

MEXICO

PROPOSAL FOR FINANCING AND TECHNICAL-COOPERATION FUNDING FOR EXPANDING AND DIVERSIFYING MICROCREDIT AND SAVINGS

(SP/TC-99-11-18-4-ME)

EXECUTIVE SUMMARY

Borrower: Desarrolladora de Emprendedores, A.C. (DEAC)

Co-executing agency: Centro de Apoyo al Microempresario, IAP (CAME)

Amount and source:	US\$	EUROS*
IDB:		
Financing:	400,000	458,292
Technical-cooperation:	180,000	206,231
Local counterpart:	<u>210,000</u>	<u>240,603</u>
Total:	790,000	905,126

The funding will be drawn on the European Economic Community Special Fund for the Financing of Microenterprise. The IDB funding will be committed in EUROS, and disbursed in local currency.

* Exchange rate: US\$1.00 = EUROS 1.15

Financial terms and conditions:	Amortization period:	10 years
	Grace period:	2 years
	Interest rate:	3% in local currency

The interest rate charged will include a percentage for maintenance of value, to be computed on the basis of the annualized change in the consumer price index for the most recent six-month period, released by the Central Bank or some other official source. The grace period will apply to amortization of principal only, not to interest.

Terms:	Execution:	3 years
	Disbursement period:	42 months

Objectives: The objective of the program is to consolidate and spur the development of family microenterprises by expanding and diversifying financial services (credit and savings) to low-income communities on the outskirts of Mexico City (Chalco, Valle de Chalco, and Ixtapaluca).

The specific objectives are: (i) to broaden access to credit and savings for microentrepreneurs in the above-mentioned communities, and (ii) to strengthen the executing agencies' technical and operating capacity to boost and diversify the savings and lending facilities they offer to microentrepreneurs. Also, this operation will help consolidate Desarrolladora de Emprendedores, Asociación Civil (DEAC), a new microfinance institution that is seeking to convert to a regulated institution that can take deposits from the public and act as an intermediary in onlending more resources to the microenterprise sector.

Description: The operation will be carried out by DEAC, which will sign a financing and technical-cooperation agreement with the Bank. DEAC will in turn enter into a subordinated agreement with Centro de Apoyo al Microempresario (CAME) to administer the resources and carry out the credit component activities under a funds transfer agreement. In the last two years, these two institutions, which have the same management, have been working closely together on joint microfinancing initiatives.

DEAC was established as a civil association (CA) for the express purpose of facilitating capitalization arrangements and of enabling it to participate in the eventual creation of a regulated financial entity.¹ Since its inception in 1993, CAME has developed a successful methodology tailored to the needs of its customers, and acquired the experience to perform its tasks efficiently. It has managed to generate a high degree of trust in the target population, creating a meaningful institutional presence in the area. CAME has a trained staff that has been honing its skills within the institution and is extremely familiar with the working conditions. Consequently, CAME is the institution that will be providing the lending, administration, and collection services proposed for the project.

¹ As a civil association, DEAC has greater legal capacity to raise financing, since it is able to avoid the constraints imposed by the present legal framework on Private Assistance Institutions, particularly with respect to potential investment of its resources in institutions other than the latter. Since the institution eventually intends to convert to a regulated financial institution in the formal sector, the designation CA is the option offering more alternatives for the future.

The following steps will be taken to protect Bank resources channeled through DEAC: (i) DEAC and CAME will enter into a funds administration agreement, approved by the Bank, setting out clearly the rights, responsibilities, and obligations of each party; (ii) the latter agreement will include the necessary incentives to protect loan resources and maintain a high quality portfolio through a fee to CAME for the services rendered based on portfolio quality and recoveries; (iii) promissory notes from customers for loans will be made out to DEAC, and principal and interest will be repaid to the account of DEAC; (iv) DEAC will use recoveries to pay principal and interest on the loan to the Bank and a fee to CAME for the services rendered; and (v) the difference between resources generated by operations and payments to the Bank and CAME will be used to capitalize DEAC for its eventual conversion to a regulated microfinance institution. In this way, DEAC would generate sufficient cash flow to cover its obligations with the Bank and to be capitalized.

The project has a financing and a technical-cooperation component. DEAC will use the proceeds of the **financing component** to expand and diversify its lines of credit and encourage savings in two new areas of work, thus providing benefits to as many microentrepreneurs as possible through more and better quality services. Also, the funding will augment the portfolio of loans to income generating groups (IGGs). DEAC will onlend Bank funds to new IGGs to supplement each group's internal savings. The loans to each group will be distributed as subloans to each group member to finance working capital for productive, viable activities proposed for consideration and approval by the group and the lending institution's loan committee.

These resources will also make it possible to introduce a new credit product (loans to financial accumulation groups (FAG)), which will be designed, tested, and put in place in the form of technical-funding support. Based on the results of the new product, DEAC will onlend Bank resources to new FAGs using a mechanism that is similar to the one used for the IGGs. Overall, approximately 7,000 additional customers are expected to receive credit while the project is under way.

The **technical-cooperation component** is designed to help strengthen DEAC and CAME in certain areas, that include (i) expanding their financial capacity to offer the lending and savings services demanded by microentrepreneurs in the project area, and (ii) improving their technical and operating capacity. Thus their capacity to ensure the sustainability of the activities undertaken will be strengthened by the end of the program.

