Midterm Evaluation of the Accessing Capital Markets Grant

Prepared for the U.S. Agency for International Development under contract number LAG-0820-G-00-4013

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CHAPTER ONE

INTRODUCTION

TERMS OF REFERENCE

ACCION International (ACCION) contracted Development Alternatives, Inc. (DAI) to conduct a mid-term evaluation of ACCION's performance under LAG-0820-G-00-4013. Work performed under the contract visits to ACCION's offices in Washington, D.C. and Somerville, MA. No field visits to the affiliates were conducted given that the consultant visited several of ACCION's affiliates in conjunction with her 1996 evaluation of ACCION's training and technical assistance programs funded by the IAF and IDB. The 1996 evaluation of the technical assistance program included ACCION's business planning process as well as activities associated with accessing financial markets — activities that are also funded in part by this grant. Therefore, telephone interviews were deemed sufficient and appropriate.

The primary objectives of the study, as detailed in the terms of reference, were:

- To evaluate the results of ACCION's technical assistance activities defined in the original grant as support to help the affiliates develop the internal capacity to interact with the players of the commercial financial markets;

- To identify the qualitative and quantitative outcomes of technical assistance and policy dialogue activities, both anticipated and unanticipated;

- To identify the factors that contribute to and/or constrain the accomplishment of the goals of the project;

- To identify specific lessons learned to serve as the basis for recommendations for improvement and continuation of the program; and

- To propose programmatic changes to the grant to reflect current status of the ACCION network and ACCION's strategy of technical assistance.

STUDY APPROACH

Documentation provided by ACCION regarding the program activities was an essential element of the study as was the information collected as part of the interview process. Personnel of ACCION and ACCION affiliates were interviewed. The personnel interviewed at ACCION included staff directly involved in the implementation of the program activities. The personnel interviewed at the affiliates included the institutions' leadership (mid-level management and the Executive Director) as part of the IAF/IDB evaluation.

THEN AND NOW: THE STATE OF AFFAIRS WITHIN THE ACCION NETWORK

Gran Salto[1]

In late 1990, ACCION and its network of affiliates throughout Latin America committed themselves to a substantial scale-up of their operations by adopting a strategy known as the *Gran Salto* (the Great Leap). Many of these organizations had proven that providing credit and other services to low-income urban entrepreneurs was not only possible but effective in terms of poverty alleviation and employment creation. Moreover, several institutions had also shown that their programs could cover operational costs, setting the stage for reaching a substantial number of poor microentrepreneurs who struggled to make a living in the informal economy and who didn't have access to financial sector credit or to business assistance services.

The *Gran Salto* strategy was based on the belief that the sheer size of the informal sector throughout Latin America required the massification of these organizations' programs if they were to have a perceptible impact. The goals of the 5-year *Gran Salto* campaign (1991-1995) were:

- To increase the number of new clients by a total of 748,000;
- To disburse one billion dollars in small loans; and
- To create and strengthen a total of one million jobs.

The *Gran Salto* campaign presented new organizational challenges for ACCION and their affiliates. To manage such rapid growth, capacity had to be developed in the following priority areas:

- Financial intermediation (gaining access to commercial sources of capital to meet the projected demand for credit and defining institutional structures that would allow the affiliates to engage in financial intermediation);

- Organizational development (human resource development, institutional restructuring, and effective internal management systems); and

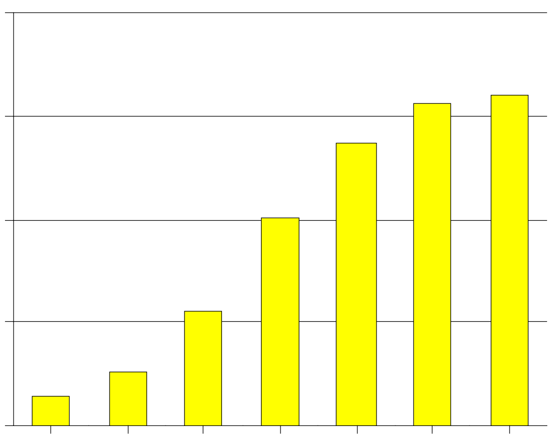
- Methodological and operational innovations.

The Centro Accion Microempresarial (CAM) was created to support the affiliates in developing their institutional capacity, so that they could provide quality services to low income entrepreneurs on a massive scale and in a financially sustainable manner. Additional initiatives were taken by ACCION that were directed at the first activity — increasing access to financial markets — one of which was the LAC grant.

Why Access Financial Markets?

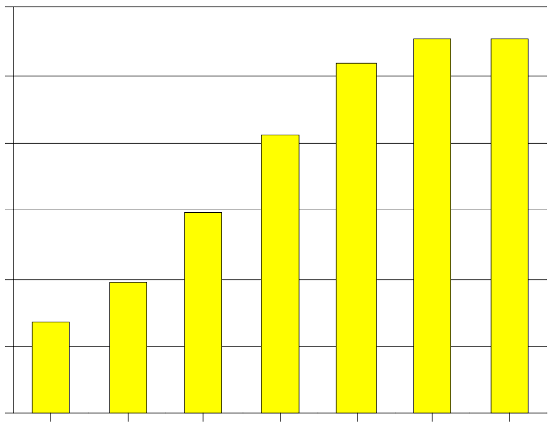
[1] "El Gran Salto. Bridging the Gap with Economic Opportunity" and "Centro Accion Microempresarial: A Program for Urban Employment Generation and Poverty Alleviation in Latin America."

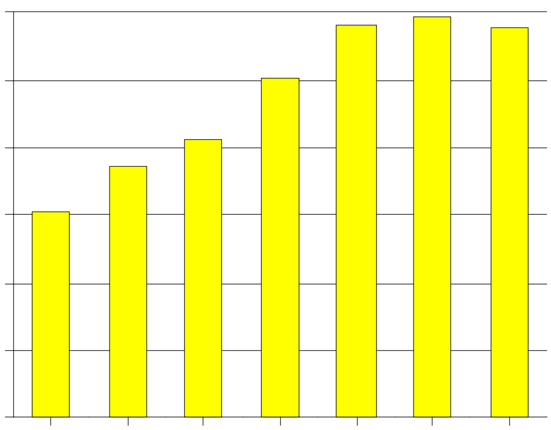
When the *Gran Salto* was launched in 1991, the network was only beginning to shift to commercial sources of funds. By the time the proposal for the LAC Grant was written in 1994, Prodem/BancoSol had undertaken its initiative to create a commercial bank and CorpoSol was well underway with its process of acquiring a finance company (to become known as Finansol). Such institutional transformations were key to funding the rapid growth of these programs. ACCION had reason to believe that the pace of transformation throughout the network would continue as the affiliates scaled up their operations. Their perceptions of the potential funding requirements were not off the mark given the network's overall statistics. The outstanding portfolio grew from US$13.8 million in 1990 to US$137.3 million by 1994 — a tenfold increase in four years[2].



The growth in the outstanding portfolio was quite rapid due to: growth in the number of active clients; increasing loan amounts; and longer loan terms. The latter two factors are key elements of the methodology successfully utilized by ACCION — that is, larger loan amounts and longer loan terms for repeat borrowers who repay their loans on time, when warranted. The graphs below reflect the trends in both active clients and average loan amounts. Active clients within the network grew from 68,423 in 1990 to a total of 258,922 in 1994, while average loan amounts within the network increased over time from a base of US$304 in 1990 to US$582 in 1994.

[2] These amounts include the portfolio of organizations that are no longer ACCION affiliates, but were at that point in time (e.g. ADEMI of the Dominican Republic).

