

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**GUATEMALA**

**SOCIAL ENTREPRENEURSHIP PROGRAM**

**CONSOLIDATION OF A COMMUNITY FINANCE SYSTEM TO  
SUPPORT LOCAL ECONOMIES**

**(GU-S1012)**

**LOAN AND TECHNICAL COOPERATION PROPOSAL**

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## **INFORMATION AVAILABLE IN THE SDS/MSM TECHNICAL FILES**

### **PREPARATION:**

- Project request
- Approved project profile
- Incorporation papers, legal registration, and by-laws of Asociación de Cooperación para el Desarrollo Rural de Occidente [Cooperative Association for the Rural Development of the West] (CDRO)
- Incorporation papers of Red Financiera Comunitaria [Community Financing Network] (REFICOM)
- CDRO and REFICOM organizational charts
- Audited financial statements
- Risk-rating report on CDRO/REFICOM prepared by Planet Rating (January 2007)
- Aide-memoire from the April 2007 analysis mission
- Letter of no objection from the Government of Guatemala

### **EXECUTION:**

## **DOCUMENTS IN THE TECHNICAL FILES**

Document I	Logical Framework, and appendix: “Performance Indicators”
Document II	Institutional analysis and project execution
Document III	Market analysis
Document IV	Plan of operations for the technical-cooperation operation and itemized budget
Document V	General outline for Credit Regulations
Document VI	Terms of the reimbursable loan
Document VII	Project financial projections
Document VIII	Transmittal memo for the Committee on Environment and Social Impact (CESI)
Document IX	Draft Procurement Plan

## ABBREVIATIONS

BANRURAL	Rural Development Bank (of Guatemala)
CDAs	Community development associations
CDRO	Asociación de Cooperación para el Desarrollo Rural de Occidente [Cooperative Association for the Rural Development of the West]
CESI	Committee on Environment and Social Impact
CPI	Consumer price index
FONAGRO-MAGA	Fondo Nacional para la Reactivación y Modernización de la Actividad Agropecuaria (Guatemala) [National Fund for Agricultural Revitalization and Modernization (Guatemala)]
MFIs	Microfinance institutions
MIX	Microfinance Information eXchange [organization that compiles and disseminates information about the microfinance market]
MSEs	Micro and small enterprises
REFICOM	Red Financiera Comunitaria [Community Financing Network]
SDS/MSM	Micro, Small and Medium Enterprise Division of the Sustainable Development Department

## I. BASIC PROJECT INFORMATION

### A. Executing agency

- 1.1 Asociación de Cooperación para el Desarrollo Rural de Occidente [Cooperative Association for the Rural Development of the West] (CDRO)

### B. Amount and source of financing

	IDB (US\$)	CDRO (US\$)	Total (US\$)
Reimbursable loan:	690,000	210,000	900,000
Nonreimbursable technical-cooperation:	<u>200,000</u>	<u>52,000</u>	<u>252,000</u>
Total:	890,000	262,000	1,152,000
Source:	Net income of the Fund for Special Operations (FSO)		

### C. Financial terms and conditions

Loan execution period:	36 months
Loan disbursement period:	42 months
Amortization period:	10 years
Grace period (principal):	4 years
Annual interest rate:	5% real
Currency:	Guatemalan quetzals

- 1.2 The Bank loan will be reimbursable and denominated in local currency (quetzals). The grace period will apply solely to the repayment of principal, not to interest. The interest rate will be calculated by adding (i) the consumer price index (CPI) and (ii) a five percentage point spread (5%) on the outstanding loan balances. Interest will accrue from the date of the respective disbursements. The interest rate will be adjusted semiannually, based on the annualized annual variation in the CPI for the last six months, using the Bank of Guatemala as the data source.<sup>1</sup> The project execution and disbursement periods will be 36 and 42 months, respectively.

