

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK  
MULTILATERAL INVESTMENT FUND

**HONDURAS**

SMALL ENTERPRISE DEVELOPMENT FACILITY

Line of Activity for Strengthening of Financial Institutions for Microenterprise

LINE OF ACTIVITY MEMORANDUM

**STRENGTHENING THE MICROFINANCE INSTITUTION  
HERMANDAD DE HONDURAS**

**(HO-M1007)**

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## **INFORMATION AVAILABLE IN THE MSM TECHNICAL FILES**

### **Preparation:**

Application from Hermandad de Honduras

Decision of the National Banking and Securities Commission allowing Hermandad de Honduras to operate as a private development organization devoted to financial activities

### **Execution:**

Document 1 Procurement plan

Document 2 Financial statements 2003-2004

## **ABBREVIATIONS**

CNBS	Comisión Nacional de Bancos y Seguros [National Banking and Insurance Commission]
MIF	Multilateral Investment Fund
ODEF	Organización para el Desarrollo Empresarial Femenino [Organization for Women's Business Development]
PCR	Project completion report
PDO	Private development organization
PDOF	Private development organization devoted to financial activities

# STRENGTHENING THE MICROFINANCE INSTITUTION HERMANDAD DE HONDURAS

(HO-M1007)

## I. EXECUTIVE SUMMARY

<b>Executing agency:</b>	Fundación Microfinanciera Hermandad de Honduras		
<b>Beneficiaries:</b>	The direct beneficiaries will be about 1,500 microentrepreneurs in rural Honduras.		
<b>Financing:</b>	MIF (nonreimbursable):	US\$294,000	68%
	Hermandad:	US\$138,000	32%
	Total:	US\$432,000	100%
<b>Objectives:</b>	The objective of the project is to improve the supply of financial services in rural Honduras. The specific objective is to strengthen and support the microfinance institution Hermandad de Honduras in its process of transformation into a regulated entity, which will permit it to consolidate its services in rural areas, expand its coverage, and build up its institutional capacity. The project has two components: (i) the design and marketing of new products; and (ii) institutional and operational strengthening.		
<b>Terms:</b>	Execution period:	36 months	
	Disbursement period:	42 months	
<b>Special contractual clauses:</b>	As a condition precedent to the first disbursement, Hermandad de Honduras will present its strategic plan 2005-2009, updated and approved by the Comisión Nacional de Bancos y Seguros [National Banking and Insurance Commission] (CNBS), to the Bank's satisfaction.		
<b>Exceptions to Bank policy:</b>	None.		
<b>Environmental and social review:</b>	The project's activities have no direct link to the environment. However, MIF funds will be used to hire a specialist in environment and gender to advise Hermandad de Honduras on designing a policy to include these concerns in its operations.		

**Coordination  
with other  
official  
development  
institutions:**

At present, no other donors are working directly with this institution. Up to mid-2004, the United States Agency for International Development (USAID) supported Hermandad through the consulting company Carana Corporation in preparing credit manuals, business plans, and training in strategic planning, all of which the institution has leveraged to its benefit.

## **II. BACKGROUND AND RATIONALE**

- 2.1 **The microenterprise sector.** Honduras has about 1 million microenterprises, at least 600,000 of which are located in rural areas. The country has about 970,000 self-employed workers (382,000 urban and 587,000 rural), which gives an idea of the number of informal microenterprises there. According to a study on demand for microfinance, in Honduras, fewer than 20% of all the country's microenterprises have access to financial services of some kind,<sup>1</sup> which are indispensable if they are to operate efficiently and thus boost their competitiveness.
- 2.2 **Supply of microfinance.** At present, microfinance products in Honduras are supplied by different types of entities, including a commercial bank (BANHCAFE), a specialized finance institution (FINSOL), the credit union sector, which is made up of approximately 127 institutions, and about 18 sizeable microfinance institutions that include PDOs (private development organizations) and PDOFs (regulated financial PDOs), which had a portfolio of close to US\$55 million at 31 December 2004 and served some 120,000 microenterprises. The most important microfinance institutions include: (i) Fundación Microfinanciera Covelo (with US\$9.1 million and 16,441 clients); (ii) Organización para el Desarrollo Empresarial Femenino (ODEF) (with US\$8 million and 12,031 clients); and (iii) Hermandad de Honduras (with US\$3.3 million and 7,033 clients). Fundación Microfinanciera Covelo and ODEF mainly serve urban microentrepreneurs, while Hermandad de Honduras concentrates 67% of its portfolio on rural microentrepreneurs, with 16% specifically going for farm credit.
- 2.3 **Developments in the regulatory framework.** In 2000, the Congress passed the Law Regulating Private Development Organizations that engage in financial activities, which enables them to become regulated and thus to attract savings, although on a limited basis. The law authorizes PDOFs that have minimum assets of approximately US\$55,000 and “can demonstrate the capacity to implement and apply financial techniques, based on best practices for the microfinance sector” to engage in lending operations and to take savings and term deposits from their

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<sup>1</sup> See: Fundación Covelo, Estudio del Mercado Microfinanciero para las Organizaciones Privadas de Desarrollo (ODP) [Study of the microfinance market for private development organizations (PDOs)], October 2003.