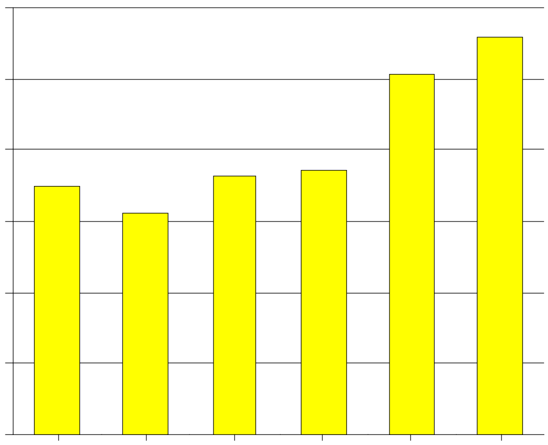




If these trends were to continue throughout the life of the LAC Grant, it would seem logical that alternative financing mechanisms would be required to fund such explosive growth. However, as can ben seen from these same graphs there has been a dramatic leveling off in the growth rate of active clients, average loan amounts and outstanding portfolio in 1995 and 1996.

Current Issues and Concerns of Affiliates

The leveling off is undoubtedly related, in part to the problems the affiliates have had with respect to **client desertion**. ACCION's affiliates, like nearly all other microfinance service providers has experienced difficulty in retaining clients.



The annual desertion rate[3] of the network has ranged from a low of approximately 31% in 1992 to a high of approximately 56% in 1996[4]. While the average annual desertion rate during the five year period was approximately 40%, there has been a marked trend upward in 1995 and 1996.

In absolute terms, more than 676,000 new clients entered the network from 1991 to 1996[5]. Yet active clients only increased by 207,899 — equivalent to 30% of the clients entering the network. Only a small portion of this is attributable to the loss of affiliates from the network. The problem with desertion is not limited to the Finansol crisis either. Emprender (Argentina), Prodem (Bolivia), FENAPE (Brazil), Propesa (Chile), Cooperative Emprender (Colombia), Finansol (Colombia), AVANCE (Costa Rica), FED (Ecuador), Genesis (Guatemala), FAMA (Nicaragua), ACP (Peru) and US programs all had desertion rates in excess of 40% during 1996. With the exception of Chile, Guatemala, and the US, the desertion rates of these programs were in excess of 50%.

In some situations, occasionally high desertion rates are not necessarily a bad thing (e.g. when the program kicks out the delinquent borrowers). However, it is clear that there are some serious issues that the institutions are grappling with — competition, adequacy of methodology and products, and macroeconomic environment.

- *Competition*. More than ever, the affiliates are facing competition from the marketplace, and not just from other donor dependent NGOs. Commercial banks and finance companies are increasingly providing financial services to the microenterprise sector. When the grant was written in 1994, the potential for competition or the idea that markets would one day mature seemed remote.

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[3] Annual rate of desertion: $\frac{\text{beginning active clients + new clients - ending active clients}}{\text{beginning active clients}}$

[4] Adjusting for the withdrawal of ADEMI, the desertion rate in 1995 was 47.7%.

[5] If adjusted for the withdrawal of ADEMI and the AsoMicro group in Ecuador, then the number of new clients would be approximately 650,000

- *Methodology*. The credit products that may have been appropriate for first time clients have not proven to be appropriate to clients needs over time. For example, the solidarity group methodology is very effective in assuring high repayment rates. However, once clients are burned, they are less reluctant to guarantee repayment of other clients in the future (particularly when there are restrictions on group size and this implies the addition of new borrowers to the group). The solidarity group guarantee has also been limiting for those businesses experiencing significant growth (e.g. other group members may be reluctant to guarantee larger loan amounts).

- *Macroeconomic Environment*. Selected countries have experienced macroeconomic instability during 1995 and 1996 that contributed to both voluntary and involuntary client turnover. In some cases it was due to internal economic and political crises (e.g. Ecuador) and others it was due primarily to spillover effects from the "Tequilazo" (e.g. Guatemala and Argentina).

The affiliates are taking a step back and taking a renewed look at their customers — not only to minimize desertion, but to make the process of attracting new clients more effective and efficient. There are a lot of questions that they do not yet have the answer to, but must consider if they are to consolidate their operations and move forward towards institutional transformation, such as:

- Do the potential clients not approach the institution in greater numbers because they are unaware of the credit products being offered or is it because the products being offered do not respond to their needs?

- What is it about the products that do not respond to the clients evolving needs?

- What is it about the product or service that makes some stay on as clients?

- Are those that stay on fundamentally different than those that leave (e.g. more successful businesses)?

Institutions such as Prodem (Bolivia), Genesis (Guatemala), FAMA (Nicaragua), ACP (Peru), all of which have long term plans to transform to more formal financial institutions (e.g. Private Financial Funds in the case of Prodem and commercial banks in the case of the other three), have to come to terms with how to meet their customers' needs. **Until such time that they minimize desertion and improve the effectiveness of attracting new clients, growth will be sluggish. Hence the need for institutional transformation (so as to have greater access to commercial sources of funding) will be diminished.**

While new product development and marketing are at the top of the list of issues to be addressed prior to undertaking institutional transformation, other major issues that continue to occupy much of management's time and efforts are developing the institution's capacity to manage growth (organizational and staff development) and improving operational efficiency. *Professionalizing* the institution's operations — namely, developing senior management's capacity in portfolio management, financial management, organizational and staff development, and new product development and developing middle management's supervisory capacity — is critical to this process.

Reducing the level of administrative expenses in relation to the outstanding portfolio has also occurred at a slower than expected pace. While there is a substantial body of knowledge within the network on strategies and performance indicators aimed at increasing productivity at the field officer level, very little is known on how to improve efficiency in the "back office" operations. As a result, many of the affiliates continue to have administrative expense ratios in excess of "best practice" levels — between 15 and 25 percent of the average outstanding portfolio.

THE LAC GRANT[6]

Goal

"The goal of the project is to advance the capacity of microenterprise institutions to reach greater scale by becoming specialized financial institutions." To that end, the project supports ACCION in its challenge of transforming non-profit organizations to formal financial entities capable of accessing financial markets on a commercial basis by:

- Providing technical assistance to emerging financial institutions;
- Improving the capacity of these institutions to access capital from financial markets; and
- Addressing key policy areas related to the legal, supervisory, and regulatory environment in which these institutions operate.

Project Components/Activities

The components of the project include: technical assistance in accessing financial markets; enhancing the capacity of the bridge fund by expanding the loan loss reserve; and policy dialogue.

Technical Assistance in Accessing Financial Markets. ACCION provides its affiliates the necessary technical assistance to access commercial financial markets and to develop the internal capacity to interact with the players of the commercial financial market including, but not limited to, bond underwriters, rating agencies, investment bankers and portfolio managers.

To that end, this project funds, in part:

- Business plans;
- Technical assistance in issuance of financial instruments such as bonds, certificates of deposits, and equity; and
- Research and development initiatives in areas such as securitization, derivative instruments and innovative uses of guarantees, among others.

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[6] References to the project are drawn (in most cases verbatim) from the proposal "Accessing Financial Markets: The Next Phase of Microenterprise Development, April, 1994

Bridge Fund Loss Reserve. The Bridge Fund, ACCION's guarantee vehicle, has played an important role in the financing of the affiliates loan portfolio. At the time of the proposal, 14 programs in 9 countries utilized the Bridge Fund.

This project funded an amount of $300,000 to the fund's loan loss reserve to enable it to meet the growing demand from the affiliates as well as to support ACCION's plan to gradually increase the loan loss reserve from 5% to 10%, given that the *Gran Salto* goals were ambitious and potentially riskier.

Policy Dialogue. This project component supports the engagement of policy makers — particularly, supervisory agencies and bank regulators — in discussions about policies from the perspective of how these apply both to microenterprise lending and to the creation of specialized financial institutions.

Among the activities to be funded were:

- Policy essays;
- Direct policy dialogue with policy makers through affiliate institutions;
- One two-day conference; and
- Cross-fertilization visits for sector leaders and government officials.

Countries/Programs

First Tier — most prepared to undertake financial intermediation and to access financial markets.	*Second Tier* — slightly lower level of development but moving in direction; and countries where experiences in financial markets are advanced and provide learning opportunities.
Bolivia (BancoSol)	
Colombia (Actuar/Finansol)	Mexico (ADMIC)
Dominican Republic (ADEMI)	Argentina (Emprender)
Ecuador (FED)	Chile (Propesa)
Paraguay (Fundación Paraguaya)	Nicaragua (FAMA)
Guatemala (Genesis)	Peru (ACP)

CHAPTER TWO

TECHNICAL ASSISTANCE ACTIVITIES

GENERAL

The LAC Grant, together with multiple other sources of funding, enable ACCION to support its network of affiliates in developing their capacity to manage large scale microfinance programs in a financially sustainable manner. Neither ACCION nor the affiliate can claim all of the credit (or culpability) for the results: they function as a team. Notwithstanding, to the extent that the ACCION network demonstrate capacity to manage growing and healthy portfolios in a financially sustainable manner, such success can be attributable, at least in part, to the support provided by ACCION.

