

DOCUMENT OF THE MULTILATERAL INVESTMENT FUND

PERU

**CONSOLIDATION OF PRIVATE MICROFINANCE INSTITUTIONS IN
THE REGIONS OF PERU**

(PE-M1031)

DONORS MEMORANDUM

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Proposed resolution

INFORMATION AVAILABLE IN THE SDS/MSM FILES

- Operating Regulations with terms of reference for the main project team
- Minutes of the CESI meeting
- Draft procurement plan
- Project request letter and original proposal
- Approved project abstract
- ASEP's articles of association and financial statements
- ASOCAJAS' articles of association and financial statements
- Institutional analysis of the executing agencies
- Tables of quantitative indicators
- Financial statistics of CRACs and EDPYMES at August 2006

ABBREVIATIONS

ASEP	Asociación de Entidades para el Desarrollo de la Pequeña y Micro Empresa [Association of small business and microenterprise development agencies]
ASOCAJAS	Asociación de Cajas Rurales de Ahorro y Crédito del Perú [Association of Rural Savings and Loan Banks of Peru]
CESI	Committee on Environment and Social Impact
CMAC	Cajas Municipales de Ahorro y Crédito [municipal savings and loan banks]
COFIDE	Corporación Financiera de Desarrollo [Development Finance Corporation]
CRACs	Cajas Rurales de Ahorro y Crédito [rural savings and loan banks]
Edpymes	Entidades de desarrollo de la pequeña y micro empresa [small business and microenterprise development agencies]
FENACREP	Federación Nacional de Cooperativas de Ahorro y Crédito del Perú [National Federation of Credit Unions of Peru]
MFIs	Microfinance institutions
MSBs	Microenterprises and small businesses
NGO	Nongovernmental organization
PCR	Project Completion Report
PPMR	Project Performance Monitoring Report
SBS	Superintendencia de Bancos, Seguros y Administradores de Fondos de Pensiones [Superintendency of Banks, Insurance, and Pension Fund Managers]

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EXECUTIVE SUMMARY

Coexecuting agencies:	Asociación de Cajas Rurales de Ahorro y Crédito del Perú [Association of Rural Savings and Loan Banks] (ASOCAJAS)		
	Asociación de Entidades para el Desarrollo de la Pequeña y Micro Empresa [Association of small business and microenterprise development agencies] (ASEP)		
Beneficiaries:	At least 166,000 microentrepreneurs in the regions of Peru who will gain access to financial services as new clients of small business and microenterprise development agencies (Edpymes) and Cajas Rurales de Ahorro y Crédito [rural savings and loan banks] (CRACs), and the 225,000 existing Edpyme and CRAC clients, who will have access to more and better financial products and services.		
Financing:	MIF Facility IIIA:	US\$1.10 million	(51%)
	Local counterpart:	US\$1.05 million	(49%)
	Total:	US\$2.15 million	(100%)
Terms:	Execution:	36 months	
	Disbursement:	42 months	
Objective:	The goal of the project is to help improve access to quality financial services for underbanked sectors in Peru's regions. Its purpose is to strengthen the capacity of CRACs and Edpymes to expand and consolidate their operations and penetrate new markets.		
Special contractual conditions:	The conditions precedent to the first disbursement of resources is evidence submitted by the executing agencies that: (i) the Temporary Association (project executing unit) and its Executive Council have been established; (ii) the project's principal consultant coordinator has been selected; and (iii) the project's Operating Regulations have been approved by the executing unit's Executive Council and have entered into force.		

**Exceptions to
Bank policy:**

None.

**Environmental
and social
review:**

The Committee on Environment and Social Impact (CESI) reviewed and approved the project abstract at meeting 24-06 of 16 June 2006. Its recommendations were taken into account in project design.

**Coordination
with other
official
development
institutions:**

Project design was coordinated with the United States Agency for International Development (USAID) and Cordaid (Kingdom of the Netherlands). During project execution, the executing agencies will continue to share information and coordinate efforts with these and other cooperation agencies to ensure the complementarity with similar initiatives.

I. BACKGROUND AND RATIONALE

A. The microfinance market in Peru

- 1.1 Peru has some 3.1 million microenterprises and small businesses (MSBs), constituting 97.7% of all business units, employing 70% of the economically active population, and generating approximately 42% of gross domestic product.¹ Although there are many financial entities that serve the microenterprise sector, much of the low-income population remains without access to financial services meeting their demand.
- 1.2 The main formal bank and nonbank financial institutions offering financial services to MSBs and other low-income sectors are: (i) **commercial banks**: at August 2006, Mibanco, Banco de Crédito, and Banco del Trabajo had a total portfolio of US\$638 million, 289,412 microenterprise loans, and 371 branches and offices. According to the Superintendency of Banks, Insurance, and Pension Fund Managers (SBS) figures, the rest of the full-service banks serve 50,137 sector clients, with a portfolio of US\$149 million; (ii) **Cajas Municipales de Ahorro y Crédito** [municipal savings and loan banks] (CMACs): Peru's CMAC system (public entities) had 13 members in August 2006, with a total of 313,568 microenterprises and a portfolio of US\$442 million. The CMACs are supervised by the SBS and take deposits from the public; (iii) **Cajas Rurales de Ahorro y Crédito** [rural savings and loan banks]² (CRACs): they were founded in the early 1990s to promote rural and agricultural credit in Peru. Today the CRACs belong to private investors. In August 2006, the CRACs had a total of 65 offices in the regions of Peru (none in Lima), 54,970 microenterprise loans (out of a total of 106,500 loans), and loans in the sector in the amount of US\$81 million. The SBS supervises the CRACs, which are authorized to take deposits; and (iv) **Entidades de Desarrollo de la Pequeña y Microempresa** [small business and microenterprise development agencies]³ (Edpymes): they specialize in MSB sector lending. They are also supervised by the SBS, but are not authorized to take deposits. The law makes provision for a gradual system in which the larger and more institutionally developed Edpymes could gain access to a module enabling them to take savings deposits. In August 2006, the 14 Edpymes had made some

¹ *Secretaría General Iberoamericana* (2006): "El Acceso al Crédito y a los Servicios Financieros—Informe de Perú."

