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SUSTAINABLE MICROFINANCE DEVELOPMENT

(TC-02-06-01-8)

DONORS MEMORANDUM

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ACRONYMS AND ABBREVIATIONS

ABDM	Brazilian Association for the Development of Microfinance
AED	Development Education Agency
ARCA	ARCA – Knowledge Association
BNDES	Brazilian Development Bank
DLIS	Local Integrated and Sustainable Development
MFI	Microfinance institution
MTN	Microfinance Training Network
OSCIP	Civil Society Organization in the Public Interest
PCPP	Low-Income Microcredit Program
PDI	Institutional Development Program
PEU	Program executing unit; project executing unit
POR	Program operating regulations
SCM	Microenterprise Credit Association
SEBRAE	Brazilian Micro and Small Business Support Service

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EXECUTIVE SUMMARY

Executing agency:	Sociedad del Conocimiento [Knowledge Association] – ARCA	
Amount and source:	MIF – Facility II Local counterpart: Total:	US$ 925,000 US$ 925,000 US$1,850,000
Terms:	Execution period: Disbursement period:	36 months 42 months

Objectives: The objective of the program is help increase the capacity of regulated and unregulated microfinance institutions (MFI) in Brazil to provide quality financial services to microenterprise on a sustainable basis. The purpose of the operation is to establish a program to support the sustainable development of the country's microfinance sector based on human resources training for the staff of MFI, dissemination of reliable information for the sector, and creation of pilot rural microcredit modules.

Description: The activities to be financed by the program are divided into three components involving: structuring a training program in microfinance to be offered throughout the country; disseminating technical information and institutional coordination for the microfinance sector; and developing rural microfinance models that are integrated into local economic development processes.

Social and environmental review: The operation was analyzed by the Committee on Environment and Social Impact on 4 October 2002. The relevant recommendations have been incorporated into the project design, specifically the program operating regulations (POR).

Beneficiaries: The program will benefit Brazil's microfinance industry overall by setting up specialized microfinance training services to be offered throughout the country. It will also set up an information and technological dissemination system focusing on best practices, which will serve Brazilian MFIs and facilitate expansion of financial services for microenterprises, as well as develop pilot models to extend the program's financial services to rural areas. The program will directly benefit at least 80 Brazilian MFIs, whose quality of service will improve once their employees and managers receive training. Quality of service will also improve once the MFIs receive better technical information about the sector, which will improve management and microfinance services offered. Microfinance policymaking and support agencies will also benefit from being able to obtain better information about the sector and from having a forum for analysis and discussion of aspects relevant to the industry and lessons learned in various contexts. The program's ultimate beneficiaries will be urban and rural microentrepreneurs and MFI customers, who will get improved access to higher quality, more efficient microfinance services.

Special contractual clauses: Prior to the first disbursement, ARCA will supply, to the Bank's satisfaction: (i) the business plan for the first year of the program, which includes the Operating Regulations and a participation agreement with the Brazilian Association for Microfinance Development (see paragraph 6.1); and (ii) evidence that the program director has been contracted (see paragraph 5.2) according to the terms of reference previously approved by the Bank.

Exceptions to Bank policy: None.

I. Country and Program Eligibility

1.1 On 9 February 1995, the Donors Committee declared Brazil eligible for all Multilateral Investment Fund (MIF) financing modalities. The proposed operation was declared eligible for MIF financing within the framework of the Facility for Human Resources Development II [Facilidad de Desarrollo de los Recursos Humanos (II)], insofar as its goal is to improve microfinance institutions' (MFIs') capacity to provide quality financial services and, introduce innovative financial mechanisms by means of training programs, the dissemination of technical information about microfinance in Brazil, and demonstration models for rural microfinance.

II. Background

A. Financing for microenterprise in Brazil

2.1 Half of Brazil's economically active population works in businesses that have no more than five employees. These businesses account for more than 8% of the gross domestic product. Various estimates put the number of microenterprises in Brazil at 13.9 million to 16.4 million, of which 20% to 30% are located in rural areas and 30% are run by women. At least 50% of these microenterprises are thought to have unmet financing needs. The most conservative estimates project a potential market of 8 million microcredit customers, while MFIs in Brazil only serve approximately 159,000 clients (i.e., less than 2% of demand). By the end of 2001, the portfolio stood at barely US$59,8 million[1], just 17 MFIs had more than 1,000 clients each.

2.2 A sizeable portion of the Brazilian population (18%) resides in about 2 million small communities and microregions across the country in rural areas where opportunities for work and making money depend largely on microenterprise. In many of these microregions, particularly those where the integrated local sustainable development program (LSDP)[2] has been implemented as a methodology for social capital formation and agreement on local economic development priorities, major unmet basic financing needs for microenterprise have been identified. In spite of this shortfall, the supply of microcredit has not expanded on a sustainable basis for the rural sector. It is estimated that over 90% of microenterprise credit programs in Brazil are designed for urban communities and that few organizations exist to minister effectively to the needs of the rural population. One reason for this has been a lack of microfinance technologies and tested operating models that are suited to the particular needs of the rural sector.

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[1] S. Nichter, L. Goldmark and A. Fiori: *Understanding Microfinance in the Brazilian Context*; PDI/BNDES, July 2002. It does not include credit union data.

[2] The local sustainable development program is a process in which the different actors of a rural community or microregion (in the public and private sectors and civil society) carry out an assessment of their situation and agree jointly on a development plan and strategy for their communities.

B. The microfinance sector

2.3 Development of the microfinance industry in Brazil has historically been slow, for a number of reasons including: an adverse macroeconomic climate prior to the 1994 stabilization; a regulatory framework inadequate for the sector; a tradition of lending programs that are subsidized by the government; and the absence of successful microfinance models that could serve as an example for development of the industry, accompanied by technology and microlending products suitable for the microenterprise sector. In recent years, however, the microfinance industry has shown new energy. Between 1999 and 2001, the number of clients served by microlenders doubled, and the value of the MFIs' active portfolio tripled, with heightened interest by private microfinance institutions. This new approach is attributable in part to four main factors: (i) adjustments to the regulatory framework, particularly the creation of two new legal structures designed to stimulate private financial services for microenterprise and that can be accessed by MFIs: the Microenterprise Credit Association (SCM)[3] and the Civil Society Organization in the Public Interest (OSCIP)[4]; as well as a loosening certain regulations of Brazilian Central Bank regulations; (ii) more second-tier resources for financing microcredit operations that are available to the MFI from state-controlled enterprises such as the National Economic and Social Development Bank (BNDES) or the Brazilian Microenterprise and Small Business Support Service (SEBRAE); (iii) the establishment of various state and municipal microlending programs, and (iv) a growing interest on the part of private financial institutions such as credit unions and banks in providing these services.

