

PUBLIC

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MULTILATERAL INVESTMENT FUND

**PERÚ**

**SMALL ENTERPRISE DEVELOPMENT FACILITY  
LINE OF ACTIVITY FOR THE STRENGTHENING OF FINANCIAL  
INSTITUTIONS FOR MICROENTERPRISE**

**(TCOO12023)**

**LINE OF ACTIVITY MEMORANDUM**

**2001**

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## **ABBREVIATIONS**

CMAC	Caja Municipal de Ahorro y Crédito
COFIDE	Corporación Financiera de Desarrollo S.A.
CRAC	Caja Rural de Ahorro y Crédito
EDPYME	Entidad de Desarrollo de la Pequeña y Microempresa [Small business and microenterprise development agency]
SBS	Superintendencia de Bancos y Seguros [Superintendency of Banks and Insurance Companies]
SMB	Small business and microenterprise

## PERU

### **MIF: SMALL ENTERPRISE DEVELOPMENT FACILITY LINE OF ACTIVITY FOR THE STRENGTHENING OF FINANCIAL INSTITUTIONS FOR MICROENTERPRISE**

#### **LINE OF ACTIVITY MEMORANDUM**

**Project title:** Institutional strengthening of EDPYME Confianza, a small business and microenterprise development institution [Entidad de Desarrollo de la Pequeña y Microempresa]

**Project number:** TC-00-12-02-3-PE

**Executing agency:** EDPYME CONFIANZA S.A.

**Financing:**

MIF (nonreimbursable):	US\$190,000	(Facility III-A)
EDPYME CONFIANZA S.A.:	<u>US\$140,000</u>	
Total:	<u>US\$330,000</u>	

#### **I. FRAME OF REFERENCE**

##### **A. Microenterprise and small business and microfinance in Peru**

- 1.1 Currently, there are 3.1 million microenterprises and small businesses (MSBs) in Peru, which provide employment for 74% of the economically active population and account for 43% of gross domestic product. Since commercial banks offer virtually no financial services to this sector, the unmet demand for financing on the part of MSBs has led nonbank financial entities and nongovernmental organizations (NGOs) to serve their credit needs.
- 1.2 In December 1996, under the Ley de Bancos (Bank Act), the Peruvian government created a new kind of financial institution known as “Entidad de Desarrollo de la Pequeña y Microempresa” [small business and microenterprise development agency] (EDPYME). EDPYMEs seek to provide incentives for transforming “credit NGOs” into supervised financial entities. Likewise, the Superintendencia de Banca y Seguros [Superintendent of Banks and Insurance companies] (SBS) has issued special prudential standards for microfinance institutions (MFIs) and has set special provision levels for microenterprise portfolios.

