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MICROFINANCE SUPPORT PROJECT

FINAL REPORT

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I. EXECUTIVE SUMMARY

A. INTRODUCTION

On April 2, 2000, a team of consultants from CARANA Corporation working under the task order signed by USAID/Honduras and Barents,¹ arrived in Honduras to begin work on the microfinance support initiative as part of the Mission's Productivity and Policy Enhancement Program (PROPEP). At the time, PROPEP was the Mission's main activity in the area of economic growth through 2004. PROPEP was designed to contribute to achieving USAID's Strategic Objective (SO) #1, "expanded and equitable access to productive resources and markets". The goal of PROPEP was to reduce poverty and stimulate economic growth by opening the economy and providing opportunities to the majority of Hondurans who live in poverty.

PROPEP included two major areas of activity. One aimed to improve the economic policy environment, with emphasis on those policies, regulations and practices that had a direct impact on the poor. The other dealt with improving the market access and competitiveness of the poor, with emphasis on expanding business and financial services at a reasonable cost to micro and small businesses.

B. SCOPE OF WORK FOR CARANA CORPORATION UNDER THE BARENTS CONTRACT

CARANA Corporation's scope of work under its subcontract to Barents included a wide range of activities, all designed to support the Mission's goal of expansion of financial services to micro and small businesses in Honduras, particularly focusing on those businesses hardest hit by hurricane Mitch.

Specific activities in the scope of work included:

- Assisting and complementing the Covelo Foundation's efforts in the implementation of its short and medium term credit program to micro and small businesses (funded by USAID).
- Assisting the Covelo Foundation in refining its sub-proposal appraisal and selection criteria.
- Designing and implementing a training plan to improve both the technical and managerial capabilities of participating institutions and their staff.
- Designing and implementing an integrated monitoring system to generate quarterly and semi-annual reports used primarily by the Covelo Foundation, participating institutions, and USAID to guide management decision making.

¹ The task order between USAID and Barents was signed in March of 2000 and followed a design phase, which was carried out in August/September of 1999. In 2002, Barents formally changed its name to BearingPoint.

- Providing special services to the small business sector.
- Identifying and conducting special studies and research on the dynamics of the micro and small business sectors.
- Preparing semi-annual reports to USAID on the status of program implementation.
- Undertaking other specific assignments as may be identified in discussions involving the technical assistance team, Covelo and USAID.

C. EVOLUTION OF THE WORK CARRIED OUT UNDER THIS TASK ORDER

The task order foresaw two main phases, the diagnostic phase, which was carried out in the period from April 2000 to June of 2000, and the implementation phase, which was developed from July of 2000 to May of 2003².

1. The Diagnostic Phase

The Diagnostic Phase of the task order focused on an in-depth evaluation of the key Financial Private Voluntary Organizations (FPVO's) in the Covelo Foundation's network. The diagnostic phase was also important in defining the key FPVO's that would be the focus of CARANA's technical assistance. This diagnostic work also helped the consulting team develop a greater understanding of the overall level of sophistication within the different target FPVO's which was used to develop the technical assistance strategy for the FPVO's in general, and for the specific technical assistance and training program for each of the individual FPVO's.

Specific FPVO's identified in the diagnostic phase, and which received the bulk of the technical assistance and training under this task order were:

- World Relief of Honduras - WRH
- Fundación Nacional para el Desarrollo de Honduras/FINSOL
- Organización de Desarrollo Femenino - ODEF
- Instituto para el Desarrollo de Honduras - IDH
- Hermandad de Honduras (Hermandad)
- FINCA
- Covelo (wholesale lending operations)

2. The Implementation Phase

The implementation of the technical assistance and training under this task order was carried out in two main areas: 1) Specific training and technical assistance to the targeted

² The original task order completion date was March 31, 2003, however a two-month extension was approved in order to bridge the gap between this task order and a follow on task order, which started up in late May 2003.

FPVOs; and, 2) Technical assistance activities in support of an enabling environment for micro finance lending in Honduras.

- a. Specific technical assistance and training activities provided to target FPVOs

Technical assistance and training activities focused on all aspects of the institution, not just on credit methodology as is often the case in technical assistance programs. This approach was rooted in our belief that in order to build dynamic and sustainable micro banking institutions, technical assistance needs to be channeled to all aspects of the institution. As a result, our assistance to selected FPVOs tended to cover each of the seven main areas below:

Organizational Development

These activities included assistance and training to the boards of directors and management of these institutions, and included assistance with strategic planning, understanding the role of the board of directors, financial sustainability, organizational structures, and most importantly, the transition to a regulated financial institution under the new laws in Honduras that will monitor these institutions in the future.

Credit Operations

These activities include the simplification and streamlining of the overall credit process, from loan analysis to collection. Our work also focused on the need to develop more decentralized processes, improved training on loan supervision and loan officer supervision, and the development of new credit products.

Marketing

For many of the FPVOs that we worked with over the three-year period, the assistance we provided in this area represented an entirely new subject. Our work in this area included assistance in understanding the marketing function within a microfinance institution, development of client surveys, market surveys, and branch demand analysis. Work in this area led to the development of new loan products in addition to specific programs to retain loyal customers and attract new customers.

Human Resources

At the start of the microfinance project's activities, the human resources function was viewed as a personnel function by most of the institution's management and board members. As a result, our work in this area started with providing a greater understanding of what the human resources function was, and then later on implementing a true human resources function within these institutions. Specific activities also included establishing job descriptions and job evaluation criteria, incentive systems for loan officers, and establishing training programs for selected FPVOs.

Internal Audit and Control (Loan Supervision)

In most cases, our early diagnostic work found that the internal audit and control function was barely present within these institutions (some did not have an internal audit unit), and

in those cases where there was an internal audit and control function or unit, it was not effectively performing its duties. As a result, a great deal of effort went into working with the boards of directors and management on helping them better understand the role of the internal audit function and then on developing or strengthening such a function within these institutions. Work in this area was particularly crucial given the passage of the new law governing FPVOs in Honduras which requires the establishment of a true internal audit department and which places new reporting demands on these institutions.

Impact Analysis

This activity responded to a request by USAID/Honduras to assist the FPVOs to better understand the impact of its microfinance activities in Honduras. However, it quickly developed into a high priority topic for the FPVOs in the Covelo network. Based on the AIMS-SEEP Project, which was designed to better understand the processes by which micro enterprise services strengthen business and improve the welfare of micro entrepreneurs and their households, it led to the implementation of two specific tools; a) exit surveys (designed to understand why clients left the institution); and, b) client satisfaction (geared towards existing clients). The use of these tools brought about a better understanding of the need to carry out market research, and also led to changes in some of the loan products and methodologies used by the institution.

Information Systems

All of the FPVOs in Honduras suffer from poor management information systems that hamper their ability to develop into more efficient micro banking institutions. Assistance in this area was limited to creating a greater awareness of the need for more integrated and responsive systems. Given budget constraints in the project, however, a major focus of the follow-on project awarded by USAID is to assist the institutions in finding and implementing a better MIS solution by September 2004.

- b. Technical assistance activities in support of an enabling environment for micro finance lending in Honduras

CARANA Corporation also carried out a number of activities that were designed to support an enabling environment for microfinance lending in Honduras. Over the course of the three-year timeframe for this contract, CARANA worked in five major areas, which are discussed below.

Assistance in the reorganization of the Covelo Foundation

This major activity was carried out in 2001. Under this assignment, CARANA resident staff and short-term consultants provided a wide range of support to the Board of Directors and Management of the Foundation in the process of conceptualizing, engineering and managing a strategy and reorganization plan for Covelo's operations within the new legal/regulatory environment. The process began in February of 2001, and involved providing support on an ongoing basis to the special working committees of the Covelo Board of Directors that were established for this purpose. The consultants

coordinated the efforts of the working committees, carefully prepared for and managed each of the working sessions, and documented decisions and other progress.

The process itself went through six distinct phases, beginning with the decision to undertake the reorganization of the Foundation in February of that year, and finalizing with the decision of the Board of Directors to approve the strategic plan and financial projections prepared by the working committees and the consultants on November 30, 2001.

Assistance to the CNBS (*Comisión Nacional de Banca y Seguros*) in the approval and implementation of the new law governing FPVOs in Honduras

Assistance in this area was undertaken in two distinct phases. The first phase consisted of limited support for the new law governing FPVO activity in Honduras, which was passed in early 2001. During that year, CARANA staff prepared an analysis of the Honduran FPVO Law & Regulations at the request of USAID/Honduras and also prepared two manuals required under the recently passed legislation: a) an inspection manual; and, b) an external audit manual.

The second phase covered activities in 2002 and into 2003. These activities were not initially envisioned in our contract, but were added as the importance of providing assistance to the CNBS (*Comisión Nacional de Banca y Seguros*) in the implementation of the new law became evident. Assistance to the CNBS revolved around four main areas:

- General guidance and assistance to the CNBS in understanding and implementing the new law governing FPVOs in Honduras;
- Development of an approval process for FPVOs applying to operate under the new law;
- Development of an accounting manual for FPVOs as required by the law; and,
- Development of an internal controls manual for FPVOs as required under the new law.