ACCION's **impact has been particularly noteworthy at the institutional strategic level**. However, such impact has not been necessarily attributable to the specific activities funded under this grant, rather it is attributable to the range of services and vision provided by ACCION over time (not just since December, 1994 when this grant became effective). For example, when the *Gran Salto* was launched in 1991, the network was only beginning to shift to commercial sources of funds. Now **nearly all of the affiliates intermediate commercial sources of funds: programs in Bolivia, Colombia, Peru and Paraguay have accessed funds from their national capital markets**. In 1991, there was talk of financial self-sufficiency, yet none of the affiliates had achieved it. Only a handful of the affiliates were barely achieving operational self-sufficiency. Now the affiliates have a clear idea of how to achieve financial sustainability and they are making serious strides at improving operational efficiency. The result: **9 of the 18 affiliates are financially self-sufficient[7].**

Portfolio quality has also been managed and maintained.[8] Late payment rates for the network as a whole have consistently been below 5% since 1992 — at December 1996, 11 of the 18 affiliates in Latin America had late payment rates of less than 5%: only 4 programs had late payment rates greater than 10%— Finansol (Colombia), Actuar/Tolima (Colombia), ADMIC (Mexico), and AVANCE (Costa Rica). The **global portfolio-at-risk rate is estimated to be slightly less than 10%**. However, 6 of the 18 programs in Latin America had portfolio-at-risk rates in excess of 10% — the four previously mentioned plus FUNDAP and GENESIS (both in Guatemala). This would appear to be somewhat excessive. However, comparable statistics are not available for the vast majority of programs around the world, so it is difficult to gauge whether it is truly excessive.

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[7] Using the more stringent adjustment criteria of the CAMEL — namely loss provisions that are even more stringent than those of the regulatory agencies — only 7 are financially self-sufficient. The other 2 are very close, but not quite there yet.

[8] Since the inception of this grant, there has been a change in arrearage ratios used. In the earlier years, the late payment rate (payments in arrears greater than 30 days divided by the outstanding portfolio) was used. Now, the more conservative measure used by banking authorities, the portfolio-at-risk rate (principal balance of loans with payments in arrears greater than 30 days divided by the outstanding portfolio) is used by most of the institutions. Some institutions track both, but BancoSol, for example only tracks portfolio-at-risk data. Notwithstanding, some conclusions could be drawn regarding the statistics since, by definition, the portfolio-at-risk rate must be greater than the late payment rate.

BUSINESS PLANNING

Effective business planning which is market driven — that is, based on an assessment of the market and the institution's targeted market share — is essential to successfully managing growth. ACCION actively supports the affiliates in developing their capacity to prepare comprehensive business plans.

For the first business planning exercise at an affiliate, ACCION personnel (typically ACCION's Executive Director or the Vice President of Latin America Operations) meet with senior management to discuss the business planning process and the issues which need to be addressed. Particular attention is paid to the multitude of financial and operational consequences of rapid growth. From there, the affiliate assumes responsibility for preparing the draft plan. ACCION personnel guide them through the process and provide them with feedback and assistance, as needed. ACCION's feedback and hands-on assistance is supplemented with a business planning manual.

As per the proposal, by 1996, **business plans were to be implemented throughout the countries in the first tier programs and several in the second tier**. Through 1996, **ACCION had in fact, exceeded all targets as they have provided assistance in business planning to all of the first and second tier country programs as well as other programs not originally designated as potential recipients** (those designated in italics). The only exception was the first tier affiliate that withdrew from the network in 1995 (ADEMI in the Dominican Republic).

RECIPIENTS OF TECHNICAL ASSISTANCE IN BUSINESS PLANNING

The business planning services have been ranked as one of the most valuable services by several of the affiliates. According to the Executive Directors, the business planning process has revolutionized their institutions. It has forced them to focus on both the external environment, and on the internal implications or tradeoffs of growth strategies. The institution's options in many critical areas were examined (e.g. accessing financial markets, decentralizing operations, developing new services and financial products, making key structural or legal changes, designing human resource development strategies, achieving profitability, etc.)

Some commented that they previously had action plans, but they did not consider competition and they were not very rigorous. Very few numbers were involved: desertion rates were not taken into consideration, funding sources required to finance projected growth were not identified, and so forth. Whether or not the institution met their projected targets (e.g. FAMA) or whether or not they completed their business plans (e.g. Propesa), they believe that they have learned a lot from the experience. In the case of Propesa, for example, the initial technical assistance in business planning unleashed a major debate at the board level as to the future role of Propesa in light of major competition from the commercial banking sector. The document itself was never prepared. However, the process forced the institution to begin to come to grips with the issues that it faced.

In a the case of BancoSol and Finansol, the nature of technical assistance was not directed in the preparation of an actual business plan. In the case of BancoSol, assistance in strategic planning was provided primarily via. ACCION's President and CEO's role on the Board of Directors — Michael

Chu is currently the Chairman of the Board. A strategic plan was prepared, but not one modeled from the traditional business plan. In the case of Finansol, extensive support was provided in strategic planning, but for the preparation of the offering memorandum, and not a traditional business plan.

ACCION has noted that the demand for business planning services has been strong throughout the network: only AVANCE did not demand support in this area, but they are not a subject to this grant. In fact, ACCION has not been able to meet the demand as quickly as they would have liked due to human resource constraints. ACCION's President and CEO, Michael Chu, brings much experience and insight to the business planning process, particularly in the institution's first planning exercise. He generally wishes to be involved, and while he makes every effort to do so, his time is limited. The extended vacancy of the Director of Financial Analysis position (of the CAM office in Bogota, Colombia) has also complicated matters. The effects of the vacancy were mitigated somewhat when CAM hired an individual responsible for business planning. However, her time is also somewhat constrained as she is part of the CAMEL team.

ISSUANCE OF FINANCIAL INSTRUMENTS[9]

Under the project, ACCION provides technical assistance to the affiliates in the emission of debt in various forms (interbank loans, senior bank facilities, notes and bonds, private or public, subordinated, convertible, etc.) or equity (common or preferred). This support is as a consultant in the design of both the overall financing plans and the specific obligations, the analysis of proposals and the negotiation of terms and conditions.

The primary activities supported or carried out by ACCION in this regard — funded in part by the LAC Grant — are detailed below.

Placement of Debt in International Capital Markets

ACCION has been working on two primary initiatives with regard to placing debt internationally.

- During the life of the project, ACCION has been assisting BancoSol in the placement of certificates of deposits to U.S. and European investors. **As of December, 1996, the cumulative amount outstanding was US$2,096,000**.
- Efforts to establish a Special Purpose Corporation (SPC) to purchase up to $5 million in BancoSol's two year time deposits were initiated (e.g. working with legal counsel to determine the proper structure and venue for the SPC, etc). Conceptually ACCION will provide subordinated debt and possibly equity to the SPC: other financial institutions such as Bank of Boston indicated their interest in participating in the SPC as either subordinated or senior lenders.

This effort was suspended for the time being for two primary reasons. First, BancoSol does

[9] Some of the information in this section has been drawn directly from ACCION's internal documents.

not currently require funding from the SPC given that the Bolivian government has recently launched several initiatives that provide below market funding to microfinance intermediaries. Second, the legal costs associated with establishing the SPC as well as the rating costs are quite high and raise the average cost of funds to unacceptable levels given the relatively limited volume of funding required at this point in time.

Placement of Debt Instruments in National Capital Markets

ACCION has been providing assistance to its affiliates either exploring the possibilities of issuing debt or actually engaged in the process of issuing debt.

