# MICROFINANCE

# ANTI-POVERTY LENDING IN GUATEMALA:

# A PRELIMINARY ASSESSMENT

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**August 6, 1994**

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# ANTI-POVERTY LENDING IN GUATEMALA: A PRELIMINARY ASSESSMENT

## 1. INTRODUCTION

Guatemala is moving quickly to the end of a civil war that lasted over 30 years. Negotiations are on-going and it appears that a comprehensive Peace Accord facilitated by the United Nations will be reached by the end of 1994. The Peace Accord opens a window of opportunity so that USAID may support the peace and national reconstruction process that will begin in Guatemala.

A relatively rapid response is required by USAID/Guatemala to assist the poor that were severely affected by the armed struggle in the conflict and surrounding zones. One option that the Mission is assessing, is the possibility of supporting a group of private voluntary organizations (PVOs) that currently have anti-poverty lending program(s) so they may provide financial services to those persons that were affected by the armed conflict. This option has the advantage that some of the existing PVOs have the technical know how on how to disburse funds to the proposed target group within a relatively short time frame. Ideally, the funds should be disbursed by the PVOs that have proper financial policies in place. The additional funding provided to these PVOs will permit them to increase their loan portfolio so the financial programs may have an opportunity of becoming self-sustainable in the process. The additional technical and financial resources would also serve as the basis for the creation of an informal financial network intermediation that will continue to provide sustainable financial services to the poor after the assistance has ended.

Guatemala has the largest economy in Central America and a population of about 9.5 million. Around 62% of the population lives in the rural areas and nearly half of the adult population is illiterate. Income distribution is extremely skewed, approximately 10% of the population receives 50% of the national income, and in the other extreme, 50% of the population receives about 13.5% of the national income[1]. The agricultural sector in Guatemala contributes about one forth of the Gross Domestic Product (GDP) and accounts for nearly 60% of the labor force. The manufacturing sector on the other hand, generates about 15% of the GDP and accounts for 14% of the labor force.

The average twelve month inflation rate ending June 30, 1994 was 11.8%. During the calendar year of 1994 inflation is expected to increase slightly to just a little over 12%. On the other hand, the average lending rate in the economy has declined slightly from an average of 25.7% in December 1993 to 23.9% in June 1994.

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[1] *See Appendix F, for the household income distribution of Guatemala.*

## 2. PURPOSE

The USAID/Honduras Small Business Advisor was invited by USAID/Guatemala to examine selected institutions that are involved in anti-poverty lending to determined if the models utilized by the PVOs are sustainable and have the potential of providing some financial services to the poor in the conflict

4. Financial status and self-sufficiency of the anti-poverty lending programs.
5. Financial policies and procedures utilized by the PVO to manage its services.
6. Budget size and percentage allocated for anti-poverty lending.
7. Vision of the organization. Where do they see its credit program in five years?

# 5. THE PROGRAMS

## 5.1 *Catholic Relief Services (CRS)*

CRS is a non-profit Christian organization that seeks to improve the economic welfare of the poor. CRS has a basic agreement with the Government of Guatemala and has been working in the country for nearly 30 years. Its anti-poverty lending programs initiated in 1991. CRS acts as a second tier facility providing financial and technical assistance to PVOs that in turn deal directly with the informal sector.

CRS works through the following four NGOs:

1- Fundación para el Desarrollo Integral de Programas Socio Económicos (FUNDAP);
2- Cooperación para el Desarrollo Integral del Sur Occidente (CEDRO);
3- Coordinación de Asociaciones en Desarrollo Integral del Sur Occidente de Guatemala (CADISOGUA);
4- Fundación Internacional para la Asistencia Comunitaria de Guatemala (FINCA/Guatemala).

The above mentioned NGOs utilize different methodologies to make anti-poverty lending loans. The NGO intermediaries make individual loans, solidarity or group loans, and village bank loans. Due to the time constraint, this preliminary assessment did not cover the two of the first level institutions[5]. It is recommended that a preliminary assessment be conducted with the two remaining NGOs if USAID/G decides to work through them.

To implement its projects, CRS provides grants to the intermediary organizations. CRS informed us that its mandate is not to become self-sufficient, but to assist in the institutional development process of the implementing organizations so those organizations may in turn become self-sustaining and help the working poor after CRS assistance has terminated. CRS signs grant agreements with each implementing institution stipulating that the reflows of the credit program financed by CRS should be utilized to capitalize the loan fund of the financial intermediary. Interest rates charged to the ultimate client varies by institution and is between

[5]*Only CEDRO and FINCA/Guatemala were visited by the Small Business Advisor.*

2% and 3% a month[6]. However, CRS informed us that it "encourages" the implementing institutions to charge positive market interest rates.

CRS defines sustainability at two different levels. The first level of sustainability is the village bank. CRS wants the village banks to continue operation after it has reached its ninth cycle. Following the FINCA methodology, CRS argues that after the ninth cycle the village bank should have enough savings from the community to finance the business needs of its members. Consequently, no additional external resources are needed by the community to finance its business needs. This approach is flawed because it assumes that an informal entrepreneur will not outgrow the financial services offered by the village bank. The key issue is; will the village bank survive and continue to grow without professional assistance? The village banks are managed and controlled by persons with little education who are taught by the intermediary PVO, how to manage a small fund. If the fund is going to serve the needs of its members it should grow as the business needs grow. As the funds increase, you will most likely need a paid staff to manage the portfolio. This transition has not yet occurred in the vast majority of the village banks and will undoubtedly present an array of challenges as the village bank movement matures.

