

PD-ABQ-785

98969

MEMORANDUM OF UNDERSTANDING
REGARDING THE
MICROENTERPRISE INNOVATION/AFRICA REVITALIZATION PROJECT

Between

THE AGENCY FOR INTERNATIONAL DEVELOPMENT

of

THE UNITED STATES OF AMERICA

and

THE REPUBLIC OF KENYA

The U S Government, acting through the U S Agency for International Development ("USAID") and the Government of the Republic of Kenya, acting through the Ministry of Finance (the "Parties") have entered into the following understandings

I The Microenterprise Innovation/Africa Revitalization Project (the "Project")

The goal of this project is to convert a group of existing, already sustainable credit unions into highly effective providers of microfinance services that will in turn assist an expanded group of microentrepreneurs

The purpose is to strengthen the management and administration, and improve the quality and variety of financial services offered by a group of 15 Kenyan credit unions using World Council of Credit Unions' (WOCCU) "model" credit union development methodology Management and institutional development will target changes in operating policies (e g , loan and deposit interest rates, provisioning and delinquency control, and the variety of savings and loan services, etc), improvements in Management Information System (MIS) and reporting systems, and actions to expand credit union markets by field of membership or common bond expansions Financial development will emphasize the delivery of credit and other financial services to the micro and small scale businesses that populate Kenya today A detailed Program Description is attached as Annex 1

II It is agreed that

The Microenterprise Innovation/Africa Revitalization Project resources will be used to pay for the technical assistance cost of the program, as well as finance the purchase of commodities and equipment (e g , computer hardware and software) to upgrade the capabilities of the participating credit unions

The criteria for selecting participating credits union will be designed to include a mix of rural and urban SACCOs Some of the key requirements that the potential credit unions will be expected to demonstrate will include 1) the willingness of the credit union members to adopt market interest rate pricing, 2) allow withdrawable savings deposit, 3) where applicable and in conformity with the Cooperative Societies Act, and with the approval of the members, expand the field of membership, and 4) experiment with new micro-loan products

II Implementation Methods and Responsibilities of Parties

A Pursuant to USAID Grant No PCE-A-00-97-00050-00, USAID has obligated US\$3,140,000 to WOCCU to finance the Project

B WOCCU will be responsible for the project management and implementation WOCCU agrees to work in partnership with the Ministry of Cooperative Development, the Kenya Union of Savings and Credit Cooperatives (KUSCCO), a local umbrella organization for credit unions in Kenya, and other local microenterprise organizations It will work with the Ministry of Cooperative Development (1) for direction on how to effectively work with Cooperatives in Kenya, (2) continuing dialogue on how to improve the legal framework for Cooperatives, (3) exchange ideas on how to ensure the safety and soundness of Savings and Credit Cooperatives (SACCOs), (4) to establish financial and non-financial standards for SACCOs, (5) arrange periodic meetings to make briefings on the status of the program, and (6) to the extent training funds under the project are available, and where applicable, support capacity building needs of the Ministry, particularly local training of staff responsible for credit union activities Additionally, USAID in collaboration with the Ministry of Finance will provide local currency funds to the Ministry of Cooperative Development for capacity building activities in furtherance of the objectives of the WOCCU program To meet these objectives, WOCCU will establish an office in Nairobi

C WOCCU and KUSCCO will identify 15 high potential Kenyan credit unions to receive intense on-site technical assistance and equipments to up-grade their capability to contribute to the achievement of the project purpose

- D Beneficiary credit unions will be responsible for meeting the required conditions to be able to participate in the program. Each will be expected to comply with the terms of the grant agreements signed between the recipient credit union and WOCCU, as well as all the applicable laws of the Government of Kenya.
- E The Government of Kenya agrees to exempt the import, export, purchase, use or disposition of any equipment or property financed by USAID/Kenya under the Microenterprise Innovation/Africa Revitalization Project from any taxes, duties or fees of whatever nature charged in Kenya.
- F The Government of Kenya agrees to exempt from income tax and National Social Security contributions all the income or other emoluments received by any persons performing services under the Microenterprise Innovation/Africa Revitalization Project, other than citizens or permanent residents of Kenya.
- G The Government of Kenya agrees to exempt from customs duties and other forms of taxation all new or used personal and household effects, and on up to one motor vehicle for each individual performing services under the Microenterprise Innovation/Africa Revitalization Project, other than citizens or permanent residents of Kenya, provided that such items are either brought into Kenya or acquired in Kenya ex-bonded warehouse within one year of the individual's first arrival in Kenya.
- H The Government of Kenya agrees to grant work permits in an expeditious manner for all such individuals named in F and G above for the period of the Microenterprise Innovation/Africa Revitalization Project.

