RESTRUCTURING AND MODERNIZATION OF THE RURAL MICROFINANCE PROGRAM IN THE FUNDACION MEXICANA PARA EL DESARROLLO RURAL

(TC-98-02-259)

EXECUTIVE SUMMARY

BENEFICIARY/ EXECUTING AGENCY:	Fundación Mexicana para el Desarrollo Rural (FMDR)
OBJECTIVES:	The objective of the project is to strengthen the institutional capacity of the FMDR to deliver high quality and sustainable financial services to rural entrepreneurs.
DESCRIPTION:	The proposed project will provide (i) technical assistance to facilitate strategy formulation and improve management and service delivery capacity as well as (ii) provide a credit enhancement that will permit the FMDR to access new funds. The technical assistance component will precede the provision of credit enhancement and the execution of the latter will be conditioned on the achievement of institutional strengthening benchmarks at the level of three affiliates and the headquarters.
FINANCING:	Modality: Grant (Window 3A) MIF: US$ 500,000 Beneficiary (FMDR): US$ 500,000 Modality: Reimbursable (Window 3B) MIF: US$1,000,000 Beneficiary: US$1,000,000 Total: US$3,000,000
IMPLEMENTATION SCHEDULE:	Execution Period: 5 years Disbursements Period: 6 years
EXCEPTIONS TO BANK POLICY:	None
SPECIAL CONTRACTUAL CONDITIONS:	As a condition prior to first disbursement , FMDR must submit for the Bank's approval a Plan of Action that includes: (i) appointment of a project coordinator; (ii) selection of three of the stronger affiliates with appreciable credit programs and a clear commitment to sustainable microfinance to

participate in institutional strengthening activities; and (iii) a list of planned work activities to be undertaken during the Transition Strategy Formulation and the Institutional Strengthening Components.

The condition prior to the establishment of the guarantee and the first disbursement of the Financing Component is a Plan of Action that includes: (i) evidence that a separate but affiliated organization specialized in financial services has been incorporated; (ii) fulfillment with the institutional benchmarks agreed upon with the Bank, namely (a) an adequate accounting system in the new credit organization and the affiliates; (b) loan product design and marketing studies completed; (c) successful completion of the design and testing of the Management Information System (MIS); (d) development and approval of administrative and policy manuals and credit regulations; (e) successful completion of training and exchange visits by majority of the selected staff (80%); (iii) participation agreements entered into with selected affiliates covering inter alias assignment of agreed upon performing loan portfolios to the IDB; and (iv) line of credit agreement between the Mexican commercial bank and the FMDR.

Contractual conditions during the execution of the Financing Component shall be: (i) adequate provisioning and maintenance of appropriate liquidity ratio, (ii) access to tranches of the IDB guaranteed line of credit will be subject to evidence pari passu of increases in capital or deposits equivalent to the amounts disbursed by the Bank, and (iii) and compliance with indicated institutional benchmarks and financial indicators agreed upon with the Bank. Terms and conditions of the guarantee will be those stated in this document.

When the new credit specialized organization of the FMDR is duly constituted and deemed eligible to replace the FMDR in the execution of the Financing Component, the project team will request from the Donor's Committee authorization to change the beneficiary/executing agency of the Financing Component. This step will be necessary because the new entity will be a separate entity from FMDR, with its own legal status. At that time, the project team will present to the Donor's Committee a memorandum stating that the conditions prior to the establishment of the guarantee have been met as well as an amendment to the Resolution proposing the name

of the new entity that will benefit from the guarantee.

I. ELIGIBILITY

1.1 The MIF Donor's Committee declared Mexico eligible for all forms of MIF Financing on January 21, 1994.

II. BACKGROUND

2.1 At present, few commercial banks directly finance small farmers and rural microentrepreneurs in Mexico. The majority of nonbank financial institutions (Uniones de Crédito, Sociedades de Ahorros y Préstamos, and NGO's) that do, depend on a complicated system of Federal and state level government guarantee and incentive schemes [Fondo Especial de Asistencia Técnica y Garantía para Créditos Agropecuarios (FEGA), Fondos Instituídos en Relación con la Agricultura (FIRA), Programa de Apoyo Directo al Campo (PROCAMPO), Programa de Crédito para Administración (PROCREA), etc.]. These schemes impose high transaction costs on both lenders and borrowers and limit margins of intermediation, thereby inhibiting the development of viable rural financial intermediaries and the delivery of high quality financial products.

