

# STRENGTHENING VILLAGE BANKING INSTITUTIONS FOR MICROENTERPRISES

(TC-98-04-289)

## EXECUTIVE SUMMARY

**EXECUTING AGENCY:** Foundation for International Community Assistance (FINCA) GUATEMALA

**OBJECTIVES:** The objective of the program is to strengthen FINCA International's three largest affiliates in Latin America to become sustainable financial intermediaries with potential to transform into regulated financial institutions.

**DESCRIPTION:** The proposed Program would provide: (i) technical assistance in the areas of board and governance, human resource development, strategic and operational planning, management information systems, credit administration, organizational restructuring and (ii) action research in: product enhancement, new product development and transformation.

<b>FINANCING:</b>	Modality:	Grant
	Counterpart:	US\$ 540,000
	MIF:	<u>US\$ 1,025,000</u>
	Total:	US\$ 1,565,000

<b>TERMS:</b>	Period for project execution:	36 months
	Period for disbursements:	42 months

**EXCEPTIONS TO BANK POLICY:** FINCA International will be hired as "Sole Provider" without open competition as allowed by Chapter GS-403 of the Procurement Manual, to provide technical assistance to the affiliates in the areas where it has demonstrated a competitive advantage as detailed in paragraph 4.2 of this document. Hiring of the remaining consulting services (firms or individual experts) by the Executing Agency (FINCA Guatemala) will follow bank procedures.

**SPECIAL CONTRACTUAL CONDITIONS:** As a condition prior to first disbursement, FINCA Guatemala must submit evidence to the Bank's satisfaction that it has: (i) appointed the Credit Administration Specialist; (ii) prepared a detailed technical assistance plan to be carried out during the first year of the project. This plan should include the annual benchmarks for year 1 of the project as well as terms of reference for the product

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enhancement research and board development activities; (iii) signed an Agreement with FINCA International committing to provide all the counterpart funding, and (iv) presented the procedure agreed upon with the Bank, for contracting of consultants to be hired under the open and competitive system.

## I. COUNTRY ELIGIBILITY

- 1.1 The MIF Donor's Committee has declared Guatemala, El Salvador, Nicaragua, and Honduras eligible for all forms of MIF financing.

## II. BACKGROUND

- 2.1 FINCA International (FI) is a non-profit private voluntary organization founded in 1985. FI's mission is to support the social, economic, and personal development of families trapped in severe poverty. Using the Village Banking methodology that it pioneered, FINCA accomplishes its mission through the creation and development of non-government organizations (NGOs) which provide basic financial services to low income entrepreneurs.
- 2.2 FI is currently present in 8 countries servicing more than 50,000 families with self employment loans averaging less than US\$150. Ninety-five percent of these clients are women and most have incomes below the poverty line. FI's programs are active mostly in urban areas.
- 2.3 The FI network faces challenges in the future that will require it to make fundamental changes in its traditional approach to development. FI is committed to moving its strongest affiliates towards market based financing as the primary source of funding for large scale expansion in the future. In order to qualify for significant quantities of these resources, the FI affiliates will need to demonstrate that they are a good enough organizations to put themselves forward as good investment for others to make. Key requirements to achieve this improved competitiveness include ensuring a strong and solid client base, high quality staff, an effective methodology, sound lending portfolio, good record keeping and systems, and a strong committed board of directors.

## III. PROJECT OBJECTIVES AND BASIC COMPONENTS

### A. Objectives

- 3.1 The general objective of this Program is to increase income and employment opportunities for microentrepreneurs by increasing their access to permanent financial services.
- 3.2 The specific objective of the proposed non-reimbursable technical cooperation is to strengthen FI affiliates in Nicaragua, El Salvador, and Honduras to become sustainable financial intermediaries with potential to transform into regulated financial institutions, by addressing priority areas of institutional capacity building and product marketability.
- 3.3 The Program will have two main components: technical assistance and research and development.

B. Technical Assistance

- 3.4 Direct technical assistance will be provided to the affiliates in Honduras, El Salvador, and Nicaragua to improve their operational and financial performance. The primary areas of assistance are described below.

