

**PROGRAM FOR STRENGTHENING THE INSTITUTIONAL SETTING
FOR MICRO-LENDING IN BRAZIL**

(TC-96-08-46-7)

EXECUTIVE SUMMARY

REQUESTER: The Government of Brazil, through its Ministry of Planning

CO-EXECUTING AGENCIES: The Banco Nacional de Desenvolvimento Econômico e Social (BNDES) and local credit-granting NGOs and Intermediate Financial Institutions (IFIs).

BENEFICIARY: The Banco Nacional de Desenvolvimento Econômico e Social (BNDES). The final beneficiaries will be urban and rural microentrepreneurs as well as NGOs and other intermediary financial institutions that provide credit to microentrepreneurs.

FINANCING: IDB: US\$5 million
(FSO net income in local currency, non reimbursable)
Local counterpart funding: US\$2.5 million
Total: US\$7.5 million

The local counterpart funding will be in-kind and will come from the logistical support provided to this program by the BNDES, the beneficiary NGOs and IFIs.

Additionally, the BNDES has committed US\$60 million of its own resources in parallel credit financing to be channeled through local NGOs that onlend to the microenterprise sector. These activities complement each other since the Bank funds will provide resources for institutional strengthening while the BNDES will provide credit funds.

TERMS: Execution period: 36 months
Disbursement period: 42 months

ENVIRONMENTAL AND SOCIAL ASPECTS: The Technical Cooperation profile of this operation was considered by the Committee on Environmental and Social Impact (CESI) on June 13, 1997. The recommendations from that meeting have been incorporated in the design of this operation.

OBJECTIVES:

The objective of this operation is to maximize the impact of the Brazilian government's current initiative to strengthen the institutional framework for microlending activities in the country.

Specifically, it will strengthen the capacity of a group of institutions which have the potential to become providers of credit to this sector on a sustainable basis. In doing so, it will complement the resources currently available in Brazil for lending to the microenterprise sector through the BNDES-Programa de Credito Produtivo Popular (PCPP).

DESCRIPTION:

This operation will finance the contracting of highly specialized consulting services to:

(i) Support the development and strengthening of first tier institutions such as NGOS and other intermediate financial institutions that provide credit to this sector;

(ii) Cooperate with the BNDES-PCPP program in: hiring a program coordinator, defining selection criteria for participating institutions, designing appropriate financial products for beneficiary institutions, setting up program monitoring and disbursement systems; and financing outreach activities such as workshops, seminars and publications in order to disseminate best practices and lessons learned in the development and consolidation of credit-granting institutions in Brazil;

(iii) Analyze and present an action plan to address bottlenecks that exist in the regulatory framework which create obstacles to the growth and formalization of microenterprises as well as to the efficient development of credit programs for microenterprises;

BENEFITS:

The benefits of this operation will be the creation and consolidation of sustainable credit mechanisms to the microenterprise sector in Brazil, which in turn will contribute to reduce unemployment and underemployment in the program's areas of influence. The program will have a positive impact on low income groups, particularly women, who represent a majority of the informal sector.

Moreover, the program presents a unique opportunity for the Bank to contribute to the success of a local initiative by transferring knowledge and lessons learned in the development and execution of microenterprise programs, which it has acquired over

more than 15 years of work in this field. The proposed technical cooperation is intended to have a catalytic effect on an important joint government and private sector initiative in Brazil that involves substantial additional resources.

Moreover, the program will promote competition among different credit methodologies for serving the microenterprise sector and will help lay the foundations for institutions which in the future can be integrated into the formal financial system. The increased competition for the provision of financial services to this segment of the market should also generate a decrease in interest rates and better overall financial conditions for microentrepreneurs.

RISKS:

The main risks associated with this operation are related to the fact that on the one hand, consolidating sound credit granting institutions is a time and labor intensive process, and on the other, the political pressure to obtain specific results and channel substantive credit funds to this sector are high. The risk of having large sums of credit disbursed to incipient institutions before they reach an adequate level of consolidation could jeopardize the sustainability of these programs. This risk is expected to be mitigated through the hiring of highly specialized consulting firms, with both theoretical and practical experience in the development and consolidation of microlending institutions. This would permit achieving the intended institutional consolidation while responding effectively to the urgent need for providing appropriate credit services to this sector.

**EXCEPTIONS TO
BANK POLICIES:**

Not Applicable

**PROCUREMENT OF
GOODS AND
SERVICES:**

Procurement of services would be conducted in accordance with the Bank's policies, rules, and procedures.

**THE BANK'S
COUNTRY STRATEGY:**

The Bank's strategy in Brazil concentrates on supporting its objectives of systematically eliminating the causes of chronic inflation, alleviating some of its social consequences, investing in human resources, and promoting economic modernization. It also calls for an increased role of the Bank in support of microenterprise development in the country through its various instruments such

as small projects, technical cooperation and global credit loans.

The proposed program is consistent with the aforementioned strategy inasmuch as it supports the development of the microenterprise sector and reinforces private sector participation in the provision of financial services to this sector as well as the strengthening of civil society institutions which have traditionally played a crucial role in the support of microenterprise development.

The overall goal of the Bank's Microenterprise Development Strategy is to expand economic opportunities in Latin America and the Caribbean through sustainable, dynamic microenterprise development. The objective is to promote the conditions necessary for the growth and development of the microenterprise sector in the region: a favorable policy and regulatory environment; strong, sustainable institutions providing financial and non-financial services to meet the demand of microenterprises; improved access of microentrepreneurs to financial and business services; and expanded, continuous and permanent flows of resources for investment in microenterprise.

This operation is aimed at achieving precisely these objectives.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

Conditions precedent to the first disbursement:

- a. Selection and hiring of a consulting firm in charge of program coordination, in accordance with terms of reference previously agreed upon with the Bank (paragraph 3.19);

Other contractual clauses:

- a. Prior to the disbursement of funds for the institutional strengthening component for each NGO, the BNDES shall demonstrate to the Bank's satisfaction that: (i) the beneficiary institution has complied with the selection criteria for participation in the program as agreed upon by the BNDES and the Bank (paragraph 3.20); and (ii) the BNDES has executed an agreement with the beneficiary institution whereby the latter agrees to comply with the obligations of co-executing agency of the program (paragraph 3.21);

- b. Prior to the disbursement of funds for the regulatory framework component, the BNDES shall demonstrate to the Bank's satisfaction that it has signed an agreement with the selected consulting firm in accordance with terms of reference previously agreed upon with the Bank (paragraph 3.22);
- c. Monitoring reports: During program execution, the BNDES will submit quarterly reports to the Bank on the results of program implementation (paragraph 3.28);
- d. Final Report: Within three months after the operation is completed, the BNDES will submit, a final report on the operation that will include an evaluation of program outputs and outcomes in relation to its objectives (paragraph 3.29);
- e. Audits: The program's financial statements, audited by independent external auditor, will be submitted annually (paragraph 3.30);
- f. One year after the program actions have been completed (42 months after the effective date the technical cooperation agreement), the BNDES will hire outside consultants to conduct an ex-post evaluation of the program in accordance with terms of reference previously agreed upon with the Bank (paragraph 3.31).
- g. Given that the success of this operation depends on the hiring of highly specialized consulting firms to provide the institutional strengthening component of the operation and that such experience is relatively recent in Brazil, resources from the net income of the FSO in local currency may be used to hire international consulting firms, following standard Bank procedures.

