

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK  
MULTILATERAL INVESTMENT FUND

**ARGENTINA**

**CONSOLIDATING THE MICROFINANCE SYSTEM IN ARGENTINA  
WITH THE SUPPORT OF FONDO DE CAPITAL SOCIAL S.A.  
(FONCAP)**

**(AR-M1005)**

**DONORS MEMORANDUM**

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Make-up of the FONCAP Board of Directors

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Establishing agreement and by-laws of FONCAP S.A.

Audited financial statements of FONCAP S.A. and of the Social Capital Trust Fund 1999 to 2004

Organizational structure of FONCAP

Institutional evaluation of FONCAP S.A.

Loan portfolio (June 2005)

Financial indicators 1998-2004

Information relating to FONCAP

FONCAP funding proposal for AECI

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Procurement plan

## **ABBREVIATIONS**

AECI	Agencia Española de Cooperación Internacional
AR\$	Argentine pesos
FONCAP	Fondo de Capital Social
MFI	Microfinance institution
MIS	Management information system
NGO	Nongovernmental organization
GDP	Gross domestic product
POC	Programming and Operations Committee of the MIF
SMEs	Small and medium-sized enterprises
PCU	Project Coordinating Unit

# CONSOLIDATING THE MICROFINANCE SYSTEM IN ARGENTINA WITH THE SUPPORT OF FONDO DE CAPITAL SOCIAL S.A. (FONCAP)

(AR-M1005)

## EXECUTIVE SUMMARY

<b>Executing agency:</b>	Fondo de Capital Social FONCAP S.A.						
<b>Beneficiary:</b>	The beneficiaries will be FONCAP and the Argentine microfinance institutions that FONCAP will support with technical assistance and financing.						
<b>Financing:</b>	<p>Technical assistance-Facility IIIa</p> <table> <tr> <td>MIF:</td><td>US\$ 800,000</td></tr> <tr> <td>Local counterpart funds:</td><td><u>US\$ 800,000</u></td></tr> <tr> <td>Total:</td><td>US\$1,600,000</td></tr> </table>	MIF:	US\$ 800,000	Local counterpart funds:	<u>US\$ 800,000</u>	Total:	US\$1,600,000
MIF:	US\$ 800,000						
Local counterpart funds:	<u>US\$ 800,000</u>						
Total:	US\$1,600,000						
<b>Description and objectives:</b>	<p>The Program to consolidate the Argentine microfinance system initially got under way 18 months ago, when FONCAP opened parallel discussions with the MIF and the Agencia Española de Cooperación Internacional (AECI) in an effort to obtain resources for financing the MFIs and to strengthen them (see paragraph 1.9).</p> <p>The <i>general</i> objective or <i>aim</i> of the project is to strengthen and consolidate a network of solid microfinance institutions with the capacity to respond sustainably to the growing demand for microfinance services. The <i>specific</i> objective or <i>purpose</i> is to consolidate FONCAP technically at an institutional level as a leading second-tier entity, and the platform of technical services that FONCAP presently offers MFIs, through a program involving the Agencia Española de Cooperación Internacional [Spanish International Cooperation Agency] (AECI) and the MIF with FONCAP. To attain the specific objectives proposed, the project would have three components, namely: (i) technical assistance and training for the MFIs; (ii) strengthening FONCAP as a second-tier institution; and (iii) dissemination and sensitization to the microfinance industry.</p>						
<b>Timetable for execution:</b>	This project is to be executed over 36 months, as of the signing of the agreement; the disbursement period will be 42 months, from the same date.						

**Exceptions to Bank policies and procedures:**

None.

**Social and environmental impacts and measures proposed:**

The project was analyzed by the Committee on Environment and Social Impact (CESI) at its meeting of 3 June 2005. Its recommendations have been included in the document (see Section VIII).

**Coordination with other government development agencies:**

This project is part of a joint program with the AECI (see Section I: Background and Rationale, paragraph 1.8).

In April 2005, FONCAP was notified that it had the winning bid to administer a trust fund of the United Nations Development Programme (UNDP)/Italian Cooperation to support productive development in four provinces of the country through microcredit. FONCAP was also selected by the Ministry of Social Development of the Argentine Republic to administer the institutional strengthening for socioproductive development subcomponent of the program for vulnerable groups – income for human development, which is being financed with IDB funds. (IDB loans 1021-OC/AR and 996/SP/AR).

## **I. BACKGROUND AND RATIONALE**

- 1.1 While the development of the microfinance industry in Latin America has evolved at a fast pace over the last ten years, displaying great depth and efficiency, it has not advanced uniformly in every country of the region. The microfinance industry has made the greatest strides in the Andean and Central American countries. Much remains to be done in countries such as Argentina, Brazil, Uruguay, and Mexico, which still have substantial unmet demand that will only be satisfied if there are new sustainable institutions with the capacity for rapid growth and if many institutions that currently operate in those markets receive the strengthening they need to expand their scope of action, using proven methodologies and ensuring sustainability.
- 1.2 The economic crisis in Argentina in the early part of this decade saw unemployment climb to more than 20%, when historically it was no more than 8%, generating a sharp increase in informal-sector activity accompanied by substantial financial disintermediation. The crisis left more than half the population in extreme poverty.
- 1.3 As a result, the expansion of informal-sector activity and the proliferation of initiatives and undertakings aimed at generating self-employment grew significantly, in social terms, and in terms of this sector's contribution to GDP. The consequent increase in unemployment has led to the growth of the informal economy, as many people have started up their own small businesses and productive units in this sector.
- 1.4 The current situation presents a clear opportunity to develop and consolidate the microenterprise sector. Nonetheless, the data from various sources show that only a very small proportion of all microenterprises has access to formal lending and to the payments system. In Argentina in particular, there is a pressing need to expand the credit frontier and design new financial services geared to the microenterprise sector.
- 1.5 According to calculations based on the Encuesta de Condiciones de Vida de 2001 (2001 Survey of Living Conditions), there are nearly two million microentrepreneurs in Argentina, approximately 72% of whom receive formal-sector income, and who in theory should qualify for credit. If we accept the statistics of the Argentine Chamber of Commerce (Cámara Argentina de Comercio), which show that 30% of merchants have access to credit sources, whereas the other 70% are self-financing, then of the 72% with formal-sector income, 30% (i.e. 430,000) have access to credit. This figure is consistent with the findings of the impact of microfinance in more developed countries, where 30% to 40% of the consolidated microentrepreneurs have access to credit.
- 1.6 There are few sound institutions that can address this demand. The paucity of institutions and the lack of a specific regulatory framework contribute to today's



insufficient supply, and to the failure of the few existing institutions to meet quality standards, or to have the depth and efficiency of their peers in other countries. Nor is the legal and tax framework favorable for microenterprises and microfinance. Strengthening the sector, which is needed in order to embark upon an overall process of sustainable growth, requires technical assistance in several forms, for which there is a shortage of support providers, and a scarcity of financial resources. Moreover, there is limited public information on the local microfinance sector; difficulties are clearly impeding the flow of information among microfinance operators, and there are scant relationships and exchanges with the main actors and experiences of international microfinance institutions. These limitations, which are hard to overcome, call for a joint effort on the part of several actors. In 2004, the MIF began taking a series of initiatives to further the dialogue with the government, which included organizing a coordinated workshop bringing together the Bank's Country Office in Argentina, the Bank, and the MIF at Headquarters, with two experts experienced in regulatory reforms in Bolivia and other countries of the Region. Planet Finance, a French-based institution that is entering the microfinance sector in Argentina, is also supporting the creation of an environment favorable to microfinance. Since it was established, FONCAP has been a relatively constant point of reference, always adapting its policies to address the needs of the microfinance industry.