### D. Statement of no objection

- 1.3 The Government of Guatemala stated its no objection to Bank financing of the project in Ministry of Public Finance letter 0301 of 21 May 2007.

### E. Problem to be addressed

- 1.4 Despite steady growth of the urban population, 53% of Guatemalans still live in rural areas where poverty indicators are higher than the national average. Seventy-four percent of the rural population is poor, compared to 57% at a national level, and lack access to economic opportunities and basic services (housing, drinking

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<sup>1</sup> The average annual variation in the CPI was 6.6% in April 2007. Average inflation for the past three years was 7.6% in 2004, 9.1% in 2005, and 6.6% in 2006. The exchange rate has been relatively stable over the past five years.

water, etc.). Totonicapán has one of the four highest poverty rates (85.6%) among departments in Guatemala. It is located in the western highlands and has a population density three times higher than the national average (356 inhabitants per square kilometer). It stands out for having a large number of rural villages, giving rise to a sizeable number of microenterprises devoted to various activities. The low-income population in the department's rural communities is mainly comprised of families engaged in microenterprise activities related to production, services, and trade. Many of these activities operate in the informal sector with a substantial number of women involved. According to estimates, microenterprises account for over 50% of the economically active population at the national and department level.

- 1.5 **Financing in rural areas.** One of the things most lacking for these people to raise their socioeconomic status is financing for their businesses or investment in fixed assets and business ventures. A finance ministry study<sup>2</sup> identifies the lack of financing as one of the main obstacles facing microenterprises for their development, given that most must finance their activities using personal savings (56%) or family loans (10%), sources that are typically insufficient in rural communities with few resources available. This is due to the fact that financial services for microenterprises are limited in Guatemala; only about 14% of microenterprises that need credit can obtain it. As a result, the capacity of many microenterprises to develop their own businesses, enhance their productivity, and generate income is diminished. Besides the lack of financing for productive activities, the low-income population also faces problems in terms of access to housing, due largely to the absence of financial services designed to cover housing needs in rural areas.
- 1.6 Guatemala's financial system has become increasingly open to microfinance, but its scope remains limited. One study<sup>3</sup> notes that just 5% of all commercial bank loans made in 2005 (equivalent to US\$60 million) were for amounts under US\$2,500. In addition, only 8% of this small portfolio went to microenterprises. Such lending falls far short of meeting the strong demand for credit from the microenterprise sector, which some studies estimate at US\$300 million annually.
- 1.7 The shortage of credit services is even more acute in rural areas. Two out of three entrepreneurs there have no relationship with a financial institution. Expansion of lending in these areas poses a challenge for financial institutions because of: (i) high transaction costs associated with difficulties in generating data about customers, as well as their geographic dispersal; (ii) the use of ineffective lending technologies (e.g. registered collateral requirements, bureaucratic procedures, cultural bias toward urban customs, etc.); and (iii) the small size of the loans

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<sup>2</sup> See "Propuesta de política para el fomento de la competitividad de la MIPYME [Proposed policy for promoting the competitiveness of micro, small, and medium-sized businesses]," Guatemala, April 2005.

<sup>3</sup> "Caracterización nacional de oferentes de servicios financieros especializados [National survey of specialized financial services providers]," Mineco, April 2005.

required. For this reason, banks have a limited presence, and, with the exception of the Rural Development Bank of Guatemala (Banrural), are largely unwilling to address the needs of rural microenterprises because they consider it risky. As a result, delivery of this type of services to rural populations remains a significant challenge.