**SOCIAL
CLASSIFICATION:**

According to paragraph 2.13 of the Eighth Replenishment document (AB-1704), the operation proposed herein can be classified as a social program inasmuch as its actions are aimed at creating employment opportunities through the development of the microenterprise sector. It also is classified as a poverty-targeted program (paragraph 2.15 of AB-1704).

I. FRAME OF REFERENCE

A. The microenterprise sector in Brazil

- 1.1 For a long time, the microenterprise sector in Brazil was overlooked by mainstream economic and development policy, which tended to favor direct state intervention and import substituting industrialization on a massive scale. However, policy makers now recognize that microenterprises constitute an important and steadily growing sector of the Brazilian economy. Reliable estimates of its size and contribution to employment are scarce, but official data issued by the Instituto Brasileiro de Geografia e Estatísticas (IBGE) show that, as of 1993, Brazil had approximately 5 million officially registered micro and small enterprises.
- 1.2 The IBGE statistics certainly underestimate the size of the microenterprise sector, as they take into account only formal operations. More recent studies carried out on behalf of IBGE, SEBRAE and IBASE suggest that microenterprises may account for as much as 40% of gross domestic product (GDP), and encompass between 40 and 60% of the economically active population.
- 1.3 The majority of microenterprises operate in the commerce sector (60%), followed by services (25%) and small-scale manufacturing (15%). Most of them are family businesses, with at most one or two additional paid employees. Roughly 86% of the informal microenterprises report monthly sales of up to US\$2,000.
- 1.4 The significant estimated growth of the sector in recent years is due to the structural adjustment measures that have been undertaken since 1994 in connection with the "Plano Real" and to the economic stabilization it has helped achieve.
- 1.5 The stabilization plan included scaling back the involvement of the state in the economy. The divestiture and downscaling of public sector enterprises, as well as widespread reorganization and downsizing of larger private sector enterprises, have led to a reduction of employment opportunities in the traditional sectors, forcing large numbers of workers to look for alternative sources of income. Self employment or flexible employment in the mostly informal microenterprise sector is a logical choice, especially for unskilled and manual workers. According to a study entitled "Informalidade e Renda" carried out by SEBRAE and IBASE in 1997 in the Rio de Janeiro region, 50% of the newly founded microenterprises were set up primarily for this reason.
- 1.6 Brazil's increased macroeconomic stability over the past few years has also stimulated the growth of the microenterprise sector. Low inflation rates (approximately 10%) and a steady rise in GDP (between 3 and 5% p.a.) have improved the climate and the prospects for investment throughout the corporate sector, and thus also for the many micro and small enterprises. The growth potential of

microenterprises is also enhanced by the broadening of economic horizons offered by MERCOSUR.

- 1.7 However, consolidation and growth of this sector and its full integration into the Brazilian economy are hampered by a number of important constraints. One is the lack of formalization. It is estimated that only half of Brazil's microenterprises are registered and operate in a formal setting, i.e. comply with tax and employment legislation and other official requirements. Full registration of a microenterprise with the appropriate federal, state and local authorities represents a hurdle that only few microenterprises are able and willing to overcome. The procedure is complex and arduous, and entails high transaction costs for the entrepreneur. A total of 29 documents and certificates issued by a wide variety of different public authorities are required, costing some US\$400 in all to collect. This problem has been the subject of analysis, which has led to various proposals for reform. Among these, is the introduction of the "simples", a quicker and cheaper tax form designed for microenterprises. However, further analysis is needed and concrete solutions must still be pursued.
- 1.8 The informality of so many microenterprises, coupled with a banking regulatory regime which poses serious obstacles to lending to informal businesses, makes it extremely difficult for them to gain access to credit from the formal financial system. And indeed, lack of access to credit is the most significant obstacle to the development of all microenterprises, be they formally registered or informal. To date, most microenterprises rely predominantly on informal loans. According to various studies, friends and relatives are their main source of finance (50%), followed by supplier credit and loans from moneylenders (40%). Financial institutions, by contrast, are reported by only 10% of microentrepreneurs as a source of finance, with banks being of much lesser importance than other formal and semi-formal institutional providers, such as cooperatives, financieras, NGOs, etc.
- 1.9 Informal providers of finance, however, offer terms and conditions that are unfavorable to microenterprises. While the amounts lent by friends and relatives tend to be small and short-term, supplier credits and moneylender loans are also short-term - usually between 2 weeks and 3 months at the most - but generally carry extremely high interest rates. Suppliers may charge between 6% and 20% per month, depending on the type of merchandise and the length of their relationship with the entrepreneur, while moneylenders may charge up to 30% per month. Faced with restricted access to formal-sector finance and the prohibitive cost of informal-sector credit facilities, the majority of microenterprises (an estimated 65%) have no alternative but to finance their working capital and investment capital needs with own funds which prevents them from realizing their growth potential, and in many cases, borrowed funds merely enable their businesses to survive.

B. Development in the supply of credit

1. Private sector initiatives

a. Private commercial banks

1.10 Traditionally, the private commercial banking sector has focused on financing medium-sized and large enterprises as well as on other more profitable and less risky financial products such as the buying and selling of financial assets (government bonds). However, as a consequence of the 1988 reform of banking regulation and the declining role of the state in the financial market over the past few years, interest rates have been liberalized, which in turn has raised the intensity of competition within the banking system. This process has been amplified by the "Plano Real", which put an end to hyperinflation, thereby eliminating a source of easy profits for the banks and forcing them to reduce their administrative costs. Against this background, private-sector banks have been compelled to look for new market segments, initially focusing on personal and consumer loans, i.e. on short-term lending. Some of the large private sector banks have reported loan portfolio growth rates of over 60% and even as much as 150%.

1.11 A small number of private banks have begun to develop credit products aimed at microenterprises, notably Banco Excel and Bamerindus, both of which are working in collaboration with SEBRAE under arrangements similar to those which SEBRAE has established with the public sector banks, as described below. In addition, Bradesco is providing microcredit facilities in the state of Sao Paulo financed entirely with its own funds. Although growing, these initiatives remain small.

b. Non-governmental organizations

1.12 Against this background, and in response to the growing unmet demand for credit, various non-governmental organizations (NGOs) have recently been set up (60% of them have been founded since 1995) with the objective of providing informal micro and small entrepreneurs with access to credit. These NGOs have been founded as private local initiatives with support mainly from international organizations: Centros de Apoio aos Pequenos Empreendimentos (CEAPEs), affiliated to Acción Internacional and Banco da Mulher, affiliated to Women's World Banking. Other NGOs are being founded with the support of multilateral institutions, as is the case with VIVACRED in Rio de Janeiro, supported by the IDB. To date, there are approximately 20 credit-granting NGOs operating in the microenterprise sector in different regions of Brazil. These NGOs have a combined loan portfolio of roughly US\$15 million.

