

IMPLEMENTATION PLAN:

TECHNICAL ASSISTANCE FOR INNOVATIVE PARTNERING IN MICROFINANCE

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List of Acronyms

AGEPMF -	<i>Agence d'Exécution de Projet Microfinance</i>
APEM -	<i>Association pour la Promotion de l'Entreprise à Madagascar</i>
APIFM -	<i>Association Professionnelle des Institutions Financières Mutualistes</i>
CEM –	<i>Caisse d'Epargne de Madagascar</i> (Savings Bank of Madagascar)
CIDR -	<i>Centre Internationale de Développement et de Recherche</i>
CSBF -	<i>Commission de Supervision Bancaire et Financière</i>
DID -	<i>Développement International des Jardins</i>
IQC –	Indefinite Quantity Contract
LOE –	Level of Effort
MFI -	Microfinance institution
MIS –	Management Information System
PAMF -	<i>Projet d'Appui à la Microfinance</i>
PSDR -	<i>Programme Sectorielle de Développement Régionale</i>
RFP –	Request for Proposal
TO –	Task Order
UNDP -	United Nations Development Program
USAID –	United States Agency for International Development

1. Purpose of the Task Order

Through the Financial Services Indefinite Quantity Contract (IQC) mechanism, USAID competitively selected Chemonics International to work on Task Order 815. The Task Order objectives as described in the Statement of Work (see Annex 2) were to provide the analytic information and guidance needed to:

- assist the *Caisse d'Epargne de Madagascar* (CEM) in expanding its geographic coverage through innovative, mutually profitable partnerships, and
- inform USAID about legal and regulatory constraints in the development of commercial microfinance in rural areas as well as alternative approaches and policies for overcoming them.

In order to meet the objectives of the Task Order, Chemonics' team leader prepared this Implementation Plan, which describes the team members, their backgrounds and roles in accomplishing these objectives, proposes a detailed description of the technical approach and provides information on other major donors' current programs and future planned activities in the area of microfinance development. Annex 1 summarizes the key tasks, indicators and results, and proposes a timeline indicating when certain milestones will be achieved and deliverables conveyed to USAID. All deliverables will be translated so as to be available in French and English within a few weeks of USAID/Madagascar's approval and provided in hard copy and electronic formats.

2. The Team

The Chemonics team offers the ideal composition of expertise in microfinance regulation and supervision, rural savings mobilization and USAID project management, and builds on previous relationships built with the CEM on past Task Orders in Madagascar. For the Team Leader, Chemonics selected Anita Champion for her in-depth knowledge of international best practices in microfinance and her three years of field experience in Mali, where the microfinance methodologies and regulatory frameworks are similar to those of Madagascar. As the current Project Manager of the Financial Services IQC and former manager of the two previous TO with the CEM, Ms. Champion has the USAID management skills as well as familiarity with the issues related to this TO. As Team Leader, Ms. Champion will lead the team, which comprises two international Microfinance Specialists and two local Field Researchers, in achieving the TO objectives. She will provide substantive technical input into the identification of potential partners for the CEM to expand its rural savings coverage and will play a key role in overseeing the second component of the TO, the assessment of the legal and regulatory framework for microfinance in Madagascar.

In working with the CEM, Ms. Champion will be supported by a local financial specialist, Mr. Abraham Elison, who will assist in the collection and analysis of information and make sure that recommendations incorporate the Malagasy perspective and culture. Mr. Elison's previous work

on the CEM in developing their business plan in 2001 will greatly facilitate the tasks related to this component of the task order. Mr. Elison will play a key role in drafting the Final Report.

Chemonics has learned through experience on multiple microfinance regulatory reform projects that Central Bank and regulatory officials are much more likely to listen to and implement suggestions that come from others who have worked as regulators in the past. Hence, Chemonics is extremely pleased to have Dr. Jacques Trigo, former Minister of Finance and Superintendent in Bolivia, on the team to conduct the assessment of Madagascar's legal and regulatory framework for microfinance. Chemonics has subcontracted Mr. Thierry Rajaona of FTHM Conseils to support Dr. Trigo's work. Mr. Rajaona's previous work conducting studies related to legal and regulatory frameworks make him well suited to contribute to this assignment. He will conduct field research, contribute to writing the "Position Paper" and make sure that recommendations incorporate the Malagasy perspective and culture.

