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**HONDURAS**

**SMALL ENTERPRISE DEVELOPMENT FACILITY**

**LINE OF ACTIVITY FOR STRENGTHENING FINANCIAL INSTITUTIONS FOR  
MICROENTERPRISE**

**DEEPENING FINANCIAL SERVICES FOR RURAL  
MICROENTERPRISE IN HONDURAS**

**(HO-M1005)**

**Line of Activity Memorandum**

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## ABBREVIATIONS

CABEI	Central American Bank for Economic Integration
CNBS	National Banking and Insurance Commission
EAP	Economically active population
GDP	Gross domestic product
HDI	Human development index
IDB	Inter-American Development Bank
INE	National Statistics Institute
MFI	Microfinance institution
MIF	Multilateral Investment Fund
NGO	Nongovernmental organization
ODEF	<i>Organización de Desarrollo Empresarial Femenino</i> [Organization for Women's Enterprise Development]
OPDF	<i>Organizaciones Privadas de Desarrollo que se dedican a Actividades Financieras</i> [Private Development Organization's Devoted to Financial Activities]
PDO	<i>Organización Privada para el Desarrollo</i> [Private Development Organization]
USAID	United States Agency for International Development

## DEEPENING FINANCIAL SERVICES FOR RURAL MICROENTERPRISE IN HONDURAS

(HO-M1005)

### I. EXECUTIVE SUMMARY

<b>Executing agency:</b>	Organización de Desarrollo Empresarial Femenino (Organization for Women's Enterprise Development), ODEF	
<b>Beneficiaries:</b>	The direct beneficiaries will be approximately 2,100 microentrepreneurs in rural areas of Honduras.	
<b>Financing:</b>	MIF (nonreimbursable)	US\$260,000 (62%)
	ODEF:	<u>US\$158,000</u> (38%)
	Total:	US\$418,000 (100%)
<b>Objectives:</b>	The general objective of this project is to improve the coverage of financial services in rural areas of Honduras. The specific objective is to strengthen and support ODEF, a microfinance institution, in expanding its rural services with products that are relevant and competitive. The project entails three components: (i) upgrading and managing rural financial products; (ii) improving the delivery of the institution's rural financial services; and (iii) strengthening the corporate culture and governance of ODEF, so that it can become a leader in providing rural financial services in Honduras.	
<b>Execution schedule:</b>	Execution period:	36 months
	Disbursement period:	42 months
<b>Contractual conditions:</b>	As a condition precedent to the first disbursement, ODEF must present, to the Bank's satisfaction, evidence that it has approved a work plan for setting up offices in the project areas, and that it incorporates detailed financial projections for the financial products to be offered at those offices.	
<b>Exceptions to Bank policy:</b>	None	
<b>Social and environmental review:</b>	Project activities will have no direct impact on the environment. Nevertheless, an expert in environment and gender matters will be hired to help ODEF define a policy for incorporating these criteria into its operations.	

**Coordination  
with other  
official  
development  
institutions:**

There are currently no other donors working directly with this institution on this project. However, USAID has provided ODEF, through the contracting firm Carana Corporation, useful support in specific areas of strategic planning.

## II. BACKGROUND AND RATIONALE

- 2.1 **The microenterprise sector.** Honduras has perhaps a million microenterprises, of which at least 600,000 are in rural areas. In addition, there are some 970,000 self-employed workers (382,000 urban and 587,000 rural), a figure that may be considered a rough reflection of the number of informal microenterprises. Another study on the demand for microfinance in Honduras suggests that there are approximately 870,000 micro and small enterprises, 257,000 of which are non-farm businesses. Of this total, fewer than 20% have any form of access to financial services,<sup>1</sup> which are indispensable if these businesses are to operate efficiently and thereby become more competitive.
- 2.2 **The supply of microfinance.** Currently, financial products are being offered for microenterprise in Honduras by several entities: (i) BAHNCAFE, a commercial bank, which offers financial services to Honduran microenterprises and now has some 2,700 urban microenterprise clients served through 14 of its 46 branches, representing a portfolio of US\$1.7 million. It also offers financial services to 2,100 small farmers through five branches in the Department of Olancho; (ii) FINSOL,<sup>2</sup> a finance company active in the microfinance sector, which currently has 15,400 active clients served through a network of 10 urban branches; (iii) the savings and loan cooperatives sector, which consists of 127 entities with a portfolio of approximately US\$195 million and a total of 450,000 members, half of whom are active borrowers. It is estimated that 90% of the members are in urban areas; and (iv) finally, there are currently 37 PDOs (Private Development Organizations) devoted primarily to serving microcredit clients.
- 2.3 At 31 December 2003 the 18 largest microfinance institutions (MFI) in the country, which include PDOs, cooperatives, and the two regulated banks, had a total portfolio of US\$33 million and were serving around 120,000 microenterprises. The most important institutions are the Fundación Microfinanciera Covelo (US\$9.1 million and 16,441 clients) and ODEF (US\$7.3 million and 12,031 clients). Less than 30% of the PDOs' portfolio is concentrated in rural areas and less than 3% is specifically targeted at farm credit.
- 2.4 **The importance of remittances.** Financial remittances to Honduras have become a very important factor for the rural economy. It is estimated that Honduras receives US\$800 million a year in remittances from abroad, making this the largest source of foreign exchange, followed by *maquila* exports. Some 600,000 persons, or 16% of the country's adult population, receive remittances from abroad. Of these, around

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<sup>1</sup> Covelo: Study of the Microfinance Market for Private Development Organizations (PDO), October 2003.

<sup>2</sup> FINSOL is a finance company created in 2001 by FUNADEH, a private development organization (PDO), supported by an MIF line of activity (project ATN/ME-6342-HO).