1.13 Only three NGOs (Portosol, Caixa do Povo and VIVACRED) confine their activities solely to lending. The majority of the established NGOs offer other services in addition to credit, e.g. training in management, administration or marketing skills. In

numerous NGOs, the conflicting roles placed on the organization by these different types of products have caused problems that have affected their sustainability.

- 1.14 The existing NGOs differ substantially from one another in terms of productivity, efficiency, and success in reaching the target group. However, all of them face similar constraints: shortage of liquidity and a lack of institutional consolidation.

2. Public sector initiatives

- 1.15 In line with its economic policy shift, and as part of its drive to reduce unemployment levels, the federal government now attaches a high priority to supporting the microenterprise sector. As part of its initial activities in support of the microenterprise sector, Mrs. Ruth Cardoso, the First Lady, headed a high level delegation of government officials to Washington in 1995 to discuss and learn from the Bank's experience with microenterprise development. Lessons learned, different microlending methodologies and their results in several countries were discussed as well as alternative courses of action for government and private sector programs.
- 1.16 Another manifestation of this support is Comunidade Solidaria, a government program with a high level of participation by private individuals and non-governmental entities within society, whose general function is to coordinate the government's various social welfare activities.
- 1.17 Comunidade Solidaria is currently drafting proposals designed to improve the legal framework that applies to the granting of loans by formal and informal financial institutions as well as encouraging the establishment of "popular credit" programs in different states. Currently, preliminary work is underway to analyze the possibility of allowing NGOs to lend directly to the target group under the existing regulatory framework. However, solutions to this issue are not yet clear.
- 1.18 The Bank has contributed to the launching of these activities by maintaining a high level dialogue with the government on issues related to microenterprise, through its Country Office in Brazil, sharing the successes and failures of its own programs in support of this sector and providing access to the latest international research and publications in this area. Through its intra-regional cooperation programs (CT-Intra) it has also helped organize and finance several visits by government officials, private sector bankers and local NGOs, to successful experiences in Latin America, accompanied by high level consultants who have shared with them the process of creation and consolidation of this type of institution (Bolivia and Paraguay).
- 1.19 The Brazilian Government has also set aside funds from FAT (Fundo de Amparo ao Trabalhador, founded in 1988 as a workers' insurance and income support program). Part of these resources is being used

to fund the Banco Nacional de Desenvolvimento Econômico e Social (BNDES). In the past, BNDES focused almost exclusively on long-term investments, but has recently set up the Programa de Crédito Produtivo Popular (PCPP) which targets microenterprises. FAT money accounts for 40% of BNDES's funding for these programs, foreign loans for 40%, and own funds 20%. The PCPP, which administers a fund totaling US\$60 million for 1997, is a microenterprise financing program in which BNDES offers a line of credit to NGOs that onlend to microenterprises, regardless of whether they are run privately or with government participation, with the objective of expanding the lending capacity of these institutions and broadening the scope of their activities. This is a relatively new instrument, and so far only one NGO (Portosol) has actually benefitted from it, although the BNDES has already received numerous inquiries from other NGOs.

- 1.20 Additionally, the Banco do Brasil and Caixa Econômica Federal, which also have access to FAT funds, are collaborating with the Serviço Brasileiro de Apoio às Micro e Pequenas Empresas (SEBRAE) to provide credit to microenterprises. The agreements between SEBRAE and these public banks call for a division of labor: SEBRAE is responsible for the selection of small entrepreneurs, credit analysis and loan monitoring, while each financial institution, since it bears the credit risk, reserves the right to make the final decision whether or not to lend. This initiative is still in its early stages, and the transaction costs incurred by the clients appear too high, due especially to the complex and bureaucratic procedures involved in gathering information on micro and small entrepreneurs. So far, this program has focused its activities solely on formal small enterprises and the majority of them is finding it difficult to qualify for financing.
- 1.21 State and municipal governments have also perceived an opportunity to cast themselves in the role of principal promoters of development in their regions by supporting and financing private initiatives such as the creation of NGOs. The most successful experience to date has been the founding of "Instituição Comunitária de Crédito-Portosol", in Porto Alegre, Rio Grande do Sul, which was set up in November 1995 with funds provided by the Municipality of Porto Alegre (US\$700,000), the State of Rio Grande do Sul (US\$350,000) and others, and started its lending operations in January 1996. By January 1997 this NGO had already channeled US\$2.5 million to the microenterprise sector. Similar experiences are being replicated in other states such as Ceará (Fundação Caixa do Povo), Pernambuco and Paraíba.

C. Bank strategy in Microenterprise

1. Evolution and lessons learned

- 1.22 The Bank seeks to promote the activities of microenterprises as a means to encourage both the economic growth of the borrowing

countries and a more equitable distribution of the fruits of that growth.

- 1.23 The Bank initiated its activities in support of the Microenterprise sector in 1978 with the creation of the Small Project Program (SPP) and has since shifted its approach to microenterprise development from a primary emphasis on transferring financial and technical resources to the beneficiaries, to the strengthening of intermediary institutions that could deliver these services to the target group on a sustainable basis. Similarly, it evolved from focusing almost entirely on the sector's lack of access to credit to recognizing that a broad, integrated strategy was needed to address the wide array of constraints microenterprises face, such as the non financial aspects of the enabling environment surrounding microenterprises and their support organizations.
- 1.24 The Bank's extensive experience with credit-granting NGOs points to the need to strengthen their sustainability and viability in order to have a meaningful impact on the target population. The lessons learned from more than 15 years of experience in this field are that credit-granting NGOs have been very effective in reaching the intended target population, although their performance with respect to long-term financial viability has been uneven. Important changes are needed in their management structure, incentive systems, and others. If the Bank wants to contribute to the consolidation of sustainable financial institutions, it must provide adequate technical assistance to render these institutions more efficient. It must also monitor this development closely.

2. Bank strategy and experience in Brazil

- 1.25 The Bank's strategy in Brazil concentrates on supporting its objectives of systematically eliminating the causes of chronic inflation, alleviating some of its social consequences, investing in human resources, and promoting economic modernization. It also calls for an increased role of the Bank in support of microenterprise development in the country through its various instruments such as small projects, technical cooperation and global credit loans.
- 1.26 The proposed program is consistent with the aforementioned strategy inasmuch as it supports the development of the microenterprise sector and reinforces private sector participation in the provision of financial services to this sector as well as the strengthening of civil society institutions which have traditionally played a crucial role in the support of microenterprise development.
- 1.27 The Bank's support to microenterprise development in Brazil since 1981 has mainly been channelled through its Small Projects Program. To date, a total of 19 small projects and 13 parallel technical cooperations have been approved for a total of US\$11.3 million.