The second level of sustainability defined by CRS is the survival and expansion of the businesses that are financed by the village banks. CRS's anti-poverty lending program seeks to create viable microbusinesses that will continue to grow and provide income to the families. In addition, CRS claims that its technical and financial assistance will contribute to make the NGO intermediary self-sufficient. CRS however, has not developed the criteria to qualify eligible NGOs that could eventually become self-sufficient by receiving its financial and technical assistance. Of the two NGOs visited, only FINCA/Guatemala claims to have a strategic plan that will provide the guidelines and targets for moving towards self-sufficiency.

CRS informed us that it has a computerized management information system in place but was unable to provide a copy of the last report to the Small Business Advisor. Statistical and financial information was delivered more than a week later. It was specially prepared for the occasion.

CRS has a budget of approximately $1.0 million. It reports that 30% to 35% of the budget is utilized to support anti-poverty lending programs.

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[6]*The PVOs should at a minimum charge rates that will permit them to; 1) cover its operating expense, including the required reserves for bad debt, 2) cover the cost of the funds, 3) maintain the value of the fund by covering the rate of inflation and 4) have a surplus (equivalent to a profit) to capitalize the loan fund.*

**Observations:** CRS does not operate as a financial institution. There is no intention of developing a strategic plan to move the organization toward self-sufficiency. Its village bank coverage is very limited and its primary mandate and role is that of a social organization.

**Recommendation:** In the specific case of CRS it would make more sense to work directly with the implementing institutions that it is assisting. For example, FINCA/Guatemala would be a good financial intermediary to support directly. The Mission however, would have to meet with the other two PVO intermediaries to assess how their financial programs are managed and determine if they are a viable option.

### 5.2 *Cooperative for American Relief Everywhere, Inc. (CARE)*

Care is a US based PVO with headquarters in Atlanta, Georgia. To work in Guatemala, CARE signed a basic agreement with the Government. CARE/Guatemala started its Village Bank Program in February of 1988. The purpose of the village bank program is to improve the economic and social conditions of low-income women in Guatemala. CARE has supported the creation of 150 village banks which serve about 6,700 women. Its active portfolio consists of 123 village banks with outstanding loans of Q2.7 million. CARE has the largest village bank program in Guatemala. In addition, CARE claims that it has mobilized over $240,000 in community savings.

CARE distinguishes its village bank methodology from that of FINCA by emphasizing specialized training and technical assistance to the project participants. In CARE's opinion, this additional assistance, significantly increases productivity and the businesses returns.

CARE does not have a self-sufficiency strategy and is not concerned about the sustainability of its loan fund. The Program Manager of CARE informed us that the institution will rely on donations to cover its operating deficit. According to the program manager, the financial spread from its loan portfolio covers between 50% to 60% of its operating expenses, the difference is financed by grants.

CARE reported that is has a world wide unified computerized accounting system. A copy of the last financial statement was promised but not delivered to the Small Business Advisor. CARE also reported that it has a computerized management information system that contains vital information on the loan portfolio. A copy of the report was delivered to USAID/Guatemala. The information received however, did not include a copy of the types of reports that are generated by CARE's management information system. The charts received contained general information for each village bank including; dates of disbursement, interest and capital paid by the village bank, amount of savings, number of members in the group and general comments.

CARE charges an up-front 2.5% monthly interest rate to the loans that it makes to the village banks. The loan cycles have a duration of 6 months. The village bank members are required to save 20% of the amount loaned. The women are encouraged to utilize their savings to finance their projects.

CARE has a yearly budget of about $8.5 million. Approximately $1.0 million is utilized to support its anti-poverty lending program. In the next five years CARE would like to open a village bank program in the urban areas and operate in four secondary cities. It also wants to expand it rural village bank program to cover 8 departments in the country. In addition, it will seek to develop a partnership with other PVOs to support this strategy. The Program Manager informed that CARE would be interested in working with USAID/Guatemala if a decision is made to support anti-poverty lending in the old conflict zones.

**Observations:** CARE is ideally positioned to expand its village bank program. It has adequate financial and human resources as well as the potential for becoming and important financial service center for the working poor. The main issue with CARE is its philosophy of not caring about self-sufficiency because it considers itself to be more than just a "financial institution".

**Recommendation:** The Mission should initiate a policy dialogue with CARE to explain the importance of having a self-sufficient financial program. CARE will undoubtedly argue that training and technical assistance is just as important to the village banks as the credit component. The Mission should insist however, that the technical assistance activity be separated from the credit fund as a separate cost center. CARE could then utilize grant funds to cover the operating deficit of the training and technical assistance program. The financial program should generate (over a period of time) sufficient resources to be self-sufficient. The financial policies and procedures utilized by CARE should be reviewed by the Mission to ensure that they respond to market conditions.

### 5.3 Self-Help and Resource Exchange (SHARE)

Share is a US based PVO committed to ending hunger and poverty. Share initiated operation in Guatemala in 1986. During the month of September 1987 it obtains its legal license (personeria juridica) to operate a local PVO called Asociacion SHARE de Guatemala. The General Assembly and Board of Directors of SHARE/Guatemala are one and the same. It is composed of three persons. The Executive Director indicated that SHARE/Guatemala will expand its membership to include five additional persons for a total of eight.

SHARE/Guatemala operates as a second level institutions working through local organizations. It currently has five major social programs in place: 1) maternal-child health, 2) natural resource conservation, 3) rural infrastructure development, 4) child in need and 5) communal banks. SHARE/Guatemala's development strategy is to strengthen and supporting local community development organizations to serve their own communities.