1. Board/Governance:

- 3.5 The technical assistance will include an assessment of the institutional missions; board operations and composition; information channels and systems in place to move the mission forward; and visioning exercises with board members. The results of this technical assistance will include recommendations for changes in board policies, procedures, roles and responsibilities, composition, and structure that will be required to move the affiliates towards a more entrepreneurial vision.

2. Human Resources:

- 3.6 Human resource experts will be hired to conduct an in-depth analysis of core competencies of staff capacity and human resource policy. Emphasis will be placed in areas of financial management, credit administration, marketing, and internal auditing. This assessment will result in a comprehensive training program for affiliate staff. The training program will include personalized and group training for upper and mid management level staff as well as field staff.
- 3.7 The assessment will also include recommendations for changes in salary structures, pay scales, and incentive systems in order to maintain skilled personnel and to orient policies more towards those practiced in the private sector. The expected results of this technical assistance will be a more committed and technically competent staff and less staff turnover.

3. Strategic/Operational Planning:

- 3.8 In order to build the affiliates capacity to conduct strategic and operational planning, key affiliate staff will be trained in the use of a strategic and operational planning model that allows users to project financial results over a 5 year period using sensitivity analysis under varying "best case" and "worst case" scenarios. Ongoing monitoring will be provided to ensure its adequate and proper use.

4. Management Information Systems/ Internal Controls:

- 3.9 To date, the new management information system has been installed in the central offices in the Honduras and El Salvador affiliates. Nicaragua is slated for installation in early 1999. The work that remains to be done in the three affiliates will include decentralization of the new system in the regional offices in

Honduras and El Salvador during 1999; decentralization of system in Nicaragua during 1999-2000; introduction of new internal control systems; and monitoring in the systems use for all three affiliates over the next three years.

5. Credit Administration:

- 3.10 Recommendations for ways that the core lending product can be changed will come from the product enhancement research. Technical assistance in credit administration will focus on putting into practice these recommendations at the affiliate level. This technical assistance will include the following aspects: revision of credit administration manuals in village banking to reflect the changes in the methodology; development of new manuals for new products; revision of administrative manuals; training of credit staff in the implementation of product changes; pilot testing of new products in the field; and on-going monitoring and supervision of results.

6. Organizational Restructuring:

- 3.11 Large scale expansion will include the decentralization of responsibilities at the field level and will require changes in the organizational structure of the three affiliates. Technical assistance will be provided in the development of a replicable model that can be installed by the affiliates in response to demand.

C. Research/Development/Dissemination

- 3.12 A three year action research agenda will be developed that focuses on critical areas that the three affiliate need to address in order to become more competitive and client oriented.

1. Product Enhancement:

- 3.13 The first year of the program will focus on researching and putting into action necessary changes in the core lending product to address client drop out. Experts will be hired to help conduct an assessment of their village banking methodology and their individual lending methodologies and to determine areas for improvement. This analysis will result in the development of a strategy to incorporate changes in the core lending products. Pilot tests of these changes will take place in year 1 in the three affiliates and will be supervised by the Credit Administration Specialist. During year 2, the results of the pilot tests conducted in the three affiliates will be documented and disseminated in a regional conference which will include not only FI affiliates but also other village banking programs from around the region.

2. New Products:

- 3.14 Year 2 action research will focus on analyzing the potential to introduce new products such as lines of credit in village banks, leasing and insurance programs and voluntary savings. New products will be crucial in the future to diversify lending risk and increase the number of clients for the FI affiliates. Year 3 will include pilot testing and dissemination of the new products research in a regional conference.

3. Transformation Studies:

- 3.15 It is expected that by the 30th month of project implementation the three affiliates will have achieved sustained levels of financial sustainability and will be accessing market based capital for expansion. It is at this stage that the affiliates will be prepared to undergo a detailed institutional assessment to determine potential for transformation into regulated financial entities. The transformation studies will serve as a prospectus for potential investors interested in purchasing shares in the future financial institution.