“registered clients,” among other activities. Hermandad de Honduras was one of the first entities to be approved to operate as a PDOF under an administrative decision issued by the CNBS on 7 December 2004 (Resolution 1244/07-12-2004).

- 2.4 **Microfinance in central and western Honduras.** Hermandad de Honduras is a microfinance institution that plans to grow and is in the process of expanding its supply of financial services to five departments. Its head office is in San Marcos de Ocotepeque, and it has a total of 10 branches in six departments. In the last four years, Hermandad has doubled its portfolio and tripled its clientele. It has also developed appropriate products for the rural microenterprise sector, particularly farm credit. It is also experimenting with products and services for savings, remittances, insurance, credit, leasing, pensions, and public utilities payments at its branches. Hermandad plans to expand its services by opening six new branches, three in the departments of Comayagua and La Paz, where it already has other offices, and three in the departments of Santa Bárbara, Cortes, and Yoro. After having obtained legal status to operate as a PDOF in December 2004, Hermandad is in the stage of complying with the CNBS’ comments, in order to consolidate its transformation, which the proposed project will support.
- 2.5 **Specific problems.** Given the institution’s recent expansion and its coverage, Hermandad needs to streamline its growth and products with a view to improving its systems and internal procedures and its mode of operation. In particular and since it has become a regulated financial institution (PDOF), the following problems need to be addressed, if it is to increase its supply of financial services in Honduras in a sustainable and feasible manner:
- (i) **There has been no systematic development of innovative products to meet the needs of clients in rural areas.** The strong economic growth in Honduras’ rural areas is based on increased economic opportunities, the larger presence of educational services and infrastructure, and growth in remittances. The rural population and microentrepreneurs are seeking alternatives to finance their nonagricultural activities that are tailored to rural needs and conditions. For example, the seasonal nature of certain household costs in rural areas, such as agricultural production cycles or school years, is not matched by financial products that support families in those needs. Also, schools and local technical training institutions turn out graduates—some with experience and others without—who seek to launch productive and innovative ventures but who, on account of the absence of sources to provide rapid financing, fail to do so and move to the city. This situation has prompted Hermandad to seek financial solutions to those needs by designing innovative products that are tailored to actual conditions.



- (ii) **Inadequate human resource structure for an effective rural financial entity.** In the process of changing from a PDO to a PDOF, Hermandad needs to improve its human resource structure by clearly defining the functions and responsibilities of each professional and technical employee. Coupled with this factor, the institution's rapid growth has meant that: (i) key personnel who recently joined Hermandad's branches are not properly trained to shoulder the responsibilities linked to competitive management of a financial institution; (ii) the turnover rate is not healthy for an institution that operates in areas where the supply of qualified personnel is not abundant; and (iii) some positions that require greater specialization in financial and strategic analysis are filled by lower-level staff who were simply "promoted" since there was no clear definition of roles and responsibilities. Hermandad needs to immediately revise its current human resources policy and align its key positions and functions, so that its growth will be supported by an effective personnel management system.
- (iii) **There are weaknesses in the information systems that form the foundation for the delivery of rural financial services.** Hermandad faces certain difficulties in logistics and the approval and monitoring of credit, which are typical of fast-growing institutions. Although it has achieved a good level of technology with its management information and portfolio control system, which allows it to automate many activities and analyze large volumes of information, the dynamism of its markets, the demands of its clients, and the speed at which growing numbers of operations need to be processed have brought a great deal of pressure to bear on its systems, which now need to be adapted and upgraded. In the individual branches, it is important to free up advisors so they can devote more time to the analysis of loans and portfolio growth, rather than having to be concerned with procedures such as preparing promissory notes, paperwork, and processes. It has become fundamental to adapt the system and train personnel for more efficient handling of information and technology.
- (iv) **There are weaknesses in the corporate and managerial structure, particularly in financial management.** Hermandad is growing, taking on new challenges, and broadening the range of its products and their coverage. The professionals on the management team and the directors who oversee the soundness and growth of Hermandad need better tools for financial management and internal control so that the institution has a competitive and sound position in rural areas. Also, aware of its transformation into a regulated entity and with a view to future growth, Hermandad needs to improve its institutional image, which will allow it to position itself in the market as a competitive entity that specializes in

microfinance, clearly distancing itself from the image of a PDO and the mainly social activities it carried out in the past.

- 2.6 **The Bank's country strategy.** This project is consistent with the Bank's country strategy with Honduras (document GN-2238-1), which mentions the need to improve the financial intermediation of nonbank financial institutions such as Hermandad. In addition, in mid-2004, the Bank commissioned a study of the microfinance sector whose findings suggest supporting microfinance institutions that are legally regulated under the PDOF format.
- 2.7 **Katalysis project (ATN/ME-8046-HO).** The Bank currently has a project under way in the country to promote and implement savings services with a group of selected microfinance institutions. The project is led by Katalysis—the executing agency—and Hermandad has been participating actively in it, successfully training its key branch and managerial staff and developing special procedures and regulations for managing deposits. Progress is needed in other project activities intended to consolidate a platform of savings services for different microfinance entities seeking regulation.