- In July, 1995, Fundación Paraguaya successfully placed bonds into the Paraguayan stock market (the US$150,000 issue was fully subscribed in less than 10 minutes). This issue was not guaranteed and the rating was based solely upon the CAMEL evaluation[10] carried out by ACCION in March 1995.

- As of December, 1995 and 1996, nearly 100% of Finansol's portfolio was funded by financial instruments issued into the financial markets (certificates of deposit). During the same period, 85% and 91% of BancoSol's respective portfolio was funded by financial instruments issued into the financial markets (savings deposits, certificates of deposits, and bonds).

- Preliminary discussions have been held with Genesis (Guatemala) regarding a bond placement: the institution has authorization to issue bonds up to the amount of its operating costs. However, given that Genesis has access to 12 different lines of credit, and is not constrained by a lack of funding, there is currently no real sense of urgency. The necessary groundwork for when financing is needed is merely being laid.

Placement of Equity

ACCION's primary activity in this regard has been its intensive support in the intervention and recapitalization of Finansol. With the assistance and collaboration from both the private and non-profit sectors, ACCION developed and implemented a recovery plan. To ACCION's dismay, the implementation did not go as planned.
Citibank's Colombian brokerage affiliate was to sell in a private Colombian equity placement Finansol's equity shares in September, 1996. The participation of Citibank Colombia as both investor and equity placement agent was to mark the first time that a premier world financial institution partnered with a microfinance NGO to restructure a microcredit organization and assume an ownership position. As such, it was to be a further milestone of the integration of microfinance into mainstream capital

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[10] The CAMEL is the financial analytical tool utilized by ACCION to diagnose the financial and operational health of the affiliates and prepare them for integration into their national financial markets. It draws upon the financial analytical tools used to assess commercial banks, but has been modified to reflect the nature and realities of microfinance intermediaries. The areas of analysis include: **c**apital adequacy, **a**sset quality, **m**anagement, **e**arnings, and **l**iquidity. While the analysis is primarily quantitative in each of the areas (with the exception of management), many qualitative aspects are assessed.

markets. The confidence that ACCION placed in Citibank, unfortunately was misplaced. Citibank, by all accounts, failed in the placement in part due to poor timing — at the onset of market recession downturn and the Samper political crisis — and in part due to overoptimism and over reliance upon their personal connections.

At the end of the day, Finansol was recapitalized, but it was Instituto Fomento Industrial (a government entity) and PROFUND (a quasi donor funded investment firm) that saved the day. The governmental owners of the majority of Finansol shares arrived at this position most reluctantly. They had loans outstanding that Finansol was unable to repay on schedule. If Finansol's capital position was not improved, the institution would have been closed down by the Superintendency, and most of Finansol's portfolio would have become unrecoverable in the process. Thus, for the governmental creditors, their only practical alternative was to capitalize much of this debt, and hope that future profits make it possible to retire their outstanding advances to Finansol. Government ownership in Finansol is not viewed as desirable by either Finansol or the government. The recapitalization of Finansol is highlighted in the box below.

Institutional Transformation Initiatives

Since the inception of the project, no additional ACCION affiliates have undergone the transformation process. Notwithstanding, ACCION has been supporting additional initiatives related to: transforming NGOs into formal financial sector institutions and working with formal financial institutions to move down market.

- ***ACP*** initiated its process to transform into an EDPYME (Entidad de Desarrollo para la Pequeña y Micro Empresa): authorization from the Peruvian Superintendency of Banks was received in August, 1996. Subsequent to such authorization, there has been a change in plans: ACP now intends to convert into a Bank. Apparently, the Peruvian government was set on creating a ***Mi Banco*** not a ***Mi EDPYME***. After meeting with ACP, it was tentatively agreed that ACP should consider becoming *Mi Banco*: the government would be represented on the Board with voice but no vote. The conversion should be completed late 1997/early 1998. Capital requirements for a commercial bank are S/. 14.9 million (approximately $US 6 million): ACP's capital at December, 1996 was approximately S/. 22 million. ACCION had a strong participation in making this deal happen. As ACP moves forward in it transformation process, ACCION expects to work with them on a number of fronts, one of which will be to develop their financing strategies (e.g. get their paper rated, etc.).

- ***Genesis*** has also shown interest in transforming to a commercial bank. The decision to transform to a commercial bank appears to be based on the desire to take advantage of the political will currently in existence, not to mention a matter of image. A finance company would more than suit their purposes, given that Genesis is not likely to accept savings: the reserve requirements on deposits in Guatemala are approximately 34%. Furthermore, Genesis is generally under leveraged, and as noted above, does not appear to have funding constraints in the near to medium term. Genesis has begun to take the necessary steps to convert to a commercial bank. One key step was to separate legally from FUNTEC, the Guatemalan NGO of which it was a division. The transformation to a financial institution should be completed late 1998.

- ***FAMA*** also has a vision of one day becoming a formal financial sector institution.

Their board members have initiated contact with high level policy makers and regulators to explore such options. In addition, they have requested ACCION to become a part of their committee to examine the creation of a financial intermediary. In the near term, FAMA has access to substantial donor funding, thereby obviating the need to otherwise transform or access commercial capital markets.

· ***FUNADEH***, an NGO in Honduras with an eye set on one day becoming a formal financial institution has been the recipient of technical assistance from ACCION for the past year. Last month, they were admitted to the ACCION network. The process of transforming into a finance company is underway and should be completed mid 1998.

Assisting Formal Financial Institutions in Moving Down Market

During the past year, ACCION has added a new dimension to its strategy — namely, linking with existing formal financial sector institutions interested in moving down market. The first institution of this kind requesting ACCION's assistance has been BancoSolidario of Grupo ENLACE in Ecuador. BancoSolidario (formerly a finance company that recently transformed into a commercial bank) has begun to move down market to the microenterprise sector. Such a strategy, while quite promising is not without its challenges, particularly when the institution is driven by short term profitability objectives.

In summary, by the end of year 2, it was estimated that three affiliates would access financial markets on a commercial basis (excluding conventional bank loans). This target, in fact, was achieved. The estimated amount of the portfolio to be funded by financial markets on a commercial basis in the project proposal was 30% by the end of year 1 (December, 1995) and 40% by the end of year 2 (December, 1996). It is unclear if this relates to the portfolio of only those affiliates accessing capital markets or to the total portfolio of the network as a whole. If it's the former, ACCION's affiliates clearly exceeded the target: if its the latter, they fell somewhat short, coming in at a level of approximately 34%[11].

RESEARCH AND DEVELOPMENT INITIATIVES[12]

Under the project, ACCION is to carry out research and development efforts in areas such as securitization, derivative instruments and innovative uses of guarantees, among others. Since there had been little experience in this area as related to the microenterprise field, the research and development was intended to advance the learning curve and the practice in this field.

Securitization

[11] This amount does not take into consideration the amount of "commercial sources" of equity raised by Finansol and BancoSol, nor does it include any sources of funding from BancoSolidario in Ecuador.

[12] Some of the information in this section has been drawn directly from ACCION's internal documents.

ACCION has been actively pursuing securitization initiatives within the network throughout 1995-1996. Securitization offers an alternative model for expansion of microcredit institutions that does not require that the institutions become banks or finance companies to access the financial markets directly.

In **Ecuador**, ACCION created an SPC in Ecuador for potential securitization (named ACCISOL). The concept was for ACCISOL to dedicate itself to the purchase of microenterprise loan portfolios. ACCISOL was to fund itself through the issuance of corporate debentures into the Ecuadorian market and service such debt with the payment stream of the assets it acquired from the microenterprise lending institutions. In order to maximize the acceptance of the ACCISOL's debt in Ecuador's financial markets, the securities were to be backed by a structure that would ensure top investment grade quality including 1) a strong equity base of approximately US$ 2 million; 2) reserves held by ACCISOL several times larger than the technically-verified default rate of its loan portfolio; and 3) a clean balance sheet comprised of only one asset of a known quantity (microenterprise loans). ACCISOL's paper was expected to be highly rated by one of the two major Ecuadorian rating agencies and ACCISOL was to be registered in Ecuador's stock exchange. Ownership of ACCISOL was by ACCION and INVESTBAN C.A. an established financial sector institution. The brokerage arm of INVESTBAN (Investbolsa), a well established securities broker, was to undertake the role of introducing ACCISOL's paper to the Ecuadorian capital market. INVESTBAN's commercial bank (Unibanco) was to administer ACCISOL thereby minimizing expenses.

