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PANAMA

SOCIAL ENTREPRENEURSHIP PROGRAM (SEP) FINANCING AND TECHNICAL-COOPERATION PROPOSAL

EXPANSION OF RURAL MICROCREDIT IN THE CENTRAL PROVINCES

(TC/SP-03-03-01-0-PN)

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EXECUTIVE SUMMARY

Executing agency: Asociación para el Desarrollo de las Cajas Rurales [Association for the Development of Rural Savings and Loan Institutions] (PROCAJA)

Financing plan:	US\$	Euros*
Reimbursable financing (European Commission):	250,000	214,450
Technical cooperation (European Commission):	250,000	214,450
Local contribution:	<u>154,000</u>	<u>132,101</u>
Total:	654,000	561,001

Source of funds: The resources will come from the European Community Special Fund for Microenterprises (ECM). The commitment of funds will be recorded in euros (€).

*Exchange rate: US\$1.00 = €0.8578 as of 20 October 2003

Terms and conditions:

<u>Financing:</u>	
Amortization period:	15 years
Grace period:	5 years
Disbursement period:	60 months
Interest rate:	2.5 per annum
Currency:	U.S. dollars (US\$)

<u>Technical cooperation:</u>	
Execution period:	66 months
Disbursement period	72 months

The grace period will apply only to amortization of the principal, not the interest. The financing will be denominated in euros, but disbursed in U.S. dollars. The loan will be repaid in U.S. dollars.

Problem to be addressed:

In Panama, rural areas have the highest poverty rates and marginality indices. Roughly 37% of the country's total population lives in poverty, while 18.8% lives in extreme poverty. There is a very limited supply of financial services, particularly in the central provinces, which have some of the highest poverty rates in the country. Poor inhabitants of those areas have sporadic access to credit, primarily through informal banking facilities or moneylenders who charge usury rates. Under these conditions, a sustainable rural microcredit instrument would be an important factor in helping to reduce poverty and improve the standard of living of low-income inhabitants. PROCAJA is one of the few institutions that serve this sector. It needs support to expand its portfolio, strengthen its institutional structure, and implement new rural credit technologies.

Objectives:

The project's general objective is to boost the income and improve the living conditions of poor, rural inhabitants in Panama's central provinces, by providing greater access to financial services. The specific objectives are to: (i) increase access to credit for rural inhabitants of the central provinces; (ii) improve and expand the supply of financial products in those areas; and (iii) strengthen PROCAJA as an institution, so that it can provide financial services to this sector and operate sustainably and efficiently.

Description:

The project has a reimbursable financing component and a nonreimbursable technical-cooperation component.

Reimbursable financing component (US\$300,000: European Commission/Bank–US\$250,000; PROCAJA–US\$50,000). The purpose of this component is to increase PROCAJA's loan portfolio, to improve and expand the supply of financial products in the central provinces. The reimbursable financing will enable PROCAJA to offer poor, rural inhabitants microcredits with a joint and several guarantee. Expansion of the program will enable members to increase their capital base and have own resources to implement productive activities or meet their general needs. The project will grant roughly 20,000 loans during project execution, benefiting approximately 8,000 poor inhabitants, including current members of existing rural savings and loan institutions, new members who join, and members of any new savings and loan institutions created. The expansion of financial services should also enable PROCAJA to regain financial self-sustainability.

Technical cooperation (US\$354,000: European Commission/Bank–US\$250,000; PROCAJA–US\$104,000). The nonreimbursable technical-cooperation component is aimed at providing PROCAJA

with technical assistance for institution-strengthening and expansion of rural microcredit. To achieve this objective, it will focus on the following courses of action: (i) expansion and diversification of financial products; (ii) institution-strengthening; (iii) increased coverage of services; (iv) general training; and (v) support for project execution.

Environmental and social review:

The Committee on Environment and Social Impact (CESI) reviewed this operation at meeting 18-03 of 16 May 2003. Its recommendations are reflected in this document.

Beneficiaries:

Roughly 8,000 low-income rural inhabitants and their families in the central provinces of Panama (Veraguas, Herrera, Coclé, Los Santos, and Oriente Chiricano) will benefit from the project. Many of these families are currently living in extreme poverty, with their main basic needs going unmet, and have average annual per capita income of approximately US\$600. An estimated 45% of the beneficiaries will be women.