### III. DESCRIPTION

- 3.1 The general objective of the proposed project is to improve the coverage of financial services in rural Honduras. The specific objective is to strengthen and support the microfinance institution Hermandad de Honduras in its process of transformation into a regulated entity, which will permit it to consolidate its services for rural areas, expand its coverage, and build up its institutional capacity.<sup>2</sup> The project has two components: (i) the design and marketing of new products to turn Hermandad into a leader in the provision of rural microfinance services; and (ii) institutional and operational strengthening.
- 3.2 **Component I: Design and marketing of new products for rural areas.** The purpose of this component is to prepare Hermandad's operating systems to provide appropriate new financial services in rural areas that meet the needs of its clients. The following will be produced for each of the products identified below: a market and economic feasibility study, a design with the respective manuals and policies, and an implementation and execution plan. Key personnel from the institution will be trained in these areas. The preidentified products, which will be subject to review at the time the project is executed, are:

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<sup>2</sup> The project would open six branches in the cities of Comayagua in the department of Comayagua, La Paz in the department of La Paz, Santa Bárbara in the department of Santa Bárbara, Choluteca in the department of Cortes, and El Progreso in the department of Yoro.

**(1.A) Line of credit.** This product will be designed for clients who have already gone through two loan cycles and are current on their payments. The objective is to have a flexible product in which the credit analysis will be more efficient and faster.

**(1.B) Entrepreneurial loans.** This product will be designed bearing in mind the needs of professionals and technicians who have graduated from technical institutes or schools and who have enough training to enable them to establish businesses or specific business projects. Although they entail a certain level of risk, they will be referred by an agency that specializes in technical assistance or a training institution such as the Instituto de Formación Profesional [Professional Training Institute] (INFOP), with which Hermandad has many years of experience working in the field of training.

**(1.C) Education loans.** This product meets a specific cyclical need in rural families, who have predictable expenditures and who cannot be served today with traditional products for microenterprises.

**(1.D) Loans for home improvements or purchases.** This product will be directed to families with stable incomes, such as workers, teachers, and salaried professionals who seek to participate in one of the government's housing programs. Given the delays in processing and disbursing government loans of this kind, Hermandad would offer bridge financing to enable clients to go ahead with the improvement or new construction, without being adversely affected by the delays in government financing.

- 3.3 **Component II: Institutional and operational strengthening of Hermandad de Honduras.** The purpose of this component is to increase and boost the institution's capacity to offer financial services in rural areas, through a strategy for support that covers personnel management systems, information systems, and the leadership and financial control systems. The following actions will be carried out for that purpose:

**(2.A) Strengthening financial management capacity.** The growing complexity of Hermandad's financial operations requires more exacting administrative and accounting management systems. The project will: (i) establish a risk unit in the institution, using project funds to finance the design and introduction of manuals and regulations for internal control, and internal auditing manuals; and (ii) establish a cash management unit to enable the institution to improve its systems for control of cash and liquidity. The project will finance the design and introduction of manuals for managing liquidity, which will include the considerations related to matching maturities and asset and liability management.

**(2.B) Development of the human resources unit.** To boost the capacity of human resources and strengthen Hermandad's administrative structure and personnel, the project will finance the establishment of a human resources unit. It

will include: (i) an institutional reorganization based on an analysis and diagnostic study of the institution's human resources area, including a revision of existing policies and procedures, regulations for control, and mechanisms for personnel identification and selection; (ii) the design and implementation of human resource policies and standards, including the adaptation of wage policies, review of the incentives plan, and an analysis of skills, and job classification; and (iii) the design and implementation of an in-house professional training program, which includes the design of different manuals on personnel management, wage scales, performance standards, hiring of new staff, and professional ethics, and the corresponding training of personnel in these areas.

**(2.C) Upgrading of information systems.** To improve Hermandad's information processes and systems, the project will earmark resources for updating and improving the financial information system. In this area, the project will support: (i) the procurement of computers to ensure that the six new branches have computer equipment and many of the procedures for data entry, monitoring, processing of promissory notes, and issuing receipts can be automated; (ii) procurement of software licenses for communications and human resource modules for better personnel management, monitoring of individual and branch performance, and up-to-date supervision of the portfolio; (iii) purchase of telecommunications equipment to enable the computerized branches to operate online and keep their information current; and (iv) training in information system programs to enable personnel to assimilate technology and understand how to use information optimally, making the best use of the computer platform and the new modules implemented under the project.

**(2.D) Improvement in governance.** To ensure that the management and leadership of the institution is consistent with the requirements of a competitive financial institution, the capacity of the board of directors will be built up through a series of activities that include: (i) exchange programs with leading microfinance institutions in the region; (ii) direct training for the directors in strategic growth and competitiveness of microfinance institutions; (iii) design of a manual and policies for the directors and the different management committees; and (iv) specialized external advisory services to provide key support in this stage of consolidation as a specialized financial institution.

**(2.E) Design and positioning of the corporate image.** Given Hermandad's sound track record as a development agency and its commitment to local economic development, it is important for the new financial entity to acquire and strategically assimilate a new corporate image as a financial institution. The main step already taken by the board of directors of becoming a regulated institution will go hand in hand with this component, which will include: (i) the design of a marketing strategy; (ii) training and advisory services for key personnel in institutional change and corporate image; (iii) the design of publicity campaigns

to disseminate the new image; and (iv) implementation of the marketing strategy and due evaluation of it.