- 1.28 By and large, these projects accomplished their intended objectives of reaching the lower income segments of the population by providing them with an improved productive infrastructure and some credit funds. However, in terms of the sustainability of these programs, the results of the Bank's experience in Brazil are very uneven. Ten of the approved small projects were directed toward urban credit programs and were managed by NGOs with clearer objectives of financial sustainability. Of these, however, only a handful are still expanding their programs and have consolidated institutionally.
- 1.29 This generally weak performance can be attributed to several factors: (i) a long period of stagnation and high inflation in Brazil which curtailed the demand for credit, (ii) the prevalence of subsidized interest rates in several programs, (iii) the existing severe institutional weaknesses on the one hand and poorly designed technical cooperation components parallel to the credit or investment components, on the other, (iv) the difficulty encountered by the Bank in monitoring these programs closely, (v) a restrictive legal and regulatory framework, and (vi) the lack of specialized institutions with a strong commitment to developing sustainable programs.

D. Prevailing constraints

- 1.30 Based on the previous analysis it is possible to identify the main obstacles both to the consolidation and growth of the microenterprise sector and its integration into the Brazilian economy, and also to the successful implementation of programs designed to promote lending to this sector.

1. Legal and regulatory framework

- 1.31 As was detailed in paragraph 1.7, the lack of formalization is a serious barrier to the development of microenterprises and makes it extremely difficult for them to gain access to finance from the formal financial system.
- 1.32 The existing regulatory regime creates strong disincentives for banks to lend to informal businesses. Indeed, the requirements imposed by the Central Bank supervisory authority (business clients must present their business registration documents (CGC), submit a profit and loss statement, hold a bank account, show proof of income and provide real assets as collateral) make it impossible for microentrepreneurs, the majority of which operate in the informal sector, to obtain access to formal credit. The alternative of setting aside larger provisions to cover the possible loss of these loans also creates disincentives for the private banks since it involves high costs in relation to the loan amounts sought by microentrepreneurs.
- 1.33 Given that the commercial banks are unable or unwilling to lend to microenterprises, NGOs might, in theory, represent an alternative

source of finance. However, there are legal and regulatory obstacles to micro-lending by these organizations too. As NGOs are not formal financial institutions, they are not bound by the specific guidelines of the Brazilian banking law, but only by general laws and regulations. The main obstacle facing NGOs is Decreto N. 22.626 of April 7, 1993, the "Lei da Usura", which, although permitting NGOs to engage in direct lending, it forbids them to charge more than 1% per month (compared with lending costs in the banking sector of between 5% and 10% per month). Given the high level of administrative expenses and the cost of funds in Brazil, this would effectively deny NGOs the chance of covering their costs in the long-term, thereby undermining the goal of self-sustainability.

- 1.34 A possible way of circumventing this problem is an arrangement whereby a specialized NGO acts as an external "service provider", the service being to administer loans to microenterprises. However, under the present law, such service providers are not permitted to assume any of the risks involved. This is a severe impediment insofar as the NGO does not have a financial incentive to act like a financial institution.
- 1.35 In short, there is no suitable regulatory framework for institutions interested in serving the micro and small enterprise sector, be they private or partly-state-owned non-governmental entities, or private commercial banks, thus making it impossible to create a healthy competitive environment.

2. Shortcomings of the public initiatives

- 1.36 The relatively recent public initiatives to promote microenterprise financing are progressing slowly, and have so far failed to reach the vast majority of microentrepreneurs.
- 1.37 Until recently, the majority of development finance projects in Brazil were based on direct (mostly subsidized) lending via state-owned banks, and often failed in terms of outreach and sustainability. Within this tradition, BNDES focused almost exclusively on long-term investments. In contrast, the programs currently being developed and implemented by various Brazilian government departments can be described collectively as "indirect intervention", whereby the public sector makes resources available to private intermediaries which then channel them to the target group at their own risk. In this new context BNDES is expected to act as a second-tier institution, lending indirectly to an unfamiliar target group via specialized first-tier institutions.
- 1.38 The problem remains that BNDES lacks experience in precisely the areas on which the success of such a strategy depends: in selecting the first-tier institutions, in designing appropriate credit products and in monitoring the implementation of the programs. Ideally, in a strategy of this type, the transfer of resources would be accompanied by a transfer of know-how designed

to reduce the risks and the costs of product development incurred by the private-sector actors. BNDES is currently unable to provide this kind of support.

3. Constraints facing non-commercial private initiatives

- 1.39 In addition to the absence of a conducive regulatory framework, lending by NGOs and similar private-sector financial institutions is impeded by two factors:
- a) the lack of institutional consolidation due to the fact that they were created recently - specifically, they do not have appropriate information and monitoring systems, their staff is poorly trained, and their salary systems do not offer incentives by making pay levels a function of performance;
 - b) the lack of funding resources appropriate to their present stage of development - they lack funds not only for onlending, but also for technical assistance in the area of staff training and information systems.

II. PROGRAM OBJECTIVES AND RATIONALE

A. Specific Objectives

- 2.1 The objective of this operation is to maximize the impact of the Brazilian government's current initiative to strengthen the institutional framework for microlending activities in the country.
- 2.2 Specifically, it will strengthen the capacity of a group of institutions which have the potential to become providers of credit to this sector on a sustainable basis. In doing so, it will complement the resources currently available in Brazil for lending to the microenterprise sector through the BNDES-PCPP program.
- 2.3 The combined catalytic effect of these measures will be to foster, and maximize the impact of an effective collaboration between first-tier and second-tier institutions for the benefit of the microenterprise sector.

B. Program Rationale

- 2.4 The proposed operation seeks to address prevailing constraints by intervening at three levels: (i) overcoming the weaknesses of NGOs as long-term, sustainable providers of loans to microenterprises; (ii) collaborating with BNDES-PCPP in selecting first tier institutions and in designing appropriate financing products for them; and (iii) redesigning the regulatory framework so as to remove the existing constraints and disincentives it creates.
- 2.5 The project's approach evolved out of an analysis of traditional development finance projects in Brazil, the majority of which were

based on direct (mostly subsidized) lending via state-owned banks, and often failed in terms of outreach and sustainability. The unique contribution of the proposed operation is not so much that it focuses on institutional development, but that it emphasizes a market orientation and a financial systems perspective as the key to the development of a financial sector capable of serving microenterprises, and low income groups in general.

