MULTILATERAL INVESTMENT FUND
PROJECT ABSTRACT
Regional
TC Number RG-M1027

I. BASIC PROJECT DATA

- Country/Region: Regional
- Program Name/Number: Expanding outreach of financial services to micro and small enterprises through the generation of new products and access to capital markets (TC Number RG-M1027)
- Team: Tomas Miller (MIF) project leader; Edgar Rivera (MIF); Susana Garcia-Robles (MIF); Carla Bueso (MIF); Lissette Barbero (MIF); Calos Novoa COF, Colombia; Fernando Catalano COF, Bolivia; Gerardo Martinez-Freyssinier COF, Brazil; Armando Chamorro, COF República Dominicana.
- Date of Request: April, 2004
- Beneficiaries: approx. 22,164 microenterprises and small businesses which are clients of eight selected microfinance institutions (MFIs). Low income women clientele are expected to have a relevant participation within this project
- Executing Agencies:
  In USA the executing agency for part of the technical cooperation exclusively is Stichting To Promote Women's World Banking (WWB-Stichting).
  The following local executing agencies will manage the credit lines and the technical cooperation received:
  Dominican Republic: Banco Adopem.
  Colombia: Fundación Mundial Banco de la Mujer Cali; Fundación Mundo Mujer de Popayán; Fundación Mundial de la Mujer de Bucaramanga; Corporación Mundial de la Mujer, Popayán; Fundación Mundial de la Mujer de Bogota; and Corporación Mundial de la Mujer de Medellín.
  Bolivia: Fundación Boliviana para el Desarrollo de la Mujer (Funbodem); in Santa Cruz, Bolivia
  Brazil: Banco da Familia, in Lages, Santa Catarina.

- Financing Plan:
  (i) Revolving Line of Credit
  MIF * (IIIB): US$ 8,000,000
  Local **: US$ 16,000,000
  Total: US$ 24,000,000

* Allocated among the 8 microfinance institutions mentioned above (see table 1) ** This is the expected increase in liabilities that will be generated as a result of implementing this project.

- Technical Cooperation
  (ii) At the MFI level
  MIF (IIIA): US $ 600,000
  MFIs *: US $ 600,000
  Total US $ 1,200,000

*Allocated among 8 microfinance institutions mentioned above (see table 1)

(iii) For global activities with regional impact

MIF (IIIA)	US $ 952,500
WWB-Stichting-USA	US $ 1,667,640
Total	US $ 2,620,140

Tentative Dates: EVP: October 2004

II. BACKGROUND AND PROBLEM STATEMENT

A. Background

2.1 Latin America continues to be the region of emerging markets with the largest number of self-sufficient and profitable MFIs.[1] These institutions provide a variety of financial services to the microenterprise sector. Because of the large unattended demand for these services and the limited supply available, the annual growth rate of well-run microfinance institutions is much higher than their capacity to attract local funding. According to the figures of MIF's portfolio with microfinance institutions, and the data provided by the institutions rated by Microrate, the annual growth of the average microfinance portfolio was around 40% in 2003.

2.2 MIF's strategy has been to engage in business relationships with select high performancing microfinance institutions that can provide a demonstration effect on the market. The rationale for MIF's interventions is to help these institutions leverage funds so that they can recycle capital from savers to borrowers (microenterprises). In order to achieve this goal, MIF has used a variety of financial instruments: direct equity participation, subordinated loans, credit lines, term loans, and the purchase of bonds. In the implementation of this strategy. MIF has either acted directly or through several investment funds, such as Profund, Gateway-MIF Trust Fund, Lacif, Accion Investments in Microfinance, Solidus and ELF. In designing these instruments, care has been taken to avoid crowding out local financial sources and private financiers. Therefore, the pricing and other conditions of MIF's instruments are made under market conditions.

B. The Problem

2.3 Although it is widely recognized that financial services to small economic units can be delivered on a profitable and efficient basis, the lack of access to financial services, and credit in particular, continues to be the most important obstacle to the development and growth of micro and small business in Latin America. Several internal and external restrictions still persist and slow down the emergence of more MFIs.

2.04 Among the prevailing external limitations, the following can be mentioned:

[1] According to the Microbanking Bulletin, as of July 2003, there are 43 operationally sustainable MFIs in Latin America. In 1997 there were only 12 that were operationally sustainable.

- Inappropriate regulatory frameworks, such as: high levels of minimum capital requirements; lack of recognition of microcredit as a financial service differentiated from consumer lending; corporate loans or retail lending; inadequate provisioning policies; penalizing the fact that the collaterals owned by microenterprises cannot be legally registered. Other restrictions are price controls and high compliance costs.