- 1.8 **Rural financial services in Totonicapán.** The problems described above are particularly evident in the rural area of Totonicapán, where financial services focus little on serving businesses that operate in rural communities. Although there are four banks in the department, their services are concentrated primarily in its administrative center (urban and periurban areas), with limited presence on the rural frontier. Unregulated microfinance institutions (MFIs) such as nongovernmental organizations or credit unions have been meeting demand for rural financial services. Despite this, the development of MFIs has been hindered by difficulties they have encountered in financing their own growth. Few MFIs have managed to develop suitable methodologies and effectively reach rural populations, gaining a reasonable number of customers so that they can operate in a sustainable manner. There are, however, cases in which this has been achieved; such cases demonstrate that rural microlending can be sustainable and have a significant impact on rural microentrepreneurs' incomes, thereby improving their families' well being. One such MFI is Asociación de Cooperación para el Desarrollo Rural de Occidente [Cooperative Association for the Rural Development of the West] (CDRO).
- 1.9 **CDRO** is a Maya-Kiché community organization comprised of grassroots groups and community development organizations that provides multiple socioeconomic development services to rural populations in Totonicapán and works to strengthen the social capital of the communities in which it operates. Its objectives include ensuring that rural microentrepreneurs have continual access to financing; for this purpose, it has established a financial program known as the Community Financing Network (REFICOM), which it runs as an independent cost center. So that its performance can be measured and compared with other MFIs, this program issues separate financial statements, which are subject to specific, annual external audits.<sup>4</sup> These statements are then consolidated with those of CDRO. REFICOM has its own rural credit model, which channels financing to microentrepreneurs both directly and through a community organization network managed by local grassroots groups with the active involvement of community leaders. CDRO/REFICOM currently provides financial services to microentrepreneurs via a central office (known as POP), eight community "branches" (that operate in a manner similar to village banks, but under CDRO's corporate umbrella), and three community development associations (CDAs) that operate as separate legal entities.
- 1.10 This work model has enabled CDRO/REFICOM to meet the credit needs of a growing number of people. As of 31 December 2006, it had 1,792 borrowers in

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<sup>4</sup> Given this structure, the analysis for this project will focus primarily on CDRO's REFICOM program operations (CDRO/REFICOM).

25 communities. Its loan portfolio was US\$2.8 million, with a 1.8% arrears rate (more than 30 days past due) and a financial sustainability level of 158%. Such achievements set it apart as a major provider of rural microcredit in Totonicapán and demonstrate its potential to meet the lending needs of the region's micro and small enterprises and to strengthen the fabric of the community. This potential is, however, limited by the following: (i) insufficient funding to meet the communities' lending needs; (ii) weaknesses in the management capacity of "branches" and community associations and in the governance mechanisms and internal controls in their credit system that keep each of the different CDRO/REFICOM levels from operating optimally; and (iii) the lack of specific lending products to meet the needs of rural customers (particularly those seeking to finance their homes or new entrepreneurs without prior financing experience).

- 1.11 **Entrepreneurship.** As part of its community development activities, CDRO provides business development services for women interested in improving their craft-making, weaving, baking, and other skills. Through these activities, CDRO has identified women with an entrepreneurial spirit, whose business initiatives are often thwarted by a lack of technical, administrative, and production guidance to support them in starting and managing their businesses; such shortcomings also jeopardize their access to financing. In order to address these problems, CDRO has created a Rural Entrepreneurship Program that still needs structure and strengthening to enhance its impact. CDRO is also intends to develop a lending product specifically for new entrepreneurs.
- 1.12 **Project beneficiaries.** The beneficiaries will be at least 560 low-income individuals, the majority of whom are indigenous people living in Totonicapán's rural communities whose individual financing needs range between US\$250 and US\$10,000, and who are principally engaged in microenterprise activities. Their activities include agriculture, raising animals, trade, services, and manufacturing. These individuals generally have unmet basic needs and an annual average net income per capita of between US\$800 and US\$2,000.

## II. THE PROJECT

### A. Objectives

- 2.1 The **general objective** of the project is to improve the socioeconomic conditions of microentrepreneurs and low-income individuals living in rural areas of western Guatemala by expanding and strengthening the supply of microlending services in the Department of Totonicapán. The **purpose** is to strengthen and build on the community-based rural financial services model promoted by the Community Financing Network (REFICOM) of Asociación de Cooperación para el Desarrollo Rural de Occidente [Cooperative Association for the Rural Development of the West] (CDRO).