2.2 Despite Government efforts over the years through a variety of market interventions and programs, less than 10% of the economically active rural population is estimated to have had access to formal credit and the entire rural financial system continues to be highly segmented and inefficient. As a result, most rural residents depend on informal sources for credit.

2.3 The "Fundación Mexicana para el Desarrollo Rural" (FMDR) was founded in 1963 as a non-profit organization to promote integrated rural development of low income peasant families. It has a network of 35 autonomous affiliates in 24 states, a staff of 269 persons, capital of US$638,000 and an operating budget of US$1.1 million in 1997. The Foundation provides four types of services: (i) training, (ii) social and economic studies, (iii) agricultural extension services; and (iv) rural credit.

2.4 The credit program started in 1994 in response to the liberalization of financial and trade policies in Mexico. Hitherto 1992 - 1993, banks had rural credit quotas and FMDR served as an agent for banks identifying creditworthy farm groups, helping the groups prepare loan applications, and then providing extension services to groups whose loans were approved. Since then the Government has decided to provide guarantees and operational subsidies to commercial banks who would on-lend to rural credit granting NGO's such as the FMDR in order to meet rural credit demand of peasant families. To date, FMDR has disbursed a cumulative total of US$8.4 million to 28,081 clients and reports a repayment rate of 95%. However, FMDR's credit program is financially unsustainable and distorted. FMDR has two main sources of funds for credit operations: (i) various State governments; and (ii) the Federal government through commercial

banks. Many State programs donate funds for the establishment of targeted revolving loan funds with fixed below-market interest rates. Federal programs (FIRA, PROCREA, PROCAMPO) impose conditions that result in the delivery of directed and supervised credit. Because the margins of intermediation are capped, only certain crops are financed, and only means-tested groups can receive financing, the loan process is complicated (25 steps), unprofitable, and slow (the length of time between credit application and disbursement ranges from 60 to 120 days).

2.5 A third but minor source of funding has been IDB Small Projects (SP). Nine different affiliates of FMDR have received SPs, totalling US$4.5 million in loan value and US$735,000 in non-reimbursable technical assistance. All projects have performed satisfactorily and permitted the affiliates to mature institutionally.

2.6 The management of FMDR wants to separate financial services from non-financial services and convert the institution into a well managed and viable rural microfinance institution. External assistance is being requested to improve the management information system, adopt and perfect a new microcredit technology, and to professionalize the staff.

III. PROJECT OBJECTIVES AND BASIC COMPONENTS

A. Objectives

3.1 The objectives of this proposed project are threefold: (i) define a transformation strategy from a multipurpose non-governmental organization to a potentially regulated microfinance institution; (ii) strengthen the institutional capacity of FMDR and three of its strong credit granting affiliates; and (iii) to provide access to funds for on-lending purposes without debilitating conditions.

B. Project Components

3.2 The project contemplates three sequenced components leading to the creation of a network of institutions specialized in rural microfinance.

1. Transition Strategy Formulation (Stage 1)

3.3 The Board of Directors, the national and regional directors, and the technical staff have agreed to explore ways of how to strengthen and improve credit services. While broad sentiments exist favoring the creation of an affiliated, specialized microfinance institution, no clear agreement exist on what legal structure should be assumed. It is known that each of the four recognized non-bank structures have serious weaknesses. The ideal structure would be a bank but the capital requirements and the lack

of financial know-how and appropriate information technology makes this step a more distant possibility.

3.4 This component proposes to finance a strategic assessment and feasibility study that will examine the advantages and disadvantages of conversion to a regulated financial entity and options short of conversion. In addition, the study should recommend the ideal outline of appropriate prudential norms, supervisory techniques and institutional platforms, using the experiences of other Latin American countries. This outline will assist the FMDR's Board of Directors in lobbying more proactively and constructively for regulatory reform. The adoption of a more favorable framework could help the FMDR move toward becoming a potentially regulated entity in the medium term.