- 2.6 Moreover, this is a particularly opportune time for such a project in Brazil, given that the majority of these initiatives are still relatively new, and that the IDB has acquired an acknowledged breadth of experience in this field. In order to maximize the catalytic effect of this operation, it is important to ensure that the intervention takes place in a timely and well designed manner, so as to complement and reinforce the government and private sector initiatives.
- 2.7 The proposed operation seeks to produce tangible benefits for microenterprises by helping them realize, and enhance, their growth potential by increasing their access to financial services provided on a sustainable basis. The goal is to create viable financial institutions that are capable of efficiently catering to the micro enterprise sector. Special emphasis is placed on private-sector institutions and instruments that target the "bottom end" of the financial market.
- 2.8 By contributing to the creation of commercial incentives to promote private-sector involvement in micro-lending institutions, competition will be generated for the informal providers, reducing the degree to which microentrepreneurs are dependent on them. This will lower the financing costs for the microentrepreneurs and will therefore mean a transfer of income from the informal providers to the enterprises. The long-term goal is to promote financial deepening, i.e. to enable the formal banking system to offer efficient micro-credit services at commercial terms, thus guaranteeing the sustainability of those services.
- 2.9 The governance and management structures of financial institutions are matters of prime concern, since they are crucial elements in determining the institutions' outreach and sustainability. Greater emphasis than usual has to be placed on technical assistance aimed at ensuring effective, focused governance, and in particular on the design of ownership structures, management style and structure, management information systems, pricing and risk management. Furthermore, institutions will need support in the introduction of an appropriate financial technology, which is the precondition for profitability in this market segment. And, to facilitate the development of a sustainable private-sector supply of financial services to the target group, it will be necessary to design an incentive-compatible regulatory framework.

- 2.10 Moreover, the program should foster competition between different credit methodologies for serving the microenterprise sector (e.g. individual vs. group loans). Therefore, the selected institutions and technical assistance providers should be heterogeneous in terms of their approach to microfinance. Comparative analysis of the results will form an integral part of the program. The purpose of this analysis will be to identify factors which promote efficiency in micro-lending programs, thereby optimizing learning processes for the institutions involved.
- 2.11 Care will also be taken not to disperse the technical assistance activities across an excessively large number of institutions. Experience indicates that institution-building measures of this type, especially in the initial stages, entail comprehensive "institutional engineering" that requires very intensive, high level advisory assistance, placing heavy demands on resources in terms of both time and funds. Experience also shows that the provision of intensive advisory assistance to a limited number of market participants is the most efficient way of creating an optimal degree of competitive pressure. The key is quality rather than quantity.

III. DESCRIPTION

A. The Program

- 3.1 The program's proposed objectives would be achieved through the provision of highly specialized consultancy services for the development of the following components:
- a. **Institutional support to first tier institutions** such as NGOs and other intermediate financial institutions that provide credit to this sector;
 - b. **Cooperation with the BNDES-PCPP program**, in hiring a program coordinator, defining selection criteria for participating institutions, designing appropriate financing products for NGOs and IFIs, setting up program monitoring and disbursement systems; and in financing outreach and dissemination of best practices and lessons learned in the development and consolidation of credit granting institutions in Brazil.
 - c. **Regulatory framework:** analysis and action plan to address bottlenecks that exist in the regulatory framework which create obstacles to the growth and formalization of microenterprises as well as to the efficient development of credit programs for microenterprises;

1. Institutional strengthening of first-tier institutions (NGOs and IFIs) (US\$5,800,000)

- 3.2 In view of the lack of strong first tier credit institutions, this component will focus on building the necessary institutional capacity to ensure the consolidation of an efficient and sustainable credit mechanism that reaches the microenterprise sector. Given that learning costs and the barriers of entry into this segment of the market are high, the initial cost of investing in microlending institutions will also be high. Therefore, the program will temporarily and partially subsidize the start-up costs of these institutions, making it easier for them to penetrate this sector. These interventions will also be coordinated with the supervisory body within the Central Bank in order to maximize their familiarization with the needs and constraints of these institutions (and microentrepreneurs) in terms of regulation.
- 3.3 This component will provide resources to a few selected credit-granting institutions, with a limit of up to US\$500,000 per organization, in order for them to hire highly specialized consulting firms that will provide them with an appropriate financial technology to reach this sector effectively.
- 3.4 The transfer of a financial technology that is appropriate to the establishment of an efficient and effective microlending operation involves the following basic elements: training of loan officers, a computerized system/software capable of efficient loan monitoring and enforcement, technical support in organizational areas, and technical assistance to the institutions' middle and senior management. The appropriate financial technology package will be tailored to each participating institution based on its degree of consolidation and potential for expansion.
- 3.5 In order to guarantee competition and achieve demonstration effects that will benefit other programs operating in Brazil, the Bank will support institutions which have the potential to develop into sustainable channels of credit to this sector, and which employ a representative cross-section of the different microfinance methodologies.

2. Program Support Activities (US\$1,520,000)

- 3.6 This component of the program will cooperate with the BNDES-PCPP program in implementing its microenterprise program in a more effective manner. Specifically, a high level consulting firm will be hired to perform the following general tasks:
- a. Program coordination
- 3.7 Provide an overall program coordinator, in charge of the start up and close monitoring of all the components of the proposed program which will include:

- (i) Ensuring the application of the selection criteria for the organizations participating in the institutional strengthening component. For example, for existing NGOs: application of parameters included in IDB's Technical Guide, number of years in operation, ownership structure, rate of arrears, financial results, etc. For newly created institutions: ownership structure, business policy, proposed funding structure, proposed microfinance methodology, etc. Selection criteria will also include a balanced regional representation within Brazil (see Annex II for specific selection criteria).
- (ii) Analyze selected organizations and collaborate with them in the design of technical assistance request for institutional strengthening; prepare the terms of reference for the consulting firms that will be hired for this purpose by the beneficiary institutions.
- (iii) Organize dissemination seminars in order to analyze best practices and lessons learned in the development and consolidation of credit-granting institutions in Brazil.
- (iv) Carry out the comparative analysis of results from various programs and methodologies implemented, at the end of project execution.

b. Technical support in product design and monitoring systems

- 3.8 The consulting firm will propose flexible disbursement mechanisms and design appropriate packages of financial and technical support (particularly regarding loan terms, grace periods, repayment schedules, etc.) taking due account of the level of maturity of the institutions involved, their needs and specific characteristics.
- 3.9 It will also provide the BNDES with a monitoring system to allow for a very close supervision of the evolution of these programs.

c. Outreach and dissemination activities

- 3.10 In order for the program to have an important demonstration effect and to maximize the use of funds for institutional strengthening, the program includes resources to organize seminars to share lessons learned, compare credit-granting methodologies, analyze the local impact the individual programs are having and discussing future courses of action with the BNDES-PCPP program. Leading international experts in the field will be invited to share the evolution of this innovative experience in Brazil.
- 3.11 This operation will also include resources to cover for travel expenses to several cases of successful microenterprise projects in the region (for example in Bolivia, Paraguay, El Salvador and

Peru). Both public and private sector agents will be invited so that results may be replicated and disseminated.

