

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK
MULTILATERAL INVESTMENT FUND

MEXICO

**FINANCIAL SERVICES FOR RURAL WOMEN IN
SOUTH-SOUTHEASTERN MEXICO**

(ME-S1005)

LOAN PROPOSAL

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INFORMATION AVAILABLE IN THE TECHNICAL FILES

In Preparation

- Project request
- Approved project profile
- Documents on the establishment, legal registration, and by-laws of Alternativa Solidaria Chiapas (ALSOL AC) and ALSOL CONTIGO S.A. DE C.V. SOFOM ENR
- Audited financial statements for 2007, 2008, and 2009 of ALSOL AC and ALSOL CONTIGO S.A. DE C.V. SOFOM ENR
- Risk rating report on ALSOL AC by MicroRate (June 2009)
- ALSOL CONTIGO credit manual
- Social performance rating by MicroFinanza Rating (March 2007)
- Strategic plan of ALSOL CONTIGO 2010-2014
- List of external financing for ALSOL CONTIGO at July 2010
- Institutional brochure for ALSOL CONTIGO and ALSOL AC
- Institutional and fiduciary risk analysis of ALSOL CONTIGO

DOC 1	Logical framework
DOC 2	Institutional analysis and implementation of the operation, with financial projections for the project
DOC 3	Milestone planning table for the technical-cooperation component
DOC 4	Plan of operations of the technical-cooperation component. Detailed budget and execution timetable
DOC 5	Summary of ALSOL CONTIGO's credit regulations
DOC 6	Historical financial statements and financial indicators of ALSOL AC/ALSOL CONTIGO 2007 - 2009
DOC 7	Procurement plan
DOC 8	Summary of project financial conditions
DOC 9	Terms and conditions of the loan
DOC 10	Integrity Review Summary

I. BASIC PROJECT INFORMATION

A. Executing agency

1.1 ALSOL CONTIGO SA de CV SOFOM ENR (ALSOL CONTIGO)

B. Amount and source of financing

	IDB US\$	Local US\$	Total US\$
Reimbursable financing:	1,000,000	500,000	1,500,000
Technical cooperation funding:	250,000	113,300	363,300
Total:	1,250,000	613,300	1,863,300

Source: Spanish Trust Fund for the Social Entrepreneurship Program (FEP)

C. Terms and conditions

Amortization period:	6 years
Grace period:	36 months for the principal
Interest rate:	11.5% a year on balances
Currency:	Mexican pesos
Execution periods:	36 months for the technical-cooperation funding 33 months for the reimbursable financing
Disbursement periods:	42 months for the technical-cooperation funding 36 months for the reimbursable financing

1.2 The grace period will only apply to amortization of the principal and not to interest. The loan will be denominated, disbursed, and repaid in Mexican pesos.

D. Statement of no objection

1.3 The Mexican government, through the Department of Finance, issued its no objection to this project in communication 347.-A- of 27 September 2010.

E. Problem to be addressed

1.4 **Poverty in Mexico, particularly in the south.** With a population of over 104 million, Mexico is the 11th largest country in the world by population and, according to the World Bank, it ranks second in Latin America in per capita income, with an average in 2009 of US\$14,337. However, these indicators mask sharp inequalities. Studies by the Consejo Nacional de Evaluación de la Política de Desarrollo Social (CONEVAL) [National Social Development Policy Evaluation Council] suggest that 49 million Mexicans (47% of the population) live below the 'asset poverty' line,¹ which affects 38% of city dwellers and 62% of rural dwellers. Mexico's rural population is scattered and isolated, which is directly related to poverty levels. The biggest challenge for services of all kinds is posed by about

¹ CONEVAL considers three poverty indexes. The 'food poverty' index which is defined as the income required to purchase the basic food basket; the 'capacity poverty' index adds spending on health care and education; and the 'asset poverty' index adds spending on clothing, housing, and transportation.

64,000 isolated communities which are home to nearly 5 million people (about 78 people per community), the vast majority of whom live in poverty and extreme poverty and just 44% of whom have access to passable roads. The illiteracy rate is 40%. Mexico's southern region² presents an even worse picture owing to adverse farming conditions, a production system based on micro-holdings, and the isolation of the majority of rural communities. The poverty index is 30% higher among indigenous groups, where 44% of the children suffer from stunted growth (compared to 17% of the non-indigenous population) and schooling averages 4.6 years (compared to 7.9 for the non-indigenous population).