² CRACs are private companies that specialize in granting loans to medium-sized and small business, and microenterprises in secondary cities and in some rural areas. They are corporations whose stockholders are generally farmers, agribusinessmen, merchants, craftsmen, and small businesses located in their areas of influence.

³ Most Edpymes have emerged from the process of formalization of development NGOs and chambers of commerce with microcredit programs. They fulfill a social mission while adhering to principles of efficiency, profitability, and compliance with oversight provisions.

179,814 microenterprise loans, and had a microenterprise portfolio of US\$197 million (78% of their total portfolio).

- 1.3 In August 2006 these 42 financial institutions served 915,177 microenterprises and had a microenterprise loan portfolio of US\$1.507 billion. The commercial financial system covers only 30% of Peru's estimated 3.1 million MSBs. There is even less financial service coverage in the country's rural areas and small cities since they are not a priority. Rural credit is perceived as risky, unprofitable, and lacking in real guarantees, and the products offered and guarantee requirements are not appropriate for MSBs.
- 1.4 In recent years, competitive pressure has increased markedly in the microfinance sector. The large number of institutions serving the sector and the improvement in the quality of the services—particularly by the commercial banks—have forced smaller institutions such as CRACs and Edpymes to become established in market niches of clients less attractive to the banks. Because of their commitment to underserved groups, these institutions are more active in rural areas. As a result, while these microfinance institutions (MFIs) were pioneers in the sector 10 years ago, they now must continue to push the financial system frontier into still unbanked sectors and to develop a higher quality supply.
- 1.5 Whereas the full-service banking system is highly concentrated in the Lima metropolitan area and the CMACs are public entities, the CRACs and Edpymes are the private entities *more firmly established outside the capital*: four of the 14 Edpymes have operations in Lima. Proximity to the client and products tailored to low-income clients are some of the strengths of the two groups. These entities have less risk aversion.

B. Specific problems of Peru's microfinance institutions

- 1.6 To be able to compete in this market and continue to offer quality financial services to sectors less prone to using bank services the Edpymes and CRACs must address the four specific problem areas in the short to medium term:
 - **Limited product supply:** at present, the Edpymes only offer loan products, mainly for urban microenterprise, while the CRACs handle deposit operations, commercial credit, mortgage loans, and consumer credit, among others. The Edpymes would like to incorporate deposit products to diversify their supply of products, gain client loyalty, and finance their portfolios.⁴ The CRACs wish to strengthen their urban microcredit products and develop a debit card product. Both groups need to add other innovative products in order to serve more clients with better products.

⁴ At least five Edpymes would be in a technical and financial position to offer savings deposit services if so authorized by the SBS.

- **Lack of adequate lending technology for rural sectors:** These are Peru's most underbanked areas, and rural credit is a product with potentially high demand in the regions. If the CRACs and Edpymes wish to grow their portfolios and, in turn, expand the use of bank services in the country, they must offer efficient, profitable rural credit products tailored to their clients.
- **Lack of a comprehensive risk management system.** The new financial regulations will require Peru's nonbank entities to adopt more sophisticated risk management techniques. Yet CRAC and Edpyme risk management capacity is weak as a result of information system limitations and budgetary constraints. In general, such entities lack a systematic and comprehensive platform for analysis, prevention, and management of credit, operating, and market risk.
- **Weaknesses in corporate governance and strengthening of the capital base.** As a rule, most CRACs and Edpymes are owned small local business owners and nongovernmental organizations (NGOs). This results in the formation of boards of directors of limited capacity and without the financial specialization required. Both groups need to consolidate corporate governance as a condition for strengthening their capital base, which might be achieved by attracting private investors or through mergers.

C. **Project rationale and approach**

- 1.7 To increase the supply of microfinance services to underserved areas, strengthen the quality of current services, and, consequently, be more competitive with the larger, more developed MFIs, the CRACs and Edpymes as a group have decided to undertake a joint program to strengthen their technical, operational, and management capacities. This initiative is **innovative** since it is the first time that two microfinance competitors have formed an alliance for collaboration with the aforementioned common purpose, seeking to transform the sector over the long term. The operation will capitalize on opportunities for cross-learning of know-how and best practices among the CRACs and Edpymes in their respective areas of specialization. Lessons learned will have substantial added value for promoting possible replication of the experience in other countries.

D. **MIF and Bank strategy**

- 1.8 Project activities are consistent with the priorities of the Bank's strategy with Peru (document GN-2205-1, of 24 September 2002), in which two areas related to this project were explicitly identified: (i) access to credit in rural sectors; and (ii) development of financial products for microenterprises and small businesses and small low-income producers.
- 1.9 The project complements other microfinance operations of the Bank in Peru: (i) projects under the line of activity for institutional strengthening of MFIs, with

the five most representative Edpymes; (ii) support for the conversion of Edpyme Crear Arequipa into a financial institution through an equity investment; (iii) a project with the Corporación Financiera de Desarrollo [Development Finance Corporation] (COFIDE) (ATN/ME-6636-PE), that promoted diversification of CRAC lending activities by introducing proven microcredit technology. Only three CRACs benefited, as it was prematurely cancelled owing to changes in COFIDE's strategic guidelines; (iv) project ATN/ME-9486-PE with the Federación Nacional de Cooperativas de Ahorro y Crédito del Perú [National Federation of Credit Unions of Peru] (FENACREP), the purpose of which is to strengthen the capacity of cooperatives outside the metropolitan area of Lima to offer specialized products and services for microenterprise; and (v) a MIF project being prepared with the SBS to support the development of a risk bureau for operations with commercial banks and nonbank intermediaries, in which the beneficiary MFIs will be able to participate and improve their risk management capacity.

II. PROJECT DESCRIPTION

A. Objectives

- 2.1 The goal of the project is to help improve access to quality financial services for underbanked sectors in Peru's regions. Its purpose is to strengthen the capacity of the CRACs and Edpymes to expand and consolidate their operations and penetrate new markets in Peru.