- 1.3 In Peru, there are 37 regulated entities that specialize in MSBs including: (i) a specialized bank (MIBANCO); (ii) 14 municipal savings and loan banks (CMACs); (iii) 12 rural savings and loan banks (CRACs); and (iv) 10 EDPYMEs. The Bank has been one of the main sources of funding for Peruvian microfinance institutions. To date, it has approved two credit lines —global microenterprise credit programs I and II— totaling US\$55 million. These loans have been implemented successfully, with their entire amount being placed among more than 77,000 entrepreneurial clients, through banks, CMACs, CRACs and EDPYMEs. The average amount of each loan is US\$784. The global multisector credit program II (1137/OC-PE) will also extend lines of credit to microfinance institutions, under a global microcomponent, to use part of the resources of the project's budget, which exceeds US\$94 million. These operations are considered fundamental to supporting the sector's growth, and will continue to be very important for financing microfinance institution operations over the next few years, as an adjunct to the Bank support for institutional strengthening through the MIF Line of Activity.
- 1.4 Currently 10 EDPYMEs operate in the country and more than 10 applications are being reviewed by the SBS. The longest standing EDPYMEs are just completing their third year of operation. Although the EDPYME experience is too recent, the general view is that they suffer from major shortcomings and require sustained support during this consolidation phase to strengthen their financial, technical and operational management capacity as well as in issues related to their equity capital, ownership, and governance.
- 1.5 The Bank's strategy for using the MIF Line of Activity in Peru focuses on providing support for the EDPYMEs that show the best performance and the strongest commitment to competitively and efficiently expanding their financial services to reach underserved markets. The other kinds of specialized MFIs (CMAC, CRAC, etc.) have received both financing and technical assistance for institutional strengthening under other Bank or MIF operations. Thus, EDPYMEs are the institutional category that combines a significant potential for expansion with the need for institutional strengthening to realize this potential.
- 1.6 Peru's microfinance industry is characterized by: (i) freely determined interest rates; (ii) the existence of a special regulatory framework; (iii) a high degree of competition among microfinance institutions; (iv) a market with considerable potential that has barely been penetrated; and (v) low levels of efficiency compared with the best MFIs in Latin America. Some of these factors have had a positive impact by improving the quality of services, steadily reducing interest rates and expanding the microfinance portfolio. As a result, the system's microlending portfolio grew by 86% during the last three years, for an average yearly increase of 23%, to exceed US\$290 million in December 2000 and to reach about 500,000 active clients.

## **B. Microfinance in rural areas**

- 1.7 Peru is one of the countries in the region with the highest rates of financial market segmentation. For example, in recent years, more than 80% of lending in the banking system has been to borrowers in Lima, and approximately 78% of total lending went to borrowers in Lima's six wealthiest districts. Of the small percentage of loans to rural areas, most are channeled to large-scale farmers and medium-sized landowners along the coast.
- 1.8 For most regulated financial institutions, rural areas are simply not a priority, given the characteristics of their residents and economic activities. Rural zones contain the highest concentration of low-income groups and highest incidence of critical poverty, and income distribution is extremely inequitable and skewed against people in rural areas. Products offered by the commercial banking sector, its lending technologies, and security requirements are not suitable for successfully funneling loans to small rural producers.
- 1.9 Due to these factors, the only financing alternative available to microproducers and small rural producers are the CRACs, cooperative banks, EDPYMEs, and credit NGOs that work in rural sectors. Although these entities have a limited rural coverage, and suffer from different weaknesses, their presence in rural areas makes them the only financial service channels for these underserved clients. During their years of operation in rural sectors, they have developed a deep understanding of the sector's needs and potential, lending technologies adapted to the clients' characteristics, and a level of credibility that enables them to offer the sector increasingly greater financial services.

## **C. Microfinance markets in Junín y Huancavelica**

- 1.10 The departments of Junín and Huancavelica, in Peru's central Andean zone, have very favorable characteristics for developing urban and rural MSBs. The Mantaro valley in the department of Junín, where Huancayo, the department's capital is located, is one of the most fertile and productive valleys in the country. In this area a wide variety of agricultural products are cultivated and the agroindustry, manufacturing, fabric, shoe sectors, and marketing play an important role in the local economy. The department of Junín and the city of Huancayo are well known for their thriving agricultural and commercial activities, forming a dynamic center of business development and source of employment in the central Peruvian sierra. In addition to linking areas of production with the main market in Lima, Huancayo has considerable potential for the growing sectors of tourism and small industry.
- 1.11 A recent study shows that there are more than 35,000 MSBs in Junín, which need over US\$25 million in financing each year. However, the regulated MFIs in the area, including Caja Municipal de Huancayo, EDPYME Confianza (hereinafter Confianza) and a new MIBANCO agency are providing a total of approximately

US\$14 million in loans on a yearly basis. This means that in Junín alone unmet demand is about US\$11 million per year for just formally registered MSBs, without even considering those in the informal sector. Nevertheless, it is important to note that approximately 90% of said portfolio is lent to urban clients, with rather standardized products designed mainly for urban MSBs.