Unfortunately, this initiative never got off the ground, because ACCION's affiliate, FED withdrew its support of initiative late in the process. FED is the largest and most successful microcredit institution in the country and when they withdrew, there were no other suitable institutions capable of filling the void[13]. ACCION recently started working with another partner (BancoSolidario of Grupo ENLACE), however the prospects of them ever using the securitization mechanism would appear to be slim given some of the basic underlying prerequisites for such initiatives (described below).

- Securitization represents an alternative model for expansion of microcredit institutions that does not require that the institution become a bank or finance company to access the financial markets directly. However, while conversion to a bank or a finance company is not required, the **internal organizational transformation must still occur** if it is to continue growing a healthy and sizeable microcredit portfolio. The transformation process of a growing institution often involves changes. Such changes— namely the loss of control that accompanies the need for increasingly sophisticated and professional management — threatened the management of FED.

  ENLACE, on the other hand, was already a finance company beginning to move down market to the microenterprise sector while at the same time undertaking to become a bank — Banco Solidario. Such conversion was not based on underlying economic rationale, rather it was primarily because ENLACE wanted to take advantage of the temporary window of opportunity that presented itself in the Ecuadorian regulatory environment (e.g. easing of regulatory and capital requirements).

[13] The consultant has worked extensively with all of the other principal microcredit institutions in Ecuador, including ENLACE, and has first hand knowledge of each of these institution's operations.

· The primary purpose of securitization is to get the assets off a growing institution's books so as to keep the institution from being over leveraged. FED basically fulfilled this condition, in that its portfolio had been growing and it was becoming over leveraged. In BancoSolidario's case, the conversion, together with revised minimum capital requirements, resulted in the situation where they are so overcapitalized, that their problem is building up their asset base — not getting the assets off their books.

· Other issues that affect securitization of microfinance portfolios in varying degrees depending on the structure of transaction and the country context include: 1) conformity of loans (e.g. most loans do not conform to specific terms); 2) prepayment and packaging issues, particularly given that microfinance loans are relatively short term and would require extensive substitution; 3) lack of really good data on recovery of loans that attests to history; and 4) lack of mature capital markets in countries where ACCION has promising programs.

ACCION is now exploring potential securitization with their affiliate Emprender in **Argentina**. Banco Privado, a small private investment firm in Argentina, has agreed to structure the securitization transaction for Emprender. Preliminary recommendations of the bank are to proceed with trial securitization transactions utilizing a trust structure with the securities placed being trust certificates instead of debentures issued by an SPC. The first transaction is expected to be completed in 1997.

Initial research is also being conducted in Bolivia: ACCION recently hired a capital markets consultant to begin researching the legal issues and constraints involved in structuring securitization transactions.

Derivative Instruments

ACCION has pursued no activities in this area to date.

Innovative Uses of Guarantees

While there has been no activity in this particular area, Genesis, ACP and Fundación Paraguaya are all potentially interested in using Bridge Fund letters of credit to guarantee future bond issues. As noted above, Fundación Paraguaya successfully completed a small bond issue and is contemplating another bond issue. However, given that their operations have been small and growth has been stagnant since 1991 — their focus has been on restructuring and consolidating their operations — the immediate prospects of a second issue for a substantially larger amount that would require utilizing the backing of a Bridge Fund Letter of Credit are low. Genesis already has authorization to issue bonds in the amount of their operating costs, so the probability of them requiring the innovative use of guarantees would also appear low. While ACP has yet to define its funding strategy as it undergoes transformation , they do seem to be a prospect for taking the lead on some innovations.

By the end of year 2, it was estimated that two research and development initiatives would have been undertaken. While two initiatives have been undertaken (securitization in Ecuador and Argentina) neither has yet to result in actual transactions taking place.

CHAPTER THREE

BRIDGE FUND LOSS RESERVE

The Latin America Bridge Fund was established by ACCION in 1984. It is funded by loans from a number of foundations, private investors and religious organizations. The Bridge Fund operates by providing guarantees on loans made by local commercial banks to ACCION affiliates. Given that the fund shares much of the risk in extending loans to the affiliates, the Bridge Fund induces commercial banks to enter into business relationships that they may not have otherwise. Typically, first time loans by commercial banks are guaranteed up to 90% by the Bridge Fund. Over time, as the relationship between the affiliate and the bank develops, the percentage guaranteed may drop progressively. In some cases, the guarantee has been eliminated altogether.

ACCION maintains three layers of protection to the Bridge Fund:

- Each affiliate maintains a loan loss reserve equal to a minimum of 2% of the outstanding microenterprise portfolio;

- The Bridge Fund itself maintains a loan loss reserve equal to a minimum of 5% of the outstanding letters of credit; and

- All loans made to the Bridge Fund are pooled with each investor sharing a proportional burden of the risk (to date, no investors in the Bridge Fund have suffered any losses)

The loan loss reserve of the Bridge Fund is the subject of this grant agreement: the loan loss reserves are funded by grants from foundations, individuals, and donors (e.g. USAID). At the time of the proposal, the loan loss reserve was capitalized at $315,629. This project was to fund an additional amount of $300,000 to the fund's loan loss reserve to enable the Fund to meet the growing demand from the affiliates as well as to support ACCION's plan to gradually increase the loan loss reserve from 5% to 10%, given that the *Gran Salto* goals were ambitious and potentially riskier.

At the time of the proposal, 14 programs in 9 countries utilized the Bridge Fund. Demand for the fund was projected to increase substantially as the affiliates scaled up their programs and moved toward transformation: it was projected that by the end of 1997, 11.2 million in letters of credit would be outstanding. Thus, the loan loss reserve would have to be increased by more than $800,000 ($300,000 from USAID and $500,000 from other sources).

Not surprisingly, as noted above in Chapters One and Two, growth in the affiliates was much slower than expected, thus the projected demand for the Bridge Fund did not materialize. Moreover, with the crisis of CorpoSol/Finansol, for example, actual reductions in letters of credit occurred. Thus, **the volume of letters of credit outstanding decreased by approximately 37% from year-end 1994 to year-end 1996 rather than doubling in size as projected**. The table below reflects the level of letters of credit outstanding as well as the level of portfolio that it backed and the resulting leverage factor.

The additional funding of the loss reserve (e.g. from donations and operational surpluses.) was approximately $720,000 or approximately 90% of what was estimated. However, given that the affiliates demand for funding did not increase, the result has been that the ending balance of the reserve in relation to letters of credit outstanding was approximately 15% — a level higher than projected at the time of the proposal even after the significant losses absorbed as a result of the CorpoSol/Finansol crisis. The current strategy is to increase the loss reserve over time to a level sufficient to absorb the failure of two borrowers at any point in time. Given that the concentration limit is $1 million, this could potentially mean a loss reserve of $2 million — at December, 1996 the letters of credit outstanding to the two largest borrowers totaled $1.9 million. The table below provides details on the status of the loss reserve. The ending reserve balance at December 31, 1996 was $573,676, of which $321,856 pertained to the LAC grant.