SHARE/Guatemala initiated its income generation project in 1990 with the mother s that were participants in the maternal-child health project. The village bank program is seen as a complement of its social programs in order to increase family income. As of May 1994, SHARE had sponsored 18 village banks through 6 organizations. The village banks assists about 400 women and has an outstanding portfolio of Q200,000. Borrowers are charge 10% per cycle of four months. SHARE/Guatemala keeps 2% while the community organization keeps 8% to assist in covering its costs[7]. The loan capital however belongs to SHARE. Self-sufficiency is a non-issue and not a priority for SHARE/Guatemala. The Executive Director believes that the country requires external grant assistance to develop. SHARE/Guatemala gives priority to the sustainability of the target group. It expects the village banks to continue to operate once the external assistance is terminated. One of the village bank has already graduated and continues to operate with their own savings. SHARE/Guatemala believes that the increase in family income that leads to a higher standard of living and democratic principles learned by using the village bank methodology are in a higher plane of priority than the sustainability of the loan fund. Share plans to open 10 banks per year. In the medium run, the executive director would like to have a village bank in each of its 50 maternal child health unit.

SHARE/Guatemala informed the Small Business Advisor that Price Waterhouse drafted its financial policies and credit manual. When question if the manual included collection policies and procedures and methodology to establish reserves for bad debt, the executive director informed that it was not included.

SHARE/Guatemala has a budget of approximately $5.0 million for 1994. Only $34,000 of the budget is dedicated to support its anti-poverty lending program.

**Observations:** SHARE has a very small program that is not worth supporting given the negligible impact that its credit program has in Guatemala. The cost of opening 10 banks per year in a country with such vast needs clearly is not justifiable from the point of view of a cost/benefit analysis. In addition, SHARE's priority is not in the area of providing financial services. Only .01% of its total budget is directed toward anti-poverty lending.

**Recommendations:** SHARE should not be selected to participate in the anti-poverty lending program supported by USAID/Guatemala.

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[7] *An 8% spread will normally not cover the operating cost of a credit program with a small portfolio.*

### 5.4 *Asociacion de Mujeres en Desarrollo (MUDE)*

MUDE is a local PVO that initiated operations in 1991. MUDE works with ladina and indigenous women. MUDE seeks to integrate women's social, cultural and economic development in Guatemala. MUDE obtained its legal license (personeria juridica) to operate on July 4, 1994. MUDE is a small organization composed of 120 women represented by 7 different groups. The members are part of the General Assembly that elects a Board of Director composed by 7 members. MUDE coordinates six different activities for its members, these are; 1) organizational promotion, 2) technical assistance in basic business administration, 3) training in environmental management, 4) education and training in human and women rights and 5) a credit fund with two components, a microenterprise program and a village bank program.

MUDE has six village banks with 119 women members. Its outstanding village bank loan portfolio is Q70,000. Two of the village banks will "graduate" this year and MUDE expects that the village banks will continue to operate with the internal savings generated by the group. MUDE charges an interest rate of 22% up-front to the borrowers in the village bank. The loan cycles vary as follows; cycle 1 = 4 months, cycle 2 = 6 months, cycle 3 and 4 = 7 months.

MUDE does not have adequate financial nor statistical information. Its resources are very limited and the institutional development phase is just starting. Mude has just been selected by Katalysis as its newest partner in Guatemala. Mude is expecting to receive technical assistance from Katalysis to develop institutionally in the areas of accounting, credit and management information systems.

**Observation:** At this moment, MUDE does not have adequate human resources to embark in a program expansion. The organization is in its infancy and lacks adequate controls, systems and procedures to effectively expand its village bank program.

**Recommendation:** MUDE should not be selected to participate in the anti-poverty lending program supported by USAID/Guatemala. They should first received technical assistance and training from KATALYSIS to establish their internal accounting, credit and management information systems. In addition MUDE's staff should receive training in financial management. It might be necessary to contract professional assistance from outside the organization to manage the expansion of MUDE's financial program in the future.

### 5.5 *Fundacion Internacional para la Asistencia Comunitaria de Guatemala (FINCA/Guatemala)*

FINCA/Guatemala is a private voluntary organization that was created in April 1990. The organization was legally incorporated as a PVO on November 1993. FINCA/Guatemala is the affiliate organization of FINCA International (the US based PVO that designed and promoted the village bank methodology in Latin America).

FINCA/Guatemala initiated its village bank programs in 1991 with the creation of 12 village banks supported by CRS. Today FINCA/Guatemala has 50 village banks with 1,397 active clients and a portfolio of Q526,3723. In addition, the village bank clients have mobilized Q323,076 in savings.

The Guatemalan operation is still in its infancy, however; this organization claims that it has a strategic plan in place with the objective of establishing 1,000 village banks in Guatemala in a four year period. FINCA's philosophy differs from those of the other NGOs. FINCA wants to become a financial viable institution offering financial services to the working poor. Its priority is to provide loan and savings services to the poor. FINCA does not manage other social programs like the rest of the NGOs in Guatemala. It believes in specialization and financial consolidation.

FINCA/Guatemala's expansion program is based on the possibility of receiving funds from a business group based in the Seattle, Washington. FINCA/Guatemala believes that USAID could also support its operation with resources from the Peace Fund that would be leveraged with APPLE funds, plus a matching grant submitted to USAID/W to support its regional office in Guatemala. If the funding requests are approved, then FINCA/Guatemala will rely on technical assistance from the FINCA International Regional Office to expand its program. Under the proposed Matching Grant, FINCA's regional office proposes to assist its local affiliate in the implementation of a large scale national expansion plan.

**Observation:** FINCA/International has been the leader in promoting the Village Bank methodology in Latin America. If properly managed FINCA/Guatemala would be in a condition to play an important role in creating village banks in the conflict zones. All this however, is projected on the basis that the Mission will obtain the necessary resources to finance FINCA's anti-poverty lending program. FINCA/Guatemala's main donor is CRS (with USAID funds). To expand its program to the conflict zone most of the resources would have to come from USAID/Guatemala. There is a possibility that FINCA International will receive some grant funds from the Business Alliance which is a non-profit organization supported by the business sector of Seattle, Washington. In addition, there is the possibility that FINCA/Guatemala will receive technical assistance from FINCA/International if the USAID/W matching grant is approved.