## **B. Description**

- 2.2 The project will have two components: a reimbursable loan of US\$900,000 (IDB: US\$690,000; CDRO: US\$210,000) and US\$252,000 in nonreimbursable technical-cooperation funding (IDB: US\$200,000; CDRO: US\$52,000). Both components will be executed by CDRO under its REFICOM program.

### **1. Reimbursable loan component**

- 2.3 These resources will be used to expand CDRO/REFICOM's loan portfolio and to finance the working capital and investment needs of microentrepreneurs and low-income individuals from the Department of Totonicapán's rural communities. The resources will also finance two new lending products, one for low-income housing (renovation, additions, and construction) and the other for the development of new businesses; US\$300,000 is expected to be allocated for housing loans. Loans with these resources will be made both directly to the end borrowers—at CDRO/REFICOM's central office (POP)—and through some 12 to 15 community organizations designated by CDRO/REFICOM as intermediaries for project resources. Over the project execution period, this component is expected to provide at least 560 low-income rural residents with loans averaging between US\$1,400 and US\$1,600. The project will also give CDRO customers access to higher credit balances, depending on their expansion needs, with loans ranging between US\$250 and US\$10,000. The lending will be governed by Credit Regulations, which will be approved by CDRO's Board of Directors as a condition precedent to the first disbursement of the reimbursable loan proceeds.

### **2. Nonreimbursable technical-cooperation component**

- 2.4 This component will have two subcomponents: (i) strengthening of the CDRO/REFICOM rural lending program; and (ii) support for microenterprise development. The technical-cooperation operation's activities are described in detail in the Plan of Operations contained in the project's technical files.
- 2.5 **Strengthening of the CDRO/REFICOM rural lending program.** Resources under this subcomponent will be directed toward: (i) enhancing the institutional capacity of the entities comprising the rural lending system led by CDRO/REFICOM; and (ii) developing the two new lending products (low-income housing and new businesses) to be implemented as part of the loan component and improving the quality of credit services offered to the system's customers.
- 2.6 This subcomponent will fund the procurement of specialized consulting services and training, and, to a lesser degree, software and computer equipment to help develop the system's institutional capacity both at the central level of the CDRO/REFICOM program (central office and POP branch), and at the level of the community organizations that comprise it. It will include the following main activities: (i) strengthening of financial management and administration; (ii) strengthening of operations processes; (iii) planning; (iv) development of

internal controls; (v) strengthening of the information system; and (vi) development and fine-tuning of lending products.

- 2.7 **Support for microenterprise development.** Resources under this subcomponent will strengthen CDRO's new Rural Entrepreneurship Program, which provides technical, administrative, and production guidance to individuals (mainly women) with entrepreneurial potential, so that they can get their new businesses up and running. Funding will be provided for: (i) a regional market study, which will serve as a foundation for CDRO in improving both demand-based entrepreneur training modules and its own methodology for providing advisory services; and (ii) implementation of the business development and guidance activities for women, either by hiring qualified individuals or by assigning new staff from within CDRO to the program (counterpart contribution in kind). Support will be provided to make a group of at least 45 women "bankable" (i.e. qualified to obtain loans under the lending product for new entrepreneurs that CDRO/REFICOM will develop with the project's support).