- 1.5 **Microfinance in Mexico and the extent of rural finance.** The microfinance sector in Mexico is broad, complex, and with great potential for growth and consolidation. It has a wide variety of institutions³ that provide different services for different population segments, which makes it difficult to obtain a complete enumeration by type of institution. However, most of the institutions that serve the micro and small business sector are affiliated with Prodesarrollo, a national network consisting of 86 organizations that provide grassroots financial services. In December 2009, its members served over 4.4 million people through 1,522 agencies around the country, with a total portfolio of about US\$1.8 billion and average loans of US\$514. Despite these impressive figures, most of the financial institutions operate mainly in urban and semi-urban zones, neglecting most rural areas, particularly communities with fewer than 20,000 people. Some authors estimate that just 13% of rural households have access to a savings account and just 2.5% to credit from formal sector institutions.⁴ Also, a little over 700 municipios (out of a total of 2,443) have no savings bank or the presence of any microfinance institution.
- 1.6 **The socioeconomic situation of women heads of families in rural and semi-urban areas in Chiapas.** Chiapas, like other states in the Mexican south-southeast, is pluri-ethnic and pluri-cultural. About 70% of the population is rural and lives in small settlements scattered throughout the territory, with difficult access. Women make up 51% of the population and 26% speak indigenous languages. Human development is in the middle range (Human Development Index 0.50 to 0.79), although Chiapas is ranked nationally in 32nd place (with the lowest HDI in Mexico). In Chiapas, most women are heads of families with scant resources, and engage in flower growing, farming (maize, beans, sugar cane), crafts, the raising and sale of backyard animals, and the sale of garden vegetables and groceries.

² Which include Chiapas, Veracruz, and Tabasco.

³ Microfinance institutions do not fall into a distinct legal category, but rather belong to different categories that have in common the fact that they use methods designed to offer financial services for microenterprise. The most common categories are: Sociedad Financiera de Objeto Múltiple (SOFOM) [multi-purpose finance company], Asociación Civil (AC) [civil association], Institución de Asistencia Privada (IAP) [private assistance institution], Sociedad Financiera Popular (SOFIPO) [nonmember-based microfinance company], and banks.

⁴ "Formas de asociación cooperativa y su participación en la provisión de servicios financieros en México" [Forms of cooperative associations and their involvement in the provision of financial services in Mexico]. USAID Mexico Report. The Ohio State University. 2006

Many of them do not have access to financial services to improve their productive opportunities. According to the Progress Out of Poverty Index (PPI)⁵ used by ALSOL (the microfinance institution proposed as the borrower in this project), deprived rural women have average annual incomes of US\$600 and women living in semi-urban and urban areas have average annual incomes of over US\$800.

- 1.7 **Women and access to financial services.** For the low-income population in this part of the country, the possibilities of gaining access to basic financial services are extremely limited. The traditional financial system has looked on rural areas as unattractive for investment mainly owing to the high transaction costs of dealing with small, scattered settlements, inhabited by people who are mainly unilingual (native languages). Women, in particular, are in the least favorable situation. Not only is their work in the home not recognized, but they receive no personal support of any kind to enable them to conduct or expand productive activities to the benefit of themselves, their families, and the communities where they live.
- 1.8 **ALSOL CONTIGO's experience in rural microfinance in southern Mexico.** Fundación Alternativa Solidaria Chiapas A.C. (ALSOL) is a civil association founded in 1999 to offer microfinancial services to neglected populations in the state of Chiapas, particularly women. As of June 2010, through a recently-created SOFOM (2009)⁶ in which it is the majority shareholder, it was serving 18,713 clients at 10 offices in Chiapas. During its first 10 years of existence, ALSOL combined financial services with parallel social projects: basic literacy, health education, and 'business chats.'⁷ To operate in an increasingly competitive and demanding market, ALSOL found it necessary to separate its financial activities (microloans and microinsurance) from its nonfinancial ones (mainly education in health, business culture, and literacy), establishing a new institution known as ALSOL CONTIGO S.A. de C.V. SOFOM E.N.R. (the borrower in this operation) and maintaining Fundación ALSOL which specializes in and is restricted to activities related to the management of nonfinancial social services. ALSOL CONTIGO has worked to align financial products with the needs of women living in bypassed areas with low economic concentration, which translates into high poverty levels. Apart from its central office in San Cristóbal de las Casas, it has a network of nine branches and one agency, in San Cristóbal de las Casas, Ocosingo, Palenque, Yajalón, Motozintla, Ecuintla, Comitán, Bochil, and Oxchuc. Seventy percent of its clients live in rural areas, 20% in semi-urban zones, and 10% in urban areas.
- 1.9 ALSOL CONTIGO offers loans to women only through group credits (solidarity groups adapting the Grameen methodology) and since 2009 it has begun to offer

⁵ PPI is a management and measurement tool for evaluating poverty that ALSOL applies year to year, which it uses to monitor the poverty status of its clients, determine the effectiveness of its financial and nonfinancial programs, and improve its programs, products, and services.

