), which suggests that it is capable of achieving the institutional scale required for large-scale, sustainable microlending; (ii) it focuses on offering microcredit to segments not served by any other MFI, with an average balance of US\$187, one of the lowest in the region relative to national income; (iii) it has developed innovative systems for delivering services, such as outreach offices and the scheduling of collections and disbursements for specific days of the week, which points to efficiency gains; (iv) it has sufficient administrative, financial, and human resource capacity to manage large-scale operations (since 2001 its employee

³ FIE Gran Poder, another MFI with 2,400 clients and an average balance of US\$1,250, operates in 20% of the areas where FIS operates, but lends to larger microenterprises. In 2003, the Multilateral Investment Fund (MIF) supported FIE (ATN/ME-8510-AR).

⁴ In addition to supporting FIE Gran Poder in 2003, the Bank supported the Women's World Bank with credit and technical-cooperation projects in 1995. Technical-cooperation projects with Argentina Microfinanzas S.A. and Pro Mujer Argentina are in the pipeline. A comparison of all entities is found in the Technical File, Annex IV, Appendix 1.

retention rate is 87%); (v) it applies international financial best practices, including FIS's close proximity to clients in the poorest neighborhoods, both central and branch offices; (vi) it offers a solidarity lending product that clients understand well and that permits rapid growth without excessive increases in administrative costs; and because (vii) its 26 employees, including management, have demonstrated a service orientation to the target population, as reflected in strong growth in clients with a low default rate.

- 1.10 **Relevance and impact of FIS microcredits.** Microentrepreneurs in FIS's areas of influence have demonstrated a demand for the credit products FIS offers. In a survey of 180 clients, FIS's services were rated as "excellent" by 98%, while 95% also rated the clarity of credit terms and benefits as "excellent". Furthermore, an impact study at the end of 2004 with 100 randomly selected FIS clients indicated that, eight months after the first disbursement, sales by those clients had increased by 29%, their net incomes by 36%, and total household incomes by 31%, with income produced by the microentrepreneurial activity accounting for 89% of the rise in total income.
- 1.11 **The proposed solution: reimbursable financing for FIS.** With financing from the Bank, FIS can finance approximately 12,500 microentrepreneurs in the next three years, and thus respond to the accelerated growth in the credit portfolio in the suburbs of Buenos Aires. The credit portfolio will grow from US\$635,000 at end-2005 to approximately US\$2.7 million at end-2008, which represents average annual growth of 63%. Accordingly, financing of US\$500,000 would cover 18.5% of FIS's credit portfolio at end-2008. The Bank's financing will enable FIS, one of the Argentine MFIs with the best performance indicators (see Technical Files), to leverage capital resources from social investors with which it is in the process of negotiating, such as Unitus in the United States of America and Novib-Oxfam in Holland. Without the Bank, there are currently no investors in the international community that could invest venture capital in a new Argentine MFI, whose long-term presence is critical to ensuring that thousands of microentrepreneurs have access to financing. The Bank's support will also complement FIS's existing financing, i.e. FONCAP S.A., the Social Investment Trust, and Etimos in Italy, and financing in the process of negotiation with Planet Finance, Oikocredit, and others. In this way, FIS could attract private capital and financing from the Bank's other private sector windows⁵ over a three-year period. The technical files show financial projections, FIS's relationships with its institutional partners and financiers, and all agreements in effect.
- 1.12 **Need for technical-cooperation funding.** With technical-cooperation support from the Bank, FIS could address certain institutional weaknesses to implement the proposed solution:

⁵ Similarly, Inter-American Investment Corporation (IIC) operations were recently approved with MFIs such as Procrédito and Prodem in Bolivia, former Small Projects Program recipients.