42% live in rural areas and typically receive amounts of up to US\$150 eight times a year. Fewer than 20% of remittance recipients have a bank account.<sup>3</sup>

- 2.5 **Regulatory moves.** In 2000, Congress enacted a law to regulate Private Development Finance Organizations (OPDFs), creating thereby what is a unique institutional arrangement in Latin America: regulated nonprofit financial institutions with no clear shareholding structure. The law authorizes the establishment of OPDFs that have a minimum equity capital of approximately US\$55,000 and “demonstrated capacity to implement and apply financial techniques in accordance with best practices in the microfinance sector” to engage, among other things, in lending transactions and to accept savings and term deposits from “registered clients”. In January 2005, ODEF was the first entity to receive a license to operate as an OPDF.
- 2.6 **The market for microfinance in the project’s target departments.** According to estimates in a recent study, the number of urban micro and small businesses in the four project departments (i.e. Colón, Intibucá, Islas de la Bahía and Yoro) stands at 28,769.<sup>4</sup> However, the number of rural microenterprises in those departments is estimated at more than 150,000,<sup>5</sup> given the economy’s heavy focus on farming and agroindustry. Yet the supply of financial products for microenterprises is limited by the scarcity of institutions operating in the microfinance sector. The financing that does exist in these areas is limited to medium-sized and large agro-export firms and banana and coffee processors and, despite their substantial economic impact, they have failed to establish financial or business linkages with the microenterprise sector. Although institutions such as BAHNCAFE and FINSOL have a certain presence in microfinance in the target departments, their level of coverage is minimal.
- 2.7 One MFI (microfinance institution) that is now consciously expanding the supply of financial services in the four departments is the Organization for Women’s Enterprise Development (ODEF), an OPDF whose license to operate in this field was only recently granted. Its headquarters is in San Pedro Sula and it has a total of 13 offices and seven service points throughout the country. ODEF has developed products well suited to the rural microenterprise sector, in particular farm credit. As well, the institution is now introducing savings and remittance products at its offices and plans to expand those products to rural areas in the near future. Among

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<sup>3</sup> See “Remittances Recipients in Central America.” Study by Bendixen and Associates. IDB document, September 2003.

<sup>4</sup> See consultant’s report by Miguel Arango Ospino to the IDB (May 2004): Bank Intervention Strategy for Promoting the Microfinance Sector in Honduras.

<sup>5</sup> According to calculations based on data from the 2001 National Population and Housing Census, the four departments contain 25.39% of the country’s rural population. Applying this percentage to the minimum estimate of 600,000 rural microenterprises in the country as a whole yields a minimum figure of 150,000.



the offices earmarked for expansion into rural areas are those in the municipios of Morazán, Yoro, Olanchito, Tocoa, Roatán, and La Esperanza.

2.8 **Specific problems.** In its efforts to expand its financial products into rural areas, ODEF has encountered a series of obstacles that it must overcome to ensure the efficiency and sustainability of its services:

- (i) **There is no accurate information on the various market niches in rural areas.** The strong economic growth in the project zones as well as the appearance of commercial banks in rural areas mean that ODEF must design financial products based on an analysis of the various rural market niches if it is to serve producers who need these services to upgrade their microenterprises. A detailed study of each of these branches would help to adapt current credit products or create new ones so that coverage will be greater and the range of services offered will be broader.
- (ii) **Lack of microfinance technology appropriate to rural areas.** The financial products that ODEF currently offers, particularly its savings and remittance products, are now at the pilot stage in urban areas. However, much work remains to be done to design and develop specialized products for rural areas, where the economic mainstays are farming, tourism, housing, and processing. There is a lack of sound systems for planning and supervising liquidity, security, and transfers, and operating manuals, policies, and procedures need to be adapted. Operating personnel in the rural branches (branch managers, loan officers, tellers etc.) need to be trained for serving rural clients and meeting the special demands of this market. ODEF has estimated that 42% of its clients receive remittances from abroad, and it has launched pilot experiments with remittances in partnership with United States and Nicaraguan firms with a view to serving their rural clients.
- (iii) **There are shortcomings in the logistics and information processing systems that are the foundation of rural financial services.** ODEF is encountering problems in delivering efficient and sustainable financial services at its rural branches. In particular, its computer systems are not up to the demands of expansion. The portfolio management system is excessively dependent on externally supplied maintenance services, which are not always available to make timely improvements or adjustments. ODEF does not have the technology to manage its information centers properly. Its procedures are slow and susceptible to data entry and processing errors. Finally, an essential condition for introducing savings and remittance products in the offices is that they have adequate infrastructure, with suitable computer equipment, safes, storage facilities, and security services, and a reliable real-time system for communications between the branches and head office.

- (iv) **There are weaknesses in the institution's corporate structure and in its strategic leadership.** ODEF is growing, taking on new challenges, and expanding the range of its products and their coverage, even into rural areas with which it is not very familiar. In this respect, members of the management team and the directors who must oversee ODEF's integrity and growth need better tools for financial management and strategic analysis if the organization is to be competitive in rural areas. Moreover, recognizing that the institution is engaged in the process of transformation into a regulated entity, and that it must grow, this group of professionals needs prompt and in-depth training in rural microfinance so it can lead the organization into this new stage of its institutional life.

- 2.9 **Project strategy.** The thrust of this project is to help ODEF expand its financial products to rural areas in the departments of Colón, Intibucá, Islas de la Bahía, and Yoro. To this end, it will finance consulting and training services as well as systems and equipment for upgrading the financial products and the rural branches to meet the needs of expansion, and to reinforce ODEF leadership capacity to make the move to a regulated MFI.
- 2.10 **Bank strategy with the country.** In mid-2004 the Microfinance Strategy for Honduras was launched, headed by the Bank's Micro, Small and Medium Enterprise Division (SDS/MSM) together with the Bank's Country Office in Honduras (COF/CHO). That strategy foresees growing participation by regulated entities taking the legal form of OPDFs in the microfinance sector. The Bank strategy calls for supporting specialized microfinance entities that are ready to organize themselves in this form and to be regulated.
- 2.11 **The Katalysis project (ATN/ME-8046-HO).** The Bank currently has a project under way in the country to promote and implement savings services with a group of selected MFIs. ODEF has played an active role in this project, together with the executing agency, Katalysis. The project is designed to establish a platform of savings services for various microfinance entities that are seeking to become regulated institutions. The results of this project will help ODEF to expand and improve its pilot savings project that was launched in June 2004.