Annex 1 summarizes the tasks and indicates which of the team members are involved in each. Annex 3 provides a list of project participants, along with their contact information.

3. Technical Approach

The Implementation Plan follows the results framework, which includes the key indicators, tasks, milestones, deliverables and timeline required to complete the TO, as summarized in Annex 1. This section describes the technical approach to be implemented by the team to achieve these results, including a detailed description of the specific activities and tasks that will be conducted and who the team will meet with to collect the requisite information.

3.1. Result No. 1 - The CEM is provided with the guidance and supporting research/analysis needed to undertake commercial partnerships to expand its rural savings outreach.

Since the disruption of the collaboration between the CEM and the Post Office in June 2001, 70,000 clients no longer have access to CEM services. In addition, CEM's branches are generally located in urban areas, making the cost of transport and time required to access CEM services prohibitive for many rural savers. Given that 80 percent of Malagasies live in rural areas, there are both social and commercial reasons for the CEM to be interested in reaching more rural clients.

Ms. Anita Campion and Mr. Abraham Elison will be the key contributors to this component of the project. Together, they propose the following technical approach to achieving Result #1:

1. Assess CEM expansion strategies and objectives. Within the first few days of arrival to Madagascar, the full team will meet with CEM senior management to discuss the objectives of this component of the TO and to gain a better understanding of the CEM's expansion plans, strategies and objectives. This discussion will include an assessment of the CEM's desired target clients, geographical expansion areas and how it plans to balance social and commercial objectives. This information will help the team to focus its efforts on partnership options that best fit within the CEM's current expansion plans.

2. Develop criteria for potential partnering. Ms. Campion and Mr. Elison will work with the CEM, incorporating USAID's suggestions, to develop a list of criteria for identifying potential partners. Potential criteria include:

- unmet demand for savings services
- potential for profitability with proposed partnership
- amount of investment required
- potential for the CEM to maintain control of its operations/reputation
- geographic location and coverage of potential partner
- financial strength of potential partner
- strength of potential partner's management and governance
- complementarity of vision for expansion, institutional culture and infrastructure
- acceptable division of roles and responsibilities and related costs
- types of transactions/products and their volume over time

3. Meet with various institutions to identify potential partners for the CEM. Ms. Campion and Mr. Elison will meet with a variety of institutions in an effort to identify potential partnerships or other options for the CEM's expansion of rural savings services. At a minimum, the team will meet with representatives from the following institutions:

- Post Office – to see on what terms the Post Office would be interested in collaborating again with the CEM on rural savings
- Association Professionnelle des Institutions Financières Mutualistes (APIFM) – to assess strength and market outreach of mutualist MFIs and potential for partnering or competition with the CEM
- Association pour la Promotion de l'Entreprise à Madagascar (APEM) - to assess strength and market outreach of mutualist MFIs and potential for partnering or competition with the CEM
- FENU's Projet d'Appui a la Microfinance (PAMF) – to collect rating information on various MFIs
- Microfinance institutions – to better understand the institution and assess potential interest in partnering
- Central Bank – to understand legal and regulatory constraints to potential partnership options
- Commission de Supervsion Bancaire et Financière (CSBF) - to understand legal and regulatory constraints to potential partnership options
- Bank of Africa – to understand potential for refinancing MFIs

4. Meet with donors to assess their current and future support of rural finance and their potential impact on partnering options for the CEM. Ms. Campion and Mr. Elison will meet with representatives of some of the other major donors in the microfinance sector, including UNDP, World Bank and Association Française de Développement (AFD), to gain a better understanding of their current approaches to microfinance development, collect their opinions on various actors in the sector and to understand how their future interventions might impact the CEM's approach to rural savings expansion. Additional information on donor visits is covered in section 5 of this document.