**Recommendation:** FINCA/Guatemala should be selected to participate in the anti-poverty lending program supported by USAID. This is the only organization that will dedicate all of the resources received from USAID/Guatemala to directly support its' self-sufficiency strategy to expand their financial services nationwide. The key issue however is that FINCA does not "yet" posses the required funding. In order to obtain a solid commitment from FINCA International, the Mission should earmark its funds for the credit program and have FINCA International obtain the necessary funds to cover its operating expenses.

### 5.6 *Cooperacion Para el Desarrollo Rural de Occidente (CDRO)*

CDRO is the principal partner of Katalysis (a US California base PVO) in Guatemala. CDRO was established in 1981 by local Mayan community leaders. CDRO manages integrated community development projects that provides, education, technical assistance, training and credit to Mayan-Quiche Guatemalans in 24 communities in the Department of Totonicapan. CDRO utilizes a unique Mayan organization system to manage all of its activity. Decisions are reached by consensus at the community level. The community in turn selects a member to represent them at a council level compose of various communities. Each council then selects a member to represent them at a Board of Directors. The hierarchy structure is not in the typical pyramid level but horizontal. The Board of Directors cannot impose mandates on the councils. The Board of Directors will coordinate all activities with the councils and reach agreement only after they have the support of the councils. The councils in turn consult with the communities that it represents and obtain their concurrence.

The credit system of this organization is unique. CDRO has a series of productive projects that have a credit and savings components. All the credit programs fall under one overall system called "Banco Pop", which in Quiche means weaving pattern. That is, everything is related to everything else. The Banco Pop, coordinates all the credit program but does not manage any of the funds. Each credit program is managed independently by the group that coordinates the project. For example, the committee that manages the Artisan Program, manages the credit program for that component. The committee that manages the Women Program, manages the credit for the program and so on. The interest rate charge to its member 12% over the balance of the loan. CDRO also promotes savings and pays 8% for the funds that are mobilized. In addition, when a loan is made, CDRO discounts 15% up-front of the amount of the loan. This amount is distributed as follows; 3% is given to the board of directors, 3% to the community councils, 3% reserve for bad debts and 6% for other miscellaneous items. CDRO is presently introducing the concept of rotating funds within the communities. For example, if community A receives a Q200,000 loan, they will be eligible to receive a second loan for that amount of credit once the loan has been repaid. In other words, a rotating fund is assigned to the community for its exclusive use.

The credit and accounting controls also follows this pattern. The loan is made to members of the community. If one member of the community does not pay, the other members must pay in order to qualify for another loan. If the community does not pay, then the Council that represents various communities will not be eligible for a loan. This pressure system appears to work very effectively since the Banco Pop coordinator told us that only three loans have defaulted since the program started. On the accounting side, we were informed that each program keeps its own accounting system and CDRO consolidates the information for all the programs. When asked if we could see the financial statements, we were informed that they were not available because CDRO was preparing it for its general assembly on July 30, 1994.. When asked if we could see the previous year financial statement, CDRO informed us that they did not have any extra copies. We did not insist further.

CDRO informed us that on July 11, 1994, it had just inaugurated 4 village banks with the participation of 60 women. Each woman received a Q1,000 loan. In addition, its artisan program has made about 150 group loans that have benefited about 7,500 persons. CDR claims that the outstanding portfolio for the artisan program is about Q1,250,000.

**Observation:** This is truly a grassroots organization. Its emphasis is integrated rural development. The organization follows the traditional values of the Mayans. As such, this organization will most likely never develop into a financial organization, since it was not created for this purpose. The Mission however, should not rule out this type of organization because most of the people affected by the war are Mayans and this type of organization is in their cultural heritage.

**Recommendations:** If the Mission decides to take a one shot approach, a CDRO type organization may serve its purpose because it works with the target group that the Mission wants to support. If the Mission utilizes an institutional building approach, then this institution will most likely not qualify because the members who control CDRO stated that they do not accept outside interference in the management of the organization. The accountability system of the funds may be a problem for the Mission, unless an agreement is reached prior to disbursement of funds on the controls and reports that CDRO should maintain and submit to USAID.

### *5.7 Fundacion de Asesoria Financiera a Instituciones de Desarrollo y Servicios Sociales (FAFIDESS)*

FAFIDESS is a Guatemalan PVO that was supported by the Rotary Club and business sector in 1985. The purpose of this organization is to obtain financial resources to actively collaborate in Guatemala's development through social, educational and credit programs. FAFIDESS offers the following services to the community at large; project design and administration, project evaluation, technical and financial assistance and finance packaging.

FAFIDESS initiated a pilot project with 4 village banks in 1989 utilizing the FINCA methodology. Since then, FAFIDESS claims to have assisted in the creation of 50 village banks. Twenty have been transferred to other institutions and/or have graduated. Currently, FAFIDESS has 30 active village banks with approximately 1,000 women members. The outstanding loan portfolio is about Q500,000. These village banks in turn have mobilized about Q325,000 in savings from its members. FAFIDESS charges its village banks between

24% and 30% a year, depending on its source of funding. The village bank in turn charges its members between 3 and 4% a month. The village banks also lend funds to other non-bank members at 5% a month. FAFIDESS village bank program is concentrated in rural areas and all of its beneficiaries are women.

FAFIDESS has just signed a "Small Project Agreement" with the Interamerican Development Bank (IDB). It will obtain $500,000 for its credit program and $150,000 for institutional development and support. The funds will be disbursed as a grant from the IDB.

FAFIDESS does not have an adequate management information system in place but is in the process of contracting this out with the IDB funds. The IDB funds will permit FAFIDESS to consolidate its credit program and establish adequate policies and controls. The Executive Director informed us that he will develop a strategic plan with selected members of his board and staff during the month of August 1994[8].