Assistance in the creation of a Credit Bureau in Honduras

The establishment of a Credit Bureau in Honduras was a major target for this project. This activity was undertaken early on in the project, and was implemented ahead of schedule, becoming fully operational in December 2001, one year ahead of our original projection.

DataCrédito Centroamericana S.A. de C.V. has done well, but recent interpretations of the banking regulations regarding bank secrecy laws have confused issues and have resulted in several commercial banks withdrawing from the Credit Bureau because of fears that they could be sued for sharing information (violation of banking secrecy laws).

The lack of clarity in this area could threaten the viability of the credit bureau in the long run and would be a serious blow to the overall initiative to increase transparency and

stability in the banking sector in Honduras. CARANA's staff in Honduras continues to support this project in hopes of finding a resolution to this latest problem, which threatens the long-term success of the Credit Bureau.

Support in the development of a diploma program in Microfinance

CARANA provided support to Covelo and the University of Honduras in the implementation of a joint program to offer a Diploma in Microfinance in the country. Courses offered by CARANA staff under this program during the course of the project included:

- A three-day workshop/course titled "Successful experiences in Microfinance in Latin America". This course presented the experiences of Banco Sol in Bolivia, FAMA in Nicaragua, and MiBanco, Caja Municipal de Piura and Caja Municipal de Arequipa in Peru.
- "The Marketing Mix in Microfinance Institutions With a Focus on Client Service". This three-day course was offered to 42 participants and included a detailed presentation of the marketing function within a microfinance institution.
- Credit Methodology. This was a twenty-hour course which included individual and group exercises in addition to written material on the subject that would serve as reference material to the participants.

Impact assessment of microfinance in Honduras

This activity responded to a request by USAID/Honduras to assist the FPVOs to better understand the impact of its microfinance activities in Honduras. It also responds to a very high level of interest among the FPVOs in the Covelo network to better understand client behavior (desertion, satisfaction) in order to improve products and services. Work in this area was based on the USAID/Washington funded AIMS-SEEP Project which was designed to better understand the processes by which micro enterprise services strengthen business and improve the welfare of micro entrepreneurs and their households. It also sought to strengthen the ability of USAID and its partners to assess the results of their micro enterprise development programs.

In 2001, CARANA sponsored two training workshops on the use of the AIMS-SEEP impact tools. The first of these workshops was carried out in July, and focused on the Client Desertion tool (survey methodology). A second workshop was carried out in December 2001, and it consisted of a one-week training program on the Client Satisfaction tool. The findings from the client satisfaction tool workshop led to a greater understanding of client satisfaction issues and contributed to the design of new products and services.

Towards the latter half of 2002, CARANA staff continued its work in this area with both Hermandad de Honduras and World Relief to conduct an impact analysis survey among

its clientele. These surveys, which are discussed in Section IV of this final report revealed some interesting findings regarding the benefits and use of microfinance funds in rural and urban areas in Honduras.

II. THE DIAGNOSTIC PHASE

A. INTRODUCTION

The major focus of CARANA's efforts during the first three month's activities was the completion of an in-depth analysis of selected FPVOs. This diagnostic work was analyzed and discussed with Covelo and USAID's project manager, and was used as the basis for developing CARANA's work plan. Other activities included developing a working relationship with Covelo and its the FPVOs as well as defining other logistical and administrative matters under this contract.

B. RESULTS OF THE DIAGNOSTIC WORK

The diagnostic study was designed to gain a better understanding of the strengths and weaknesses of the principal FPVOs, and to determine their technical assistance and training needs. The FPVOs visited were carefully selected so as to sample a cross section of FPVOs by size, location, and lending methodology. The institutions listed below were selected with Covelo's assistance. One or two field visits were conducted on each (a minimum of six person days was spent at each institution) and this was followed up with additional short-term visits to confirm findings and / or follow up on specific issues.

- World Relief of Honduras - WRH
- Fundación Nacional para el Desarrollo de Honduras/FINSOL
- Organización de Desarrollo Femenino - ODEF
- Instituto para el Desarrollo de Honduras - IDH
- Hermandad de Honduras (Hermandad)
- FINCA
- Covelo (wholesale lending operations)

In carrying out the diagnostic study the team focused on the weaknesses in each institution in order to determine the training and technical assistance requirements of each. Our initial findings identified different institutions with varying levels of sophistication as well as problems in each of the four major areas that were analyzed during this phase. These findings proved an accurate diagnostic assessment of the institutions with whom we orked.

1. Management Information Systems

In general, almost all institutions visited required MIS improvement and four required immediate and intensive assistance. CARANA's position from the beginning of the project was that without a fully operational MIS supporting all levels of the institution it will be difficult to achieve the levels of efficiency while increasing the levels of service.

2. Controls, Policies and Procedures

In reviewing the internal controls, policies and procedures of the FPVOs, the diagnostic team encountered several areas of concern.

- Several of the organizations were operating with policies and procedures that were not ideally suited for micro finance programming. Policy and procedural manuals were not commonly used in most of the FPVOs and many times the diagnostic team found that the actual field procedures and controls of FPVOs that did have manuals often did not reflect the written standards and procedures specified in those manuals.
- Most of the FPVOs were in need of assistance with the development and implementation of policies and strategies for risk management, including financial risk management (credit, liquidity, interest rate, etc.) and operating risk management (fraud, inefficiencies, contingencies, etc.).
- Many of the FPVOs were found to need assistance with organizational restructuring, staffing pattern modernization and cost reduction initiatives.
- Many FPVOs were found to have inadequate policies for portfolio evaluation, classification and provisioning.

3. Technical Skills

Although the credit personnel of each FPVO appear well intentioned and enthusiastic, many require additional training in the areas of basic financial and “client capacity to pay” analysis. It was believed at the time, and was subsequently confirmed that the high delinquency rate that the FPVOs were experiencing was attributable to superficial client cash flow analysis. It was also determined that training would be required at all levels, from the loan officers on up through management and the Board of Directors (governance issues).

We also found that there was very little sharing of information or “lessons learned” among the FPVOs.

4. Organization, Management, Human Resources, and Board of Directors

All of the FPVOs visited were found to be in need of considerable assistance with human resources management.

- High staff turnover was common. In one case, loss of personnel had required management to halt all lending operations. Although the staffs of most of the FPVOs expressed enthusiasm for their work and tended to reflect a legitimate “service orientation”, budding morale problems were evident in several FPVOs. Much of the problem appears to be associated with salary dissatisfaction; however, inadequate training appears to be causing morale problems as well.
- The incentive systems in place for credit officers were lacking, and in some cases emphasized the wrong things (incentives were in place for attracting new clients, but not in place for retaining existing clients).

- All of the FPVOs expressed concerns for self-sufficiency and are attempting to reduce costs and the efficient use of personnel was paramount among their concerns. Most of the FPVOs, however were unprepared to develop and implement personnel management strategies that were consistent with cost containment efforts while appropriately addressing the unique needs of micro finance programming.
- Specialized training at the Board of Directors level was identified, focusing on strategic planning issues and on better understanding the role of a Board of Directors.
- Organizations were found to be very "top heavy". Many exhibited a very "top down" approach, and there was some frustration expressed at lower levels as a result.
- There was a lack of decentralization, especially in the credit approval process.
- Although only three of the six FPVOs visited specifically requested assistance with staff patterns, salary policies and incentive program development, it was determined that most probably the entire Covelo network would require attention, particularly with establishing and managing a loan officer incentive program.
- Most of the FPVOs required assistance with job position description development and general personnel manual development.
- Few of the FPVOs have well designed programs for training and staff advancement.

C. A TIERED APPROACH TO TECHNICAL ASSISTANCE AND TRAINING

In working sessions with Covelo's management and USAID's project manager, the CARANA team proposed that the technical assistance and training resources available under the Barents/CARANA contract should not be made available to all FPVO's equally. CARANA's position was based on the belief that if the available level of effort under the contract was divided equally among all of the FPVOs, the project faced a very real danger of achieving little impact in the short run due to the dilution of efforts among all FPVOs as a result.

After considerable discussion, the working group (Covelo, USAID and CARANA) decided to establish a tiered approach that would concentrate technical assistance and training resources among the most promising institutions. In this way, we hoped to achieve the highest possible impact in the short run, while also working to strengthen the entire FPVO network in the long run. A three-tiered approach was developed in order to guide the allocation of the level of effort (LOE) under the project. Subsequent reviews of the tiered approach validated this initial approach, and it was maintained throughout the duration of the project.

The three tiers for the technical assistance and training program, along with the overall levels of LOE assigned to each tier were:

Tier I FPVOs: CARANA would concentrate its initial technical assistance and training LOE among these institutions. Tier I FPVOs would receive as much as 50% of the total LOE during the initial months of the program.

Tier II FPVOs: CARANA was to channel approximately 30% of technical assistance and training to these FPVOs during the initial months of the program.

Tier III FPVOs: Assistance to Tier III FPVOs was designed to consist mostly of workshops and courses that will be open to all FPVOs and other financial institutions interested in microfinance issues. Twenty percent of the initial LOE under the project was earmarked for these activities.