#### IV. ESTIMATED COST AND FINANCING

- 4.1 The total budget for the project is US\$432,000, with the MIF providing US\$294,000 (68% of the total) as nonreimbursable financing. These funds will be chiefly used in four areas: (i) hiring of technical consulting services for the professionalization and expansion of rural financial services; (ii) the procurement of hardware and software to improve the information and analysis systems; (iii) financing for training and exchange programs for the institution's managers and directors; and (iv) external evaluation and auditing costs. The balance of US\$138,000 will be financed by Hermandad to: (i) contribute to the consulting and training costs; (ii) contribute to the costs associated with the procurement of hardware for the information systems; and (iii) finance project coordination and supervision. At least 50% of the counterpart resources will be provided in cash.

**Table 1 – Project budget (in U.S. dollars)**  
**Strengthening the microfinance institution Hermandad de Honduras (HO-M1007)**

		<b>MIF</b>	<b>Hermandad</b>	<b>Total</b>	<b>%</b>
I.	Design and marketing of new products comp.	25,000	13,000	38,000	9
II.	Institutional strengthening component	248,000	89,000	337,000	
2.A	Strengthening financial management capacity	24,000	-	24,000	6
2.B	Developing the human resources unit	49,000	21,000	70,000	16
2.C	Upgrading information systems	85,000	37,000	122,000	28
2.D	Improving governance	44,000	19,000	63,000	15
2.E	Designing and positioning the corporate image	46,000	12,000	58,000	13
III.	Project evaluation, auditing, and coordination	21,000	36,000	57,000	13
	TOTAL	294,000	138,000	432,000	100
	Percentage of the total	68%	32%	100%	

#### V. EXECUTING AGENCY AND EXECUTION MECHANISM

- 5.1 **Institutional considerations.** Hermandad de Honduras is a microfinance institution whose mission is to help improve the standard of living of the country's rural families by providing competitive and efficient financial services. Hermandad was legally established under Agreement 42 of 1 April 1977, to support the low-income population in technical assistance, health care, education, and financial support for

microenterprise and small business. Since 1980, Hermandad has focused on providing credit services, mainly for agricultural projects. It received financing from the Bank through the program for the recovery of microenterprises affected by Hurricane Mitch (TC9811019) and through a Bank small project (SP9105132), both of which are currently up to date in payments and installments.

- 5.2 **Lending operations.** Hermandad offers loans to microenterprises using group credit techniques (accounting for about 10.2% of the portfolio) and individual loans (89.8%). Hermandad differs from other microfinance institutions in its growing supply of farm credit. It has managed its loan portfolio efficiently over the last three years. The number of borrowers has risen from 2,863 (December 2002) to 7,085 (December 2004), and the portfolio has grown from about US\$1.9 million to US\$3.5 million. Over the same period, the productivity of its credit advisors has risen from 178 clients each to 208, and operating costs as a percentage of the average gross portfolio have fallen from 25% to 22%. The portfolio more than 30 days in arrears has shrunk from 18% to 9% in the last two years, which although still relatively high, points clearly toward improvement.
- 5.3 **Financial statements.** At 31 December 2004, Hermandad had assets of approximately US\$4.2 million, with 78% corresponding to the loan portfolio. Total income was about US\$1.2 million, mostly (78%) from interest on the portfolio and, to a lesser extent, current income from services and transactions, grants, and other sources. Net worth of about US\$2.3 million is composed of grants (69%) and institutional reserves from the retention of surpluses (30%). Hermandad's leverage has been stable in the last three years, with debt-to-equity ratios of 0.2 to 0.8, which are below one. In the coming years, the debt indicators will increase as Hermandad gains access to external commercial financing and begins to attract savings.
- 5.4 **Responsibilities.** The IDB will sign an agreement with Hermandad to execute the proposed project. Hermandad's general manager will be responsible for project coordination and will receive technical and administrative support from the operations manager, who will coordinate and supervise the work of the consultants, organize the training seminars, and coordinate the procurement and installation of software and the procurement and/or rental of hardware. The management information system will be used as a mechanism for continuous monitoring to ensure that the information sent to the IDB is consistent. The quantitative targets that will be used to measure fulfillment of the project's objectives are presented in Annex II.
- 5.5 **Execution and disbursement periods.** The execution period for the project will be 36 months and the disbursement period, 42 months.
- 5.6 **Procurement.** For contracting consulting services and procuring goods using MIF resources, Hermandad must comply with all the Bank's procurement rules, procedures, and policies. The consulting and training activities will be performed

by individual consultants to be hired by Hermandad. For the procurement of goods and small equipment, Hermandad will shop between different suppliers.