**Observations:** With this initial support from IDB, FAFIDESS will be on its way of becoming one of the leading PVOs in Guatemala. The amount of resources that will be disbursed by the IDB will probably ensure FAFIDESS self-sufficiency in no more than three years. FAFIDESS has specialized in rural lending and would eagerly participate in a USAID supported project for those affected by the armed struggle. In addition, the PVO is supported by members of the business community and has the backing of the Rotary Club of Guatemala City.

**Recommendation:** This PVO should be selected to participate in the anti-poverty lending supported by USAID/Guatemala. This is one of the few PVOs that will have adequate counterpart funds to expand its program in a relative short period of time.

### *5.8 Banco de Exportacion , S.A. (BANEX)*

BANEX is a Guatemalan commercial bank created in December of 1985. This is the fourth largest bank in terms of assets in the country. We visited this bank because it has collaborated with international donors in managing a loan fund for persons that were affected by the armed conflict in Guatemala.

BANEX manages (but does not control) two programs for the refugees. One of the program is called "Refugiados" and the other is called "Discapacitados". Both programs worked on the principle of group loans; i.e., if one borrower does not pay the others will pay. On the average the solidarity group consisted of three persons, mostly male indians who originally lived in the conflict area near the boarder with Mexico and then move to the Capital City of Guatemala.

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[8]*The Exec. Director of FAFIDESS has just returned from an INCAE seminar that concentrated on the importance of developing strategic work plans.*

In our experience we have never seen such mismanaged programs. The percentage of loans in arrears in the "Refugiado" program which started in October of 1991 is 97%. This only includes capital and not the interest in arrears. The "Discapacitados" program which is newer and started on April of 1993 has not reached total failure but its well on its way with a percentage of loans in arrears of 68% (excluding interest).

This program is full of lessons learned on what not to do. The problem is that by 1991 and 1993 these lessons had already been learned and were never applied to these programs. In addition, the interest rate charged to the borrowers is subsidized so the program never had an opportunity from the start. Some of the major mistakes made in this program are the following:

- BANEX disbursed the loans without taking any risk. The risk in case of default belonged to the fund. The result was inadequate loan analysis.

- The credit committee was composed by two donor representatives and one BANEX representative. The donors obviously had no credit experience and BANEX saw it as a social service and had no risk in the venture.

- BANEX was given a 2% fee for just reporting on the loans. It had no management or financial responsibility.

- No collection effort was ever done by BANEX or the owners of the funds to collect the loans in arrears. When asked why, we were informed that BANEX had notified the owners of the funds the names of the borrowers that had loans in arrears. The owners of the funds however, made no effort to collect or instructed the bank to collect.

- Funds were disbursed without any supervision. No one knows if the funds were utilized for the intended purposes.

The Deputy Manager of the bank informed us that it was preparing the necessary documentation together with the owner of the funds to forgive the debt because there was no possibility of ever recovering it. Below you will find a table summarizing the programs.

**LOAN PORTFOLIO**
**In Quetzales**
**(JUNE 1994)**

| Program | Liquid In Bank | Loan Portfolio | Program Started | Number of Loans | Percent in Arrears |
|---|---|---|---|---|---|
| Refugiados | 303,122 | 526,081 | Oct. 1991 | 43 | 96% |
| Discapa-citados | 174,891 | 209,899 | April 1993 | 22 | 68% |

# 6. ISSUES, FINDINGS AND RECOMMENDATIONS

## *6.1 Sustainability vs Short Term Impact*

The most critical decision that the Mission has to make is to determine the type of approach that it will utilize to assist the target population that will resettle in the conflict zones. There are two different approaches that may be used in the process. One option is to use a one shot approach. That is, disburse funds to organizations that are in a position to provide some financial services through individual loans, group loans, village banks and integrated community programs to those persons that were affected by the conflict. This approach has the advantage that the assistance will be delivered to the target group as desired without considering other complications such as the institutional sustainability of the intermediaries or the program. The disadvantage is obvious. It is a one time assistance.

The second option is to use this window of opportunity, to assist in the creation of a permanent financial system for the informal sector that will reach the targeted segment of the population that the Mission wants to support. Under this option, the Mission would have the added burden of assisting in the institutional development process of the intermediaries. The payoffs however, are higher because in the end the assistance would have served as a basis for establishing a self-sufficient mechanism that will continue to provide financial services to the informal sector on a continuous basis.

Recommendation: From the development point of view the Mission should invest its limited resources in activities that offer the highest possible return. In this sense it is advisable to select the second option, because the Mission will have the opportunity to establish the basis for a permanent financial system for the poor. The methodologies and system developed in the area of micro enterprise and anti-poverty lending should make this option viable and self-sustaining. USAID has the technical experience and expertise to carry this out.

### 6.2 *Absorptive Capacity of the PVOs and Scale of the Operation*

The PVO network that provides anti-poverty lending in Guatemala is fragile. That is, the programs and loan portfolio of the implementing agencies are small and have limited impact. At their present institutional development stage the vast majority of the PVOs interviewed required financial and management assistance to expand their programs.

USAID/Guatemala should not expect to have a strong impact in the conflict areas once the anti-poverty lending project is approved. Time is needed to select and hire additional qualified staff to manage the expansion programs of the PVOs. The staff has to be trained, management systems have to be upgraded and/or even established because they do not exist within the institutions. Adequate financial policies have to be drafted and accepted by the implementing institutions in order to increase the profitability of the financial intermediaries. These steps are a prerequisite for proper management of a successful financial program.

Recommendation: USAID/Guatemala should provide technical assistance to the selected PVOs in three key areas: 1) strategic planning, 2) financial management and 3) internal controls, including adequate information systems in accounting, portfolio management and impact. Experience has shown that by not addressing these three key areas, the ability of the institution to significantly expand and control its financial program is seriously affected. The strategic plan developed for each institution will help determine the absorptive capacity of the PVO and estimate project impact and portfolio level needed to break-even. The management assistance will help the organization to adequately manage the credit program, with appropriate loan loss reserves, maintaining a spread that will eventually permit it to cover costs and break-even. The Internal controls will assist the PVO in developing adequate management information systems that will provide valuable information on the performance of the institution to its management.