- In order to secure a steady and permanent flow of funding MFIs should be able to link their operations to the local financial markets. Hard currency loans can not substitute for local funding, which is the ultimate source of long-term growth for MFIs. Since microenterprises demand loans in local currency, mechanisms for foreign exchange risk hedging, and the development of local currency instruments are clearly needed.

- Lack of knowledge of the required financial technologies. The risk assessment of a micro-loan is very different than the evaluation for a consumer loan or a corporate loan. The production function of micro credit is different than the production functions of financial products offered by traditional commercial banks. This lack of knowledge varies within the region. Certain countries have advanced their enabling environment and housed successful MFIs. In other countries, the microfinance industry is still at an incipient stage.

- Although in the last years several promising examples have come out of private commercial banks incorporating microfinance as part of their portfolio of services, microfinance as a whole has not fully caught the attention of mainstream Latin American banks, despite the extraordinary results of MFI's in terms of growth, profitability, quality of assets, and impact.

- Difficult macroeconomic environments. The size of the informal sector determines the demand for microfinance services. The higher the unemployment rate and the poverty levels are, the larger the demand for microfinance is. It has been difficult to attract private investors under these socio economic conditions, because microfinance institutions are still perceived as risky ventures.

2.05 Among the internal factors that limit the growth of a number of microfinance institutions are:

- Lack of sufficient qualified technical partners or consultants able to effectively train credit officers. The growth in the sector globally does put pressure on the stable supply of experienced consultants.

- Inability to attract private funding. This restriction is more severe for small, new, and unknown microfinance institutions. Those few MFIs that have reached a critical size and have been subject to evaluations by international financiers and

multilateral entities are now receiving extensive amounts of funding from several socially responsible investors.

- Lack of good governance. Good governance aims at creating structures that maximize shareholder value. In the case of microfinance institutions, shareholders are not only looking for the generation of profit but also for outreach, quality and quantity of services to the clientele, transparency in reporting of decision making, and other measures of social return.

Program Rationale and Additionality

2.06 This project has several innovative and catalytic features. The project will:

-) *Mobilizing capital for microfinance.* In addition to the US $ 8,000,000 in loans to fund eight Latin American MFIs institutions, MIF will also provide support to develop local currency instruments and foreign exchange risk coverage. Through this transactions it is expected that these institutions will be able to leverage resources with local banks and in the domestic capital markets.

-) *Demonstration effect in Brazil.* The local microfinance industry is currently weak and underdeveloped. By supporting the expansion of Banco da Familia, which is a small Brazilian MFI positioned among the top five microfinance institutions in Brazil, MIF will be able to show which are the best practices that allow for a profitable and sustainable growth of a MFI. Several researchers have pointed out that the lack of a demonstration effect hinders the industry, as Brazilian MFIs have not had examples of unqualified success from which they can be inspired. This will be the first time that a Brazilian microfinance institution will receive direct funding from the MIF.

-) *Provision of benchmarks, supervision, and evaluation*. Working with a group of similar institutions will reduce supervision and due diligence costs, while improving monitoring, and project implementation. It will allow for comparisons between microfinance institutions that operate in countries with immature microfinance markets, and those that operate in mature microfinance markets. By working with a group of MFIs, some of which have a proven track-record and pose less risk compared to others which are smaller and have not yet reached maturity, MIF is in a position to diversify risk, and allocate proportionately more resources to the smaller institutions.

-) *A demonstration effect* for policy reform and mobilization of banks into the microfinance sector. Participating MFI's will serve as show-cases, demonstrating how policy changes can eliminate bottlenecks and restrictions that slow down growth.

III. PROGRAM OBJECTIVES AND DESCRIPTION

Objectives

(i) At the microfinance institutional level (micro) the objective of this project is to support the expansion of the supply of financial services available to micro and small enterprises in Latin America.

(ii) At the aggregate level (macro) the objective of the project is to help shape the financial systems and foster policy reforms so that regulatory, legal and institutional structures are more conducive to building a sound microfinance industry.

Description

At the microfinance institution level.

The eight microfinance institutions will received and accumulated line of credit of US $ 8 million. Individual exposure and the conditions of each loan has been determined based on the financial and institutional characteristics of each organization. MIF's resources will be on-lent by the microfinance institutions to microenterprises with an average loan size of around US $ 400. Given the low leverage ration of these MFIs, it is expected that for every 1 US $ provided by MIF as debt, the institutions will be able to mobilize US $2 from the local financial markets.