- 1.7 Despite the difficulties mentioned, the sector continues to grow, and successful cases are emerging, such as the MIF operation involving technical cooperation and financing for FIE Gran Poder, approved in November 2003 as part of an effort to fill this gap. The operation with FIE Gran Poder is unfolding satisfactorily. It has opened three new branches; as of May 2005, it had a portfolio of 7,344 loans for a total of US\$2,641,747, with a relatively low arrears rate of less than 3%.
- 1.8 *Rationale.* In carrying out its activities, FONCAP came up against the problem of the relative non-existence of solid first-tier institutions that would allow it to channel its resources efficiently to microenterprise. An unmet demand for technical assistance and/or training became apparent for the different levels of institutions: executives and directors, technical staff, and managers, which were ratified after consultations and other mechanisms for sounding out the views of the MFIs. In addition, the AECI reached similar conclusions regarding the demand for services on the part of MFIs when it undertook its feasibility study for granting the loan to FONCAP (see paragraph 1.9). In addition to their financial needs, it became clear that the management and administration of the MFIs needed to be improved, through specialized consultancies.
- 1.9 A year and a half ago, FONCAP began parallel conversations with the MIF and the Agencia Española de Cooperación Internacional [Spanish International Cooperation Agency] (AECI), as it sought resources to finance and strengthen MFIs. FONCAP

has signed an agreement with AECI<sup>1</sup> to develop a program of financial services for microenterprise. The agreement grants FONCAP a loan of 3 million euros. These resources will help FONCAP respond to the sector's demand for financing. At the same time, the technical assistance that the MIF will provide will help FONCAP respond to the need to strengthen the MFIs, while enabling it to better perform its role as a second-tier institution. There is important complementarity between then two operations, since both have the same objective of consolidating and supporting the microfinance sector. The MIF and the AECI are coordinating their activities to monitor these initiatives.

- 1.10 The operation proposed herein will help solve the problem of difficult access to financing that microentrepreneurs face, since FONCAP will be able to transfer the knowledge and capacities needed to strengthen the supply of credit through MFIs, and at the same time provide them with the resources they need to expand their scope of action, thereby deepening their financial services. This project is also complemented by the MIF's line of activity for MFIs, and the financial projects that the MIF carries out within the microfinance sector, since the strengthening of the institutions by FONCAP could prepare them to become part of the line of activity's project pipeline. Once they have matured to a certain point, they might qualify for a MIF-financed project. This was the case of FIE Gran Poder, which, when it first began to operate in Argentina, received an initial loan from FONCAP. Two years later it received MIF support for the first time. Some of the institutions being considered for support under this line of activity are FONCAP clients today.
- 1.11 *Additionality and aspects of the project of special relevance to the MIF:* MIF resources would clearly bring additionality, for they would not be replacing other resources since there are currently no other concessional resources from other technical-cooperation donors in Argentina. In this operation, the MIF will be supporting the only second-tier institution in Argentina so that it can carry out its lending tasks more efficiently. Through the coordinated effort with the AECI, FONCAP will be endowed with stability and financial resources so that it can grow, train new technical personnel in microfinance methodology, expand its coverage, considerably increase its portfolio, and be sustainable. The project has been designed to ensure absolute complementarity between the two operations, and also to enable the MIF to have a major impact strengthening several first-tier entities with the potential to expand the channeling of resources for microfinance, without having to work with each of them. As a second-tier institution, FONCAP can obtain major economies of scale.

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<sup>1</sup> The loan agreement was signed on 28 December 2004.

## II. PROJECT DESCRIPTION

- 2.1 The *general* objective of the project is to finance and consolidate a network of solid microfinance institutions capable of providing sustainable service to the growing demand for microfinance services. The *specific* objective is to consolidate FONCAP, technically and institutionally, as a leading second-tier entity, and the platform of services that FONCAP currently offers MFIs, through programs carried out by the AECI and FONCAP, and the MIF and FONCAP.
- 2.2 To attain the specific objectives proposed, the project would be divided into three *components*: (i) technical assistance and training for the MFIs; (ii) the strengthening of FONCAP as a second-tier institution; and (iii) dissemination and sensitization to the microfinance industry.
- 2.3 **Technical assistance and training component of the MFIs. (MIF: US\$521,000; counterpart: US\$219,806).** This is the most important component for the success of the project, for without strengthened MFIs that can use their financial resources efficiently, there would be no reason to support FONCAP as a second-tier institution. This component would make it possible to finance the strengthening of areas critical to the MFIs. The incentive that these MFIs will have to accept the training is that FONCAP, as a general rule, will require that an MFI that applies for a loan must also receive technical assistance for the institutional evaluation. This evaluation will yield an assessment based on which an agenda for institutional development specifically tailored to the MFI would be drawn up and the latter would then have to implement it. A new system of institutional evaluation will be designed to replace the current one that makes it possible: (a) to establish standardized criteria for evaluating MFIs, considering the subsequent implementation of the MFI rating agency in the project, (b) to promote processes of standard-setting and standardization of criteria for institutional evaluation in FONCAP, and (c) to transfer the methodologies developed to FONCAP's team of analysts, to be applied in all the client institutions. Once the new system is completed, the institutional assessment will be performed, making it possible to determine the weaknesses of the MFIs that are to receive technical assistance. Through this component, technical and methodological resources will be transferred to each participating MFI. At first there will be six MFIs, a number that is to increase to 34 by the end of the program. The consultant to be hired to train FONCAP's technical staff should also provide international industry standards, preferably from the region, for the comparative analysis and benchmarking of MFIs. This set of indicators of portfolio volume and growth, arrears rates, and net worth, as well as diversification of loan products and lending technologies, will serve as a reference for the institutions of the FONCAP network, and will also apply to the MFI rating system planned for the project. The MFIs will cover up to 30% of the costs of the technical assistance they receive. In some cases FONCAP will determine a lower percentage, in keeping with the level of institutional

development of the MFIs. In addition, FONCAP's current training program will be reviewed; it will be geared to both the organizations of its network and others that are not FONCAP clients. FONCAP will develop a virtual classroom that will be based at its website. The training services for MFIs will provide for a system of cofinancing between FONCAP and those institutions, through a declining subsidy aimed at bolstering the sustainability of these activities, of which FONCAP would cover 70% in the first year, 50% in the second year, 25% in the third year, and 0% by the end of the program, with MIF financing. FONCAP has been implementing a training program based on cofinancing by FONCAP and the MFIs to provide services, which ensures that this scheme can also be implemented within the project. To enhance the process of monitoring the MFIs' activities, they will be interconnected by creating a matrix-based control panel for implementing a management information system (MIS). FONCAP will develop the IT platform for capturing the information from monitoring, and will install the IT and organizational resources needed for the MFIs to become part of the system. FONCAP will also develop the methodology for updating the baselines of the target group of MFIs needed for impact evaluation and monitoring.

- 2.4 **Component for strengthening FONCAP as a second-tier institution. (MIF: US\$94,000; counterpart: US\$423,231).** This component will make it possible to consolidate and improve the platform of technical services that FONCAP offers the MFIs with which it works. FONCAP will receive support to standardize the criteria for selecting and rating MFIs; integrate the auditing and information management systems; establish a pilot credit bureau system; and enable the members of the FONCAP board of directors to participate in a course on corporate governance, to be indicated by the MIF Investment Unit, which will select the consulting firm to give the course, and the specific subjects for the FONCAP board. The strategy for assessment and rating, essential for a second-tier institution, is intended to bolster FONCAP's capacity to evaluate and rate the MFIs with which it works, developing improved benchmarks for estimating institutional risk. Such an assessment is essential for the financing decisions to be made by FONCAP and for identifying the areas of weakness to be covered by the MFIs technical assistance component. This activity would make it possible, over time, to obtain industry-level statistics on microfinance (e.g. consolidated arrears in the sector) and it would contribute to greater institutional transparency, both of which are important requirements for attracting investors to microfinance. The pilot credit bureau system is an important initiative, since Argentina does not have a clearinghouse for information for the microfinance sector, and therefore there is a lack of up-to-date and systematized data on its borrowers' payment history. This gap results in high costs to MFIs for evaluating their potential clients, and it also keeps microentrepreneurs from establishing a credit record. The pilot credit bureau based at FONCAP would begin with the data base of those MFIs that are currently in the network, and would gradually incorporate other institutions interested in joining the system. It would begin with a negative baseline and would then be expanded to include all borrowers.