4. Regional Conferences/Cross Visits and Technical Exchanges:

- 3.16 The Program will support the implementation of two regional conferences to disseminate results of the applied research. In addition, a total of 2 cross visits/technical exchanges will be financed to support management and staff cross visits to other microfinance programs in the region.

**IV. EXECUTION AGENCY AND MECHANISM**

- 4.1 FINCA Guatemala, a newly created, locally based NGO and FI affiliate will be the legal entity responsible for the execution of this project. FINCA Guatemala will contract the services of FINCA International (FI) to provide technical assistance in the areas of strategic and operational planning, management information systems, and project supervision.
- 4.2 Finca International will be contracted as "Sole Provider" without competition, in accordance with Chapter GS-403 of the Procurement Manual, because in addition to an institutional advantage, as demonstrated through a comparative analysis of the skills and experience of other agencies and firms, possess a technical superiority in the areas of project supervision, management information systems and strategic planning, which provides, also, a technical comparative advantage. These services are additional and incremental to the services traditionally provided by FI.
- 4.3 All the criteria required by such Chapter are met in this case for the following reasons: (i) FI possesses a known ability and

experience in the area of the professional services to be contracted, not found specifically or to the degree desired in other firms or agencies; (ii) FI has a unique knowledge of the institutional strengths and weakness of the three affiliates not available to other service providers; (iii) FI has been providing technical assistance to the three affiliates for the past three years resulting in marked improvements in their financial and operational performance; (iv) FI has specialized qualified staff who are experts in the areas of village banking, strategic planning, management information systems, and financial analysis not easily found in other consulting firms; (v) FI as a network agency, has established a reporting systems that allows it to develop specialized consolidated reports and to effectively coordinate activities with the different affiliates participating in this project; (vi) FI has an excellent on-going relationship with its affiliates as demonstrated by their willingness to remain active members of the network and to increase their cash contribution for FI's technical assistance; (vii) FI support to the affiliates will continue beyond the life of this project and will include assisting them in accessing commercial sources of capital and investment funds for their institutional transformation; (viii) FI has demonstrated significant capacity in project administration and has successfully abided by covenants and agreements with various international organizations such as World Bank, and the Agency for International Development; (ix) FI has a strong capacity to facilitate project implementation and has also assisted its affiliates in developing appropriate policies and procedures to manage and properly track disbursements and expenses from the various funders of its programs; (x) FI staff have access to a large database of qualified consultants and have instituted an effective hiring system within the organization; and (xi) the project team considers that the average performance evaluation of the technical assistance provided by FI has been excellent.

- 4.4 The hiring of remaining consulting firms and individual experts will be done in accordance with Bank policies and procedures. For consulting services provided by firms, if the estimated cost of the services exceeds US\$200,000 or its equivalent, international competitive bidding method will be used. If the estimated cost of the services is equal or less than US\$200,000 or its equivalent, an open and competitive bidding process will be established whereby a minimum of three bids from service providers will be required for all outside technical assistance not provided directly by FI under the sole provider provision for the research and development activities. The details of the actual procedure will be agreed upon between Finca Guatemala and the Bank prior to the disbursements of the funds for activities that will be contracted or hired under the open competition system. Consultants will provide technical assistance based on terms of reference agreed upon by FINCA Guatemala and the Bank. Consultant contracts will be renewable, performance based, and will not exceed 6 months in length to ensure fulfillment of contractual agreements within the

annual planning periods. Annex II provides details of the project procurement plan.

- 4.5 The project will be supervised by the Bank's office in Guatemala. The project will be implemented in three annual phases. Activities will be implemented based on annual technical assistance plans (see paragraph 8.1). FINCA Guatemala will submit progress reports one month prior to completion of the annual plans, providing details on activities implemented and the progress made in achieving the benchmarks. This information will serve as the basis for the Bank's annual assessment of project performance. The assessment will include meetings with FINCA Guatemala staff to determine overall progress and to negotiate annual benchmarks. A mid-term evaluation will be conducted by external consultants approximately 18 months into project execution. This evaluation will include a detailed financial assessment in-situ of each affiliates operational and financial performance and will identify any corrective actions required of FINCA Guatemala to improve project performance. This evaluation will also determine whether project disbursements should continue.

