

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**

**DEEPENING OF RURAL MICROCREDIT IN CENTRAL HONDURAS**

**(HO-M1010)**

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## CONTENTS

I.	EXECUTIVE SUMMARY .....	1
II.	BACKGROUND AND RATIONALE .....	2
III.	PROJECT DESCRIPTION .....	5
IV.	ESTIMATED COST AND FINANCING .....	8
V.	INSTITUTION AND EXECUTION MECHANISM.....	9
VI.	MONITORING AND EVALUATION.....	10
VII.	BENEFITS AND RISKS.....	12
VIII.	ENVIRONMENTAL AND SOCIAL CONSIDERATIONS .....	13

## **ANNEXES**

Annex I	Logical framework and project indicator
Annex II	Itemized budget
Annex III	Similar and related project

## **APPENDICES**

Proposed resolution
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## **INFORMATION AVAILABLE IN THE TECHNICAL FILES**

### **Preparation:**

Application from Asociación Familia y Medio Ambiente (FAMA)

Decision from the National Banking and Insurance Commission authorizing FAMA to operate as a private development organization engaged in financial activities (PDOF)

### **Execution:**

Document 1	Procurement plan
Document 2	Financial statements 2003-2005
Document 3	Terms of reference for consulting services

## **ABBREVIATIONS**

CABEI	Central American Bank for Economic Integration
CNBS	Comisión Nacional de Bancos y Seguros [National Banking and Insurance Commission]
EAP	Economically active population
FAMA	Asociación Familia y Medio Ambiente
GDP	Gross domestic product
HDI	Human development index
INE	Instituto Nacional de Estadística [National Statistics Institute]
MFI	Microfinance institution
NGO	Nongovernmental organization
PDOF	Private development organization engaged in financial activities
POD	Private development organization
USAID	United States Agency for International Development
VTI	Vocational Training Institute

## I. EXECUTIVE SUMMARY

<b>Executing agency:</b>	Asociación Familia y Medio Ambiente (FAMA)		
<b>Beneficiaries:</b>	The direct beneficiaries will be approximately 4,000 microenterprises in rural areas of Honduras.		
<b>Financing:</b>	MIF (nonreimbursable):	US\$280,000	64%
	FAMA::	US\$156,000	36%
	Total:	US\$436,000	100%
<b>Objectives:</b>	The project's objective is to improve the coverage of financial services in rural areas of Honduras. The specific objective is to strengthen and support Asociación Familia y Medio Ambiente (FAMA) as a regulated microfinance institution, enabling it to expand into underserved rural areas, develop its product line, and enhance its institutional capacity. The project has two components: (i) design and marketing of new products; and (ii) administrative and operational strengthening.		
<b>Execution timetable:</b>	Execution period:	36 months	
	Disbursement period:	42 months	
<b>Special contractual clauses:</b>	The technical cooperation agreement will state that FAMA has submitted its strategic plan to the Bank's satisfaction.		
<b>Exceptions to Bank policy:</b>	None.		
<b>Environmental and social review:</b>	This document was sent to the Committee on Environment and Social Impact (CESI) for information on 19 May 2006. The project activities will have no direct link to the environment. However, an environmental specialist will be hired with MIF resources to aid FAMA in developing a policy to build such criteria into its operations.		
<b>Coordination with other official development agencies:</b>	Until 2004, FAMA received assistance from the United States Agency for International Development (USAID) to train personnel in microcredit-related topics. In 2005, FAMA received a line of financing from the Central American Bank for Economic Integration (CABEI) to expand its microcredit portfolio. Currently, however, no other donors are working directly with the institution on this specific project.		

## II. BACKGROUND AND RATIONALE

- 2.1 **The microenterprise sector.** There are around one million microenterprises in Honduras, at least 600,000 of them in rural areas. According to a study on the demand for microfinance, fewer than 20% of Honduras's microenterprises have access of any kind to financial services.<sup>1</sup> At present, financial products for microenterprises in Honduras are supplied by different types of institutions, including a commercial bank (BANHCAFE), a specialized financial institution (FINSOL), 127 credit unions, and about 18 microfinance institutions (MFIs), including 15 private development organizations (PDOs) and 3 regulated PDOs engaged in financial activities (PDOFs). These had a portfolio of nearly US\$75 million and served approximately 120,000 clients as of 31 July 2005. The majority of these microfinance institutions concentrate on urban areas, and only a limited group of PDOFs offer services in rural markets. One of them is Asociación Familia y Medio Ambiente (FAMA), a PDOF that has operated in Honduras since 1993 and established itself as a microfinance institution. As of October 2005, it had 8 branches and some 15,000 customers, mainly in rural areas.
- 2.2 **Developments in the regulatory framework.** Congress passed the Law on Regulated Private Development Organizations Engaged in Financial Activities in 2000, enabling social development organizations specializing in finance to become regulated institutions and thus take savings deposits and channel funds from second-tier institutions. The law authorizes institutions with the technical and financial wherewithal to do so, to bring themselves into line with the prudential standards of the National Banking and Insurance Commission (CNBS) and become PDOFs, so that they can take in savings and term deposits from their "registered customers."
- 2.3 FAMA was the third Honduran entity to avail itself of this law, and with the commitment of its founders and management has elected to become a supervised institution. The decision has had financial implications that FAMA has been willing to shoulder, notably: (i) increasing its cash reserves to cover the full amount of depositor savings; (ii) increasing its provision for bad debts to 5.5% of the total portfolio; (iii) bringing its 2006 past-due portfolio estimates within the risk parameters established by the CNBS; and (iv) increasing its investment in the information systems needed for monthly reporting to the CNBS. FAMA was granted authorization to operate as a PDOF under a CNBS administrative decision

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<sup>1</sup> See: Fundación Covelo, Estudio del Mercado Microfinanciero para las Organizaciones Privadas de Desarrollo [Study of the Microfinance Market for Private Development Organizations (PDOs)], October 2003.

dated 3 June 2005.<sup>2</sup> FAMA has also submitted, to the Bank's satisfaction, its updated 2005-2009 strategic plan, approved by the CNBS.