III Modification

This Memorandum of Understanding may be amended in writing by mutual agreement of the parties.

FOR THE GOVERNMENT OF KENYA

BY Wemenguh

TITLE Permanent Secretary

DATE 1st Sept 1998

FOR THE UNITED STATES OF AMERICA

BY Lee Ann Ross

TITLE Acting Director

DATE 3 Sept 98

THE PERMANENT SECRETARY
MINISTRY OF FINANCE
P O Box 30007 NAIROBI

ANNEX 1

PROGRAM DESCRIPTION

I Program Purpose

The goal of this project is to convert a group of existing, already sustainable credit unions into highly effective providers of microfinance services to an expanded group of microentrepreneurs

The purpose is to strengthen the management and administration, and improve the quality and variety of financial services offered by a group of 15 Kenyan credit unions using WOCCU's "model" credit union development methodology. Management and institutional development will target changes in operating policies (e.g., loan and deposit interest rates, provisioning and delinquency control, and the variety of savings and loan services, etc.), improvements in MIS and reporting systems, and where applicable and in conformity with the Cooperative Societies Act, and with the approval of the members, expand the field of membership. Financial development will emphasize the delivery of credit and other financial services to the micro and small scale businesses that populate Kenya today.

II Program Resources

The USAID financing will pay for the technical assistance cost of the program, as well as finance the purchase of commodities and office equipment (e.g., computer hardware and software) to upgrade the capabilities of the participating credit unions. A cash contribution equal to a minimum of 10% of the development grant received by each credit union, as well as the savings to be mobilized, will constitute counterpart contribution required of grant recipients.

III Program Description

WOCCU's implementation strategy envisions a step-by-step process wherein 15 credit unions will be selected (after an indepth diagnostic process) and provided with technical support and training to upgrade operating policies and procedures. WOCCU's model credit union framework will be used to guide implementation of the Model Credit Union Building (MCB) component. WOCCU will use its PEARLS monitoring and evaluation system to track and report progress and improvements in financial structure, earnings and costs, and growth on a quarterly basis. PEARLS is a financial rating system used by WOCCU and stands for Protection, Earnings, Asset quality, Rates of growth, Liquidity Structure. According to WOCCU, the two most important reforms that need to

take place are 1) adopting market interest rate pricing, and 2) allowing withdrawable shares or savings deposits. WOCCU will make every effort within the provisions of the Cooperative Societies Act to accomplish these critical requirements in the project.

A Microfinance Services Development (MSD) component will work parallel to the institutional development activity, and will focus on the delivery of financial services to micro and small-scale business. WOCCU has not defined what methodology or policies will be developed and used by the credit unions to more effectively reach the microenterprise market. The MSD products and strategy will be clarified to USAID approximately 6 months after start-up, once the diagnostics and market assessments have been completed, and the credit union participants have been selected.

Implementation will be led by a local Project Management Office (PMO) to be established in Nairobi. WOCCU will also contract services from KUSCCO, the national credit union federation, for replication activities, as well as additional assistance from local microenterprise NGOs such as Kenya Rural Enterprise Program (KREP) and Kenya Management Assistance Program (KMAP). Finally, WOCCU will provide development grants averaging \$30,000 to each credit union participant to help them finance the purchase of computer systems and upgrade infrastructure.