## VI. MONITORING AND EVALUATION

- 6.1 **Monitoring.** Hermandad will be responsible for compiling and analyzing relevant information for continuous monitoring of project execution and the indicators established in the logical framework (Annex I). Its management information system will generate the necessary institutional information. In addition, Hermandad will document progress on specific indicators for the six rural branches in the project. The system will be discussed in the semiannual progress reports and in the midterm and final evaluations. The Bank's Country Office in Honduras has basic responsibility for monitoring the project and will be supported by the Micro, Small and Medium Enterprise Division of the Sustainable Development Department (SDS/MSM) and the MIF in the evaluations and exchanges of information and lessons learned from other similar projects.
- 6.2 **Reports.** During the execution period, Hermandad will submit semiannual progress reports to the Bank within 60 days after the end of each six-month period. As a minimum, the reports will present an account of progress toward the project's goals and will include: (i) information on the development and implementation of the new financial products in the project branches; (ii) statistical and financial information on progress in Hermandad's performance indicators and fulfillment of the annual targets for the indicators established in the logical framework; (iii) information on the quality of on-site technical assistance and its results; (iv) information on training for operational staff in the project branches, including data on the number of employees trained and the methodology used; (v) information on progress in the measures to improve logistical communications related to the services provided at the rural branches, including information on the development and implementation of the information systems (hardware and software), and on communications between branches and the head office; (vi) information on participation by Hermandad's directors, managers, and staff in exchange programs and training courses, including a description of the actions carried out and a brief evaluation by the participants; and (vii) a summary of budget performance and the counterpart contributions in cash and in kind.
- 6.3 **Evaluations.** With MIF resources, the Bank will commission a midterm evaluation 18 months after the first disbursement to measure: (i) progress in introducing the new financial products in the six project branches; (ii) the impact of the larger supply of financial services on the microentrepreneurs who benefit from the project; (iii) progress in project activities; (iv) difficulties encountered and solutions proposed; and (v) lessons learned and recommendations to improve the project and for its replicability. To measure these elements, the indicators presented in the

logical framework (Annex I) and in the table of project indicators will be taken into account.

- 6.4 At the end of the project, within 120 days after the last disbursement, Hermandad will present a final report to the Bank (project completion report) summarizing the main achievements, experiences, and lessons learned from the project's activities.

## VII. BENEFITS AND RISKS

- 7.1 **Benefits.** The main benefits of this project are:

- (i) Efficient, sustainable financial products will reach at least 1,500 low-income families in rural areas. There are few financial institutions in the project zones that offer financial services for microentrepreneurs, most of whom have to turn to sources of financing, types of savings, and money transfer systems that are inefficient. Supplying efficient financial products (loans, savings, and remittances) for these microentrepreneurs will improve the well-being of the beneficiary families through various mechanisms: the opportunity to increase their incomes through financing for businesses and projects with more timely loans or with remittances that do not bear high transaction costs, and the possibility of saving to prevent external events from turning into crises in family liquidity (for example, illness in the family or damage caused by climatic events).
- (ii) Transformation from a microfinance institution into a regulated entity will help to expand the frontiers of the financial system. The institutional transformation of Hermandad into a PDOF—a nonprofit regulated financial institution—is the first step in deeper institutional change, since Hermandad plans to become a finance company in the next three to five years. This would mean that rural microentrepreneurs could become clients of the formal financial system in a country where that segment's experience with the financial system is very limited.

- 7.2 **Risks.** The main risk for the project is that the CNBS fails to tailor its regulatory and supervisory systems to the distinctive nature of rural microfinance. CNBS has little experience in supervising microfinance activities and none at all with entities that work on a large scale with rural microcredit. This risk can be mitigated through fluid communications between Hermandad and other players in the microfinance sector, including the Bank, with CNBS, which will be strengthened under the project on specialized strengthening of CNBS (ATN/SF-8344-HO), which is intended to assist with the rules already established for the microcredit portfolios of PDOs.



- 7.3 Another risk of the operation is that Hermandad's current rate of growth could continue for a lengthy period without adequate control over the impact of that growth. The project itself will mitigate this risk, since it has a major component to streamline the growth of products, placing greater emphasis on microcredit products for the rural sector.

## **VIII. ENVIRONMENTAL AND SOCIAL CONSIDERATIONS**

- 8.1 The new guidelines<sup>3</sup> for microenterprise projects state that projects in the line of activity for strengthening of financial institutions for microenterprise do not need to present a profile to the Committee on Environment and Social Impact. The project's activities have no direct linkage to microcredit clients or to the environment. However, Hermandad will be provided with educational materials and information on environmental conservation and occupational health and safety for microentrepreneurs and its own employees. The project's budget includes funds to hire an expert in this field to advise Hermandad on the best use of these materials and help it establish a policy for incorporating both environmental protection and occupational health concerns for its clients and employees.

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<sup>3</sup> "Guidelines for Environmental and Social Impact Due Diligence for IDB Microenterprise Operations," SDS/MSM, 2003.