- 1.12 Despite being one of the poorest departments in the country, Huancavelica has a promising market potential due to its high numbers of small rural producers and the complete absence of microfinance agencies. At present, there are no regulated MFIs in the entire department of Huancavelica, with the exception of a Confianza agency in the town of Pampas. Credit demand is almost entirely unmet in rural sectors and small towns and an MFI with experience and knowledge is needed to serve these potential clients.
- 1.13 The specific needs of the small business units are rapid lending to accommodate the business cycle, with variable terms for payments, collection, and guarantees as well as a reasonable price within the market spread. The flexible nature of microenterprise operations calls for an efficient custom-made financial service, where the credit product can be tailored to the needs and priorities of rural and urban MSBs.
- 1.14 Confianza has indicated its intention to continue expanding its credit to rural and urban sectors in the departments of Junín y Huancavelica, in order to help meet the credit demand of microentrepreneurs and entrepreneurs. Despite its advances in recent years to convert an NGO credit program into a regulated EDPYME, and the experience and lessons learned in rural microlending, Confianza needs institutional strengthening to be able to expand into new niches in a competitive and efficient manner. The present project responds to Confianza's request to the MIF for support in this expansion and strengthening process.

## **II. EXECUTING AGENCY**

- 2.1 Confianza, S.A. is a corporation regulated by the SBS. It was legally established in November 1997, and began its operations in June 1998. Confianza's main shareholder is Servicios Educativos Promoción y Apoyo Rural (SEPAR),<sup>1</sup> an NGO that owns 87% of Confianza's equity. The other shareholders are the NGO Instituto de Fomento a la Comercialización Campesina (IFOCC) with an 11% share, and 10

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<sup>1</sup> In 1992, SEPAR began its lending activities when it received technical-cooperation funding from the Bank, under operations SP/ST-92-26-PE (US\$500,000) and ATN/ST-4091-PE (US\$150,000). Of four Peruvian NGOs that received funding in 1992 under the former Small Projects Program for start up of new credit programs, SEPAR is the only one that has expanded successfully and become a regulated MFI. SEPAR is well known as an NGO with considerable experience in lending activities and support for production in rural sectors.

- individual shareholders that hold the remaining 2%. Confianza has a total equity of approximately US\$500,000.
- 2.2 Confianza has a total of 18 employees, of which 3 fill executive positions, 7 are loan officers and 11 perform administrative tasks. Through its main office in Huancayo, and an agency in Pampas, a rural city in the department of Huancavelica, Confianza offers the following credit products: (i) individual credits for microenterprises, with loans that range from US\$500 to US\$5,000; (ii) individual credits for small businesses, with loans that range from US\$1,500 to US\$10,000; and (iii) personal loans that range from US\$300 to US\$3,000. Confianza also offers short-term parallel loans to its best clients and working capital loans during the school year and the Christmas season. The average loan amount is US\$601, and the breakdown by amounts indicates that 77% of the loans granted are less than US\$1,000, and 98% below US\$3,000.
- 2.3 At the close of 2000, it had assets of US\$2.075 million and a net equity of US\$516,000. It has leveraged (debt-equity) almost three times its equity, and has several financing sources, most of which are on concessional terms. These liabilities include loans from: Alterfin, SOS FAIM, the Government of Canada Counterpart Fund (Peru-Canada Fund) and the Corporación Financiera de Desarrollo S.A. (COFIDE). The fact that Confianza is not authorized to attract deposits from the public is a significant disadvantage vis-à-vis its main competitor, Caja Municipal de Huancayo. Nevertheless, Confianza's main strategy over the next few years is focused on improving its loan products and stepping up the efficiency of its lending activities, before requesting authorization from the SBS to add deposits to its operations.
- 2.4 In December 2000, Confianza had a gross portfolio of US\$1.49 million and 2,473 active clients, of which 50% were women. Of its clients, 41% are in services and the commercial sector, 37% in agriculture and 22% in manufacturing and production. With 70% of its clients living in urban areas, and 30% in rural areas, Confianza has the highest percentage of rural clients of any EDPYME in the country. In order to maintain appropriate diversification and satisfactory control of its risks, Confianza projects an increase in the number of its rural clients by generally expanding its customer base in various unattended areas, while keeping the ratio of urban to rural clients relatively stable.
- 2.5 Despite having a significant percentage of its portfolio in the rural sector, the portfolio over 30 days past due was 3.5% in December 2000, one of the best portfolio indicators in Peru's microfinance system. As a benchmark, the average at-risk portfolio of Banca Múltiple was 10% while the EDPYME average was 7%.
- 2.6 Since its incorporation, Confianza has made remarkable progress. Confianza brought its first year of operations (1998) to a close with a US\$440,000 active portfolio and a net profit of US\$5,000. After a difficult year in 1999, in which it