### 6.3 *Selection of NGO and Other Candidates*

There are three institutions that in our opinion should be selected to participate in an anti-poverty lending program in Guatemala. These are CARE, FINCA and FAFIDESS.

CARE: In the case of CARE, the Mission should initiate a policy dialogue to demonstrate the advantages of having self-sufficient financial services for the poor. CARE does not have to eliminate its specialized training and technical assistance programs from it loan program. I should however separate the activities into individual cost centers. That way, CARE would continue to request grants to cover the cost of its training and technical assistance program. The financial service program however, should be self-sufficient. In addition, the Mission should review CARE's financial policies, systems and controls. At present, we have no concrete evidence that this organization has adequate financial information or policies for its loan program.

**FINCA:** FINCA/Guatemala with the assistance of FINCA/International has the technical know-how to expand its program. The issue that affects FINCA is the lack of funding. The Mission should review in detail FINCA's financial plan and request that FINCA come up with the necessary counterpart funds to receive assistance from USAID[9]. It would be appropriate for USAID to request that FINCA obtain the resources to finance its operating expenses, while the Mission provides funding for the loan program.

**FAFIDESS:** FAFIDESS, with the IDB assistance will eventually become a leading PVO in Guatemala. It has just signed a grant with the IDB that will provide it with $500,000 for its loan fund and $150,000 for institutional support and technical assistance. This assistance will provide FAFIDESS with the necessary resources to become self-sustaining within a period of three years. In addition, FAFIDESS specializes in rural lending and would eagerly participate in a USAID supported project for those affected by the armed struggle. One the strength of this organization is that it is supported by business leaders of the Rotary Club of Guatemala City.

**Recommendation:** This PVO should be selected to participate in the anti-poverty lending supported by USAID. This is one of the few PVOs that will have adequate counterpart funding to expand its program in a relative short period of time.

**Other Organizations:** USAID/Guatemala should consider using other institutions that have microenterprise programs such as Genesis Empresarial, FUNDAP and other PVOs that have successful microenterprise programs.

**Selection Criteria:** The Mission should establish the criteria to classify PVOs so they may participate in this new program anti-poverty lending program.

### 6.4 *Institution Building*

If decision is made to utilize this window of opportunity to help set the foundation for a permanent financial system in place, the Mission should then be prepared to invest in institution building. This has the disadvantage that it is more costly, but in the long run its' benefits would exceed its cost.

### 6.5 *Leveraging Resources (APPLE)*

The Mission should contact Elizabeth Hunt the project officer of the Anti-Poverty Lending Program (APPLE) and send a concept paper to her, defining how the anti-poverty lending program would work in Guatemala and the counterpart required from APPLE. The APPLE

[9] *As of the date of this report, the Agency has modified its 25% counterpart funding requirements for certain institutions.*

programs works on a competitive basis and the Mission are evaluated based on the merits of the proposals.

### 6.6 *Market Policies*

The Mission should request a copy of the financial policies utilized by the PVOs to make sure that they respond to market forces so the programs have the opportunity of becoming viable. Some of the institutions continue to give priority to their social programs and regard the financial service component as a complement. This could easily be assessed by examining the portion of the budget dedicated to micro enterprise and anti-poverty lending.

### 6.7 *Second Tier Lending Facility*

Given the cuts in the levels budget and staff, the Mission might want to consider working through a second level institution that would in turn provide financial and technical assistance to the PVOs selected to participate in the anti-poverty lending program. This would give the advantage to the Mission of only having to work with one institution instead of several PVOs. The Mission would select a PVOs to manage two components, a second tier loan fund and technical assistance facility. The lending facility would provide liquidity to selected PVOs so that they in turn would finance village banks in the agreed upon areas. The fund could work as a rediscount mechanism or a loan or grant window, depending on the Mission's intent. In addition, technical assistance would be provided to the selected PVOs through the second level intermediary to help achieve minimum financial performance standards.

## 7. NEXT STEP

Determine the amount of resources that the Mission will receive to implement a viable and sustainable anti-poverty lending program. The funding level will most likely influence the approach that the Mission will take. A one shot approach, or the establishment of a viable and permanent informal financial sector intermediation system. Once the decision is made, the Mission should determine how it will manage the assistance. That is, will the Mission sign individual grant agreements with the PVOs or will the Mission work through a second floor organization. In addition, the Mission should conduct a full scale institutional and financial assessment of the selected institutions to determine their absorptive capacity and financial and technical assistance needs[10]. This information will then assist the Mission in clearly laying out its anti-poverty lending strategy for Guatemala.

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[10] *The USAID/Honduras Small Business Advisor did not have access to the internal financial information of the PVOs that were visited during the two week assignment.*

## APPENDIX A: DEFINITION OF METHODOLOGIES EMPLOYED BY THE NGOs ANTI-POVERTY LENDING PROGRAMS

### 1. *SECOND FLOOR INTERMEDIARY*

A second floor organization is an agency that does not deal directly with the ultimate client. The second floor organization will obtain resources and provide them to one or more intermediaries. The intermediaries will utilize theses resources and in turn provide financial and non-financial services directly to the informal sector or microenterprises.

### 2. *FIRST FLOOR ORGANIZATION*

A first floor organization is an agency that deals directly with the microenterprise customer.