5. *Collect information and analyze against criteria.* At all the meetings mentioned above, the team will collect information on potential partners and options for expanding rural savings, as well as on environmental factors that could have an influence, whether positive or negative on how the CEM approaches its partnership and expansion initiatives. For analyzing potential MFI partners, the team will use the Consultative Group to Assist the Poorest's "Format for Appraisal of Microfinance Institutions" as a guide, assessing institutional factors, such as human resources and management information systems, as well as market factors, such as client profile and products. In addition, the team will assess financial performance and other due diligence factors, such as the strength of the MFI's strategic planning, management and governance.

6. *Conduct field visits to two rural locations to assess validity of information and conduct a "reality check" on potential options for partnering.* As the Team Leader and the consultant with the broadest institutional experience with rural savings mobilization, Ms. Campion will conduct the initial field visit to Fianarantsoa. This first visit will help her to assess which of the various partnership scenarios are potentially viable and to determine additional factors that could impede implementation of a related pilot project. Either Mr. Elison or Mr. Rajaona will conduct the second field visit to Fort Dauphin in Tulear to further test the applicability of various partnership scenarios there. Visits will include meetings with CEM branch managers, MFI managers and potential rural clients, among others. Based on the findings of the visits, potential partnership scenarios will be adjusted or eliminated.

7. *Draft written recommendations for possible partnerships and/or approaches to expand rural savings.* Once information has been collected and analyzed, Ms. Campion and Mr. Elison will draw comparisons between the various partnership scenarios, based on the institutional types and functional linkages offered, division of responsibilities, potential for profit and outreach, in terms of additional clients, products and services. The strengths and weaknesses of potential partnership scenarios will be highlighted and weighted against the proposed criteria, which will form the basis for recommendations on how the CEM might proceed if its management chooses to pursue such as partnership or rural savings expansion strategy. These recommendations will be compiled in the "Final Report," along with a discussion of the relevant findings of the "Position Paper" on legal and regulatory framework that could impact the CEM's decisions.

3.2. Result No. 2 - USAID is provided with the requisite analytical information for addressing legal and regulatory policy issues, as applicable to the Madagascar context, in a manner congruent with microfinance "best practices."

In assessing the potential for CEM's partnership-based service expansion, it is important to consider the legal and regulatory framework for microfinance, as microfinance institutions currently play a significant role in rural finance and represent potential partnership options. Therefore, the second component of this task order is to conduct an assessment of the legal and regulatory framework in which the CEM and MFIs operate. Below is a description of the tasks required to develop a "Position Paper" that USAID will be able to use for donor-coordination and dialoguing with Government officials on policy-making and regulatory reform.

Dr. Jacques Trigo and Mr. Thierry Rajaona will be the key contributors to this component of the project. Together, they propose the following technical approach to achieving Result #2:

1. Meet with CEM and Central Bank officials, as well as microfinance organizations to assess key legal, regulatory and supervisory constraints related to commercial partnering with the CEM in rural savings mobilization. The team will discuss with the CEM their present legal status and how they are developing their organizational structure to become a private entity. The team will meet with the Governor of the Central Bank and the General Secretary of the CSBF to discuss the current legal status of CEM and whether there is a possibility to give CEM a special status distinct from the existing banking and financial institution regulation and supervision. In addition to the questions listed in Annex A of the RFP, the team will ask the follow questions:

- Are there regulatory/supervisory constraints that might prevent CEM's operational partners from acting as CEM agents for collecting savings, making withdrawals and other transactions? from refinancing operational partners? or from diversifying its product line and developing innovative savings services?
- What supervisory policies/practices should be endorsed by USAID/Madagascar in order to lessen the risk of the CEM undertaking commercial partnerships under existing regulatory conditions?
- What are the prospects for specific regulation for microfinance activity? (Identify current and projected projects aimed at addressing legal, regulatory and supervisory constraints hindering expansion of commercial microfinance).
- Should non-mutual microfinance institutions be granted tax-free status?
- Are there potential pitfalls in creating a legal definition of a « non-mutual Microfinance institution »?
- Would increased access to supportive public supervision result in accelerated growth of indigenous microfinance groups?
- Could supervisory authorities establish new categories of licenses in order to facilitate the development of indigenous microfinance institutions?
- Should there be an independent entity to assist supervisory authorities in monitoring the health of the microfinance sector and/or to provide training in internal control systems and management for group clients?
- Would supporting innovative approaches to cost-effective supervision policies and practices likely encourage the growth of sustainable indigenous microfinance organizations under the existing regulatory framework?

2. *Draft a summary of issues that hinder potential commercial partnering for the CEM to expand rural financial services to be included in the Final Report.* Dr. Trigo and Mr. Rajaona will write a few paragraphs on the legal, regulatory and supervisory issues that impact the CEM and its ability to partner with microfinance institutions to expand rural savings services. This summary will be passed to the Team Leader for review and inclusion in the Final Report.

3. *Meet with Central Bank officials as well as microfinance organizations to assess legal, regulatory and supervisory constraints hindering expansion of commercial microfinance.* The team will pose the following questions among others:

- What is the minimum capital required for microfinance institutions?
- Are there restrictions on who may own shares of a licensed financial institution?
- What are the entry requirements?
- What capital adequacy requirements apply to licensed financial institutions?
- What sorts of loan loss provisioning are required under the country's laws and regulations?
- Do the laws or administrative regulations set forth specific requirements for security or collateral on different types of loans?
- Are the loan assets classified according to some mandate scheme under the country's laws?
- Do the laws limit risk concentration? If so, how?
- What are the liquidity reserve requirements for microfinance Institutions?
- Are there limitations on the type of financial services provided by microfinance institutions?
- Do your laws require particular forms of internal supervision for licensed microfinance institutions?
- Are microfinance institutions required to be audited by an external auditor?
- Are there any nongovernmental organizations that exercise supervisory powers over microfinance institutions?
- What requirements are contained in the laws governing the documentation of loan agreements?
- Do laws impose limits on the level of interest that may be charged on loans?
- What types of loan security or collateral are possible under the laws?
- Are central registries or other mechanisms in place for easily determining what other claims might already exist on proposed loan or collateral?
- Do the laws in Madagascar provide for company income or profits tax or other taxes on net revenues, interest rates and other revenues from financial operations?

- How does the reality differ from the official laws? For example, are MFIs mobilizing savings without a license to do so?

4. Meet with various donors to assess their understanding of the legal, regulatory and supervisory constraints and their current and projected projects aimed at addressing such constraints. The team will meet with the other major donors that intervene in microfinance, including World Bank, UNDP and AFD, to assess the role they might play in influencing the policy and regulatory environments. These findings will be integrated into the Implementation Plan as well as the Position Paper.

5. Analyze constraints to determine potential policy, legal or regulatory changes that could be made to encourage the expansion of commercial microfinance. After completing all visits, Dr. Trigo and Mr. Rajaona will conduct an analysis of the key constraints to expanding microfinance in Madagascar, and prioritize them in order of importance and urgency. This analysis will include a comparison of Madagascar's legal, regulatory and supervisory framework to that of other leading microfinance countries, such as Bolivia and Peru, which will form the basis for recommendations.

6. Draft Position Paper including recommendations for possible policy, legal and regulatory changes that could be made to stimulate competitive markets for commercial microfinance, with specific recommendations on how USAID could support such changes. Mr. Rajaona will focus on drafting a description of the current legal, regulatory and supervisory framework and practices, applying his intimate knowledge of the country and culture. Dr. Trigo will conduct the analysis and proposed recommendations based on his broad knowledge of international best practices in microfinance regulation and supervision, as well as from his personal experiences as a former Superintendent of Banks in Bolivia.