### C. Sustainability and findings of the financial analysis

- 2.8 The project's financial viability was evaluated on the basis of: (i) CDRO/REFICOM's capacity to maintain a sound financial position, honor its financial obligations to the Bank, and continue providing the lending products supported by the project once it ends; and (ii) the setting of competitive terms that enable CDRO/REFICOM to cover the operating costs of its services and make a profit. The sustainability of CDRO/REFICOM was also evaluated in terms of its relevance for the rural population that requires its services.
- 2.9 The project will enable CDRO/REFICOM to capitalize on its loan program's strong financial performance in recent years. The REFICOM program's assets (US\$3.2 million)—89% (US\$2.8 million) of which is comprised by its microenterprise loan portfolio—have grown healthily over the past years, with a controlled at-risk portfolio (between 1.8% and 4%), enabling these assets to increase to nearly US\$1 million (December 2006).<sup>5</sup> Significantly, a benchmarking study of Guatemala's microfinance institutions (MFIs)<sup>6</sup> rated CDRO/REFICOM as the MFI with the greatest operational self-financing capacity and return on assets, and the lowest ratio of operating costs to loan portfolio, demonstrating how efficiently the program operates. This performance makes it possible to predict that the services provided to the rural population will extend beyond the project's execution period.

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<sup>5</sup> The REFICOM program's assets account for nearly 43% of CDRO's total assets of just over US\$2.2 million.

<sup>6</sup> "Benchmarking de las Microfinanzas en Guatemala" [Benchmarking of Microfinance in Guatemala] (as of December 2005) by the Central American Microfinance Network (REDCAMIF) for Microfinance Information eXchange (MIX).

- 2.10 The project's projections (see the project technical files) show that the proposed lending terms will enable CDRO/REFICOM to onlend these resources on competitive terms and generate a surplus in their operations. The resources will be lent on market terms within the ranges applicable to rural microfinance, such that CDRO/REFICOM can increase the average loan amounts and lengthen maturities in keeping with its customers' needs. In addition, the market analysis shows that unmet demand for financial services in rural areas is and will remain high, so the project should continue to be relevant in the long term. CDRO/REFICOM's methodology, which relies on the involvement of community organizations, will make it possible to expand and tailor financial services to rural customers, using the appropriate technology, so as to help meet their needs.
- 2.11 In recent years, CDRO/REFICOM has been adapting its services to the needs of rural communities in order to ensure their continued relevance. For example, the gradual shift in emphasis from solidarity group loans to individual loans has enabled CDRO/REFICOM both to respond to its customers' preferences (borrowers are increasingly reluctant to continue participating in solidarity groups) and to operate in a self-sustaining manner in an environment as complex as rural areas. The development of new lending products for housing and new entrepreneurs, together with the willingness to provide financing in larger amounts and for longer maturities, will better enable the program to keep its services relevant for its customers.

#### **D. Credit risk for the Bank**

- 2.12 This operation poses a moderate credit risk to the Bank. The analysis of CDRO/REFICOM reveals a stable financial situation and operations, assets, and profitability at levels that enable it to generate a sustainable surplus, with financial indicators that demonstrate an acceptable performance that is expected to improve with the approval of the project (see the project technical files). The Bank loan and the financing CDRO/REFICOM obtains to fund the counterpart contribution (US\$210,000) do not exceed the current value of the REFICOM program's assets and would raise their leverage ratio from 2:1 to 3:1, which is considered an acceptable level for microcredit programs. The situation is even more manageable if one considers the asset level of the CDRO organization as a whole: US\$2.2 million. It should be noted that in order to submit its request to the Bank, CDRO/REFICOM contracted the services of a risk-rating agency.<sup>7</sup> This agency—Planet Rating—gave CDRO/REFICOM a “B–” (Good), with “stable” performance trends.<sup>8</sup> The risk rating report also indicates that “the institution anticipates that it will need US\$1 million in financing for 2007,” and estimates that CDRO could absorb this amount without incurring risk (see the project technical files).

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<sup>7</sup> CDRO/REFICOM contracted these services in January 2007, within the framework of the Risk Rating Fund established by the Multilateral Investment Fund/Consultative Group to Assist the Poorest (CGAP).

<sup>8</sup> CDRO is one of two microfinance institutions in Guatemala to have been rated by this fund.