B. Description and components

- 2.2 The project comprises four components: (i) development of new financial products and services; (ii) improvement of rural credit methods; (iii) development of a risk management system; and (iv) improvement of corporate governance. To optimize the transfer of know-how and achieve economies of scale, the project will provide technical assistance and training services jointly to the participating entities. The individual entity's level of development will determine what services will be provided to address the specific weaknesses identified. Needs common to all MFIs will be addressed through activities benefiting the universe of participants will be made.

1. Component I: Development of new financial products and services. (MIF: US\$391,000; counterpart: US\$391,000)

- 2.3 The purpose of this component is to develop financial products and services that allow regional private MFIs to expand the frontier of banking services to new areas, and offer current clients better services. Three of the new products already identified are **deposit services, debit cards, and microinsurance**, among others that could be identified during project execution. The details of the design and implementation of these products are presented in the Operating Regulations.

- 2.4 *Other component activities:* In addition to the three products given as examples, resources have been budgeted for the development of other innovative financial products to be defined during project execution. In addition, internships, workshops, and short replication consulting assignments will be financed to disseminate and implement the products, based on the pilot experiences, in the other entities of the CRAC and Edpyme system.
- 2.5 By project end, it is expected that at least four new financial products or services will have been implemented in at least 10 of Peru's regional MFIs. The addition of these products will contribute to sustained growth in the number of Edpyme and CRAC microenterprise clients and a reduction in the institutions' operating costs as a percentage of their portfolio. The regular reports will include information in this regard.

2. Component II: Improvement of rural credit methods (MIF: US\$133,500; counterpart: US\$113,500)

- 2.6 This component will support the CRACs and Edpymes in strengthening their rural credit methods to serve Peru's rural population in the regions more effectively and efficiently. To that end, the following activities will be carried out: (i) three regional studies (coast, highlands, and rainforest) to evaluate the country's existing rural credit models and how well they are tailored to the target group's needs and risk profile; (ii) a consulting assignment for generic design of the product(s), processes, controls, manuals, and procedures, which may be developed based on existing successful experiences in the country; (iii) consulting assignments to adjust the generic design to an estimated eight MFIs; (iv) consulting assignments to implement the pilot tests in the eight MFIs; and (v) training of personnel in implementing the product. In addition, internships, workshops, and short replication consulting assignments will be financed for MFIs that have not participated directly in the technical assistance actions.
- 2.7 Additionally, consulting services will be contracted to address microfinance environmental risk analysis, through a diagnostic assessment of the current status of beneficiary MFIs' environmental policies and procedures. Moreover, the MFI environmental training guidelines developed by COFIDE under an earlier Bank project will be updated.
- 2.8 An expected final output of this component is at least one rural credit product to serve microentrepreneurs and other rural sectors efficiently and sustainably implemented in at least eight of Peru's regional MFIs. In addition, the regular reports will include data on the number of new rural clients, the expansion of the rural portfolio, and the opening of new CRAC and Edpyme offices in rural areas over the three years of the project.

3. Component III: Development of a risk management system (MIF: US\$100,000; counterpart: US\$100,000)

- 2.9 The purpose of this component is to improve MFIs' credit, operational, and market risk management by generating risk management know-how from which all the MFIs can benefit, thereby preparing them to move on to a more sophisticated level. This will include detection and prevention of money laundering in the MFIs.
- 2.10 Some 20 MFIs (both CRACs and Edpymes) that qualify for the project are expected to participate in this component, which consists of the following activities: (i) a diagnostic assessment of risk management systems currently implemented in all MFIs that will participate in the component; (ii) the design of a corporate risk management model, which may include the development of shared risk management platforms, administered by the respective associations; (iii) the implementation of pilot tests in MFIs participating in this component; and (iv) training of personnel to implement and use the systems developed.
- 2.11 An expected output of this component is at least 20 CRACs and/or Edpymes that will have access to a corporate risk management system meeting SBS requirements that enables them to reduce the risks they face. The use of this system is expected to help improve the average high-risk portfolio (arrears + refinanced) of the two groups by about 1.5 percentage points by the end of the project. The regular reports will include information on this key indicator.

4. Component IV: Improvement of microfinance institutions' corporate governance (MIF: US\$198,500; counterpart: US\$248,500)

- 2.12 This component will contribute to consolidating the CRAC and Edpyme system by strengthening their governance and developing and implementing strategies to strengthen their capital base.
- 2.13 The component includes the following activities: (i) prepare diagnostic assessments of governance in approximately 20 MFIs; (ii) individually train board members of 20 MFIs on topics related to modern microfinance institution management⁵; (iii) hold three regional workshops to disseminate knowledge of MFI management methods and best practices; (iv) develop strategies for Edpymes to strengthen their capital base, which may include a search for strategic investors, mergers, or development of sector initiatives; and (v) provide technical assistance to consolidate the CRAC system, which may include actions such as corporate alignment (harmonization of articles of association, shareholder agreements), drafting of agreements for cooperation and limitation of competition among CRACs,

⁵ Topics will include: (i) the role of the board of directors and key personnel; (ii) performance standards for board members and how to eliminate conflicts of interest; (iii) reports and information essential to board members; (iv) analysis and interpretation of financial statements and performance indicators; (v) MFI benchmarking; (vi) strategic planning; and (vii) manager selection and evaluation.

formulation of corporate expansion strategies, and design of a second-tier bank for the CRAC sector.⁶

- 2.14 Expected outputs of this component are: (i) 20 regional MFIs have assessments of their main corporate governance needs and difficulties; (ii) board members of 20 MFIs trained in MFI corporate governance best practices; (iii) further consolidation of the CRAC system through harmonization of articles of association, cooperation and competition agreements, establishment of a common corporate governance structure, and development of a strategy to form a second-tier financial institution for the CRACs; (iv) strategies designed for Edpymes to strengthen their capital base; and (v) initiatives implemented to strengthen the capital base of at least four entities. The regular reports will include information on these indicators and on the capital base strengthening of beneficiary MFIs.