3.5 As an intermediate but not necessarily final step, the creation of a new, credit specialized civil association affiliated to FMDR, is being proposed as a means to immediately improve mission focus and accountability. At present, the wide variety of activities undertaken by FMDR and a donor driven accounting system, contribute to an unclear mission and little autonomous use of information to improve management. Many of the staff in credit functions do not have a strong financial or banking background and are currently required to perform a variety of tasks. A clearer separation in functions, redefinition of missions, and revision of compensation policies will facilitate the recruitment and retention of professionals with the desired profiles. In addition, a separation would allow the new entity to increasingly function de facto as a regulated finance entity, indirectly testing the viability of transformation.

2. <u>Institutional Strengthening</u> (Stage 2)

3.6 This component seeks to improve the capacity of the FMDR and three of the stronger credit granting affiliates to design microfinance loan products, disburse and recover the loans, and earn a profit while operating as a non-regulated civil association. The participating affiliates will be selected based on size of outstanding portfolio, asset quality, levels of operational efficiency, profitability, prior experience with unsupervised credit methodologies, and amount of unencumbered capital. Four specific areas of action are identified below: (i) contracting a short term expert in financial management to conduct an institutional management diagnostic and to assist management in the restructuring process; (ii) contracting a long-term resident rural microfinance expert (18 months) to guide and assist in product design and marketing studies, transfer and adopt microcredit technologies, to impart new management practices, techniques, and to train credit staff; (iii) implementing intensive and high quality training program for the staff in the headquarters and the three selected affiliates. Programs will include theoretical training, on-the-job practical training, and exchange visits to leading Latin American rural finance programs. Six courses are

envisioned for a cadre of twenty-five line staff plus forty managers and directors; and (iv) designing and installing an improved management information systems (MIS) as well as improving the connectivity between and among affiliates and headquarters.

3. Financing Component (Stage 3)

3.7 Financial analyses indicate unsatisfied demand and currently unsustainable credit operations. However, financial projections suggest the credit program can become viable using a set of conservative assumptions. Based on the analysis of the costs and risks of two alternative financing instruments (a Standby Letter of Credit (SLC), and direct deposit in a Mexican private bank collateralizing a line of credit in local currency), the recommended bank's option is a direct deposit because of lower cost. The use of a SLC would have implied US$5,000 a year in commission fees, or US$20,000 over the life of the project. Two other instruments, a direct loan in dollars and a direct loan in local currency, were considered but dismissed because of the unviable final lending rate implied and expected foreign exchange losses.

3.8 The project envisions a direct deposit in a highly rated Mexican private commercial bank to back a line of credit not to exceed the equivalent of US$1.000,000 in Mexican pesos for the period of four years. The FMDR will offer as guarantee for the operation, assignment of the performing loan portfolio of the three affiliates that will participate in the program. A new entity of FMDR will serve as a second-tier institution, obtaining external financing that will be channelled to three first-tier lending affiliates or "centrales" who have agreed to participate. These "centrales" will then on-lend to clients who reside in rural and peri-urban areas.

3.9 Procedures will be initiated to receive proceeds from the performing portfolio of one or more of the affiliates participating in the program. In order to prevent delinquency with the commercial bank, the FMDR should provision conservatively and maintain an appropriate liquidity ratio. In addition, the FMDR will be required to provide the equivalent of US$1.000,000 as an unencumbered counterpart cash contribution to increase the available amount of loanable funds. Access to tranches of the external line of credit will be subject to evidence pari passu of increases in capital or deposits and to the achievement of the institutions benchmarks and financial indicators agreed upon by Bank.

3.10 The FMDR affiliates will be encouraged to charge effective rates of interest that will cover operating expenses and lending risks. The aim of the pricing policy will be the quick attainment of financial self-sufficiency. Under no circumstances will IDB-MIF guaranteed funds be allowed to be used under the existing directed credit scheme or to support operational expenses. Under no circumstances shall lending rates be less than the cost of funds. The final

lending rate is expected to be considerably above the rates encountered in lending programs backed by FIRA guarantees. However, it is believed that the FMDR and its lending affiliates can compete effectively based on quality of service (faster loan processing times and the provision of credit without end use restrictions).