### 3. *INDIVIDUAL LOANS*

Individual loans are similar to the loans that the formal banking system offers to its business clients. The microfinance intermediary conducts credit analysis using the financial statements and projected cash flows of the business. Guarantees are normally required from the borrowers. Loans are given for short term working capital and/or fixed asset financing. Credit officers establish a one to one relationship with the microenterprise customers. Loans are normally approved for a twelve month period and customers are normally charged an interest rate above the bank rate. Individual loans tend to be larger than group loans and are mostly used for business expansion or transformation.

### 4. *GROUP LENDING (SOLIDARITY GROUPS)*

Solidarity groups are formed by four to eight microentrepreneurs that band together to receive a loan. The group is responsible for selecting its members. The group also selects its spokesmen/women who coordinate all the group activities. The loan is made to the group. If one person in the group doesn't pay back his/her loan, the other members of the group are collectively responsible for paying back the loan. The group coordinator is responsible for collecting the payment from each of its members and paying the microfinance intermediary. This peer group lending reduces the risk and transaction costs for the microfinance intermediary. Loans are normally made for a twelve week period and are paid back on a weekly basis. Microfinance intermediaries in Guatemala normally charge a 2.5% to 3% flat fee plus a commission to cover other direct costs. Most loans are disbursed for short-term working capital purposes. The first loan normally ranges between $150 to $200 and is approved for a period of twelve weeks. Clients with a reliable track record automatically qualify for a larger loan, once the existing loan has been paid back. Microfinance organizations tend to open their offices in or near the markets where there is a large concentration of microentrepreneurs.

## 5. *VILLAGE BANK*

Village Banks function as informal credit union cooperatives. A village bank is normally comprised of a group of 20 to 40 persons (mostly women). The group elects from its members a board of director (President, Treasurer and Secretary) and committees to coordinate its activities. The microfinance intermediary makes a loan to the group which in turns approve the individual loans of its members. This reduces the risk of default and lowers the transaction costs, since most of the loan appraisal, disbursement and collection functions are passed to the village banks. The members know the persons in their community and select people they know and trust. The group decides who may join the village bank. The first loan made to the individual members are typically for the equivalent amount of $50.00 to $100 and are repaid on a weekly or bi-weekly basis[11]. The loans are used to finance short-term working capital for a period averaging four months. This period is called a loan cycle. . Interest rates charged in Guatemala are about 2.5% a month. If the village bank pays back its first loan on time, they automatically qualify for a second larger loan. Most microfinance organizations require a compulsory savings of 20% of the amount of the active loan. This amount is saved by each member during the loan cycle. At the end of the loan cycle a member may then obtain a larger loan equivalent to the previous loan plus the accumulated savings. The amounts saved by the village bank members are used to finance their own business activities, other investments or are sometimes used to finance activities of non-members of the village banks. The village bank will normally charge its members a 2.5% monthly flat fee. The village bank however will charge non-members a 5% to 10% monthly flat fee for the use of the funds. The members distribute the dividends earned from their internal savings proportionately to the amount of the savings that each member has. Each village bank determines the rules and regulations that govern their internal savings account. The group usually receives funding for up to nine cycles. The savings generated by the group at the end of the ninth cycle should be sufficient to cover the groups credit needs.

The promoter of this methodology in Latin America has been FINCA/International. In Guatemala, FINCA has shared its methodology with FAFIDESS and CARE. Since FINCA's creation in 1988, its affiliated organizations have supported the development of over 1,500 village banks benefiting over 30,000 families in Latin America.

## 6. *INTEGRATED COMMUNITY DEVELOPMENT PROGRAMS*

The integrated community development programs uses credit as only one of the elements necessary to achieve its objective. Normally these programs include strong health and education programs, such as maternal and child health programs, alphabetization, basic infrastructure, etc.

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[11] *Almost all loans under disbursed utilizing this methodology are of a value of less than $300.*

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## APPENDIX C: PERSONS INTERVIEWED

**Catholic Relief Services**
John A. Wiater, Country Representative
Anabella Cerezo, Coordinator of Microenterprise Projects

**International CARE/Guatemala**
Louis Alexander, Coordinator of the Sector of Economic Activities and Microenterprises

**Asociacion SHARE/Guatemala**
Sean T. Gallagher, Executive Director

**Asociacion de Mujeres en Desarrollo (MUDE)**
Catarina Mendoza, President and Executive Director

**Fundacion Internacional para la Asistencia Comunitaria de Guatemala**
Adriana Rivera Irias, President and Executive Director

**Cooperacion para el Desarrollo Rural de Occidente**
Julio Arango, Coordinator, Bank Pop
Candelaria Guitierrez, Coordinator, Women Programs

**Banco de Exportaciones, S.A. (BANEX)**
Daniel Villatoro, Deputy General Manager

**Fundacion de Asesoria Financiera a Instituciones de Desarollo y Servicio Sociales (FAFIDESS)**
Reynal Walter, Executive Director
Arturo Melville, Member of the Board of Directors

**Unites States Agency for International Development, Guatemala (USAID/Guatemala)**
Hilda Arellano, Mission Deputy Director
Elizabeth Warfield, Director/Program Development & Management (PDM)
Margaret Kromhout, Deputy Director/PDM
Liliana Gil, PDM

# APPENDIX D: GUIDELINE FOR INTERVIEW WITH PVOS

Name and Title of Person Interviewed: ______________________________

## 1. Legal Framework

When was the PVO established?

When were the by-laws formally approved by the government?

Do the by-laws permit the PVOs to make loans?

What is the composition of the General Assembly

When did the General Assembly last meet?

What is the composition of the Board of Directors?

Does the PVO have a credit committee?

Are there experienced bankers in the credit committee?

## 2. Market of PVO

What methodology is utilized to make poverty lending loans (Individual loans, village banks, solidarity, etc.)?

When did the credit program start?

How many loans and amounts have been disbursed since the beginning of the credit program?

How many active borrowers does the PVO currently have?

What is the size of the outstanding loan portfolio?

## 3. Management Information System

Does the PVO have a computerized accounting system?