- 2.5 **Dissemination and sensitization component (MIF: US\$25,000; counterpart: US\$23,763).** This component includes publishing a manual of best practices, holding two workshops for disseminating results and best practices, and the participation each year of two staff members of FONCAP in the Inter-American Microenterprise Forum. The project will tap into this component to disseminate good practices in the industry, the objective being to create a favorable environment for microfinance. In the context of this component, experts from other banks or second-tier financial institutions of the region may be invited to share their experiences and facilitate the comparative analysis with the results obtained by FONCAP.
- 2.6 The MIF's contribution to the project would be earmarked mainly for financing international consulting services, whose purpose would be: (i) to transfer technology appropriate for developing a network of solid first-tier intermediaries, with the capacity needed to intermediate FONCAP's financial resources; and (ii) to improve the quality of the investment of those intermediaries, and diminish their credit risk, and FONCAP's credit risk, through the system for rating MFIs and the pilot credit bureau. The contribution by FONCAP would be earmarked mainly to contract personnel who would work closely with the international firms to absorb and incorporate the technologies provided to FONCAP. This personnel would remain in FONCAP after the project is executed. This strategy would ensure the development of a permanent capacity in the organization, which would be very important for attaining the objective of the MIF cooperation project.

### III. COSTS AND FINANCING

- 3.1 The total estimated cost of the project is US\$1.6 million, to be financed with a MIF grant in the amount of US\$800,000, and a contribution in local counterpart resources of US\$800,000, with up to 50% of the resources from FONCAP in kind. Table I shows a breakdown of the budgetary information for the project corresponding to the activities proposed.

**Table I**  
**Consolidated budget by component**

<b>Budget category (in US\$)</b>	<b>MIF</b>	<b>FONCAP</b>	<b>Total</b>	<b>%</b>
Component I: Technical assistance and training for MFIs	521,000	219,806	740,806	46.30
Component II: Strengthening FONCAP as a second-tier institution	94,000	423,231	517,231	32.32
Component III: Dissemination and sensitization for the microfinance industry	25,000	23,763	48,763	3.05
Executing unit and operating costs	90,000	133,200	223,200	13.95
Contingencies	40,000	0	40,000	2.50
Evaluation and external audits	30,000	0	30,000	1.88
<b>Total</b>	<b>800,000</b>	<b>800,000</b>	<b>1,600,000</b>	<b>100.00</b>

- 3.2 With the Bank's acceptance, up to US\$50,000 of the expenditures incurred by FONCAP during the months prior to project approval, between approval by the Programming Committee in May 2005 and September 2005, may be recognized, in the following categories: (a) IT applications for MFIs; (b) contracting of local consultants for drawing up the bidding conditions for the awarding of contracts to international firms; and (c) first hirings of incremental personnel for the project.
- 3.3 *Sustainability.* After overcoming its first hurdles as an institution, and advancing along the learning curve, FONCAP is today an institution that is succeeding in attracting other institutions that want to work with it. As a sign of FONCAP's positive development, after the crisis that came about with the exit from the convertibility program, special mention should be made of the following quantitative indicators: in the 2002-2003 period, the formal financial system saw a contraction in lending of more than 50%, with total private sector lending bottoming out at 6% of GDP, and with the nonperforming portfolio at 55% for the public banking system, and 42% for the private institutions. During the same period, FONCAP showed 13% growth in its portfolio, with an arrears rate in December 2003 of less than 5%. In 2004, the formal system saw a 20% recovery in lending, with 45% of the private sector portfolio in nonaccrual status. During that same period, FONCAP experienced 103% growth in the portfolio, with the nonperforming loan portfolio accounting for less than 5%. The project team, on undertaking the institutional analysis, verified FONCAP's sustainability. As to the sustainability of the program itself, at the beginning of the project FONCAP will subsidize training of the MFIs for up to 70% of the total cost, but its contribution will diminish as the MFIs find value added in the training provided (see paragraph 2.3).

#### IV. EXECUTING AGENCY AND MECHANISM

- 4.1 FONCAP S.A. is a company established under private law (*sociedad anónima*), whose purpose is to administer trust funds for developing microfinance institutions in Argentina. At present, it administers the Fondo de Capital Social, constituted in 1997 with AR\$40 million provided by the federal government of Argentina. FONCAP's board of directors is made up of representatives of the private sector (51%) and representatives of the state (49%); there are nine directors in all. Each director serves a three-year term. Control over the privately-held equity package is exercised by Acción International, an NGO with a recognized record of providing financial support to the microenterprise sector in Latin America. Acción International was a founding shareholder of FONCAP, with 45% of the shares, increasing its equity to 51% of total shares in 2002. Acción International has 30 years experience working in Latin America as a provider of technical assistance, creditor, and shareholder. The MIF has a close relationship with Acción International, specifically through the project to provide technical assistance and an investment fund for microfinance institutions (MIF/AT-515).
- 4.2 In this way, the private shareholders ultimately control decision-making, ensuring FONCAP's governance. The board of directors as a whole, through the executive committees, establishes the policies and criteria for managing the fund, and designates the general manager, who performs executive functions administering the organization's equity. Under the general manager is the manager for administration and finance, and the manager for institutional development. FONCAP's objectives include: (i) promoting the formation, training, strengthening, expansion, and specialization of the microenterprise sector service providers; and (ii) inducing development and using institutions and financial instruments suitable for addressing the particular circumstances of microenterprises.
- 4.3 *Overview of FONCAP's development.* In FONCAP's early years (1998-1999), there are two differentiated and not-very-integrated lines of work, established to initiate the work of giving an institutional framework to microfinance in Argentina. These two lines were the work of promotion, with a strong social component, and the financial work, focused basically on seeking institutions to carry out microcredit operations geared to self-reliant sustainability. FONCAP began making loans with a limited number of products: there was a single credit line that was not very flexible, which meant that there were few operations, in some cases with results that fell short of expectations. In addition to portfolio financing, micro-banks (institutions that finance microenterprises), received financing for training their technical teams at MFIs in Paraguay, Ecuador, Colombia, Peru, and Bolivia, since in Argentina there were not yet enough experiences or institutions to carry it out.
- 4.4 In 2000 and 2001, efforts began to reconcile the social and financial lines of work based on what had been initiated and built institutionally in these early years. In

2001, specific lines of credit were designed for small producers in the rural sector, through the cooperatives that represent them.