3.11 The new entity to be created will be primarily responsible for fundraising, negotiating terms and conditions for external lines of credit, administrating the line of credit, coordinating training and other institutional strengthening activities, monitoring performance, and assuring prompt repayment. External funds will be channeled by the new entity to selected affiliates who will then on-lend to clients. Clients will either repay the affiliate or the Mexican bank, extending the line of credit, depending on what is agreed with the bank.

3.12 The project combines both technical assistance and a guarantee in one operation for the following reasons. First, the unified approach provides a strong incentive for the FMDR and its affiliates to quickly attain the institutional benchmarks set. Introduction of new methodologies and investments in staff training without assured fresh sources of unencumbered funding, will not permit the FMDR to achieve financial self-sufficiency in credit operations. Second, a unified approach represents a saving in administrative processing time, reduces uncertainty for the FMDR, and minimizes delays in the sequencing of project elements. One operation will increase the probability of success compared to two sequenced operations due to elimination of timing difficulties in obtaining approval for the Financing Component, improved leverage in fundraising, and better capacity to negotiate with commercial banks and to win the full commitment of affiliates who will be asked to contribute capital as counterpart. The knowledge that financing has beeen authorized will greatly assist the FMDR effect the desired institutional restructuring.

IV. EXECUTING AGENCY AND MECHANISM

4.1 The FMDR will be the executing agency with full responsibility for planning, organization, and coordination. The FMDR will prepare terms of reference for consultancies, select successful bidders, verify work progress, authorize payments, and manage project accounts. The FMDR will submit documentation to the Bank for review and approval following normal Bank procedures. The FMDR will submit bi-annual progress reports to the Bank in Stage 2 (Institutional Strengthening Component) and quarterly progress reports in Stage 3 (Financing Component).

4.2 The procurement of goods and services in the execution of this project will follow the rules for the private sector. In order to successfully accomplish the responsibilities mentioned in paragraph 4.1, the FMDR will hire a project coordinator with expertise in

accounting, management systems, and microfinance. One consulting firm may be considered to carry out all of the institutional strengthening activities. In the process of execution, attempts will be made to institute loan evaluation and monitoring steps to assure gender and ethnic equality as well as environmental protection.

V. COST AND FINANCING

5.1 In general terms the cost and financing of the proposed program is presented in the following table. The counterpart contribution for the financing component is expected to be entirely in cash and unencumbered while it will be a mix of in-kind and cash for the strategy and institutional strengthening components.

A. Budget

	MIF (US Dollars)	Counterpart (US Dollars)	Total (US Dollars)	%
Strategy Formulation	30,000	30,000	60,000	2.0
Institutional Strengthening	423,000	370,000	793,000	26.4
Evaluation	7,000	80,000	87,000	2.9
Financing (Window IIIb)	1.000.000	1.000.000	2.000.000	66.7
Contingencies	40,000	20,000	60,000	2.0
Total	1.500.000	1.500.000	3.000.000	100

B. Terms and Conditions of the Financing Component

5.2 This Financing Component is submitted to Donors Committee based on what is stated in Doc. MIF/GN-41-7 of March 5, 1998, "MIF's Strategies, Priorities, and Principal Operational Guidelines for 1997 and 1998" which authorizes MIF to fund partial guarantees that will permit borrowing by unregulated microfinance entities. The terms and conditions of the guarantee provided to FMDR will be consistent with the IDB Charter and Bank Polices on guarantees.