cleaned up its nonperforming portfolio, and US\$68,000 in losses were generated, 2000 saw its active portfolio soar to US\$1.49 million, with a net profit of US\$81,000. In December 2000, the accumulated provisions offered 140% coverage of its portfolio over 30 day's past due. The return on equity (ROE) increased from -19% in 1996 to 16% in 2000.

- 2.7 Moreover, productivity, measured by the number of clients for each loan officer, increased from 195 in 1998 to 225 in 2000, but was still well below the best Peruvian levels of 400 clients per officer in urban areas. At the same time, operating efficiency improved, with administrative costs decreasing from 48% in 1998 to 29% of the average portfolio, compared with an EDPYME average of 30%.
- 2.8 The SBS permanently monitors Confianza's operations which ensures that an adequate level of requirements are set. Also, Confianza has obtained financing from specialized agencies, like COFIDE and the Latin American Challenge Investment Fund (LA-CIF), which also perform monthly analyses of the institution's risk. These evaluations have shown that Confianza has the following strengths: (i) high quality portfolio; (ii) proven capacity for strategic and operational restructuring in order to achieve adequate solvency and profitability levels; (iii) a continuous improvement in operating efficiency; and (iv) significant and demonstrated experience in the MSB sector in rural and suburban areas.
- 2.9 The institutional analysis shows that the agency has weaknesses in the following areas: (i) planning; (ii) lending technology; (iii) human resources; and (iv) the information system.

(i) **Strategic and operating planning:**

- The agency currently has a **basic strategic planning, which does not include medium-term business plans or monitoring** of compliance with guidelines and activities. Furthermore, there are no adequate structures for involving all of the entity's staff in the planning processes;

(ii) **Lending technology**

- **Inadequate financial products**, which do not satisfy the wide range of different needs that potential clients may have;
- **Inadequate loan ranking and disbursement processes**: there is limited understanding of the rural and urban microenterprise production processes, which causes deficiencies in evaluating the clients' risks. Also, the approval process currently has a series of **illogical procedures**, that slows down the credit approval process which takes an average of five days to disburse the first loan,

resulting in high transaction costs for the client and high operating costs for the agency;

(iii) **Human resources policies and staff training:**

- An improvement in the **policies for promoting staff productivity** is needed: there is no appropriate policy or updated manuals that establish the staff evaluation, pay and job description policies. Although there is an incentives system and bonuses for the staff as a whole, its qualifying variables do not make it possible to assign rankings equitably or to perform individual evaluations of productivity;
- Credit staff **needs greater capacity to identify good borrowers** by means of adequate risk management for each evaluation. All staff linked to the entity's financial services should know and interpret the financial terms and ratios to improve their analysis skills and productivity; and

(iv) **Information system**

- The system is inadequate for identifying potential risks in a timely manner. **The interface with the user system is obsolete** (COBOL and DOS), the flexibility needed to process data is lacking, and the **software does not generate sufficiently detailed management reports** for proper monitoring. This forces them to make use of supplementary tools, requiring greater costs, learning time, additional dedication from the official in charge and a heavy reliance on the provider. Also, the hardware is old and slow and does not adapt to the specifications of the new software programs.