- 2.4 **Microfinance in central Honduras.** FAMA is an MFI whose strategy is to expand financial services to the rural areas of the six departments where it works. FAMA's headquarters is in Juticalpa, Olancho, and it has 8 branches around the country. It has tripled its portfolio in the last three years from 22 million to almost 60 million lempiras, the equivalent of US\$3.3 million. Its customer base nearly doubled in the same period from 8,000 to 14,5000 customers. Over the years FAMA has developed three lending mechanisms: village banking, solidarity groups, and individual loans. In 2005 it experimented with a new product, the farm loan, in response to demand perceived and experienced at its branch offices. Starting at its Patuca branch, FAMA has found strong demand for farm lending, due principally to a lack of products from financial institutions.
- 2.5 According to estimates, there are some 90,000 microenterprises in the departments of Olancho, El Paraíso, Comayagua and Choluteca, only 20% of which have access to financial services. FAMA now has close to 10,000 clients in these departments, and so hopes to expand its services to serve this unmet demand. Informal interviews with suppliers of agricultural inputs and services in the region confirm such demand and say they lack the capacity to make loans to producers; indeed, they need financing themselves. Now that it is a regulated institution, FAMA plans to expand its microlending services to more than 4,000 additional rural microenterprises through its eight branches and open two new branches in the departments of Comayagua and Choluteca.
- 2.6 FAMA is committed to serving the country's most vulnerable groups. More than 70% of its customer base is in rural areas where there are no other regulated financial institutions, and more than 78% of its customers are women. FAMA has had such an impact because of its clear focus on following best practices in rural microfinance, its executives' commitment to making the financial changes necessary to become a regulated institution, and its management's leadership throughout that process. FAMA has reduced its reliance on donors while increasing its rural and farm lending portfolio by securing commercial and foreign loans. Its creditors include several of the country's major commercial banks, as well as regional and foreign financial institutions.
- 2.7 **Specific problems.** In particular, and in light of its transformation into a regulated financial institution (PDOF), the following problems need to be addressed so that FAMA can sustainably and feasibly increase the financial services it provides in Honduras:

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<sup>2</sup> The other two institutions are Organización para el Desarrollo Empresarial Femenino (ODEF) in 2004 and Hermandad de Honduras in 2005.



- (i) **There is no precise information about different niche markets in rural areas, so there are no products designed to meet demand.** The vigorous economic growth experienced in areas where FAMA operates, and the emergence of commercial and banking institutions in rural areas, are driving it to design financial products based on analysis of different rural niche markets in order to serve productive sectors that need these services to build their microenterprises. A detailed study in each of the areas where FAMA has branches would allow current lending products to be adapted or others to be created, expanding coverage and deepening financial services. Financial products currently offered by FAMA, in particular farm credits and remittances, are still in their introductory pilot phase.
- (ii) **Inadequate human resource structure for an effective rural financial institution.** Now that it is a regulated institution (PDOF), FAMA needs to improve its human resources structure by clearly defining the roles 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 FAMA branches are not properly trained to shoulder the responsibilities associated with competitive management of a financial institution; and (ii) turnover rates are affecting the institution's performance. FAMA needs to immediately review its current human resources policy and adjust its key positions and functions so that growth is supported by an effective personnel administration system.
- (iii) **There are weaknesses in the computer systems that are the foundation for rural financial services.** FAMA has attained a good technological level with the introduction of its management information and portfolio oversight system. Yet its dynamic markets, customer demand, and the speed required to process a growing number of operations have put a great deal of pressure on the current systems, to the point where they need to be upgraded and enhanced. At the branches, this will mean decentralizing certain levels of operational capacity and establishing online communication with the central database. It also is important to free up advisors so they may devote more time to loans analysis and portfolio growth, rather than dealing with procedural issues.
- (iv) **There are weaknesses in the corporate and management structure, particularly in financial management.** FAMA is growing, taking on new challenges, and broadening its range of products and their coverage. Both the management team and

executives responsible for FAMA's soundness and growth need better tools for financial management and internal control, so that the institution can enter rural areas on a strong and competitive footing.

- 2.8 **The Bank's country strategy with Honduras.** This project is consistent with the Bank's country strategy with Honduras (document GN-2238-1), which calls for improved financial intermediation of nonbank financial institutions such as FAMA. A study of the microfinance sector, commissioned by the Bank, was done in mid-2004. Given the large number of nonprofit institutions offering microlending services, the study recommended supporting microfinance institutions that have shown a commitment to supervision under the PDOF legal structure (private development organizations engaged in financial activities) with its strict financial transparency criteria.
- 2.9 **Katalysis project ATN/ME-8046-HO.** A Bank project is underway in the country to promote and introduce savings services with a select group of MFIs. FAMA has been actively participating in this project led by the executing agency Katalysis. While FAMA has received no direct financing, it has benefited, along with five other microfinancing institutions, from technical assistance and training equivalent to US\$15,000. These activities have been focused on developing special regulations and procedures to manage savings and to consolidate a savings services platform for microfinance institutions. The proposed project complements the Katalysis project in that it will strengthen FAMA in several other areas so that it can offer savings services more efficiently and competitively.