5.3 The IDB-MIF will deposit stipulated amounts in three tranches in a renewable dollar denominated one year certificate of deposit (yielding 5.1-5.75% currently). The Mexican private commercial bank will extend credit at 90% of the deposit value to the newly created credit entity affiliated with FMDR, at the passive rate of

interest ("Tasa de interés interbancaria de equilibrio" (TIIE)) plus 3 percentage points. As a guarantee fee to cover the risk premium, the IDB-MIF will charge 5 percentage points of the amount guaranteed payable in local currency, determined as the difference between the lending rate observed in the Mexican market for small businesses (TIIE+5 to TIIE+8) and TIIE+3, the quoted rate at which Mexican banks will lend to FMDR with a MIF guarantee. Part of this risk premium will be used to cover the monitoring cost incurred by a specialized firm, estimated to be US$80,000 over the life of the project (See paragraph 7.2). In addition, the FMDR will pay a special commission on the outstanding guarantee of 1% per year. The frequency of these payments to the Bank will be later determined.

5.4 The cost of funds to the FMDR will be approximately TIIE+8. Based on the financial projections, the affiliates of FMDR will have to charge approximately 60% APR to clients to cover all costs and generate a 13% profit rate. Final rates will vary from affiliate to affiliate depending on level of capitalization, structure of costs, and the riskiness of activities being financed. The second-tier FMDR entity and its affiliates will divide the spread with the major proportion assigned to the affiliates.

5.5 The IDB-MIF will receive the going rate of return on a dollar denominated certificate of deposit (5.1-5.75%) plus net guarantee fee income (approximately 1.4% in the first year in dollar terms). The justification for the low net guarantee income and below market rate on capital invested (5.75+1.4=7.2% in the first year) is that this project is a highly innovative and the potential for a positive demonstration effect is high. The net guarantee fee income will be used to cover potential losses. (See Annex II)

C. <u>Disbursement and Tranching of Guarantee</u>

5.6 Disbursements from the Transition Strategy Formulation Component (Stage 1) to the consultants will be 50% of the amount budgeted at the time of signing the agreement with the consultants and 50% after consultant's document submission and approval. Disbursements from the Institutional Strengthening Component (Stage 2) will be based on pro-rated amounts to be determined at contract negotiation with the winning consultant firm or individuals. The evaluation of Stage 2 will be conducted by a different individual or firm and payment procedures will be the same as Stage 1. The firm charged with monitoring the financing component will receive payment on a bi-annual basis.

5.7 The IDB-MIF deposits are expected to be tranched in the following manner: US$600,000 in the first year; an additional US$200,000 in the second year; and an additional $200,000 in the third year. The reason for tranching is to avoid excessive guarantee fees on amounts that may not be fully disbursable. In the early years of the operation, FMDR is not expected to use the full amount of the facility. As confidence is gained in the new microcredit

technology and as arrears and earnings performance indicate, larger amounts of the line of credit are expected to be accessed in the later years. The FMDR, through the newly created second tier institution, will be responsible for matching the MIF deposit with an equivalent amount in Mexican pesos. Only the amount of MIF's funds matched will be allowed to be on-lent.

VI. PROJECT JUSTIFICATION AND RISKS

A. Justification

6.1 This proposed project seeks to improve the functioning of Mexican rural financial markets and will have three main benefits. First, the project seeks to create a viable intermediary that will be a candidate for transformation into a regulated financial entity. Second, the project will improve the quality of financial services in the three target areas. Third, it will have a demonstration effect and help to liberalize rural financial markets by proving the validity of an unsupervised microcredit technology.

B. Compatibility with Other Bank Programs

6.2 In October 1997, the Bank approved a technical cooperation project to support microfinance training program technology [COLCAMI-(ATN/ME-5737-RG) approved by October 29, 1997 for the amount of US$ 1.740,000]. This project stands to benefit because it will be more convenient and less costly for many of the FMDR staff to attend microfinance training sessions in Mexico. In addition, the Bank is currently supporting a loan operation (1069/OC-ME approved on December 3, 1997 for the amount of US$8.000,000) to strengthen the National Banking and Security Commission (Comisión Nacional Bancaria y de Valores) to assist in the review and reform of prudential norms and supervisory techniques. This project could serve as laboratory to observe efficient microfinance and to explore the new applicability of new rules and norms. Still another important related project is the Latin American Challenge Investment Fund (LACIF) [TC-9703233 in the process of approval] which will establish a credit enhancement facility for B-rated microfinance institutions in the Region. The FMDR could become a potential client of this fund after successful implementation of this project.