## V. COST AND FINANCING

- 5.1 The cost and financing of the proposed program is presented in the following table. The counterpart contribution for technical assistance and research and development activities is expected to be entirely in cash. It will support the FI's technical assistance to the affiliates. FINCA Guatemala will sign an agreement with FINCA International defining sources of counterpart funding. This agreement will commit the level of counterpart funding that will be contributed by the affiliates in Honduras, Nicaragua and El Salvador.

## VI. PROJECT JUSTIFICATION AND RISKS

### A. Justification

- 6.1 FINCA International is among the largest providers of village banking services in Latin America. The three largest affiliates targeted in this project have a combines active clientele of more than 35,000. The project confronts the challenges of client drop out, weak performance, and increased competition by strengthening the largest affiliates to become sustainable service providers of microfinance and to reach many more clients over the next few years. The R&D component of this project addresses the need to change the core village banking product and to incorporate innovative, client friendly, financial services.



	MIF	COUNTERPART	TOTAL	%
<u>Project Supervision 1/</u>	180,000	235,000	415,000	26
<u>Technical Assistance 2/</u>	482,000	235,000	717,000	46
1. Board Development		32,000	32,000	
2. Human Resources	120,000		120,000	
3. Strategic Planning	18,000	38,000	56,000	
4. MIS	140,000	165,000	305,000	
5. Credit Administration	144,000		144,000	
6. Org. Restructuring	60,000		60,000	
<u>Research and Development 3/</u>	283,000	70,000	353,000	23
1. Product Enhancement	48,000		48,000	
2. New Products	48,000		48,000	
3. Transformation	75,000		75,000	
4. Regional Conferences	70,000	70,000	140,000	
5. Cross Visits	18,000		18,000	
6. Publications	24,000		24,000	
SUB-TOTAL	945,000	540,000	1,485,000	95
1. Mid Term Evaluation	30,000		30,000	2
2. Contingencies	50,000		50,000	3
TOTAL	1,025,000	540,000	1,565,000	100

6.2 The successful implementation of this project will have far reaching effects on the three affiliates, the FINCA network and the Village Banking industry as a whole. If the three affiliates are able to achieve their performance standards and the transformation studies indicate an attractive investment potential, they will be well positioned to access more sophisticated sources of financing and to convert into regulated financial institutions. The successful transformation of the three affiliates will encourage others in the network to follow suit. This will also demonstrate to the industry that it is possible to successfully and profitably service clients at the lowest end of the microenterprise spectrum through village banking.

1/ Honorarium US\$333,000; General Support US\$82,000.

2/ Honorarium US\$439,000; Training US\$120,000 and General Support US\$158,000.

3/ Honorarium US\$171,000; General Support US\$182,000.

B. Risks

- 6.3 The FINCA affiliates in Honduras, Nicaragua, and El Salvador are facing unfair competition from NGOs that are providing village banking services at higher costs and with subsidized interest rates. Experience throughout the region has demonstrated that in the long run, microenterprises are willing to pay higher interest rates for high quality services and efficient and rapid credit. This project will help mitigate the threat of unfair competition from other NGOs by funding improvements in the products provided by FINCA to their clients. This will result in improved services to the clients, lower operational costs for FINCA affiliate credit programs, and lower costs of borrowing to FINCA clients. The three affiliates will also require significant amounts of new loan capital to expand their portfolios to levels needed to become sustainable institutions. It is assumed that the technical assistance provided through this project will strengthen the affiliates allowing to them to attract commercial bank funds and private sector investment in the future. In the interim, the recent establishment of the FINCA International Village Banking Guarantee Fund is expected to help affiliates leverage loan capital funds for portfolio expansion over the next three years during the process of institutional consolidation. Another potential risk is the loss of qualified personnel from the three affiliates to the competition. The human resource activities funded by this project will address key areas of human resource policies allowing for significant improvements in salary, incentives, and work conditions for staff of the FINCA affiliates.