⁶ Sociedad Financiera de Objeto Múltiple – an unregulated legal structure authorized to perform credit, factoring, and financial leasing operations.

⁷ Training in business management and different trades

individual loans (to microenterprises), with just 88 clients and a portfolio of US\$59,000 in this product in December 2009. Since 2008, it has also been offering low-cost life insurance to its borrowers and up to two more family members.

- 1.10 **The main comparative advantages of ALSOL CONTIGO** in the market are: (i) social focus on its supply of financial services whereby it seeks to reach zones not served by other institutions at lower interest rates than the competition; (ii) strategic partnerships with different international cooperation players and the management of projects to improve the standard of living of poor indigenous women (for example, through its partnership with Fundación ALSOL⁸), contributing to customer loyalty among clients/members; (iii) credibility in the microfinance sector and leadership in women's associations; (iv) quality of client services; and (v) knowledge of the rural environment (bilingualism, work with groups and communities) and geographic coverage in rural zones with difficult access to financial services. More information on the background, structure, management, and financial situation of ALSOL CONTIGO can be found in DOC 2 in the project's technical files.
- 1.11 ALSOL CONTIGO's portfolio and client numbers have always been on the rise despite the international crisis and the problems in Mexico, growing from fewer than 500 women served in 2001 to more than 18,700 in June 2010, with a portfolio of US\$4,503,000 and an at-risk portfolio (>30 days) of 2%. However, to be able to increase its supply and continue expanding into rural zones by opening new rural agencies, it needs additional long-term funding,⁹ which is the reason why it has applied to the Bank's Social Entrepreneurship Program.
- 1.12 During this stage of rapid growth and transition from a multiservice foundation (Fundación ALSOL) to a specialized microfinance institution (ALSOL CONTIGO), the entity has come up against several challenges that need to be addressed to assure its solid and healthy growth in the medium term. The main challenges include:
- a. The accounting and portfolio information system suffers from weaknesses relating to the interconnection of branches and agencies, scant flexibility for adapting to organizational changes, and some security aspects. Therefore, using its own funds and funds from other financiers ALSOL CONTIGO is in the process of selecting a new system by October 2010 and expects to have it operating as a pilot project in the first quarter of 2011.
 - b. Declining client retention rates owing to stiffer competition in some work zones that offers more expeditious credit technologies and larger loans. This has led ALSOL CONTIGO to hire a consultant to review its internal processes and suggest full-scale reengineering to boost the competitiveness and

⁸ And with cooperation funds such as Oxfam-Novib (Netherlands), Fundación Gilles (Belgium), USAID Mexico, and others to support its literacy, health, and training programs.

⁹ According to conservative projections for growth in its clients and portfolio, ALSOL CONTIGO will require a minimum of US\$5 million in external financing in the next five years.

responsiveness of its credit products and update its credit manual, with the aim of reducing the time required to arrange a loan from three visits to one, and disbursement time from 15 days in 2009 to three days in 2012.

- c. Growth in the at-risk portfolio from 0.3% in 2007 to 4.6% at the end of 2009 owing to less stringent application of the credit methodology, insufficient supervision of the work of the loan officers, and economic problem that affected income in the region (less tourism and lower remittances on account of the global crisis). This reflects the need to improve the analysis and management of financial, operating, and market risks and assure a chain of supervision and discipline running from management to the loan officers, through periodic reinforcement of credit methodologies and good managerial and supervisory skills.
 - d. Higher personnel turnover in ALSOL CONTIGO (from 10% in 2006 to 21% in 2009) owing to the lack of an institutional career path, the loss of personnel to other microfinance institutions that pay better salaries and benefits, and the lack of an adequate incentive system. This indicates that ALSOL CONTIGO should strengthen its human resource management, design an institutional career plan, offer training and skills-improvement opportunities for staff, and other incentives that help to retain committed personnel.
 - e. The board of directors, under the new legal category of SOFOM, needs to build up its knowledge and skills for analyzing the financial, strategic, and competitive aspects of the company and take good corporate decisions on the strategic management of ALSOL CONTIGO in an increasingly complex and competitive context.
- 1.13 The project's technical-cooperation component will support ALSOL CONTIGO in addressing these priority needs, with stress on the last three (c, d, and e), given that it will cover the needs of the management information system and internal processes with its own funds and other financial supports.
- 1.14 **Beneficiaries.** The direct project beneficiaries will be about 6,000 low-income women microentrepreneurs in rural areas in south-southeastern Mexico who will receive loans of between US\$80 and US\$4,000 to finance working capital and/or investments, in addition to life insurance and coverage of the unpaid balance of their loans. ALSOL CONTIGO's clients average 32 years of age, 21% never attended school, 32% did not complete primary school, do not know how to read or write, and have an average of six children. About 43% are heads of households and 40% are indigenous, primarily speaking their native tongues. Eighty-four percent of its clients had no access to credit before applying to ALSOL CONTIGO. Fifty percent live below the poverty line of US\$1/day and another 33% earn less than US\$2/day.