C. Risks

6.3 The primary risks to the proposed project are: (i) failure to agree on a strategy of transformation and implement it; (ii) failure to adopt a business orientation to the delivery of credit services; (iii) failure to raise the necessary counterpart funds; and (iv) credit risk. The FMDR is a network of autonomous institutions, with boards and technical staff that do not have intimate knowledge of successful microfinance programs and hold different visions of the “new organization.” Though the

institutions have been successful in past fundraising activities, uncertainties exist about capacity to deliver in the future, especially unencumbered funds. These risks will be partially mitigated through project sequencing and a reliance on a fundraising campaign wherein a fraction of proceeds from the sale of merchandise from contributing businesses will help meet the target set. If the institutional benchmarks are not achieved, the financing component will not be authorized. If counterpart funding goals are not met, the financing component will not continue. If delinquency occurs and the direct deposit has to be debited, access to the line of credit will be closed and steps taken to recover the overdue amount.

6.4 The secondary risks are: (i) uncertainty in the macroeconomic environment; (ii) willingness on the part of the commercial bank accepting the deposit to assume greater risk exposure with the FMDR over time; and (iii) difficulties on the part of FMDR to fully comply with the institutional strengthening benchmarks that could generate pressures to reduce the eligibility standards for the Financing Component in order to avoid deobligation of authorized funds. Possible devaluations and weak agricultural sectorial policies could increase price risk, limit productivity gains, and reduce repayment capacity. This risk will be minimized through the adoption of credit management risk techniques and increasing the share of off-farm microenterprise credits in the loan portfolio. An instrument (direct deposit) will be used that will eliminate the foreign exchange risk for the FMDR. In the out years, greater risk exposure will be expected from the partner commercial bank.

6.5 Tertiary risks include (i) the lack of knowledge about new microfinance technology; and (ii) the limited number of personnel with strong finance and banking skills. These risks will be mitigated through training, exchange visits, consultant services, and the hiring of experienced persons.

VII. PROJECT PERFORMANCE STANDARDS AND EVALUATION

7.1 The Project will be evaluated a total of five times. The first will occur at the end of the Institutional Strengthening Component (Stage 2), estimated to be 12-18 months from agreement signing. Thereafter, there will be yearly evaluations during the Financing Component.

7.2 The condition prior to the establishment of the guarantee and the first disbursement of the Financing Component is a Plan of Action that includes: (i) evidence that a separate but affiliated organization specialized in financial services has been incorporated, in accordance with terms previously agreed with the Bank; (ii) fulfillment with the institutional benchmarks agreed upon with the Bank, namely (a) establishment of an adequate accounting system in the new credit organization and the selected affiliates; (b) loan product design and marketing studies

completed; (c) successful completion of the design, installation, and testing of the Management Information System (MIS); (d) development and approval of administrative and policy manuals and credit regulations; (e) successful completion of training and exchange visits by majority of the selected staff (80%); (iii) participation agreements entered into with selected affiliates covering inter alias assignment of agreed upon performing loan portfolios to the IDB; and (iv) line of credit agreement between the Mexican commercial bank and the FMDR.

7.3 After the Financing Component has been authorized, yearly evaluations will occur from the date of first disbursement. Firms and/or consultants qualified to perform financial analysis of microfinance entities and provide strategic/management advice will be hired by the Bank to perform monitoring and supervision activities. The winning firm will obtain monthly financial reports, analyze them, attend quarterly FMDR board of directors meeting in a non-voting capacity, prepare quarterly reports for the Bank, and accompany the Bank project team on annual visits. In the event of an alarming pattern in financial indicators, the monitoring agent will inform SDS/MIC and immediately send staff to investigate and develop a remedial plan of action with FMDR staff. If the situation continues to deteriorate, non-compliance will be declared and future access to the line of the credit will cease.

VIII. SPECIAL CONTRACTUAL CONDITIONS

8.1 As a condition prior to first disbursement for Stage 1 (Transition Strategy Formulation and Stage 2 (Institutional Strengthening), FMDR must submit for the Bank's approval a Plan of Action that includes: (i) appointment of a project coordinator; (ii) selection of three of the stronger affiliates with appreciable credit programs and a clear commitment to sustainable microfinance to participate in the strengthening program; and (iii) activities to be undertaken during the first two components of the project (not to exceed 18 months).