### III. DESCRIPTION OF THE PROJECT

- 3.1 The general objective of the present project is to improve the coverage of financial services in rural areas of Honduras. The specific objective is to strengthen and support ODEF, a microfinance institution, in expanding its rural services and in making its products suitable and competitive. The project entails three components, for: (i) the upgrade and management of rural financial services; (ii) improving the delivery of the institution's rural financial services; and (iii) strengthening the corporate culture and governance of ODEF, so that it can become a leader in

providing rural microfinance services in Honduras. Details of these components are provided below.

3.2 **Component I. Adaptation, expansion and management of financial products in the program's targeted rural areas.** The purpose of this component is to introduce new financial products for rural microenterprise in the six project offices, and to ensure that they are prudently and efficiently managed. In particular, lending, savings, and remittance products will be introduced for microenterprises in the departments of Colón, Intibucá, Islas de la Bahía, and Yoro. This will involve the following activities:

- a. **Rural loans.** A consultant will be hired to conduct a study of market niches, especially in the areas of farming, productive housing, agricultural processing, tourism and education, as well as to design loan products for these target areas. The consulting services will include: (i) a market niche study in the project rural offices, to quantify and qualify demand in these sectors; (ii) the design of suitable credit products for serving those niches; (iii) a cost-benefit analysis of the products designed; and (iv) development of a promotional strategy and instruments for the new product.
- b. **Rural remittances.** Consulting services will be contracted to identify, design and implement remittance products. Those services will include: (i) a study to identify the final recipients of remittances in target rural areas, quantifying and qualifying their characteristics and analyzing their final use; (ii) development of manuals, policies and procedures for remittance products, as well as internal control mechanisms for ODEF adapted to the needs of this project; (iii) identification of the specific information and processes needed to complement the management and portfolio information system that will be implemented; and (iv) promotional instruments and a strategy for the new product.
- c. **Remittance-related products.** Consulting services will be contracted to design at least two remittance products, covering: (i) an evaluation of the demand for and the technical and economic feasibility of relating microentrepreneurs' and rural families' remittance proceeds with other financial products (for example business, housing, savings, consumer loans); (ii) the technical design of viable products in greatest demand, including operating manuals, policies and procedures and control and supervision tools; and (iii) a strategy for introducing these products in the rural offices.
- d. **Training in the new products.** Three seminars will be held to train directors, managers and senior employees of ODEF in the characteristics of loan, savings, and remittance products, the challenges that these products pose, and strategies for dealing with those challenges. This training will also be offered to operating staff in the rural offices.

3.3 **Component II. Improving the delivery of financial services in rural areas.** The purpose of this component is to ready ODEF's operating systems to provide financial services in rural areas efficiently and sustainably. To this end, the technologies needed for efficient operation will be introduced and office equipment will be upgraded to the needs of the new financial products. This component covers the following activities:

- a. **Information technology (IT) applications.** An information control system at rural service points will be instituted using PDAs (palm pilots), including the purchase of PDAs and consulting services to develop applications. Specialists from the IT departments of other Latin American microfinance institutions will be hired to help introduce the PDAs.<sup>6</sup> The new system is expected to improve internal and external procedures for handling rural credit data. This will cut the current level of multiple data entry errors, improve the timing of meetings and reviews with clients, and reduce the time that loan officers must now spend on noncritical administrative processes, which will be automated.
- b. **Computer equipment and security.** The purchase of computer, logistics and security equipment for the six project branches will: (i) support operating procedures with the infrastructure needed to secure the institution's cash and securities and its communication with the head office; (ii) provide the public image and confidence that a branch needs to raise funds from the public through savings and remittances; and (iii) create the physical infrastructure to support the organization's information system.
- c. **Information systems.** A new information system will be purchased and installed to ensure the efficiency and security of operations with the greatest information demands (geographic expansion and introduction of new products), and timely system maintenance services will be provided. As well, leasing costs of equipment and installations for real-time communication between the six branches and head office will be covered for the 36 months of project execution.<sup>7</sup>

3.4 **Component III. Strengthening ODEF's corporate culture and governance.** The purpose of this component is to help the directors and managers of ODEF acquire practical and theoretical knowledge of microfinance strategies and in this way give ODEF the business vision to be a leader in the Honduran microfinance sector. It will finance the following activities:

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<sup>6</sup> ODEF prefers to hire the services of an MFI because it is familiar with experience elsewhere, where the new technology functioned only after the institution had developed specific customized applications (i.e., FinComun de México).

<sup>7</sup> ODEF has done a cost-benefit study of the communications system and has found that leasing communications equipment entails lower costs and less risk of technical obsolescence than purchasing.