2.4 The growth observed in the sector has been accompanied by an increase in the number of MFIs, from 67 in 1999 to 121 in early 2002. In this context, the number of public entities providing microfinance services has grown, with state-owned banks playing a predominant role in some cities. Brazil's leading MFI in terms of loan volume and number of customers is Banco do Nordeste (BNE) under its Crediamigo program[5], with a portfolio of US$25.5 million and 85,000 active clients at the end of 2001. However, given the potential and the size of the microfinance market in Brazil, a significant number of private entities have been making inroads into this activity in recent years. Most of the MFI now active in Brazil are privately owned in the form of commercial enterprises (25 SCM) or nongovernmental organizations (that include 51 OSCP and more than 20 that have not decided to take this designation). More recently, some private banks have begun pilot operations in the microfinance sector, including Banco Real in Sao Paulo and Unibanco. Some of

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[3] The SCM: a type of financial institution, regulated by the central bank that is not allowed to accept deposits and has limited lending ability. It operates as a corporation.

[4] OSCIP: a category established under the "Ley del Tercer Sector" ["Civil Society Law" or "Third Sector Law"], which authorizes exemptions from certain legal restrictions—such as the usury legislation—for nongovernmental organizations classified as "public interest" by the State. OSCIP's directors have a personal fiduciary obligation.

[5] The Bank has been supporting the Crediamigo program with a loan of US$30 million (PR-2648).

the country's nearly 1,360 credit unions have shown interest in participating in the sector, with one, Cresol, succeeding in acquiring a substantial volume of microcredit operations.

C. Obstacles to sustained growth in the sector

2.5 The growth observed in the number of private MFIs does not indicate a strong microfinance industry, because it has not been accompanied by development of technical capacity. Most of MFIs in Brazil have shortcomings in the use of microfinance technology and in training their human resources to handle such operations, which are caused by a lack of training and access to technical information. The shortcomings noted stem in turn from the use of credit technologies that are ill-suited to the needs of their customers—and therefore problems for MFIs to expand their services—and in low productivity of their loan officers and high operating costs, which hinder the growth of the MFIs and their ability to keep customers, thus undermining their long-term viability.[6] According to the results of a recent survey by Knowledge Association (ARCA) 32% of more than one hundred organizations contacted (microfinance and others) were found to have their demand unmet in terms of microlending agencies and managerial and technical personnel with training in microfinance (see technical files). The supply of these services is weak and dispersed. Training services in program management and microfinance technologies for managerial and technical personnel are underdeveloped in the country, both qualitatively and quantitatively. Moreover, geographic coverage is low. Access to these services is hindered by the vast distances in Brazil.

2.6 As to the willingness to pay for training services, all MFIs surveyed were willing to pay somewhere between 25% and 100% of the cost of training for a US$200 per student course. The type of training requested ranged from basic collections training to more complex areas, such as developing MFI business plans. The MFIs surveyed cited fewer than 10 agencies[7] nationwide that offered training. Courses offered were isolated. This deficiency has made many MFIs turn to international consultants, whose high costs and language barriers affect the quality of services received.

2.7 In addition to the lack of trained personnel, little specialized technical information about microfinance is available; for example: industry performance data and parameters, and regulations that affect the sector, and microfinance experiences and best practices, as well as data on new technologies, innovative products, or services

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6 According to a recent DAI/BNDES study (2002), the key performance ratios of Brazilian MFIs fall below the average for Latin America (e.g. performance adjusted assets –4.3% compared to 8.2%; risk portfolio of 7.5% compared with 4.6%; loan officer productivity 191 compared with 312).

7 Public AED program, SEBRAE and Agencia Catarinense de Fomento. Private CEAPE, ICCape, CREAR, Delnet, GIT and Microbank.

that MFIs can access. As a result, technologies and knowledge needed for the industry to function well are disseminated slowly, which hurts MFIs, policymakers, potential investors, and others who play an active role in the sector. To help reverse this situation, the Brazilian Association for the Development of Microfinance (ABDM) was formed within the last year. Its goal is to coordinate and bring together MFIs, and serve as a source of information, with a goal of developing a microcredit website that facilitates access to technical information among entities in the sector. It is made up of public and private MFIs, including agencies that provide support to the industry.

D. Programs to support microfinance

2.8 The most important agencies in Brazil that provide support to local MFIs are the BNDES and SEBRAE. The BNDES operates through two lines: the Institutional Development Program (PDI), which is nearing completion, and the Low-Income Microcredit Program (PCPP). Both receive financing from the Inter-American Development Bank. The PDI is designed to provide institutional strengthening for MFIs (including technical assistance, training, and information systems procurement which have now benefited 10 MFIs), improvements in the regulatory framework, and instruments to promote the industry (for example, the program has published six manuals for MFIs and regulatory agencies.) The PCPP provides approximately US$18.3 million in financing for the portfolios of 32 MFIs. SEBRAE launched the Microcredit Support Program in 2001 in order to help 89 MFIs (44 of which are in the process of being formed) increase lending. These groups will receive funding to contract technical assistance and training. In addition, 41 MFIs will receive direct support for their initial operating expenses and for financing their portfolios. SEBRAE identified a shortage of quality training services and a lack of technical information on the microfinance industry as an impediment to development of its program.