- 1.13 *Development of credit products and growth management tools.* FIS has a simple and successful project that has enabled its rapid growth. However, caps per credit cycle and the obligation to form joint-liability groups of borrowers limit future development to better address individual client needs. To address this problem, FIS is exploring a pilot project to provide credit to individuals. However, it needs specialized technical advice to better satisfy the demand of dynamic microenterprises. The project would also be strengthened if FIS were to develop the human resource and market management tools necessary in a phase of growth involving the continual hiring and training of human resources.
- 1.14 *Adoption of financial management tools and information technology system.* To support the growth of a new MFI in a local environment with limited microfinance experience and to achieve the goals of the project, FIS should have: (i) access to tax and legal advice; (ii) a financial planning manual; (iii) a budget and control manual; (iv) costing reports by agency; (v) a chart of accounts that meets the financial system's requirements; and (vi) a system of payments and transfers to optimize mechanisms for paying providers and transferring funds between the central and branch offices. Due to the growing complexity that will result from the introduction of new products and the continual opening of new branches, FIS will also need to develop a more sophisticated information technology system than its current one.
- 1.15 **Beneficiaries.** The direct beneficiaries of this project will be approximately 12,500 microentrepreneurs in the Buenos Aires suburbs and their families. Business activities are distributed among commercial (66%), production (12%), and services (22%). The most significant categories in the commercial area are stores and kiosks; in small-scale production, the tailoring and garment industry; and in services, construction and trades. Fifty-four percent of clients have at least four years of experience in their line of work. Seventy-one percent have a fixed workplace. At least two-thirds of beneficiaries are subsistence microentrepreneurs, many living in poverty and unable to meet their basic needs. Currently, 39% of FIS's clients earn monthly incomes⁶ of US\$155 or less, while 31% earn more than US\$310 per month. It is estimated that by the end of the project, 20% of beneficiaries will be dynamic microentrepreneurs able to produce sufficient income not only to cover their subsistence needs, but also to reinvest in their businesses and generate growth in sales or employment. With respect to the Don L. Sturzo Trust Fund for Microenterprise (Italian Fund), FIS will give special attention to credits received by those microentrepreneurs in its progress and evaluation reports.
- 1.16 **FIS in the context of Argentine microfinance and the Social Entrepreneurship Program (SEP).** Unlike the rest of the region, sufficient sustainable microfinance institutions with the necessary scale have not emerged in Argentina due to: (i) an adverse regulatory environment where reform is not a priority due to the lack of a

⁶ Sales less purchases and operating costs, i.e. net income.

microfinance industry; (ii) late access⁷ to local and international financing; (iii) the scarcity, small size, and weaknesses of providers; and (iv) limited local experience with microcredit technologies. At the same time, requirements have been set by international financiers based on the characteristics of mature MFIs in other countries, and there has been limited financing for new entities in Argentina. SEP could fulfill this role by supporting an entity like FIS, which in five years may have the necessary scale to become a pillar of the local microfinance industry. In the 1980s and early 1990s, the Bank made the birth of many of today's largest MFIs in the region possible through credits and technical cooperation under the Small Projects Financing Program, which was replaced by the SEP.

II. THE PROJECT

A. Objectives

- 2.1 The project seeks to improve the socioeconomic conditions of microentrepreneurs and their families in the southern suburbs of Buenos Aires. Its purpose is to facilitate access by approximately 12,500 microentrepreneurs in the southern suburbs of Buenos Aires to efficient and sustainable financial services.

B. Description

- 2.2 The project has two components: (i) a reimbursable financing component for US\$500,000, and (ii) a nonreimbursable technical-cooperation component for US\$250,000.
- 2.3 **The reimbursable financing component** (IDB: US\$500,000, local US\$2,000,000) will be allocated to finance the purchase of inventory, equipment, fixed assets, and other productive assets for 12,500 microentrepreneurs in the southern suburbs of Buenos Aires, i.e. owners of businesses that have been operating for at least one year, who will receive microcredits from FIS under the credit regulations contained in the technical file. Approximately 60% of beneficiaries who receive financing will be women, and at least 20% will be dynamic microentrepreneurs with differentiated patterns of growth in sales, profits, or employment. Credit will be extended for between US\$140 and US\$650 using a group or individual lending methodology. FIS will supplement the reimbursable financing component with US\$2 million in funds from other sources (see financial projections in the technical file and the breakdown of financiers who will supplement the Bank's resources).
- 2.4 **The technical-cooperation component** (IDB: US\$250,000) will be allocated for the institutional strengthening of FIS. Specifically, technical assistance activities

⁷ International donors showed no interest until the 2001 crisis, and since then only in a few cases.

and the procurement of equipment and systems will be aimed at: (i) improving FIS's business model; (ii) training FIS's credit advisors and middle management; (iii) designing market-based credit products; (iv) implementing financial management tools; and (v) scaling FIS's equipment and systems to the volume of operations. The Plan of Operations for the technical-cooperation component is in the technical file.