II. THE PROJECT

A. Objective and purpose

- 2.1 The objective of the project is to increase the supply of financial services for low-income populations in south-southeastern Mexico. The purpose is to provide low-income rural women microentrepreneurs in that area with access to personalized financial resources to start up or develop their business activities.

B. Description

- 2.2 Two components will be financed to attain the objectives: reimbursable financing for US\$1.5 million (IDB: US\$1 million and ALSOL CONTIGO: US\$500,000); and nonreimbursable technical-cooperation funding for US\$363,300 (IDB: US\$250,000 and ALSOL CONTIGO: US\$113,300), both to be executed by ALSOL CONTIGO.
- 2.3 The **reimbursable financing component** will be used to finance the expansion of ALSOL CONTIGO's rural credit portfolio to about 6,000 rural women microentrepreneurs with very low incomes to provide them with funds to cover their working capital and/or investment requirements for productive, commercial, or service activities. ALSOL CONTIGO's clients mainly engage in commerce, production and sale of crafts, sale of flowers, clothing, and food, and raising backyard animals. ALSOL CONTIGO will offer loans for solidarity groups, in accordance with its methodology and under the conditions described in DOC 5 in the project's technical files ("Summary of ALSOL CONTIGO's credit regulations"). The funds committed by the Bank and ALSOL CONTIGO in this project will be used exclusively for loans for women microentrepreneurs in rural areas under the modality mentioned above. The amounts of the loans for each client range from the equivalent of US\$80 to a maximum of US\$4,000 equivalent (the average in June 2010 was US\$389), which are always disbursed and repaid in Mexican pesos. The terms of the loans range from 10 to 50 weeks, with weekly or bi-weekly payments. The guarantees of the loans are exclusively joint and several (the clients in each group undertake as a whole to cover any unpaid balances and interest on any unpaid loan in their group). In addition, with the payment of each installment, the clients also contribute 20% of their periodic principal payment, which builds up in a personal 'guarantee fund.' The fund serves as an additional guarantee for the loan and is returned to the client when she has finished repaying her loan. Clients whose loans are up to date can obtain an additional 'parallel loan' to meet other financial needs, for example school expenses, a family emergency, or additional needs owing to higher seasonal demand for their products. Together with their loans, all the clients also receive life insurance that costs 2 Mexican pesos (US\$0.16) a week that pays a benefit equal to US\$800 plus the outstanding loan balance. The Bank's financing for ALSOL CONTIGO will charge annual interest

on the unpaid balance of 11.5% in Mexican pesos for a term of six years, with a 36-month grace period.¹⁰

- 2.4 The **project's technical-cooperation component** will support five main areas: (i) activities to support the expansion of credit into underserved rural zones; (ii) strengthening of ALSOL CONTIGO's new risk unit to ensure healthy portfolio growth; (iii) strengthening of human resource capacity and retention (middle managers, loan officers, area managers); (iv) strengthening of ALSOL CONTIGO's corporate governance; and (v) support for project execution. The funds will mainly be used to: (a) conduct market studies for opening new rural agencies and investments in infrastructure and equipment for those agencies; (b) contract consulting services to evaluate ALSOL CONTIGO's credit risks, strengthen the risk unit, and fund a study visit by the risk manager to a similar microfinance institution; (c) hold training events and courses for personnel on different levels and study visits to learn about best practices in similar microfinance institutions; (d) educate the members of the board of directors in good governance practices in microfinance and cover the cost of their participation in microfinance forums; (e) contract a project coordinator; and (f) contract project evaluations and audits. The work plan for the technical-cooperation component, which can be consulted in the technical files, describes this support in greater detail and includes an itemized budget.