E. Proposed program

2.9 The goal of the proposed program is to help develop the microfinance industry in Brazil by taking action designed to reduce three of the barriers identified: (i) a lack of qualified personnel in microfinance through improvements in quality training services and demand-based mechanisms to encourage the use of these services; (ii) a lack of access to specialized information and poor coordination within the industry through the refinements in and consolidation of an IMF information system as an institutional mechanism to coordinate activities in the sector, and (iii) a lack of sustainable microfinance products and technology modules to expand the operations of privately-owned MFIs in rural areas. Each initiative sees to fill a gap existing in development of the sector and represents additionality with respect to efforts under way to strengthen the sector. Within the context of the MIF's strategy for developing microenterprise, the proposed program will clearly have a positive effect on Brazil's microfinance industry. It will give MFIs and potential

MFIs access to information and services, training, organizing the market for such services. The program is expected to raise the efficiency of MFIs, make their activities sustainable, and enhance their capacity to provide better services to microenterprise on a sustainable basis. The project will spur the expansion of privately-owned MFIs in a market in which the public sector still has a strong presence and will develop pilot models to promote the expansion of such services to rural areas where demand exists. Lastly, the MIF resources will make it possible to develop and test two innovative pilot models in order to expand microfinance to the rural market.

F. Lessons learned

2.10 The program applied the lessons learned from other MIF-financed projects. Two recent evaluations were considered in particular: (i) MIF microfinance projects (October 2002); and (ii) microfinance training consortium (ATN/ME-5737-RG), to be completed in 2003. Consideration was given to the following: (i) the success of the MFIs depends on their capacity to access quality technical services and to have qualified local staff that would give them the necessary technical capacity to offer support services to these organizations; (ii) the design of training programs aimed at MFIs calls for detailed identification in advance of their needs; (iii) the adoption of a decentralized structure for training service deliver needs to be given on the basis of a network of local suppliers in order to achieve greater geographic coverage and to reduce program operating costs as a strategy for sustainability; (iv) the coverage of the fixed costs of training services and the supply of information call for sustained support from institutions that promote the sector; (v) the use of databases disseminated and fed by means of interactive information systems such as websites are essential tools that MFIs can use to determine demand; and (vi) the development of microfinance technologies and products that can be replicated is associated with their incubation in MFIs with incentives to make their operations sustainable.

III. BASIC PROGRAM OBJECTIVES AND COMPONENTS

A. Program objectives

3.1 The objective of the program is to help increase the capacity of regulated and unregulated MFIs in Brazil to deliver quality financial services to microenterprise on a sustainable basis. The aim is to establish a program in support of sustainable development of the country's microfinance sector through training for the staff of MFIs, the dissemination of reliable information for the sector, and the creation of rural microcredit pilot models.

B. Components

3.2 The program consists of three components: (i) setting up microfinance training services; (ii) institutional coordination and dissemination of technical information for the microfinance sector; and (iii) developing microfinance models that are integrated into local economic development processes.

1. Setting up microfinance training services

3.3 The objective of this component is to establish a structure for a nationwide decentralized microfinance specialized training system to address the technical training needs of MFI staff at an executive, administrative, and a technical level as a means of strengthening the institutions. With the executing agency (ARCA) acting as a second-tier institution, the program will organize training services for Brazilian microfinance institutions, by means of training and certifying individual and institutional trainers, who will in turn sell training services to regulated and unregulated MFIs across the country. A microfinance training network (MTN), to consist of trainers qualified and trained by the program, will be set up in order to meet the needs of MFIs in Brazil's various regions.

3.4 The activities to be financed are: (i) establishment of a database on training services supply and demand that can be accessed through the internet to make it easier to pair potential customers and suppliers of MIF services; (ii) partial financing for onsite evaluations of a sample of 30 private MFIs and the preparation of a individualized training plan for each entity; (iii) development of a promotional and business plan for the training services; (iv) development of technical and training materials, training content, and methodologies that respond to the demand identified, including distance training to reduce the cost of access to training services for MFIs; (v) training programs for trainers; (vi) a temporary program of shared funds (partial scholarships) to make it easier for trainers certified under the program to meet MFIs that require training services, with financing for one half (50%) of the cost of the training for staff of private MFIs; and (vii) design and implementation of a quality control system for training programs, that will include a data base of individuals trained. Mechanisms will be set up to promote the sustainability of the services upon completion of the program (see paragraph 4.4).

3.5 Results expected from the component are: (i) a structured network of private-sector providers of microfinance training services for MFIs having a presence in five regions of the country, and a system for updating of content and methodologies that will be supported by the sale of materials and services; (ii) at least 80 trainers trained in the products developed by the program, and who have co-financed their training; (iii) an online database of microfinance training programs and the demand for these programs (see "Microlending Portal," paragraph 3.8); (iv) eight training products developed for MFI directors, managers, loan officers, and staff in response to identified demand; (v) 970 staff members from 80 MFIs and institutions with an

interest in microfinance will be trained according to their needs, of which at least 680 are from private MFIs and 80% keep working for the institutions in the sector; (vi) at least 30 MFIs have developed training plans, on the basis of individualized assessments; and (vii) improvements in the management of participating MFIs, in accordance with the preestablished baseline indicators (see paragraph 6.3).

2. Institutional coordination and dissemination of technical information for the microfinance sector

3.6 The goal of this component is to facilitate MFIs' access to technical information about microfinance, promote dissemination of best practices, and facilitate coordination among microfinance institutions by: (i) developing a technical information database in Portuguese for MFIs that is accessible through the internet (Microlending Portal); (ii) setting up a series of awards as an incentive to encourage and disseminate the use of best practices in the microfinance industry; and (iii) the strengthening of an existing organization representative of the sector. This organization, ABDM (see paragraph 2.7), will operate the technical information system on a permanent basis, and will serve as a forum for coordinating and promoting topics of relevance to the industry. The program will use an existing Internet portal, as well as written materials in several languages on best practices in microfinance, to disseminate technical information and create forums for discussion that will help improve management of Brazilian MFIs and make them more efficient. The portal will also disseminate information from the program about training services offered and demand for training, as well as the results of the pilot programs in rural microfinance from Component 3.

3.7 The activities to be financed are: (i) development and refinement of the virtual technical information system ("microlending portal"); (ii) selecting microfinance information and translating it into Portuguese, which will be part of the virtual library that will be disseminated on the portal; (iii) designing and promoting a system that rewards the use of best practices in microfinance, and evaluating, preparing, and disseminating case studies on MFIs that have been rewarded; (iv) strengthening the ABDM, that includes hiring a part-time professional level individual to administer and maintain the virtual information system; and (v) organizing five workshops for MFIs and various participants in the market in order to discuss policies of interest to the sector and ways to promote microfinance to formal banking institutions.