C. Sustainability and results of the financial analysis

- 2.5 **Financial results.** The financial statements of the FIS Microcrédito Program for 2003 and 2004, as well as estimates for 2005, are in Annex III, Appendix 1, of the technical file. The audited financial statements of El Ceibal for 2003 and 2004 are also in the technical file and include the financial statements of FIS Microcrédito.
- 2.6 **In its 2004 year-end balance sheet,** the FIS program had assets, liabilities, and equity of US\$271,736, US\$251,048, and US\$20,688, respectively. By the end of 2005, FIS Empresa Social expects to post US\$726,000 in assets, US\$721,000 in liabilities, and US\$5,000 in equity. FIS's recent incorporation in August 2005 to continue operating the FIS Microcrédito Program is the reason why the first capital investments expected from Unitus and Novib-Oxfam will not have materialized by the end of 2005. These will enable FIS to increase its equity in the first quarter of 2006, achieving capital adequacy ratios similar to those of solid MFIs in the region.
- 2.7 The FIS balance sheet shows that: (i) its credit portfolio has been growing by more than 250% per annum, with a default rate of less than 1%, to reach 85% of total assets; (ii) the large majority of its loan portfolio has been financed with debt, mainly the FIS Social Investors Trust and FONCAP, (iii) FIS has had sustainable operations during its growth, and (iv) as a program operating within an NGO, FIS has been unable to attract venture capital, which means that equity levels have been less than desirable for an MFI. This is one reason why El Ceibal decided in April 2005 that FIS should operate as a separate program and be structured as a corporation starting in August. Annex X of the technical file provides the details of that decision.
- 2.8 **FIS's income statements** show profits in 2003 and 2004. In 2005, income is expected to equal expenses. For the last three years, FIS's income statements show the following: (i) increasing sustainability of the microcredit program, for which operating income rose to 60% of total income for 2005 – a notable achievement for a new MFI in Argentina; (ii) an institutional capacity to cover all program expenses and to grow without generating operating deficits in all years; and (iii) an increase in operating efficiency as the scale of operations has increased, set to be below 45% by the end of 2005.

- 2.9 **Financial projections.** In 2008, at the end of the three years of the project, net after-tax income of FIS is projected to be approximately US\$94,000. In 2006 and 2007, net after-tax income is projected to be between US\$36,000 and US\$32,000.

Financial Projections (US\$)	2005	2006	2007	2008
Loan portfolio	635,000	1.1 million	1.8 million	2.7 million
Net earnings	-	36.000	32.000	94.000
Efficiency (total operating cost/average portfolio)	63%	47%	43%	33%
Maximum leverage ratio (total debt to equity)	19 to 1	5 to 1	5 to 1	5 to 1
Operating income/Total income	60%	75%	91%	98%
Operational sustainability: Income/Total expenses	100%	109%	105%	113%
Financial sustainability: Income/(Total expenses + Adjustments for subsidies and inflation)	99%	105%	99%	105%
IDB debt coverage (net income before IDB payment/IDB debt service)	N/A	4.4 times	2 times	3.7 times

- 2.10 Annex III, Appendix II, of the technical file includes indicators of the historical and projected performance of FIS, specifically: (i) an increase in scale to a portfolio of nearly US\$2.7 million by 2008 will permit a reduction in operating costs as a percentage of the average portfolio by nearly half,⁸ from 63% in 2005 to 33% in 2008; (ii) profits and fresh equity financing from international partners will enable FIS to maintain a maximum leverage ratio (debt to equity) of 5 to 1; (iii) the IDB debt coverage during the three years of the project presents multipliers of between 2 and 4.4 times the debt service; (iv) based on projections, FIS will be operationally sustainable for all years of operation, while financial sustainability will be achieved in two of the three years of the project, reaching 99% in the remaining year. FIS's performance and its selection of international partners lend support to the feasibility of the proposed growth, which is also the only means to create a sustainable microfinance institution with the necessary scale that is relevant to microenterprises in the southern suburbs of Buenos Aires.

D. Credit risk for the Bank

- 2.11 The project's credit risk is concentrated in three areas: (i) the socioeconomic viability of microentrepreneurs who will become FIS clients; (ii) effective recovery by FIS staff of principal and interest on microcredits; and (iii) the generation of sufficient profits for FIS to make principal and interest payments to the Bank and other financiers, and to sustain adequate liquidity and capital adequacy levels.
- 2.12 In the first area, based on its track record, we can conclude that FIS will select 12,500 microentrepreneurs that represent a good credit risk from among the hundreds of thousands of clients in the southern suburbs requiring credit for their productive activities. Even if real demand for microcredits is ultimately less than

⁸ A significant reduction considering that nearly 30% of FIS's operating costs correspond to taxes.

projected, FIS has sufficient experience to prevent this from representing a risk for the Bank.