## **E. Expected outcomes and capture of benefits**

- 2.13 The project will generate benefits for: (i) **Rural microentrepreneurs**, who will have greater access to credit and therefore the means to grow their businesses and increase their incomes. At least 560 microentrepreneurs will benefit, the majority of them indigenous people living in rural communities, including: (a) approximately 45 entrepreneurs, primarily women, who will receive both technical guidance and loans (averaging US\$260) to launch their new businesses; and (b) some 90 individuals and their families who will be able to purchase or make additions to their homes with the financing they obtain from CDRO/REFICOM. The higher number of operations is expected to enable the REFICOM system to lower real interest rates with respect to current levels; (ii) **Rural community organizations** that act as intermediaries in the CDRO/REFICOM system, whether as agencies or borrowers, whose financial, organizational, and management capacity will be strengthened through the project's technical assistance and through the loan proceeds that they onlend, enabling them to generate surpluses so that they can build their own capital and finance priority community spending. Approximately 12 of these rural community organizations are expected to benefit over the course of the project; and (iii) **CDRO**, through the strengthening of its REFICOM program, which will be supported with a loan and technical-cooperation funding. The project is expected to make it possible to both boost the organization's volume of lending and net income and strengthen its institutional capacity, so that it can continue to expand its activities in the future. Increasing the loan portfolio by at least US\$900,000 will also help the institution to become more financially self-sufficient (which it is already) and reinvest the surplus to strengthen the program's assets.

## **F. Relationship to the Bank's country strategy**

- 2.14 The central objective of the Bank's country strategy with Guatemala 2004-2007 (document GN-2355-1) is to reduce poverty through economic growth and job creation, and one of its strategic objectives is to improve the conditions for efficient production and to incorporate excluded sectors into the productive process. Among other things, the country strategy calls for support for the development of MSEs, which will promote an increase in the productive assets of the lower-income population. Moreover, the Bank's Strategic Guidelines for the Private Sector identify the limited access to credit faced by Guatemalan MSEs, particularly in rural areas, as an obstacle to the development of this sector. They go on to propose actions to strengthen both bank and nonbank financial institutions that provide services to rural MSEs. The proposed project fits into both strategies, in that it will help provide greater access to credit for microentrepreneurs in rural areas.

## **G. Coordination with other development agencies**

- 2.15 CDRO/REFICOM has received resources from other sources to fund its portfolio, most notably: Katalysis (Bootstrap Fund and Red Microfinanciera) and the Central

American Bank for Economic Integration, as well as from FINAGRO programs and the Fideicomiso Crédito Rural MAGA-Banrural trust fund. In addition, negotiations with Katalysis for a new loan are nearing completion; the loan will be used for the project's counterpart funding. This operation complements, but does not replace, the funding obtained from these sources by CDRO/REFICOM. The loan under this operation will help to expand the loan portfolio beyond the areas now served, and the accompanying technical-cooperation resources will support the institutional strengthening of CDRO/REFICOM and the development of new products.

## **H. Summary of the environmental and social review**

- 2.16 The Committee on Environment and Social Impact reviewed the operation at its meeting 10-07, and determined that the project requires no environmental evaluation nor any specific action in such regard, other than as described in the profile. Accordingly, since CDRO/REFICOM lacks specific policies to determine the environmental risks of the activities it finances, the technical-cooperation operation component provides for external consulting services to advise CDRO on how to formulate a specific policy in this regard and to train staff and the members of the communities with which it works. The policy must be completed to the Bank's satisfaction and added to the credit regulations before CDRO may begin using the Bank's reimbursable financing.