- a. Hiring a facilitator for strategic planning within ODEF, in order to update its strategies for geographic expansion and the launching of new financial products, and to ensure that financial, human, and institutional resources are applied in a manner consistent with the strategies.
- b. Two employees will take a strategic planning course that will equip ODEF with know-how about strategic planning tools for formal microfinance institutions.
- c. Exchanges will be arranged for members of the Board of Directors and senior staff with other regulated MFIs in the region, so they can learn from successful experiments with rural-focused transitions similar to that now under way at ODEF.<sup>8</sup>

#### **IV. ESTIMATED COST AND FINANCING**

- 4.1 The total budget for the project is US\$418,000, of which the MIF will finance US\$260,000 (62% of project total) on a nonreimbursable basis. These funds will be used primarily in four areas: (i) hiring of technical consultants to upgrade and expand rural financial services; (ii) purchase of hardware and software for upgrading the information and analysis systems; (iii) training and exchanges for technical and management staff and directors of the organization; and (iv) the cost of an external evaluation and audit. The remaining US\$158,000 will be financed from ODEF's own funds, and will be used for: (i) supplemental consulting and training costs; (ii) supplemental computer hardware purchase costs; and (iii) infrastructure improvements in the branches relating to security and deposit safety. At least 50% of the counterpart contribution will be in cash.

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<sup>8</sup> Exchange visits to other MFIs are part of the ongoing ODEF training process. Each employee who visits another institution or participates in a training course abroad is expected to pass on what he has learned to other employees back home.

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

Project budget			
	<b>MIF</b>	<b>ODEF</b>	<b>TOTAL</b>
<b>Expansion of financial products into target rural areas</b>	<b>140,000</b>	<b>58,000</b>	<b>198,000</b>
Technical assistance	82,000	46,000	128,000
Training	58,000	12,000	70,000
<b>Improving the delivery of financial services in rural areas</b>	<b>63,000</b>	<b>88,000</b>	<b>151,000</b>
Technical assistance	15,000	5,000	20,000
Software and equipment	48,000	33,000	81,000
Upgrading rural office infrastructure	-	50,000	50,000
<b>Strengthening the corporate culture and governance of ODEF</b>	<b>30,000</b>	<b>12,000</b>	<b>42,000</b>
Technical assistance	15,000	3,000	18,000
Training	8,000	2,000	10,000
Exchanges and training assignments	7,000	7,000	14,000
<b>Project evaluation, audit and coordination</b>	<b>27,000</b>	<b>-</b>	<b>27,000</b>
Midterm evaluation	10,000	-	10,000
External audit	5,000	-	5,000
Environmental consulting services	4,000		
Contingencies	8,000	-	8,000
<b>Total</b>	<b>260,000</b>	<b>158,000</b>	<b>418,000</b>

## V. EXECUTION AGENCY AND MECHANISM

5.1 **Institutional aspects.** The Organization for Women's Enterprise Development (ODEF) is a nonprofit MFI established with the mission "to offer financial services in the area of micro and small business, as well as other financial services permitted by law, in order to improve the standard of living of clients".<sup>9</sup> ODEF was founded in 1985, under a USAID project, as a Private Development Organization (PDO)<sup>10</sup> to promote economic development opportunities for low-income women. Since 1992, ODEF has specialized in microfinance services with a focus on self-sufficiency, and it has received assistance through a small Bank project (ATN/NF-4024-HO, 1992). It maintains close relations with Katalysis, a network of Central American MFIs, and with the National Microfinance Network Association in Honduras (*Red Micro*), and has taken the lead in debate over the OPDF law (see 2.3). ODEF was the first MFI to become an OPDF (specialized financial institution), and the National Banking and Insurance Commission (CNBS) granted it an operating license in January 2005. ODEF's business strategy and operating systems are

<sup>9</sup> See ODEF Business Plan 2004.

<sup>10</sup> The legal status of an PDO in Honduras corresponds to that of a nongovernmental organization (NGO) in most other Latin American countries.

designed for operation as an OPDF. The institution currently has 13 branches and seven service points, located primarily in the northwestern portion of the country.

- 5.2 **Lending operations.** ODEF offers credit to microenterprise through the techniques of group credit and community banks (which together represent about 75% of the portfolio) and individual loans secured with collateral, guarantees, or mortgages (25%). ODEF stands apart from other MFIs in its growing involvement in farm credit, using methodologies adapted from urban microcredit. In recent years ODEF has been managing its credit portfolio efficiently. The number of borrowers rose from 8,672 in December 2001 to 12,031 in December 2003, and the loan portfolio increased from US\$4.9 million to US\$7.3 million. Over that same period, the productivity of loan officers has increased from 161 portfolio loans per officer to 246, and operating costs have declined as a percentage of the gross average portfolio from 20.7% to 19.3%. The portfolio more than 30 days in arrears has fluctuated around 7% over the last two years, but it was reduced to 5.4% in August 2004. At the beginning of 2004, ODEF shifted its lending policy, because of the rising average size of loans in recent years and the desire of managers and directors to refocus on the institution's target group. Thus, the maximum loan size was reduced from roughly US\$40,000 to US\$8,340, with some grandfathered exceptions.
- 5.3 **Operations with savings and remittances.** During 2004, ODEF began to equip its branches in the vicinity of San Pedro Sula to capture savings and to operate with remittances. In the San Pedro Sula and Chemelecon (a low-income district of San Pedro Sula) branches a pilot project is now under way to improve operating systems in preparation for further expansion. The short-term goals are to offer its microentrepreneur clients, active or inactive, deposit services (savings accounts and term deposits) and remittance services at lower cost than the competition, in offices equipped to handle cash.
- 5.4 **Financial statements.** At 31 December 2003, ODEF reported assets of US\$7.53 million, of which 95% was represented by the loan portfolio. Liabilities stood at US\$4.54 million, most of which (72%) are lines of credit for financing the portfolio, primarily from the Central American Bank for Economic Integration (CABEI) and the second-tier Covelo Foundation. ODEF's capital, at US\$3 million, consists of donations (61%) and retained surplus reserves (39%). ODEF's leverage has declined in the last three years: the debt-to-equity ratio was 1.8 in 2001 and 1.5 as of December 31, 2003. The return on capital, however, was up from 6.7% in 2001 to 11.7% in 2003.
- 5.5 **SWAT analysis.** The main strengths of ODEF are: (i) its high credibility with the microenterprise sector in its areas of activity, resulting primarily from the constant review of products and procedures based on clients' needs; (ii) its credibility with the private and public sectors of Honduras, as reflected in its access to commercial bank lines of credit and the willingness of the National Banking and Insurance