**LOGICAL FRAMEWORK**  
**STRENGTHENING THE MICROFINANCE INSTITUTION HERMANDAD DE HONDURAS (HO-M1007)**

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<b>GOAL</b>			
To help improve the supply of financial services for microenterprises and small businesses in rural Honduras.	3 years after the project is completed: Access to financial services by at least 1,500 families in the project areas has been consolidated.	1. Hermandad reports 2. Survey of producers 3. Executing agency's measurement methodology	Stable political and economic situation. Continuity by regulatory agencies in strengthening the microfinance sector. Subsidized credit programs or debt forgiveness do not affect Hermandad's rural portfolio.
<b>PURPOSE</b>			
Hermandad de Honduras is strengthened institutionally by improving its strategic areas, thus consolidating its financial services in rural Honduras.	<u>By the end of year two of the project:</u> <ul style="list-style-type: none"> <li>Rural credit portfolio increased by US\$600,000.</li> <li>600 additional microenterprises served.</li> </ul> <u>By the end of year three of the project:</u> <ul style="list-style-type: none"> <li>Rural credit portfolio increased by US\$800,000.</li> <li>900 additional microenterprises served.</li> <li>Increase in the number of clients served from 7,500 to 10,000 for the institution as a whole.</li> <li>Three new rural credit products introduced.</li> </ul>	<ul style="list-style-type: none"> <li>➤ Hermandad monthly reports</li> <li>➤ Semiannual and final reports by the executing agency</li> <li>➤ Midterm and final evaluations by the external consultant</li> <li>➤ Project progress report</li> <li>➤ Project completion report (PCR)</li> </ul>	Government policies do not distort rural financial markets (e.g., through debt forgiveness or subsidies for financial programs).

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<b>COMPONENTS</b>			
<p><b>Component I</b></p> <p>Hermadad de Honduras's operating and institutional capacity is strengthened.</p> <p>1.1 Financial management capacity</p> <p>1.2 Human resources</p> <p>1.3 Information systems</p> <p>1.4 Governance</p> <p>1.5 Corporate image</p>	<p><u>By the end of year two for each category in the component:</u></p> <p>The institution's arrears fall from 9% to 7% according to the National Banking and Insurance Commission (CNBS) (portfolio 30 days overdue).</p> <p>Average length of employment of credit advisors rises from 1.5 to 2.5 years.</p> <p>Increase in productivity (number of clients per credit advisor and portfolio) of at least 10%.</p> <p>At least 3 of the new branches are connected on-line to the head office, using the management information system.</p> <p>Reduction in client loss by 10%.</p> <p><u>By the end of year three:</u></p> <p>The institution's arrears fall from 7% to 6% according to the CNBS (portfolio 30 days overdue).</p> <p>Average length of employment of credit advisors rises from 2.5 to 3.5 years.</p> <p>Increase in productivity (number of clients per credit advisor and portfolio) of at least 10% over the previous year.</p> <p>At least 5 of the new branches are connected on-line to the head office, using the management information system.</p> <p>Operating efficiency (operating costs/ average gross portfolio) improves by at least 10%.</p> <p>Reduction in client loss by 20% compared to the start of the project.</p>	<ul style="list-style-type: none"> <li>➤ Hermadad reports</li> <li>➤ Semiannual and final reports by the executing agency</li> <li>➤ Midterm and final evaluations by the external consultant</li> <li>➤ Project progress report</li> <li>➤ PCR</li> </ul>	<p>The operating, financial, and managerial changes in Hermadad meet the specific needs of the sector.</p> <p>The CNBS accepts the rural financial operations carried out by Hermadad.</p>

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p><b>Component II</b></p> <p>Financial products in the program's rural areas designed and implemented.</p>	<p><u>In year one of the project:</u></p> <p>At least 1 financial product for rural microenterprises is implemented in at least 2 project branches.</p> <p><u>In year two of the project:</u></p> <p>At least 2 financial products for rural microenterprises are implemented in 4 branches and at least 1 new financial product in 5 branches.</p> <p><u>In year three of the project:</u></p> <p>At least 3 financial products are implemented in 5 project branches.</p> <p><u>By the end of year two of the project:</u></p> <ul style="list-style-type: none"> <li>i. Rural credit portfolio increased by US\$600,000;</li> <li>ii. 600 additional clients served.</li> </ul> <p><u>By the end of year three of the project:</u></p> <ul style="list-style-type: none"> <li>i. Rural credit portfolio increased by US\$800,000;</li> <li>ii. 900 additional clients served.</li> </ul>	<ul style="list-style-type: none"> <li>➤ Hermandad reports</li> <li>➤ Semiannual and final reports by the executing agency</li> <li>➤ Midterm and final evaluations by the external consultant</li> <li>➤ Project progress report</li> <li>➤ Project completion report (PCR)</li> </ul>	<p>The demand detected by Hermandad in the project areas is maintained and corroborated by the market studies.</p> <p>Hermandad has sources of financing or funding that are appropriate (terms, frequency of payments, rates, etc.) for rural financing.</p>