2.10 Confianza's institutional weaknesses have a negative impact on the quality of the financial services that it provides to the microentrepreneurs in the area. The lack of a variety of credit products makes it impossible for the clients to access a quality financial service to adequately respond to market and sales opportunities. The slow loan approval process increases transaction costs for the client and administrative costs for the agency. The weaknesses identified in the risk analysis capacity have a negative impact on the selection of less risky clients, the establishment of the loan amount and its terms and the particular conditions of the loans.

2.11 Confianza plans to continue with its expansion plan and to increase its loan portfolio by 25% in 2001, while enhancing productivity and efficiency through ameliorations in its lending technology, internal systems and risk control. Fulfilling the expansion plan and improvements depend on the following operating factors: (i) consolidation of the strategic and operating planning; (ii) development of a

marketing plan and penetration of new markets; (iii) adaptation of its credit products to the different segments of its potential clientele;<sup>2</sup> (iv) reengineering of operating procedures and updating of loan procedures manual; (v) a credit, financial, and market risk analysis system especially designed for rural niches; (vi) improvement in the incentives system for credit analysts; and (vii) updating of the information system, including those modules aimed at systematizing the collection process, credit risk analysis and interagency connections. Another important factor is the need for increasing its capital stock and lines of credit to finance its expansion plans and growth.

### III. PROJECT DESCRIPTION

#### A. Objectives

- 3.1 The project's main objective is to increase the volume and improve the quality of financial services that are offered to underserved microenterprises and small businesses in rural and urban areas of Junín and Huancavelica. This goal will be achieved by strengthening Confianza's financial and operational management capacity.

#### B. Activities

- 3.2 Confianza will coordinate project execution through the following three main activities:
- a. Contracting of **specialized technical assistance** to strengthen Confianza's personnel in areas related to:
    - (i) **Strategic planning:** Design, implement and institutionalize a **planning process** in the entity. Define strategic positioning and its areas of expansion. Develop a series of performance indicators to monitor the progress made in achieving the targets set. Prepare a five-year **business plan**. This will include an analysis and recommendations regarding governance and organizational structure in the context of its expansion and consolidation plan. Also, analyze new potential markets, both rural and urban, in the departments of Junín y Huancavelica, including the preparation of **marketing and communication plans** for penetrating these markets.

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<sup>2</sup> Products readapted to the specific needs of the different client types (agricultural, market, commercial campaigns, etc). With specific terms with installments adapted to each production or service activity, differentiated frequency and conditions (interest and capital) of collections, more rapid disbursements and onlending and other conditions in keeping with the business cycles.

- (ii) **Lending technology:** Support for adapting credit products, process reengineering, and risk analysis. This entails the following activities:
    - **Adapt financial products** to specific client needs. For example, this could include agricultural products, agricultural seasons for different specific products, buying machinery and equipment for rural areas, as well as very short-term loans for sellers in popular markets in cities and small rural towns;
    - Review, **evaluate and streamline** the current administrative and management **procedures** for granting credit and collection procedures. Identify the elements that hinder fluid operations and raise the portfolio's risk, and incorporate any modifications.
    - Develop and implement a **credit, financial, and market risk rating system**<sup>3</sup> that could influence portfolio quality and other financial aspects of the entity. This involves identifying the main risks, implementing information gathering systems and inputting it into database, generating the necessary reports and learning to interpret such reports. The possibility of developing a credit scoring methodology adapted to microlending will be explored.
  - (iii) **Human resources:** Evaluate and adjust the **incentives policy** for the agency's staff, particularly for loan personnel, and update the functions manuals.
  - (iv) **Environmental and job safety issues:** Disseminate information on **environmental protection and job safety standards** in microenterprises. To the extent possible, the materials related to these issues prepared by COFIDE will be used (paragraph 3.6).
- b. Offering **training and technical exchange** opportunities for key personnel at the managerial and operational levels, in order to improve their technical and managerial skills. The exchanges will take place with leading MFIs in different countries throughout the region (Bolivia, El Salvador, etc.). It is expected that the specialized courses will cover risk management, productivity and financial indicators, staff self-esteem, and the development of an entrepreneurial culture.