3.8 The results expected are: (i) a dynamic microcredit internet site, partially supported by advertising sales and other sources, that offers updated information about microfinance, including financial services offered by the FMIs, access to a database of training services available and demand for such services and information on the courses developed by ARCA, and a specialized virtual library in Portuguese; (ii) 30% of private MFIs promote their products and services at the website; (iii) a sponsor-supported program of rewards that recognizes innovations and best

practices in microfinance in Brazil, with at least complete prize cycles and information disseminated on FMIs receiving awards; and (iv) the ABDM, as a association representative of the microfinance industry is operational and sustained largely through the fees of its members, with a membership of at least 60 FMIs, as well as other entities in the sector.

3. Developing rural microfinance models that are integrated into local economic development processes.

3.9 The objective of this component is to generate models that can be replicated to deliver sustainable lending services to microenterprises in rural areas with the DLIS process. Under the program will be implemented two rural microfinance pilot projects in two "microregions" in Brazil, to be identified. The two microregions should comprise groups of municipalities of up to 50,000 residents, where integrated local development processes are being carried out and where an active demand for microlending services can be demonstrated. These pilot projects will develop and test: (i) a methodology to provide incentives for setting up microfinance services in rural areas that are not being served but that have a significant microenterprise presence; and (ii) microfinance technologies and products adapted to the needs and characteristics of rural environments in Brazil, that may be replicated to deliver sustainable rural microfinance services.

3.10 The pilot projects will be developed in two stages. The first stage will include: (i) project design (market analysis, feasibility study, analysis of technical and financial needs, and identification of possible funding sources); (ii) mobilizing local, regional, and other resources, and designing an incentive package to attract MFIs to the designated microregion; (iii) identifying an organization with microfinance experience that will enter into a partnership with the project and assume its credit risk; and (iv) formalizing agreements with the organization identified in order to ensure that the pilot project begins operations. The second stage will include structuring and developing rural microfinance operations managed by the organization identified, including designing and applying technologies suitable for a rural environment; and collecting, cataloguing, and disseminating experiences via the microlending portal, workshops, and other methods.

3.11 Activities to be financed in the first stage are: (i) evaluation and final selection of the two microregions in which the pilot projects will be implemented; (ii) mobilizing and raising awareness of local leadership; (iii) preparation of market studies and preliminary business plans for the two pilot projects; (iv) advising local communities on how to structure the incentives to be offered to attract microlending programs to their microregion; (v) searching for and selecting strategic partners with the minimum financial and technical requirements and the minimum microfinance experience to participate in the pilot project; and (vi) consultations on negotiating and designing agreements with the strategic partners in order to set up

the rural microfinance pilot project. The second stage will involve financing for: (i) specialized technical assistance and training services geared to individual needs for MFIs in the two pilot projects. This will facilitate the development and adaptation of microfinance technologies and products suitable for rural areas; and (ii) cataloguing of experiences and workshops that will disseminate pilot experiences. Financing will also be provided to hire a consultant with microfinance experience, who will help coordinate, monitor, and supervise the activities in this component.

3.12 The results expected from this component are: (i) two MFIs operating in the microregions selected, validating the methodology introduced under the program in order to attract microlending services to rural areas; and (ii) at least one institution with experience in microfinance has been associated with each of the pilot programs; and (iii) the MFI with pilot projects are using sound lending technologies (conforming to financial ratios) and have developed at least four microfinance products that the MFIs can use to reach at least 500 microenterprise customers.

IV. COSTS AND FINANCING

A. Costs

4.1 The program has a total budget of US$1,850,000. The MIF will finance US$925,000, and ARCA will contribute US$925,000 as a local counterpart, which will come from funds provided by SEBRAE. Of the latter, at least 50% is to be provided in cash. ARCA has submitted a document confirming that the SEBRAE resources will cover the cash counterpart contribution (US$630,000), with a commitment that this will be maintained for the duration of the program. The following table outlines the program costs (in US dollars).

Components	MIF	ARCA	Total	%
1. Structuring of microfinance training services	349,200	298,500	647,700	35%
2. Institutional coordination and dissemination of information	140,200	151,400	291.600	16%
3. Development of rural microfinance models that are integrated into local development processes	300,100	175,900	476,000	26%
Support for execution, evaluation, audits, and contingencies	135,500	299,200	434,700	23%
TOTAL	**925,000**	**925,000**	**1,850,000**	**100.0%**

4.3 MIF resources will finance technical assistance and training services to develop the three components, as well as 50% of the partial scholarship fund called for in component 1. The local counterpart resources will finance overhead, and expenses relating to the logistics of the various components. The local counterpart will cofinance the scholarship fund and local consulting and technical assistance expenses.

B. Program sustainability

4.4 Program sustainability comprises the sustainability of the activities supported in each component. Generally speaking, the program is expected to include mechanisms to increase recovery of the variable costs of the recurring activities it supports.

4.5 For **Component 1,** ARCA will have a decentralized, second-tier training structure, establishing an MTN and will cover on an increasing basis its variable costs from the fees charged for enrollment in the training of MTN trainers (which will cofinance up to 70% during the program), developing forums and seminars for dissemination and refresher training, and selling materials developed and updated for use in MTN courses. According to ARCA projections, Component 1 activities will achieve an increasing level of financial sustainability, covering more than 70% of costs in the third year of the program. The shared funds (50%) for partial study grants for private MFIs will be temporary, and are designed to promote the program's training services to the MFIs during the initial phase. The fund will cease operations during this component as the program gains recognition. The MTN suppliers will support themselves by selling its services to a group of MFIs on an increasing basis, mindful of their training needs and of the benefits of such services. **Component 2** provides for recovery of expenses associated with the microlending portal and ABDM management services through fees for membership in the association and advertising sales on the website. The services generated will enable the ABDM to increase its membership and thus its income, virtually achieving self-sufficiency (>90%). The microfinance awards are not intended to be a cost recovery

mechanism, and will achieve sustainability by seeking out sponsors. As a condition precedent to disbursement of the proceeds of Component 2, the ABDM must prepare a business plan that shows the sources and the website sustainability strategy. The first stage of **Component 3** will be to test a methodology for bringing microfinance services to rural areas. The intention is not to recover expenses but to achieve a demonstration effect, for which resources have been budgeted. The second stage involves setting up rural microfinance operations. Their sustainability will be assured through the technical and financial support to be received by the beneficiary MFIs, and the favorable environment created by the DLIS methodology used in the first stage.