1. Categorizing FPVOs

After agreeing on the tiered approach and the level of effort that would be channeled to each group, the working group categorized the FPVOs among the three tiers using a selection criteria developed for this purpose:

- Capacity for rapid and efficient placement of funds to small and micro business in areas most affected by Hurricane Mitch. This issue addressed a short-term objective under the project.
- Plans and capacity for conversion to a regulated entity. This criterion addresses a long-term objective under the project. It is our belief that only those institutions capable of operating under a regulated environment and leverage market resources would be able maximize outreach in the long run without continued donor support.
- Geographic coverage. This criterion addressed both a short-term objective as well as a long-term objective (broader coverage within the country).
- Aptness as a pilot or development laboratory. Given limited resources, the working group was interested in identifying FPVOs that were willing to be a learning laboratory and that would also provide a demonstration effect for other FPVOs.
- Requires technical assistance. The FPVOs must require technical assistance in areas that can be met through the project.
- Receptive to technical assistance. The institution must have demonstrated a willingness to receive outside technical assistance.
- Capacity to utilize technical assistance. Here CARANA intended to measure the institutions capacity to absorb technical assistance and apply new techniques quickly throughout its network.
- MIS development laboratory. Given that an MIS solution is required by almost all of the FPVOs, and that most are either working with or contemplating using the SIEM software, it was important that FPVOs be willing to share their "lessons learned" in this area with their peers.

2. FPVO Selection

Based on the results of the diagnostic study, and using the selection criteria discussed above, three institutions were selected as Tier I beneficiaries, and three more were

selected as Tier II beneficiaries. All FPVOs will participate in training programming and receive other assistance under Tier III activities.

Selected Tier I beneficiaries are FINSOL, ODEF and HDH. Selected Tier II beneficiaries were FINCA, World Relief and Covelo's "1st story" credit operations. The selection of the institutions within each category was decided and agreed upon by all members of the working group.

3. Implementation of the Tiered system

The tiered system was used through December 2001 when it was replaced by a specific focus on five of the six Tier I and Tier II institutions. The five institutions were Covelo, World Relief of Honduras, Hermandad de Honduras, ODEF and Finca. FINSOL, originally one of the Tier I beneficiaries was dropped from our technical assistance program in early 2001 at the request of USAID. At the time, FINSOL was also receiving USAID funded technical assistance from ACCION International, and USAID did not want to see a duplication of efforts.

At that time assistance to Tier III institutions was also eliminated at the request of USAID's CTO for this project. Consequently for the final 17 months of the project, the bulk of the technical assistance to PVOS was channeled almost exclusively on the remaining five institutions listed above³.

³ In October of 2002, CARANA and USAID also made the decision to drop its technical assistance program with FINCA. The decision to cease technical assistance to FINCA was made because the organization was not responsive to our advice.

III. TECHNICAL ASSISTANCE TO SELECTED TIER I AND TIER II FPVOS

This section of the report provides a summary of the specific technical assistance provided to six primary microfinance institutions over the three-year period of the contract. As is evidenced by this section, technical assistance to these institutions concentrated on almost all aspects of the microfinance institution, reflecting our philosophy that assistance in improving the overall performance and sustainability of the institution needs to cover all aspects of the microfinance institution.

A. FUNDACIÓN COVELO – RETAIL CREDIT OPERATIONS

Assistance to Covelo's retail credit operations were carried out in six main areas over the three year period under this contract:

- Credit Operations;
- Marketing;
- Human Resources;
- Internal Audit and Control (Loan Supervision);
- Impact Analysis; and,
- Management Information Systems.

Each of these is discussed below:

1. Credit Operations

a. Development of a small business lending program

Covelo began its small business lending operations in the second semester of 2001 in response to the needs of some of its existing clients which were growing beyond its traditional microfinance lending programs. CARANA's assistance to the launching of this program consisted of a review of the loan program's regulations which were developed by Covelo with the assistance of an independent consultant. CARANA also developed a procedures manual for this program which detailed the credit evaluation process based on a financial review of the small business.

Covelo carried out a pilot of this program in Tegucigalpa and, after its successful completion, conducted a "roll out" across the entire institution.

b. Training

As an integral part of our activities in the strengthening of Covelo's overall business operations, CARANA staff conducted several training programs aimed at strengthening the business skills of its managers and loan officers. The courses included sessions in credit evaluation and tools, administration of branches and supervision of the loan

portfolio, service to the client, internal controls, and a team building session designed to improve the performance of work groups within the institution.

c. Capturing new clients and new client orientation

As part of our efforts to improve the productivity of loan officers and to increase market share, CARANA staff conducted an analysis of the existing procedures utilized by Covelo and designed a new, simplified process for capturing and orienting new clients. Among the products delivered in this area were the development of audio visual materials to be used by the loan officers as part of the new client orientation process, and the development of a manual detailing the sales process for the various financial products in the institution.

d. Assistance in streamlining the approval and disbursement of loan funds

As part of this initiative, CARANA consultants developed new procedures and formats for the credit analysis process which were designed to improve the credit analysis while at the same time speeding up the analysis process. As part of this work, our consultants also developed an analysis tool that was used by loan officers for this purpose. The result of this work was better client service and improved credit analysis (reduced credit risk).

e. Decentralization

Work in this area was developed in order to decentralize the credit approval process, which we believe is critical if these institutions are going to evolve into more efficient micro credit institutions. Assistance in this area consisted of the unification of the different credit regulations that existed for each credit product into one regime that applied to all credits regardless of lending methodology. This new system proposed revised credit policies and levels of autonomy for the approval process.

As of the end of the project in May 2003, this decentralization policy had still not been implemented, however, with the new organizational structure of the Covelo Foundation, it is anticipated that this decentralization system will be implemented in at least some of the branches later in the year.

f. Improved management reports

As part of our work in 2001, our consultants recommended a new series of management reports that were designed to improve overall supervision of different aspects of the institution. Unfortunately, given the limitations of the current MIS (SIEM) utilized by Covelo and other microfinance institutions in the country, these could not be implemented to our satisfaction. Almost all of the microfinance institutions that we work with under this project are currently viewing the possibility of upgrading or migrating to a new MIS.

2. Marketing

Assistance provided to Covelo in this area focused on developing tools to better understand its clients and to better promote its products among its potential product base. Technical assistance in this area covered a broad range of areas, including the design of new promotional campaigns (i.e. "Crecemos contigo"), alliances with other institutions (i.e. ASHONPLAFA) and suggestions for existing financial products in response to market feedback.

3. Human Resources

a. Development of a revised loan officer incentive program

CARANA consultants finalized the development of a new loan officer incentive program for Covelo in early 2002, which included a manual on managing the system and the development of specific coefficients to be applied to loan officer performance in order to calculate the amounts in the incentive program. This work also included an excel worksheet which could be used by management for calculating and tracking the incentive program. The program was implemented in 2002.

b. Development of an employee evaluation system

At management's request, CARANA consultants developed an employee evaluation system that included a procedures and regulations manual for its implementation and management. This program was also implemented in 2002.

4. Internal Audit and Supervision

The focus of our assistance in this area was to strengthen the institution's internal audit function. Work carried out in this area included a definition of the responsibilities of the internal audit function, a proposed policies and procedures regulation, the development of an annual work plan for the internal audit function, the implementation of specific audit programs, and follow-up of audit issues or problems. This work was carried out in early 2003 and is currently being reviewed by management.

5. Impact Analysis

As part of CARANA's overall work in the area of Impact Analysis, Covelo participated in the training program carried out for this purpose on the AIMS-SEEP Impact analysis methodology. Two specific tools were introduced: a) exit survey (designed to understand why clients left the institution); b) client satisfaction (geared towards existing clients). The use of these tools led to a better understanding of the need to carry out market research, and also led to changes in some of the loan products and methodologies used by the institution.

6. Management Information System

In 2001, CARANA consultants carried out an in-depth analysis of the MIS utilized by several microfinance institutions in Honduras, including Covelo. The study pointed out major weaknesses of the current MIS utilized by many of these institutions. Additionally, some work was carried out to help Covelo identify a better system for the future.

Covelo originally thought that it could develop its own MIS system, but has since subsequently decided to identify other systems for implementation in Honduras.

B. ORGANIZACIÓN DE DESARROLLO EMPRESARIAL FEMENINO – ODEF

Assistance to ODEF was carried out in six main areas over the three-year period under this contract:

- Credit Operations;
- Marketing;
- Human Resources;
- Internal Audit and Control (Loan Supervision);
- Impact Analysis; and,
- Management Information Systems.

1. Credit Operations

a. Support in improving customer loyalty and stability

CARANA consultants assisted ODEF's management and staff in the identification and implementation of strategies to reduce client desertion and reduce client loans in arrears. This work included assistance in the redesign of existing loan products, introduction of new clients, client satisfaction surveys, and improvements in the analysis and approval of new loans (see sections below). The combination of actions in this area have helped to reduce client desertion rates as well as the percentage of loans in arrears.

b. Improvements in the overall credit process

After an extensive diagnostic phase, which included visits to ODEF's branches and interviews with a sample of its clients. Work in this area resulted in an overall improvement through the creation of a single credit regulation manual applicable to all credit products which included overall credit policies and norms, revised procedures, and increased levels of autonomy in the field. The unification of credit procedures and regulations across the entire institution represented an important advance for the ODEF as the prior system (separate credit procedures and regulations for each loan product) was cumbersome and ineffective.

