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VENEZUELA

**MICROENTERPRISE DIVISION
SMALL PROJECTS FINANCING PROGRAM**

PROPOSAL FOR FINANCING AND TECHNICAL COOPERATION FOR:

FUNDACIÓN PARA EL DESARROLLO SOCIAL (FUNDESOC)

(SP/TC-98-01-31-8-VE)

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ABBREVIATIONS

ADC	Andean Development Corporation
CESAP	Grupo Social-Centro al Servicio de la Acción Popular
CESI	Committee on Environment and Social Impact
CORDIPLAN	Central Office for Planning and Coordination
DFC	DFC International Inc.
FEM	Fundación Eugenio Mendoza
FONCOFIN	Fondo de Apoyo, Cooperación y Financiamiento de Empresas Asociativas [Fund for Support, Cooperation and Financing of Member Companies]
FUNDESOC	Fundación para el Desarrollo Social [Social Development Foundation]
IAF	Inter-American Fund
LCFS	Luso Consult Financial Systems
UNICEF	United Nations Children's Fund

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EXECUTIVE SUMMARY

AMOUNT AND SOURCE:	IDB: Financing:	US\$200,000
	Technical-cooperation	
	funding:	<u>US\$100,000</u> nonreimbursable
	Total:	US\$300,000

Resources for the financing and technical-cooperation funding will be drawn on the net income of the Fund for Special Operations (FSO) in local currency.

FINANCIAL TERMS AND CONDITIONS:	Amortization period:	20 years
	Grace period:	4 years
	Disbursement period:	4 years
	Fee:	1%

Maintenance of value will be applied to the proceeds of the financing.

OBJECTIVES: The general objective of this project is to improve the socioeconomic situation of microentrepreneurs and small agricultural producers in the state of Mérida. Its specific objectives are to: (i) increase the capacity for granting credit to this target group through FUNDESOC; and (ii) provide institutional strengthening for FUNDESOC, enabling the Foundation to develop the capacity for efficient and sustainable administration of its financial resources.

DESCRIPTION: The financing resources will be used to provide credit for needed investments in fixed assets and to supply working capital for low-income micro-entrepreneurs and small agricultural producers operating in areas served by FUNDESOC within the state of Mérida.

At the same time, the nonreimbursable technical-cooperation resources will be used to provide institutional strengthening for FUNDESOC in order to achieve the following objectives: (i) draw up a business plan for the institution; (ii) develop and install a management information system incorporating changes in the handling of the institution's accounts; and (iii) implement lending methods consistent with the Credit Regulations designed for

this operation. A portion of these resources will go to finance a mid-term evaluation which will be used to determine future disbursements under this operation. This technical-cooperation funding is intended to help FUNDESOC develop the tools needed to make the institution self-supporting.

**ENVIRONMENTAL
CLASSIFICATION:**

The Committee on Environment and Social Impact (CESI), at its meeting of February 20, 1998, reviewed this operation and made recommendations which have been taken into account by the project team in designing the present operation.

BENEFICIARIES:

The beneficiaries will be approximately 200 microentrepreneurs and small agricultural producers of both genders operating in the areas served by FUNDESOC within the state of Mérida.

RISKS:

The principal risk associated with this operation relates to the need to ensure that the interest rates applied are real and positive. At least at the beginning of the operation, this factor could cause a drop in estimated demand for credit among the micro-entrepreneurs. However, the experience of FUNDESOC and other similar institutions in Venezuela would seem to indicate a willingness on the part of micro-entrepreneurs to pay the proposed interest levels in exchange for the certainty that the loans will be granted promptly. Another risk factor stems from FUNDESOC's current weaknesses in financial administration and credit management which, if they are not corrected, could prevent the goals and objectives of the program from being attained. Carrying out the technical cooperation to provide institutional strengthening for FUNDESOC, and conducting the proposed mid-term evaluation will substantially reduce the risks associated with this operation.

**THE BANK'S
COUNTRY STRATEGY:**

A preliminary planning paper (revision of November 18, 1997) stresses the need for the Bank to help reduce poverty by supporting projects such as the present program designed to generate income and jobs in the productive sector.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

It is recommended that, in addition to the general contractual provisions, the following special conditions be added to the financing and technical-cooperation agreement:

The following conditions will be included as conditions precedent to the first disbursement under the Credit Program: (i) that FUNDESOC submit a

business plan for the institution; (ii) that the Credit Regulations agreed on in advance with the Bank be placed in effect; (iii) that FUNDESOC show proof of implementation of lending methods acceptable to the Bank; and (iv) that FUNDESOC present evidence of satisfactory operation of its accounting and management information systems (see paragraph 4.7).

As a condition precedent to the first disbursement under the technical-cooperation funding, FUNDESOC must have agreed on the terms of reference with the Bank and selected the consultants to carry out the technical-cooperation program for institutional strengthening of FUNDESOC (see paragraph 4.9).

No more than 70% of the proceeds of technical-cooperation funding may be disbursed until such time as at least 20% of the resources of the Credit Program have been committed (see paragraph 4.11).

A mid-term evaluation of FUNDESOC will be carried out when 30% of the Credit Program funds have been committed or, alternatively, when FUNDESOC'S assets have grown by 30% (see paragraph 4.14).

Disbursements under the Credit Program may not exceed 40% of total allocated resources until such time as FUNDESOC shows to the Bank's satisfaction, that it has taken the corrective measures agreed on with the Bank based on the results of the mid-term evaluation of that program (see paragraph 4.12).

Given the nature of this program, the resources of the technical-cooperation funding must be immediately available for institutional strengthening purposes. Accordingly, at FUNDESOC's request the Bank will advance up to 30% of the total amount of the technical-cooperation funding (see paragraph 4.11). At the same time, the Credit Program must have sufficient liquidity to meet the target group's demand for credit. To this end, the Bank will advance up to 20% of the resources of the Credit Program (see paragraph 4.12).

I. FRAME OF REFERENCE

A. Macroeconomic context

- 1.1 Serious political and institutional problems, combined with the financial crisis in 1994 and 1995, caused the Venezuelan economy to go through a period of relative stagnation from 1993 through 1996, clear signs of recovery finally began to emerge in 1997. In spite of the country's economic recovery, however, deteriorating socioeconomic conditions among broad sectors of the population, accompanied by marked inequalities in income distribution, has severely affected low-income groups.
- 1.2 Unemployment figures rose to 12.5% in 1996, 2.3 percentage points higher than the previous year. Real wages dropped 30% in 1996, then stabilized during the first half of 1997. The cumulative effects of high inflation over the last few years has had a major impact on purchasing power, and high unemployment has driven large numbers of workers into the informal sector. At year-end 1997, Venezuela's economy was growing at a rate of around 5%, on the heels of a contraction of 1.6% in 1996, and inflation fell from 103% in 1996, to 37.5% in 1997.

B. Poverty level in Venezuela

- 1.3 The depth and intensity of poverty in Venezuela rose perceptibly in the 1980s, becoming even worse with the economic recession of 1993-1995. It is estimated that 21% of those living in rural areas and 10% of the urban population live in extreme poverty. As a result of an already high and still growing rate of urbanization, 90% of the increase in poverty took place in urban areas. Rural families and those in which the mother is head of the household continue to be at greatest risk. The ability to alleviate or reduce poverty in Venezuela will depend upon three factors: (i) macroeconomic stability and increased productivity; (ii) effectiveness of programs aimed at high-risk groups living in extreme poverty; and (iii) efficient administration of labor resources.