### III. PROJECT DESCRIPTION

- 3.1 The project's general objective is to improve the coverage of financial services in rural areas of Honduras. The specific objective is to strengthen and support Asociación Familia y Medio Ambiente (FAMA) as a regulated microfinance institution, enabling it to expand into unserved rural areas, develop its product line, and enhance its institutional capacity. The project's two components are described below.
- 3.2 **Component I: Design and marketing of new products for rural areas (Total: US\$126,900. MIF: US\$70,800; FAMA: US\$56,100).** This component seeks to prepare FAMA's operational systems to provide suitable, new financial products in rural areas that meet the needs of its customers. FAMA currently engages in some microlending, but lacks differentiated products that build the features that customers demand into their design. A market and economic feasibility analysis will therefore be done for each project branches, to more precisely identify the features of the products to be developed. Consulting services will be engaged to determine the appropriate tenors, interest rates, disbursement

arrangements, amounts, and repayment periods for each kind of market in the project areas. For branches in remote areas in particular, issues such as payment frequency, financial and nonfinancial service providers, and remittance recipients will be studied so that products can be designed that compliment these regional activities and offer value added for customers.

- 3.3 **Expected outcomes.** FAMA will design products for each of the markets identified<sup>3</sup> in the studies, along with their respective manuals and policies, development and execution plans, and a cost-benefit analysis to evaluate their effectiveness and potential. A process is also planned for training the organization's key personnel on such products. The process of incorporating new products will also entail changes in infrastructure that involve upgraded equipment and information systems, larger customer service teams, better security equipment, and tills for handling cash.
- 3.4 **Component II: Administrative and operational strengthening of FAMA (Total: US\$309,100 MIF: US\$209,200; FAMA: US\$99,900).** This component seeks to build and enhance the institution's capacity to offer financial services in rural areas, through a support strategy that encompasses personnel administration systems, information systems, and financial oversight and leadership systems. This will be accomplished through the activities described below.
- 3.5 **II.A. Improvements in internal control, accounting, and financial capacity.** The increasing complexity of FAMA's financial operations requires more rigorous accounting and administrative management systems. For example, four years ago FAMA managed only one financier with foreign loans and was funded principally using international donor resources. FAMA now has five national and international external creditors with credit lines that have preferential rates and repayment schedules but are more stringent than in previous years. It has also begun taking deposits from existing customers and plans to expand these services. Consequently, its liability structure has become more complex. The project will therefore finance the design and development of manuals on cash management, which will cover term matching and asset and liability management. Technical assistance and specialized consulting services will be engaged in these areas.
- 3.6 **Expected outcomes.** As expected outcomes of this activity: (i) a risk unit will be created within the institution, with internal control regulations and manuals and internal auditing manuals; and (ii) a cash management unit will be set up to improve the institution's cash and liquidity control systems.
- 3.7 **II.B. Development of the human resources unit.** In order to improve FAMA's human resources capacity, as well as its personnel and administrative structure, the

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<sup>3</sup> There are a series of "pre-identified" products, such as supplier credits, agricultural investment loans, revolving agricultural credit, business loans, microenterprise housing loans, and consumer loans.

project will finance training and technical assistance in human resources. Adjustments will be made to the institution's organizational structure based on an analysis and diagnostic assessment of its human resources area, including a review of current policies and procedures, control rules, and personnel identification and selection mechanisms.

- 3.8 **Expected outcomes.** These activities are expected to culminate in: (i) a human resources department, along with improvements to remuneration policies, review of the incentives system, and an analysis of skills and job classifications; and (ii) an inhouse professional training program, including the design of different manuals on personnel administration, wage scales, performance standards, recruitment of new personnel and professional ethical standards, as well as staff training in these areas.
- 3.9 **II.C. Technical and management strengthening of FAMA.** FAMA's loan officers and line staff are quite experienced and have succeeded in garnering national recognition for their institution in the area of rural microfinance. Yet weaknesses remain that it must overcome to better utilize its resources and systems and achieve levels of competitiveness comparable to other microfinance institutions in Central America. Loan advisors still operate at low levels of efficiency, many managing fewer than 200 customers. A series of activities will be conducted under the project to address these needs, including: (i) the possibility of internships for loan advisors and midlevel management personnel to visit other rural microfinance organizations with higher levels of operational efficiency; (ii) training and education of administrative and financial personnel in risk management and expansion of rural microlending; (iii) participation of key midlevel management personnel in regional training sessions and events on rural microfinance.; and (iv) exchange programs for FAMA's executives to become familiar with other rural microfinance organizations with broad coverage.
- 3.10 **Expected outcomes.** As expected outcomes of this activity: (i) loan officers will attain higher levels of efficiency, as measured by the portfolio amount and number of customers managed by each; (ii) the loan portfolio will grow to US\$5.4 million by project year three; and (iii) a customer base of 19,000 active clients will be reached, 70% in rural areas and 75% women.
- 3.11 **II.D. Implementation of improvements in computer systems.** In order to improve FAMA's information systems and processes, the project will devote resources to updating and enhancing the portfolio management and control computer system. Project support in this regard will be earmarked for: (i) purchasing computer terminals so that project branches have modern technology and many of the processes for data entry and tracking, processing of promissory notes, and issuing receipts can be automated; (ii) purchasing licenses for communication software and human resources modules for better personnel administration, individual and branch performance monitoring, as well as current supervision of portfolio performance; (iii) purchasing telecommunications

equipment so that branches with modern technology can operate online and keep computer systems updated; and (iv) computer training so that personnel can assimilate this technology and make optimal use of information.