Risks:

The project has two main risks. *First risk.* Since PROCAJA's specific market niche is in the lowest-income segments of the economy and the project plans to expand that niche in the coming years, there is the risk that the projected demand will not materialize or that undue growth will affect PROCAJA's sustainability. To minimize this risk, the project will: (i) establish mechanisms for PROCAJA to gradually expand its client base, all the while continuing to serve current clients who have proven to be good payers; (ii) advise PROCAJA on the design and implementation of new financial products tailored to its market and of the corresponding Credit Regulations; (iii) support the controlled expansion of PROCAJA services, by disbursing the funds over a relatively long period (five years), compared to other Social Entrepreneurship Program (SEP) operations; and (iv) establish that disbursements under the subcomponent for the possible expansion of rural savings and loan institutions will only begin with the Bank's approval three years into the project, once the established targets have been achieved. *Second risk.* Given the rapid expansion being proposed in a somewhat risky segment of the market, the second risk is that the quality of the institution's portfolio will deteriorate due to negligence, fraud, or inadequate internal control systems. To minimize this risk, the project will: (i) establish mechanisms for reviewing PROCAJA's operating and financial controls system and support improvements and stricter controls; (ii) offer support for the evaluation of and improvements to the current information system and propose and coordinate options for interconnecting savings and loan institutions; and (iii) request detailed information in PROCAJA's first semiannual progress report on the steps taken to make internal controls function

properly and to offer a reasonable safety margin for Bank control of its disbursements.

Strategy of the government and the Bank:

The Bank's country strategy with Panama includes supporting sustainable regional development and alleviating poverty. The Bank's strategic objectives are set forth in the country paper, which also accords priority to growth and eliminating barriers to the business activities of productive sectors. The proposed project is consistent with the Bank's strategy with Panama, contained in country paper GN-2136-6 of 24 April 2001, and Programming Memorandum CP-1136, approved on 20 November 2002, because it would implement strategies to reduce rural poverty and enhance equity. This operation is therefore in line with the Bank's country strategy with Panama.

The operation is also consistent with the criteria established in the SEP policy approved by the Bank in 1998 (GP-75-9), because the final beneficiaries are inhabitants of economically-depressed rural areas. The proposed project has the potential to help boost the income that population generates from its productive activities.

Coordination with other official development institutions:

The project was prepared in coordination with other donors. In particular, it takes into account the lessons learned by the Program for Cooperation with the Social Emergency Fund (PROCOOFES), financed by the European Union from 1995 to 1998. The proposed project would strengthen and complement the local economic development activities undertaken through PROCOOFES and make them sustainable, as well as consolidate and give continuity to the management vision that PROCAJA has advanced, by creating a rural financial system in the central provinces of Panama.

Rationale:

The project is justified because: (i) it will give the poorest inhabitants of rural areas in the central provinces access to sources of credit, enabling them to obtain the capital they need to implement productive and business activities; (ii) that source of credit will increase their ability to generate income, boost purchasing power and generally enhance the standard of living of inhabitants of those regions; (iii) it will establish a sustainable mechanism, promoted by the private sector, that could encourage other public- or private-sector organizations to offer financial services to that market; and (iv) it will develop best practices in rural credit technology. Another important justification is that PROCAJA, through the technical-cooperation component, will be able to strengthen its organizational and technological capacity, so it could feasibly obtain loans from other financial institutions in the future or attract private investors.

Reports and evaluations:

Reports: PROCAJA will submit semiannual reports to the Bank containing financial and narrative information, within 60 days following the end of each six-month period, starting in the period in which disbursements commence. At a minimum, the reports will contain: (i) statistical and financial data on portfolio quality, clients, and performance indicators, based on the indicators agreed to with the Bank; and (ii) information on the technical assistance received and its results. PROCAJA must indicate which activities were achieved and, for those not fulfilled, the reasons why. Lastly, PROCAJA must include a review of the initial work plan and projected indicators, outlining the reasons for the achievements, unfulfilled tasks, and any deviations.

Since PROCAJA must implement an internal control system satisfactory to the Bank, to prevent its past experiences from repeating themselves and jeopardizing Bank funds, its first progress report must provide a detailed account of the steps taken to ensure that those controls function properly, providing a reasonable safety margin for Bank control of its disbursements.