C. Sustainability and results of the financial analysis

- 2.5 The financial viability of the project was evaluated on the basis of: (i) the analysis of ALSOL CONTIGO as a microfinance institution able to sustain a sound financial position, honor its financial obligations with the Bank, and maintain the credit products supported by the project beyond the life of the loan; and (ii) the establishment of competitive financial conditions to permit ALSOL CONTIGO to meet demand by its target clientele, cover the operating costs of its services, and generate sufficient profits to capitalize itself and repay the Bank loan.
- 2.6 ALSOL CONTIGO's historical financial statements (DOC 6 in the technical files) show a strong capital structure, a good-quality portfolio, high levels of efficiency and productivity, and profitability that permits it to continue growing and generating surpluses sustainably. ALSOL CONTIGO's portfolio and operations have been growing since it was founded and its management of assets and liabilities has been adequate. In December 2009, its arrears portfolio (>30 days) ratio was 4.61%, which fell to 2% in June 2010 after it wrote off its portfolio more than 360 days in arrears, after not having written it off for more than 15 months. This figure compares favorably with the average in the microfinance industry in Mexico of 4% in December 2009 for mid-sized microfinance institutions using the solidarity group methodology. Its risk coverage ratio (reserves/at-risk portfolio) was

¹⁰ Although the ideal would have been to agree on a variable rate in local currency to cover possible changes in the exchange rate and inflation, this was impossible since the Bank's Finance Department only permits the use of fixed rates in local currency for loans under the Special Entrepreneurship Program.

117% in December 2009 and rose to 160% in June 2010. Its total net worth in December 2009 was US\$3.2 million and its liabilities at the same time were US\$2.5 million, for a leverage ratio of just 0.78 times. The IDB's total financing would amount to 31% of its net worth at December 2009 and if it is fully disbursed, it would raise its financial leverage from 0.78 to 1.1 times (liabilities/equity), which is a very low level for a microfinance institution. The net results have also been growing annually and are positive, for US\$925,940 in financial year 2009. Also, the project's financial projections (in the technical files) indicate that ALSOL CONTIGO will be able to continue posting growing returns and maintain a leverage ratio of under 4x for the duration of the loan, despite its strategy of gradually reducing the interest rates charged to its clients. Therefore, it is safe to say that ALSOL CONTIGO will be able to honor its financial obligation with the IDB and support the development and growth of its loan portfolio with higher levels of external financing.

D. Credit risks for the Bank

- 2.7 ALSOL CONTIGO has been demonstrating positive trends in portfolio growth, profitability, levels of assets, equity, and solvency, and in maintaining a good-quality portfolio. The project's projections indicate that the present loan will allow it to continue along the same path. Its performance in managing other external loans to finance its portfolio has been and continues to be positive.¹¹ In addition, ALSOL CONTIGO is in the process of opening up its shareholding to include a foreign investor (ASN-Novib Fonds-[ANF] operated by Triple Jump) in 2011, which will help to build up its net worth and improve its corporate governance, further reducing the credit risks for the Bank in the future. In June 2009, MicroRate rated ALSOL CONTIGO's risk and gave it a general rating of B+,¹² and a financial profile of α (alpha), with a stable trend. Therefore the credit risk of this operation for the Bank is small.

E. Expected outcomes and capture of benefits

- 2.8 The direct benefit of Bank resources will be captured by about 6,000 low-income rural women microentrepreneurs in south-southeastern Mexico, 40% of whom are indigenous, who will have access to: (i) credit to finance their working capital and/or investment requirements to boost the capacity of their economic activities; and (ii) low-cost life insurance that covers the outstanding balance of their loan, plus a cash benefit of US\$800 equivalent for the policy beneficiary. Clients will also benefit from a gradual reduction in interest rates on their loans as a result of ALSOL CONTIGO's strategy to reduce its rates to its clients' benefit, without jeopardizing moderate returns in its financial results. By the end of the three-year project, ALSOL CONTIGO will have expanded its rural credit program through

¹¹ The foreign external financiers Oxfam-Novib operated by Triple Jump (Netherlands) and Grameen Foundation (USA) have verified ALSOL CONTIGO's good performance in complying with its financial obligations relating to loans for US\$750,000 and US\$910,000 respectively.

¹² B+ means "moderate credit risk, profitable microfinance institution, with a solid financial structure. Organizational structure in the process of consolidation."

solidarity groups as part of the gamut of financial services it offers its clients, with a new portfolio of over US\$1.5 million, having granted at least 25,000 loans, with an arrears portfolio (>30 days) of 4% or less, which generates sufficient income to cover all its financial and operating costs. With support from the project's technical-cooperation component, ALSOL CONTIGO will also have opened at least six new rural agencies and strengthened its risk management, corporate governance, and the application of good technical and managerial practices to its operations and management staff.

F. The Bank's country strategy

- 2.9 The Bank's country strategy with Mexico for 2007-2012 identifies promoting opportunities for job creation, income generation, accumulation of physical, human, and financial assets among the very poor, including better access to credit for low-income populations among its main pillars. The present operation is compatible with this strategy because it will permit ALSOL CONTIGO to continue acting as one of the few microfinance institutions with the specific mission of bringing financial services to low-income women microentrepreneurs living in rural parts of the country.