- 3.12 **Expected outcomes.** As expected outcomes of this activity: (i) FAMA will be able to meet CNBS requirements for monthly portfolio and financial reporting; (ii) FAMA will be able to use current portfolio information more efficiently in decision-making; and (iii) FAMA's 11 rural branches will operate online.

#### IV. ESTIMATED COST AND FINANCING

- 4.1 The total project budget is US\$436,000, with the MIF providing US\$280,000 (63% of the project total) in nonreimbursable financing. These funds will be used chiefly in four areas: (i) hiring technical consulting services for the professionalization and expansion of rural financial services; (ii) purchasing hardware and software to improve the analysis and information systems; (iii) financing training and exchange programs for the organization's managers and executives; and (iv) external audit and evaluation costs. The balance of US\$156,000 will be financed with FAMA's own resources and earmarked for: (i) contributing to consulting costs and training; (ii) contributing to the costs associated with hardware purchases for computer systems; and (iii) financing project coordination and supervision. At least 50% of the counterpart resources will be in cash.

**Table 1. Project budget (US\$)**

	MIF	FAMA	Total	%
<b>Component I: Design and marketing of new products</b>				
I.A Development of new lending products at the branches	70,800	56,100	126,900	29%
<b>Component II: Administrative and operational strengthening of FAMA</b>				
II.A Improvements in financial capacity and internal control	35,000	5,000	40,000	9%
II.B Development of FAMA's human resources unit	29,000	12,5000	41,500	10%
II.C Administrative and management strengthening of FAMA	48,000	12,400	60,400	14%
II.D Improvements in FAMA's computer systems	72,500	40,000	112,500	26%
Project evaluation, audits, and coordination	24,700	30,000	54,700	13%
Total	280,000	156,000	436,000	
Percentage of total	64%	36%	100%	

## V. INSTITUTION AND EXECUTION MECHANISM

- 5.1 **Institutional considerations.** Asociación Familia y Medio Ambiente (FAMA) was founded as a nonprofit private development organization (PDO) in 1993. It initially devoted its efforts to social work and activities with women in rural areas. It began operating exclusively in the Department of Olancho using the village banking methodology. More recently, it has experienced positive growth, making 216,000 loans to almost 52,000 microentrepreneurs in the 2001-2003 period. This has allowed FAMA to satisfactorily compete with organizations specialized in financial services, applying principles of institutional sustainability as a basis for its financial viability. FAMA received financing from the Bank through a line to support microfinance institutions affected by Hurricane Mitch, which it has repaid in a timely manner.
- 5.2 The Honduran Congress enacted Decree-Law 299-2000 in November 2000 to regulate financial activities of PDOs involved in microenterprise finance. This legislation was designed to ensure the regulatory compliance, transparency, and security of these institutions' operations, and enhance their viability and sustainability. In order to comply with this legislation, its implementing regulations, and the guidelines issued by the National Banking and Insurance Commission (CNBS), FAMA organized as a private development organization engaged in financial activities (PDOF) in 2005 under the name, "Asociación Familia y Medio Ambiente FAMA, PDOF," providing financial services to the country's microenterprises and small businesses. On 3 June 2005, FAMA received CNBS authorization to operate as a PDOF. From the time it began operating as a regulated institution in late 2005, and even before then, FAMA has been operating under market financial conditions, setting deposit and lending rates that cover its operating and financing costs. It also made accounting changes to require interest accrual in accordance with CNBS requirements.
- 5.3 **Lending operations.** FAMA lends to microenterprises using several different mechanisms: solidarity groups (accounting for approximately 28% of its portfolio), village banking (33%), and individual loans (39%). After a difficult period in the mid-1990s, when default rates rose and the portfolio experienced no significant growth, FAMA's leadership decided to make changes in the institution's management in order to turn it around and improve its operating levels. Thus, since 2000 FAMA has been in a phase of recovery and operational changes that have enabled it to grow in a sustainable fashion. Between 2002 and 2005 it tripled its portfolio from 22 million to almost 60 million lempiras, the equivalent of nearly US\$3.3 million. Its customer base has nearly doubled in the same period from fewer than 8,000 to around 15,000 customers. At the same time, FAMA has brought its default rates under control; it now has one of the lowest rates in the industry for its type of organization, at 5.7%.