C. The microenterprise sector in Venezuela

- 1.4 Typically, microentrepreneurs are individuals who own the business that employs them. They usually have a grade 6 education or less, and an average family size of five members. The net worth of a microentrepreneur does not exceed the equivalent of US\$5,000, with average monthly sales of approximately US\$700.
- 1.5 Microenterprises employ relatively simple technologies which, in most cases, fall into the handicrafts category. They employ from one to five workers, work out of a fixed place of operation, which may be their own home or a stall in a public square or market. The

businesses they engage in are many and varied, and include the following activities: manufacturing of goods (food products and beverages, garments and textiles, leather goods and wood products); automobile and bicycle repairs and repair of household items; sundry services including transportation, construction, printing, carpentry and plumbing; and various commercial activities. Except for transportation services, all of these activities afford easy access since they require little capital and involve fairly simple technology.

D. Financial needs and demand among microenterprises

- 1.6 Recent studies based on the household survey carried out as part of the population and housing census show that in the first half of 1997 the informal sector employed 3.7 million workers, accounting for 60% of urban and rural employment. One of the realities faced by the microenterprise sector is lack of access to financial services. It is estimated that at present in Venezuela, barely 1% of a potential market of close to 2.2 million microenterprises have access to financial services. For the most part, these mini-businesses require only small investments, plus greater access to sources of financing to see them through seasonal fluctuations caused by shifts in demand for their products.
- 1.7 Mérida has a population of 687,000, among which FUNDESOC has identified some 2,300 microentrepreneurs (700 in manufacturing, 500 in trade, 800 in agriculture and 300 in services) interested in using its services. In monetary terms, this represents a potential demand for credit of approximately US\$3.5 million.

E. Availability of financial services for microenterprises

- 1.8 In Venezuela, the financial services available to microenterprises are provided for the most part through government agencies and nongovernmental organizations (NGOs).
- 1.9 The government agencies active in this sector include the Fondo de Apoyo, Cooperación y Financiamiento de Empresas Asociativas (FONCOFIN); Corpoindustria; and the Regional Funds. FONCOFIN operates as a second-tier lender and has agreements with a number of NGOs which serve as intermediaries in distributing resources to microentrepreneurs. Between 1990 and 1997, FONCOFIN allocated approximately US\$9.3 million for lending to microenterprises, benefiting some 14,743 microentrepreneurs. However, recent figures show that FONCOFIN is now placing greater emphasis on financing the cooperative movement. Meanwhile, the Regional Funds and Corpoindustria have begun to make minor inroads into the microenterprise sector.
- 1.10 In Venezuela, as in most other parts of Latin America, NGOs have begun to assume a leadership role in the microenterprise sector over the last ten years. Recent studies by the Bank's consultants

identified some 80 different NGOs active in Venezuela's microenterprise sector. In some areas of the country's interior, NGOs are the sole source of lending for microentrepreneurs. In addition to granting loans, almost all of these NGOs also offer training, technical assistance and other business services for microenterprises. However, given their evident assistance-based approach to the task, the majority of these NGOs have encountered great difficulty in becoming financially self-supporting, with the result that the continuity of their lending services is placed at risk.

- 1.11 There are at present only two NGOs offering financial services for microenterprises in the areas within the state of Mérida served by FUNDESOC: Uniandes and FUNDESOC, which serves a total of approximately 460 borrowers between them, 72% of which are clients of FUNDESOC. Other (government) agencies in Mérida lend only to the agricultural sector, and find themselves in increasing difficulty due to budget constraints. This brief analysis of supply and demand reveals a serious lack of financial services for microenterprises in the state of Mérida, a need which FUNDESOC is more than qualified to fill.

F. Background to the operation

1. The request

- 1.12 In September 1997, the Bank's Country Office received a request from the Fundación para el Desarrollo Social (FUNDESOC), an institution serving the marginalized inhabitants in Mérida, a state in which individuals living in poverty or extreme poverty make up 48.87% of the total population.

2. Statement of nonobjection

- 1.13 The Government of Venezuela, acting through the Central Office for Planning and Coordination (CORDIPLAN), indicated to the Bank its nonobjection to the financing of this operation.

3. The government's strategy

- 1.14 Having recognized the special importance of the microenterprise sector in the generation of income and employment, the Government of Venezuela, through FONCOFIN, a Foundation attached to its Ministry of Family Welfare, set about developing a national plan in support of microentrepreneurs. To implement this program, State funds were allocated to the Ministry of Family Welfare. The program is being carried out primarily in urban areas through cooperatives, NGOs and other local groups or associations. Since the credit needs of the microenterprise sector are substantially greater than FONCOFIN can supply, the resources of this program will not compete with those provided under FONCOFIN.

4. The Bank's strategy and experience in Venezuela

- 1.15 This project is consistent with the report on the Bank's Eighth Replenishment, which places special emphasis on the development of microenterprise, and will help further the goal of the microenterprise development strategy by giving disadvantaged and low-income microentrepreneurs access to financial services and promoting the growth of sound and sustainable institutions offering high calibre services. A preliminary programming paper (revised on November 18, 1997) stressed the need for the Bank to help reduce poverty by supporting projects designed to generate income and productive employment.
- 1.16 Following its strategy, the Bank approved 13 operations for Venezuela in 1993 under the Small Projects Financing Program, and these are currently being carried out by the Fundación Eugenio Mendoza (FEM) and the Grupo Social-Centro al Servicio de la Acción Popular (CESAP). In mid-1997, the Bank commissioned two firms, Luso Consult Financial Systems (LCFS) and DFC International Inc. (DFC), to conduct the first interim review of these projects with the two companies evaluating six small projects administered by FEM, and the seven projects administered under the CESAP.
- 1.17 In the case of the small projects under CESAP, the DFC concluded that they were strongest in their ability to orient target groups, whereas they were less successful in institutionalizing credit programs which will need to generate larger volumes of activity if they are to meet the basic parameters of the program. For its part, the LCFS concluded that the programs under the FEM had accomplished their social mission and succeeded in providing microentrepreneurs with training and access to credit, thereby helping to reduce poverty in the areas in which they operate. Nevertheless, in order to expand the program's coverage - an essential requirement for creating sustainable institutions - credit technology needs to be streamlined, along with intensive training programs for their personnel.
- 1.18 The specific suggestions and recommendations of the consultants were carefully examined by the Bank, CESAP, and FEM, and resulted in important changes and improvements in the way the programs are being managed today. In recent evaluations carried out in Venezuela, the Bank's Country Office reports that the level of performance of these institutions has shown notable improvement. Based on this experience, the CESAP and FEM have joined with the Banco del Caribe on a project to create a new commercial bank (Bangente) devoted exclusively to providing financial services for the microenterprise sector and small business. With technical support from Acción Internacional, and using the financial experience of Banco del Caribe, an effort is being made to further refine credit technology and improve the skills of personnel, both of which are essential to the creation of the new bank. The IDB is currently exploring the possibility of participating in this

project using resources from the MIF. It is expected that local investors, the Andean Development Corporation (ADC), and an international private investment fund called PROFUND which specializes in the microenterprise sector will also contribute the capital and financing for the project. By serving geographical areas other than those covered by Bangente, the present operation with FUNDESOC will mesh nicely with this initiative.