- 2.13 In the second area, although FIS is a new entity, its performance in the suburbs of Buenos Aires enables us to predict that its loan portfolio will be properly managed. At the outset of the project, FIS already has a diversified and high-quality portfolio, with a default rate (ratio of portfolio more than 30 days past due to total portfolio) of 1.01%, and well-defined default control procedures.
- 2.14 In the third area, we can conclude that greater efficiency will increase the profitability of FIS, such that it can service its debt with the Bank and other financiers. The project also includes a contractual conditionality requiring FIS to maintain an institutional debt-to-equity ratio of less than 5 to 1, thus ensuring a capital adequacy level during execution consistent with best practices in microfinance.

E. Expected outcomes and benefits

- 2.15 **Expected outcomes for beneficiaries.** At the end of the three years of the project, the following outcomes are expected for the 12,500 beneficiary microentrepreneurs (60% women): (i) microentrepreneurs in the project for more than 2 years will see a 20% increase in their business sales, net household income, and average values of business assets compared to a control group; and (ii) 20% of microentrepreneurs will have created additional employment and/or experienced growth in assets, equity, or sales of greater than 40% in one of their last two years.
- 2.16 **Expected outcomes for FIS.** This project will strengthen one of the few MFIs with the potential for substantial alleviation of the problem faced by microentrepreneurs in the suburbs of Buenos Aires of accessing credit to meet their demand. Specifically, the project will achieve the following: (i) finance a portion of FIS's growth, allowing it to build a portfolio valued at approximately US\$2.7 million in three years; (ii) strengthen the entity's equity and, consequently, its ability to attract additional financing from Argentine social investors in the FIS Trust, venture capital from other financiers like Unitus, and debt financing from private entities such as Etimos, Oikocredit, Novib, and others; and (iii) strengthen the sales area and institutional capacity of FIS, giving it the tools it needs for strong growth. The project's logical framework provides indicators for the expected outcomes for beneficiaries and the institution.

F. The Bank's strategy

- 2.17 The project is compatible with the Bank's current country strategy with Argentina as part of creating a more favorable climate for investment and productivity growth, which includes actions to enhance the country's competitiveness. Specifically, the strategy mentions "reform of the financial structure for credit to microenterprises

and small businesses”. This project will have a positive impact on promoting the competitiveness of microenterprises and small businesses in Argentina through the delivery of sustainable microfinance services in the medium and long term.

G. Cooperation with other donors and international agencies

- 2.18 Other than the Bank, there are currently no official bilateral or multilateral donors that support first-tier MFIs in Argentina. However, FIS has garnered the support of various private donors, such as Etimos, Fundación Telefónica, Fundación Repsol-YPF, and Ashoka, and has also been selected among seven MFIs in Latin America for a new initiative of the Consultative Group to Assist the Poorest (CGAP) and the Ford Foundation to measure the impact of microfinance on five of the Millenium Development Goals indicators.

H. Summary of the environmental and social review

- 2.19 The Committee on Environment and Social Impact (CESI) reviewed this operation at its 3 June 2005 meeting and requested clarifications and action in a number of areas, which are detailed in Annex VI of the Technical File. In response FIS prepared a list of microentrepreneurial activities that are potentially harmful to the environment, which will be appended to its credit regulations. FIS will also perform environmental monitoring in its semiannual project reports and will include a section on the environmental impact of the credits in the project’s midterm evaluation.

I. Special conditions

- 2.20 As a condition precedent to the first disbursement of up to US\$50,000 in reimbursable financing, FIS will provide the following to the Bank’s satisfaction: (i) evidence that it has received equity financing commitments of at least US\$150,000 from Novib, Unitus, or other social investors; (ii) the project’s final credit regulations with a list of activities that will not be financed; (iii) the baseline values for impact indicators; (iv) evidence that at least two additional independent members have been added to FIS’s Board of Directors. As a special condition precedent to each subsequent disbursement, FIS must present evidence that it has maintained a *pari passu* of 1 to 5 between the local contribution and the balance of all FIS debt. Additionally, during the entire term of the reimbursable financing agreement, FIS may not distribute dividends if delinquent in its payments to the Bank.
- 2.21 As a condition precedent to the disbursement of *technical-cooperation* resources, FIS will provide the following to the Bank’s satisfaction: (i) a project execution plan for the first 12 months that includes annual targets for meeting the project’s objectives and outcomes; and (ii) a registry of Italian or Italy-based consultants and consulting firms specializing in microfinance that will be invited to bid on

consulting assignments under the project. As established by the Italian Fund from which the resources originate, the executing agency will endeavor to ensure that at least 70% of the technical-cooperation contribution earmarked for consulting assignments will be paid to Italian consultants or consulting firms.