BRIDGE FUND LETTER OF CREDIT VOLUME

Country	1994			1995			1996		
	L/C Outstand.	Portfolio Backed	Lev.	L/C Outstand.	Portfolio Backed	Lev.	L/C Outstand.	Portfolio Backed	Lev.
Argentina	600	600	1:1	800	800	1:1	1,000	1,000	1:1
Bolivia	850	850	1:1	250	250	1:1	—	—	—
Chile	900	900	1:1	1,000	1,000	1:1	900	900	1:1
Colombia	2,252	6,664	3:1	2,453	7,570	3.1:1	579	1,532	2.6:1
Costa Rica	100	100	1:1	100	100	1:1	96	96	1:1
Ecuador	1,050	1,050	1:1	1,050	1,050	1:1	600	600	1:1
Mexico	100	200	2:1	—	—	—	—	—	—
Paraguay	200	400	2:1	300	600	2:1	—	—	—
Peru	200	500	2.5:1	738	1,844	2.5:1	738	1,844	2.5:1
TOTAL	**6,252**	**11,264**	**1.8:1**	**6,690**	**13,214**	**2:1**	**3,912**	**5,972**	**1.5:1**

BRIDGE FUND LOSS RESERVE

Year	L/Cs Outstanding	Loan Loss Reserve				%Reserve to L/Cs	Losses to Ave. L/Cs
		Beginning	Inflows	Losses	Ending		
1994	6,251,527	315,629 [1/]	30,424	60,000 [2/]	286,053	4.6%	1%
1995	6,690,052	286,053	513,947	0	800,000	12.0%	0%
1996	3,912,332	800,000	175,082	401,406 [3/]	573,676	14.7%	7.6%

[1/] Balance reported at time of proposal
[2/] Losses incurred by FADEMI (a member of AsoMicro/CorpoMicro, a former ACCION affiliate in Ecuador)
[3/] Losses incurred by CorpoSol in Colombia

CHAPTER FOUR

POLICY DIALOGUE

The **objective of this component is to examine regulatory and supervisory policies and how they foster the adequate provision of financial services to the poor and to disseminate these findings to policy makers**. The focus of this component will be to engage policy makers in discussions about policies from the perspective of how these apply both to microenterprise lending and to the creation of specialized financial institutions. The **goal will be to inform them of important advances and to explore with them the policy implications these bring**. The emphasis will be to reach supervisory agencies (superintendencies) and bank regulators.

To accomplish the above stated goals and objectives, the following activities were proposed:

- **Five policy essays** focused on topics such as level of risk in this type of lending, monitoring and internal control mechanisms in use, ownership structure of these institutions, and supervisory systems established in some countries;

- **Up to fifteen events of direct policy dialogue** with policy makers through affiliate institutions (e.g. short seminars, working lunches or other events directed at policy makers on the topics covered by the documents);

- **One two-day regional conference** to address issues related to supervision and control of financial institutions and their relationship to the creation of microenterprise financial institutions; and

- **Up to five cross-fertilization visits** per year for sector leaders and government officials to visit relevant institutions in other countries.

The activities of ACCION in this component of the project (funded in whole or in part by this Grant) are detailed below.

REGIONAL CONFERENCE

In November, 1995 ACCION hosted an international conference on regulation and supervision of microfinance. Twenty high level superintendents and regulators were invited to the conference. Superintendents of Argentina, Bolivia, Colombia, Guatemala and Paraguay attended as well as senior officials from Brazil, Chile, Costa Rica, Dominican Republic, El Salvador, Honduras, Mexico, Nicaragua, Panama, Peru and the United States. While a small segment of the conference was limited to the superintendents, the rest of the conference was open to a broader community of donors, practitioners, etc.

The conference was well received among the practitioners, and was also important for ACCION's affiliates, as the conference enabled much more fruitful discussions between the affiliates and the superintendencies. However, the general level of interest among the regulators was relatively lower than what was expected. Notwithstanding, a handful of superintendents were very good and very interested in discussing regulatory and supervisory policies and how they might foster the adequate provision of financial services to the poor (particularly the superintendents of Bolivia and Colombia). Thus a working group was created.

DIRECT POLICY DIALOGUE

The direct policy dialogue that ACCION and its affiliates maintained with the regulators and superintendencies, has been primarily in Bolivia and Colombia, and to a lesser extent in Peru and Nicaragua. Not only are Bolivia and Colombia the two countries that seem to show the most interest in this subject matter, these are the two countries where ACCION's affiliates are formal financial sector microfinance institutions: ACCION's affiliate in Panama, while a regulated institution, has a comparatively small microfinance portfolio in relation to the totality of its operations. Notwithstanding its ongoing involvement with the Bolivian authorities, ACCION has clearly had the most involvement with the Superintendency of Colombia. The Superintendency of Colombia was at the heart of the Finansol crisis that absorbed ACCION so intensively throughout 1996.

It is not an uncommon occurrence for microfinance institutions to suffer “operational” crisis, but such institutions are rarely required to provision for loss reserves in a financially prudent manner as they are not regulated by the superintendency. Moreover, non-regulated microfinance institutions generally have a greater degree of latitude with respect to the timing of its recapitalization. Finansol's management crisis which resulted in a deterioration of its portfolio quality nearly resulted in the institution's closure. The absorption of the provisioning requirements imposed by the Colombian regulators essentially wiped out the institution's equity base. If the institution were not recapitalized in a timely manner the superintendent would have had to intervene.

This experience with the Finansol crisis has taught ACCION a lot about the implications of transforming to its affiliates to regulated formal financial sector institutions. At the same time it has provided some valuable lessons to the regulators— lessons which are continually being disseminated.

POLICY ESSAYS

Originally it was contemplated that consultants would be hired to write five essays (one per year) focused on topics such as level of risk in this type of lending, monitoring and internal control mechanisms in use, ownership structure of these institutions, and supervisory systems established in some countries. It was later decided what was needed was a comprehensive document that laid out the issues. In that regard, **ACCION decided to write and publish a monograph “From Margin to Mainstream: The Regulation and Supervision of Microfinance” that, in a sense, replaced four essays (published in January, 1997).**

- Chapter One introduces how regulation fits within overall financial system reforms and the distinct characteristics of microfinance.

- Chapter Two (written by Robert Peck Christen) synthesizes the issues and constraints of regulating and supervising a microfinance portfolio.

- Chapter Three documents the experience of supervision and regulation of microfinance institutions from the perspective of the Bolivian Superintendent of Banks and Financial Institutions (Jacques Trigo Loubiere).

- Chapters Four and Five document the experience of from the perspective of the institutions being regulated (e.g. BancoSol, ACP, Finansol, MultiCredit Bank, and Caja de Ahorro y Préstamo Los Andes).

ACCION, together with the Micro Finance Network (MFN)[14], have been working on a follow up publication to the monograph "*Regulation and Supervision of Microfinance Institutions: Experience from Latin America, Asia and Africa*". The publication is based on detailed questionnaires of 12 countries and details risks as well as procedures and processes to assess risk in microfinance portfolios. The intended audience for the publication are the superintendencies. At the time of evaluation, this publication was at the printers: its release is expected to be June, 1997.

CROSS-FERTILIZATION VISITS

Such visits by policy makers have not been funded as a separate activity. Cross-fertilization, per se, among leading microfinance practitioners, have occurred as part of the conferences, annual MFN meetings, etc. but these were not funded by the LAC grant.

[14] The Micro Finance Network is a network of 17 microfinance institutions from around the world that are regulated or in the process of becoming regulated. Membership is by invitation only.

CHAPTER FIVE

MONITORING AND EVALUATION

GRANT BUDGET

The total grant approved for the aforementioned activities was $1,444,393 ($1,144,393 approved in December 1994 for the various technical assistance and policy related activities and $300,000 approved in May, 1995 for the loan loss reserve of the Bridge Fund). Of this amount, $1,200,000 has been obligated over the course of the project (see text box).

The amount budgeted to be spent (in the proposal) in relation to the actual amount spent to date is presented in the box below. In the aggregate, ACCION is basically on target with their projections —
they have spent 97% of the total budgeted.

BUDGET	**Cumulative Thru Year Two**		
	Budget	**Actual**	**%**
Salaries and Wages	131,405	178,822	136%
Fringe	32,851	44,705	136%
Travel, Transportation, Per Diem	84,173	50,359	60%
Procurement	56,250	2,720	4.8%
ODCs	61,500	42,264	68.7%
Indirect Costs	57,490	86,281	150%
SUBTOTAL	**423,669**	**405,151**	**96%**
Loss Reserve	300,000	300,000	100%
TOTAL PROGRAM COSTS	**723,669**	**705,151**	**97%**

However, within the various line items there has been substantial variation. Salaries and wages, for example, are being spent at a faster rate, in part due to increased time being charged to the project, and in part due to higher average wages. The faster spending rate of fringe is a function of the spending rate of salaries and wages. Indirect costs are being spent at a higher than budgeted rate, as ACCION is now using an indirect rate of 43.37% on salaries and fringe (per the last obligation) as opposed to the indirect rate of 35% submitted in the original proposal. The overruns are largely offset by savings in procurement (e.g. consultant services) and to a lesser extent ODCs (airfares, per diems, etc.).