II. THE PROGRAM

A. Objectives

- 2.1 The general objective of this project is to improve the socio-economic situation of microentrepreneurs and small agricultural producers in the state of Mérida. Its specific objectives are to: (i) increase the capacity for granting credit to this target group through FUNDESOC; and (ii) provide institutional strengthening for FUNDESOC, enabling the Foundation to develop the capacity for efficient and sustainable administration of its financial resources. FUNDESOC is expected to use the proceeds of the program to provide credit to at least 200 low-income microentrepreneurs and small agricultural producers in the State of Mérida.

B. Description

- 2.2 The project will consist of two subprograms: (i) provision of financing for FUNDESOC to expand its portfolio of loans to microentrepreneurs; and (ii) nonreimbursable technical-cooperation funding to provide institutional strengthening for FUNDESOC.
- 2.3 The sum of US\$200,000 in financing will be used to fund a loan program intended to meet the credit needs of microentrepreneurs and small agricultural producers in the areas in which FUNDESOC operates. These resources will be used to provide working capital for the purchase of raw materials, inputs, light tools, etc., and for the acquisition of fixed assets (heavy tools, equipment, machinery, etc.) needed by microentrepreneurs.
- 2.4 The objective of the nonreimbursable technical-cooperation funding will be to provide institutional strengthening for FUNDESOC as a means of ensuring proper execution of the project. This operation will be designed to meet the following specific objectives: (i) devising a business plan for the institution; (ii) designing and implementing a management information system, which will include modifying the institution's accounting system to handle its lending program as an independent cost center separate from other programs; and (iii) implementing lending criteria based on the Credit Regulations designed for this operation. In addition, these

resources will finance a mid-term evaluation to be carried out in accordance with Chapter IV, Section E, of this document.

C. Costs and financing

- 2.5 The total estimated cost of the program will be US\$300,000 equivalent. Of this total, US\$200,000 will be allocated for lending operations, and US\$100,000 will go to finance the Technical Cooperation funding. The resources used for the credit operations (US\$200,000) will be disbursed to FUNDESOC on the following conditions: that they be repaid in local currency - with maintenance of value - over 20 years, including a four-year grace period, and with a credit fee of 1% per annum on the outstanding balance. By contrast, the US\$100,000 of the technical-cooperation subprogram will be nonreimbursable in nature and disbursed in local currency.

III. THE INTERMEDIARY

A. Identity, origin and objectives

- 3.1 The Fundación para el Desarrollo Social (FUNDESOC) is a non-profit civil association created in 1985 to help carry out the archdiocese of Mérida's pastoral mission. According to its articles of association, FUNDESOC's primary objective is to support and develop the various programs that make up the Archdiocese of Mérida's pastoral mission, promote social development projects, and research, expand, stimulate and sponsor leadership training. Depending on the progress of the program, FUNDESOC is open to the idea of adopting a form of independent legal status in order to better manage its lending program.
- 3.2 FUNDESOC's organizational structure consists of: (i) a board of directors chaired by the Archbishop of the metropolitan area, assisted by an Executive Vice-President; and (ii) the Office of the Executive Vice-President, which is responsible for managing FUNDESOC's day-to-day activities. The Foundation is currently modifying its articles of association to permit expansion of the board of directors in order to include between five and seven new directors reflecting the existing diversity within the state of Mérida which, in addition to those already named, will include representatives of business, and the academic and scientific communities.
- 3.3 The institution has 30 employees in all, six of whom work directly with the loan program (known within FUNDESOC as the "Production Unit Support Program"), while a further 12 are indirectly involved. The remaining staff work in the Foundation's other three programs,

i.e. the job training and placement, community health, and childcare.

3.4 The overall administration of FUNDESOC includes the following divisions and positions: (i) the General Management, which reports to the Office of the Executive Vice-President for the internal operations of the Foundation and overall administration; (ii) Director of Management Control and Planning, who is responsible for facilitating the planning process and general oversight of the institution, and for supervising the management of each of the Foundation's programs; (iii) General Counsel, who advises the Foundation in all matters having to do with the law and coordinates the activities of the Legal Department; (iv) Office of the Director of Projects, which formulates and negotiates all proposals for cooperation and financing presented by the Foundation; (v) the Administrative Office, which is responsible for the organization's general administration, including finance, human resources, accounting and budget performance; and (vi) the Operations Department, which is responsible for directing the Production Unit Support Program. In addition, FUNDESOC has a Loan Committee made up of the General Manager, Director of Administration, General Counsel, Executive Vice-President, a marketing expert and one loan officer.

3.5 FUNDESOC has established offices in a house owned by the Archdiocese in downtown Mérida, where it provides easy access and convenient service for its clients. In addition, the Foundation has the use of church halls in 38 local parishes in the area where it can hold promotional meetings and training sessions for microentrepreneurs.

B. Activities of the Foundation

3.6 FUNDESOC launched its Production Unit Support Program in 1989 by offering credit, training and technical assistance for low-income microentrepreneurs and small agricultural producers under an agreement signed with the FONCOFIN Foundation. Until the signing of this agreement, FUNDESOC had been providing marketing support and training under a program entitled the Cooperative Movement and Self-Help Initiatives, which lacked a credit component. Since 1989, the Foundation has concluded four agreements with FONCOFIN, under which it has granted a total of 540 loans worth a total of approximately US\$400,000.

3.7 In 1993, and again in 1995, FUNDESOC signed two trust contracts with the Banco Unión covering execution of the last two agreements concluded with FONCOFIN. Under these contracts, Banco Unión has undertaken to disburse funds and recover amounts owing under loans, using the collection mechanisms agreed to between the two institutions.

- 3.8 Although the agreements with FONCOFIN have given FUNDESOC substantial experience in granting loans to microentrepreneurs, they have not enabled the institution to develop a proper credit methodology. In accordance with the provisions of these agreements, FUNDESOC has granted loans at subsidized rates, with ample grace periods and generous repayment terms. In addition, FUNDESOC has been requiring a mandatory period of training prior to granting a loan, resulting in borrowers often having to wait up to four months before receiving the funds and making for exceedingly high transaction costs. ^{1/} These factors have detracted from the institution's ability to become self-supporting. Accordingly, FUNDESOC has chosen to allow all of the resources it currently administers to gradually revert to FONCOFIN, thereby enabling FUNDESOC to focus on its other projects in 1997, that is to say on its job training and placement, community health, and childcare programs.