G. MIF strategy: Access framework

- 2.10 In the access framework, under the subject of microfinance, the agenda is to expand and diversify the penetration of microfinance services to neglected and rural populations, whose specific objective is to expand the scope of microfinancial services to unserved rural and urban populations mainly through support (loans, technical assistance, capital, etc.) for microfinance institutions. The proposed project is in line with the MIF access framework and the objectives of the agenda, since it seeks to serve low-income rural women, including a significant percentage of indigenous women.

H. Summary of the environmental and social review

- 2.11 The environmental and social review (ESR) team commented on the project on 23 August 2010 (ESR 34-10) and recommended as part of the environmental study that a careful examination be performed of ALSOL CONTIGO's environmental and social procedures during the analysis mission, using the Bank's policies as the yardsticks. The operation falls under Section B.13 of policy OP-703.
- 2.12 The analysis and design of the project resulted in the following agreements and conclusions with ALSOL CONTIGO relating to its environmental and social aspects: (i) more than 98% of ALSOL CONTIGO's loan portfolio is placed in very small loans (averaging US\$390) to women who belong to 'solidarity groups' and the majority are used for commercial activities and, to a lesser extent, for very small-scale production activities, and therefore the environmental impact of the operations is minimal; (ii) ALSOL CONTIGO will apply the exclusion list to activities financed by its general portfolio, following the recommendations established in the Guidelines for Social and Environmental Impact Due Diligence

for IDB Microenterprise Operations of August 2003; (iii) ALSOL CONTIGO will also ensure that the client activities financed by its loans do not violate Mexican social and environmental legislation; (iv) the semiannual project reports will include information on the application of policies and procedures for monitoring the social and environmental aspects of the portfolio (see paragraph 4.1) and the final evaluation will include a review of the application of the social and environmental criteria in the analysis and granting of loans; and (v) ALSOL CONTIGO's sister institution, Fundación ALSOL AC, will offer training programs for ALSOL CONTIGO's clients in preventive health care, literacy, and personal business, adding value to the financial services offered in rural areas, using materials that are primarily graphic (drawings) and literacy materials in native languages.

- 2.13 ALSOL CONTIGO's clientele is composed exclusively of low-income women microentrepreneurs and the institution does not discriminate in terms of race, creed, or size of economic activity. Almost 30% of its clients are indigenous women from the Tzotzil, Tzeltal, Chol, and Tojolabal groups, many of whom do not speak Spanish. A rating of ALSOL's social performance in 2007 noted that its clients have the following characteristics: (i) 53% without primary education; (ii) 70% living in rural zones; (iii) 71% below the country's poverty line; (iv) 33% living on less than US\$1/day; and (v) 95% with no bank account. The institution contracts loan officers who preferably come from the zones where they work, which ensures that they have a good understanding of the traditions, customs, and particular cultures of their clients. Where necessary, it also contracts bilingual personnel (Spanish and the client language) to deal with clients in their main tongue. Seventy percent of the loan officers are bilingual.

I. Special conditions, disbursements, and procurement

- 2.14 Conditions precedent to disbursement. As conditions precedent to the first disbursement of the reimbursable financing, ALSOL CONTIGO will present the following to the Bank's satisfaction: (i) a work plan that includes an estimated schedule for disbursements and compliance with the targets; (ii) an institutional baseline with financial information, portfolio information, and performance indicators; and (iii) an annual procurement plan updated by ALSOL CONTIGO.
- 2.15 As conditions precedent to disbursement of the technical-cooperation funds, ALSOL CONTIGO will present the following to the Bank's satisfaction: (i) evidence that the project coordinator has been selected; and (ii) list of staff assigned by the institution to manage the project.
- 2.16 **Recognition of expenses.** On account of the urgency of some activities for expansion into rural areas and for training and consulting services in this year of transition to ALSOL CONTIGO, the Bank may recognize as counterpart funding expenses incurred by ALSOL CONTIGO after 1 September 2010 in respect of market studies, installation and equipping of new rural agencies, training, and study visits by personnel, to a maximum of US\$30,000.

- 2.17 **Disbursement of the financing:** Disbursement of the reimbursable financing will be conditional on compliance by ALSOL CONTIGO with institutional performance indicators agreed on with the IDB, which may be adjusted in exceptional cases as part of annual work planning. The indicators will include parameters for the arrears portfolio, equity exposure ratio, and return on equity, among others. The following table presents a summary of the indicators.