- 5.4 **Financial statements.** As of 31 December 2005, FAMA had assets of approximately US\$3.5 million, with 90% corresponding to its loan portfolio. Total revenue was approximately US\$981,000, mostly from interest on the portfolio (92%), and to a lesser extent from current revenue on services and transactions, grants, and other items. Its equity of approximately US\$800,000 is made up of capital stock (69%) and institutional reserves from retained surpluses (30%). FAMA's leverage ratio has remained stable over the last three years, with a 23% solvency margin, as measured by the percentage of assets covered by equity. FAMA is sufficiently solvent with low levels of indebtedness and a debt-to-equity ratio of 3.3, which is within the acceptable leverage range for a microfinance institution. Its sustainability is also based on the return on its operations, which has been positive and sustained over the last four years. FAMA has an ongoing relationship with its creditors, which include Fundación Covelo, the Central American Bank for Economic Integration (CABEI), and two local banks.
- 5.5 **Responsibilities.** The IDB will enter into an agreement with FAMA to execute the project. FAMA's general manager will be responsible for project coordination with technical and administrative support from the operations manager, who will coordinate and supervise the work of consultants, organize training seminars, coordinate the purchase and installation of software, and the purchase and/or leasing of hardware. They will also use the management information system as a continuous monitoring mechanism to ensure that information sent to the IDB is consistent. Quantitative targets, listed in Annex I, will be used to measure compliance with project objectives.
- 5.6 **Execution and disbursement periods.** The execution period for the project will be 36 months, and the disbursement period 42 months, running from the execution date of the technical cooperation agreement.
- 5.7 **Procurement.** FAMA will comply with all applicable Bank rules, procedures, and policies for the procurement of consulting services and goods with MIF resources,<sup>4</sup> in accordance with the procurement plan and terms of reference in the technical file.

## VI. MONITORING AND EVALUATION

- 6.1 **Monitoring:** FAMA will be responsible for compiling and analyzing relevant information for the ongoing monitoring of project execution and the indicators established in the Logical Framework (Annex I). FAMA will also be required to document progress on specific indicators for the project's rural branches. This

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<sup>4</sup> Policies for the Procurement of Goods and Works Financed by the Inter-American Development Bank (document GN-2349-4), specifically Appendix 4, "Policies for the Procurement by the Private Sector;" and Policies for the Selection and Contracting of Consultants Financed by the Inter-American Development Bank (document GN-2350-6).

system must be used for the semiannual progress reports, as well as the midterm and final evaluation. The Bank's Country Office in Honduras will have basic responsibility for monitoring the project with support from the Micro, Small, and Medium Enterprise Division of the Sustainable Development Department (SDS/MSM) and the MIF in the evaluations, information exchanges, and lessons learned from other, similar projects.

- 6.2 **Reports.** FAMA will submit semiannual progress reports to the Bank during the execution period, within 60 days after the end of each six-month period. At a minimum, such reports will present an account of progress toward the project objectives and will include (i) information on the development and introduction of new financial products at the project branches; (ii) statistical and financial information on movements in FAMA's performance indicators and fulfillment of annual targets for indicators established in the Logical Framework; (iii) information on quality of onsite technical assistance and its outcomes; (iv) information on training of line staff at project branches, including data on the number of employees trained and methodology used; (v) information on progress on measures to improve logistical communications related to services provided at rural branches, including information on the development and implementation of computer systems (hardware and software), and communications between branches and the main office; (vi) information on participation by FAMA's executives, managers, and staff in exchange programs and training courses, including a description of the action taken and a brief evaluation by the participants; (vii) information on progress in implementing the management information system; and (viii) a summary of budget performance and counterpart contributions in cash and in kind.
- 6.3 When reviewing progress reports, the Bank's Country Office will verify that there is no more than 20% negative variation from the proposed project indicators. In such event, the Bank may halt disbursements until the obstacles to meeting the targets have been identified and action taken to address them, to the Bank's satisfaction.
- 6.4 **Evaluations.** With MIF resources, the Bank will commission a midterm evaluation 18 months after the first disbursement that will measure: (i) progress in introducing new financial products at the six project branches; (ii) the impact of more financial services on the microenterprise beneficiaries of the project; (iii) progress on project activities; (iv) difficulties encountered and proposed solutions; and (v) lessons learned and recommendations to improve and replicate the project. The indicators established in the Logical Framework and in the table of project indicators will be used to measure these factors (Annex I).
- 6.5 FAMA will submit a final report (project completion report) to the Bank at the end of the project, within 120 days after the last disbursement, summarizing the main achievements, experiences, and lessons learned from the project's activities.



## VII. BENEFITS AND RISKS

- 7.1 **Benefits.** Strengthening of FAMA as a regulated entity will contribute to the financial system's expansion, reaching at least 4,000 low-income families in rural areas. There are few financial institutions that offer financial services to microentrepreneurs in the areas where FAMA works, so most have to rely on inefficient and costly sources of financing, savings arrangements, and money transfer systems. Providing new financial products to rural microentrepreneurs will increase the well-being of their families, giving them the opportunity to increase their income by financing business and projects with more suitable loans.
- 7.2 **Risks.** The most significant risk to this project's outcomes is that the National Banking and Insurance Commission (CNBS) may fail to tailor its regulatory and supervisory framework to the special features of rural microfinance. The CNBS has little experience in supervising microfinance activities and none at all with institutions devoted to rural microlending on a large scale. This risk will be mitigated by fluid communication between the CNBS and FAMA and other players in the microfinance sector, including the Bank. Such communication is being strengthened under the project, "Specialized Strengthening of the CNBS" (ATN/SF-8344-HO), working with the regulations already issued for the microcredit portfolios of private development organizations (PDOs).
- 7.3 Two additional risks should be mentioned. First, the rapid growth over the last three years, and the growth foreseen in coming years under the project, could put a great deal of pressure on existing human resources and personnel, to the point that some may decide to leave, or simply will not be able to continue operating effectively as they had previously. Pressure on personnel could also weaken risk and internal control systems as the institution grows. This risk will be mitigated by the different technical cooperation activities to improve staff productivity and efficiency by creating monitoring systems and a human resources unit devoted to this kind of task.
- 7.4 There is also a risk with regard to information on the Honduran microfinance market. Without reliable and recent data on the structure of the potential microenterprise market, the projected supply and demand of services under this project plans could be adversely affected. This risk will be mitigated by information from the market study to be done under the project.