A reference manual was also developed to facilitate the marketing of credit products by ODEF's loan officers that summarized the characteristics of all of the credit products.

c. Simplification of credit procedures

CARANA's support for the simplification of credit procedures (part of the overall process to improve credit procedures) began in the second half of 2000. During 2001, against our advice, ODEF only partially adopted our recommendations. This did not lead to the improvements that they had anticipated, and in 2002 CARANA consultants again worked with the institution to simplify and improve the credit procedures. Major changes were achieved in the area, specifically in the application and loan analysis and approval process (new formats, procedures, autonomy levels, etc.).

This process was carried out first in several branches, and is now being implemented across the entire institution.

d. Training

Training in the credit area began with the development of a training calendar, which was presented to and approved by the Board of Directors in December 2001. Training activities, which were comprised of both a formal theoretical component and a "hands-on" field component, included training in marketing and sales for loan officers and managers, loan analysis (clients capacity to borrow and repay successfully), and basic finance for improved credit evaluation. All of these training activities supported our consultant's activities in the improvement of credit operations within the institution.

e. Decentralization

ODEF's management was timid in accepting our recommendations for increase decentralization in the overall credit process. However, in 2002 our consultants were able to make some process in several areas including the reception and processing of credit applications, the processing of loan repayments and the emission of checks (loan disbursements) in two key branches of the institution.

As of May of 2002, this initial decentralization of activities was being carried out on a pilot basis in both of the selected branches. Management will evaluate the results in these two branches prior to approving the roll out of these new procedures across the entire institution.

2. Marketing

CARANA's support in the marketing area began in the second semester of 2000. Initial support was provided by a microfinance marketing specialist who, together with ODEF's staff, developed a market study for La Ceiba and La Entrada de Copan. This analysis resulted in the opening of a new branch in Santa Barbara, increased capacity within

ODEF to carry out this type of analysis. In addition, ODEF is carrying out a market study in Yoro with little support from CARANA.

In 2003, CARANA consultants provided some support in a preliminary market study in Valle de Amaratéca. The preliminary analysis was positive, though, however, ODEF still needs to carry out a more in depth study before committing to opening a branch in this area.

CARANA believes ODEF's staff in this area were able to improve their knowledge and skill base. CARANA also feels additional support, particularly in the development and implementation of new microfinance credit products is still required.

3. Human Resources

During the first half of 2002, CARANA consultants designed, developed and assisted in the implementation of a new loan officer incentive system. This system included a procedures manual for the administration of the system and an Excel spreadsheet which could be used by management to calculate and track loan officer performance and the resulting bonus / incentive. A pilot program was carried out in San Pedro Sula, and then implemented throughout the institution.

The loan officer incentive system is flexible and allows for the adjustment of the different variables based on continued analysis of its impact on loan officer productivity.

In 2003, additional support was provided in the Human Resources area with the design and implementation of a course on basic finance for the evaluation of microfinance credit. Our support included the design of the training program and assistance to the human resources department for the implementation and supervision of this program. The program was carried out successfully by the Human Resources department without our support.

4. Internal Audit and Control (Loan Supervision)

Assistance in this area began in 2003 with an analysis of the institution's capacity to respond to the demands of the National Banking Commission (Comisión Nacional de Banca y Seguro - CNBS) that required an internal audit unit be established in all FPVOs. ODEF does not have an internal audit unit, and consequently does not currently meet the requirements of the CNBS. Continued assistance in this area is required if ODEF is to comply with the CNBS's requirements.

5. Impact Analysis

ODEF also actively participated in the training program carried out for this purpose on the AIMS-SEEP Impact analysis methodology. ODEF staff received training on two specific tools; a) exit survey (designed to understand why clients left the institution); and, b) client satisfaction (geared towards existing clients). The use of these tools within the

institution has led to a better understanding of the need to carry out market research, and also led to changes in some of the loan products and methodologies used by the institution.

6. Management Information System

In 2001, ODEF participated in the analysis that CARANA consultants carried out on the MIS utilized by microfinance institutions in Honduras. The study pointed out some of the major weaknesses of the current MIS utilized by many of these institutions in Honduras (SIEM). In early 2003, ODEF made the decision to purchase the new release of the SIEM system. CARANA staff has not evaluated the new SIEM system to see if it resolves the problems which were identified with the previous release of this software.

C. HERMANDAD DE HONDURAS

Assistance to Hermandad centered around seven main areas:

- Organizational Development;
- Credit Operations;
- Marketing;
- Human Resources;
- Internal Audit and Control (Loan Supervision);
- Impact Analysis; and,
- Information Systems.

1. Organizational Development

Two major initiatives were developed in this area for Hermandad. The first was carried out during the second semester of 2000 in which CARANA consultants developed an organizational manual, that included the definition of functions and responsibilities of staff. This manual was approved and implemented by Hermandad in early 2001.

During the second semester of 2002, CARANA consultants designed a new organizational structure for Hermandad as it prepares to transition to a regulated institution under the new law governing FPVOs. As of the end of this project, the Board of Directors was still discussing the new structure. If approved, Hermandad will require assistance in developing a new organizational manual detailing the new responsibilities and functions of staff under this new structure.

2. Credit Operations

a. Simplification of the credit process

Our work on the simplification of the credit process in Hermandad began in the second semester of 2001. Our work focused on the redesign of the credit evaluation process and included the introduction of new credit forms, as well as improved analysis procedures

for new and existing clients focusing on better estimating the client's capacity to borrow and repay. A pilot program with these new procedures was initially carried out in San Marcos de Ocotepeque and as of the writing of this report these procedures were being implemented throughout the institution.

b. Review of the credit reporting system

CARANA consultants carried out an in-depth review of the existing reporting system being used to manage the credit portfolio. This review led to changes in the preparation of the reports and to a recommendation for training to be carried out in this area with branch managers and loan officers. Hermandad's credit manager assumed the responsibility for implementing the recommendations throughout the institution.

c. Training

Training in the credit area was carried out in two ways areas. The first was a training program to improve the credit evaluation process. This included a review of Hermandad's credit policies, how to review a client / family business, cash flow, capacity to repay, and determining the real utilization of credit funds. Training was carried out first in the classroom and then in the field with real clients.

The second training area was on the loan collection process. This training also included both a theoretical and a practical component in the field.

d. Review of credit policies and procedures

In early 2003, Hermandad's management requested that CARANA's resident advisor review proposed changes to the general credit policies of the institution and of the specific credit regulations. CARANA's staff made several recommendations which were accepted by Hermandad's management.

3. Marketing

CARANA's support in the marketing area began in the second half of 2001 when we carried out a market study designed to explore the market potential in areas where Hermandad was already working and to estimate current levels of market penetration and market share. CARANA's staff found that market penetration levels were low and that there was a high level of unmet demand. This led to the implementation of a program to increase market penetration in the areas that had been studied.

The market analysis also identified new market areas (nine areas were identified). These findings influenced the development of the 2002 – 2006 strategic plan which reflects the decision to enter into Intibucá, La Paz, and Santa Bárbara. In 2002, Hermandad open two new branches, one in Santa Rita de Copan and another in Gracias Lempira (the latter also serves San Juan de Intibucá).

In the first semester of 2002, CARANA consultants also assisted in the strengthening of the overall marketing function through the development of specific tools and methodologies. These were implemented on a pilot basis in early 2003 and adaptation of these tools throughout the institution is currently under way. Specific actions in this area included the implementation of a plan to improve client loyalty, an incentive program for good clients, a client referral program (Cadena de Amistad), improved tools for the management of the marketing process (better administration of marketing territories and better control of loan officer productivity), and improved market / client knowledge.

4. Human Resources

During the second semester of 2001, CARANA consultants designed and assisted in the implementation of a new loan officer incentive system designed to compensate loan officers in line with the overall institutional goals and objectives. The program was introduced on a pilot basis in San Marcos de Ocotepeque, and is currently being reviewed to alter some of the variables, placing almost total emphasis on client growth.

5. Internal Audit and Control (Loan Supervision)

In the second semester of 2002, CARANA consultants assisted in the design of a proposal to strengthen this area, including the development of an internal audit work-plan that had not previously existed. Unfortunately, CARANA's recommendations were only partially implemented and a large portion of the internal audit function is still not focused on the evaluation and classification of the credit portfolio.

In the second half of 2002, Hermandad's Board of Directors requested that CARANA review this area again which led to new recommendations in this area focusing the internal audit more on evaluating the overall credit risk in the institution. Continued assistance is required if Hermandad is make necessary changes.

6. Impact Analysis

Hermandad also participated in the training program carried out for this purpose on the AIMS-SEEP Impact analysis methodology. Staff received training on two specific tools: a) exit survey (designed to understand why clients left the institution); b) client satisfaction (geared towards existing clients).

In the second semester of 2002, Hermandad carried out an additional survey with CARANA's support designed to better measure the impact of its credit programs. The findings in this area were reported to USAID in the December 2002 semester report.

7. Management Information System

In 2001, Hermandad participated in the analysis that CARANA consultants carried out on the MIS utilized by microfinance institutions in Honduras. The study pointed out some

of the major weaknesses of the current MIS utilized by many of these institutions in Honduras (SIEM).

In 2001, Hermandad's management also made the decision to install the SIEM system and equipment in all of its branches. While this was an important step forward, limitations in the SIEM system (Hermandad uses a dated release of the system), have not resolved the institution's MIS problems in this area. Hermandad is actively involved in the search for a new MIS.