- 4.5 After the December 2001 financial crisis and the change in the foreign-exchange policy in early 2002, FONCAP decided, as a strategic policy, to direct its lines of financing to sectors of small export producers in the context of the regional economies, as a supplement to its usual microlending activities. FONCAP was able to get past the difficult financial crisis that hit Argentina in 2001 and 2002—safeguarding the capital placed in trust through a smart investment of resources within the restrictions in force, developing a special flexibility for finding solutions that made it possible to recoup the resources loaned to the first-tier institutions; thus enabling the latter to continue making loans to microenterprises at a time when lending activity had practically come to a standstill. While the net worth of the institutions borrowing from FONCAP often suffered as a result of this situation, at present they have a positive cash flow as a result of the recent process of stabilization, leading to a recovery in activity and in lending.
- 4.6 Since 31 December 2004, FONCAP has organized forums for sharing and providing technical and financial services with a network of more than 200 organizations that support the microenterprise sector, serving 33,612 microenterprises and small producers in 15 provinces of Argentina. As for the expansion of the network of microfinance institutions (MFIs), a group of 11 first-tier operators has been consolidated, with adequate institutional credentials and growth potential, which also account for almost 50% of FONCAP's active portfolio. In addition, a microenterprise information system has been consolidated, known as the RIFIM<sup>2</sup>, which is available on line with data on approximately 200 institutions that provide technical and financial support to the sector.
- 4.7 FONCAP operates with a wide variety of first-tier institutions, NGOs, cooperatives, finance companies, and even banks, through various arrangements, setting itself apart from more traditional models (see Annex III), and assuming the participation of the local governments in their role as catalysts in the nongovernmental initiative for microfinance development and in their role as major actors for implementing mixed public-private arrangements. FONCAP's experiences to date with mutual aid societies and the municipio of Rafaela, province of Santa Fe, and with the local development agencies of the cities of Córdoba and Rosario, and, working with a mixed model of intervention, show the feasibility of such arrangements. The project team is of the view that this is an innovative operational modality that could be replicated elsewhere.

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<sup>2</sup> Registry of Institutions Financing Microenterprise (Registro de Instituciones de Financiamiento a la Microempresa).



4.8 In addition to the agreements with the organizations mentioned in the executive summary, FONCAP has signed technical cooperation agreements with the following institutions:

- **Planet Finance:** This international nonprofit organization of French origin, whose objective is to help eradicate poverty by promoting and assisting the microfinance sector, will give pilot training to some of the MFIs assisted by FONCAP, and will transfer to the FONCAP technical teams the technology for assessment and strategic planning, with a view to the future implementation of the rating agency for MFIs. This program will include the first practical experiences with assessment and strategic recommendations for some MFIs;
- **Japan International Cooperation Agency (JICA):** Through a three-year program, JICA will finance the execution of training activities for some 50 MFIs and NGOs from across the country aimed at strengthening their institutional management capacities. This program is still under consideration, but if approved it could be considered a counterpart to MIF technical assistance; and
- **Ford Foundation:** There are agreements, with the financial support of the Ford Foundation, to implement a guarantee fund to ensure MFIs' access to FONCAP's supply of credit products.

4.9 *Execution mechanism.* FONCAP SA will form a Management Committee and a Program Coordinating Unit (PCU). The Management Committee will be in charge of running the program. It will be made up of two members of the board and the general manager of FONCAP. The Coordinator of the PCU will serve as its secretary, with the right to speak but not vote. The main functions of the Management Committee will be: (i) to provide technical direction to the program and to serve as liaison between FONCAP and the Bank; (ii) to designate and remove the Coordinator of the PCU; (iii) to approve the program's Operating Regulations; (iv) to approve all the reports submitted to the Bank; and (v) to resolve all matters relating to the execution of the program raised by the Coordinator of the PCU.

4.10 The Project Coordinating Unit, which is under this Management Committee, will be established with FONCAP to execute, supervise, and coordinate the program, technically and administratively. It will be headed up by a coordinator financed by MIF resources for up to US\$90,000 for the 36 months of the program. It will be supported by one technical assistant and one full-time secretary, who will be financed by FONCAP. The program will be executed with the human resources structure of FONCAP, plus the technical staff incorporated as indicated in paragraph 2.7. To attain this purpose, the coordinator will maintain ongoing coordination with FONCAP's general manager and the managers for institutional development and financial management. The process of carrying out the program should entail the constant in-service training of the technical staff of FONCAP, so

as to leave in place an installed capacity that makes it possible to sustain the program, once the resources of the MIF financing have been used up.

- 4.11 The main responsibilities of the PCU will be: (i) to manage the execution of all the activities of the program, in coordination with the persons responsible for the different areas of FONCAP; (ii) to prepare the six-month reports on execution, and all other reports required by the Bank; (iii) to prepare and present the requests for disbursement to the Bank, and to ensure the timely allocation of the counterpart resources; (iv) to ensure that the accounting records of the program are in order, in line with an accounts plan approved by the Bank, and to organize its files so as to facilitate their supervision; (v) to ensure the program's Operating Regulations are being applied; (vi) to participate and coordinate all procurement for the program and the contracting of consultancies, in keeping with the Bank's rules and procedures; and (vii) to supervise all the program's contracts and payments.
- 4.12 *Procurement of goods and services.* FONCAP will be responsible for procuring the goods and services needed for the project, in keeping with the Bank's rules, procedures, and policies (GN-2350-4 Policies for selection and contracting of consultants financed by the IDB and GN-2349-4 Policies for the procurement of works and goods). FONCAP will issue two calls for bids from international consulting firms, which will design different systems; it will then contract individual consultants for specific tasks. The procurement of goods will be financed from MIF resources and the local contribution, applying the procedures indicated.
- 4.13 *Status of the project.* The project design, its budget, activities, and logical framework, including the appropriate indicators, were entrusted jointly to FONCAP and the IDB project team. The project is at an advanced stage, and there is already a draft of the Operating Regulations, prepared jointly with FONCAP, and a 2004-2007 work plan. A consultant is being hired to draw up the terms of reference for the international consultancies and the terms for the bidding process in accordance with Bank standards.

## **V. MONITORING AND EVALUATION**

- 5.1 Using the consulting services of external experts hired by the Bank, the project will be subjected to a midterm evaluation once 50% of the resources have been disbursed, and a final evaluation prior to the last disbursement, or once 95% of the resources have been disbursed. The evaluations will be guided by the execution plan and by the indicators established in the logical framework presented in Annex I.
- 5.2 The midterm evaluation will measure, among other things, whether the objectives of strengthening the MFIs are being achieved in the first six MFIs, whether FONCAP is incorporating the recommendations of the international consultancy as

- regards updating its systems and procedures, and whether FONCAP's financial indicators have continued improving as a result of applying best practices industrywide. The project's final evaluation will measure these same indicators over the three years of the project, as well as its sustainability after three years. For both evaluations, attainment of the purpose and specific objective of the project will be analyzed, mindful of the baseline indicators and the logical framework.
- 5.3 *Reports.* FONCAP, through the coordinating unit, will be tasked with supervising and preparing the semiannual progress reports on the project. Each progress report should document the activities carried out during the six months, highlighting the project's results and effects, and should follow a format previously agreed upon with the Bank. In addition, the coordinating unit will draw up work plans and schedules for disbursement for the subsequent six-month period. Progress reports should be submitted to the Bank within 30 days after the end of the six-month period. The Country Office in Argentina will use these reports to supervise progress in implementing the project, and will prepare the Project Completion Report not later than three months after the last disbursement. CAR and an officer of MIF's Investment Unit at Headquarters will work closely together supervising the project.
- 5.4 *Accounting and audits.* FONCAP will be responsible for: (a) establishing and maintaining accounting and financial controls, as well as adequate internal audits and a system to provide detailed documentation on the source and use of the program's resources, including: (i) identifying the amounts and sources of the resources; (ii) information on the program's expenditures, distinguishing those whose costs are covered by MIF resources from those financed by other sources; and (iii) the details needed to identify the goods procured and the services contracted; (b) opening separate bank accounts for administering the MIF contribution and the local counterpart resources; (c) processing requests for disbursement and the corresponding report on expenditures in accordance with the Bank's disbursement procedures; and (d) preparing and submitting to the Bank the final audited financial statements for the program, as well as the six-month reports on the revolving fund. The executing agency should submit the final audited financial statements to the Bank within 90 days after the last disbursement. The Bank must first accept the auditing firm, and the cost of the external audit will be financed from the MIF contribution.