C. Financial position

- 3.9 As of December 31, 1997, FUNDESOC possessed total assets equivalent to US\$241,671, approximately 58% of which were invested in loans to microentrepreneurs. Its accounts showed a net worth equivalent to US\$12,849, with a surplus in the 1997 fiscal year of US\$8,336, primarily as a result of new aid resources of close to US\$308,000 consisting for the most part of financing for the other programs administered by FUNDESOC (see paragraph 3.3 and Annex II - Financial Statements 1995-1997).
- 3.10 Between 1995 and 1997, FUNDESOC's assets declined sharply from US\$239,499 to US\$24,276, due mostly to the fact that a new trust agreement was not signed with FONCOFIN during 1996. As a result of its strategy of allowing resources to revert to FONCOFIN, together with the devaluation of the bolivar, the real value of the Foundation's loan portfolio dwindled by 67%. The percentage of nonperforming loans in the portfolio soared from 13.35% in 1995 to 33.7% in December 1997. This deterioration in the quality of loans occurred because the portfolio returned to FONCOFIN consisted of loans recovered by FUNDESOC, whereas problem loans were retained by the latter institution.
- 3.11 FUNDESOC's liabilities in this period declined by 67% as a result of the loan recoveries by FUNDESOC and returned to FONCOFIN, together with the devaluation of the bolivar. FUNDESOC does not report any significant financing costs since it does not pay for the trust contract or for the savings it is required to raise

^{1/} FUNDESOC is aware of the problem and this situation has been improving to the point where FUNDESOC now takes only 15 days on average to approve a loan.

through its Contingency Fund. 2/ Because of the increase in aid resources, however, FUNDESOC's net worth rose from US\$8,963 to US\$12,849 over this period.

- 3.12 Performance: The agreements signed with FONCOFIN specify that FUNDESOC is to charge interest on its loans at up to 80% of the average lending rate charged by the country's eight largest banks. Based on a recent communication issued by Venezuela's Banco Central dated February 5, 1998, the lending rate charged by FUNDESOC would be 19.32%. This compares favorably with the Venezuelan financial market's current lending rate of 24.15%, as well as a rate of 60% or so charged under similar microenterprise programs operated by the Mendoza Foundation and CESAP. 3/
- 3.13 The interest from FUNDESOC's credit operations is not reported in the institutions's final results since they are remitted in their entirety to FONCOFIN. This explains why management of the financial spread has not been a source of concern for the institution. By contrast, the coverage of its operating expenses has been a major priority, and has been accomplished through a series of donations from FONCOFIN, the United Nations Children's Foundation (UNICEF), the Inter-American Fund (IAF), and the Ministry of Family Welfare. Income in aid resources during 1995-1997 were equivalent to US\$651,581 4/, and operating expenses over the same period totalled US\$632,308. The result is that during each of the last three fiscal years, FUNDESOC has ended with an operating surplus (see Annex II). The operating efficiency ratio for its lending program was calculated at 32%, 5/ which falls far short of best practices. Its current financial position, together with the above mentioned indicators, show that FUNDESOC needs to change its financial and credit policy, which is the purpose of the present operation.
- 3.14 Projections: An important aspect for improving its financial position has to do with the negotiations to terminate the Foundation's agreements with FONCOFIN. Under these agreements, FONCOFIN owes FUNDESOC the equivalent of US\$60,000 to finance operating expenses under FUNDESOC's lending program. At the same time, FUNDESOC owes FONCOFIN some US\$190,000 which are invested in FUNDESOC's loan portfolio, of which the equivalent of US\$47,000 is currently in arrears. At present, FUNDESOC is actively seeking to

2/ The Contingency Fund is generated through a 10% deduction from each loan granted, serving both to promote savings as a form of guarantee.

3/ The projected inflation rate for Venezuela in 1998 is 30%.

4/ Only about 13% of these aid resources were used to cover operating costs under the lending program.

5/ Operating costs for the lending program over average total portfolio during the period.

negotiate an end to these agreements, thereby minimizing the costs to the institution.

- 3.15 To this end, and according to projections based on information provided by FUNDESOC, in the course of the next three years, the present program is expected to help the Foundation build up its loan portfolio to US\$250,000, a volume of lending which will enable FUNDESOC to become approximately 65% financially self-sustaining in its credit program by the third year of the program. The attainment of this goal will be aided as well by an agreement that FUNDESOC is about to sign with the Inter-American Foundation, under which the IAF will provide US\$50,000 in financing for the loan portfolio, and US\$25,000 to fund operating expenses. To cover a projected operating deficit of approximately US\$60,000 during the first two years, FUNDESOC will need to tap new sources of additional financing as well. FUNDESOC will need to secure further sources of funding to ensure future growth of its loan portfolio permitting the Foundation to reach critical mass, that enables it to become institutionally sustainable.

D. Evaluation of the institution

- 3.16 FUNDESOC is one of the primary sources of credit for microentrepreneurs in the state of Mérida, and has the institutional base needed to administer one of the Bank's small projects. That it has the unconditional endorsement of the Archbishop's pastoral mission, together with financial support from UNICEF and the IAF, are among the institutional strengths of FUNDESOC. As shown in the above financial analysis, however, FUNDESOC also suffers from certain weaknesses which this program will seek to correct. The institution is now ready to change its institutional strategy, along with its credit policy, so that it no longer needs to rely on FONCOFIN for its resources. The technical-cooperation funding under this project will seek to make substantial changes in the management and administration of the Foundation, setting a positive course for FUNDESOC.

IV. EXECUTION OF THE PROGRAM

A. Responsibility for execution

- 4.1 Execution of the credit program and the technical-cooperation operation will be the responsibility of FUNDESOC.

B. The credit program

- 4.2 The credit program will begin after the technical-cooperation funding has been carried out. The Credit Regulations governing execution of the program are described in Annex III of this

document. These regulations will be consistent with the Bank's standards and policies, as well as with the laws and banking and financial practices of Venezuela. The loans that are granted to microentrepreneurs will be subject to the terms and conditions set out below.

- 4.3 Terms: Amortization periods will be established by FUNDESOC based on the characteristics of each project, taking into account the type of investment, cash flow of the production unit, and the borrower's ability to pay. The term for repayment of loans for working capital may not exceed 12 months. Loans for purchase of fixed assets will have amortization periods of up to 18 months. No grace period will be allowed under either type of loan.
- 4.4 Interest rate, charges and commissions: The interest rates charged by FUNDESOC on loans granted with the program's resources must be real and positive, but will be freely set by the Foundation. The calculation used to determine this rate must take into account the average rate of inflation, the opportunity cost of the money, the costs of intermediation (financing and operating costs), establishment of a conservative reserve fund to cover bad debts, and a surplus to provide capitalization for the institution.
- 4.5 Loan amounts and limits: The debt ceiling set for each borrower or group of borrowers will take into account all operations for which the individual or group is responsible, and may not exceed 70% of the borrower's total assets, 10% of FUNDESOC's net worth, 6/ or the equivalent of US\$6,000.
- 4.6 Environmental protection and gender component: FUNDESOC will take special care to ensure that the projects financed with resources from this project do not harm the environment. To this end the Foundation will observe the Bank's preliminary guidelines for improving the environmental quality of lending operations for microenterprise. In addition, FUNDESOC will encourage participation and facilitate access to the program by women microentrepreneurs.
- 4.7 The following will be conditions precedent to the first disbursement under the Credit Program: (i) that FUNDESOC submit the business plan referred to in paragraph 2.4 of this document; (ii) that the Credit Regulations agreed to in advance with the Bank are in effect, in accordance with Chapter IV, Section B, of this document; (iii) that FUNDESOC demonstrate that lending methods acceptable to the Bank have been implemented; and (iv) that FUNDESOC present evidence that its accounting and management information systems are operating satisfactorily.