V. PROGRAM EXECUTION

A. Executing agency

5.1 The program will be executed by the ARCA, a private, not-for-profit agency, established in July 2000, to promote sustainable development and democratization of knowledge. It was recognized as an OSCIP in October 2000. ARCA's headquarters are in Brasilia, and it has a staff of 37. Currently, ARCA runs the Development Education Agency (AED)" program, set up in January 2001 by SEBRAE, the United Nations Development Programme, the United Nations Educational, Scientific and Cultural Organization, and Active Community in order to increase the managerial and entrepreneurial capacity of micro and small enterprises, local governments, and civil society organizations, especially those involved in participatory and integrated local development processes. ARCA has used AED to set up a microlending unit that offers microfinance training courses. It also offers training courses in DLIS, an area in which it has trained more than 1,300 people, in entrepreneurship, equity capital, and management. Within this framework, ARCA has set up a national network of approximately 125 training and local development providers, with whom it maintains a working relationship and who are likely to form the basis of the MFN. ARCA is authorized to execute this program because of its experience in training and program execution. Although its own net worth is nominal, ARCA manages a budget of nearly US$2.1 million (most of which belongs to the AED program), and it has disbursed nearly US$3.4 million in the 18 months since it was created. ARCA has secured additional resources from SEBRAE totaling approximately US$2 million, which it will use to continue the AED program and finance the local counterpart contribution for this program.

B. Structure for program coordination and supervision

5.2 To execute the program, ARCA will establish a "Sustainable Microfinance Development Program Council." The members of the Council will be: (i) a representative of the Brazilian entrepreneur support system (SEBRAE); (ii) a

representative of the Brazilian Association of Credit Unions (ABSCM); (iii) a representative of a private MFI appointed by the board of directors of ABDM; (iv) the Director General of ARCA; and (v) the Director of the program, who will serve as Secretary. The members of the program council will provide these services on a fee basis. The Council will be the program's decision-making body and will be in charge of (i) approving the program Operating Regulations (OR) and amendments to these Regulations, with the Bank's nonobjection; (ii) monitoring compliance with the objectives and targets of the program; (iii) approving the annual work plans and ensuring that they are fulfilled; and (iv) approving the annual budgets and ensuring their compliance.

5.3 Program execution will be managed by a program executing unit (PEU) headed by a program director. The other members will be a financial and operations coordinator and an administrative assistant, both of whom will be contracted through a competitive process, per Bank procedures. The program director will be responsible for executing program activities and meeting program objectives. The PEU will be responsible for managing the program according to the POR and coordinating the activities necessary to meet the objectives and performance indicators in the Logical Framework (see Annex I). The program director will report directly to the general director of ARCA, who will be responsible for providing leadership and promotion, and for ensuring that the program objectives and goals are met. The Program Director must be hired, as a condition precedent to the first disbursement (see paragraph 8.1). The PEU will manage the technical assistance, training, and pilot projects described in the various components, by using mechanisms that are transparent, competitive, and documented. All mechanisms will follow the Bank procedures established in the POR, a draft of which is available in the program's technical files and has been negotiated with the local counterpart.

5.4 The POR must be in place before the program's first disbursement can be made (see paragraphs 6.1 and 8.1). At a minimum, the POR will contain: (i) a detailed description of the program's components; (ii) the program's organizational structure and the PEU's duties and responsibilities; (iii) the responsibilities and institutional commitments of the participating organizations; (iv) the eligibility criteria for the services to be offered by the program's three components, including the scholarship fund and selection of the microregions in which Component 3 will be executed; (v) the criteria for the incentives that the program will offer to participating organizations; and (vi) the mechanism for allocating funds, both from the MIF and the local contribution, including cofinancing from the participating organizations.

C. Execution of the components

5.5 **Component 1**. The program will finance up to 70% of the cost of the **individualized assessments** of the human resources training needs of 30 MFIs and

their training plans. The eligibility criteria for selecting the MFIs will include: (i) fulfillment of the minimum indicators for institutional strengthening (see POR), (ii) operating as an entity established under private law; and (iii) signature of a letter agreement with ARCA stipulating that the MFIs have the obligation to cofinance at least 30% of the costs of the diagnostic assessment and the training plan, collaborating with the assessment/training plan and permitting the use of information generated by the assessment for the purposes of the program.

5.6 To **become members of the MTN**, the trainers (institutions or individual professionals) will be required to satisfy the minimum eligibility criteria set out in the POR (including having relevant training experience and a sound technical basis in the service area offered) and to have entered into a participation agreement indicating its commitment to cofinance a portion (up to 70%) of the cost of their initial formation and agreement to the conditions for membership in the network, including those concerned with the use of program teaching materials, the offering of a minimum number of courses per year as agreed and participation in the quality measurement system. The program will not finance the establishment of suppliers in the public sector. Active membership in the MTN will qualify the trainers to offer services to the MFIs that benefit from the partial study grant fund to be financed under the program.

5.7 ARCA will administer a **shared fund (study grants)** that will finance a portion of the MFI staff training costs (up to one half) and will operate in accordance with the criteria contained in the POR. The average cost of the courses is estimated at US$400 per student. The study grant will be granted to the private MFIs meeting the minimum eligibility criteria. The POR will establish the maximum amount that the shared fund will grant to any MFI. The study grant will be paid directly to the supplier giving the course upon presentation of the results of the course evaluation and other releases. ARCA will perform an annual audit to certify to the Bank that (i) the total cost paid per grant recipient for the course was equal to or less than the cost charged by the trainer to other students of that same course; and (ii) the cost financed through the study grant was not financed by another donor as well. ARCA will set up a monitoring system to evaluate the quality of the courses offered and their usefulness to the MFIs.

5.8 **Component 2**. This component will be carried out by ARCA with the direct help of ABD, where the virtual information system will be established. Although responsibility for financial execution and general supervision will fall to ARCA, by delegation, ABDM will be responsible for administration of the virtual information system and for the award, thus gradually assuming the operating and administrative costs of both. Participation by ABDM will be assured under a participation agreement that will be signed prior to initiation of this component (see paragraphs 6.1 and 8.1) together with evidence that the board of directors of ARCA has approved a business plan with a strategy for ensuring the sustainability of the program activities and expanding MFI membership.