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<sup>3</sup> For example, analysis of movements in **portfolio** due to such factors as amount, product, area, activity, loan officer; analysis of **financial** considerations such as terms, currency, financial expenses, inflation, exchange rate, etc.; and analysis of trends in the microfinance **market** (rates, arrears, placements, etc.), and in the case of clients (prices, production, etc).

- c. **Procurement of necessary computer hardware and software** to update and adapt the current information system to growth requirements. This will include the installation, adaptation to Confianza's particular needs, migration of data, testing of the system, and staff training in the use of software and hardware implemented. Telecommunications equipment and a server will be acquired to connect the branch offices and headquarters.

### C. Estimated cost and financing

- 3.3 The project's total budget is US\$330,000, of which the MIF will contribute US\$190,000 on a nonreimbursable basis, to be drawn on **the Line of Activity for the Strengthening of Financial Institutions for Microenterprise**. Confianza will contribute local counterpart funding of US\$140,000, of which US\$80,000 will be in cash, in accordance with the following budget in U.S. dollars:

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

Description	MIF	MIF %	Confianza	Total	Total %
<b>A. Technical assistance</b>	<b>120,000</b>	<b>63</b>	<b>75,000</b>	<b>195,000</b>	<b>60</b>
i. <i>Strategic planning</i>					
- Strategic/business plan	20,000		5,000	25,000	
- Marketing	10,000		10,000	20,000	
ii. <i>Lending technology</i>					
- New products	15,000		15,000	30,000	
- Reengineering of procedures	30,000		30,000	60,000	
- Risk analysis	30,000		10,000	40,000	
iii. <i>Human resources</i>	10,000		5,000	15,000	
iv. <i>Environmental issues</i>	5,000		0	5,000	
<b>B. Training</b>	<b>14,000</b>	<b>8</b>	<b>4,000</b>	<b>18,000</b>	<b>5</b>
i. Regional technical exchanges	8,000		2,000	10,000	
ii. Specialized courses	6,000		2,000	8,000	
<b>C. Software and equipment</b>	<b>48,000</b>	<b>25</b>	<b>51,000</b>	<b>99,000</b>	<b>30</b>
<b>D. Other</b>	<b>8,000</b>	<b>4</b>	<b>10,000</b>	<b>18,000</b>	<b>5</b>
i. Contingencies	8,000		0	8,000	
ii. Audits	0		10,000	10,000	
<b>Total</b>	<b>190,000</b>	<b>100</b>	<b>140,000</b>	<b>330,000</b>	<b>100</b>

### D. Justification and risks

- 3.4 During its first three years of operation, Confianza has made significant progress, learning difficult lessons and taking the necessary rigorous steps to correct its shortcomings. It has shown a large capacity for providing financial services demanded in remote and isolated rural areas. Its clientele includes a significant portion of rural MSBs, which are traditionally excluded from credit by other financial institutions on grounds that they are too risky. Nevertheless, in order to

expand its range of action and deepen and perfect its services, Confianza needs to accelerate the process of improving the quality of information, as well as its operating efficiency levels and profitability. The support to Confianza is justified because the technical assistance planned for this operation will help achieve this objective, through the expansion and diversification of its credit, strengthening of its internal processes, a better risk analysis and control, and an increase in its operating efficiency. Also, the project will support Confianza's efforts to raise its capital stock and access external lines of credit. This will bring significant benefits to the microentrepreneurial clients and the institution.