## **VI. PROJECT BENEFITS AND RISKS**

### **A. Benefits**

- 6.1 This project is perceived as being very important, as Argentina is in need of a second-tier institution that can support and strengthen the country's MFIs, with both financing, so they can grow their customer base, and technical assistance, to transfer methodologies and systems that incorporate international best practices.

This project will not only benefit FONCAP and the 34 institutions with which FONCAP will work most closely; it will also impact 22,600 microentrepreneurs who are clients of these institutions.

## **B. Risks**

- 6.2 FONCAP has suffered weaknesses in the past that could come up again in the course of the project. **Consideration.** The project team has been working very closely with FONCAP in coordination with CAR for more than 18 months, verifying the positive change the institution has undergone, which is a fruit of the lessons learned in the 1997-2001 period, and its commitment to incorporate the best practices in the microfinance industry; it has been engaged in this endeavor since 2002. After 2002, several development agencies have been eyeing FONCAP, and have chosen it to carry out their projects. These include the AECI, UNDP, JICA, the Ford Foundation, and the IDB.
- 6.3 There could be a lack of willingness on the part of the MFIs to participate and coordinate. **Consideration.** FONCAP sought the support of the MIF after implementing pilot training courses for the MFIs that revealed a series of new needs, and which made it possible to verify the interest of the MFIs in receiving further training, so as to become more competitive institutions.
- 6.4 In Argentina, the microfinance market is still in its early stages, as is the question of regulation to an even greater degree. An excessively interventionist role on the part of the State in this sector—directly by imposing rules that limit or jeopardize microfinance operations, or indirectly by creating massive subsidy programs—would harm the culture of credit among microentrepreneurs. **Consideration.** Microfinance has been evolving in Argentina despite a relatively unfavorable regulatory environment, and there are already successful cases, such as FIE Gran Poder. FONCAP, by having the State as a shareholder with representatives on its board, could serve as an indirect liaison between the sector and the government for conveying MFIs' needs to the government, and thereby make a positive contribution to the drafting of regulatory provisions favorable to the industry.
- 6.5 The project is based on the assumption that FONCAP will be able to administer it diligently, despite having other projects and agreements that might be executed almost simultaneously. **Consideration.** Each project will have persons in charge of carrying them out, and directors will monitor them. FONCAP will be contracting at least four more technical staff once the project starts, in addition to the personnel who will make up the PCU. Some of the other agreements complement the activities of this project. The project will be closely monitored within FONCAP, and by the MIF and the AECI, to ensure that the program as a whole (both financing and technical assistance) unfolds in a satisfactory manner.

## **VII. ENVIRONMENTAL AND SOCIAL CONSIDERATIONS**

- 7.1 FONCAP, as a second-tier institution, is not directly engaged in any activity that impacts the environment. Nonetheless, this program will include positive training activity for the MFIs, helping them to develop environmental controls, when microentrepreneurs are evaluated for loans. To this end, the products designed and their operating manuals will also take into account environmental management. These manuals should also reaffirm the principle of nondiscrimination based on ethnicity, sex, or age.
- 7.2 In another financial project carried out in Argentina a few years ago, an environmental guideline for Argentine institutions was developed that FONCAP may be able to use. Additionally, the loan officers will be trained in environmental analysis of the undertaking to be financed, in accordance with the MIF's operating guidelines. Under the training and advisory services component, the MFIs that are the direct beneficiaries of the operation will receive support in the form of information, training, and technical assistance to integrate the environmental variable into their business plans, thereby ensuring their environmental feasibility, including compliance with Argentina's environmental legislation as well as the applicable Bank policies.
- 7.3 The eligibility criteria for the projects to be financed by FONCAP should include an evaluation of the beneficiaries' environmental management practices, and ensure that the Credit Regulations for each MFI include the environmental variable at each stage of the project cycle. In the context of the MFI selection process to be implemented by FONCAP, emphasis will be placed on detecting and eventually avoiding any activity linked to money laundering and other ways of reintroducing money illegally obtained into circulation.

## CONSOLIDATING THE MICROFINANCE SYSTEM IN ARGENTINA WITH THE SUPPORT OF FONDO DE CAPITAL SOCIAL S.A. (FONCAP) – AR-M1005

### LOGICAL FRAMEWORK

Objectives	Indicators and goals	Means of verification	Assumptions
<b>Aim</b>			
To strengthen and consolidate a network of sound microfinance institutions with the capacity to sustainably service the growing demand for microfinance services.	<ul style="list-style-type: none"> <li>Two years after project completion, a network of microfinance institutions, coordinated by FONCAP, is consolidated.</li> </ul>	<ul style="list-style-type: none"> <li>FONCAP's Annual Report and Financial Statements and portfolio reporting system showing interaction with at least 34 microfinance institutions active in the network.</li> </ul>	<ul style="list-style-type: none"> <li>Stable macroeconomic situation with growth in demand for microcredit.</li> <li>The country's economic development is maintained, in terms of growth, inflation, and terms of trade.</li> </ul>
<b>Purpose</b>			
To consolidate FONCAP technically and institutionally as a leading second-tier institution, and the platform of technical services that FONCAP presently offers to MFIs.	<p>Three years after project completion, FONCAP:</p> <ul style="list-style-type: none"> <li>Is implementing technical and financial services for at least 40 MFIs, and its activity is recognized by its clients.</li> <li>Is improving the indicator of operating efficiency, measured by a reduction in operating costs as a percentage of total portfolio, from 11% at present to 8% by the end of the program.</li> <li>Is increasing by 20% its geographic coverage (communities across the country) of MFIs served.</li> <li>The number of clients increases 20%.</li> <li>More than 30 MFIs are strengthened.</li> </ul>	<ul style="list-style-type: none"> <li>Semiannual progress report and final report prepared by the executing agency.</li> <li>Statistical information from FONCAP, in relation to the baseline.</li> <li>Project Performance Monitoring Report (PPMR).</li> <li>Midterm and final evaluation of the project prepared by an external consultant.</li> <li>Project Completion Report (PCR).</li> <li>- Survey on satisfaction.</li> </ul>	<ul style="list-style-type: none"> <li>The FONCAP board of directors introduces the changes proposed by the program.</li> <li>The MFIs continue to be interested in improving their products and services and in applying the services developed by the program.</li> </ul>

Objectives	Indicators and goals	Means of verification	Assumptions
<b>Components</b>			
<b>Component 1:</b> Training and technical assistance for MFIs.	<ul style="list-style-type: none"> <li>During the first year of implementation, 100 persons participate in the training courses.</li> <li>By the end of the second year, 6 MFIs are receiving technical assistance.</li> </ul> By the end of the program: <ul style="list-style-type: none"> <li>More that 30 MFIs received technical assistance.</li> <li>More than 150 MFIs received training.</li> <li>The annual indicator for client drop outs diminishes 15% compared to the current registration.</li> <li>At least one new line of financial services is designed.</li> <li>The MFIs' portfolios grow 30%.</li> <li>The arrears rate is reduced 20%.</li> </ul>	<ul style="list-style-type: none"> <li>Semiannual progress report and final project report prepared by executing agency.</li> <li>Statistical information from FONCAP, in relation to the baseline.</li> <li>Project Performance Monitoring Report (PPMR).</li> <li>Midterm and final evaluations of the project, prepared by the external consultant.</li> <li>Project Completion Report (PCR).</li> <li>Satisfaction survey.</li> </ul>	<ul style="list-style-type: none"> <li>The MFIs are interested in the training and technical assistance that will be provided by FONCAP through the Program.</li> <li>The MFIs understand the benefits of the trainings and technical assistance, and remain interested in receiving training so as to improve their operations.</li> </ul>
<b>Component 2:</b> Strengthening FONCAP as a second-tier institution.	<ul style="list-style-type: none"> <li>By the end of the first year of the program FONCAP increases by 10% the number of MFIs that receive its services; and by the end of the program, by 30%.</li> <li>By the end of the first year of the program, FONCAP reduces the arrears rate by 10%, and by the end of the program, by 20%.</li> </ul>	<ul style="list-style-type: none"> <li>Semiannual progress report and final project report, prepared by the executing agency.</li> <li>Statistical information from FONCAP, in relation to the baseline.</li> <li>Project Performance Monitoring Report (PPMR).</li> <li>Midterm and final project evaluations, prepared by external consultant.</li> <li>Project Completion Report (PCR).</li> </ul>	<ul style="list-style-type: none"> <li>FONCAP has a team of professionals ready to receive training and make the necessary changes.</li> </ul>