3. Regulatory framework (US\$180,000)

- 3.12 As in most countries in the region, the policy environment, the economic, legal and political structures in Brazil have not necessarily been conducive to the development of the microenterprise sector. From costly registration requirements to lack of adequate access to public services, to excessive regulation in the financial sector, the institutional framework and government policies have presented obstacles more than opportunities for microenterprises.
- 3.13 In this context, a consulting firm will be hired to analyze existing programs and studies and propose essential modifications to elements of the existing banking legislation, which currently act as a disincentive to microlending based on commercial criteria.
- 3.14 It will also propose improvements to the regulatory framework that would, on the one hand, facilitate the formalization of informal sector microenterprises, and on the other, enable NGOs to lend directly to microenterprises and to become formal financial intermediaries once they have been strengthened institutionally.
- 3.15 The specialized consultants hired for this purpose will work in close coordination with the Central Bank of Brazil and with the team within Comunidade Solidaria that is addressing these issues.

4. Environmental and social aspects

- 3.16 The profile of this technical cooperation was considered by the Committee on Environmental and Social Impact (CESI), through its Technical Review Group (TRG), on June 13, 1997. The recommendations of that meeting will be fully integrated into the components of this operation during their execution, through:
- a. The inclusion of environmental mitigation aspects in training of credit agents (component of institutional strengthening of NGOs and IFIs);
 - b. The dissemination of information on courses available in Brazil for microentrepreneurs that may be engaged in activities that could be detrimental to the environment (component of institutional strengthening of NGOs and IFIs);
 - c. The periodic reporting from NGOs and IFIs on the types of activities financed through their credit programs (reporting requirements which are coordinated by the Program Coordinator);
 - d. The coordination with the BNDES' environmental division on its implementation of the "Protocolo Verde" which entices IFIs to

lend for environmentally beneficial programs (in as much as it applies to microenterprises);

- e. These activities, and others that may still be identified, will all be included in the terms of reference of the consulting firms to be hired through this operation.

- 3.17 In terms of the social impact of this operation, it is expected that by providing better financial services to the microenterprise sector, this program will benefit mostly low income groups (mainly in the informal sector) and particularly women, who represent the majority of this sector. The appropriate financial technology that will be transferred to the beneficiary institutions, implies the efficient delivery of very small loans, flexible guarantee requirements, credit for activities in commerce and services, all of which particularly benefit women entrepreneurs. Moreover, special provisions will be included in the credit monitoring systems to allow the Bank to closely monitor their participation in the program. Also, through the training courses for credit agents, the program will include gender specific elements that must be taken into account to ensure a high percentage of women borrowers.

B. Program Execution

1. Execution mechanism

- 3.18 In view of the scarcity of specialized institutions in Brazil that support the development of the microenterprise sector, both at the second tier and first tier levels, the bulk of the program's resources will be provided to strengthen credit-granting NGOs that have the potential to become sustainable channels of credit to this sector. The program also contemplates providing support to the BNDES-PCPP program in order for it to become more efficient as a second tier institution for the benefit of this sector. The BNDES was selected as executing agency of this program in view of its interest in supporting this sector through the provision of credit, but it is expected that by participating with local NGOs as co-executing agency of the institutional strengthening component, it will benefit from a deeper knowledge of the institutions and sector it supports which will result in the delivery of better financial products to them.
- 3.19 Given the Bank's considerable experience in the development and execution of microenterprise programs in most of its borrowing member countries which encompasses work with both public and private sector programs, and, within the private sector, with a wide array of formal and semi-formal institutions (private banks, financieras, NGOs, cooperatives, credit unions), the BNDES has requested that the Bank participate in the selection of the consulting firm in charge of project coordination. Bank procedures for hiring consultants will be adhered to. The selection and hiring of this firm by the BNDES will be a condition prior to first

disbursement, in accordance with terms of reference previously agreed upon with the Bank.

- 3.20 For participation in the component of institutional strengthening for credit-granting institutions, the BNDES will design specific selection criteria using as a guide those provided in Annex II of this document. These criteria will be submitted for Bank approval. The beneficiary institution's compliance with the selection criteria agreed upon between the BNDES and the Bank, will be a condition prior to disbursement of resources under this component.
- 3.21 Once selected, each beneficiary institution will sign an agreement with the BNDES, which will be approved by the Bank as a condition prior to the disbursement of funds under this component, specifying the components and costs of each technical assistance package and will include the terms of reference for said firm. The beneficiary institutions will then proceed to hire a consulting firm that provides it with the most adequate package of technical assistance. The program coordinator will assist the beneficiary institutions in the preparation of terms of reference for each consulting firm.
- 3.22 The BNDES will also hire the highly specialized firm that will carry out the component related to the regulatory framework, as described above. The terms of reference of the contract to be signed between the BNDES and said consulting firm will have to be approved by the Bank as a condition prior to the disbursement of funds under this component.
- 3.23 Also, as described above, given that there is a scarcity of institutions with long term, highly specialized experience in the design and execution of programs in this sector in Brazil, resources from the program may be used to hire international consulting firms, following the Bank's standard bidding procedures. In all cases, Bank procedures for hiring consultants will be strictly adhered to.
- 3.24 This procedure will ensure transparency in the hiring of specialized firms, and will achieve the institutional consolidation that is necessary in order to meet the credit needs of the microenterprise sector. Moreover, this execution mechanism will create a healthy competition between different credit methodologies, which in turn will maximize the quality and sustainability of these programs.

2. Execution period

- 3.25 The program will be executed over a period of 36 months and the financing will be disbursed over a period of 42 months.

3. Procurement of goods and services

- 3.26 Procurement of services would be conducted in accordance with the Bank's policies, rules, and procedures.

C. Monitoring and reporting

- 3.27 The country office in Brazil will be responsible for monitoring the operation as a whole. It will be assisted by a special program monitoring team comprised of the Project Team Members which will report to the Country Office Representative.
- 3.28 The BNDES will present quarterly reports to the Bank which will include: (i) individual reports for each beneficiary financial institution with precise benchmarks as to their degree of consolidation and the performance of their credit programs, (ii) the impact of the Bank's cooperation with the BNDES-PCPP Program and the results of dissemination seminars and (iii) a consolidated report that ascertains the advance in the regulatory framework proposals. Some of the specific indicators for program monitoring are included in Annex I "Logical Framework and monitoring indicators".
- 3.29 Also, within three months after the operation is completed, the BNDES will submit to the Bank, a final report on the operation that will include an evaluation of program outputs and outcomes in relation to its objectives.
- 3.30 During program execution, within the first three months of each calendar year, the BNDES will submit an annual financial report on the program to the Bank, prepared by an independent external auditor, indicating the use of the resources of the Bank financing and the local counterpart contributions.
- 3.31 One year after the program actions have been completed (42 months after the effective date the technical cooperation agreement), the BNDES will hire consultants to conduct an ex-post evaluation of the program in accordance with terms of reference previously agreed upon with the Bank. The data that will be used for this evaluation will be collected by the BNDES during program execution and will be presented in the quarterly reports to the Bank (paragraph 3.28) to ensure consistency and comparability. The evaluation will also include a comparison of the different methodologies and financial technologies used by the first-tier institutions and the specific results attributable to them in terms of program effectiveness in providing credit to microentrepreneurs on a sustainable basis.