C. Compatibility with other Bank Programs

- 6.4 In 1996, the Bank approved a technical cooperation to support the strengthening of the Katalysis Network. Katalysis is a USA based NGO network with 5 affiliates in 4 different countries in the region. The technical cooperation assisted the affiliates in introducing new products to their microenterprise programs through a series of pilot tests. A special exception to Bank policy was granted to Katalysis USA to provide direct technical assistance to its affiliates. The Bank has also approved programs with other US based networks. The advantage to supporting networks lies in their ability to specialize in a particular technology, franchise the technology to local affiliates, and generate economies of scale in the provision of high quality technical assistance.

VII. BENCHMARKS

- 7.1 The five indicators selected measure financial performance, outreach, loan portfolio safety and soundness, and return on assets. The specific indicators are included in the technical files. All of these indicators are considered primary for any potential investor interested in the institution's solvency, operational soundness, and potential returns.

#### VIII. SPECIAL CONTRACTUAL CONDITIONS

- 8.1 As a condition prior to first disbursement, FINCA Guatemala must submit evidence to the Bank's satisfaction that it has: (i) appointed the Credit Administration Specialist; (ii) prepared a detailed technical assistance plan to be carried out during the first year of the project. This plan should include the annual benchmarks for year 1 of the project as well as terms of reference for the product enhancement research and board development activities. FINCA Guatemala will be required to submit these plans on an annual basis. The plans will serve as the monitoring tool for the Bank's supervision of the project; (iii) signed an Agreement with FINCA International committing to provide all the counterpart funding; and (iv) presented the procedure, agreed upon with the Bank, for contracting of consultants to be hired under the open and competitive system.

## F

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
Increased access for microenterprises to permanent financial services	<ul style="list-style-type: none"> <li>85,000 combined active clients by 2001</li> <li>affiliates are financially sustainable institutions</li> </ul>	<ul style="list-style-type: none"> <li>progress reports</li> <li>benchmarks</li> </ul>	<p>stable macro environment</p> <p>government policies support growth</p>
Strengthen FINCA affiliates to become sustainable financial intermediaries	<ul style="list-style-type: none"> <li>Improved financial and operational performance</li> </ul>	<ul style="list-style-type: none"> <li>accounting and portfolio tracking systems of each affiliate</li> </ul>	<p>Affiliates are able to obtain sufficient quantities of capital to support expansion strategy</p>
Stronger more diversified and focused Board of Directors	<ul style="list-style-type: none"> <li>increased local private sector representation in Board</li> <li>board vision transmitted understood and accepted throughout personnel ranks in the affiliates</li> </ul>	<ul style="list-style-type: none"> <li>mid term evaluation</li> <li>consultant reports</li> </ul>	<p>FI accepts board decisions and recommendations and makes changes</p>
Improved levels of technical capacity for Executive Directors, Financial Managers, Credit Managers, Administrative Managers and Field Staff	<ul style="list-style-type: none"> <li>improved field staff efficiency</li> <li>greater autonomous decision making</li> <li>higher staff retention rates</li> </ul>		
New Human Resource Policies and Procedures in place	<ul style="list-style-type: none"> <li>increases in staff salary and benefits</li> </ul>		
Management Information Systems installed and functioning properly in central and regional offices	<ul style="list-style-type: none"> <li>accurate and consistent reporting</li> </ul>		
Affiliates independently preparing and monitoring strategic and operational plans	<ul style="list-style-type: none"> <li>annual strategic/operational plans developed by affiliate staff</li> </ul>		
Village Banking Product changed and becomes more client oriented	<ul style="list-style-type: none"> <li>decreased client drop-out rates</li> <li>more diversified lending portfolio</li> </ul>	<ul style="list-style-type: none"> <li>client surveys</li> </ul>	<p>Increased demand for new products</p>
Improved Savings Product	<ul style="list-style-type: none"> <li>increased amounts of savings from clients</li> </ul>	<ul style="list-style-type: none"> <li>management information systems</li> </ul>	
Affiliates demonstrate that they are good investment for others to make.	<ul style="list-style-type: none"> <li>three affiliates have sound lending portfolios, financial sustainability, and positive return on investment ratios</li> <li>minimum of 30% of lending portfolio of the three affiliates</li> </ul>	<ul style="list-style-type: none"> <li>Transformation studies</li> </ul>	<p>FI vision is to convert into regulated financial institutions</p>