Objectives	Indicators and goals	Means of verification	Assumptions
<b>Component 3:</b> Sensitization and disseminating results.	<ul style="list-style-type: none"> <li>By the end of the third quarter of execution, at least 100 MFIs participate in a workshop to raise awareness, and no less than 20% become involved in the program.</li> <li>By the end of the project, at least 100 MFIs participate in the activities to disseminate results and best practices, and at least 20% of the participating MFIs become interested in obtaining FONCAP's services.</li> </ul>	<ul style="list-style-type: none"> <li>Semiannual progress report and final project report, prepared by the executing agency.</li> <li>Statistical information from FONCAP, in relation to the baseline.</li> <li>Project Performance Monitoring Report (PPMR).</li> <li>Midterm and final evaluations of the project, prepared by the external consultant.</li> <li>Project Completion Report (PCR).</li> </ul>	<ul style="list-style-type: none"> <li>The MFIs remain interested in attending the workshops for disseminating the program's results and best practices.</li> </ul>
<b>Activities</b>			
<b>Component 1:</b> 1.1 Developing the evaluation methodology, updating the training program, and monitoring the activities of the MFIs. 1.2 Designing and implementing a MFI institutional evaluation system. 1.3 Developing and transferring management standards for the MFIs receiving FONCAP resources. 1.4 Review of the standard training program for MFIs. 1.5 Development of a virtual classroom. 1.6 Review and updating of the current model for monitoring the activities of the MFIs.	MIF: US\$521,000 Local contribution: US\$219,806 Total: US\$740,806 1.1 Consulting firm contracted by the end of the first six months of execution. 1.2 Criteria for institutional, organizational, and financial evaluation developed and transferred to the team of analysts at FONCAP by the end of the first year. 1.3 Documents assessing six MFIs done after the first 18 months of execution, and assessing 34 institutions, 30 months into project execution.	<b>For all the activities in components 1 and 2:</b> <ul style="list-style-type: none"> <li>Semiannual progress report and final project report prepared by the executing agency.</li> <li>Project Performance Monitoring Report (PPMR).</li> <li>Midterm and final evaluations of the project, prepared by the external consultant.</li> <li>Project Completion Report (PCR).</li> <li>Accounting records of the project.</li> <li>Roster of consultants contracted.</li> <li>Consultants' reports.</li> </ul>	<b>For all the activities in component 1:</b> <ul style="list-style-type: none"> <li>The beneficiaries continue to be interested in training and in the capacity to use the new processes/procedures.</li> <li>The financial resources are available on the terms and in the amounts required.</li> </ul>



Objectives	Indicators and goals	Means of verification	Assumptions
1.7 Developing and implementing the IT platform for capturing data from monitoring, 24 months into project execution.	<p>1.4 Lending methodologies, the development of microcredit products, institutional management arrangements, and technologies for monitoring and recovery of clients transferred to six MFIs 24 months into the program, and to 34 MFIs by the end of the program.</p> <p>1.5 Development of the contents, support materials, and virtual and distance technologies transfer, by the end of the third quarter of execution. Virtual classroom up and running 18 months into execution.</p> <p>1.6 Document with proposals for improving the monitoring of MFI activities, 18 months into execution.</p> <p>1.7 IT platform for capture of information from monitoring developed and in operation by 24 months into the project.</p>		
<p><b>Component 2:</b></p> <p>2.1 Standardizing FONCAP's selection criteria.</p> <p>2.2 Creating internal rules, indicators, and standards of reference for the comparative analysis of institutions.</p> <p>2.3 Selection of MFIs.</p> <p>2.4 Strengthening and systematizing audit integration procedures.</p> <p>2.5 Development of a control panel as an instrument for monitoring and</p>	<p>MIF: US\$94,000 Local Contribution: US\$423,231 Total: US\$517,231</p> <p>2.1 Document with the definition of criteria to be applied for selecting beneficiary MFIs of the program, by the end of the first six months of execution.</p> <p>2.2. Document containing the rules, indicators, and reference standards developed by the end of the first six</p>		<p><b>For all the activities in component 2:</b></p> <ul style="list-style-type: none"> <li>▪ FONCAP is capable of providing the necessary support to the beneficiary MFIs.</li> <li>▪ The financial resources are available on the terms and in the amounts required.</li> </ul>

Objectives	Indicators and goals	Means of verification	Assumptions
<p>measuring results and indicators for decision-making.</p> <p>2.6 Development of audit, risk, and benchmarking modules for software for MFIs to manage and monitor microcredit.</p> <p>2.7 Equipping, updating, and expanding the installed IT capacity.</p> <p>2.8 Integration of a specific systems area into the FONCAP structure.</p> <p>2.9 Strengthening FONCAP's technical teams for carrying out the training actions.</p> <p>2.10 Improving FONCAP's capacity for rating.</p> <p>2.11 Establishing a credit bureau.</p> <p>2.12 Holding a course on corporate governance.</p>	<p>months, and implemented by the end of the second six-month period.</p> <p>2.3 Six MFIs selected during the second six months of execution, and another 28 selected by the end of the third six months of execution.</p> <p>2.4 Review of the finalized current audit model, and document with proposals for improvements, by the end of the third six-month period of execution, to be forwarded to the board of directors of FONCAP for consideration and eventual implementation.</p> <p>2.5 Implementation of the proposals in six institutions by the end of the second six-month period of execution, and in 28 more by the end of the project.</p> <p>2.6 Control panel developed by the end of the third six-month period of execution.</p> <p>2.7 Modules for the management and monitoring software developed and transferred to the MFIs selected, by the end of the second year of execution.</p> <p>2.8 Procurement of IT equipment by the end of the first six months of execution.</p> <p>2.9 Systems area operating efficiently with specialists in IT and auditing of systems to make it possible to service such needs internally and to support</p>		

Objectives	Indicators and goals	Means of verification	Assumptions
	<p>the MFIs' software, by the end of the program.</p> <p>2.10 At least 10 professionals from FONCAP participate in providing the program's technical assistance, and implement the knowledge acquired.</p> <p>2.11 Document with proposal for bolstering the capacity to rate the MFIs it works with, implemented by the end of execution.</p> <p>2.12 Pilot credit bureau system implemented by the end of execution.</p> <p>2.13 A course on corporate governance organized for the FONCAP board of directors during the project.</p>		
<p><b>Component 3:</b></p> <p>3.1 Publication of a manual of lessons learned and best practices.</p> <p>3.2 Workshops for disseminating results and practices, and on sustainability held.</p> <p>3.3 Participation in the Inter-American Microenterprise Forum.</p>	<p>MIF: US\$25,000 Local Contribution: US\$23,763 Total: US\$48,763</p> <p>3.1 Manual for dissemination and raising awareness published at the end of program execution.</p> <p>3.2 Two workshops for disseminating results held halfway through and at the end of program execution.</p> <p>3.3 Annual participation of two FONCAP officers in the Microenterprise Forum.</p>	<ul style="list-style-type: none"> <li>▪ Accounting records of the project.</li> <li>▪ Record of distribution of the publication.</li> <li>▪ Record of participants in the workshops.</li> <li>▪ Reports of the officials who participated in the Microenterprise Forum.</li> </ul>	<ul style="list-style-type: none"> <li>▪ FONCAP and the beneficiary MFIs understand the benefits of the program. In addition, the various public- and private-sector actors confirm the need for a regulatory framework to permit for the sound development of the microfinance industry.</li> <li>▪ The financial resources are available in the terms and amounts required.</li> </ul>