## **I. Special conditions**

- 2.17 As a condition precedent to the disbursement of the **technical-cooperation** resources, CDRO will produce evidence, to the Bank's satisfaction, that it has selected a project coordinator. For disbursements above 60% of the technical-cooperation resources, CDRO/REFICOM must have disbursed at least 30% of the total amount of the loan.
- 2.18 As conditions precedent to the disbursement of the **loan** proceeds, CDRO will produce evidence, to the Bank's satisfaction, that its Board of Directors has approved and implemented (i) prior to the first disbursement: (a) project lending program regulations that incorporate eligibility criteria and monitoring to mitigate the environmental risks of its lending operations; and (b) evidence that it has secured resources to fund the local counterpart of the loan component; and (ii) prior to the disbursement of more than 30% of the loan component resources: a policy of exposure and control of matching with respect to maturities, interest rates, and currencies.
- 2.19 During the loan term and until the the last installment has been paid to the Bank, CDRO will: (i) maintain sound financial performance, in keeping with the institutional performance indicators agreed upon with the Bank (see the project technical files), and report any worsening of such indicators to the Bank in writing; and (ii) invest the surplus earned on the loan proceeds in its REFICOM program, and not distribute it. During this period, CDRO will also deliver its audited

financial statements and a table with the agreed indicators to the Bank each year, within 120 days after the close of each fiscal year.

- 2.20 During the loan component's disbursement period, CDRO will ensure that the Bank's contributions to such component are not used to cover other financial liabilities of CDRO/REFICOM as of the project approval date. This requirement will be verified via the progress reports and financial statements that CDRO will periodically deliver to the Bank, which must show evidence of increases in the balances of CDRO/REFICOM's gross loan portfolio for amounts at least equivalent to the disbursements made by the Bank. Failure to meet this condition may result in the suspension of disbursements by the Bank.
- 2.21 CDRO will guarantee repayment of the Bank loan, transferring immediately upon request the loans, rights, and collateral pledged by borrowers of the Bank loan proceeds. Such authorization must be expressly stated in the respective loan agreement signed between CDRO and each borrower. Such transfer will not in any way alter the legal relationship between the Bank and CDRO with respect to underwriting of the loan. The loans made by CDRO to its borrowers using the Bank loan proceeds may not be made subject to new liens, mortgages, or used as security by the borrowers without the the Bank's written authorization, under penalty of the loan being called for immediate repayment.

#### **J. Reports, evaluations, and audits**

- 2.22 **Indicators and baseline.** CDRO/REFICOM will be responsible for compiling and analyzing relevant data in order to monitor the project's performance indicators. A specialist will be contracted to establish baseline parameters and a set of indicators for monitoring and evaluating project activities and performance. These parameters and indicators must supplement or update those included in the project's logical framework, as well as the performance indicators agreed upon with the Bank. The baseline indicators, as well as those from the logical framework, will provide a reference for monitoring project performance. CDRO/REFICOM and the Bank will use a monitoring system and the indicators for periodic supervision of the project (in progress reports). They will also be used for the scheduled project evaluations (midterm and final). The logical framework indicators may be modified by agreement between the Bank and the executing agency, with the approval of the Bank's Representative in Guatemala.
- 2.23 **Reports.** CDRO/REFICOM will deliver project progress reports and reports on the use of project resources to the Bank within 60 days after the close of each six-month period. The reports will be delivered in the formats agreed upon with the Bank and will include: (i) a description of progress on the project execution plan and its indicators, as well as the main achievements and difficulties encountered in meeting the targets and objectives; (ii) the updated project execution plan for the following 12 months, with measures to overcome the obstacles identified; (iii) information about the procedures and outcomes of the process of analysis and selection of community organizations to manage project resources; (iv) statistical,