5.9 **Component 3**. Given the innovative nature of this component and its complexity, ARCA will hire a professional with extensive experience in microfinance to head and supervise execution of the component, working closely with the PD. The microregions will be selected following an evaluation of the different alternatives based on the criteria contained in the POR, which includes (i) the degree of microenterprise participation in the local economy, (ii) insufficient financing in microregion, (iii) the level of community organization and the progress made with the DLIS process, (iv) the initial willingness of the community to contribute a package of incentives for establishing the program, and (v) the proximity of the MFI region or of financial institutions interested in taking part in the program.

5.10 **Execution and disbursement period.** The program execution period will be 36 months, and the disbursement period will be 42 months. The Bank will establish a revolving fund for a maximum of 10% of the total amount, which will be administered in a special account. Disbursements will be made as the conditions specified in this document are met (see paragraph 8.1).

5.11 **Contracting procedures.** ARCA will procure goods and contract for services needed according to applicable IDB/MIF policies and procedures. These procedures will also be applied to PEU-related contracts made with local counterpart funds.

5.12 **Accounting and auditing.** ARCA will maintain adequate systems for accounting records and monitoring program funds. The accounting system will be organized to supply the necessary documentation, enable verification of transactions, and facilitate timely preparation of financial statements and reports. ARCA will: (i) open separate bank accounts for administering the MIF and local counterpart contributions; (ii) manage disbursement requests and their corresponding expense reports, according to Bank procedures; and (iii) submit to the Bank: (a) semiannual financial reports on the status of the revolving fund; and (b) the program's final financial statements audited by an independent firm acceptable to the Bank within 90 days following the program's final disbursement.

VI. MONITORING AND EVALUATION

A. Monitoring

6.1 **Business plans and progress reports.** The program will be monitored according to the provisions of the annual business plans and progress reports submitted by ARCA to the Bank's satisfaction, in a previously agreed-upon format: (i) the business plan: (a) will be designed to meet the goals and results set forth in the Logical Framework; and (b) will include semiannual qualitative and quantitative performance indicators for each of the program components; the business plan will be submitted at the beginning of the program and revised at least annually while being executed; (ii) the semiannual progress reports will be submitted within thirty

(30) days following the end of each six-month period and will include: (a) information about the execution of the program and the progress made in meeting its objectives during the previous six months, including references to the performance indicators; (b) information about budget performance and the contributions from local counterpart funds; (c) information on the program materials and assets subject to copyright; (d) a description of the main difficulties anticipated or encountered, if any, in program execution; and (e) revisions considered necessary to the annual business plan and their rationale. The Bank's Country Office will use these reports to monitor the progress of the program's implementation and to prepare a final program report during the three months following the final disbursement. As a condition precedent to the first disbursement, the first Program Plan of Operations duly approved must be submitted, to the Bank's satisfaction, with evidence that the POR has been implemented and that a participation agreement has been signed between ARCA and ABDM (see paragraph 8.1).

6.2 **Disbursements and meeting performance indicators.** In order to facilitate monitoring of the project and ensure that disbursements from the MIF contribution are accompanied by progress in meeting the performance indicators established in the Logical Framework, ARCA shall demonstrate, to the Bank's satisfaction, that it has met the conditions indicated in Annex II before disbursements are made that exceed 30% and 70% of these contributions. Should any significant delays or undesirable deviations from fulfillment of the schedule occur, the Bank will be entitled to suspend all further disbursements until such time as the situation has been corrected to its satisfaction by ARCA.

B. Evaluations

6.3 The Bank will contract consultants to carryout two program evaluations, to be paid for by operating funds budgeted for that purpose: an interim evaluation once 50% of the funds have been disbursed, and a final evaluation within six months after the final disbursement. The interim evaluation will measure the program's progress in meeting its objectives and performance indicators. It will also recommend, if necessary, corrective measures needed to achieve the objectives and performance indicators, or it will recommend they be cancelled. ARCA will use the information obtained from the diagnostic assessments of the 30 MFIs targeted in Component 1 to establish a baseline with indicators and parameters that will serve as a reference for gauging the performance of the MFIs benefiting from the program. The final evaluation will seek to determine the impact of the program on MFIs in Brazil.

VII. RATIONALE, BENEFICIARIES, AND RISKS

A. Rationale

7.1 Improvements in Brazil's macroeconomic and regulatory environment and an increase in the financial resources available for microfinance have fostered significant portfolio growth for Brazilian MFIs. However, growth is still fragile because of the technical weaknesses that continue to beset most MFIs. The program seeks to maintain the trend towards growth in the sector, strengthening the private agents in the sector by structuring training services (to be offered through a network of private trainers) and to broaden access and exchange of specialized information between MFIs.

7.2 The program will help develop the industry, fostering two pilot experiences for the delivery of sustainable financial services in rural areas, by testing both a methodology for attracting credit services for microenterprise to microregions with a local economic development processes such as microfinance technologies adapted to the needs and particular features of a rural environment. The ultimate aim is to establish models that can be replicated for delivery of sustainable rural microfinance services.

B. Beneficiaries

7.3 The program will benefit Brazil's entire microfinance industry by establishing a nationwide supply of specialized microfinance training services and an information and technical dissemination system about best practices. All these services will respond to the needs of Brazilian MFIs and facilitate expansion of financial services to microenterprises, as well as develop pilot models for extending their financial services to rural areas. The program will directly benefit at least 80 Brazilian MFIs, who will improve the quality of their services by training their employees and managers, as well as by obtaining better technical information about the sector. This will enable them to improve both management quality and the quality of the microfinance services they offer. Microfinance policy and support agencies will also benefit from being able to obtain better information about the sector and having a forum for analysis and discussion of key aspects of the industry and lessons learned in various contexts. The program's ultimate beneficiaries will be urban and rural microentrepreneurs and MFI users with improved access to efficient quality microfinance services.

C. Risks

7.4 One risk associated with the program has to do with a change of authorities in the public sector. New authorities could redefine the priorities charted for the microfinance sector, thus affecting the activities being carried out. Given the approach of targeting the development of services in support of microfinance as a

whole, it is estimated that the impact of such changes would not be significant on the results of the program. The dissemination of information on the sector promoted under Component 2 will contribute to more enlightened discussion of the situation of the industry, and to mitigating some of the potential effects that could stem from a redefinition of priorities.