Commission to grant it an OPDF license; (iii) its experience in undertaking projects with bilateral and multilateral agencies; (iv) the effectiveness of its governance bodies (Board of Directors, Board of Supervisors), whose members are technically proficient and dedicated to the entity; and (v) the effectiveness of its management, which has put together an excellent team of managers, many of whom have been with the institution for a long time. Among the **weaknesses** of ODEF must be noted, above all, its technological shortcomings, in particular its reliance on external services to maintain its computer system, which is consequently not very effective and efficient, and the high cost of communication with rural offices. ODEF's **opportunities** lie in the new legislation that allows it to offer its clients a broader range of financial services, and its positioning in rural financial markets, where few financial services are available. The greatest **risk** to its future growth is the uncertainty posed by the CNBS's lack of experience in supervising OPDFs.

- 5.6 **Responsibilities.** The IDB will sign an agreement with ODEF for execution of this project. ODEF will appoint a part-time financial manager for technical coordination of the project. The financial manager will be responsible for coordinating and supervising the work of the consultants, organizing the training seminars, coordinating the purchase and installation of software and the purchase or lease of hardware, as well as upgrading the rural branches. In addition, the financial manager will be supported by the Management Information System as a mechanism of continuous oversight, to ensure consistency in the information provided to the IDB. Quantitative targets will be used to measure compliance against the project objectives detailed in Annex II.
- 5.7 **Execution and disbursement periods.** The execution period for the project will be 36 months, and the disbursement period will be 42 months.
- 5.8 **Procurement of goods and services.** For the contracting of consulting services and for the purchase of goods financed from the MIF, ODEF will comply with all the standards, procedures, and policies established by the Bank for this purpose. With respect to consulting services and training, these are expected to be provided by individual consultants contracted directly by ODEF. For minor items of goods and equipment procurement, prices quotations will be requested from various suppliers.

## VI. MONITORING AND EVALUATION

- 6.1 **Monitoring.** ODEF will be responsible for compiling and analyzing relevant information for continuous monitoring of project execution and the indicators established in the logical framework (Annex I). ODEF's management information system will generate the necessary institutional data. In addition, ODEF will document changes in the specific indicators for the six rural branches included in the project. ODEF and the IDB will use this monitoring system to supervise and evaluate the project. This system must be used in preparing the semiannual progress



reports as well as the midterm and final evaluations. The IDB Country Office in Honduras will have basic responsibility for monitoring the project, and will be supported by SDS/MSM and MIF in the evaluations and in the exchange of information and lessons learned from other similar projects.

- 6.2 **Reports.** During the execution period, ODEF will submit semiannual progress reports to the IDB within 60 days after the close of each six-month period. At a minimum, those reports will demonstrate the progress achieved in meeting project objectives, and will include: (i) information on the degree of development and introduction of new financial products in the target branches; (ii) statistical and financial information on the evolution of ODEF's performance indicators and a report on the extent to which the annual targets for the indicators established in the logical framework (Annex I) have been achieved; (iii) information on the quality of on-site technical assistance and its results; (iv) information on training for operating personnel in the offices, including data on the number of employees trained and the methodology used; (v) information on the rate of advance of measures to improve the delivery of services in rural branches, including data on the development and introduction of the computer systems (hardware and software), the provision of PDAs to loan officers, the renovation of the offices, and the status of communications between offices and head office; (vi) information on participation by ODEF directors, managers, and employees in training and exchange programs, including a discussion of the activities conducted and a brief evaluation by the participants themselves; and (vii) a summary of budgetary performance and counterpart contributions, in kind and in cash.
- 6.3 **Evaluations.** MIF funds will be used to pay for a midterm evaluation of the project. A midterm evaluation of the project commissioned by the Bank, will be conducted 18 months after the first disbursement, to measure: (i) progress achieved in introducing new financial products at the six branches; (ii) the impact of the expanded offer of financial services on demand, as measured in the market study of microenterprises benefited by the project; (iii) the rate of advance of project activities; (iv) difficulties encountered and solutions proposed; and (v) lessons learned and recommendations for improving the project and replicating it. The evaluation will be based on the indicators in the logical framework (Annex I) and in the table of project indicators (Annex II).
- 6.4 At the conclusion of the project, within 120 days after the last disbursement, ODEF will present a final report to the Bank, summarizing the main achievements, experiences, and lessons learned in relation to the activities sponsored by the project, for purposes of facilitating dissemination of experiences during execution.
- 6.5 COF/CHO has basic responsibility for monitoring project execution on behalf of the Bank, and will be supported by SDS/MSM and the MIF in the evaluations and in the exchange of information and lessons learned from other similar projects. The budget includes funds for a potential midterm evaluation by the Bank, 18 months

after the first disbursement; otherwise, these funds could be used to engage a specialized risk-rating agency.

- 6.6 **Launch workshop.** At the beginning of the project, COF/CHO and ODEF will hold a project launch seminar to review procurement, disbursement, and reporting procedures, as well as ODEF's strategic plan for implementing its savings and remittance services and for expansion into rural areas of the departments served by the project.

## VII. PROJECT BENEFITS AND RISKS

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

- (i) The offer of efficient and sustainable financial products to at least 2,100 low-income rural families. In the project zones there are few financial institutions offering financial services to microentrepreneurs, most of whom must rely on sources of financing, forms of saving, and money transfer systems that are inefficient. Offering efficient financial products (loans, savings, and remittances) to these microentrepreneurs will enhance the welfare of beneficiary families in various ways: it will allow them to increase their incomes by financing businesses and projects with more timely credit or with remittances that do not carry high transaction costs, and it will allow them to save so that unforeseen events (i.e. family illness or losses due to extreme weather conditions) do not trigger a family liquidity crisis.
- (ii) Transforming an MFI into a regulated entity will help expand the frontiers of the financial system. The conversion of ODEF into an OPDF, a regulated nonprofit financial entity, is just the first step in a deeper institutional transformation, since ODEF plans to become a finance company (*sociedad financiera*) over the next three to five years. This would mean that rural microentrepreneurs would become clients of the formal financial system in a country where that system has had very little experience with this sector to date.