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<b>ACTIVITIES</b>			
<p><b>I. Strengthening the institutional and operating capacity of Hermandad de Honduras</b></p> <p>The financial management capacity of Hermandad is improved.</p>	<p>In year one: The Hermandad risk unit is implemented and operating by the end of the year.</p> <p>18 months into the project: At least 15 staff on the managerial and branch levels are trained in risk issues.</p> <p>In year two: The Hermandad cash management unit is implemented and operating.</p> <p>At least 10 directors and managers are trained in cash management issues.</p>	<ul style="list-style-type: none"> <li>➤ Hermandad reports</li> <li>➤ Semiannual and final reports by the executing agency</li> <li>➤ Midterm and final evaluations by the external consultant</li> <li>➤ Project progress report</li> <li>➤ PCR</li> <li>➤ Project reports</li> </ul>	<ul style="list-style-type: none"> <li>➤ Hermandad is able to identify specialized consultants to provide training, or specialized organizations that can offer practical training in specific areas, geared to the timetable for starting up the branches.</li> <li>➤ Hermandad identifies service suppliers that can offer information system products tailored to the needs of rural finance.</li> <li>➤ Hermandad offers incentives and maintains its interest in institutional change.</li> <li>➤ The products developed meet the specific needs of the beneficiaries.</li> </ul>
<p>The human resources unit is developed and structured.</p>	<p>In year one: Document evaluating and analyzing the human resource structure is prepared and accepted by Hermandad's board of directors.</p> <p>The new human resource policy manual is designed in year one.</p> <p>In year two, personnel management regulations, wage policies, and performance standards are prepared and introduced.</p> <p>At least 70% of the institution's technical and managerial staff are trained in the new policies and standards.</p>		
<p>Information systems</p>	<p>Hardware suitable for software requirements has been procured and is operating in at least 3 new rural branches by the end of <u>year two</u> and in 5 new branches by the end of <u>year three</u>.</p>		

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
	<p>The information system is implemented in at least 3 rural branches in <u>year two</u> and in 5 branches by the end of <u>year three</u>.</p> <p>The personnel training program has been implemented in each project branch.</p> <p>At least 3 branches are linked on-line to the head office by the end of <u>year two</u> and 5 branches in <u>year three</u>.</p>		
Governance	<p>At least 7 Hermandad directors have participated in exchanges with other leading organizations in rural finance by the end of <u>year two</u> and 14 directors in <u>year three</u>.</p> <p>6 workshops are held on governance.</p>		
Corporate image	<p>A marketing strategy is developed and accepted by the institution's board of directors by the middle of <u>year two</u> of the project.</p> <p>A marketing campaign is launched by the end of <u>year two</u>.</p>		
<b>II. Development and marketing of new financial products in rural areas</b>  Validation of the market studies and design of a marketing strategy for the new credit products at the rural branches.	<p>1 market niche study prepared for 2 branches by the end of <u>year one</u>.</p> <p>2 market niche studies prepared for 3 branches by the end of <u>year two</u>.</p> <p>3 market niche studies prepared for 5 branches by the end of <u>year three</u>.</p>	<ul style="list-style-type: none"> <li>➤ Hermandad reports</li> <li>➤ Semiannual and final reports by the executing agency</li> <li>➤ Midterm and final evaluations by the external consultant</li> <li>➤ Project progress report</li> <li>➤ PCR</li> <li>➤ Market studies</li> </ul>	
Design of credit products for rural areas.	At least 3 new financial products designed by the end of <u>year three</u> .		
Promotion of new products.	Strategy for promoting the financial products in rural areas designed and implemented by the end of <u>year two</u> .		