The credit lines will be structured in such a way that the periodic supervision and performance monitoring will determine the renewal and/or the anticipated prepayment of the loans. The line of credit will be available to the institutions as long as they maintain the pre-agreed quality of assets, profitability, solvency ratios, and outreach (developmental) indicators. The project is self-sustainable inasmuch as it will charge market interest rates, it will also strengthen the institutions and it will improve the enabling environment of microfinance. The interest rate generated by these credit lines throughout the life of the project is estimated at US $ 2,060,000, this amount is larger than the total non reimbursable technical assistance that MIF will provide to the 9 executing agencies (US$1,552,500)

3.03 For the case of MFIs that exhibit a stronger financial position, this is the case of Banco Adopem in Dominican Republic and the Colombian MFIs, the loans under the credit lines will have a maturity of 3 years renewable once for three more years. The smaller and less develop MFIs (Funbodem in Bolivia and Banco da Familia in Brazil) are eligible for loans with a maturity of up to two years, renewable once for two more years. In both cases renewals are conditioned to satisfactory performance in terms of financial and developmental (social) impact. These facilities will be priced at market terms with the maturity of the draw-downs matching the tenor of the microcredits, typically two years. Interest rates will be set at a minimum of Libor + 4,5 %, (except for Banco da Familia which will be charged L + 3%). MIF is lending in US $ terms and is not taking the foreign exchange risk.

Discussions have been conducted with major private Latin American banks in order to leverage and secure local funding to the selected MFIs. Furthermore, it is expected that these linkages, in addition to the policy dialogue and workshops planned under this project between banks and MFIs, will result in the incorporation of microfinance into the local financial systems and in the expansion of the financial frontier.

In addition to the credit lines, which are priced at market interest rates, the participating microfinance institutions will receive US $ 600,000 in technical assistance distributed as shown in table 1. This amount of technical assistance was determined by reviewing the strategic plans for the next three years of each participating microfinance institution. MIF will provide 45% of the required consulting services necessary to implement the activities define in each institution's strategy.

Total technical assistance required by the 8 microfinance institutions to execute their strategic planning over the next three years are US $ 1,342,617 out of which MIF will provide US $ 600,000 and the executing agencies will finance US $ 742,617. The components that will be partially finance with MIF's technical assistance at the MFI's level are: strategic planning, market expansion and training for mid- level management (MIF US $ 59,649, executing agencies US $ 161,226); improving credit technologies, up-dating credit manuals, policies, regulations and procedures, streamline processes and credit analysis (MIF US $ 150,877, executing agencies US $ 146,569); development of new services and products, market research, testing and introduction of new services (MIF US $ 256,140, executing agencies US $ 268,710); other services such as internal control, ABC costing, treasury management, risk management, and consulting services in banking law (US $ 115,789, executing agencies US $ 141,684).

At the global level with regional impact

MIF and WWB-Stichting-USA will finance a regional effort to shape the financial systems and foster policy reform so that the regulatory, legal structures, and institutional change result in a better environment for microfinance. Since these activities go beyond the scope of individual microfinance institutions, the partnership with WWB-Stichting-USA is essential, given the fact that its outreach is regional; and its commitment to this project, its knowledge of the microfinance industry, and experience is beyond question[2].

The total cost of this project is US $ 2,620,140 over a three year period, WWB-NY will contribute US $ 1,667,640 and MIF US $ 952,500. The components that will be financed are the following:

Capacity building and innovations partnerships. (MIF US $ 296,550 - WWB-NY US $ 724,800). Under this component several workshops will be organized on topics such as management development, asset building, savings, housing and formalization.

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[2] The WWB network comprises 26 affiliates reaching out to 650,000 clients and working in 11 Latin American and Caribbean countries, besides Asia, Africa and Eastern Europe.

3.06 Building Financial Systems that work for the majority (MIF US $ 164,900, WWB-NY US $ 293,280). The starting point to improving the access of micro and small economic units to financial services is to recognize that often times, existing public policies prevent financial markets from working efficiently. To that effect, several workshops and seminars will be organized during the next 3 years, in Mexico, Brazil and Colombia. These activities will take place in various countries in which country-level policy changes could: 1) make microfinance more conducive to growth, and 2) make the environment friendly to the establishment of specialized financial intermediaries.

3.07 Mobilizing banks for microfinance (MIF US$151,300 - WWB-NY US$338,000). In order to mobilize mainstream private commercial banks for microfinance, several exchanges will be organized to introduce credit officers and middle management from these banks to the lending technologies applied by microfinance institutions. At the senior management level, WWB will organize several capital market workshops in coordination with the Federación Latinoamericana de Bancos (FELABAN) and different Banking Associations of several Latin American countries, that will have the opportunity to learn how to build responsive, efficient and profitable microfinance institutions. It is expected that this market development work will expand the role of domestic and international commercial banks in microfinance.