- 7.2 **Risks.** The most important risk associated with this project is that the CNBS will not adapt its regulatory and supervisory systems to the characteristics of the rural microfinance business. The Commission has little experience in supervising microfinance activities, and no experience at all with entities that provide large-scale rural microcredit. If the CNBS fails to adapt its regulatory and supervisory parameters appropriately, ODEF could be forced to shift institutional direction in order to meet specific indicators required by the regulator. This risk will be mitigated by maintaining constant communication between ODEF and other microfinance players (including the IDB) and the CNBS, to ensure that regulation

and supervision do not become obstacles to the delivery of financial services to low-income rural people.

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

- 8.1 The new guidelines<sup>11</sup> for microenterprise projects do not require a profile to be presented to the CESI for projects under the line of activity for strengthening financial institutions for microenterprise. Project activities are not directly related to microcredit clients or the environment. Nevertheless, ODEF will be given learning materials and information on environmental conservation and on worker safety and health for microentrepreneurs and ODEF employees. The project budget includes funds for an environmental expert who will guide ODEF in making the best use of these materials and will help it to draw up a joint policy for instilling in its clients and employees a culture of environmental protection and worker health awareness.

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<sup>11</sup> Guidelines for Environmental and Social Impact Due Diligence for IDB Microenterprise Operations, SDS/MSM, 2003.

## LOGICAL FRAMEWORK

### *Deepening Financial Services for Rural Microenterprise in Honduras*

Narrative summary	Indicators	Means of verification	Assumptions
<b>Goal</b>			
To strengthen and deepen financial services for rural micro and small businesses in Honduras.	2 or 3 years after project completion: at least 2,100 families in project areas have access to financial services.	<ol style="list-style-type: none"> <li>1. ODEF reports</li> <li>2. Producer survey</li> <li>3. Final project evaluation</li> </ol>	<p>Stable political and economic situation.</p> <p>Regulatory agents continue to strengthen the microfinance sector.</p> <p>ODEF's rural portfolio is unaffected by subsidized credit programs or debt forgiveness.</p>
<b>Purpose</b>			
To strengthen ODEF's capacity to expand its current coverage for financial services in rural areas, with appropriate and competitive products.	<p><u>After three years of the project:</u></p> <ul style="list-style-type: none"> <li>• the offer of financial services has been increased for at least 2,100 microenterprises.</li> <li>• 6 branches offering rural financial products in Morazán, Yoro, Olanchito, Tocoa, Roatán, and La Esperanza.</li> <li>• number of clients served increases from 12,500 to at least 19,000</li> <li>• two new rural credit products introduced.</li> <li>• remittances service introduced in at least three new branches.</li> <li>• at least two new remittance-related products have been introduced.</li> </ul>	<ul style="list-style-type: none"> <li>➤ Monthly reports of ODEF</li> <li>➤ Semiannual and final reports from the executing agency</li> <li>➤ Midterm and final evaluation by an external consultant</li> <li>➤ Project progress monitoring report</li> <li>➤ Project completion report (PCR)</li> </ul>	<p>Rural financial markets are not distorted by government policy (e.g. through debt forgiveness, subsidized financial programs).</p> <p>CNBS accepts rural operations on the conditions established by ODEF.</p>

Narrative summary	Indicators	Means of verification	Assumptions
<b>Components</b>			
<p><b>Component 1</b></p> <p>Introduce the financial products in rural areas of project.</p>	<p><u>For the first year:</u></p> <p>At least one financial product introduced for rural microenterprise in at least two branches.</p> <p><u>For the project year:</u></p> <p>At least two financial products for rural microenterprise introduced in at least four branches and at least one new financial product in all six branches.</p> <p><u>For the third year:</u></p> <p>At least two financial products introduced in six branches.</p> <p><u>At the end of the second year:</u></p> <ul style="list-style-type: none"> <li>i. rural credit portfolio has grown by US\$400,000;</li> <li>ii. the voluntary deposits portfolio has grown by US\$100,000; and</li> <li>iii. at least 800 remittance transactions have been performed.</li> </ul> <p><u>At the end of the third year:</u></p> <ul style="list-style-type: none"> <li>iv. rural credit portfolio has grown by US\$750,000;</li> <li>v. the voluntary deposits portfolio has grown by US\$150,000; and</li> <li>vi. at least 1,000 remittance transactions have been performed.</li> </ul>	<ul style="list-style-type: none"> <li>➤ Monthly reports of ODEF</li> <li>➤ Semiannual and final reports from the executing agency</li> <li>➤ Midterm and final evaluation by an external consultant</li> <li>➤ Project progress monitoring report</li> <li>➤ Project completion report (PCR)</li> </ul>	<p>The demand identified by ODEF in the project zones is maintained and is confirmed by market studies.</p> <p>ODEF has sources of funding on suitable conditions (term, frequency of payment, interest rate, etc.) for rural financing.</p>