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

- 8.1 This document was sent to the Committee on Environment and Social Impact (CESI) for information on 19 May 2006. The new guidelines<sup>5</sup> for microenterprise projects state that projects under the Line of Activity for Strengthening of Financial Institutions for Microenterprise are not required to submit a profile to CESI. The project's activities will have no direct link to microcredit customers or the environment. Nevertheless, FAMA will be provided with information and teaching materials related to environmental conservation and occupational health and safety for microentrepreneurs and its own employees. The project's budget includes funds for an expert to advise FAMA on the best use of these materials and help it develop a joint policy for implementing environmental protection and occupational health standards for its customers and employees.

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<sup>5</sup> Guidelines for Environmental and Social Impact Due Diligence for IDB Microenterprise Operations, SDS/MSM, 2003.

## LOGICAL FRAMEWORK

### *Deepening of Rural Microcredit in Central Honduras – Asociación Familia y Medio Ambiente (FAMA)*

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<b>GOAL</b>			
To contribute to the strengthening and deepening of financial services to microenterprises and small businesses in rural areas of Honduras.	By the end of the 3-year project, the number of people with a FAMA loan has increased from 14,500 to 19,000.	<ol style="list-style-type: none"> <li>1. FAMA reports</li> <li>2. Customer surveys</li> <li>3. Project final evaluation</li> </ol>	<p>Economic and political conditions remain stable.</p> <p>Regulators remain committed to strengthening the microfinance sector.</p> <p>Subsidized lending programs or debt forgiveness do not affect FAMA's rural portfolio.</p>
<b>PURPOSE</b>			
To strengthen and support Asociación Familia y Medio Ambiente (FAMA) as a regulated microfinance institution, enabling it to expand into unserved rural areas, develop its product line, and enhance its institutional capacity.	<p><u>By the end of the 3-year project:</u></p> <ul style="list-style-type: none"> <li>▪ Increase in financial services from 14,500 to 19,000 microenterprises served, with approximately 70% in rural areas and approximately 75% women.</li> <li>▪ Microlending portfolio grows to US\$5.4 million.</li> <li>▪ 11 rural branches operating online in the following departments: Morazán, Yoro, Olanchito, Tocoa, Roatán and La Esperanza.</li> <li>▪ Four new rural lending products implemented at all branches.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Semiannual and final reports of executing agency</li> <li>▪ Midterm and final evaluation by external consultant</li> <li>▪ Project performance monitoring report (PPMR)</li> <li>▪ Project completion report (PCR)</li> </ul>	<p>Government policy does not distort rural financial markets (e.g. through debt forgiveness, subsidies to financial programs).</p> <p>National Banking and Insurance Commission (CNBS) approves rural operations under the terms set by FAMA.</p>

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
COMPONENTS			
<p><b>Component I</b></p> <p>Financial products introduced in the program's rural areas</p>	<p><u>For project year 1:</u></p> <p>At least 1 financial product for rural microenterprises is introduced in at least 2 project branches.</p> <p><u>For project year 2:</u></p> <p>At least 2 financial products for rural microenterprises are introduced in at least 6 branches.</p> <p><u>For project year 3:</u></p> <p>At least 4 financial products are introduced in 11 project branches.</p>	<ul style="list-style-type: none"> <li>▪ Semiannual and final reports of executing agency</li> <li>▪ Midterm and final evaluation by external consultant</li> <li>▪ PPMR</li> <li>▪ PCR</li> </ul>	<p>Demand perceived by FAMA is maintained in project areas and is corroborated by market studies.</p> <p>FAMA has financing or funding sources with suitable features (tenors, payment frequency, rates, etc.) for rural financing.</p>
<p><b>Component II</b></p> <p>Strengthening of FAMA's financial, administrative, and management capacity.</p>	<p><u>By the end of year 1:</u></p> <p>At least 6 branches are online with the head office using the management information system.</p> <p>At least 6 of the branches have an infrastructure suitable for savings services and development of new products.</p> <p>Microlending portfolio grows to at least 3.5 million in the different FAMA methodologies.</p> <p>17,000 customers are served by financial services in rural areas.</p> <p><u>By the end of year 2:</u></p> <p>At least 8 branches are online with the head office using the management information system.</p> <p>At least 8 branches have an infrastructure suitable for savings services and development of new products.</p>	<ul style="list-style-type: none"> <li>▪ Semiannual and final reports of executing agency</li> <li>▪ Midterm and final evaluation by external consultant</li> <li>▪ PPMR</li> <li>▪ PCR</li> <li>▪ Reports generated by FAMA's management information system</li> </ul>	<p>There are information systems that meet the institution's requirements.</p>