8.2 The condition prior to first disbursement of the Financing component is a Plan of Action that includes the stipulations mentioned in paragraph 7.2 under the evaluation criteria.

8.3 Contractual conditions during the execution of the Financing Component shall be: (i) adequate provisioning and maintenance of appropriate liquidity ratio, (ii) access to tranches of the IDB guaranteed line of credit will be subject to evidence pari passu of increases in capital or deposits equivalent to the amounts disbursed by the Bank, and (iii) and compliance with indicated institutional benchmarks and financial indicators agreed upon with the Bank.

8.4 Terms and conditions of the guarantee will be those stated in this document.

8.5 When the new credit specialized organization of the FMDR is duly constituted and deemed eligible to replace the FMDR in the execution of the Financing Component, the project team will request from the Donor's Committee authorization to change the beneficiary/executing agency of the Financing Component. This step will be necessary because the new entity will be a separate entity from FMDR, with its own legal status. At that time, the project team will present to the Donor's Committee a memorandum stating that the conditions prior to the establishment of the guarantee have been met as well as an amendment to the Resolution proposing the name of the new entity that will benefit from the guarantee.

LOGICAL FRAMEWORK
REFORM AND MODERNIZATION OF THE RURAL MICROFINANCE PROGRAM OF THE FUNDACION MEXICANA PARA EL DESARROLLO RURAL

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUM
To improve the quality of rural microfinance products, to broaden access to rural credit, and to build viable rural microfinance intermediaries	Replication and validation of the pilot experience in other parts of the country.	Published reports on adoption of "model"by other FMDR affiliates and other entities.	Leadership Com Sound macroeco
To restructure and strengthen the microfinance program	Increase client outreach Increase in measures of profitability Improvement in measures of operational efficiency	Monitoring Reports and Audited Financial Statements	The fundamental improve the reta FMDR through t transfer and acce without conditio FMDR headquar coordinating pro FMDR affiliates harmony with he
1.0 Strategy and feasibility paper completed and approved by Board of Directors and the IDB. 2.0 Improved institutional capacity to administer credit program in financially sustainable manner 3.0 Increase in lending portfolio(non-directed credit).	Legal incorporation of organization specialized in financial services. Functioning and adequate accounting system New loan products designed, tested, and introduced. Functioning Management Information System Development and approval of administrative manuals and credit regulations. Completion of staff training program. Increase in number of clients and value of credit that is disbursed with no end use restrictions and interest rate limits.	Ex-post training reports of instructors Student course evaluations MIF-IDB site inspection of equipment, software, accounting systems, and manuals. Project Progress Reports Consultant reports and Debriefings Accounting records	The leadership o be fully commit financially susta Stability in the n trained personne The recommenda consultants and r learning will be p accepted , and ir

Stage 1: Transition Formulation Strategy 1.1 Hire consultant(s) to conduct strategic assessment and transformation feasibility study.	Terms of references for various consultancies prepared and approved by both FMDR and the IDB. Successful completion of bidding.	Budget Expenditure: Stage 1: US$60,000 Project progress reports	Appropriate con consulting firms FMDR and avai basis under the t agreement.
Stage 2: Institutional Strengthening 2.1 Hire long term resident consultant or firm to transfer microfinance technology and assist management in restructuring institution. 2.2. Training Courses for credit staff and upper management (6) 2.3 Exchange Visits 2.4 Design, install, and test management information system (MIS) in the second tier entity and three affiliates or 'centrales'. Includes purchase of computer equipment, software development, systems integration. 2.5 Review and Evaluation of entire Institutional Strengthening Component.	Successful completion of course work in microfinance, accounting, computer applications for 20 to 25 staff and managers. Successful completion of on-the-job training for 20-25 staff. Successful completion of exchange visits to two successful microfinance programs in Latin American for 10-15 staff. (Note: the group will be divided, one subset going to one country and another subset to another). Successful completion of an orientation course by 30-40 board of directors and upper managers Functioning and well integrated MIS in three participating affiliates and the newly created second tier entity. Compatible software in use, consistent and rational use of information occuring. Design of 1-2 loan products at each of the three affiliates. Development of administrative, personnel, and credit policy manuals.	Stage 2: Budget Expenditure: US$860,000 (includes contingency fund) Bi-annual progress reports Stage 2 evaluation report.	Equipment and s under the terms deliverable to FN delay or fault.
Stage 3: Financing 3.1 Provision of Guarantee 3.2. Monitoring and Supervision	Successful negotiation of a line of credit and establishment of guarantee with highly rated Mexican commercial bank.	Budget Expenditures: Stage 3: US$2,080,000 3.1 US$2,000,000 3.2 US$ 80,000 Monitoring and evaluation reports.	