Narrative summary	Indicators	Means of verification	Assumptions
<p><b><u>Component 2</u></b></p> <p>Improved delivery of financial services in rural areas</p>	<p><u>At the end of the first year:</u></p> <p>At least two of the new branches are online with head office using the new management information system.</p> <p>At least two new branches have the infrastructure to provide savings services and expand into new products.</p> <p><u>At the end of the second year:</u></p> <p>At least four of the new branches are online with head office using the new management information system.</p> <p>At least four new branches have the infrastructure to provide savings services and expand into new products.</p> <p>Operating efficiency (operating costs/gross average portfolio) is improved by at least 5%.</p> <p>Productivity (number of clients per loan officer) rises by at least 5%.</p> <p><u>At the end of the third year:</u></p> <p>At least six of the new branches are online with head office using the new management information system.</p> <p>At least six new branches have the infrastructure to provide savings services and expand into new products.</p> <p>Operating efficiency (operating costs/gross average portfolio) is improved by at least 10%</p> <p>Productivity (number of clients per loan officer) rises by at least 10%.</p>	<ul style="list-style-type: none"> <li>➤ Monthly reports of ODEF</li> <li>➤ Semiannual and final reports from the executing agency</li> <li>➤ Midterm and final evaluation by an external consultant</li> <li>➤ Project progress monitoring report</li> <li>➤ Project completion report (PCR)</li> </ul>	<p>Information systems meet the needs of the institution.</p>

Narrative summary	Indicators	Means of verification	Assumptions
<b><u>Component 3</u></b>  Strengthen the capacity for strategic leadership	Strategic plan approved by CNBS at the end of the second year.	<ul style="list-style-type: none"> <li>➤ ODEF reports</li> <li>➤ Semiannual and final reports from the executing agency</li> <li>➤ Midterm and final evaluation by an external consultant</li> <li>➤ Project progress monitoring report</li> <li>➤ Project completion report (PCR)</li> </ul>	The leaders and directors of ODEF maintain their commitment to geographic expansion and rural service.
<b>Activities</b>			
<b>I. Expansion of financial products in rural areas served by project</b>  Training for operating staff in rural branches.  Participation in specialized technical training courses.  Market niche study and design of a marketing strategy for the new loan, savings, and remittance products in rural branches.	<p>At least 30 operating staff in the newly opened branches have been trained in providing financial services to rural microenterprise. <b>10 in the first year, 10 in the second year, and 10 in the third year.</b></p> <p>At least six junior management level staff in the six branches have been trained in strategic, technical and management aspects relating to the provision of rural financial services. <b>Two in the first year and four in the second year.</b></p> <p>Three market niche studies prepared for three branches by the end of the <u>first year</u>.</p> <p>Three market niche studies prepared for three branches by the end of the <u>second year</u>.</p> <p>Marketing strategy for savings and remittance products developed in the rural branches by the end of the <u>second year</u>.</p>	<ul style="list-style-type: none"> <li>➤ ODEF reports</li> <li>➤ Semiannual and final reports from the executing agency</li> <li>➤ Midterm and final evaluation by an external consultant</li> <li>➤ Project progress monitoring report</li> <li>➤ Project completion report (PCR)</li> <li>➤ Project reports</li> <li>➤ Market niche studies</li> </ul>	<ul style="list-style-type: none"> <li>➤ ODEF can identify specialized training consultants, or specialized organizations that can offer ad hoc practical training, in keeping with the branches' implementation schedule.</li> </ul>

Narrative summary	Indicators	Means of verification	Assumptions
Design of remittance-based products	At least 2 remittance-based products designed by the end of the <u>third year</u> .		
Promotion of new products	Strategy to promote new financial products in rural areas implemented by the end of the <u>second year</u> .		
<b>II. Improving the delivery of financial services in rural areas</b>			
Purchase of computer equipment	Hardware purchased and operating, consistent with software requirements in at least three rural branches by the end of the <u>first year</u> , and in six branches by the end of the <u>second year</u> .	<ul style="list-style-type: none"> <li>➤ ODEF reports</li> <li>➤ Semiannual and final reports from the executing agency</li> <li>➤ Midterm and final evaluation by an external consultant</li> <li>➤ Project progress monitoring report</li> <li>➤ Project completion report (PCR)</li> </ul>	<ul style="list-style-type: none"> <li>➤ ODEF identifies service providers that can offer IT products meeting the needs of rural financing.</li> <li>➤ ODEF identifies service providers that can offer PDA technology in accordance with ODEF needs.</li> </ul>
Infrastructure upgrades in the branches	At least three branches equipped with the basic requirements for the financial products at the end of the <u>first year</u> , and six branches at the end of the <u>second year</u> .		
Acquisition of an information system	The new information system acquired and implemented in at least three rural branches in the <u>first year</u> , and in six branches at the end of the <u>second year</u> .		
Training for branch staff in the new information system.	The staff training program has been implemented in each office.		
Purchase of PDAs for loan officers	At least 8 PDAs purchased and in use by loan officers at the end of the <u>second year</u> .  At least 24 PDAs purchased and in use by loan officers at the end of the <u>third year</u>		
Development of software for PDAs	PDA software developed by the <u>end of the first year</u> .		
Training in PDA systems for loan officers and branch staff.	System specialists have provided training.		



Narrative summary	Indicators	Means of verification	Assumptions
Communications system	At least 2 rural branches are communicating online with head office at the <u>end of the first year</u> , 4 in the 2nd year, and 6 in the 3rd year.		
<b>III. Strengthening the strategic leadership capacity</b>  Strategic planning in ODEF  Exchange program for directors and managers          Participation in the strategic planning course	Strategic plan developed and implemented at the end of the <u>second year</u> .  At least two ODEF directors have participated in activities for exchanging experience with other leading organizations in rural finance by the end of the <u>second year</u> .  At least four managers have participated in exchange programs for familiarization with rural branch expansion by the <u>end of the second year</u> .  At least two ODEF managers and directors have participated in strategic planning courses by the end of the <u>third year</u> .	<ul style="list-style-type: none"> <li>➤ ODEF reports</li> <li>➤ Semiannual and final reports from the executing agency</li> <li>➤ Midterm and final evaluation by an external consultant</li> <li>➤ Project progress monitoring report</li> <li>➤ Project completion report (PCR)</li> </ul>	<ul style="list-style-type: none"> <li>➤ A consultant is identified with expertise in strategic planning for MFIs.</li> <li>➤ Honduran or international institutions can be identified that are prepared to share their experience with ODEF.</li> </ul>

## ANNEX II - DETAILED BUDGET

### *Deepening Financial Services for Rural Microenterprise in Honduras*

Note: hardware and software expenses and costs amount to 27% of the total project (not counting security and cash handling systems). The MIF contribution to this percentage will not exceed the standard 70%.