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
	<p>Microlending portfolio grows to at least 4.3 million in the different FAMA methodologies.</p> <p>18,000 customers are served by financial services in rural areas.</p> <p>By year 2, FAMA executives present an analysis and interpretation of FAMA's financial statements and their management of the microlending portfolio.</p> <p><u>By the end of year 3:</u></p> <p>At least 11 branches are online with the head office using the management information system.</p> <p>At least 11 branches have an infrastructure suitable for savings services and development of new products.</p> <p>Microlending portfolio grows to at least 5.4 million in the different FAMA methodologies.</p> <p>19,000 customers are served by financial services in rural areas.</p>	<ul style="list-style-type: none"> <li>▪ Minutes of the board of directors meetings</li> <li>▪ Reports generated by FAMA's management information system</li> </ul>	

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
ACTIVITIES			
<b>Component I. Expansion of financial products in the project's rural areas</b>			
Niche market study and design of a marketing strategy for new loan products at rural branches.	<p>2 niche market studies done by 5 branches for the end of <u>year 1</u>.</p> <p>2 niche market studies done by 5 branches for the end of <u>year 2</u>.</p> <p>Marketing strategy developed for new products at rural branches by the end of <u>year 2</u>.</p>	<p>Niche market studies</p> <p>Project reports</p>	
Improvement of branch infrastructure.	At least 3 branches outfitted with basic requirements for financial products at the end of <u>year 1</u> , 6 branches by the end of <u>year 2</u> , and 11 by <u>year 3</u> .	Project reports	
Training for line staff at rural branches.	At least 30 branch employees at the operational level trained in providing financial services to rural microenterprises: <u>10 in year 1</u> , <u>10 in year 2</u> , and <u>10 in year 3</u> .	<p>Semiannual and final reports of executing agency</p> <p>Midterm and final evaluation by external consultant</p> <p>PPMR</p> <p>PCR</p>	<ul style="list-style-type: none"> <li>FAMA succeeds in identifying specialized consultants to provide training services or a specialized firm to organize the training in a practical and as-needed fashion, in keeping with branches' implementation timetable.</li> </ul>
Participation in specialized technical training courses.	At least 6 employees at the technical/managerial level at 6 branches trained in management, technical, and strategic topics related to providing rural financial services: <u>2 employees in year 1</u> , and <u>4 employees in year 2</u> .	Project reports	<ul style="list-style-type: none"> <li>FAMA succeeds in identifying specialized consultants to provide training services or a specialized firm to organize the training in a practical and as-needed fashion, in keeping with branches' implementation timetable.</li> </ul>
Promotion of new products.	Promotional strategy for financial products implemented in rural areas by the end of <u>year 2</u> .	Project reports	

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<b>Component II. A Improvement of financial capacity and internal control</b>		Project reports	
Review and update of internal control and audit manuals.	<p>FAMA's Risk and Cash Management Units established by year 1.</p> <p>Liquidity and cash management manuals developed by year 1.</p> <p>Manuals on assets and liabilities and cash management developed by year 2.</p>	<ul style="list-style-type: none"> <li>Project reports</li> <li>Reports generated by FAMA's management information system</li> </ul>	
<b>Component II.B Strengthening FAMA's human resources management systems.</b>			
Review and updating of human resources manuals and personnel policies.	<p>Human Resources Unit established and operating.</p> <p>Procedures and manuals on hiring and remuneration prepared by year 2.</p>		
<b>Component II.C Technical and management strengthening at FAMA</b>	<p>At least 10 loan advisors have had the opportunity to participate in internships with other specialized microfinance institutions in the region.</p> <p>At least 3 branch directors have participated in internships at specialized microfinance institutions in the region.</p> <p>At least 15 FAMA executives and senior managers have participated in high-level technical events or conferences by year 3.</p> <p>Strategic plan developed and implemented by the end of <u>year 2</u>.</p>	<p>Project reports</p> <p>Reports generated by FAMA's management information system</p>	

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
Participation in strategic planning course.	At least 2 FAMA executives and senior managers have participated in strategic planning courses by <u>year 3</u> .	Project reports	
<b>Component II.D Improvement in FAMA's management information systems</b>			
Purchase of computer equipment and licenses.	Hardware purchased and running, in keeping with software requirements, in at least 3 rural area branches by the end of <u>year 1</u> , in <u>6 branches by the end of year 2</u> , and <u>11 by the end of year 3</u> .	Project reports	FAMA identifies service providers that can deliver computer products that meet the needs of rural financing.
Upgrading of information system.	New computer system purchased and implemented in at least 3 rural area branches by the end of <u>year 1</u> , in <u>6 branches by the end of year 2</u> , and <u>11 by the end of year 3</u> .	Project reports	FAMA identifies service providers that can deliver computer products that meet the needs of rural financing.
Communication system.	At least 4 rural branches communicate online with head office by the end of <u>year 1</u> , in <u>8 branches by the end of year 2</u> , and <u>11 by the end of year 3</u> .	Project reports	There are no changes in the telecommunications infrastructure in Honduras allowing online information transmission in rural areas.