The last progress report will serve as the final report and must summarize the progress made, based on the original objectives. The Bank will review the outcomes and recommendations in those reports. If significant shortcomings in project execution are detected, the Bank will not authorize any further disbursements until PROCAJA has taken satisfactory steps to correct them.

During project execution, within 90 days following the end of each fiscal year, PROCAJA will present its audited financial statements to the Bank. In addition, within 90 days following the end of the period for the last disbursement of nonreimbursable technical-cooperation funds, PROCAJA will present a financial report, audited by independent authorities, showing how the Bank's contribution was used.

Evaluations: Baseline: PROCAJA will be responsible for compiling and analyzing relevant information for ongoing monitoring of the project performance indicators. At the outset of the project, PROCAJA will hire a consultant to establish baseline parameters and design a system of indicators for monitoring and evaluating project activities and performance, to complement or update those contained in the logical framework. The baseline study will establish initial measurements for all the indicators in the logical framework, as well as any others the consultant and PROCAJA deem necessary to gauge project impact. PROCAJA will present the proposed monitoring

indicators and baseline parameters to the Bank's Country Office for approval, within the first three months of the project. Once they have been agreed upon, those parameters and indicators and the ones contained in the logical framework will constitute the basis for monitoring project performance.

For project supervision and evaluation, PROCAJA and the Bank will use an indicator monitoring system. PROCAJA will keep that information in a database that will also be used to measure the operation's impact. During project execution, PROCAJA will be responsible for collecting data on the income level of each client and other indicators identified in the baseline in time to perform credit analyses. Those indicators will be considered in the progress reports and midterm and final evaluations.

Midterm evaluation: When 40% of the financing has been disbursed, the Bank will commission an external evaluator to perform a midterm evaluation. The main elements to be examined will include: (i) the executing agency's compliance with project procedures, regulations, and indicators; (ii) improvements in the socioeconomic situation of project beneficiaries, with respect to the baseline; (iii) recommendations for the Bank and the executing agency on how to improve project administration; and (iv) progress made in PROCAJA's expansion plan and the need to expand its network of rural savings and loan institutions.

Final evaluation: In order to document the experience and gauge progress, the Bank will use technical-cooperation funds to commission a final project evaluation when 100% of the financing has been disbursed. The final evaluation will analyze the following elements, among others: (i) the efforts made to disseminate the project; (ii) the results from strengthening rural savings and loan institutions and PROCAJA; (iii) the executing agency's efficiency and effectiveness in administering Bank resources; and (iv) the lessons learned from the project that could be applied to other SEP operations. The initial data compiled on the beneficiaries will serve as the basis for measuring changes in the indicators as a result of the project. The indicators presented in the logical framework and the table of project performance indicators will be taken into account for measuring these elements.

Special contractual conditions:

For the first disbursement of the reimbursable financing, PROCAJA will present to the Bank: (i) the final Operating and Credit Regulations and evidence that they are in effect; and (ii) the business and investment plan.

PROCAJA must present to the Bank the Credit Regulations for the new products to be developed, before they will be financed.

The Bank can release up to US\$5,000 in technical-cooperation funds, without any conditions precedent to disbursement, to hire a consultant to help meet the contractual conditions precedent to disbursement and facilitate start-up of the project. For subsequent disbursements of technical-cooperation funds, PROCAJA must: (i) present a work plan for project execution, within the first 12 months; it must include, *inter alia*: (a) targets for the first year of fulfillment for each activity; (b) the number of consulting services to be performed; (c) targets for the number of microentrepreneurs who would be final beneficiaries of the loans; (d) mechanisms for supervising and controlling consultants' activities; and (e) human, physical, and financial resources earmarked for each activity; and (ii) appoint a project coordinator.

For disbursement of over 50% of the technical-cooperation resources, PROCAJA will present evidence to the Bank that its loan department has disbursed at least US\$150,000 in funds from the financing component to its members.

Disbursements in the technical-cooperation subcomponent to expand rural savings and loan institutions can begin in the third year of execution, however only with the Bank's authorization, if PROCAJA achieves the project targets and presents the following to the Bank's satisfaction: (i) a market study showing sufficient demand for its services in the areas where the new institutions would be established; (ii) proof of ownership of the land that would be used; and (iii) an investment plan describing the use of own resources to complete the works.

Exceptions to Bank policy:

None.