How recent is its' last balance sheet?

Does the PVO have computerized information on its' loan portfolio?

Does the PVO have impact information on its' credit program?

May I get a copy of the most recent MIS report?

## 4. Financial Status

Is the credit program commingled with the other programs or is it a separate cost center?

Is the credit program self-sufficient?

What is the cost of lending $1.00?

What is the percentage of loans in arrears by age?

Does the PVO mobilize savings?

Does the PVO have a strategic plan to achieve self-sufficiency?

## 5. Policies and Procedures

Does the PVO have written financial policies and procedures (credit manual)?

Does the PVO have a collection policy, eg.; letters, lawyers, court, etc.?

Does the PVO have a policy on writing off bad debt?

Does the PVO have external auditors?

May we have a copy of the last audit report including the management report?

## 6. Budget

What is the amount of the 1994 budget?

How much or what percentage of the budget is dedicated to microenterprise development?

What is the PVO main source of funding?

## 7. Vision

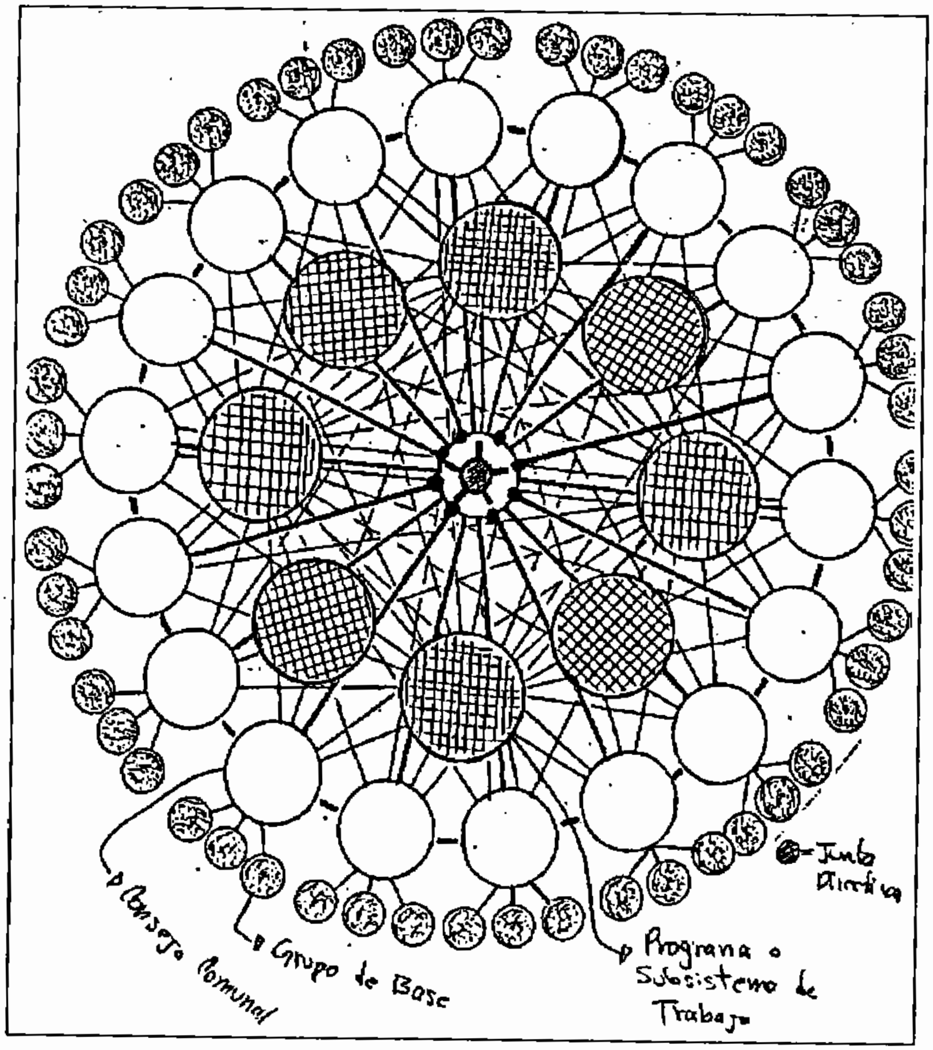
Is the Village Bank an end or means to the PVO?

How do they see their program in five years?

## 8. Other

What other PVO makes poverty loan in Guatemala?

## APPENDIX E: MAYAN ORGANIZATION STRUCTURE OF COOPERACION PARA EL DESARROLLO DE OCCIDENTE




**Explanation of the Organization Structure of CDRO:** The Mayan hierarchy structure is not the typical pyramid but horizontal. The outer small circles are the communities. The communities in turn elect representatives to a Council which are the immediate larger white circles. The councils are composed of representatives from various communities. The council then elects members to represent them at the Board of Directors. This is the middle of the circle. The Board of Directors, the councils and the communities designed the programs. This is identified by the circles with the squares.

Decisions are based on consensus. Every level consults with the other level before a decision is made.

## APPENDIX F: HOUSEHOLD INCOME DISTRIBUTION GUATEMALA: 1991

| DECILE LEVEL OF POPULATION | INCOME DISTRIBUTION | CUMULATIVE INCOME DISTRIBUTION |
|---|---|---|
| First Decile | 1.2 | 1.2 |
| Second Decile | 2.1 | 3.3 |
| Third Decile | 2.1 | 6.0 |
| Fourth Decile | 3.4 | 9.4 |
| Fifth Decile | 4.3 | 13.7 |
| Sixth Decile | 5.4 | 19.1 |
| Seventh Decile | 7.1 | 26.2 |
| Eight Decile | 9.8 | 36.0 |
| Ninth Decile | 14.8 | 50.8 |
| Tenth Decile | 49.2 | 100.0 |
| Total | 100.0 | |