**Annex II**  
**Strengthening of the Microfinance Institution FAMA (HO-M1010)**

<b>Project Budget</b>							
	<b>Units</b>	<b>Number</b>	<b>Unit Price</b>	<b>MIF</b>	<b>FAMA</b>	<b>TOTAL</b>	<b>%</b>
<b>Component I: Design and Marketing of New Products</b>							
<b>I.A Development of New Lending Products at Branches</b>				<b>70,800</b>	<b>56,100</b>	<b>126,900</b>	<b>29%</b>
Market study for each branch	Months	3	5,000	15,000	-	15,000	
Consulting services for designing new loan products - 4 products	Product	4	3,000	12,000	-	12,000	
Training for the introduction of new products	Events	5	1,200	6,000	-	6,000	
Implementation of a promotional strategy for new products	Product	4	3,000	12,000		12,000	
Preparation of teaching materials for training in new products	Product	54	200	10,800		10,800	
Customer service improvements and equipment for new branches	Equipment	9	3,600		32,000	32,000	
Security equipment for customer service	Equipment	9	2,200	15,000	4,600	19,600	
Equipment for cashiers	Equipment	9	1,160		10,500	10,500	
General equipment for lobby	Equipment	9	1,000		9,000	9,000	
<b>Component II: Administrative and Operational Strengthening of FAMA</b>							
<b>II.A Improvements in Financial Capacity and Internal Control</b>				<b>35,000</b>	<b>5,000</b>	<b>40,000</b>	<b>9%</b>
Consulting services for review and update of internal control manuals	Months	2	4,000	7,000	1,000	8,000	
Preparation of inhouse work procedures	Months	2	4,000	7,000	1,000	8,000	
<b>Development of Risk Unit</b>							
Consulting services for development and implementation of manuals and regulations	Months	3	4,000	10,500	1,500	12,000	
<b>Development of Cash Management Unit</b>							
Consulting services for development and implementation of manuals and regulations	Months	3	4,000	10,500	1,500	12,000	
<b>II.B Development of FAMA's Human Resources Unit</b>				<b>29,000</b>	<b>12,500</b>	<b>41,500</b>	<b>10%</b>
Review of HR manuals and procedures	Months	5	2,500	8,000	4,500	12,500	
Establishment of HR Unit	Months	1	2,500	1,500	1,000	2,500	
Training and dissemination of HR policies	Months	1	2,500	1,500	1,000	2,500	
HR-related training and courses for FAMA's midlevel management personnel	Branches	6	4,000	18,000	6,000	24,000	
<b>II.C Administrative and Management Strengthening of FAMA</b>				<b>48,000</b>	<b>12,400</b>	<b>60,400</b>	<b>14%</b>
Internships for loan advisors on microlending methods and products	Advisors	8	2,000	12,000	4,000	16,000	
Internships for executives on lending and administrative processes and systems	Heads	3	3,300	8,000	1,900	9,900	
Training and education for administrative and accounting personnel	Event	3	1,000	2,000	1,000	3,000	
Participation in finance and microlending summits and events	Event	2	5,000	8,000	2,000	10,000	
Training and courses for FAMA executives	Event	4	2,000	6,000	2,000	8,000	
Exchange programs for members of FAMA's board of directors	Event	2	3,750	6,000	1,500	7,500	
Development of strategic plan for CNBS	Event	2	3,000	6,000		6,000	
<b>II.D Improvements in FAMA's Computer Systems</b>				<b>72,500</b>	<b>40,000</b>	<b>112,500</b>	<b>26%</b>
Hardware for project branches (servers, printers, cash registers)		9	2,600	23,000	40,000	62,852	
Software and licenses		1	8,000	8,000		8,000	
Telecommunications equipment		9	2,000	18,000		18,000	
Consulting services for upgrading branch management information system	Months	2	2,500	5,000		5,000	
Training in computers	Months	3	2,500	7,500		7,500	
Consulting services to develop manual on computer processes and monitoring	Months	2	2,500	5,000		5,000	
Internships on information systems	Event	2	3,000	6,000		6,000	
<b>Evaluation, Audits and Project Coordination</b>				<b>24,700</b>	<b>30,000</b>	<b>54,700</b>	<b>13%</b>
Project coordination (one-fourth time of operations manager and assistant)	Months	36	1,000	6,000	30,000	36,000	
Midterm evaluation	Consultant	1	10,000	10,000		10,000	
External audits	Consultant	1		3,000		3,000	
Environmental consulting services	Consultant	1		4,000		4,000	
Contingencies				1,700		1,700	
<b>TOTAL</b>				<b>280,000</b>	<b>156,000</b>	<b>436,000</b>	
<b>Percentage of Total</b>				<b>64%</b>	<b>36%</b>	<b>100%</b>	

**MIF Projects in Honduras**  
**DEEPENING OF RURAL MICROCREDIT IN CENTRAL HONDURAS**  
**(HO-M1010)**

**A. Similar or related MIF projects**

<b>Project number and date of approval</b>	<b>Project title, sector, executing agency, and amount</b>	<b>Date of signature and disbursement period, in months</b>	<b>Amount disbursed</b>	<b>Comments</b>
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 outcomes.
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 outcomes.
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, but somewhat slow because PDOFs had to obtain authorization form CNBS. Nevertheless, 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	US\$26,000 10%	The project is proceeding on schedule.
ATN/ME-9385-HO	Strengthening the Microfinance Institution Hermandad de Honduras US\$294,000	September 2005 42 months	US\$29,000 10%	The project is proceeding on schedule.

**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-\_\_\_/06

Honduras. Nonreimbursable Technical Cooperation ATN/ME-\_\_\_\_\_-HO for  
Deepening Rural Microcredit in the Central Region of Honduras

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 Asociación Familia y Medio Ambiente, OPDF (FAMA 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 deepening rural microcredit in the central region of Honduras .

2. That up to the amount of US\$280,000, or its equivalent in other convertible currencies, shall be authorized for the purpose of this resolution, chargeable to the technical cooperation resources of the 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 \_\_\_\_\_ 2006)

LEG/OPR/RG2/IDBDOCS#756738  
HO-M1010