		<ul style="list-style-type: none"><li>• private sector investors interested in affiliates</li></ul>		
<p>Contract FI to install and provide technical assistance in management information systems, and to provide overall project supervision.</p> <p>Contract specialized firm to carry out human resource and board development activities</p> <p>Contract individual consultants to carry out institutional development activities in organizational restructuring and credit administration.</p> <p>Contract experts to assist affiliates in product enhancement , new product development and transformation assessments.</p>	<ul style="list-style-type: none"><li>• Terms of reference for consultancies developed and agreed upon between Finca Guatemala and IDB.</li><li>• Competitive bidding process undertaken for external technical assistance.</li><li>• project budget</li></ul>	<ul style="list-style-type: none"><li>• tracking of disbursement</li><li>• annual progress reports</li><li>• mid term evaluation</li></ul>	high quality consultants identified	

## PROJECT PROCUREMENT PLAN

The following table provides information on the technical services required, contracting arrangements, and sources and uses of the MIF and local counterpart contributions for the provision of these services. 33% of the total MIF contribution of \$1,025,000, will be channeled to support salaries and international travel costs for FINCA International under the sole provider provision. The remainder will be used for non-FINCA International individual experts and consulting firms. Three of the eight services provided by outside experts will be contracted to consulting firms. Contractual amounts for these services are all less than US\$200,000 obviating the need for an international bidding process.

Area	Total MIF Contribution	Local Contribution	Total Contribution	<sup>1</sup>	Estimated Hiring Dates
<b>I. Services provided by FI under "Sole Provider" Provision</b>	<b>\$ 338,000</b>	<b>\$ 438,000</b>	<b>\$776,000</b>		
a. Project Supervision	\$ 180,000	\$ 235,000	\$415,000		
b. MIS	\$ 140,000	\$ 165,000	\$305,000		
c. Strategic Planning	\$ 18,000	\$ 38,000	\$ 56,000		
<b>II. Services provided by other Experts</b>	<b>\$ 607,000</b>	<b>\$ 102,000</b>	<b>\$709,000</b>		
a. Human Resources	\$ 120,000		\$120,000	F	10/99
b. Board Development		\$ 32,000	\$ 32,000	F	5/99
c. Organizational Restructuring	\$ 60,000		\$ 60,000	I	1/00
d. Credit Administration	\$ 144,000		\$144,000	I	4/99
e. Product Enhancement	\$ 48,000		\$ 48,000	I	6/99
f. New Products	\$ 48,000		\$ 48,000	I	6/00
g. Transformation	\$ 75,000		\$ 75,000	F	1/01
h. Special Programs	\$ 112,000	\$70,000	\$182,000	I	3/00

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<sup>1</sup>. This column identifies whether services will be provided by a consulting firm (F) or an individual consultant (I).

**PROPOSED RESOLUTION**

**REGIONAL. NON-REIMBURSABLE TECHNICAL COOPERATION FOR A PROGRAM  
FOR STRENGTHENING VILLAGE BANKING INSTITUTIONS FOR  
MICROENTERPRISES**

**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 Finca Guatemala and to take such additional measures as may be pertinent for the execution of the proposal memorandum referred to in Document MIF/AT-\_\_\_\_\_, with respect to a Technical Cooperation Program for Strengthening Village Banking Institutions for Microenterprises.
2. That up to the amount of US\$1,025,000, or its equivalent in other convertible currencies, is authorized for the purpose of this resolution, chargeable to the resources of the Technical Cooperation Facility of the Multilateral Investment Fund.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.