6/ These ceilings correspond to generally accepted practices in NGO lending.

C. The technical-cooperation project

- 4.8 The technical-cooperation funding for institutional strengthening of FUNDESOC will help to ensure responsible and efficient administration of the project. The Plan of Operations contained in Annex I of this document provides a detailed description of the components of this technical-cooperation project. The responsibility for recruitment and hiring of the consulting services needed to carry out the project will be the responsibility of FUNDESOC. In addition, the Executive Vice-President of FUNDESOC will be responsible for directing and coordinating the work of these consultants so as to ensure maximum benefit for the institution.
- 4.9 As a condition precedent to the first disbursement, FUNDESOC must have reached agreement with the Bank on the terms of reference and the recruitment of consultants to carry out this project for the institutional strengthening of FUNDESOC.

D. Disbursements

- 4.10 Although a period of four years has been allotted for disbursements, it is expected that the financing will be disbursed within 36 months of the date on which the agreement takes effect.
- 4.11 Because of the nature of this program, the technical-cooperation funding must be immediately available. For this reason, if so requested by FUNDESOC, the Bank will provide an advance of up to 30% of the total amount of the funds. However, no more than 70% of the technical-cooperation funding may be disbursed until such time as at least 20% of the resources under the credit program have been disbursed.
- 4.12 Once the conditions described in paragraph 4.7 have been fulfilled, the Bank will advance up to 20% of the proceeds of the credit program in order to provide sufficient liquidity to meet the credit demands of the target group. For disbursements under the Credit Program to exceed 40% of total funds allocated for this purpose, FUNDESOC must demonstrate to the Bank's satisfaction that it has taken the corrective measures agreed on with the Bank based on results of the mid-term evaluation of the program referred to in Chapter IV, Section E, of this document.
- 4.13 During execution of the program, FUNDESOC will take appropriate measures to ensure that the level of loans in arrears in its portfolio (calculated on the basis of portfolio at risk) relating to this program remains below the 5%. The Bank reserves the right to defer disbursements in the event of failure to meet this condition, bearing in mind in all cases the possibility of circumstances justifying a temporary increase in the level of arrears. To this end, during program execution FUNDESOC will submit semi-annual reports to the Bank indicating the status of its

loan portfolio, and these will be reviewed in the course of the evaluation missions.

E. Mid-term evaluation

- 4.14 FUNDESOC will undergo a mid-term evaluation when 30% of the resources of the credit program have been committed or, alternatively, when the Foundation's assets have increased by more than 30%.
- 4.15 This mid-term evaluation will determine the operating and administrative efficiency of FUNDESOC, its financial condition, the quality of its portfolio and the results obtained. The reports to be submitted by FUNDESOC will serve as inputs for this evaluation, which will be carried out by a consultant hired with resources from the technical-cooperation funding. The findings of the mid-term evaluation will be used to determine future disbursements under this operation.
- 4.16 Among other factors, the mid-term evaluation will consider the following: (i) the overall operation of the institution; (ii) the degree to which its business plan has been carried out; (iii) the institution's solvency and liquidity; (iv) level of arrears; (v) its institutional and financial sustainability; (vi) effectiveness of the technical-cooperation funding received; (vii) implementation and use of a sound credit methodology; (viii) its accounting and management information system; (ix) the types of microenterprises served and their line of business or activity, including a breakdown by gender; (x) the quality of the services it offers; and (xi) the level of satisfaction among its microentrepreneurial clientele.

F. Reports

- 4.17 Throughout the execution period, FUNDESOC must submit to the Bank's satisfaction a progress report on the program within 30 days following the close of each semi-annual period. The report will include, *inter alia*, the Foundation's financial statements and detailed information on the status of its loan portfolio. The last of these reports will constitute the final report and must contain a summary of the results obtained and the extent to which the program's objectives have been achieved.

G. External audit

- 4.18 For a period of five years, beginning in the year in which disbursements commence, FUNDESOC must submit to the Bank the financial statements of the institution and those of the program within 120 days following the close of each calendar year. These statements must be audited by an independent auditor or an independent accounting firm acceptable to the Bank.

V. VIABILITY, RISKS AND RATIONALE FOR THE OPERATION

A. Socioeconomic viability

- 5.1 The program will help improve the living standards of approximately 200 families, directly benefiting some 1,000 people in low-income groups in Venezuela. In addition, it is expected to have an effect on the level of employment by creating roughly 100 new jobs.
- 5.2 As well, the objective of making FUNDESOC institutionally sustainable will, in itself, help to guarantee continuing access to credit and higher levels of service for microentrepreneurs, which should entail long-term socioeconomic benefits for this segment of the population.

B. Institutional viability

- 5.3 FUNDESOC has been legally established with a flexible organizational structure which will enable it to administer this operation appropriately. Its human resources receive continuous training, and it has experience in granting loans and administering projects. It enjoys important ties with international institutions such as UNICEF and the IAF, which should continue to prove useful in carrying out its plans.
- 5.4 The weaknesses in financial and credit administration mentioned earlier need to be corrected so that FUNDESOC can carry out the program efficiently, and play a greater role in formulating and executing similar programs in future. To accomplish this, it was considered necessary to provide institutional strengthening for FUNDESOC. Accordingly, a parallel, nonreimbursable technical-cooperation operation was designed as part of this operation. This operation is expected to enable FUNDESOC to develop valuable experience that will help the institution to obtain further financing in future, and this in turn will provide the economies of scale necessary for permanent operation on a financially self-sustaining basis.

C. Financial viability

- 5.5 The outcomes of the operation will provide the basic guidelines for making FUNDESOC financially viable. The business plan itself and the use of real and positive lending interest rates will need to demonstrate that the institution is financially viable. The adoption of the Credit Regulations and suitable lending methodology will guarantee a quality loan portfolio, further enhancing institutional viability. Lastly, an adequate accounting and management information system will make it possible for FUNDESOC to make for effective decisions, thereby contributing to an improvement in the institution's performance.

D. Risks of the operation

- 5.6 The principal risk associated with this operation relates to the need to ensure that the lending rates are positive and real. At least at the beginning of the operation, this factor could cause a drop in estimated demand for credit on the part of micro-entrepreneurs. However, the experience of FUNDESOC and other similar institutions in Venezuela seems to indicate that micro-entrepreneurs are able to pay the interest at the levels proposed in exchange for the certainty that the loans will be granted promptly. This has certainly been the experience elsewhere in the world. Furthermore, in most cases the only other source of resources for FUNDESOC's clients are the private lenders who charge rates of interest that greatly exceed those proposed under the program.
- 5.7 Another risk factor stems from the abovementioned weaknesses in FUNDESOC's financial and credit management. Clearly, unless these weaknesses are corrected, it will be very difficult to attain the goals and objectives of the program. The technical-cooperation operation and the mid-term evaluation described in Section E of Chapter IV, will substantially reduce the risks associated with this operation. It is therefore vital that the Bank carefully monitor the recruitment of the consultants in charge of providing the technical-cooperation funding and performing the mid-term evaluation of the program.