III. COST AND FINANCING

- 3.1 **Cost:** The project's total budget is US\$2.15 million, of which US\$1.1 million (51%) will be provided by the MIF and US\$1.05 million (49%) by the counterpart.⁷ MIF resources will be used to cofinance specialized consulting assignment costs, seminars, courses, and technical assistance for MFIs. The MIF will also defray the total cost of the Principal Consultant (see paragraph 4.6) and project supervision and audits. The project executing unit will be financed mainly with the counterpart contributions from the coexecuting agencies.

Table 1: General budget

	MIF	Counterpart	Total	%
1. Development of new financial products and services	391,000	391,000	782,000	36%
2. Improvement of rural credit methods	133,500	113,500	247,000	11%
3. Development of a risk management system	100,000	100,000	200,000	9%
4. Improvement of corporate governance	198,500	248,500	447,000	21%
5. Principal technical consultant/coordinator	180,000	0	180,000	8%
6. Executing unit	31,000	176,000	207,000	10%
7. Supervision, evaluation, and audits	52,000	5,000	57,000	3%
8. Contingencies	14,000	16,000	30,000	1%
Total	1,100,000	1,050,000	2,150,000	100%
% of total cost	51%	49%		

⁶ In fact, ASOCAJAS is negotiating a program with Rabobank and Cordaid to support consolidation of the CRAC system in this regard. Accordingly, this project will promote close coordination with possible complementary support from these institutions.

⁷ ASEP and ASOCAJAS undertake to provide US\$534,250 and US\$515,750, respectively, which includes equal contributions (50% and 50%) to cover the project executing unit's costs. If the benefits provided for under the project vary for either of the parties, the association that benefits from the budgeted activities will cover the payment of its respective part.

- 3.2 **Sustainability:** Project activities will strengthen the competitive advantages of MFIs that now operate with a high degree of financial sustainability. Of the 24 member institutions of the two associations, only the two weakest *Cajas Rurales de Ahorro y Crédito* [rural savings and loans] (CRACs) have incurred operating losses in the first six months of 2006. In addition, the executing unit will organize workshops to evaluate and disseminate lessons learned during project execution (see paragraph 5.3) in order to evaluate the replicability of experiences gained through the project in other markets and/or countries.

IV. EXECUTING AGENCIES AND EXECUTION MECHANISM

A. Executing agencies

- 4.1 The program will be executed by two coexecuting agencies: the Asociación de Edpymes del Perú [Association of Edpymes of Peru] (ASEP) and the Asociación de Cajas Rurales de Ahorro y Crédito del Perú [Association of Rural Savings and Loan Banks of Peru] (ASOCAJAS). ASEP was formed in 1999 as an entity representing 12 of the country's 14 Edpymes.⁸ Its objectives are to promote an appropriate regulatory framework, facilitate the channeling of funds to its members, strengthen Edpyme management capacity, disseminate sector advances, promote exchanges of experiences, and implement specialized programs. Its highest authority is an Executive Council, comprising five members who are also managers of affiliated entities. ASEP has a general manager, an administrative assistant, a secretary, and a part-time accountant.
- 4.2 ASOCAJAS was founded in 1994, and now brings together all 12 CRACs operating in the country. Its objectives are to support its member institutions in fulfilling their plans and goals, organize training activities, and centralize and publish sector information. The General Assembly of Members is the association's highest authority, comprised of the 12 members, each of which is represented by its president or one of its directors. ASOCAJAS has a half-time general manager, two professionals staff members, and three support personnel.

B. Execution mechanism

- 4.3 A new temporary association of the two Associations will be established for project execution. The only objective of the new temporary association will be execution of this project. The temporary association will establish an executing unit under its control and supervision. The executing unit will be governed by an Executive Council to comprise six members (three designated by each member association). The Executive Council will determine the project's plans, annual budgets, and

⁸ Only the Edpymes Raíz and Efectiva do not belong to ASEP. They do not share the same objectives as the ASEP members.

operating regulations, the contracting of its operations officials, products and services to be developed and implemented in the framework of the project, beneficiary MFIs, and agreements to determine the contribution payments to the executing unit's technical assistance actions and operating costs.⁹

- 4.4 In the operations area, the executing unit will comprise a principal consultant, a technical assistant, and a secretary. External accounting services will be contracted. The executing unit's **principal consultant** (project coordinator) will have responsibility for coordinating and executing project activities and fulfilling project objectives. His/her main responsibilities will be to: (i) prepare the Annual Work Plan (AWP); (ii) propose the corresponding budget; (iii) prepare the terms of reference and criteria for hiring the consultants; (iv) conduct visits to monitor beneficiary MFIs to ensure the quality of consulting services offered; (v) prepare project status reports; and (vi) engage in ongoing policy dialogue with the SBS on regional MFI regulatory and supervisory matters.
- 4.5 **MFI eligibility criteria:** In determining MFI eligibility to participate in this project, two types of indicators have been established, details of which are provided in the Operating Regulations. Institutions fulfilling Level A indicators will be eligible for the project's direct technical assistance actions. Level B institutions will be eligible only for replication activities subsequent to implementation of the new technologies in Level A MFIs. Should demand by MFIs eligible under each category exceed resource availability, the executing unit will conduct a competitive process for the respective selection, using the criteria set out in the Operating Regulations. The MFIs not selected for this stage of technical support will benefit in the subsequent replication stage. In addition, during the review of applications submitted, the executing unit will ensure that the project does not finance technical assistance activities duplicating or very similar to activities financed under earlier or current MIF projects with the Edpymes or CRACs.
- 4.6 **Project readiness.** The project is ready for execution. ASEP and ASOCAJAS have begun procedures to establish the temporary association. In addition, evidence has been submitted to the Bank of the commitment of the counterpart resources and draft Operating Regulations have been prepared for the cofinancing of the executing unit. The associations now have letters of commitment to participate in the project from seven CRACs and 10 Edpymes.
- 4.7 **Execution and disbursement periods.** The execution period will be 36 months and the disbursement period 42 months. The Bank will create a revolving fund of up to 20% of the total amount approved. Beginning with the second disbursement

⁹ Based on consultations with all their members, the two associations have now signed a letter of agreement to establish and operate the executing unit and finance its operating costs, sharing equitably therein. The availability of counterpart resources has also been confirmed by the associations to cover in advance the projected required contributions.

request, replenishments of the revolving fund will be subject to presentation of expense vouchers and to fulfillment of the interim targets previously agreed upon by the executing agencies and the Bank and established in the disbursement timetable, to be prepared as part of the project's plan of operations. Evidence on achievement of targets will be submitted to the Bank in summarized reports annexed to the disbursement requests.