7.5 Another risk for the training component is that programs set up to support MFI staff training but that are financed by other agencies may organize programs that provide parallel services. This would reduce the demand for the services to be provided by the MTN through this program. ARCA and SEBRAE have agreed to coordinate these types of activities, which means that the demand for training services generated by the PASM should be addressed by ARCA's MTN as it develops (see the SEBRAE–ARCA agreement in the technical files). Moreover, plans to strengthen the ABDM, of which these organizations are members, will facilitate efforts to coordinate activities with other aid agencies, such as BNDES, which have the resources to promote development of the microfinance sector.

7.6 For Component 3, there is a risk that public MFIs or new state programs designed to support microenterprise will adopt aggressive financing policies for rural areas, including high direct subsidies. To the extent that such a move would produce unfavorable competition for the program's pilot rural microlending projects, it would affect the program's capacity to create sustainable models for providing microlending services. This risk will be mitigated through careful selection of the microregions in which the program will be developed.

VIII. SPECIAL CONTRACTUAL CONDITIONS

8.1 **Conditions precedent to the first disbursement.** As a condition precedent to the first disbursement, ARCA will supply, to the Bank's satisfaction: (i) the business plan for the first year of the program, which includes the Operating Regulations and the participation agreement with the Brazilian Association for Microfinance Development (see paragraph 6.1); and (ii) evidence that the program director has been hired (see paragraph 5.2) according to the terms of reference previously approved by the Bank.

LOGICAL FRAMEWORK

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTION
Objective			
The goal of the program is to help increase MFI capacity to provide quality financial services to microenterprise on a sustainable basis.	▪ Productivity indicators for personnel, portfolio quality, and operating efficiency of beneficiary MFIs improve compared with those of nonparticipants. ▪ More services are offered to microenterprises in at least two rural regions. ▪ Microentrepreneurs satisfied with the better quality financial services that are adapted to their needs based on uptrend in customer retention rate of beneficiary MFIs.	▪ Reports on conditions in the microfinance sector. ▪ Baseline, interim, and final program evaluations. ▪ Assessments of 30 MFIs to receive financing from the program.	▪ Macroeconomic policies do not change radically during the life of the project. ▪ The policy environment for the microfinance sector does not deteriorate. ▪ Favorable regulatory framework for financing microfinance portfolios. ▪ MFIs are interested in becoming self-sufficient. Training has a significant impact on MFI performance. ▪ Political climate for microfinance sector favors consolidation of sustainable MFI financing programs and at least market interest rates apply to microentrepreneur lending.
PURPOSE			
Sustainable development support program for microfinance established in Brazil, based on training for MFI human resources, dissemination of reliable information for the sector and the generation of pilot microcredit models.	At the end of the project: ▪ A structured and sustainable network of 80 trainers specialized in microfinance. ▪ 680 officials and senior staff of privately-owned MFIs have access to quality training services according to their needs. These services are also available to 290 people from public and private institutions interested in the sector: Approximately 80% of staff trained continue to work for MFIs and	▪ Program progress reports. ▪ Baseline, interim, and final program evaluations. ▪ MFI surveys. ▪ Financial statements and reports for the two pilot microlending projects in two microregions of Brazil.	▪ Institutions or trained professionals interested in taking part in the project. ▪ Training is a key ingredient of strengthening the MFIs in Brazil. ▪ MFIs are willing to pay for training. ▪ Trained staff members keep their positions in the beneficiary MFIs.

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTION
	institutions in the sector. ▪ MFIs and their staff apply best practices on the basis of an updated information system operating for the sector. ▪ Two new rural microlending programs are operating in two DLIS regions, with new microfinance technologies and products, good performance indicators (growing number of customers, asset quality indicators above the rural average), and viability for achieving sustainability in the short term. ▪ The training program covers its operating costs from fees charged. ▪ A reliable information system on the microfinance sector in Brazil (number of MFIs, operating indicators, and updated financial data) exists, that can be used for decisions on government development policies for the sector. ▪ Government entities that promote and regulate the sector are aware of best practices in the sector and they are applied in Brazil.		▪ Pilot projects do not encounter unfair competition created by interest rate subsidies. ▪ DLIS communities in rural areas are able to organize themselves around the program. ▪ Average fee per course estimated at US$400, is affordable to MFIs, with program incentives.

COMPONENTS			
1. Set up microfinance training services.	36 months after project launch: • A second-tier training program for training trainers set up in ARCA. • Network of microfinance trainers is created, with a presence in five regions of Brazil. At least 80 instructors are trained in various courses on topics of interest to MFIs in the project trainers network. ▪ Database of supply and demand for training developed for MFIs in Brazil is operational and posted on microcredit website. • 970 staff members from 80 interested MFIs and institutions are trained and applying the new MFI expertise and skills. ▪ Eight training projects are developed based on course materials previously designed by other development or training institutions serving the microfinance sector in Latin America. ▪ At least 30 MFIs develop training plans based on individualized assessments. ▪ The study grant fund has attracted beneficiaries, private MFIs to the training courses offered by the MTN.	▪ Semiannual progress reports submitted to the Bank. ▪ Evaluations of training services, including customer surveys. ▪ Interim and final evaluation reports. ▪ Reports presented by members of the ARCA trainer network after each course.	▪ There is a national network of trainers. ▪ The courses offered are of good quality. ▪ MFIs that request training suitable to their needs find it. ▪ Customers are willing to pay for training. ▪ SEBRAE uses trainers network to offer microfinance courses.
2. Disseminate technical information and coordinate institutional efforts for the microfinance sector.	36 months after project launch: ▪ The ABDM is operational as a representative association for the microfinance industry and is largely supported by membership dues (30% of their operating costs). Its members include at least 60 MFIs in addition to other agencies in the sector. ▪ A dynamic microlending portal, supported by advertising sales and other sources, that offers up-to-date information about microfinance, including financial services offered by MFIs, access to the database of supply and demand for training and information about courses developed by ARCA, and a specialized virtual library in	▪ Semiannual progress reports submitted to the Bank. ▪ Interim and final evaluation. ▪ Review of the portal. ▪ ABDM statistics and financial statements. ▪ Announcement of award.	▪ Success in attracting MFIs to participate. ▪ MFIs share information and channel suggestions through the portal. ▪ MFIs have Internet access. ▪ Successful experiences in other countries are applied to Brazil.