- 3.5 The project's main risk is the inherent risk of developing portfolios in rural and suburban areas: natural disasters, penetration of the cooperation projects market without financial discipline and high rates of arrears resulting from fluctuations in the prices of agricultural products. However, this risk will be mitigated through the following four aspects that are an integral part of the current project: (i) the design of new, special financial products for rural areas; (ii) the activities related to improving institutional capacity for analyzing and controlling different types of risks; (iii) the improvement of the information system which will permit better monitoring of the portfolio and clients with potential problems; and (iv) the diversification of risk achieved by expanding to other areas. Another risk is the challenge that Confianza is faced with to guarantee sufficient funding to finance the level of growth proposed for this operation. Since the institutional strengthening of the current project will make the company more attractive to its potential financiers, and more than 100% of the financing needs for 2001 are already guaranteed,<sup>4</sup> the risk for future years will be minimized.

#### **E. Environmental considerations**

- 3.6 The project's activities will not be directly related to the clients, or to the microenterprises' environmental practices. However, the Bank's Environment Division will provide Confianza with instructional materials and information concerning environmental conservation, occupational health and safety measures for workers and clients. The project budget includes funds to hire an expert in the field, who will guide management in the best use of this material. Also, the overall evaluation of the Line of Activity will include a report on the usefulness and effective employment of these materials.

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<sup>4</sup> Confianza has now furnished the project team with evidence of commitments in terms of (i) additional share equity for 2001 in an aggregate amount of US\$83,000; and (ii) additional lines of credit for 2001 in an aggregate amount of US\$450,000, representing more than 100% of the funding required for its 2001 expansion plan.

#### IV. EXECUTION AND MONITORING

- 4.1 **Responsibilities:** The Bank will sign an agreement with Confianza for project execution. Confianza will hire consultants, who will carry out the planned activities, and will acquire the equipment and staff training services.
- 4.2 **Disbursement:** The project execution period will be 30 months and the disbursement period will be 36 months. Since the project will require financial resources to be available immediately, the Bank may establish a revolving fund for up to 20% of the total amount approved, based on the spending program that Confianza will present for the Bank's approval.
- 4.3 **Procurement of goods and services:** With the project funds, Confianza will acquire computer and telecommunications equipment and will hire consultants for technical assistance. It will fall to Confianza to comply with the Bank's and MIF's procurement standards, procedures and policies.

#### V. SPECIAL CONTRACTUAL OBLIGATIONS

- 5.1 Prior to the first disbursement of funds, Confianza will provide to the Bank's satisfaction, a work plan for the first year of the project, including semiannual performance targets, both quantitative and qualitative, and the assumptions on which they are based.
- 5.2 Within 60 days after the close of each six-month period, Confianza will present to the Bank: (i) a progress report which will include: (a) a description of the technical assistance received, and its results; (b) a list of personnel trained and topics addressed in the courses; (c) a list of equipment acquired as well as procurement procedures used; (d) a detailed narrative of the technical exchanges with other entities; (e) a summary of Confianza's cash contribution to the budgeted items; (f) information on statistical and analytical aspects of the expansion to rural areas; and (g) statistical and financial information on portfolio performance, clients and performance indicators, and a report on fulfillment of the yearly targets for the indicators established in Annex I; and (ii) the updated plan for the next 12 months, including semiannual targets for the indicators established in Annex I. Also, Confianza will submit annually to the Bank the external audit report of the institution's financial statements, within 180 days after the end of the fiscal year.
- 5.3 If significant and unfavorable deviations (of more than 20%) occur with respect to fulfillment of performance indicators 2, 3 or 9 in Annex I, the Bank may suspend disbursement of project funds. If any of these indicators deteriorate, Confianza will have 30 calendar days to agree with the Bank on measures that would correct its

performance. After this time is up, or if the situation has not improved to the Bank's satisfaction, the Bank may suspend or cancel future disbursements.