**Itemized Budget**  
**Strengthening the Microfinance Institution Hermandad de Honduras (HO-M1007)**

Project budget		Units	Number	Unit price	MIF	Hermandad	TOTAL	%
<b>I.</b>	<b>Component for the design and marketing of new products</b>				<b>25,000</b>	<b>13,000</b>	<b>38,000</b>	9%
	Validation of the market studies and development of new studies	Months	3	3,000	9,000		9,000	
	Product design	Months	2	3,000	6,000		6,000	
	Methodology design	Months	2	3,000	6,000		6,000	
	Operating manuals	Months	1	3,000		3,000	3,000	
	Regulations	Months	1	3,000		3,000	3,000	
	Training	Months	2	3,000	4,000	2,000	6,000	
	Travel and per diems for consultants					5,000	5,000	
<b>II.</b>	<b>Institutional strengthening component</b>				<b>248,000</b>	<b>89,000</b>	<b>337,000</b>	
<b>2.A</b>	<b>Strengthening of financial management capacity</b>				<b>24,000</b>	<b>-</b>	<b>24,000</b>	6%
	Development of the risk unit				12,000	-	12,000	
	Consulting services for manuals and regulations	Months	2	4,000	8,000	-	8,000	
	Consulting services for implementation	Months	1	4,000	4,000	-	4,000	
	Development of the cash management unit				12,000	-	12,000	
	Consulting services for manuals and regulations	Months	2	4,000	8,000	-	8,000	
	Consulting services for implementation	Months	1	4,000	4,000	-	4,000	
<b>2.B</b>	<b>Development of the human resources unit</b>				<b>49,000</b>	<b>21,000</b>	<b>70,000</b>	16%
	Institutional reorganization for the microfinance institution				10,000	-	10,000	
	Consulting services for analysis and diagnostic studies of the human resources area	Months	2	5,000	10,000	-	10,000	
	Design and implementation of human resource policies and standards				10,000	-	10,000	
	Consulting services for the design of wage policies, analysis of skills, and job classification	Months	1	5,000	5,000	-	5,000	
	Consulting services for implementation	Months	1	5,000	5,000	-	5,000	
	Design and implementation of the professional training program				5,000	9,000	14,000	
	Consulting services for program design	Months	1	5,000	5,000		5,000	
	Consulting services for implementation	Months	1	5,000		5,000	5,000	
	Travel and per diems for consultants					4,000	4,000	
	Training in information systems				24,000	12,000	36,000	
	Training in information systems	Branches	6	6,000	24,000	12,000	36,000	
<b>2.C</b>	<b>Upgrading of information systems</b>				<b>85,000</b>	<b>37,000</b>	<b>122,000</b>	28%
	Hardware for the project branches	Branches	6	2,000	-	12,000	12,000	
	Software and licenses	Various			50,000	25,000	75,000	
	Telecommunications equipment	Various			35,000	-	35,000	
<b>2.D</b>	<b>Better governance</b>				<b>44,000</b>	<b>19,000</b>	<b>63,000</b>	15%
	Training and courses	Courses	6	2,500	11,000	4,000	15,000	
	Exchange programs	Exchanges	14	2,000	20,000	8,000	28,000	
	Design of a guide on directors' functions and training	Months	2	2,500		5,000	5,000	
	External advisory services for the board	Sessions	30	500	13,000	2,000	15,000	
<b>2.E</b>	<b>Design and positioning of the corporate image</b>				<b>46,000</b>	<b>12,000</b>	<b>58,000</b>	13%
	Consulting services for the design of the marketing strategy	Months	3	4,000	10,000	2,000	12,000	
	Training and advisory services for institutional change	Months	4	2,500	8,000	2,000	10,000	
	Design of publicity campaigns	Months	2	3,000	6,000		6,000	
	Implementation of the marketing and corporate image strategies	Months	6	4,000	20,000	4,000	24,000	
	Evaluation of the strategy	Months	1	2,000	2,000		2,000	
	Travel and per diems for consultants					4,000	4,000	
<b>III.</b>	<b>Evaluation, auditing, and project coordination</b>				<b>21,000</b>	<b>36,000</b>	<b>57,000</b>	13%
	Project coordination (1/2 the time of the general and operating managers)	Months	36	1,000		36,000	36,000	
	Midterm evaluation	Consultant	1	10,000	10,000	-	10,000	
	External auditing				5,000	-	5,000	
	Environmental consulting services				4,000		4,000	
	Contingencies				2,000	-	2,000	
	<b>TOTAL</b>				<b>294,000</b>	<b>138,000</b>	<b>432,000</b>	100%
	<b>Percentage of total</b>				<b>68%</b>	<b>32%</b>	<b>100%</b>	

**MIF PROJECTS IN HONDURAS**  
**STRENGTHENING THE MICROFINANCE INSTITUTION HERMANDAD DE HONDURAS (HO-M1007)**

**A. Similar or related MIF projects**

Project number and date of approval	Project title, sector, executing agency, and amount	Date of signature and disbursement period, in months	Amount disbursed	Comments
ATN/ME-6342-HO January 1999	Institutional strengthening of Finsol US\$300,000	March 1999 66 months	US\$300,000 100%	Project completed with good results.
ATN/MT-7118-HO August 2000	Institutional strengthening of Banhcafé US\$273,000	December 2000 Completed in 2003	US\$273,000 100%	Project completed with good results.
ATN/ME-8046-HO October 2002	Savings mobilization through microfinance institutions – Katalysis US\$500,000	October 2002 30 months	US\$180,000 36%	Good progress although a bit slow because the PDOFs had to obtain authorization from the CNBS; progress is being made.
ATN/MT-8545-HO December 2003	Institutional strengthening of credit unions – FACACH US\$1,425,000	December 2003 42 months	US\$142,000 10%	The project is progressing despite a brief delay for intervention in mid-2004.
ATN/ME-9176-HO April 2005	Deepening financial services for rural microenterprises in Honduras – ODEF US\$260,000	April 2005 42 months		The project is in the agreement signature stage.

**B. Similar or related Bank projects**

None.

**C. Projects related to the same sector or beneficiaries**

None.



DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK  
MULTILATERAL INVESTMENT FUND

PROPOSED RESOLUTION MIF/DE-\_\_\_/05

Honduras. ATN/\_\_\_-\_\_\_-\_\_\_. Nonreimbursable Technical Cooperation for the  
Strengthening of the Hermandad de Honduras Microfinance Institution

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank or such representative as he shall designate is authorized, in the name and on behalf of the Bank, as Administrator of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the Fundación Microfinanciera Hermandad de Honduras, OPDF, and to take such additional measures as may be pertinent for the execution of the project proposal contained in document MIF/AT-\_\_\_ with respect to a technical cooperation for the strengthening of the Hermandad de Honduras microfinance institution.

2. That up to the amount of US\$294,000, or its equivalent in other convertible currencies, shall be authorized for the purpose of this resolution, chargeable to the technical cooperation resources of the Second Line of Activity for Strengthening of Financial Institutions for Microenterprise of the Small Enterprise Development Facility of the Multilateral Investment Fund.

3. That the above-mentioned sum is to be provided on a nonreimbursable basis.

(Adopted on \_\_\_ \_\_\_\_\_ 200\_\_)