	Portuguese, of at least 1,500 pages. ▪ 30% of the existing MFIs promote their products and services through the project. ▪ Agencies that set policies for microlending (the central bank, for example) use the website as a principal source of information. ▪ An awards program established and supported by sponsors who extend recognition to innovations and best practices in Brazilian microfinance institutions have completed three cycles of awards and dissemination of information, and have promoters to finance the fourth cycle. ▪ A system fed by the website is in place to gather information on best practices.		
3. Development of rural microfinance models that are integrated with local economic development processes.	At the end of the project: ▪ Two MFIs operating pilot projects in the microregions selected validate the program methodology for attracting microlending services to rural areas. ▪ MFIs carrying out pilot projects are operating with solid lending technologies and have developed at least four financial products that have reached at least 500 customers. ▪ A methodology that can be replicated has been established to enable more MFI to provide financial services in rural areas with revised and adjusted eligibility criteria. ▪ At least one institution with experience in microcredit has been associated with each pilot program.	▪ Semiannual progress reports submitted to the Bank. ▪ Interim and final project evaluation. ▪ Business plan for launching the two MFIs. ▪ Consultant reports.	▪ Microenterprise financial services are incorporated into the DLIS, so that demand arises from local sources. ▪ Experienced MFIs are attracted by the incentives offered by rural communities.

ACTIVITIES			
1. Structure microfinance training services 1.1 Survey supply and demand for training services. 1.2 Construct a database to disseminate information about supply and demand for services. 1.3 Develop a promotion plan and business plan for the program. 1.4 Develop training materials, content, and methodologies. 1.5 Train trainers. 1.6 Temporary scholarship program for MFIs. 1.7 Design and implement a quality control system for training.		▪ Business Plan for Program ▪ Semiannual progress reports submitted to the Bank. ▪ Interim and final project evaluation. ▪ Consultant reports. ▪ Supervisory visits.	
2. Disseminate technical information and coordinate institutional activities for the microfinance sector 2.1 Upgrade and initial setup for microlending portal. 2.2 Select and translate information about microfinance into Portuguese. 2.3 Design and promote the microfinance award, and prepare case studies about best practices. 2.4 Strengthen the ABDM: contract a part-time coordinator to revitalize operations. 2.5 Five workshops for MFIs and participants in the market to discuss policies of interest to the sector and promoting the sector to formal banking institutions.	**MIF** — **US$** Component 1 — 349,200 Component 2 — 140,200 Component 3 — 300,100 Administration — 54,000 Evaluations — 30,000 Auditing — 11,500 Contingencies — 40,000 Subtotal — 925,000		▪ MFIs are willing to provide information to determine training needs during the assessment stage. ▪ Other trainers are trained to create a stronger market and work together with ARCA.

3. Develop rural microfinance models that are integrated into local economic development processes a) **Stage 1** 3.1 Evaluate and make final selection of the two microregions. 3.2 Mobilize and raise awareness of local leadership. 3.3 Prepare case studies and preliminary business plans for two pilot projects. 3.4 Advise local communities on how to structure incentives to attract microlending operations. 3.5 Look for and select strategic partners to participate in the pilot project. 3.6 Advise on negotiating and setting up agreements with strategic partners to establish the rural microfinance pilot project. b) **Stage 2** 3.7 Provide specialized technical assistance services and training tailored to MFIs. 3.8 Catalogue project experiences and organize workshops to disseminate experiences. 3.9 Specialized consultant to coordinate and supervise the component.	**ARCA** — **US$** Component 1 — 298,500 Component 2 — 151,400 Component 3 — 175,900 Administration — 299,200 Evaluations — 0 Auditing — 0 Contingencies — 40,000 Subtotal — 925,000 Total — 1,850,000		

Annex II

PERFORMANCE INDICATORS FOR MONITORING DISBURSEMENTS

In order to ensure that funding will continue once 30% and 70% of the MIF contribution has been disbursed, ARCA shall demonstrate that it has met the following performance indicators:

I. Before more than **30%** of the MIF contribution has been disbursed, namely that:

A. Component 1: (1) individualized assessments and training plans have been completed for at least 15 privately-owned MFIs that will provide cofinancing; (2) agreements have been signed with at least 10 training institutions in 10 states to form an MTN; (3) a pilot electronic database of training supply and demand for MFIs has been developed and implemented; (4) an agreement has been reached with MTN members on the courses to be offered to MFIs by the trainers trained by ARCA during the following 12 months, based on identified demand; and (5) base-line information has been completed to measure the performance of MFIs that have benefited from the program.

B. Component 2: (1) the information and software system has been designed and the texts to be translated into Portuguese identified; and (2) the methodology for the best practices award in microfinance has been designed, including subject selection criteria, verification of information about the contestants, and (3) the Award Assessment Committee has been formed.

C. Component 3: (1) the two microregions that meet the requirements for developing a microfinance program have been identified; (2) mobilized local leaders and prepared a market study and business plan for the pilot microcredit project in at least one microregion; (3) the incentives plan that communities in at least one microregion will offer for one of the microfinance pilot projects has been established; and (4) (documented) meetings have been held with at least 15 MFIs or private institutions from Brazil's national financial system for the specific purpose of explaining and promoting the microfinance projects to be developed in Component 3 and evaluate their interest in participating.

II. Before more than **70%** of the MIF contribution has been disbursed, namely that:

A. Component 1: (1) the individualized assessments and training plans have been completed for 20 MFIs; (2) agreements have been signed for the establishment of a microfinance training network with at least 50 suppliers of training with service coverage in at least four of the country's five regions; (3) the content and methodology for six microfinance courses have been completed; (4) a total of 40 trainers have been trained; (5) 20 training courses have been carried out and received for the MFIs through the MTN; and (6) quality control system for the training programs has been designed.

B. Component 2: (1) 1,000 pages of specialized microfinance texts have been translated into Portuguese and disseminated; (2) at least 30 privately-owned MFIs have joined ABDM; (3) revenue it receives from the website for the services it

provides is sufficient to cover at least 5% of its operating expenses; and (4) at least one cycle of best practices awards in microfinance has been completed, with awards conferred on the winners and notification prepared.

C. **Component 3:** two agreement has been signed between the communities in a microregion and at least one MFI or one privately-owned financial operator to launch microfinance activities in that region.