- 4.8 **Procurement.** Goods and services and consulting services will be procured in accordance with the provisions set out in the relevant Bank documents (GN-2349-7 and GN-2350-7).

V. MONITORING AND EVALUATION

- 5.1 **Monitoring reports.** The executing unit will submit project progress reports to the Bank's Country Office in Peru within 60 days of the close of each six-month period, and a final report within 60 days of the date of the last disbursement. The reports will follow a format agreed in advance with the Bank, and will contain a work plan and disbursement timetable for the next six-month period and describe all project activities carried out, financing executed, and outputs achieved, measured using the indicators and means of verification identified in the project's logical framework (Annex I). The executing agency will organize a closing workshop 34 months into execution to evaluate outcomes and actions required to increase project impact.
- 5.2 **Evaluations:** With resources assigned to the project, the Bank will contract two external consultants for the midterm and final evaluations. The midterm evaluation will be commissioned 18 months after the MFI's first disbursement. At a minimum, this evaluation will include the following: (i) changes in the logical framework indicators; (ii) progress of project execution; (iii) institutional capacity of the temporary association and MFIs involved in the project; (iv) implementation and outputs of the environmental consulting assignment (see paragraph 2.9); and (v) provision of the counterpart resources in accordance with the budget and Operating Regulations. The midterm evaluation will also propose any necessary modifications to the logical framework, components, and/or budget. The final evaluation will be conducted when 95% of MIF resources have been disbursed, and will analyze: (i) fulfillment of the program's specific purposes and objectives; and (ii) the sustainability of actions promoted by the project when the MIF contribution has been depleted.
- 5.3 **Dissemination of best practices:** To ensure that lessons learned are disseminated and shared, and can be replicated in other countries of the region, the executing unit will carry out activities to systematize and disseminate project outcomes and lessons learned. An external consultant will be contracted to this end. The material and documents produced by said consultant will be analyzed and disseminated in two dissemination workshops.

VI. BENEFITS AND RISKS

- 6.1 **Benefits:** The program will make it possible for CRACs and Edpymes to offer new products, both credit and deposit, and to reach underserved rural communities. In addition, as a result of the strengthening of risk management, benefited MFIs will be able to provide greater security to clients and the SBS by ensuring the sustainability and quality of services. The direct beneficiaries will be over 166,000 microentrepreneurs in Peru's regions who will gain access to financial services through the Edpymes and CRACs as new clients, and the 225,000 current Edpyme and CRAC clients who will gain access to a wider variety of financial products and services.
- 6.2 **Risks:** The project is subject to three main *risks*: (i) the current expansion of the microfinance environment, which could introduce complexities and difficulties in project execution. This risk will be mitigated by close monitoring of market trends and proposed interventions by the project coordinator; (ii) the possibility that harmony among the Edpymes and CRACs on the project's Executive Council could be affected. The main element to mitigate this risk is the existence of a project technical coordinator who is well regarded by both groups of MFIs. In addition, the Executive Council will seek to benefit both parties; and (iii) the executing agencies might not act immediately in their strengthening process because of the challenge or other external or short-term factors. This risk will be mitigated by the critical need of the Edpymes and CRACs to ensure their survival and consolidation in the microfinance market through the activities envisaged in the project.

VII. ENVIRONMENTAL AND SOCIAL REVIEW

- 7.1 The Committee on Environment and Social Impact (CESI) reviewed and approved the project abstract at meeting 24-06 on 16 June 2006. The project's budget includes resources to contract specialized services in this area to assist participating MFIs in defining policy to include environmental protection criteria in their credit analysis process (see paragraph 2.9). Moreover, in project intervention areas containing campesino and indigenous communities, new product development will consider ways of overcoming cultural barriers that hinder access by such communities to financial services.

**CONSOLIDATION OF PRIVATE MICROFINANCE INSTITUTIONS IN THE REGIONS OF PERU
(PE-M1031)**

LOGICAL FRAMEWORK

Narrative Summary	Indicators	Means of verification	Assumptions
Goal			
To help to improve access to quality financial services for underbanked sectors in Peru's regions.	Three years from project end: Unmet demand for financial services reduced by at least 20%.	SBS statistics Censuses and surveys of Peru's Instituto Nacional de Estadística e Informática [National Statistics and Information Technology Institute] (INEI)	Macroeconomic framework and policies do not adversely affect the microenterprise and small business sector, CRACs, and Edpymes. CRACs and Edpymes remain interested in participating in the project.
Purpose			
Improved CRAC and Edpyme capacity to expand and consolidate their operations and penetrate new markets in Peru.	<p><i>At the end of project year 3,* and compared to the baseline, the following indicators will have improved:</i></p> <ul style="list-style-type: none"> ▪ Number of savings clients and accounts (Edpymes) ▪ Number of clients and debit card portfolio (CRACs) ▪ Number of clients with microinsurance ▪ Total number of CRAC and Edpyme microenterprise clients ▪ Ratio of operating expenses/average portfolio ▪ High-risk microenterprise portfolio (arrearers + refinanced)) ▪ Number of clients and rural portfolio MES 	<p>SBS statistics ASOCAJAS and ASEP reports Institutions' information management systems Semiannual project reports Microfinance institutions' financial statements Midterm and final evaluations Project Performance Monitoring Report (PPMR) and Project Completion Report (PCR)</p>	<p>The State does not intervene in determining national financial system prices and quantities. Competition is maintained within prudent microcredit management parameters. Full-service banking system incursion does not lead to client overindebtedness or difficulties understanding the products. Microfinance institutions (MFIs) assign sufficient human and financial resources to participate in project activities. Regulatory authorities do not object to methods utilized by MFIs to implement products.</p>