VI. JUSTIFICATION AND RECOMMENDATION

- 6.1 The proposed financing operation and technical-cooperation funding are consistent with the eligibility criteria for the Small Projects Financing Program established in documents GP-75-7 and GN-1238-2, as well as with the Operating Policy on Women in Development, set out in document GP-114-3. It will also directly benefit low-income groups that currently lack access to conventional sources of credit (it is estimated that at least 50% of those receiving loans under the program will be women). Finally, the project will generate employment and promote the use of appropriate technologies.
- 6.2 In addition, the execution of this program will strengthen the FUNDESOC's institutional and financial capacity, enabling the Foundation to play a greater role in future in the formulation and execution of projects aimed at the poorest and most vulnerable segments of Venezuela's population.

- 6.3 The above analysis supports the conclusion that the proposed program is viable. The Management of the Bank therefore places the proposed resolution for the financing before the Board of Executive Directors for its consideration, with the recommendation that the financing be approved.

PLAN OF OPERATIONS

INSTITUTIONAL STRENGTHENING FOR FUNDESOC IN VENEZUELA

I. BACKGROUND

- 1.1 As an adjunct to its request under the Small Projects Financing Program, the Fundación para el Desarrollo Social (FUNDESOC) of the state of Mérida, in Venezuela, has asked the Bank to approve nonreimbursable technical-cooperation funding for development of its institutional strengthening programs.
- 1.2 The Government of Venezuela, through its Central Office for Planning and Coordination (CORDIPLAN), has indicated to the Bank its nonobjection to the latter granting resources for execution of the proposed program.

II. RECIPIENT ORGANIZATION

- 2.1 The recipient organization under this technical-cooperation project will be the Fundación para el Desarrollo Social (FUNDESOC), of the state of Mérida.
- 2.2 FUNDESOC is a private, nonprofit institution legally constituted, among other things, to promote and develop activities and programs such as lending operations, technical assistance projects and other services that benefit the poorest and most vulnerable population groups in the region it serves.
- 2.3 FUNDESOC has the necessary legal capacity to raise loans and accept grants from national and foreign sources of financing and aid, as well as to grant loans and offer training, technical assistance and other services to third parties.
- 2.4 Inasmuch as FUNDESOC's financial and credit management suffer from certain weaknesses which need to be corrected for efficient execution of the credit program, an expert consultant should be hired to develop an institutional strengthening program.

III. OBJECTIVES AND DESCRIPTION OF THE PROGRAM

- 3.1 The objective of the nonreimbursable technical-cooperation funding will be to provide institutional strengthening for FUNDESOC in order to ensure proper execution of the project. To this end, this

operation will be designed to meet the following specific objectives: (i) draw up a business plan for the institution; (ii) develop and install a management information system, including changes in the handling of the institution's accounts intended primarily to administer the credit program as a separate cost center, independent of FUNDESOC's other activities; and (iii) implement a lending methodology consistent with the Credit Regulations designed for this operation.

3.2 Specifically, this operation is intended to do the following:

- a. Develop within FUNDESOC the capacity to design strategic planning and budget management systems, with the medium- to long-term goal of ensuring proper administration of income and expenditures under the Credit Program, thereby enabling the Foundation to become financially and institutionally sustainable.
- b. Develop and put into place a management information system and an accounting system which will give FUNDESOC greater control over its operations in general, and the activities of its credit program in particular, and provide timely, quality information for vital management decisions to ensure the institution's excellent performance.
- c. Review, improve and implement suitable credit technology for the institution and its clientele, seeking to optimize operating efficiency and offer financial products suited to the needs of the target group, which in turn will help to ensure a low default rate and the institutional sustainability desired.

3.3 To carry out these tasks, FUNDESOC will select and, with the Bank's nonobjection, hire the following consultants:

- a. An expert in strategic planning and institutional and financial policy.
- b. An expert in design and implementation of computerized accounting and management information systems for microfinancing programs.
- c. An expert in development and implementation of lending methodologies for credit programs serving microenterprises.

3.4 The Executive Vice-President of FUNDESOC will be responsible for directing and coordinating the work of these consultants such that their tasks are synchronized and produce maximum benefits for the institution.

3.5 This program also provides for one or two FUNDESOC officials to conduct a one-week exchange visit to a country in the region with

relevant experience, where they may observe similar programs in action and exchange views and experiences with institutions in the same field. The selection of these institutions will be made in coordination with the Bank.

- 3.6 A specialized consultant will be hired to carry out the mid-term evaluation described in Chapter IV, Section E, of the document.

IV. TERMS OF REFERENCE FOR CONSULTANTS

A. Strategic planning and policies

- 4.1 A specialist, preferably an international expert, will be hired for a period of from two to three months to perform the following tasks:
- a. Conduct a diagnostic study and an in-depth financial analysis of the institution.
 - b. Based on the information from these studies, develop a business plan for FUNDESOC which, among other things, will feature the following: (i) the separation of lending activities from other activities of the Foundation so that the medium- to long-term feasibility of the credit program may be clearly demonstrated; (ii) general operative factors and macroeconomic assumptions such as inflation, growth rate, cash flow, average size of loans, expected productivity of credit personnel in terms of the number of clients served per staff member, average repayment period, interest rates, default rates, etc.; and (iii) projected financial statements for FUNDESOC (balance sheets and income statements), and potential sources and uses of the institution's resources, demonstrating that it is potentially sustainable. This plan must be drawn up jointly and with the approval of FUNDESOC, and will serve as the basic instrument for implementing the institution's credit program.
 - c. Prepare a general policy statement which will serve as the basis for determining FUNDESOC's future development. This document will set out in detail the policies to be followed by the institution in the implementation of its credit program. The policies defined in this document will include: (i) personnel policy; (ii) financial policy; (iii) policy governing mobilization of funds; (iv) lending policy; (v) training policy for both staff and borrowers; (vi) policies on capital adequacy; and any other policies deemed necessary.

- d. This consultant will also be expected to provide general guidelines and criteria for improving FUNDESOC's organizational structure.

B. Accounting and management information systems

- 4.2 A specialist, preferably an international expert, will be hired for a period of from six to eight months to carry out the following tasks:

- a. Conduct a diagnostic study and evaluation of the accounting and management information system.
- b. Design an ideal accounting and management information system that will enable the credit program to be operated independently as a separate "profit center".
- c. Based on the results of (a) and (b), either upgrade, adapt or replace the software and hardware used to manage the loan portfolio and the institution in general.
- d. Cooperate with FUNDESOC in determining the best computer equipment to purchase. All purchases must be conducted in accordance with the procurement procedures indicated by the Bank.
- e. Adapt the accounting system to generate reports containing data relevant to decision making.
- f. Provide training to a Venezuelan counterpart and borrowers selected by FUNDESOC in the use and maintenance of the system, in conjunction with a specialized company hired to provide timely and appropriate servicing of the computer systems.
- g. Prepare a procedures manual on management information systems introduced.

C. Credit technology

- 4.3 A specialist, preferably an international expert, will be hired for a period of from eight months to one year, to carry out the following tasks:

- a. Review and improve FUNDESOC's credit technology for granting loans to the target group. This will entail studying the current system for preparing project files, finding ways to minimize the time it takes to grant a loan, and dealing with aspects of training programs for borrowers, mandatory savings instruments, and the handling of guarantees, etc.