D. WORLD RELIEF OF HONDURAS

Assistance to World Relief of Honduras (World Relief) also centered around seven main areas:

- Organizational Development;
- Credit Operations;
- Marketing;
- Human Resources;
- Internal Audit and Control (Loan Supervision);
- Impact Analysis; and,
- Information Systems.

1. Organizational Development

During the first semester of 2002, CARANA consultants designed a new proposed organizational structure meeting the requirements of the CNBS and the new law governing FPVOs in the country. Although not under CNBS supervision (the law takes effect in February of 2004), World Relief's management has already initiated the implementation of this program, including the creation of an internal audit unit within the institution.

During the second semester of 2002, CARANA staff also developed an organizational manual which includes the job descriptions, staff requirements and a proposed salary structure for the institution. Also as a result of this process, CARANA developed an employee evaluation manual.

2. Credit Operations

a. Improvements in the overall credit process

In early 2001, CARANA recommended the creation of a single credit regulation manual applicable to all credit products which included overall credit policies and norms, revised procedures and increased levels of autonomy in the field. A reference manual was also developed to facilitate the marketing of credit products by World Relief's loan officers which summarized the characteristics of all of the credit products.

World Relief's management has not fully implemented the proposed credit regulation manual, and continues to review and revise it. This has been frustrating for our staff given our belief the final approval and implementation of this manual is necessary for the positive development of this institution.

b. Simplification of credit procedures

The focus of our work in this area centered on the redesign of the credit evaluation process. We desired to improve the analysis while at the same time streamlining the process. This work included the development of new credit forms, improved analysis procedures for new and existing clients focusing on better estimating the client's capacity to borrow and repay.

A pilot program was carried out in several branches in Tegucigalpa, and in March of 2002, the decision was made to implement these new procedures and formats throughout the institution. CARANA staff provided support for this rollout in Dalí and El Paraíso.

c. Training

Formal training activities focused in two areas. The first was a training workshop for loan officers and managers on credit evaluation; which focused on the procedures and tools developed as part of the simplification of credit procedures discussed above. This particular training program supported the pilot program implemented in Dalí and El Paraíso and was developed with World Relief's staff so that they could continue the training activities in other branches without our support.

The second formal training, Credit Risk and the Internal Controls as part of the Internal Audit function, was carried out to create a greater awareness on monitoring and controlling credit risk throughout the institution.

d. Credit methodology

With our support, World Relief has modified its credit methodology, principally through the introduction of new loan products (changes in the frequency of payment and the term of the loan). More importantly, they have become much more aware of the fact that as their borrower's businesses evolve, their credit needs also change. With our assistance, World Relief has been able to change loan officer attitudes and methodology, making it easier for clients to move from a village banking product, to a solidarity lending one, and eventually to an individual lending product as their needs change.

e. Support in the collection / cashier process

All of the FPVOs in Honduras depend on the commercial banking system to actually handle the loan collections. This dependence on outside commercial banks has presented a series of problems for the FPVOs, which is one of the reasons that CARANA has

recommended to the FPVOs in Honduras that they establish their own cashier function within their institutions⁴.

World Relief has particularly suffered in this area when in 2001 BGA ended its agreement with World Relief to manage the collection process. World Relief was slow to contract with a new bank for this service (BANPAIS) and when it did, it was never able to receive the level of service from BANPAIS that it had achieved with BGA. This caused a series of problems for World Relief in the summer of 2001 which resulted in a huge increase in its loan in arrears rate as a result of the confusion. In that year the loans in arrears rate increased to 17%, before dropping down to approximately 7% by the end of the year.

In 2002, World Relief was able to solve most of these problems, but it has never been able to achieve the level of service that it is demanding. As a result, World Relief's management has now decided to implement an in house cashier system based on our recommendations.

3. Marketing

Client surveys carried out during the first half of 2002 as part of the impact analysis work carried out with these institutions were an important source of market information which World Relief had never had access to in the past. These surveys were particularly important in understanding client preferences and the principal reasons behind client desertion.

With CARANA's assistance, World Relief was able to react with the introduction of a combination of new marketing campaigns and new products that helped to improve customer loyalty. Specific promotional campaigns were implemented including one for preferential customers, a customer referral program with rewards, the introduction of client training sessions as an added benefit of being a World Relief customer. These marketing campaigns were complimented by programs for its own employees to promote greater competition and improved quality of service.

New loan products included a specific line of credit for preferred clients designed to provide them with better terms and service for their working capital needs, and a new credit program specifically designed for clients with a proven track record for the financing of productive assets (equipment, etc.).

4. Human Resources

CARANA's assistance in this area has been minimal, however it is important to note that in the first half of 2001, World Relief contracted a human resources professional for the first time to assist in the strengthening this function and reducing employee turnover

⁴ Only one microfinance institution within the Covelo network has moved in this area, and that was FINSOL. FINSOL's implementation of an in house cashier system was carried out with our technical assistance.

which had been very high in the past. CARANA consultants also continue to work with World Relief's management in the design and implementation of a new employee compensation / incentive system, however to date, this has not been implemented.

5. Internal Audit and Control (Loan Supervision)

During the first semester of 2002, CARANA consultants worked to create an internal audit department within World Relief. The creation of an internal audit department is an essential step in the transformation to a regulated institution under the new law governing the FPVOs in Honduras, which is scheduled to take effect in February of 2004.

CARANA's assistance in this area includes the definition of the responsibilities of this department, development of the job descriptions for the key positions, creation of the objectives and functions of this department as well as the annual work plan and audit procedures. During the first five months of 2003, our staff also helped with the development of a schedule for the implementation of the internal audit department and also assisted in the selection and hiring of the two principal positions within this unit (department head and assistant), the creation of the office, office filing system, and an action plan for 2003.

6. Impact Analysis

World Relief also participated in the training program carried out for this purpose on the AIMS-SEEP Impact analysis methodology. Staff received training on two specific tools; a) exit survey (designed to understand why clients left the institution); b) client satisfaction (geared towards existing clients). As mentioned in the section of marketing, these survey tools were useful in strengthening the marketing function and led to a better understanding of client needs and dislikes, which in turn was used to develop new promotional campaigns and loan products to improve service levels to its customers.

In the second semester of 2002, Hermandad carried out an additional survey with CARANA's support designed to better measure the impact of its credit programs. The findings in this area were reported to USAID in the December 2002 semester report.

7. Management Information System

In 2001, World Relief also participated in the analysis that CARANA consultants carried out on the MIS utilized by microfinance institutions in Honduras. The study pointed out some of the major weaknesses of the current MIS utilized by many of these institutions in Honduras (SIEM).

In 2002, World Relief's management made the decision to decentralize the MIS function by installing the SIEM system in its branch system. This process was completed successfully during the year and has led to an important increase in productivity.

E. FINANCIERA SOLIDARIA – FINSOL

FINSOL was one of the original six institutions receiving technical assistance under our project, however in early 2001, at the request of USAID, CARANA dropped FINSOL from the technical assistance program. The decision to drop FINSOL was due to the fact that FINSOL was also receiving technical assistance from ACCION International – also funded by USAID – and USAID did not want to see a duplication of efforts.

During the twenty one months that FINSOL was receiving technical assistance from CARANA as part of our program (April 2000 through December 2001), CARANA staff did provide assistance to FINSOL in four key areas discussed below.

1. Organizational Development

During the first half of 2001, CARANA staff carried out a study on FINSOL's organizational structure and presented specific recommendations structural changes e at the time. As part pf this study, CARANA worked with FINSOL's management to develop a new organizational manual which provided a description of key functions, job descriptions, and a new salary structure. It is our understanding that FINSOL implemented a portion of our recommendations.

2. Credit Operations

Assistance was provided to FINSOL in several aspects of the overall credit process. These included recommendations to strengthen several branches, the introductions of changes in the credit methodology utilized by FINSOL in their various loan products (changes in loan terms and conditions, etc.), training and technical assistance in the loan evaluation process for loan officers and the design of new credit analysis forms. Technical assistance and training was also provided to loan officers and branch managers in credit risk (analysis, supervision, reporting and monitoring).

CARANA's recommendations in this area were partially implemented.

3. Marketing

Assistance in the marketing areas was limited to the development of new promotional strategies and working sessions with branch managers to help them better analyze market opportunities. Our recommendations in this area were also partially implemented.

4. Establishment of an in house cashier system

CARANA's assistance was instrumental in development of an in house cashier system to be used for loan disbursements and payments. This new system brought about many changes in the way FINSOL processed its loan repayments, and eliminated the need to depend on a commercial bank for this process. FINSOL has its own cashier system

operating in San Pedro Sula and Tegucigalpa, and according to FINSOL's general manager, 90% of all loan repayments are now made through the in house cashier system.

F. FINCA

At the start of our project in 2000, FINCA was undergoing major problems within the institution as a result of poor management decisions in the past coupled with some fraud within the institution (reporting of false loans and skimming of repayments by officers in certain branches, etc.). This resulted in a major overhaul in 2001 that led to a decrease in staff, a decrease in the number of clients, a reduction in overall marketing efforts, a review and modification of its lending methodology, and a major effort to improve internal controls. The latter two initiatives were extensively supported by the CARANA team.