3.08 Mobilizing capital for microfinance. (MIF US$339,750 - WWB-NY US$311,480) To remain successful, MFIs must increasingly tap into commercial loans from local financial institutions and integrate themselves into the financial sector of their country. Today the bulk of funding provided by international banks is denominated in hard currency, which can represent a high foreign exchange risk. This component of the technical assistance will be directed to design local currency facilities such as bond issues and securitization of microloans. It will also allow to pilot hedging hard currency financing through forwards and swaps.

IV. COST AND FINANCING

4.01 The total cost of the project is US$27,820,140, out of which MIF will provide US$9,552,500. Eighty four percent of MIF's contribution will be provided at commercial terms, the remaining 16% is non-reinbursable.

MIF rotating line of credit	US $ 8,000,000
Counterpart liabilities	US $ 16,000,000
MIF technical assistance	US $ 1,552,500
Counterpart cooperation	US $ 2,267,640
TOTAL	US $ 27,820,140

V. EXECUTING AGENCY AND EXECUTION STRUCTURE

The executing agencies for the technical cooperation are 8 NGOs and 1 bank. Activities that have an external impact and transcend the geographic coverage of individual MIFs, will be executed through WWB-Stichting, which is an NGO registered in Holland that operates out of New York. Activities directed to strengthen the other eight microfinance institutions and increase their lending capacity will be managed by each one of them.

The rotating lines of credit will be provided to the seven NGOs and the one bank, which are involved in lending to the micro and small enterprise sector in Latin American countries.

Table 1

Executing Agencies	Technical Cooperation US $	Rotating line of credit US $
WWB-Stichting-USA	952,500	0
Banco Adopem, Dominican Republic	70,000	1,000,000
Fundacion WWB, Cali, Colombia	57,500	1,700,000
Fundacion Mundial de la Mujer, Popayán, Colombia	57500	1,700,000
Fundacion Mundial de la Mujer, Bucaramanga, Colombia	80,000	820,000
Corporación Mundial de la Mujer, Bogota, Colombia	80,000	820,000
Corporación Mundial de la Mujer, Medellín, Colombia	75,000	820,000
Funbodem, Bolivia	90,000	540,000
Banco de la Familia, Lages, Brasil	90,000	600,000
Total	1,552,500	8,000,000

All of the participating executive agencies have a sound financial situation, relevant experience to carry out this project, committed management, and transparent corporate governance. These will ensure an appropriate fiduciary responsibility for managing the resources entrusted to them. MIF has had business relationships with six of these executing agencies, and the experience has been satisfactory, with the projects being completed as expected.

In 1993 MIF approved the first microfinance transactions. The project consisted of a loan facility (US $ 4 million distributed among the 5 Colombian affiliates of Women's World Banking and technical cooperation of US $ 400,000 – US $ 80,000 for each MFI-). The revenue generated by these loans was US $ 850,000. The project was very successful, the institutions have grown at a very rapid space during the last 10 years as can be seen in the following table.

	Total Portfolio US$ x 000			Number of Clients		
	1993	2003	Growth	1993	2003	Growth
Cali	1,060	37,489	3437%	1,982	70,238	3444%
Popayan	322	18,701	5708%	587	60,140	10145%
Bucaramanga	109	10,236	9291%	176	38,810	21951%
Bogota	319	7,962	2396%	595	22,958	3758%
Medellin	337	6,596	1857%	613	19,796	3129%
TOTAL	4,140	82,987	1905%	5,946	213,945	3498%

VI. MAJOR ISSUES

6.01 With respect to the line of credit for the 8 IMFs: The due diligence is underway and in an advance stage. The team is currently elaborating a detail budget for the technical cooperation component of the project. Executing mechanisms, supervision, disbursing methods, the logical framework and monitoring instruments of the technical cooperation, to be executed by WWW-Stichting, are being designed.

6.02 With respect to the technical assistance two-fold program: Care will be taken to avoid sole sourcing and to ensure that IDB/MIF procurement rules are followed. A member of the DEU will be part of the team to ensure that appropriate indicators will be developed to measure the impact of the technical assistance as well as its supervision.

VII. ACTION PLAN

7.01 The following is a preliminary schedule for the project’s approval process:
Cesi: September 2004
Due Diligence: April-September 2004
Donors Committee: November, 2004