D. Cost and financing

- 3.32 The total cost of the program is estimated at US\$ 7.5 million . The Bank will finance up to US\$5 million in local currency, charged to the net income of the Fund for Special Operations (FSO), on a non reimbursable basis. The local counterpart will be provided in-kind through the logistical support from the BNDES-PCPP Program and from the beneficiary NGOs. It is estimated that the BNDES-PCPP will dedicate three full-time staff to the execution of this program during three years at a cost of US\$500,000. The local NGOs and IFIs, on the other hand, will also each dedicate two full-time

staff to the execution of the program at a total cost of US\$2 million (for approximately 8 participating institutions).

- 3.33 Additionally, the BNDES has committed US\$60 million of its own resources in parallel credit financing to be channeled through local NGOs that onlend to the microenterprise sector. These activities complement each other since the Bank funds will provide resources for institutional strengthening while the BNDES will provide credit funds.

Cost by Component
(US\$ thousands)

CATEGORIES	IDB/FSO	Local	Total
A. Institutional Strengthening of NGOs: 1. Consulting firms for 30 months (Up to US\$500,000 per NGO) 2. Travel for project visits (international) 3. Logistical support	US\$ 3,650 US\$ 150	2,000	3,650 150 2,000
B. Program Support Activities: 1. Consulting firm for 42 months a. Program coordinator (36 months) b. Disbursement and monitoring systems (6 months) 2. Seminars (outreach) 3. Publications 4. Travel and per diem for project visits 5. Logistical support	US\$ 612 US\$ 102 US\$ 100 US\$ 16 US\$ 190	500	612 102 100 16 190 500
C. Regulatory framework: Consulting firm for 10 months (non-consecutive)	US\$ 180		180
TOTAL	US\$ 5,000	2,500	7,500

IV. BENEFITS AND RISKS

A. Benefits

- 4.1 As a result of the proposed operation, microenterprises in Brazil will be able to count on a permanent source of credit for the development of their businesses, which in turn will contribute to reduce unemployment and underemployment in the program's areas of influence. The operation will also have a positive impact on low income groups, particularly women, who represent a majority of the informal sector.
- 4.2 Moreover, the program presents a unique opportunity for the Bank to contribute with a transfer of knowledge and lessons learned in the development and execution of microenterprise programs, which it has acquired over more than 15 years of work in this field and to have a catalytic effect on an important joint government and private sector initiative in Brazil that involves substantial additional resources.

- 4.3 The program will engender competition between different credit methodologies for serving the microenterprise sector and will help lay the foundations for institutions which in the future can be integrated into the formal financial system. The increased competition for the provision of financial services to this segment of the market should also generate a decrease in interest rates and better overall financial conditions for microentrepreneurs.

B. Risks

- 4.4 The main risks associated with this operation are related to the fact that on the one hand, consolidating sound credit granting institutions is a time and labor intensive process, and on the other, the political pressure to obtain specific results and channel substantive credit funds to this sector are high. The risk of having large sums of credit disbursed to incipient institutions before they reach an adequate level of consolidation could jeopardize the sustainability of these programs. This risk is expected to be mitigated through the hiring of highly specialized consulting firms, with both theoretical and practical experience in the development and consolidation of microlending institutions. This would permit achieving the intended institutional consolidation while responding effectively to the urgent need for providing appropriate credit services for this sector.
- 4.5 Another risk associated with this operation is the non-approval, by Congress or other instances, of changes in laws that would simplify and eliminate disincentives for banks or NGOs to operate in this sector on one hand, and for microentrepreneurs to formalize their businesses, on the other. This risk will partly be mitigated by closely coordinating the execution of the regulatory and institutional strengthening components with the Central Bank and other regulatory institutions during project execution and also through the dissemination of lessons learned from successful experiences in other countries.

LOGICAL FRAMEWORK

STATEMENT OF OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
Help promote the supply of credit to the microenterprise sector under conditions guaranteeing the sustainability of this credit supply.	Increasing financial independence for NGOs or IFIs, i.e. construction of a solid and growing financial base, clear business plans, and the operational capacity to mobilize commercial financing, eventually eliminating reliance on donor support and/or concessional resources.	<ul style="list-style-type: none"> - Final report by the lead consulting firm - Independent evaluation of the program - Sample surveys 	<ul style="list-style-type: none"> - Commitment of the NGOs or IFIs to their credit programs to the target group - NGO or IFI compliance with their development plans - BNDES will maintain its microenterprise program for a prudential period
to strengthen private sector among the institutions providing credit, thereby encouraging competition with informal supply — now the main source of financing — and lowering the cost of credit for microenterprise sectors.	Up to 10 economically viable financial NGOs or IFIs with sound administrative structure, free of political interference, well adapted to the local context, staffed with competent and long term personnel, a business plan for expansion and sustainability, and a mission or vision instilling a sense of purpose, ownership, and responsibility. Each NGO or IFI would be operating with a BNDES-PCPP credit line.	<ul style="list-style-type: none"> - Progress reports and final report by the consultant firms responsible for strengthening the NGOs and IFIs - Progress report of the lead consulting firm - Interim evaluations - Sample surveys 	<ul style="list-style-type: none"> - Regulatory framework favorable to NGOs, under effective supervision - Loans appropriate for the clients - Use of systems that efficiently administer microcredit transactions
ITS:			
Strengthening of first tier institutions: support microenterprise intermediaries in developing institutional capacity and reducing the risk of investment, through credit lines and partial subsidization of start up costs, making it easier for them to operate in this market segment.	Up to 10 NGOs or IFIs selected, strengthened, and committed to a performance plan for operating in the microenterprise credit sector..	<ul style="list-style-type: none"> - Progress reports and final report by the consulting firm responsible for strengthening the NGOs or IFIs - Progress reports of the lead consulting firm - Interim evaluation - Sample surveys 	
Support activities: provide technical assistance to BNDES for the definition, implementation, and monitoring of its microenterprise credit program, particularly in developing appropriate financial support packages (interest rates, conditions) that take into account the maturity, the needs, and the characteristics of the institutions	Up to 10 lines of credit granted by BNDES to the NGOs or IFIs strengthened by the program		
Regulatory framework: improve the regulatory framework so as to create incentives, or at least remove disincentives, for providing credit services to these sectors..	Regulatory framework reviewed and adjusted to permit the effective supply of credit to the microenterprise sector		