To achieve these objectives, DEAC will use the technical-cooperation funding to finance the following activities: (i) to hire technical consultants to design and test a new credit product (GAF), examine the feasibility of developing an individual credit product, and improve products to attract deposits; (ii) to hire technical consultants to identify the two new work areas envisaged and lay the groundwork for opening branches and attracting savings; (iii) to offer training courses in the new products developed for CAME's technical and management staff, and courses in administration of the methodology and the new products for those in charge of the IGGs and FAGs; and (iv) to streamline the management and accounting information system through technical assistance and new hardware and software.

**Environmental
and social
review:**

The Committee on Environment and Social Impact reviewed the profile for this operation at its 10 March 2000 meeting. CESI's recommendations were incorporated into the design of the plan of operations.

Beneficiaries:

Over three years, the proposed project will benefit approximately 7,000 microentrepreneurs and their families in and around the Chalco area. The average family has 5 to 7 members, which means that more than 30,000 people will benefit from the project. Over 85% of customers are expected to be women entrepreneurs.

Risks:

The main risk associated with the operation is the financial and institutional standing of the DEAC, which has limited experience and resources because it is a new entity without a long track record in microcredit programs management, despite its plans to convert eventually to a regulated financial institution. This risk hinges on DEAC's capacity to generate enough operating income to meet its financial commitments with the Bank, and maintain a program that addresses the needs of the microfinance sector and ensures that DEAC is properly capitalized. However, the Bank should accept this risk since, in the medium and long term, strengthening DEAC would help ensure more transparent and secure administration of resources and make it possible to allocate more resources to microenterprise as it attracts more deposits from the public. This risk will be mitigated through (i) the use of CAME's sound, reliable, and proven services to grant the target group credit and recover the loans under a credit administration agreement with incentives for maintaining a high quality portfolio; (ii) the financial conditions proposed for the loans (terms, interest, internal controls) and the anticipated volume of loans that will provide enough cash flow to repay the loan to the Bank, cover all financial and operating expenses, and capitalize DEAC; and (iii) improved lending products, credit technology, and institutional efficiency through activities supported with the technical-cooperation

funding, which will help guarantee financial and institutional sustainability.

**The Bank's
strategy and
project
rationale:**

This project is more than a response to the special emphasis placed on developing microenterprise and small business as major sources of employment, as described in the Bank's strategy for Mexico (GN-2405 of 17 May 1999). It also represents a contribution to the mission expressed in the strategy for microenterprise development by affording disadvantaged and low-income microentrepreneurs access to financial services, and by promoting the development of sound, sustainable institutions offering high-quality services.

**Special
contractual
clauses:**

As a condition precedent to the first disbursement, DEAC shall submit to the Bank's satisfaction (i) an initial report on the updated situation of DEAC and CAME, that includes the financial statements, portfolio information, and agreed performance indicators; (ii) the letters of intent from the principal donors that are to provide reimbursable and nonreimbursable funding for the project activities planned; and (iii) the agreement entered into with CAME for administration of Bank resources for onlending, setting out the rights, incentives, and obligations with respect to lending activities.

During project execution, DEAC will comply with the agreed performance indicators and, in its annual reports, to the Bank will indicate the extent to which its targets have been met. If any negative deviations of more than 20% are noted in more than three indicators, including operating efficiency in particular, the Bank will be entitled to suspend all further disbursements until such time as DEAC has demonstrated that it has taken the necessary steps to rectify the situation.

To ensure that Bank resources are applied directly to new loans, DEAC will submit to the Bank quarterly portfolio reports to confirm that the net portfolio has grown in an amount equivalent to, or greater than, the Bank's disbursements for the credit component. Should the net portfolio show a decline, the Bank will be entitled to suspend all further disbursements until such time as DEAC has demonstrated that it has taken the necessary steps to correct the situation.

To ensure that the financing and technical-cooperation components keep pace with one another, (i) not more than 40% of the technical-cooperation funding will be disbursed until DEAC has begun the financing component; and (ii) once 50% of the financing has been disbursed, the remainder will not be released until DEAC demonstrates, to the Bank's satisfaction, that it has hired consultants to design the new GAF product, identify new work areas, and upgrade

the information system.

As conditions precedent to the first disbursement of the technical-cooperation funding, DEAC shall submit, to the Bank's satisfaction, (i) the terms of reference for the consultants to be hired out of the technical-cooperation funding, and (ii) a timetable outlining in detail the activities for year one of the project.

Liquidity will be needed to ensure fast and timely lending and to expedite the technical assistance. Accordingly, it is recommended that the Bank set up a revolving fund in an amount equivalent to 30% of the aggregate funding for the two components.

To ensure proper execution of the program, the Bank will use nonreimbursable technical-cooperation funding to perform a midterm evaluation of the program. To this end, it will engage the necessary consultants for the evaluation, which will be performed in month 18 of the project or when 50% of the funding has been disbursed, whichever comes first. Also, the Bank will use the technical-cooperation funding to hire consultants to carry out a final project evaluation that will examine the extent to which project objectives have been accomplished in terms of the customers and the executing agencies.

**Exceptions to
Bank policy:**

None.