Indicators/conditions	Disbursement number and estimated amount		
	1st disbursement	2nd disbursement	3rd disbursement
	US\$333,000	US\$333,000	US\$334,000
At-risk portfolio (> 30 days) ¹³	≤ 7%	≤ 7%	≤ 7%
Equity exposure ratio ¹⁴	≤ 0%	≤ 0%	≤ 0%
Average return on equity ¹⁵ (ROE)	≥ 5%	≥ 5%	≥ 5%
Debt/equity (times)	< 4	< 4	< 4

- 2.18 **Execution period and disbursement mechanism for the technical-cooperation component.** The execution period for the technical-cooperation component is 36 months and the disbursement period is 42 months. Disbursements of this component will be conditional on achievement of the milestones agreed on by ALSOL CONTIGO and the MIF, which will be verified as agreed. Achievement of the milestones does not exempt ALSOL CONTIGO from responsibility for meeting the project's goals. The funds required to execute the project up to attainment of milestone 1 will be disbursed (up to 20% of the total contribution) posited on risk- and performance-based project management and against the signature of the contract, appointment of authorized representatives, and compliance with other agreed conditions. Disbursements in subsequent stages will be made against presentation of verification of achievement of the pertinent milestone and with the presentation by the executing agency of an estimate of the flow of resources needed for the next six months. In principle, disbursements will be reviewed ex post semiannually. The type and frequency of the reviews may be modified by the IDB based on the results of the reviews and/or subsequent institutional analyses performed during the project.
- 2.19 **Procurement.** Procurement of goods and contracting of consulting services will be carried out by ALSOL CONTIGO in accordance with IDB policies (documents GN-2349-7 and GN-2350-7). Prior to initiating the planned contracts and procurements, ALSOL CONTIGO will submit a procurement plan to the IDB for consideration,¹⁶ which will be reviewed and updated annually. According to the institutional analysis, ALSOL CONTIGO has medium capacity to administer the

¹³ Formula: (balance of the principal of the loan portfolio more than 30 days overdue plus the rescheduled portfolio)/balance of the principal in the gross portfolio.

¹⁴ Formula: (at-risk portfolio–reserves for the uncollectable portfolio)/net equity.

¹⁵ Formula: net profits for the period after taxes/average equity for the period.

¹⁶ A draft of the procurement plan is available in the project files.

technical-cooperation funds which is why procurement will be supervised ex post on an annual basis. The type and frequency of the reviews may be modified by the IDB based on the results of the reviews and/or subsequent institutional analyses performed during the project.

J. Reports, evaluations, and audits

- 2.20 **Indicators and baseline.** ALSOL CONTIGO will be responsible for compiling and analyzing relevant information for monitoring the project performance indicators. ALSOL CONTIGO will provide the Bank at the start of the project with an institutional baseline that includes information on the number of clients, financial and portfolio ratios, and others. The baseline and logical-framework indicators will be used as yardsticks for measuring project performance. ALSOL CONTIGO and the IDB will use these indicators during periodic project supervision. In turn, these indicators will serve for the final evaluation of the project. The indicators in the logical framework may be modified in agreement by the IDB and ALSOL CONTIGO.
- 2.21 **Monitoring of the financing.** To facilitate monitoring of the reimbursable financing, ALSOL CONTIGO will send the following to the IDB: (i) annually, within 120 days after the close of its accounting year, the audited financial statements of the institution and of the IDB's reimbursable financing; (ii) semiannually, its financial statements signed by its financial manager; and (iii) semiannually, or when they occur, information on relevant changes in the institution (for example in its board of directors or managerial staff, its equity, its share structure, its financing, etc.).
- 2.22 **Reports.** For the technical-cooperation component, ALSOL CONTIGO will be responsible for presenting project status reports (PSRs) to the MIF within 30 days after the end of each six-month period or more frequently, on the dates determined by the MIF, which will inform ALSOL CONTIGO of the change at least 60 days in advance. These reports will follow a format agreed on in advance with the MIF and will describe progress in project execution, attainment of the milestones, the results obtained and their contribution to achieving the project's objectives, as specified in the logical framework and other operational planning tools. They will also report on any problems encountered during execution, potential solutions, and information on the development and application of policies and procedures for monitoring the social and environmental aspects of the portfolio. Within 90 days after the end of execution, ALSOL CONTIGO will present a final PSR to the MIF which gives priority to the results achieved, the sustainability plan, and the lessons learned. The status reports will include a description of the technical assistance and training received, its quality, and the results.
- 2.23 MIF/CME will bear basic responsibility for monitoring the technical-cooperation component and the loan in the IDB, using the above-mentioned reports to verify the status of execution.