Narrative Summary	Indicators	Means of verification	Assumptions
	<ul style="list-style-type: none"> ▪ Total assets * The indicators will be quantified during project execution, when it is known which MFIs will participate in each component, and the reports will include information on the indicators. 		
Components			
Component 1: Development of new financial products and services	<p><i>By the end of project month 6</i>, a minimum of 3 new products defined</p> <p><i>By the end of project month 12</i>, at least 2 new products developed</p> <p><i>By the end of project month 18</i>, at least 2 new products implemented in at least 5 institutions</p> <p><i>By the end of project month 24</i>, at least 2 additional products developed</p> <p><i>By the end of project month 30</i>, at least 2 new products implemented in at least 5 institutions</p> <p><i>By the end of project month 36</i>, at least 4 new financial products or services implemented in at least 10 institutions</p>	<p>Product manuals</p> <p>On-site verification</p> <p>ASOCAJAS and ASEP reports</p> <p>Institutions' information management systems</p> <p>Semiannual project reports</p> <p>MFIs' financial statements</p> <p>Midterm and final evaluations</p> <p>PPMR and PCR</p>	<p>SBS will authorize Edpymes to receive savings deposits or their conversion into financial institutions.</p> <p>Microfinance products will be developed that are tailored to the needs of microenterprise clients of microfinance institutions.</p>
Component 2: Improvement of rural credit methods	<p><i>By the end of project month 12:</i></p> <p>Rural microfinance product(s) developed</p> <p><i>By the end of project month 24:</i></p> <p>In at least 8 institutions, tailoring and pilot tests of rural microcredit product(s) completed</p> <p><i>By the end project month 36:</i></p> <p>In at least 8 institutions, rural microcredit product(s) implemented</p>	<p>Product manuals</p> <p>On-site verification</p> <p>ASOCAJAS and ASEP reports</p> <p>Institutions' information management systems</p> <p>Semiannual project reports</p> <p>MFIs' financial statements</p> <p>Midterm and final evaluations</p> <p>PPMR and PCR</p>	<p>MFIs implement technologies and methods tailored to and tested on rural credit.</p> <p>Boards of directors and management of participating MFIs maintain a positive attitude to providing rural credit services in their areas of influence.</p> <p>Rural microentrepreneurs' demand for credit products increases.</p>

Narrative Summary	Indicators	Means of verification	Assumptions
Component 3: Development of a risk management system	<p><i>By the end of project month 12:</i> Risk management system assessed in 20 institutions</p> <p><i>By the end of project month 24:</i> Corporate risk management system developed</p> <p><i>By the end of project month 36:</i> Corporate risk management system implemented in 20 institutions</p>	<p>Diagnostic assessments of MFIs</p> <p>On-site verification</p> <p>Risk management system manuals</p> <p>Interviews with middle management and risk managers</p> <p>ASOCAJAS and ASEP reports</p> <p>Semiannual project reports</p> <p>Midterm and final evaluations</p> <p>PPMR and PCR</p>	<p>MFIs maintain interest in and commitment to continued collaboration to establish a common risk management system.</p> <p>The proposal developed for the common system meets MFI expectations in terms of time, cost, and operationality.</p>
Component 4: Improvement of microfinance institution's corporate governance	<p><i>By the end of project month 12:</i> Governance assessments prepared in at least 20 institutions</p> <p>At least 3 regional training workshops held on corporate governance-related topics</p> <p><i>By the end of project month 24:</i> Managers of 20 MFIs trained on modern MFI management-related topics</p> <p>Strategy or strategies for strengthening the capital base and financing of the Edpyme system prepared</p> <p><i>By the end of project month 36:</i> Initiatives for strengthening the capital base implemented in at least 4 institutions</p> <p>The CRAC system has been further consolidated through harmonization of articles of association, cooperation and competition agreements, establishment of a common corporate governance structure, and preparation of a strategy to form a second-tier financial institution for the CRACs.</p>	<p>Diagnostic assessments of MFIs</p> <p>Strategy documents prepared</p> <p>Workshop records and materials</p> <p>Interviews with CRAC and Edpyme board members</p> <p>ASOCAJAS and ASEP reports</p> <p>MFIs' financial statements</p> <p>Semiannual project reports</p> <p>Midterm and final evaluations</p> <p>PPMR and PCR</p>	<p>Boards of directors and managers of participating MFIs maintain their commitment to implement the recommendations emanating from the diagnostic assessments.</p> <p>Proposals and strategies for strengthening the capital base and financing of Edpymes are attractive to potential investors and feasible.</p> <p>Other entities that have committed their support to MFIs in the area of corporate strengthening fulfill their commitments.</p>

Narrative Summary	Indicators	Means of verification	Assumptions
Activities			
Component I: Development of new financial products and services (MIF: US\$391,000; counterpart: US\$391,000)			
<p>1.1 Development and implementation of savings products</p> <p>1.2 Development and implementation of debit cards</p>	<ul style="list-style-type: none"> ▪ Study of the market for savings products conducted in at least 5 MFIs by the end of project year 1. ▪ Savings products designed and their respective manuals and procedures available by the end of project year 1. ▪ Software for the new savings products evaluated in and tailored to 5 MFIs by the end of project year 1. ▪ Software and the new savings products individually tailored to 5 MFIs by the end of project year 2 ▪ Pilot tests conducted and personnel trained in 5 microfinance institutions by the end of project year 3. ▪ Study of the market for debit cards conducted in at least 5 MFIs by the end of project year 1. ▪ Generic product design developed by the end of project year 1. ▪ Debit card individually tailored in 5 MFIs by the end of project year 2. ▪ Pilot tests conducted and personnel trained in 5 MFIs by the end of project year 3. ▪ Replication workshops held in other MFIs by the end of project year 3. 	<p>Market study</p> <p>Manuals and procedures for the new products</p> <p>Software evaluation report</p> <p>Consultants' contracts and reports</p> <p>Project status reports</p> <p>Internship reports</p> <p>MFIs' financial statements</p> <p>Midterm and final evaluations</p> <p>PPMR and PCR</p> <p>Market study</p> <p>Consultants' contracts and reports</p> <p>Internship reports</p> <p>MFIs' financial statements</p>	<p>Availability on the market of qualified consultants willing to work under the proposed conditions.</p>