financial, and narrative information about the expansion of the lending program, including: (a) the number of customers and communities served by each type of loan; (b) the portfolio's performance (aggregated and broken down for the project), including placements, and the balance of the gross portfolio and the at-risk portfolio (more than 30 days past due) for both the program as a whole and the participating organizations; (c) information about the number of operations; and (d) the fees and interest rates of the first and second tier financing by CDRO/REFICOM or the CDAs, and how they compare to the financial system's lending rates for similar operations, including an analysis of the factors used to set the program's interest rates, as described in the Credit Regulations; (v) information about achievements made in the institutional strengthening of CDRO/REFICOM and the community organizations, including both quantitative (operating self-sufficiency, arrears, operating efficiency, profitability, leverage, and capitalization) and qualitative data; (vi) a summary of the work and outcomes of the consulting engagements and other services procured; (vii) progress and outcomes of the consulting services in the area of the environment and application of the criteria to mitigate the environmental risk of the REFICOM system's lending operations; (viii) a statement regarding the use of Bank resources and the counterpart contributions; and (ix) information regarding how the project's components have complemented and related to one another in the execution of the project. The latter will constitute the final report and will contain a summary of achievements based on the initial objectives and indicators.

- 2.24 **Audits.** During project execution, within 120 days after the close of each fiscal year, and beginning with the fiscal year in which disbursements are first made, CDRO/REFICOM will deliver to the Bank a report prepared by an independent auditor acceptable to the Bank, as well as the financial statements for the project's loan component and movements in the special accounts. It will also deliver its annual financial statements reviewed by an external auditor. Within 120 days after the scheduled date of the last disbursement of the technical-cooperation funding, CDRO will deliver a financial report prepared by external auditors that shows how the Bank's contribution have been used.
- 2.25 **Evaluations.** The Bank will conduct two evaluations: a midterm and a final evaluation. The *midterm evaluation* will be conducted 18 months after the first disbursement is made, or once 50% of the loan component has been disbursed. The *final evaluation* will be commissioned once 90% of the reimbursable loan component has been disbursed, or 36 months after the first disbursement. The *midterm evaluation* will measure progress toward meeting the project objectives and progress toward meeting the indicators and targets, in addition to key operating aspects of the project. The factors to be evaluated will include, at least: (i) the degree to which the project's performance indicators have been met; (ii) the institutional capacity of the executing agency; and (iii) lessons learned and recommendations for improving the project. The application and outcomes of CDRO/REFICOM's environmental policy will also be verified. The *final evaluation* will primarily measure: (i) the effects of the project on microentrepreneurs in the target area; (ii) quantitative and qualitative changes in

CDRO/REFICOM's and beneficiary community organizations' operational and financial capacity; (iii) the performance and viability of CDRO/REFICOM's lending model as a means to channel resources to rural microenterprises with little access to credit; and (iv) the lessons learned and recommendations for the future of the program. The evaluators will be hired directly and supervised by Bank's Country Office in Guatemala using resources from the technical-cooperation operation.

- 2.26 The Bank will review the findings and recommendations of the progress reports and evaluations. CDRO and the Bank's Country Office in Guatemala will hold monitoring meetings every six months to review the progress toward meeting the performance indicators and executing the work plan. The findings of the semiannual reports and the outcomes of the meetings will determine the operation's future disbursements. If significant deficiencies are found in the execution of the project, the Bank will take such measures as it deems necessary, suspending disbursements if necessary.

**K. Project risks and mitigating factors**

- 2.27 The following are the most significant risks identified in this operation: (i) *Risk*: The risk of an increase in portfolio arrears is inherent to any microfinance project, particularly during a time of rapid expansion. *Mitigating factor*: CDRO/REFICOM will maintain a standard of arrears consistent with best practices for microfinance institutions. Participating community organizations whose arrears exceed this standard will not qualify to receive project funds. The institutions will receive technical assistance for controlling arrears as part of the technical-cooperation operation. (ii) *Risk*: The occurrence of natural phenomena (hurricanes and floods) may affect repayment of the loans made by CDRO/REFICOM, particularly in a rural-based project. *Mitigating factor*: CDRO will be given a copy of the guide prepared by the SDS/MSM in 2002 on how to prevent and reduce the impact of natural disasters on microfinance institutions, for dissemination among the community organizations in its network and application in its own operations. CDRO/REFICOM will also apply and seek to qualify for the MIF-financed Emergency Liquidity Fund.

**L. Exceptions to Bank policies**

- 2.28 None.