New management in 2002 continued to focus on the restructuring of the institutions, however, CARANA staff found that new management was not being responsive to our technical assistance recommendations, and consequently made the decision to stop working with the institution in that year.

1. Credit Methodology

Most of CARANA's work with regards to improving the credit methodology utilized by FINCA centered around the need to simplify the credit process and included specific recommendations in the evaluation, approval and disbursement of loans. Extensive support in this area was necessary given the high levels of loan officer turnover as a result of the restructuring of the institution.

2. Internal Audit and Control

Towards the end of our assistance in 2002, CARANA staff also prepared a series of recommendations to strengthen the internal audit and control process. Given the highly centralized nature of FINCA's operations internationally, these recommendations were forwarded to FINCA's regional offices in Guatemala for review and approval. We do not know the outcome of these recommendations.

3. Impact Analysis

Finca staff did not participate in the initial training provided to FPVOs in 2001 on the AIMS – SEEP analysis tools. During the first half of 2002, CARANA did work with FINCA staff to develop an exit survey that was used to determine the reasons behind the high client desertion rates within FINCA. The survey captured valuable information on the impact of FINCA's loans on its clients and also provided feedback concerning its lending products resulting in specific changes.

4. Management Information Systems

FINCA participated in the initial MIS survey work executed in 2001, which pointed out weaknesses in the existing SIEM system utilized by FINCA. However, FINCA International is pursuing its own MIS solution for its microfinance network, which has led to an agreement SIEM's parent company. As a result, CARANA staff expects that FINCA will continue working with the SIEM system.

G. ASSISTANCE TO OTHER MICROFINANCE INSTITUTIONS IN HONDURAS

While the focus of CARANA's technical assistance and training activities focused on the six institutions discussed in this section, some assistance was provided to other FPVOs in Honduras as indicated below.

1. Technical Assistance and Training to FAMA

Technical assistance to FAMA was limited to two areas: assistance in the transformation to a regulated FPVO and assistance in marketing (client loyalty and branch analysis).

a. Assistance in transformation to a regulated FPVO

In late 2001 and early 2002, CARANA consultants held several working sessions with the management of FAMA to assist in understanding and preparing for the possibility of transforming to a regulated FPVO under the new law governing FPVOs in Honduras. These working sessions were followed by a planning session with members of the Board and management discussing options and a course of action for the conversion to a regulated FPVO.

b. Assistance in marketing

In February 2002, a CARANA consultant also carried out a three week technical assistance intervention at FAMA. The consultant focused on client desertion issues and made specific recommendations on how to collect and analyze client information in order to better understand the reasons leading to client desertion. The consultant carried out a limited survey on his own and in conjunction with a review of credit procedures, made recommendations and policies to address some of the problems he identified. The consultant also worked with management in carrying out an analysis of the Danli branch, which has produced marginal results and is being considered for closing.

2. Technical Assistance and Training to FUNED

Technical assistance to FUNED was limited to a four week consulting assignment in the first half of 2002, which focused on client loyalty and desertion issues. The consultant's work was based on the preliminary diagnostic work completed by CARANA's chief of party. The evaluation focused on issues affecting the growth and quality of FUNED's loan portfolio, particularly client desertion. Based on a survey of clients and an

evaluation of their market, CARANA recommended several programs that management could use to improve client loyalty, reduce desertion, and stimulate client referrals.

IV. TECHNICAL ASSISTANCE ACTIVITIES IN SUPPORT OF AN ENABLING ENVIRONMENT FOR MICRO FINANCE LENDING IN HONDURAS

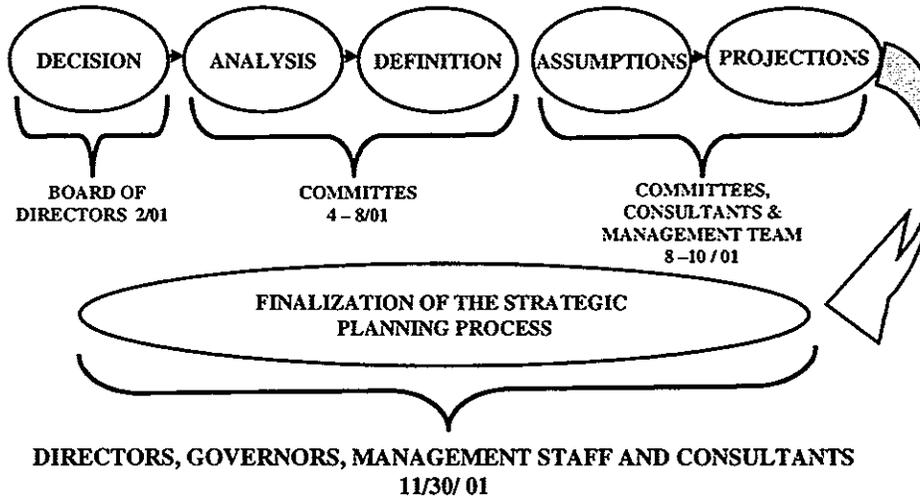
In addition to the technical assistance provided to specific FPVOs in Honduras, CARANA Corporation also carried out a number of activities, which were designed to support a positive environment for microfinance lending in Honduras. Over the course of the three-year timeframe for this contract, CARANA worked in five major areas::

- Assistance in the reorganization of the Covelo Foundation;
- Assistance to the CNBS (*Comisión Nacional de Banca y Seguros*) in the approval and implementation of the new law governing FPVOs in Honduras;
- Assistance in the creation of a Credit Bureau in Honduras;
- Support in the development of a Diploma program in Microfinance; and,
- Impact assessment of microfinance in Honduras.

A. ASSISTANCE IN THE REORGANIZATION OF THE COVELO FOUNDATION

This major activity was carried in 2001. Under this assignment, CARANA resident staff and short term consultants provided a wide range of support to the Board of Directors and Management of the Foundation in the process of conceptualizing, engineering and managing a strategy and a reorganization plan for Covelo's operations within the new legal / regulatory environment. The process began in February of 2001, and involved providing support on an ongoing basis to the special working committees of the Covelo Board of Directors which were established for this purpose. The consultants coordinated the efforts of the working committees, carefully prepared for and managed each of the working sessions, and documented decisions and other progress. The process itself went through six distinct phases as illustrated in the figure on the following page, beginning with the decision to undertake the reorganization of the Foundation in February of that year, and finalizing with the decision of the Board of Directors to approve the strategic plan and financial projections prepared by the working committees and the consultants on November 30, 2001.

FIGURE 1
THE PROCESS
 SEPARATION
 RESTRUCTURING
 STRATEGIC PLANNING



Some of the tasks that the consultants carried out or directly supervised in support of this reorganization process, including, but were not limited to:

- The preparation of the analytical work required supporting the Covelo process of institutional specialization and transition of its retail lending operations to a regulated FPVO under the new law.
- The development of assumptions and financial projections for each of the proposed Covelo institutions in the reorganization (Covelo Holding Company, a second story lending institution servicing the needs of FPVOs in Honduras, and a retail lending FPVO operating under the new FPVO law in Honduras). Several financial scenarios were prepared under the guidelines of the special working committees.
- The preparation of documentation recording the decisions made at each of the committee meetings as well as the preparation and presentation of the final recommendations of the committees, along with related financial projections and assumptions, were presented to the full Board of Directors of Covelo on November 30, 2001.

The documentation and the presentation made to the Board of Directors on November 30, 2001 resulted in the complete approval by the Board of the proposed reorganization, implementation plan and timeline for the restructuring of the Covelo Foundation. Specifics of the proposed reorganization and implementation plan include:

- A separation of the current Fundación Covelo structure into three distinct separate legal entities made up of a holding company (Fundación Covelo) and two new FPVOs operating under the new FPVO law: a separate second story wholesale lending operation; and, a retail lending operation.
- The proposed organization structure of each of the entities based on a zero based staffing basis was approved.
- It was agreed that the holding company and the two FPVOs would operate based on market pricing with no subsidies with the exception of some subsidies in providing technical assistance to other FPVOs in the Covelo network in the short run, as well as to new emerging FPVOs as approved by Covelo.
- The restructuring process began immediately, and was designed to be implemented in three phases:
 - A legal and regulatory phase, which includes a definition of the by-laws and Boards of Directors of the three institutions, to be completed by February 2002.
 - Constitution and formalization of the legal entities, including approval by the Government of Honduras (necessary for non-profits), to be started immediately and to be completed by September of 2002.
 - Operations design and implementation of the new structure, including staffing, administrative and accounting procedures, also to be initiated immediately, with a goal of finalizing this by December of 2002.

The overall target was to complete the design and transition of the process by December 2002, in order to begin operating formally under the new structure by January 2003. For the most part the Covelo Foundation was able to keep to this schedule, however some legal requirements remain to be completed and this has slowed down the process to some extent.

The detailed analyses results, assumptions, financial projections, and formal proposal for the Foundation, as well as an activity plan through the year 2005 were presented in the document titled "Supuestos y Proyecciones Financieras de: OPDF Primer Nivel, OPDF Segundo Nivel y Fundación Covelo" - Noviembre 2001, which was made available to USAID / Honduras.