No attempt was to match up the spending dollar for dollar to the activities carried out by ACCION given that: a) money is fungible; and b) this was outside the scope of work. Rather, the approach was to examine the overall activities of ACCION (funded by a variety of sources, one of which is this Grant) and assess whether the range of ACCION's activities conformed to the spirit of their grant agreements.

PROGRAM INDICATORS

A comparison of the actual results to the expected results is presented below. As is noted below, there are several issues with the program indicators that need to be addressed to make them clearer and more effective.

· *Category I: Program Growth* is fairly straightforward and not particularly problematic (with the exception of jobs strengthened). What is noticeably absent is the number of **active clients**. As is noted from the table below, the ACCION affiliates of the Tier 1 and Tier 2 programs identified in the proposal generally fell significantly short of the targets. The dramatic leveling off of program growth in 1995 and 1996, as well as the reasons for this, were discussed at length throughout this document.

· *Category II: Program Performance* indicators lack clarity and are essentially meaningless as constructed. A "composite indicator" has little meaning given the diverse nature of the affiliates in terms of size, scope, maturity, etc. The statistics from BancoSol, for example, can dwarf those of several of the smaller programs. Moreover, independently assessing the financial self-sufficiency of each of the affiliates is done through the CAMEL evaluation. The CAMEL's are performed throughout the year on a rotating basis and generally do not have the same cut off date.

A more effective approach might be to set targets for the number of programs to exceed 82% financial self-sufficiency. Operational self-sufficiency has less meaning, but if it is to be used, it needs to be clearly defined. ACCION defines it in a more strict sense in that it is calculated by **excluding only the equity adjustment for inflation** from the financial self sufficiency indicator. Their CAMELs' also take a more strict view of financial self-sufficiency in that it imposes provisioning requirements that are more stringent than those of the regulatory authorities. Most donors and practitioners do not use such strict indicators thus, if the indicators are to serve for broader comparative purposes, clarity needs to be established from the outset.

Using ACCION's more stringent calculation method, performance indicators in this category are as follows:

a/ Of the 10 Tier I and Tier II country programs, 4 programs — Finansol, Propesa, Emprender, and ADMIC[15] — had **operational self-sufficiency** indicators below the target of 97% (as of their most recent CAMEL).

b/ Of the 10 Tier I and Tier II country programs, 3 programs — Finansol, Emprender, and ADMIC — had **financial self-sufficiency** indicators below the target of 82%.

c/ Of the 10 Tier I and Tier II country programs, 4 programs — Finansol, Emprender, FED and ADMIC — had **late payment rates** in excess of the 5.5% target at year end

[15] ADMIC never received a CAMEL, rather it is assumed that they should be included here based on what is known of the program.

1996.[16]

d/ Of the 10 Tier I and Tier II country programs, only FED had **default rates** in excess of the 2% target at year end 1995 (coming in at 5%). During 1996, Finansol, Propesa, and ACP registered losses in excess of the target — 19%, 6% and 3% respectively.

The trends become readily apparent as it is a handful of country programs that are frequently mentioned — Finansol, Emprender, Propesa, and ADMIC (note that the latter three are tier 2 countries).

INDICATORS OF THE TEN TIER 1 AND TIER 2 COUNTRY PROGRAMS

	Year One			Year Two		
	Target	**Actual**	**%**	**Target**	**Actual**	**%**
CATEGORY I: PROGRAM GROWTH						
New Clients (‘000)	120	97	81%	135	72	53%
Women Clients	52%	57%	110%	52%	59%	113%
Amount Loaned (‘000)	260,000	246,771	95%	338,000	247,402	73%
Loan Portfolio Outstanding (‘000)	130,000	114,109	88%	169,000	100,642	60%
Jobs Strengthened	210,000	n/a	---	236,000	n/a	---
CATEGORY II: PROGRAM PERFORMANCE						
Average Loan Size	545	594	109%	600	575	96%
Operational Self Sufficiency	97%	a/	---	97%	a/	---
Financial Self Sufficiency	82%	b/	---	82%	b/	---
Late Payment Rate	5.5%	c/	---	5.5%	c/	---
Default Rate	2.0%	d/	---	2%	d/	---
CATEGORY III: ACCESSING MARKETS						
% Portfolio Guaranteed by Bridge Fund (assumes portfolio of tier programs using Bridge Fund)	13%			15%	16%	107%
# Programs Accessing Financial Markets on Commercial Basis*	2	3	150%	3	2	100%
% Portfolio funded by Financial Markets (assumes portfolio of tier programs accessing capital markets)	30%	85-100%	283-333 %	40%	91-100%	228-250 %
# Research & Development Initiatives	1	1	100%	2	1	50%

* excluding conventional bank loans (note: Fundacion Paraguaya accessed in 1995 but did not maintain its access, by its own decision, throughout 1996. Hence it has not been counted under 1996)

· *Category III: Accessing Markets* presents some intuitive inconsistencies and lacks clarity as well. For example, it is true that an important objective is for the programs to intermediate an increasing amount of commercial funds, one of which is commercial bank loans. Hence one might conclude that the tool used to facilitate this process (e.g. the Bridge Fund) should reflect an upward trend (as is the case in the projected target). However, if one considers that a real measure of success is the institutions capacity to: a) leverage the amount of the guarantee; or b) access commercial bank lines without using the Bridge Fund, then a downward trend might be more appropriate.

[16] While BancoSol does not track late payment rates, its portfolio at risk was 3.4%, hence its late payment rate, by definition, had to be below the target

The lack of clarity relates to percentage of portfolio guaranteed by the Bridge Fund or accessing capital markets. For purposes here, it was assumed that the percentage of portfolio relates only to those affiliates using the Bridge Fund or accessing capital markets from sources other than commercial bank debt (as the case may be) and not the portfolio of the whole group of the Tier 1 and 2 country programs.

Another issue with respect to these indicators is precisely the use of percentage of portfolio funded by financial markets, for example. The institutions have more assets on their books than just portfolio. Simply dividing the debt from financial markets by the total portfolio does not yield a meaningful indicator. Finansol, for example, has debt from the capital markets in the approximate amount of its portfolio, yet in addition, it has other debt outstanding in excess of $2 million. With the fungibility of funds, is impossible to say what's financing the portfolio vs. all of the other assets of the organization. It would be more useful to look at the capital structure of the institution — the totality of the debt and equity from commercial sources.

With the exception of research and development initiatives, ACCION is basically on track.

CHAPTER SIX

LESSONS LEARNED AND FACTORS THAT CONSTRAIN THE ACCOMPLISHMENT OF THE PROJECT'S GOALS

The LAC grant supports ACCION in its forward looking and pioneering initiatives. While much progress has been made and ACCION is clearly at on the cutting edge of the microenterprise field, they are perhaps ahead of their time. In order for them to successfully achieve all of the objectives laid out for themselves, the constraints that they have confronted will have to reduced. The primary constraints to the accomplishment of the goals of the project are primarily the lack of control over the agenda of its affiliates, the affiliates capacity to manage growth, alternative sources of funding, the ineligibility of countries, the legal compliance issues/legal fees, and rating fees.

AGENDA OF AFFILIATES

Perhaps the key constraint not easily set aside are the agenda of the various affiliates. ACCION has found out the hard way, that in the end, it has little control over the affiliates and that ACCION's agenda is not necessarily the agenda of the affiliates. In the 80's the primary challenge was moving institutions from dependence on donor funds to borrowing funds at commercial rates. The Bridge Fund, which was set up to enable such borrowing, sat idle, for all intents and purposes, for a few years, but it was eventually the key for the affiliates accessing commercial sources of funds. It took time for the mindsets to change. Institutional transformation confronts similar challenges: the mindsets of management and the board take time to change. Too many of them resist change as they fear the potential consequences of change.