IV Targets

A set of Key Non-financial and Financial Indicators have been agreed to USAID and the World Council of Credit Unions, and will be used to assess performance over the life of the grant. Performance indicators for this project include the following:

Non-Financial Indicators

PHASE I		
Indicator	Target	Date
Completion of institutional diagnostics	10 credit union institutional assessments completed	18 months after signature of agreement w/USAID
Signature of credit union participation agreements	7 participation agreements negotiated and signed	18 months after signature of agreement w/USAID
Adoption of market interest rate pricing policies	A minimum of 7 credit unions adopting the policy reforms	18 months after signature of agreement w/USAID
Policy revisions to permit withdrawable savings accounts	A minimum of 7 credit unions adopting the policy reforms	18 months after signature of agreement w/USAID
PHASE 2		
Completion of all diagnostics and signature of credit union participation agreements	A minimum of 15 participation agreements in-place between PMO and the credit unions	36 months after signature of agreement w/USAID
Adoption of market rate pricing and allowances for withdrawable savings accounts	A minimum of 15 credit unions	36 months after signature of agreement w/USAID
Reform of loan underwriting standards to lend on basis of character and repayment capacity rather than simple share multiples	A minimum of 15 credit unions using new loan underwriting standards	36 months after signature of agreement w/USAID
Mixture of open bond vs closed bond credit unions working with the project	50 percent of participating credit unions are open bond organizations providing services to unsalaried microentrepreneurs	36 months after signature of agreement w/USAID

The non-financial indicators represent revisions to policies and procedures, and several require the approval of the credit union membership. These will take time to introduce.

Nonetheless, no credit union will be provided access to development grant unless its' Board of Directors has agreed to all necessary changes. Furthermore, if credit union members later refuse to support or ratify such Board decisions, grant assistance will be withdrawn, including any commodities purchased with USAID grant resources.

The financial indicators listed below are designed to monitor credit union progress in lending to microenterprise (and to women), and to assess their ability to pay market rates for member deposits and shares (e.g., the return on operations). In addition, they will track credit union capabilities to control loan delinquency once they cannot depend on salary deductions to ensure timely loan repayments.

Financial Indicators

Indicator	Year 1	Year 2	Year 3	Year 4
Return on operations ¹	73.9%	90%	>100%	>100%
Total micro loans outstanding (\$)	\$15.4 million	\$18.9 million	\$23.9 million	\$30.2 million
Number micro loans outstanding	24,000	29,000	35,000	43,000
Number micro loans to women	9,600	12,000	15,000	19,000
Total savings (\$)	\$48 million	\$54 million	\$62 million	\$73 million
Portfolio at risk >30 days	10%	10%	<10%	<10%

WOCCU will be expected to achieve a minimum of 75 percent of the financial targets scheduled for each semi-annual reporting period of the grant.

Progress towards both the financial and the non-financial indicators will be primarily monitored by USAID through the semi-annual progress reports. In addition, WOCCU will provide USAID with copies of all pertinent project outputs (e.g., credit union diagnostic reports, market assessments and "participation agreements"), as well as regularly updated PERLAS reports on each of the project participants as they are produced by the PMO.

¹Based on using the local interbank lending rate stated in Table I.

During implementation, USAID will make periodic visits to the project to conduct field assessments and assess progress. Such visits will be completed in coordination with WOCCU.

V Budget

This program has primarily been designed to transfer skills to local SACCO leaders. It is not an on-lending or grant program for SACCOs. It will not subsidize interest rates, nor guarantee repayment. It is structured so that SACCOs will help themselves. The bulk of the investment is paid to WOCCU and KUSCCO for providing technical assistance and training to the targeted SACCOs. There is a smaller component, called "development grants" that may be paid to participating SACCOs on a performance-based arrangement. The details of the payment of the development grants have not yet been worked out. Below is a summary of the budget breakdown.

Budget Item	USAID Contribution (\$'000')	Counterpart Contribution (\$'000')
WOCCU Technical Assistance		
-WOCCU Personnel/Consultants	957	-
-Local Hires	204	-
-Office Equipment	67	-
-Training	52	-
-Other Direct Cost	122	-
-Travel & Evaluations	362	-
SACCO Development Grants	450	-
KUSCCO TA/Training	178	-
Local NGO Grant	50	-
WOCCU Indirect Cost	698	-
Development Grant Match	-	45
SACCO Savings mobilization	-	740
Total	3,140	785
Total Program budget	<u>\$3,925 million</u>	

Draft OSPP SRagana
ABEO DWeller/ZRater
RLA Fickenscher
MWR CONT PKlosky
A/DIR LARoss

[Handwritten signatures and initials]
12/15/97
17 Dec 97
15 Dec 97
LRZ

u \usaid\usaid prj\docs\abeo\microped mou

REVIEW NECESSARY
COMPTROLLER'S OFFICE
USAID KENYA
DATE 12/15/97 (Ans/w funds)