- b. Develop flexible and efficient mechanisms for ensuring recovery of loans.
- c. Train loan officers, managers and members of the Credit Committee to maintain the quality of the institution's loan portfolio.

D. Mid-term evaluation

- 4.4 The program will include a mid-term evaluation to measure the administrative and operating efficiency of FUNDESOC, its financial condition, and the quality of its portfolio and performance. The results of this evaluation will be used to determine subsequent disbursements for this operation.
- 4.5 The mid-term evaluation will, among other things, consider the following: (i) the overall operation of the institution; (ii) degree to which the business plan has been adhered to; (iii) solvency and liquidity of the institution; (iv) level of arrears; (v) financial and institutional sustainability; (vi) effectiveness of technical cooperation; (vii) the implementation and utilization of good lending methodology; (viii) the accounting and management information system; (ix) types of microenterprises served, and line of business or sector, with a breakdown by gender; and (xi) level of satisfaction among microentrepreneurial clientele.

V. COSTS AND FINANCING

- 5.1 The total estimated cost of this technical cooperation is the equivalent of US\$100,000, as shown in the following breakdown:

CATEGORIES	IDB FINANCING (US\$ equivalent)
2. Technical-cooperation subprogram	
2.1 Strategic and policy planning	
2.1.1 Consultant's fees	12,000
2.1.2 Exchange visit abroad for two officials	3,000
2.2 Accounting and management information system	
2.2.1 Consultant's fees	24,000
2.3 Credit technology	
2.3.1 Consultant's fees	32,000
2.4 Procurement	
2.4.1 Purchase of 7 computers equipped with the corresponding software, 4 ink-jet printers and 1 laser printer	15,000
8.2 Mid-term evaluation	10,000
98. Contingencies	4,000
Total for technical-cooperation subprogram	100,000

- 5.2 This technical cooperation will be financed in local currency from the net income of the Fund for Special Operations (FSO), and will be provided to FUNDESOC on a nonreimbursable basis. The Foundation will furnish the necessary logistical support, including services, office space and supplies, telecommunication services, electricity, etc.

VI. REPORTS

- 6.1 FUNDESOC will submit the following reports to the Bank:
- within 30 days following receipt of the final submissions from the consultants, an evaluation of their reports including an assessment of the work carried out by these experts; and
 - within 120 days following the close of the calendar year in which the final disbursement is made, a financial report audited by a firm of independent auditors, demonstrating the use made of the Bank's contribution.

FUNDESOC
FINANCIAL STATEMENTS
(1995-1997, in US\$) 1/

BALANCE SHEET	1995	1996	1997
Assets	709,898	326,528	241,671
Cash in bank and in hand	36,301	67,609	52,823
FONCOFIN trusts	239,499	33,146	24,276
Net portfolio	420,981	220,406	139,108
Fixed assets	13,117	11,971	17,180
Other assets	0	7,757	8,284
Liabilities	700,935	334,192	228,822
Contingency fund	28,111	35,344	33,253
Principal and interest payable to FONCOFIN	660,518	295,513	190,459
Other liabilities	12,306	3,335	5,110
Capital	8,963	6,697	12,849

INCOME STATEMENT	1995	1996	1997
Investment income (banks)	2,485	1,304	1,583
Financial expenses	0	0	0
Provision for delinquent accounts	0	0	0
Financial margin	2,485	1,304	1,583
Operating expenses	267,361	63,972	300,975 <u>2/</u>
+/- Nonrecurring income (expenditures), donations	274,888	68,965	307,728
Surplus (deficit)	10,012	6,297	8,336

Notes: 1/ The exchange rate used for the three years under consideration were US\$1.00 = Bs290 (1995), Bs477 (1996) and Bs507 (1997).

2/ The rise in operating expenses, in aid resources received during 1997, was due primarily to an increase in activities relating to the job training and placement, community health, and childcare programs.

CREDIT REGULATIONS

ARTICLE I: GENERAL CONDITIONS

These Regulations establish the terms and conditions that will govern the Credit Program for the financing of business activities of low-income microentrepreneurs and small agricultural producers in areas served by FUNDESOC in the state of Mérida (hereinafter called "borrowers"). The Credit Program will be financed with reimbursable resources granted by the INTER-AMERICAN DEVELOPMENT BANK (IDB) to the FUNDACIÓN PARA EL DESARROLLO SOCIAL (FUNDESOC) - hereinafter called "The Intermediary". The Intermediary is a non-profit civil association, one of whose objectives is to provide loans and other services to low-income micro-entrepreneurs and small agricultural producers. The Credit Program will be carried out by FUNDESOC on the terms and conditions set forth below.

ARTICLE II: OBJECTIVES AND DESCRIPTION OF THE PROGRAM

The overall objective of the Credit Program is to improve the socio-economic situation of microentrepreneurs and small agricultural producers in the state of Mérida by expanding the credit services available from FUNDESOC.

The resources of the program will be used to cover working capital needs (raw materials, inputs, small tools, etc.), and the acquisition of fixed assets (heavy tools, equipment, machinery, etc.) for the microentrepreneurs.

ARTICLE III: ELIGIBLE BORROWERS

The beneficiaries of this program will be low-income microentrepreneurs and small agricultural producers, defined in accordance with guidelines set out in these regulations, who have the capacity to execute and operate the project(s) to be financed, but who lack access to conventional sources of credit.

To be eligible for a loan financed with resources from this program, a microentrepreneur must meet the following requirements: (i) must be the owner of the microenterprise for which the loan is requested (and must have headed the operation for at least one year); (ii) he or she must be current with all obligations and have a credit history with FUNDESOC showing proper use and prompt repayment of past loans; (iii) the micro-enterprise in question must be his or her primary source of income and principal source of employment; and (iv) the applicant must either live in Mérida in the area served by FUNDESOC, or the microenterprise in question must be located there.

ARTICLE IV: ELIGIBILITY REQUIREMENTS FOR BORROWERS

In order for a loan to be eligible for financing, it must meet the following requirements: (i) the activity to be carried out by the microentrepreneur must be such as to guarantee repayment of the loan; (ii) it must reinforce existing jobs and/or create new employment opportunities; and (iii) the activities to be financed must not harm the environment.

ARTICLE V: UTILIZATION OF RESOURCES PROVIDED UNDER THE PROGRAM

The resources provided under the Credit Program will be used to finance the purchase of fixed assets and provide working capital required by microentrepreneurs and small agricultural producers to develop production, marketing or service activities judged to be technically and financially viable.

ARTICLE VI: RESTRICTIONS ON THE USE OF PROGRAM RESOURCES

The resources provided under this program may not be used to finance: (i) the purchase or lease of land or buildings; (ii) the payment of debts, dividends or capital returns; (iii) the purchase of shares, bonds or other marketable securities; (iv) the purchase of consumer goods; (v) the purchase of vehicles; or (vi) the payment of taxes.