Project budget			
	MIF	ODEF	TOTAL
<b>Expansion of financial products into rural areas of the project</b>	<b>140,000</b>	<b>58,000</b>	<b>198,000</b>
Technical assistance	82,000	46,000	128,000
<i>Consultant for market niche and product studies</i>	<i>15,000</i>	<i>3,000</i>	<i>18,000</i>
<i>Consultant to implement remittance handling systems in rural branches</i>	<i>20,000</i>	<i>3,000</i>	<i>23,000</i>
<i>Consultant to design remittance-based products</i>	<i>37,000</i>	<i>10,000</i>	<i>47,000</i>
<i>Promotion of new products</i>	<i>10,000</i>	<i>30,000</i>	<i>40,000</i>
Training	58,000	12,000	70,000
<i>Training for operating staff in rural branches</i>	<i>50,000</i>	<i>10,000</i>	<i>60,000</i>
<i>Participation in technical training courses</i>	<i>8,000</i>	<i>2,000</i>	<i>10,000</i>
<b>Improving the delivery of financial services in rural areas</b>	<b>63,000</b>	<b>88,000</b>	<b>151,000</b>
Technical assistance	15,000	5,000	20,000
<i>Consultant to develop PDA software</i>	<i>15,000</i>	<i>5,000</i>	<i>20,000</i>
Software and equipment	48,000	33,000	81,000
<i>Acquisition of PDAs for loan officers</i>	<i>-</i>	<i>9,000</i>	<i>9,000</i>
<i>Acquisition of computer equipment for rural branches</i>	<i>20,000</i>	<i>2,000</i>	<i>22,000</i>
<i>Acquisition of an information system</i>	<i>28,000</i>	<i>12,000</i>	<i>40,000</i>
<i>Lease of a communications system</i>	<i>-</i>	<i>10,000</i>	<i>10,000</i>
Improving infrastructure in rural agencies	-	50,000	50,000
Implementation of security and cash handling systems	0	50,000	50,000
<b>Strengthening the corporate culture and governance capacity of ODEF</b>	<b>30,000</b>	<b>12,000</b>	<b>42,000</b>
Technical assistance	15,000	3,000	18,000
<i>Consultant to support strategic planning</i>	<i>15,000</i>	<i>3,000</i>	<i>18,000</i>
Training	8,000	2,000	10,000
<i>Participation in strategic planning course</i>	<i>8,000</i>	<i>2,000</i>	<i>10,000</i>
Exchanges and training assignments	7,000	7,000	14,000
<i>Exchanges for directors and managers</i>	<i>7,000</i>	<i>7,000</i>	<i>14,000</i>
			-
<b>Project coordination, audit, and evaluation</b>	<b>27,000</b>	<b>-</b>	<b>27,000</b>
<i>Midterm evaluation</i>	<i>10,000</i>	<i>-</i>	<i>10,000</i>
<i>External audit</i>	<i>5,000</i>	<i>-</i>	<i>5,000</i>
<i>Environmental consultant</i>	<i>4,000</i>		
<i>Contingencies</i>	<i>8,000</i>	<i>-</i>	<i>8,000</i>
<b>TOTAL</b>	<b>260,000</b>	<b>158,000</b>	<b>418,000</b>
<b>Percentage of total</b>	<b>62%</b>	<b>38%</b>	<b>100%</b>

**ANNEX III**  
**MIF Projects in the Republic of Honduras**  
**Deepening Financial Services for Rural Microenterprise in Honduras - Strengthening ODEF (HO-M1005)**

**A. Similar or related MIF projects**

<b>Project number and approval date</b>	<b>Project title, sector, executing agency, and amount</b>	<b>Signature date and disbursement (in months)</b>	<b>Amount disbursed</b>	<b>Observations</b>
ATN/MT-7118-HO August 2000	Institutional Strengthening of Banhcafé (US\$273,000)	December 2000 completed in 2003	US\$273,000 100%	Project completed with good results
ATN/ME-6342-HO January 1999	Institutional Strengthening of FINSOL (US\$300,000)	March 1999 66 months	US\$300,000 100%	Project completed with good results
ATN/ME-8046-HO October 2002	Savings Mobilization with Microfinance Institutions - Katalysis (US\$500,000)	October 2002 30 months	US\$180,000 36%	Good progress, although a little slow, since OPDFs had to secure authorization from CNBS. Progress continues
ATN/MT-8545-HO December 2003	Institutional Strengthening of FACACH (US\$1,425,000)	December 2003 42 months	US\$142,000 10%	Project advancing despite a brief setback because of intervention in mid-2004.

**B. Similar or related Bank projects**

None

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

None

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

RESOLUTION MIF/DE-\_\_\_/\_\_\_

Honduras. ATN/\_\_\_-\_\_\_-\_\_\_. Nonreimbursable Technical Cooperation for Deepening Financial Services for Rural Microenterprises in 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 Organización de Desarrollo Empresarial Femenino (ODEF), 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 financial services for rural microenterprises in Honduras.

2. That up to the amount of US\$260,000, or its equivalent in other convertible currencies, shall be authorized for the purpose of this resolution, chargeable to the technical cooperation resources of the Second Line of Activity for Strengthening of Financial Institutions for Microenterprise of the Small Enterprise Development Facility of the Multilateral Investment Fund.

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