B. ASSISTANCE TO THE CNBS (COMISIÓN NACIONAL DE BANCA Y SEGUROS) IN THE APPROVAL AND IMPLEMENTATION OF THE NEW LAW GOVERNING FPVOS IN HONDURAS

Assistance in this area was undertaken in two distinct phases. The first phase of our assistance consisted of limited support for the new law governing FPVO activity in Honduras, which was passed in early 2001. During that year, CARANA staff prepared

an analysis of the Honduran FPVO Law & Regulations at the request of USAID Honduras and was submitted to USAID in July of 2001.

During that same year, our consultants were involved in the preparation of two manuals required under the recently passed legislation: a) an inspection manual; b) an external audit manual. Both of these manuals were prepared by CARANA staff and consultants and were submitted in September of 2001 to the CNBS for their review, final edit, and approval.

The underlying philosophy used in the preparation of these manuals was to support the CNBS's mission of overseeing FPVOs guaranteeing their legitimacy, transparency, and their operational and financial security. At the same time, it is hoped that it will not result in an over regulation of microfinance activities in Honduras, which would be detrimental to the expansion of this activity in the future.

The manuals were prepared in a manner which will allow the CNBS to introduce a minimal set of supervision criteria in the short term, but which also defines what might be an optimal system in the long run as the sector develops and becomes more sophisticated. Our specific recommendation was that the National Banking Commission begin with this minimal set of supervision guidelines in the short run recognizing both its own, as well as the FPVO's limitations. This responds not only to the state of FPVO evolution in Honduras, but to the fact that the National Banking Commission has only supervised formal financial institutions in the past and has a very limited understanding of microfinance at this time.

The second phase covered our activities throughout 2002 and into 2003. These activities were not initially envisioned in our contract, but were added in as the importance of providing assistance to the CNBS in the implementation of the new law became evident. During this period, assistance to the CNBS revolved around four main areas as discussed below:

1. General Guidance and Assistance to the CNBS

During this period, CARANA's COP José Luis Lozano, provided continual support to the CNBS, and specifically to Lesly Herrera, Superintendent for Insurance and Other Financial Institutions. Guidance was provided in developing a work plan for the CNBS supporting the implementation of the new law governing FPVOs, incorporation as part of the working group to implement the new law, and also included coordination with other donor groups on technical assistance needs.

2. Approval Process for FPVOs Under the New Law

In September of 2002, CARANA consultants completed the format design, procedures and guidelines to be followed by the CNBS in the analysis and approval of a FPVO application to operate under the new law. This study was the first of its kind for the CNBS and was in response to their request for assistance in this area.

3. Development of an accounting manual for FPVOs

CARANA consultants also participated actively as part of a working group established by the CNBS with FPVOs and the GTZ in the development of an accounting manual for regulated FPVOs under the new law. The accounting manual is intended to provide comprehensive guidance to regulated FPVOs in establishing and using a standard chart of accounts.

4. Development of an internal controls manual

As part of the discussions revolving around the development of the accounting manual for regulated FPVOs, a decision was made to utilize the base document prepared by Fundación Covelo on internal controls to develop a generic internal control manual for all regulated FPVOs, which could be customized to the needs of each institution. CARANA resident consultant, Elvis Alva prepared a draft of this generic document and submitted it to the CNBS in August of 2002, and has held subsequent meetings with them to assist in finalizing this document.

C. ASSISTANCE IN THE CREATION OF A CREDIT BUREAU IN HONDURAS

The establishment of a Credit Bureau in Honduras was a major target for this project. This activity was undertaken early on in the project, and became fully operational December of 2001, one year ahead of our original projection. The table below shows the original target dates for key milestones under this activity against the actual completion dates for this project

TASK	ORIGINAL TARGET DATE	ACTUAL COMPLETION DATE
Completion of pre-feasibility study	6/2001	3/2001
Decision by key financial institutions to support a credit bureau in Honduras	6/2001	5/2001
Completion of detailed feasibility study	12/2001	5/2001
Identification of investors and final decision to implement the credit bureau	12/2001	5/2001
Start-Up of credit bureau	6/2002	9/2001
Credit Bureau fully operational	12/2002	12/2001

The key investor in the credit bureau project was a company from the Dominican Republic - Datacrédito. Datacrédito has been successful in implementing a credit bureau in the Dominican Republic, and has been interested in expanding to other countries given

their cost effective technology. Datacrédito was first contacted by Honduran FPVOs on a USAID-sponsored trip to the Dominican Republic in which several individuals from Covelo and the FPVOs visited microfinance and related institutions in that country. Subsequently, an individual from that company was selected to conduct a seminar on credit bureaus in Honduras, and participation in that seminar led to their interest in establishing in Honduras.

Datacrédito Centroamericana S.A. de C.V. has done well, but recent interpretations of the banking regulations regarding bank secrecy laws have confused issues and have resulted in several commercial banks withdrawing from the Credit Bureau because of fears that they could be sued for sharing information (violation of banking secrecy laws).

The lack of clarity in this area could threaten the viability of the credit bureau in the long run and would be a serious blow to the overall initiative to increase transparency and stability in the banking sector in Honduras. CARANA's staff in Honduras continues to support this project in hopes of finding a resolution to this latest problem which threatens the long term success of the Credit Bureau.

D. SUPPORT IN THE DEVELOPMENT OF A DIPLOMA PROGRAM IN MICROFINANCE

CARANA Corporation provided support to Covelo and the University of Honduras in the implementation of a Diploma in Microfinance.

Courses which were offered by CARANA staff under this program during the course of the project included:

- A three day work shop / course titled "Successful Experiences in Microfinance in Latin America". This course presented the experiences of Banco Sol in Bolivia, FAMA in Nicaragua, and MiBanco, Caja Municipal de Piura and Caja Municipal de Arequipa in Peru.
- "The Marketing Mix in Microfinance Institutions With a Focus on Client Service". This three day course was offered to 42 participants and included a detailed presentation of the marketing function within a microfinance institution.
- Credit Methodology. This was a twenty hour course which included individual and group exercises in addition to written material on the subject which would serve as reference material to the participants.

E. IMPACT ASSESSMENT OF MICROFINANCE IN HONDURAS

This activity responded to a request by USAID Honduras to assist the FPVOs to better understand the impact of its microfinance activities in Honduras. It also responds to a high level of interest among the FPVOs in the Covelo network to better understand client

behavior (desertion, satisfaction) in order to improve products and services. Work in this area was based on the USAID Washington funded AIMS- SEEP Project which was designed to better understand the processes by which micro enterprise services strengthen business and improve the welfare of micro entrepreneurs and their households. It also sought to strengthen the ability of USAID and its partners to assess the results of their micro enterprise development programs.

In 2001, CARANA sponsored two training workshops on the use of the AIMS-SEEP Impact tools. The first of these workshops was carried out in July, and focused on the Client Desertion tool (survey methodology). This particular tool was chosen first given that client desertion is a problem faced by almost all of the FPVOs in Honduras. The tool was presented in the classroom and then a survey developed as part of the workshop was tested in the field. In the months following the course, several of the institutions carried out a large number of surveys and began the tabulation process. This tool provided a better understanding of the client desertion problem within each FPVO and was used by to improve marketing strategies, specifically addressing the desertion issue.

A second workshop was carried out in December of 2001, and consisted of a one-week training program on the Client Satisfaction Tool. The findings from the client satisfaction tool also led to a greater understanding of client satisfaction issues and contributed to the design of new products and services.

Towards the latter half of 2002, CARANA staff continued its work in this area with Hermandad and with World Relief to conduct an impact analysis survey among its clientele. These surveys revealed interesting findings regarding the benefits and use of microfinance funds in rural and urban areas as discussed below:

1. Hermandad de Honduras

Hermandad de Honduras conducted a survey of 99 clients during the month of November 2002. Hermandad was chosen as one of the two institutions for this survey given that its location and clientele make it one of the few microfinance institutions in the Covelo network that focuses almost exclusively on rural clients in a region that depends almost exclusively on agriculture production and processing. The results of the survey provide us with important feedback on the impact of microfinance lending on rural borrowers.

Rural poverty is perhaps the most critical problems facing Honduras today and represents the greatest development challenge facing the Government. Currently 75 percent of rural households fall below the poverty line. This involves roughly 270,000 families or a total population of two million citizens. Illiteracy is very high (42%), while access to adequate health, education and basic government services are extremely limited. The lack of alternatives for this segment of the population has led to greater levels of urban migration where employment prospects are only slightly better. The only relief has come from the estimated US\$ 500 million in annual remittances.

Most rural households Honduras survive on a combination of small farming activity and other off-farm sources of income – in many cases some sort of micro enterprise activity. Traditional microfinance credit products developed for urban areas are not always appropriate for this type of rural lending. On the other hand, Hermandad has developed credit products for its rural markets and is showing promising results. The results of the survey appear to validate the need to work to expand specialized financial services for rural areas of Honduras in order to reach a greater segment of the population.