- 2.24 ALSOL CONTIGO will oversee that this project develops in accordance with the performance indicators established in the logical framework. The MIF may suspend disbursements in the event of serious negative deviations from those indicators, particularly the following three: (i) return on equity (ROE); (ii) equity exposure; and (iii) total arrears portfolio (over 30 days, not including the current rescheduled portfolio). If these indicators are found to have deteriorated significantly, ALSOL CONTIGO will have 30 days to agree with the MIF on the measures needed to improve its performance. If this term expires without improvements to its satisfaction, the MIF may suspend or cancel future disbursements.
- 2.25 **Audits.** ALSOL CONTIGO will establish and be responsible for maintaining adequate financial accounting, internal control, and project filing systems, following generally-accepted financial information practices and Bank/MIF financial management policies. The financial statements on the technical-cooperation funds will be audited at the end of execution of this component and will be presented to the Bank 120 days after the final disbursement. The review of documentation supporting the disbursements will be performed ex post on a semiannual basis.
- 2.26 Use of ex post reviews of procurement processes and the supporting documentation for disbursements may be changed by the MIF based on the reports of the reviews and/or subsequent institutional evaluations during the project.
- 2.27 ALSOL CONTIGO will contract independent auditors acceptable to the Bank to audit the project's financial statements and documentation supporting the disbursements. The cost of the contract will be financed from the MIF contribution following Bank procedures. ALSOL CONTIGO will audit the Bank's loan annually, together with the annual audits of its own financial statements. The additional cost incurred to audit the MIF loan will be covered by the MIF contribution.
- 2.28 **Evaluation.** The project provides for a final evaluation to be performed by an individual consultant selected and contracted by the IDB Country Office in Mexico with funds from the technical-cooperation component. The final evaluation will measure and document the following, among other aspects: (i) the project's response to the problems identified originally and that gave rise to it; (ii) the design of the reimbursable financing component and the area of coverage; (iii) a review of the application of the policy and procedures relating to the social and environmental aspects of the loans made; (iv) the lessons learned; and (v) project sustainability.
- 2.29 The IDB will review the results and recommendations made in the PSRs and the evaluation report. At least once a year, the MIF specialist from CME will pay a technical visit to the project. Also, as part of monitoring and compliance with the fiduciary role, a fiduciary visit will be paid during the early months of the project, to be paid for by the MIF. The results of the PSRs and the visits will determine future disbursements of the operation. In the event significant shortcomings are

found in project execution, the IDB will take such steps as it deems warranted and may suspend disbursements if necessary.

K. Project risks and mitigating factors

- 2.30 The project faces three main risks. **Risk 1: Climate risk:** Natural disasters or adverse weather phenomena in the project zone could affect its clients' capacity to generate income and their ability to pay. **Mitigating factors:** Although it is difficult to mitigate this risk, ALSOL CONTIGO diversifies its portfolio in different geographic zones and ecological areas, which helps to minimize the impact on its operations. It has a clear contingency policy under which it will take careful measures to reschedule loans that have been heavily affected by natural disasters when strictly necessary. **Risk 2: Risk of insecurity:** The general climate of insecurity in rural zones in south-southeastern Mexico entails the risk of possible attacks or robberies of agencies and branches that handle cash, leading to loss of funds and anxiety on the part of the staff of those offices. **Mitigating factors:** ALSOL CONTIGO is taking the following measures to reduce the possible impact of this risk: (i) it has a policy of maintaining maximum cash in any branch or agency of the equivalent of about US\$8,500; (ii) it hires a security transport service to move cash between the different branches and the head office; (iii) to the extent possible, it makes most disbursements and payments by check; and (iv) it takes out life insurance for all employees. **Risk 3: Market risk:** Since in general, the microfinance sector in Mexico does not follow best practices for loan analysis and lending, suffers from significant weaknesses in managing portfolio information, is marked by stiff and frequently unfair competition, and has no effective credit reporting bureaus, there is the risk of over-borrowing by clients, which could lead to slower growth by ALSOL CONTIGO and possible problems with the quality of its portfolio. **Mitigating factors:** With the support of the technical-cooperation component of this operation, ALSOL CONTIGO will pursue its strategy of penetrating new zones that are underserved, opening rural agencies where there is less probability of unfair competition and over-indebtedness.¹⁷ Also, the technical-cooperation component will support training for middle managers and loan officers to ensure proper client selection and lending methods, which will promote healthy growth in the portfolio and the number of clients. Also, through consulting services on process reengineering, ALSOL CONTIGO is now improving the expeditiousness of its procedures for loan analysis and approval and this is expected to build loyalty among existing clients and attract new ones.

L. Exceptions to Bank policy

- 2.31 None.

¹⁷ MicroFinanza Rating's social performance rating (2007) indicated that 84% of ALSOL's clients had no previous access to credit.