ARTICLE VII: TERMS AND CONDITIONS OF LOANS

- a. Repayment periods: Repayment periods shall be established by FUNDESOC in accordance with the characteristics of each project, based on the type of investment, the cash flow of the production unit and the borrower's ability to pay. The term for repayment of loans for working capital may not exceed 12 months. Loans for purchase of fixed assets may have amortization periods of up to 18 months. No grace period will be allowed under either type of loan.
- b. Lending rates, charges and commissions: The lending rates, fees and commissions charged by FUNDESOC on loans granted with program resources must be positive and real, but may be freely set by the Foundation. The calculation used to determine this rate must take into account the average rate of inflation, the opportunity cost of the money, the costs intermediation (financing and operating costs), establishment of a reserve for bad debts, and a surplus to provide capital for the institution.
- c. Loan amounts and limits: The debt ceiling set for each borrower or group of borrowers will take into account all operations for which the individual or group is responsible, and may not exceed 70% of the borrower's total assets, 10% of FUNDESOC's net worth, or the equivalent of US\$6,000. The

amount of each loan will be commensurate with the microentrepreneur's ability to pay and cash flow.

- d. Denomination of loans and repayments: Loan financed with resources from the program, as well as repayments made by borrowers, shall be in current bolivars.
- e. Repayments: Loans granted under the program will be repaid in installments including principal and interest. The amount of each instalment shall remain constant throughout the repayment period. Payments may be made weekly, biweekly or monthly, depending on the type of business operated by the borrower, the purpose of the loan, and the cash flow and ability to pay of each applicant. Where warranted by particular circumstances involving the borrower's cash flow, other payment schedules may be permitted. The Intermediary will provide borrowers with an amortization table showing the amount of the loan, the rate of interest applied, and the amounts of principal and interest and the dates these payments are due.
- f. Surcharge for late payment: The Intermediary may charge late payment interest for amounts past due, at the applicable rate in the Venezuelan financial market.

ARTICLE VIII: ARREARS

During execution of the program, the Intermediary will take appropriate measures to ensure that the level of arrears under the proposed Credit Program remains below the 5% level (calculated on the basis of portfolio at risk). The Intermediary will submit semi-annual reports to the Bank's Country Office indicating the status of its loan portfolio.

ARTICLE IX: GUARANTEES

FUNDESOC will back its loans with the guarantees and security permitted under the laws of Venezuela, including joint and several guarantees where the borrower is a group. The Intermediary will require borrowers to post such loan guarantees as it considers necessary and sufficient, including mortgages, collateral, joint security, etc.

ARTICLE X: CREDIT COMMITTEE AND LOAN PROCEDURES

In addition to its other duties, FUNDESOC's Credit Committee shall be responsible for the following: (a) duly observe and enforce the Credit Regulations of the program; (b) issue a decision on all loan requests submitted, either approving, rejecting or deferring applications; (c) approve and sign the proceedings of the Committee containing a record of all applications received, the decisions taken and the terms established for any that are approved (amount, repayment period, interest, guarantee, etc.), or the reasons for rejection or deferment of the application; and (d) consider any unforeseen circumstances affecting

repayment of loans and, where justified, grant such extension(s) as it deems appropriate.

In granting loans to microentrepreneurs, the procedures devised by consultants under the technical cooperation will be used.

ARTICLE XI: PROTECTING THE ENVIRONMENT

FUNDESOC will apply its standards and take special care to ensure that the projects financed with resources from this project do not harm the environment. The procedures established must minimize potentially adverse effects on the environment. To this end, the Foundation will observe the Bank's preliminary guidelines for improving the environmental quality of lending operations among microenterprises.

ARTICLE XII: GENDER COMPONENT

FUNDESOC will encourage participation by women microentrepreneurs, helping to eliminate obstacles including those of a legal nature. Accordingly, it will publicize the existence of the Credit Program among them and facilitate access to the program by women entrepreneurs.

ARTICLE XIII: ACCELERATE REPAYMENT AND DEFAULT

Loans which are granted will be considered due and payment in full will be demanded if one or more of the following circumstances occurs:

- a. If false information is given by borrower in the loan application.
- b. If the borrower refuses to accept supervision of the investment or the goods offered in guarantee of the loan, or if any other event occurs which may reduce the value or call into question the ownership of such goods.
- c. If the borrower fails, in part or in whole, to make the payments of principal and interest specified in the loan contract, on the agreed dates.
- d. If the borrower in any way encumbers or conveys to a third party the goods financed or given in guarantee, without the written consent of the Intermediary.
- e. In the event of nonperformance of contractual obligations, if the borrower should fail to adhere to the provisions established under these Regulations or in the respective contracts.
- f. In the absence of due justification by the borrower, if any unforeseen circumstance should arise which, in the opinion of

FUNDESOC, makes it unlikely that the borrower will be able to meet his or her obligations as set out in the loan contract, or which prevents him or her from achieving the purpose for which the loan was granted.

- g. FUNDESOC reserves the right to suspend disbursements in the event of failure by borrowers to fulfil their obligations.

ARTICLE XIV: CONTINGENCY FUND

In order to promote savings among borrowers under the program, and as a form of guarantee, 10% of all loans granted to microentrepreneurs will be discounted in order to increase the resources available under the Contingency Fund.

ARTICLE XV: RECORD KEEPING AND CONTROLS

The movement of program resources will be recorded separately in FUNDESOC's general accounting system, in an account entitled "BID FUND". To this end, the Intermediary will prepare suitable records in the plan, chart or statement of account approved by the IDB, prior to the first disbursement of the financial resources. These records must identify the loans that are granted, as well as the use made of repayments under these loan, so as to permit the preparation of statements of net assets, earnings, and source and application of funds under the program.

ARTICLE XVI: COOPERATING FINANCIAL ENTITY

The resources of the credit program will be managed through a local financial entity, which will provide the services required for receipt, safekeeping, transfer and disbursement of the resources. The responsibility for financial intermediation will fall to the Intermediary which, acting through its Credit Committee, will be responsible for processing and issuing decisions on loan applications, instructing the cooperating financial entity to disburse resources to borrowers, and accepting repayment and collecting payments due.

ARTICLE XVII: AMENDING THESE REGULATIONS

The Intermediary may suggest changes to the present Regulations in order to adapt them to new circumstances or conditions arising during the course of this program. Any amendments to these Regulations will enter into force on the date that the IDB provides a statement of nonobjection to this effect.

ARTICLE XVIII: OFFICIAL VERSION OF THESE REGULATIONS

These Credit Regulations shall be recorded in the Proceedings of the Credit Committee, and all persons involved in the program shall be familiar with these Regulations and adhere to the terms thereof.

PROPOSED RESOLUTION

VENEZUELA. FINANCING AND TECHNICAL COOPERATION TO THE FUNDACIÓN PARA
EL DESARROLLO SOCIAL WITHIN THE PROGRAM
FOR FINANCING SMALL PROJECTS

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such agreement or agreements as may be necessary with the Fundación para el Desarrollo Social, of the República de Venezuela, to grant it, within the Program for Financing Small Projects, approved by Resolutions DE-85/78 and DE-147/79: (a) reimbursable financing for the execution of the program referred to in Document PR- ; and (b) non reimbursable technical cooperation for the execution of the program, in accordance with Annex I of said document.

2. That up to the equivalent of US\$200,000, in bolívares, is authorized for the purposes indicated in paragraph 1(a), and up to the equivalent of US\$100,000, for the purposes indicated in paragraph 1(b), both chargeable to the net income of the Fund for Special Operations.