Summary of Pricing and Returns Component

		Cost	Notes
Lending Rate of Commercial Bank to FMDR		TIIE + 3	TIIE approximately 20% as of June 1998
Guarantee Fee to be paid by FMDR to the MIF		5%	Based on lending rates to small businesses. Range TIIE+5 to TIIE+8.
Final Cost of Funds to FMDR		TIIE+8	
Final Cost to Client		TIIE+20-40	Interest Rate will vary according to affiliate, term, and loan product.
Return to MIF	Return on Deposit with Mexican Commercial Bank	5.38-5.75% on one year Certificate of Deposit	
	Guarantee Fee in Dollar Terms	1.4% 1st year 2.3% 2nd year 2.5% 3rd year	Assuming US$600K Outstanding Guarantee balance; 5% fee, 5% rate of currency devaluation, minus US$20,000 (monitoring fees) equals US$8,587 net fees or 1.4%. Second Year Outstanding Balance: US800K; third year US$1,000,000.
	Special Commission	1%	On Outstanding Gurantee Balance
	Estimated Total Return	8.1% 1st yr. 8.95% 2nd yr. 9.5% 3rd yr.	Assuming CD pays 5.75%.

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PROPOSED RESOLUTION

MEXICO. NON-REIMBURSABLE TECHNICAL COOPERATION AND GUARANTEE FOR THE FUNDACION MEXICANA PARA EL DESARROLLO RURAL, A.C., FOR THE RESTRUCTURING AND MODERNIZATION OF THE RURAL MICROFINANCE PROGRAM IN THE FUNDACION MEXICANA PARA EL DESARROLLO RURAL

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 Multilateral Investment Fund, to enter into such agreements as may be necessary with the Fundación Mexicana para el Desarrollo Rural, A.C., and to take such additional measures as may be pertinent for the execution of the project memorandum referred to in Document MIF/AT- , with respect to the non-reimbursable technical cooperation and guarantee for the Restructuring and Modernization of the Rural Microfinance Program in the Fundación Mexicana para el Desarrollo Rural ("FMDR"), hereinafter the "Program", in order to:

(a) provide a non-reimbursable technical cooperation to FMDR, for the purpose of executing the Transition Strategy Formulation and the Institutional Strengthening Components of the above-referred Program; and

(b) provide a guarantee for the benefit of FMDR, for the purpose of allowing FMDR to obtain a line of credit from a mexican private commercial bank, for the execution of the Financing Component of the above-referred Program.

2. That: (a) up to five hundred thousand United States of America dollars (US$500,000), on a non-reimbursable basis, is authorized for the purpose indicated in paragraph 1(a) of this Resolution, chargeable to the technical cooperation resources of the Small Enterprise Development Facility of the Multilateral Investment Fund; and (b) up to one million United States of America dollars (US$1,000,000), on a reimbursable basis, is authorized for the purpose indicated in paragraph 1(b) of this Resolution, chargeable to the Small Enterprise Investment Fund of the Small Enterprise Development Facility of the Multilateral Investment Fund.

3. The non-reimbursable technical cooperation and guarantee for this Program will be subject to the terms and conditions indicated in Document MIF/AT- .

4. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized to enter into such agreements related to the granting of the guarantee indicated in paragraph 1(b) of this Resolution.