MANAGING GROWTH

The most common approach to managing growth in the corporate world is through standardization. Once a business has a well-developed product or services, then it develops procedures for standard delivery on a large scale. The standardization approach, while wildly successful, is not without its disadvantages.

For microfinance institutions, standardization has a critical role given the high operating costs and need for large-scale outreach: procedures must be kept simple and highly efficient. Notwithstanding, standardization must be used with caution. The reliance on a standardized loan product exposes the institution to vulnerability, particularly if a competitor introduces a more attractive innovation.[17]

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[17] Churchill, Craig. Draft of "Managing Growth Literature Review". Microenterprise Best Practices: Development Alternatives, Inc.

ACCION's affiliates in a number of countries have experienced first hand this vulnerability. For years, they were growing quite rapidly. The underlying assumption for this Grant was that the affiliates would continue their rapid growth over a longer period of time, that funding would be a primary constraint, and thus, transformation would occur at a more rapid pace throughout the network. The institutions have not been growing and/or progressing towards transformation nearly as rapidly as expected when the proposal was written in 1994. In fact, during the past two years, problems with client desertion have set in. Primary causes —competition, adequacy of loan products to repeat clients needs, and the macroeconomic environment—were discussed above. Another may well be quality of customer service.

Customer service research has determined that it takes five times more money to find a new customer than to retain a present one.[18] Customers who had a bad experience with a firm usually tell at least nine other potential or existing customers. This is particularly critical for microfinance institutions than in other types of businesses for several reasons:

- Most microfinance institutions rely on word of mouth marketing;

- The high cost of acquiring new clients is not recovered until they have borrowed two or even three times;

- Repeat clients are generally less labor intensive, thus a loan officer who retains repeat clients should be able to manage a larger case load and be more productive; and

- One loan is not going to solve the financial problems of a low-income household.

In short, growth begins with customer retention and the integration of a customer service focus into every aspect of the institutions operations.

Other factors noted above, such as developing the institution's capacity to manage growth (*professionalizing* the institution's operations), not to mention governance and accountability issues, have also constrained growth within the network. (Note: organizational and staff development is the focus of the Matching Grant as well as other grants which fund ACCION's and CAM's technical assistance and training operations).

ALTERNATIVE SOURCES OF FUNDING

Another important constraint or factor contributing to the inability to accomplish their objectives includes the ongoing availability of subsidized donor or government resources (Nicaragua, Bolivia) or the abundant availability of conventional financing (Guatemala, Ecuador).

USAID-INELIGIBLE COUNTRIES

[18] Harper, Stephen. The McGraw-Hill Guide to Managing Growth in your Emerging Business. New York: McGraw Hill

As of September, 1996 Colombia was decertified and as of September, 1997 Chile and Argentina will no longer be eligible for support. These countries have the more developed capital markets and as such could provide learning opportunities, particularly in the area of research and development. The inability to work in these countries will constrain the accomplishment of the objectives given that Argentina's and Colombia's programs both could take the lead on some of the more innovative initiatives.

LEGAL COMPLIANCE ISSUES AND LEGAL FEES

The legal compliance issues associated with many of the innovations explored by ACCION are indeed quite substantial. Not surprisingly, as a result, the legal fees and expenses can be quite substantial, particularly if there is insufficient volume of financing to justify such expenses. To date, ACCION has made efforts to ensure compliance for example in the private placement of BancoSol's certificates of deposits and they have been careful to only place them privately with “qualified investors” — namely “socially responsible” investors that have an in depth understanding of ACCION and BancoSol. To offer the certificates of deposit on a larger scale or to create an SPC requires a different standard of compliance, as well as substantially greater legal costs.

Actual research and development also results in substantial legal fees. Most of the issues which need to be explored when assessing the viability or designing the structure of a transaction are legal in nature, and as such require the expertise of lawyers more than the expertise of financial sector expert consultants (the latter was included in the proposal).

In short, high legal costs represent an important constraint to further progress in this area, in part because USAID has been unwilling to fund such expenses (e.g. the funding of lawyers fees were never included in the project, only the honoraria for financial sector expert consultants were.).

RATING AGENCY FEES

The rating fees for the issuance of paper in the markets could potentially result in a constraint as well, until such time that there is a sufficient volume of financing to justify such expenses.

LIMITED INTEREST OF POLICY MAKERS

The impact that ACCION could potentially have on superintendencies and regulators, in all likelihood, was more limited than they might have wished for. ACCION openly acknowledges that they overestimated the level of knowledge and interest existing before the project started. However, the lack of interest has to be put in context of the environment where the superintendencies and regulators operate — namely that they are dealing with far larger issues (e.g. creating or maintaining stability within their financial markets) than those related to microfinance, which in all cases, represents a small proportion of the country's aggregate financial system.

The regulatory and supervisory structures into which microfinance institutions are entering in the mid-1990s are admittedly acquiring new strength, but often are still showing inadequate performance in key areas. In a study conducted by Glenn Westley of the Inter-American Development Bank, supervisory agencies of 11 out of 26 countries given a rating of “Reasonable”: 6 countries needed “Some Overhaul” while 9 needed “Major Overhaul”. [19]

Notwithstanding, governments and regulators from several Latin American countries are showing increasing interest in the field of microfinance, especially now that banks are starting to get involved in the sector. Colombia and Bolivia lead the way with Peru, Chile and Guatemala steadily gaining ground.

[19] Rock, Rachel and Otero, Maria. “ From Margin to Mainstream: The Regulation and Supervision of Microfinance.”Somerville, MA. ACCION International.

CHAPTER SEVEN

RECOMMENDED PROGRAMMATIC CHANGES

EXPANDED SCOPE OF TECHNICAL ASSISTANCE

The current reality of the network suggests that the affiliates require a different type of support than only a few years ago. If ACCION and their affiliates are to continue in their quest of achieving large scale outreach on a sustainable and ***durable*** basis via access to commercial markets, then support beyond that proposed in the original project will be required. Thus, it is recommended that USAID, at a minimum, consider supporting ACCION's new marketing initiative, of which product development and customer service are key components. Such support would not benefit only one country or even just the ACCION network, rather the potential is to replicate such developments to microenterprise programs throughout Latin America and around the world.

USAID might even consider moving beyond the funding of discrete mechanisms such as the business plan or the marketing and customer service activities proposed above and fund a more integrated approach. The affiliates do not require support only in the preparation of their business plans, rather they require support in developing integrated work plans that deal with a range of transformation issues (e.g. what do they have to do to grow, how to manage growth, marketing and product development issues, etc.).

Another area worth considering that would have replication benefits would be to fund some of ACCION's pioneering efforts aimed at streamlining back office operations. While there is a substantial body of knowledge within the network on strategies and performance indicators aimed at increasing productivity at the field officer level, very little is known on how to improve efficiency in the “back office” operations. As a result, the majority of the affiliates continue to have administrative expense ratios in excess of “best practice” levels — between 15 and 25 percent of the average outstanding portfolio.

LEGAL AND RATING FEES

It is recommended that USAID consider funding fees paid to lawyers, rating agencies, etc. which relate to financial innovations. At a minimum, USAID should agree to fund legal fees related to preliminary research and development necessary for evaluating the range of potential options in a country and assessing their feasibility.

EXPANDED SCOPE OF POLICY WORK

While ACCION has accomplished, in a sense, the objective of the policy component — namely examine regulatory and supervisory policies and how they foster the adequate provision of financial services to the poor and to disseminate these findings to policy makers —the need for cross-fertilization visits, for example, is marginal, given the limited interest of policy makers.

USAID might consider using some of the resources designated for such activities to funding policy education and analysis work other than regulation and supervision. There are a range of other issues that need to be addressed, such as the role of governments in microenterprise development (e.g. those that could lead to damaging effects, etc.). Participation in the 1998 Summit in Chile, for example, could ensure that microenterprise development issues stay front and center in policy makers minds and agenda. In that regard, USAID might fund: 1) ACCION's involvement in the Summit's planning; 2) the drafting of issues papers; and 3) workshops or events leading up to the summit (e.g. on topics such as market interest rates).