## Detailed project budget - MIF Program: Quarterly disbursements by subcomponent

Component	Subcomponent	Financed by	1st Year				2nd Year				3rd Year				TOTAL
			1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	
1. Evaluation, technical assistance, training, and monitoring MFIs	1.1. Evaluation	MIF	80,000	45,000	30,000	0	0	0	0	0	0	0	0	0	155,000
		FONCAP (in-kind)	19,812	5,258	3,505	0	0	0	0	0	0	0	0	0	28,575
	1.2. Technical assistance	MIF	0	0	19,500	58,500	65,667	13,333	0	0	0	0	0	0	157,000
		FONCAP (in-kind)	0	0	1,753	5,257	7,010	1,753	0	0	0	0	0	0	15,773
	1.3. Training	MIF	0	0	0	15,000	22,500	7,500	0	0	0	0	0	0	45,000
		FONCAP (cash)	4,200	5,600	3,600	3,600	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	29,000
		FONCAP (in-kind)	1,314	1,314	1,314	5,900	8,191	3,607	1,314	1,314	1,314	1,314	1,314	1,314	29,524
		MIF	49,000	0	0	0	0	38,333	57,500	19,167	0	0	0	0	164,000
	1.4. Monitoring	FONCAP (cash)	31,000	0	0	0	0	0	0	5,000	7,500	2,500	0	0	46,000
		FONCAP (in-kind)	25,495	0	0	0	0	13,686	20,529	8,303	2,191	730	0	0	70,934
2. Consolidation of FONCAP	2.1. Identifying and selecting MFIs	FONCAP (cash)	4,500	6,700	2,600	0	0	0	0	0	0	0	0	0	13,800
		FONCAP (in-kind)	9,177	21,297	9,120	0	0	0	0	0	0	0	0	0	39,594
	2.2. Auditing	FONCAP (cash)	0	0	0	0	4,200	4,200	0	0	0	0	0	0	8,400
		FONCAP (in-kind)	0	0	0	0	20,529	20,529	0	0	0	0	0	0	41,058
	2.3. Information management	MIF	0	24,000	0	0	0	10,000	5,000	0	0	0	0	0	39,000
		FONCAP (cash)	3,600	3,600	6,600	8,100	5,100	3,600	3,600	3,600	3,600	3,600	3,600	3,600	52,200
		FONCAP (in-kind)	3,262	3,262	13,684	20,529	6,842	3,797	1,899	0	0	0	0	0	53,275
	2.4. Strengthening FONCAP teams	FONCAP (cash)	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	144,000
		MIF	0	0	0	0	0	0	0	0	20,000	20,000	0	0	40,000
	2.5. MFI rating agency	FONCAP (in-kind)	0	0	0	0	0	0	0	0	11,187	11,187	0	0	22,374
		FONCAP (cash)	0	0	0	0	0	0	0	0	0	0	10,000	15,000	25,000
		FONCAP (in-kind)	0	0	0	0	0	0	0	0	0	0	11,765	11,765	23,530
	2.6. Credit bureau	FONCAP (in-kind)	0	0	0	0	0	0	0	0	0	0	11,765	11,765	23,530
		MIF	0	0	0	15,000	0	0	0	0	0	0	0	0	15,000
	2.7. Governance	MIF	0	0	0	15,000	0	0	0	0	0	0	0	0	15,000
3. Dissemination and raising awareness		MIF	0	0	0	0	0	5,000	7,500	0	5,000	0	0	7,500	25,000
		FONCAP (cash)	0	0	0	0	0	0	0	0	0	0	0	15,000	15,000
		FONCAP (in-kind)	0	0	0	0	0	0	0	0	0	0	0	8,763	8,763
4. Evaluation and auditing		MIF	0	0	0	0	0	10,000	0	5,000	0	0	0	15,000	30,000
5. Executing Unit		MIF	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	90,000
		FONCAP (cash)	5,550	5,550	5,550	5,550	5,550	5,550	5,550	5,550	5,550	5,550	5,550	5,550	66,600
		FONCAP (in-kind)	5,550	5,550	5,550	5,550	5,550	5,550	5,550	5,550	5,550	5,550	5,550	5,550	66,600
6. Contingencies		MIF	5,000	3,000	3,000	3,000	5,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	40,000
TOTAL			266,960	149,631	125,276	165,486	177,139	170,439	132,442	77,484	85,892	74,431	61,779	113,042	1,600,000

## **FONCAP: METHODOLOGY OF ANALYSIS, CREDIT PRODUCT DEVELOPMENT, AND FINANCIAL INDICATORS**

1. **FONCAP's methodology for identifying and evaluating institutions.** While organizations may come forth spontaneously, FONCAP has an intense strategy for expanding its geographic coverage, based on its area of institutional development, whose aim is to identify relevant actors and institutions at the local level with which to form partnership for implementing microfinance arrangements with major potential social and economic impact.
2. When a specific application is submitted, FONCAP, through its areas of institutional development and administration and finance, along with the organization or group submitting the application, undertakes an evaluation and analysis aimed at: (i) obtaining an adequate picture of the microenterprise sectors to which the credit operation is directed; (ii) identifying the strengths and weaknesses of the institution or organization, determining the technical assistance and/or training actions that might be undertaken by FONCAP to address this assessment; and (iii) analyzing the economic and financial aspects of the operation and other factors such as collateral, conditions of repayment, and flows.
3. The institutional analysis includes: (i) in-depth design of the operation, with emphasis on strengthening the capacities already installed in the applicant institution, and on clearly identifying those microenterprises that could potentially be beneficiaries of the lending operation; (ii) validating the background and expertise stated by the institution, through commercial and social references, and through key informants in the area of influence of the applicant; and (iii) an environmental assessment, collecting information directly, on the ground, entrusted to FONCAP's institutional analysts.
4. Once it has concluded the process of institutional analysis, FONCAP proceeds to perform the financial analysis of the proposal. The evaluation methodology considers the characteristics of each particular project, based on the analysis of the operation's sustainability. A major effort is made to detect basic inconsistencies and subsequently to identify whether or not they can be resolved.
5. At the same time, it is important to evaluate the character of the borrower and the latter's credit history. In this regard, requiring collateral is an important reinsurance mechanism for FONCAP operations. Initially a security interest is established as collateral. For this reason, the first task is to characterize the counterpart's assets, and the feasibility of using them as collateral to secure the financing. In those cases in which it is not feasible to establish a security interest in property to serve as collateral, or when the levels of coverage cannot be satisfied with the assets owned by the institution, one can work to put alternative mechanisms in place that make it possible to put up collateral that meets FONCAP's requirements, through fiduciary vehicles.