Highlights of the survey results are summarized below:

- Although located in a rural area, which is primarily dependant on agriculture, 77% of the loans were justified based on some type of commercial activity. 19% involved a service activity and 4% involved a manufacturing activity. These results appear to support the belief that most rural families earn some sort of off-the-farm income in addition to that generated from agricultural.
- 81% of the borrowers surveyed were women.
- Credit funds were primarily utilized for (in order of importance):: working capital, improvements or expansion of the business, and the purchase of equipment or tools.
- 98% of the respondents claimed that the credit loans helped them in their business (80% stated that they helped a great deal and 18% stated that the loans helped only somewhat).
- 75% of those surveyed stated that their incomes had increased in the last year. Of those that stated that their incomes had increased, 80% stated that the loans they had received contributed to the increase in income (54% stated that the loans had contributed a great deal to their increased income and 26% stated that the loans contributed somewhat to their increased income).
- There was very little impact on job creation as a result of the loans. Only 12% stated that employment had increased in their business. 85% stated that employment had remained the same. 88% of those employed in the micro businesses were family members.
- 75% of the surveyed clients stated that the loans had improved their personal / family situation a great deal. 23% sated that the loans had somewhat improved their personal / family situation. In order of importance, the loans contributed the most to:
 - Improvements in housing
 - Better education for their children or themselves
 - Improved access to medical services / medicines
 - More or better food

b. World Relief of Honduras

WRH surveyed a total of 138 clients, 59 (43%) were based in Tegucigalpa, and 79 (57%) were based in the secondary cities of Catacamas, Comayagua, Danli, and Juticalpa.

Highlights include:

- 94% of the borrowers surveyed were women.
- 77% of the borrowers were involved in some type of commercial activity and 11% were involved in some type of manufacturing activity.
- Utilization of the loan funds was primarily for working capital and/or the expansion of the business.
- 90% stated that the loans helped them in their business a great deal.
- 33% of those surveyed stated that their incomes had increased a great deal over the last year. 20% stated that their income had only increased somewhat and 40% claimed that their incomes had not changed over the last year. 88% of those that saw an increase in their income attributed this increase to their loans.
- Only 10% of those surveyed reported an increase in the number of people employed in their business. 75% reported no change, and 13% could not answer the question.
- 88% of those surveyed reported employing members of their own family in the business. 80% reported only employing family members.
- 86% of the surveyed clients stated that the loans had improved their personal / family situation a great deal. 13% stated that the loans had somewhat improved their personal / family situation. In order of importance, the loans contributed the most to:
 - More or better food
 - Better education for their children or themselves
 - Improvements in housing
 - Improved access to medical services / medicines

V. ANNEX

A. ANNEX - LIST OF DOCUMENTS AND REPORTS PREPARED UNDER THIS CONTRACT

1. Microfinance Support Project - Strategy, Work Plan, Reporting Requirements And Other Administrative Issues - June of 2000
2. Informe De Trabajo De Campo Y Diagnostico De Asistencia Técnica Para 9 OPDs - August of 2000
3. Informe De Evento De Capacitación "Metodológicas Crediticias" - October 2000
4. Evento De Capacitación "Análisis Del Riesgo Crediticio" - November 2000
5. Informe De Consultoría A Corto Plazo; Hermandad De Honduras - HDH - December 2000
6. Informe De Consultoría A Corto Plazo; Financiera Solidaria S.A. - FINSOL - December 2000
7. Informe De Consultoría A Corto Plazo; Organización De Desarrollo Empresarial Femenino - ODEF - December 2000
8. Evento De Capacitación "Gobernabilidad Y Rol De Las Juntas Directivas A 8 Organizaciones" - December 2000
9. Apoyo A La Junta Directiva De La Fundación Covelo: Informe De La Visita De Trabajo - Febrero, 2001
10. Informe de la Consultoría Realizada en la Fundación María José Covelo - Programa de Primer Piso - Marzo 2001
11. Informe de la Consultoría Realizada en FINCA - Marzo 2001
12. Informe de la Consultoría: Bureau de Créditos de Honduras
13. Diagnostico del Programa de Micro Créditos: BANCOMER - Marzo 2001
14. Informe de la Consultoría Realizada en World Relief Honduras - Julio 2001
15. Diagnostico del Programa de Micro Créditos: BANHCAFE - Julio 2001.
16. Diagnostico del Programa de Micro Créditos: AVAL Micro - Julio 2001
17. Informe del Evento de Capacitación / Seminario Taller "Marketing en Instituciones de Microfinanzas" - Julio 2001

18. Honduran FPVO Law & Regulations: Analysis And Observations - July 2001
19. Informe De Evento De Capacitación: "Curso de Evaluación de Impacto y Satisfacción de Clientes en Instituciones y Programas de Microfinanzas" - Julio 2001
20. Informe Del Evento De Capacitación: "Taller Sobre Control Interno En Finca Honduras" - Agosto 2001
21. Informe De La Consultoría Realizada En Finca Honduras - Agosto 2001
22. Progress Report on Covelo Restructuring Effort - August 2001
23. Informe De Consultoría: Manual De Inspección Y Auditoria Externa Para Organizaciones Privadas De Desarrollo - Agosto 2001
24. Informe de Consultoría: "Estructura Administrativa, Manual de Puestos y Escala Salarial", Finsol S. A. - Septiembre 2001
25. Informe De Consultoría De Corto Plazo: "Diagnostico Del Soporte Informático Sistema SIEM Utilizado En Fundación Covelo, Finca, World Relief, ODEF Y Hermandad De Honduras" - Septiembre 2001
26. Informe De La Consultoría De Marketing Realizada En La Fundación José María Covelo - Septiembre 2001
27. Informe De La Consultoría De Marketing Realizada En Organización De Desarrollo Empresarial Femenino; ODEF - Octubre 2001
28. Informe De La Consultoría Realizada En Finca Honduras - Octubre Del 2001
29. Informe De Capacitación En Finca: "Herramientas Para Mejorar Análisis De Micro Negocios" - Octubre Del 2001
30. "Experiencias Exitosas De Microfinanzas En Latinoamérica" Módulo I: Diplomado en Microfinanzas - Noviembre 2001
31. "Mezcla De Mercadeo En Entidades De Microfinanzas; Servicio Al Cliente" Módulo II: Diplomado en Microfinanzas - Diciembre del 2001
32. Progress Report on Covelo Restructuring Effort and Institutional Strengthening Initiative with Selected FPVOs in Honduras - December 2001
33. Informe De Consultoría Realizada en World Relief de Honduras de Julio - Diciembre Del 2001 - Diciembre 2001

34. Informe De Consultoría Realizada en la Fundación Covelo de Julio a Diciembre del 2001 - Diciembre 2001
35. Informe De Consultoría Realizada en Hermandad de Honduras de Julio a Diciembre del 2001 - Diciembre 2001
36. Informe De Consultoría Realizada en la Organización de Desarrollo Empresarial Femenino (ODEF) de Julio a Diciembre 2001 - Diciembre 2001
37. Informe De Evento De Capacitación: "Curso De Evaluación de Impacto y Satisfacción de Clientes en Instituciones y Programas de Microfinanzas" - Diciembre 2001
38. Informe De La Consultoría En Mercadeo Realizada En World Relief de Honduras - Febrero 2002
39. Informe Sobre El Desarrollo Del Modulo III "Metodologías Crediticias" Del Diplomado Sobre Microfinanzas - Febrero 2002
40. Informe De La Consultoría En Mercadeo Realizada En FUNED Honduras - Febrero 2002
41. Informe De La Consultoría En Mercadeo Realizada en FAMA Honduras - Marzo 2002
42. Informe De La Consultoría En Auditoria Realizada En FINCA Honduras - Abril 2002
43. Informe De La Consultoría En Mercadeo Realizada En Hermandad de Honduras - Abril 2002
44. Medición De Impacto - Encuesta De Salida Y Análisis De Deserción De Clientes en FINCA - Junio 2002
45. Informe De La Consultoría Realizada Para Covelo: Evaluación Del Desempeño Del Personal - Junio 2002
46. Report on Project Indicators as of December 31, 2001 - June 2002
47. Informe De La Consultoría en Descentralización Realizada en ODEF Honduras - Junio 2002
48. Revised Work Plan through March 31, 2003 – November 2003

49. Response to the Evaluation Conducted on the Microfinance Support Project – November 2003
50. Informe de Consultoría de Corto Plazo “ Manual De Puestos Y Escala Salarial”; World Relief Honduras - Julio del 2002
51. Informe de la Consultoría en Auditoria Interna Para World Relief-Honduras - Agosto del 2002
52. Informe de la Consultoría en Mercadeo Realizada en La Fundación Covelo - Agosto, 2002
53. Informe de la Consultoría Realizada Para La Comisión Nacional de Banca y Seguros: Formularios y Guías en el Proceso de Autorización de Organizaciones Privadas de Desarrollo Financieras - Septiembre del 2002
54. Asociación Hermandad de Honduras: Resultados De La Encuesta Evaluación De Impacto – Noviembre 2002
55. World Relief de Honduras: Resultados De La Encuesta Evaluación De Impacto – Noviembre 2002
56. Informe de la Consultoría en Auditoria Realizada en la Fundación Jose Maria Covelo, World Relief de Honduras, Organización de Desarrollo Empresarial Femenino y la Comisión Nacional de Banca Y Seguros en Honduras – Febrero 2003
57. Informe de la Consultoria en Marketing Realizada en la Fundación Jose Maria Covelo, Hermandad de Honduras, World Relief de Honduras y Organización de Desarrollo Empresarial Femenino – Febrero 2003
58. Informe De Consultoria: Implementacion del Servicio de Caja en World Relief de Honduras – Mayo 2003