Narrative Summary	Indicators	Means of verification	Assumptions
1.3 Development and implementation of microinsurance	<ul style="list-style-type: none">Feasibility study of microinsurance service offered by MFIs conducted by the end of project year 1.Strategic plan and business plan prepared for microinsurance implementation in four CRACs by the end of project year 1.Microinsurance products for MFIs promoted and validated by the end of project year 3.	Market study documents Consultants' contracts and reports Internship reports MFIs' financial statements	
1.4 Development and implementation of other financial products or services	<ul style="list-style-type: none">Internships completed, workshops conducted, and short replication consulting assignments executed by the end of project year 3.	Consultants' contracts and reports Internship reports	
1.5 Organization of internships for exchange between MFIs			
1.6 Organization of workshops to disseminate experiences			
1.7 Replication events			
Component II: Improvement of rural credit methods (MIF: US\$133,500: counterpart: US\$113,500)			
2.1 Assessment of rural credit products	<ul style="list-style-type: none">Three regional studies conducted, in the coastal, sierra, and rainforest areas, to evaluate rural credit models by the end of project year 1.Generic design of rural credit products developed, with their respective manuals and procedures, by the end of project year 1.Pilot tests conducted and personnel trained in 8 MFIs by the end of project year 3.Internships completed, workshops conducted, and short replication	Regional studies Consultants' contracts and reports Project status reports Internship reports MFIs' financial statements Midterm and final evaluations PPMR and PCR	Availability on the market of qualified consultants willing to work under the proposed conditions.
2.2 Development of product(s), processes and controls, manuals and procedures.			
2.3 Tailoring of the product to at least 8 MFIs			
2.4 Implementation of pilot tests in at least 8 MFIs			
2.5 Holding of staff training events.			
2.6 Organization of internships for exchange between MFIs			

Narrative Summary	Indicators	Means of verification	Assumptions
2.7 Organization of workshops to disseminate experiences 2.8 Holding of replication events.	consulting assignments executed by the end of project year 3. ▪ Environmental consulting assignment executed.		
Component III: Development of a risk management system (MIF: US\$100,000; counterpart: US\$100,000)			
3.1 Diagnostic assessment of current risk management systems in MFIs 3.2 Development of a corporate risk management model 3.3 Implementation of pilot tests in MFIs 3.4 Training of staff in beneficiary MFIs	▪ Rural credit models assessed by the end of project year 1. ▪ Risk management model developed by the end of project year 2. ▪ Pilot tests conducted and staff trained in MFIs by the end of project year 3.	Diagnostic assessment Consultants' contracts and reports Project status reports Internship reports MFIs' financial statements Midterm and final evaluations PPMR and PCR	Availability on the market of qualified consultants willing to work under the proposed conditions.
Component IV: Improvement of microfinance institutions' corporate governance (MIF: US\$198,500; counterpart: US\$248,500)			
4.1 Diagnostic assessment of governance in MFIs 4.2 Training of board members 4.3 Organization and implementation of regional workshops 4.4 Support for the preparation and implementation of initiatives to strengthen the capital base 4.5 Contracting of technical assistance to consolidate the CRAC system	▪ Diagnostic assessment of governance in 20 MFIs by the end of project year 1. ▪ Training workshops for board members of 20 MFIs held by the end of project year 1. ▪ Three regional training workshops held by the end of project year 2. ▪ Strategies to strengthen the capital base of Edpymes formulated by the end of project year 2. ▪ Harmonized articles of association and agreements for cooperation and competition among the CRACs drafted by the end of project year 2. ▪ A second-tier entity for the CRACs designed by the end of project year 3.	Diagnostic assessment Consultants' contracts and reports Project status reports Reports on internships and training workshops Strategy documents Articles of association document MFIs' financial statements Midterm and final evaluations PPMR and PCR	Availability on the market of qualified consultants willing to work under the proposed conditions.

**CONSOLIDATION OF PRIVATE MICROFINANCE INSTITUTIONS IN THE REGIONS OF PERU
(PE-M1031)**

**DETAILED BUDGET
(US\$)**

	MIF	Local	Total	As a %
Component I. New product development	391,000	391,000	782,000	36%
Development of savings products	168,000	168,000	336,000	
Development of other new products, such as:				
Debit cards	75,000	75,000	150,000	
Microinsurance	50,000	50,000	100,000	
Development of other products, to be identified	43,000	43,000	86,000	
Internships in other microfinance institutions with model products	15,000	15,000	30,000	
Training and replication workshops	15,000	15,000	30,000	
Consulting assignments for new product replication	25,000	25,000	50,000	
Component II. Improvement of rural credit methods	133,500	113,500	247,000	11%
Diagnostic assessment of rural credit products	15,000	15,000	30,000	
Design of product(s), processes, manuals, and procedures	24,000	24,000	48,000	
Tailoring of design to 8 microfinance institutions	16,000	16,000	32,000	
Implementation of pilot test	16,000	16,000	32,000	
Training of personnel in rural credit implementation	15,000	15,000	30,000	
Internships on successful rural credit experiences	7,500	7,500	15,000	
Workshops to share successful experiences and replication workshops	7,500	7,500	15,000	
Replication consulting assignments	12,500	12,500	25,000	
Environmental consulting assignments and workshops	20,000	0	20,000	
Component III. Development of a risk management system	100,000	100,000	200,000	9%
Diagnostic assessment of risk systems	25,000	25,000	50,000	
Design of corporate risk management model	24,000	24,000	48,000	
Implementation of pilot test	40,000	40,000	80,000	
Training of personnel in use and maintenance of system	11,000	11,000	22,000	
Component IV. Improvement of microfinance institutions' corporate governance	198,500	248,500	447,000	21%
Diagnostic assessments of governance	15,000	15,000	30,000	
Training of management	9,000	9,000	18,000	
Regional workshops	4,500	4,500	9,000	
Preparation of strategies to strengthen capital base of Edpymes	15,000	15,000	30,000	
Support for initiatives to strengthen capital base of Edpymes	55,000	55,000	110,000	
Technical assistance for consolidation of the CRAC system	100,000	150,000	250,000	