6. Once the operation begins, FONCAP intends to perform technical monitoring and accounting and environmental audits to monitor progress and attainment of the operation's goals, for early detection of problems, and to take corrective action.
7. Once the operation has concluded, FONCAP will carry out evaluations of institutional performance and the impact of the financing operation on the beneficiary microenterprises, in both economic terms—with regard to the activity and its possible consolidation—and in social terms, with respect to the family unit on which the microenterprise served is based, and its immediate context.
8. **Development of innovative products.** FONCAP has developed different lines of financing, based on the different types of institutions it supports. Some of the characteristics of the new products developed of late are:
  - *Productive Microfinance:* The productive sectors include some organizations associated with particular productive sectors, which, in the new economic context, have good potential for external sales, but not the financial capacity required to enable the small producers to wait for the payments for their sales. FONCAP provides them technical, commercial, and financial assistance that makes it possible to make external sales with financial support from FONCAP at a time when the financial system still lacks alternatives for financing.
  - *Microfinance Institutions (MFIs):* FONCAP helps these MFIs form strategic partnerships, identify possible unmet demands, and develop new products. Financial assistance is also channeled through these organizations to microentrepreneurs not members of any organization.
  - *Micro Banking Systems:* This line is more flexible than the line of financing for MFIs, and was developed to have a financial product that could respond to the financing demands of more precarious small organizations, with more vulnerable populations of microentrepreneurs. Nonetheless, FONCAP established the credit line with ceilings and the need for collateral to cover part of the loan, at the same time improving the interest charged and the terms of the loans.
  - *Pre-Micro Banking System:* The considerable deterioration of the productive apparatus with the consequent increase in poverty and unemployment led FONCAP S.A. to seek financial mechanisms for credit support to help create social capital (essential for bringing about the conditions for the development of the poor communities) and to create the conditions for developing institutions to finance vulnerable sectors who have unmet basic needs. In this context, FONCAP designed and implemented the Pre-Micro Banking System line, enabling some organizations with the potential to improve their marginal situation to begin to become reengaged with the productive apparatus.

9. FONCAP offers a general annual rate of 12%, in line with the price of other financing offers. This rate is adjusted every so often based on fluctuations in inflation. The rates that FONCAP received for loans to MFIs are not subsidized, yet there is, for the Micro Banking and Pre-Micro Banking lines, a promotional component, considering the profile of the institutions that could have access to these loans (grassroots organizations linked to poorer microenterprises). Accordingly, FONCAP established the rate for these lines at 60% of the general rate, in pesos. As shown in the table below, they represent only a small percentage of FONCAP's portfolio.
10. **Financial Indicators.** Following is an overview of the FONCAP portfolio, year by year, since it was established in 1998, with special emphasis on the period from December 2001 to June 2005. The composition of the portfolio, based on the four lines of credit, is as follows:

	<b>Dec-01</b>	<b>Dec-02</b>	<b>Dec-03</b>	<b>Dec-04</b>	<b>Jun-05</b>
Pre-Micro Banking	0	3,125 (0.03%)	28,157 (0.21%)	51,847 (0.19%)	60,831 (0.19%)
Micro Banking	35,000 (0.42%)	80,746 (0.67%)	127,169 (0.93%)	108,392 (0.39%)	332,241 (1.03%)
MFIs	8,232,419 (99.58%)	4,153,602 (34.37%)	4,942,679 (36.04%)	12,665,421 (45.52%)	12,066,856 (37.29%)
Productive Microfinance	0	7,849,024 (64.94%)	8,615,343 (62.82%)	14,996,273 (53.90%)	19,895,434 (61.49%)
<b>Total</b>	<b>8,267,419</b>	<b>12,086,497</b>	<b>13,713,348</b>	<b>27,821,933</b>	<b>32,355,362</b>

11. From December 2001 to December 2004, FONCAP's portfolio experienced sustained growth; in particular, from December 2003 to December 2004, the portfolio doubled from AR\$13,713,348 to AR\$27,821,933 (103% growth). As of June 2005, FONCAP is supporting a total of 56 institutions: eight pre-micro banking, nine micro banking, 26 MFIs, and 13 productive microfinance endeavors.
12. The composition of the portfolio based on status improved steadily during the period under analysis. As of June 2005, payments on 92% of the total portfolio are being made as agreed.

	Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2004	Dec. 2005
Normal	7,141,903	9,261,106	12,143,853	25,814,845	29,898,525
Arrears	512,766	2,587,475	1,224,329	1,385,856	1,835,605
In collection	612,750	237,916	345,166	621,232	621,232
<b>Total</b>	<b>8,267,419</b>	<b>12,086,497</b>	<b>13,713,348</b>	<b>27,821,933</b>	<b>32,355,362</b>

13. Significantly, the growing use of financial engineering structures organized through trusts appears to be an important factor explaining the permanent improvement in portfolio performance in terms of collectibility. To date, more than 70% of the total portfolio is secured through various fiduciary engineering arrangements.
14. The current FONCAP management seeks, as a key line of action, to bolster the organization's productivity, maximizing the active portfolio/operating costs ratio.

Period	Portfolio	Portfolio/ Expenditures	Productivity	
			Rate	Percentage
2001	8,267,419	25.0%	4.00	
2002	12,086,497	26.3%	3.81	-5%
2003	13,713,348	23.8%	4.20	10%
2004	27,821,933	11.0%	9.11	117%

15. The percentage for productivity results from dividing total spending by total portfolio. The rate of productivity shows the profitability of each peso spent in relation to the current portfolio. To this end, and along with the gains made in expanding its active portfolio, FONCAP S.A. has achieved savings in operating costs for administering the Trust Fund. The following table shows FONCAP's internal expenditure as a percentage of the portfolio from 1998 to date. In 1998, spending was 206% of the portfolio; by 2004, spending came to only 11% of the active portfolio.

1998	1999	2000	2001	2002	2003	2004
206%	108%	53%	25%	26%	24%	11%



**CONSOLIDATING THE MICROFINANCE SYSTEM IN ARGENTINA WITH THE SUPPORT OF FONDO DE CAPITAL SOCIAL S.A. (FONCAP) – AR-M1005**

**RELATED PROJECTS**

- A. Similar or related MIF projects:** None
- B. Similar or related Bank projects**
- C. Projects related to the same sector or beneficiaries**

<b>Project name / Date of approval</b>	<b>Project title, sector, executing agency, and amount</b>	<b>Date of signature and original period of disbursement in months</b>	<b>Percentage disbursed</b>	<b>Comments: Satisfactory execution or problems in execution, including delays, extensions, reformulation, change in executing agency, etc.</b>
ATN/ME-5489-AR 02/05/97	Servicios de Apoyo a la Microempresa Support Services for Microenterprise Confederación General Económica (CGE) of Argentina, \$1,900,000	03/26/97	100.00%	Project completed. All of the project objectives were met, both the main one and the specific ones.
ATN/ME-8510-AR 11/19/03	Expansión y Fortalecimiento de FIE Gran Poder Expansion and Strengthening of a Microfinance Institution FIE Gran Poder S.A. Technical Assistance \$390,640	03/27/04	17.00%	The project is under way, after a slower start than anticipated; it is now advancing more expeditiously.
66/MS-AR 11/19/03	Expansión y Fortalecimiento de FIE Gran Poder Expansion and Strengthening of a Microfinance Institution FIE Gran Poder S.A. Loan \$ 2,000,000	03/27/04	62.50%	The project is progressing satisfactorily; two of the three loan tranches have been disbursed.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK  
MULTILATERAL INVESTMENT FUND

PROPOSED RESOLUTION

Argentina. Nonreimbursable Technical Cooperation for Consolidating the microfinance system  
in Argentina with the support of Fondo de Capital Social S.A. (FONCAP)

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 Fondo de Capital Social S.A. (FONCAP), 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 consolidating the microfinance system in Argentina with the support of Fondo de Capital Social S.A. (FONCAP).

2. That up to the amount of US\$800,000, or its equivalent in other convertible currencies, shall be authorized for the purpose of this resolution, chargeable to the technical cooperation resources of the Small Enterprise Development Facility of the Multilateral Investment Fund.

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