<p>g: Selection and hiring of high ng firms to advise and provide the following activities:</p>	<p>TC budget: US\$7.5 million</p>	<ul style="list-style-type: none"> – Terms of reference for hiring each firm – Consulting firms hired through international competition 	<ul style="list-style-type: none"> – Interest in the program generated among internationally prominent firms; different technologies obtained to be transferred to NGOs or IFIs
<p>g of first tier institutions: al strengthening (improvements on and operating systems, information systems, cost) Quality and scope of the services mechanisms for selecting clients, delivery of loans, monitoring of services, growth in coverage) and performance (credit terms and portfolio performance, self- and sustainability of programs, dependence)</p>	<p>Budget for the component: US\$5.8 million</p>	<ul style="list-style-type: none"> – Progress reports from the consulting firms – Disbursement requests 	<ul style="list-style-type: none"> – NGO or IFIs interested in participating in the Program under its terms and conditions – NGO or IFI willingness to implement recommendations for institutional strengthening
<p>port activities: cooperation with PCPP program in (a) hiring a coordinator; (b) defining selection mechanisms; (c) Designing discount mechanisms; (e) Setting up monitoring and monitoring system; seminars to disseminate best lessons learned.</p>	<p>Budget for the component: US\$1.52 million</p>	<ul style="list-style-type: none"> – Progress reports from the consulting firms – Disbursement requests 	<ul style="list-style-type: none"> – Ability of the BNDES to accept and implement the recommendations from international consultants
<p>ramework: (a) Review of the work of the regulatory framework and studies; (b) Proposed practical measures to implement modifications to the regulatory framework, as deemed appropriate by national authorities.</p>	<p>Budget for the component: US\$180,000</p>	<ul style="list-style-type: none"> – Consulting firm progress reports – Disbursement requests 	<ul style="list-style-type: none"> – Availability of studies proposing solutions to current obstacles in the regulatory framework – Willingness of national authorities to implement changes in their regulatory framework

Eligibility Criteria for Participating NGOs

The analyses on which the Frame of Reference was based show that the Brazilian financial system is an unusual case within the Latin American context insofar as it is characterized by an absence of long-established microfinance institutions. As a consequence, an institution's eligibility for participation in a microfinance program cannot be made conditional on its track record. Therefore, selection or rejection of institutions willing to participate in a given program must not depend solely on whether or not they meet the eligibility criteria; rather, the institution's activities should be subjected to detailed assessment and ongoing observation of their performance in order to ensure that all the relevant information is taken into consideration. Thus, the following eligibility criteria have been designed not so much as definitive standards, but rather as a guide to the program, as a set of benchmarks with which to quantify the evaluators' impressions.

1. **Eligibility criteria for existing institutions (after 1,2, and 3 years)**

A. Target group orientation

Target group: microenterprises (rural and urban)	- up to 10 employees - up to US\$100,000 sales per year - up to US\$20,000 total assets
Average loan size	US\$2,500 (max. US\$10,000)
Average loan maturity	15 months (max. 36 months)
Purpose of loans	working capital, investment, refurbishment
No excessively high collateral requirements	e.g. personal guarantee and promissory note
Easy and repeated access to credit	first-time borrowers: up to 10 days; repeat borrowers: up to 3 days

<u>Outreach</u>	Year 1	Year 2	Year 3
Net loan portfolio (US\$)	>0.5 million	>1 million	>1.5 million
Outstanding loan contracts	>500	>800	>1,400

B. <u>Economic viability and sustainability*</u>	Year 1	Year 2	Year 3
Subsidy dependence (subsidies/income from lending business)	150%	100%	50%
Cost coverage (with subsidies)		Income from lending business/ average portfolio >(admin.cost + loan charge-offs + provisions + actual capital costs)/average portfolio	Income from lending business/ average portfolio >(total costs incurred in lending business as per P&L + additional inputed costs of capital/average portfolio
Arrears > 30d/average portfolio	< 5%	< 5%	< 5%
Total administrative costs/average portfolio	<55%	<45%	<30%

* Wherever a more detailed and more precise calculation of the degree of sustainability is required, the IDB's "Technical Guide for the Analysis of Microenterprise Finance Institutions" should be consulted.

2. Eligibility criteria for new institutions

New institutions should be required to submit the following documents and prepare a business plan projecting their operations for the next three years.

A. <u>Institutional structure</u>	<u>Requirements</u>
Corporate Governance	<ul style="list-style-type: none"> - Organization chart - Corporate business policy (cost recovery and target group orientation: - Governance structure: separation of executive management and supervisory bodies - Qualifications of management staff (specific knowledge of small and micro enterprise finance, and banking background)
Product design (as mentioned in the eligibility criteria for existing institutions)	<ul style="list-style-type: none"> - Definition of the target group - Average loan size (minimum credit size) - Cost of credit (borrowing costs + transaction costs) - Average loan maturity - Purpose of loan - Repayment arrangements
Credit Policy	<ul style="list-style-type: none"> - Credit analysis (cash flow oriented) - Monitoring of arrears - Collateral requirements - Organization of the credit granting process - Time required for loan processing

**Management Information
System**

- IT (reporting system, monitoring), assessed in terms of the criteria in the IDB Technical Guide

**Personnel planning/Incentive
system**

- Salary structure

**B. Projections of the following data for
a period of 3 years (business plan),
with the objective of achieving
sustainability within this period**

**Development of the loan
portfolio**

- No. of loans outstanding
- Average loan amount outstanding
- Net loan portfolio

Funding

- Financing needs
- Liquidity requirements

Balance sheet

- Assets
- Liabilities
- Equity

Income statement

- Interest income
- Personnel costs
- Administrative costs
- Loan loss provisions
- Interest expenses
- Profit/Loss

**Management remuneration,
Personnel expenses**

- Salaries of managers
- Salaries of loan officers
- Salaries of administrative staff

**Productivity of loan
officers**

- Average no. of outstanding loans per loan officer

PROPOSED RESOLUTION

**BRAZIL. NON-REIMBURSABLE TECHNICAL COOPERATION FOR THE
STRENGTHENING OF THE INSTITUTIONAL SETTING FOR MICRO-LENDING.**

The Board of Executive Directors

Resolves:

1. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into a technical cooperation agreement with the Economic and Social Development Bank (BNDES) of the Federative Republic of Brazil and to adopt such measures as may be pertinent for the execution of the plan of operations referred to in Document _____ with respect to a Program to Strengthen the Institutional Setting for Micro-Lending in Brazil.
2. That up to the equivalent of US\$5,000,000, in local currency, is authorized for the purpose of this resolution, chargeable to the net income of the Fund for Special Operations (FSO).
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.