- 2.22 **Procurement.** Procurement shall be in accordance with Bank policies for the private sector, as described in “Policies for the procurement of works and goods financed by the IDB” (document GN-2349-4) and Appendix 4 thereto, “Policies for procurement by the private sector;” and “Policies for the selection and contracting of consultants financed by the IDB” (document GN-2350-4) and Appendix 4 thereto, “Policies for procurement by the private sector.”

J. Reports, evaluations, and audits

- 2.23 **Reports.** During execution, FIS will deliver semiannual progress reports to the Bank’s Country Office within 60 days following the end of each six-month period. Such reports will include: (i) a description of progress on the project execution plan and its indicators, as well as a detailed discussion of the main achievements and difficulties encountered in the project and action taken to overcome them; (ii) an updated project execution plan for the next 12 months, including measures to overcome obstacles identified; (iii) a summary of work by consultants and technical assistance provided; (iv) the consolidated financial statements of FIS; (v) a list of environmental and social measures taken to comply with CESI’s recommendations, paragraph 2.19; (vi) a comparison of the project’s interest rates versus market rates; and (vii) a summary of progress made with the project’s stockholders and financiers. The first progress report will present the findings of the baseline study, including the start values defined for the project’s impact indicators. The last progress report will be the final report and contain a summary of achievements vis-à-vis the original objectives and indicators.
- 2.24 **Indicators.** The indicators to be used for the Bank’s evaluations and to measure the project’s overall progress are presented in the technical file. The growth of FIS’s portfolio during the project execution period will be greater than or equal to the amount of the Bank’s contribution to the reimbursable financing component.
- 2.25 **Evaluations.** The project includes two evaluations by individual consultants selected and contracted by the Bank’s Country Office in Argentina. Midterm evaluations will be made 18 months and 36 months after the project’s first disbursement. The first evaluation will measure: (i) progress in improving impact indicators in a representative sample of microentrepreneur clients; (ii) the level of efficiency, effectiveness, and additionality of the project; (iii) ability of the project to attract additional stockholders and financiers; (iv) independent verification of compliance with CESI’s recommendations; and (v) lessons learned and recommendations for project improvements in the second phase, including corporate governance structures. In addition to the above measurements for the first

evaluation, the final evaluation will measure and document: (i) the extent to which the project's objectives have been; (ii) fulfillment of proposed impact indicators; and (iii) the project's financial and operational sustainability.

- 2.26 In line with the priorities of the Italian Fund, both evaluations will also examine progress in financing microenterprises with greater productivity and/or growth potential. In particular, information will be gathered and monitored on beneficiaries who own microenterprises operating in the fastest growing sectors and/or demonstrating patterns of development that set them apart from other clients. Specifically, those companies will be monitored over the course of the project to evaluate: (i) how many dynamic microenterprises have been financed and how the investments were used; (ii) the impact on dynamic microenterprises of financial services offered by FIS; and (iii) what recommendations can be made for financing dynamic microenterprises in microfinance projects oriented toward subsistence microenterprises, such as the FIS project.
- 2.27 **Audits.** FIS will deliver its audited financial statements during execution of the operation and within 120 days of the entity's year-end. Audit services will be contracted and paid for by the executing agency. FIS will also use funds from the Bank's contribution to contract a final audit of the technical cooperation and reimbursable financing components once the execution period has ended. The Bank will review the findings and recommendations of the progress reports, evaluations, and audits, and in the event of significant variances in any of the project indicators, it may suspend disbursements until the executing agency has taken corrective action to the Bank's satisfaction.

K. Project risks and mitigating factors

- 2.28 **Risk of very rapid growth.** Very rapid growth could result in errors in staffing decisions and identification of new clients, which could cause an increase in the portfolio's default rate or administrative costs that are higher than expected. To mitigate this risk, the project's technical-cooperation component includes activities to develop growth management tools, such as training modules for new employees. FIS's track record indicates that it applies best practices in managing microfinance growth.
- 2.29 **Regulatory and tax risk.** Although the Argentine legal system allows corporations to extend credit, there is a risk that policy toward the microfinance sector could change in the future, or that new taxes or regulatory fees could be imposed on microcredits, adding to their already high cost. To mitigate this risk, the technical-cooperation component of this project provides funds to finance legal counsel for the entity. FIS's management also actively leads the Argentine microfinance network and remains alert to any possible changes.

L. Exceptions to Bank policies

2.30 None.