	MIF	Local	Total	As a %
Principal consultant/project coordinator	180,000	0	180,000	8%
Executing unit	31,000	176,000	207,000	10%
Technical assistant (42 months x US\$2,000)	0	84,000	84,000	
Accountant (3 x US\$2,000)	0	6,000	6,000	
Secretary (3 x US\$8,333)	0	25,000	25,000	
Lease of offices (3 x US\$5,000)	0	15,000	15,000	
Utilities (36 months x US\$833)	0	30,000	30,000	
Office supplies	0	6,000	6,000	
Shipping/postage/bank fees	0	5,000	5,000	
Equipment (2 laptops and printers), office furniture and equipment	10,000	5,000	15,000	
Travel and per diems for executing unit consultants (3 x US\$7,000)	21,000	0	21,000	
Monitoring, evaluation, and audits	52,000	5,000	57,000	3%
Annual audits (3 x US\$4,000)	12,000	0	12,000	
Evaluations (midterm and final)	25,000	0	25,000	
Dissemination events (year 2 and final)	5,000	5,000	10,000	
Project systematization and final publication	10,000	0	10,000	
Contingencies	14,000	16,000	30,000	1%
Total	1,100,000	1,050,000	2,150,000	100%

**CONSOLIDATION OF PRIVATE MICROFINANCE INSTITUTIONS IN THE REGIONS OF PERU
(PE-M1031)**

PROJECTS IN PERU

A. Related or similar MIF projects

Project number/Approval date	Project title, sector, executing agency, and amount	Date of signature and original disbursement period in months	Percentage disbursed	Comments: Satisfactory execution or problems with execution, including delays, extensions, reformulation, change of executing agency, etc.
ATN/ME-9486-PE 11/02/2005	Support for Microfinance in Rural Credit Unions in Peru Federación Nacional de Cooperativas de Ahorro y Crédito del Perú (FENACREP), US\$423,000	06/01/2006 36 months	0%	At fulfillment of conditions precedent stage.
ATN/ME-8949-PE 11/17/2004	Enhance Development Impact of Peruvian Workers' Remittances from Japan Banco del Trabajo, US\$200,000	06/30/2005 42 months	25%	In normal execution.
ATN/ME-9943-PE 08/02/2006	Small Business and Microenterprise Development Agency Crear Arequipa Technical-cooperation operation = US\$55,000; Investment = US\$500,000; Loan = US\$2 million	Not signed 84 months	0%	Agreement being drafted.

B. Related or similar Bank projects

Project number/Approval date	Project title, sector, executing agency, and amount	Date of signature and original disbursement period in months	Percentage disbursed	Comments: Satisfactory execution or problems of execution, including delays, extensions, reformulation, change of executing agency, etc.
ATN/NF-9628-PE 12/19/2005	Rural Microcredit Global Program Technical-cooperation operation = US\$241,000; Loan = US\$1 million	08/28/2006 48 months	0%	At fulfillment of conditions precedent stage.
ATN/ST-8171-PE 12/19/2002	Microcredit and Savings Expansion for Women Technical-cooperation operation = US\$16,000; Loan = US\$500,000	02/10/2003 36 months	0%	Owing to legal details, the executing agency was changed in August 2006. It is expected that 50% of the loan amount will be disbursed by late October 2006.

C. Projects related to the same sector or beneficiaries

Project number/Approval date	Project title, sector, executing agency, and amount	Date of signature and original disbursement period in months	Percentage disbursed	Comments: Satisfactory execution or problems of execution, including delays, extensions, reformulation, change of executing agency, etc.
ATN/ME-6520-PE 05/25/1999	Institutional strengthening of Edpyme Crear Tacna, S.A., US\$200,000	06/25/1999 37 months	100%	Project satisfactorily executed, the development objectives having been achieved.
ATN/ME-6635-PE 09/01/1999	Strengthening of Credit Unions Ministry of Economy and Finance, US\$1 million	Project completely cancelled		
ATN/ME-6636-PE 09/01/1999	Strengthening of Cajas Rurales de Ahorro y Crédito Ministry of Economy and Finance, US\$1.5 million	12/27/1999 43 months	42%	Project cancelled at the request of the executing agency (COFIDE), owing to changes in its priorities for the sector.
ATN/ME-7465-PE 06/08/2001	Institutional strengthening of Crear Arequipa	08/22/2001 37 months	100%	Project satisfactorily executed, the development objectives having been achieved.
ATN/ME-691 03/17/2000	Institutional Strengthening of Proempresa US\$290,000	04/26/2000 24 months	100%	Project satisfactorily executed, the development objectives having been achieved
ATN/ME-7534-PE 08/01/2001	Institutional strengthening of Confianza US\$190,000	09/10/2001 37 months	100%	Favorable implementation prospects (outputs and outcomes), with a 15-month extension.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK
MULTILATERAL INVESTMENT FUND

PROPOSED RESOLUTION MIF/DE-___/06

Peru. Nonreimbursable Technical Cooperation ATN/ME-____-PE
Program for the Consolidation of Private Microfinance Institutions
in the Regions of Perú

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank or such representative as he shall designate is authorized, in the name and on behalf of the Bank, as Administrator of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the Asociación de Cajas Rurales de Ahorro y Crédito del Perú (ASOCAJAS) and the Asociación de Entidades para el Desarrollo de la Pequeña y Micro Empresa (ASEP), and to take such additional measures as may be pertinent for the execution of the project proposal contained in document MIF/AT-___ with respect to technical cooperation program for the consolidation of private microfinance institutions in the regions of Perú.

2. That up to the amount of US\$1,100,000 or its equivalent in other convertible currencies, shall be authorized for the purpose of this resolution, chargeable to the technical cooperation resources of the Small Enterprise Development Facility of the Multilateral Investment Fund.

3. That the above-mentioned sum is to be provided on a nonreimbursable basis.

LEGIII/PE-842182-06
PE-M1031