4. Other Major Donor Interventions in Microfinance

To assess the programs and planned activities of other major donors that support microfinance development, the full team visited the World Bank and its partner project, Agence d'Execution de Projet Microfinance (AGEPMF), United Nations' Development Program (UNDP) and its partner project, PAMF, and the Association Française de Développement (AFD). Below is a brief description of each of their current and future areas of intervention related to microfinance, integrated with some analysis on how these donor interventions are likely to have an impact on rural finance in the future.

4.1 World Bank

The team met with Ziva Razafintsalama of the World Bank who explained the three main World Bank projects, of which the second two are managed by its partner, AGEPMF.

Institutional Development of MFIs. The first project is a 15 year, \$17 million project focused on rural finance and implemented in three five year phases. The first phase was from 1994 to 1999, in which World Bank tested approaches by supporting WOCCU in its development of the

mutualist MFI, TIAVO in Fianarantsoa and then DID's mutualist MFI, OTIV in Tomative. Support was given through low cost loans to finance their equipment and operations, but not their credit line. The first phase was considered successful, so the World Bank is now committed to completing the next two phases. World Bank is now conducting feasibility studies for the second phase in the regions of Majunga and Tulear. Through this project, World Bank has recognized that there is a significant number of urban poor as well as rural poor. In addition, the World Bank realized that microfinance needs to be done by microfinance institutions on a commercial basis, and so the Bank moved its microfinance project from its Rural Development Department to its Finance Department.

MFI Staff Training. The second project is related to training or capacity building of MFI staff. World Bank recognizes that there is a national lack of competence in microfinance and is targeting trainings that are applicable to mutualist MFIs or to all MFIs regardless of structure, such as training on how to set interest rates. World Bank has identified an individual who is responsible for organizing and overseeing all their training activities, but will not conduct all of them.

Legal and Regulatory Development and Reform. The third World Bank project works to improve the legal and regulatory framework for MFIs by lobbying the Government for necessary additions and changes. Some of the issues they deal with include:

- determining whether an issue is better addressed through legal channels or by setting standards or norms for supervision
- developing a national policy platform and definition for microfinance. There was a decree drafted but it was not accepted as it was seen as too limiting. For example, it proposed defining a microenterprise as an enterprise with 250,000 FMG or less in assets, but that amount would quickly become outdated overtime with inflation. The Malagasies want more research and debate before deciding on a national strategy.
- whether there should be new regulations specifically for non-mutualist MFIs or new regulations that cover the sector as a whole?
- addressing issues of MFI governance. For example, how much money should board members and directors be allowed to borrow?
- reviewing and publicizing issues, such as the lack of land titling, that hinder making larger loans to entrepreneurs in Madagascar. In addition, when land is available for collateral, it is very hard for an MFI to recover the loan in case of non-payment as the judicial system tends to favor the borrower. Plus it is a long and expensive process – it can take up to 12 years to adjudicate and is usually too costly for the size of the loan. This issue is not likely to be resolved soon.

PSDR Grants. While not mentioned by World Bank as part of its microfinance portfolio, several people mentioned the role that its Programme Sectorielle de Développement Régionale (PSDR) is having on rural microfinance. Through the 5 year PSDR project, World Bank is giving out grants totaling \$90 million in amounts of \$1000 to \$9,000. The grants are made to village associations, who then use the money to create a revolving loan fund to lend to individual members at 0% interest. Some argue that these grants are being distributed in very rural areas where there is no formal microcredit and therefore are not directly competing with MFIs, while others argue that PSDR is in fact reaching some of the same clients and fear that these grants

could damage the repayment culture of MFIs, by communicating the message that the rural villagers are too poor to repay loans. The impact of this program should be closely monitored and adjust or ceased if these fears become realized. One change that would have less of a negative impact on the repayment culture would be to allow the village associations to charge a higher interest rate, at least high enough to maintain the value of the revolving loan fund over time.

4.2 UNDP

The team met with UNDP, but learned most about what UNDP is doing in microfinance from Mr. Robert Theoret who manages its partner project, FENU/PAMF, and who is the Chair of the Donor Coordination Committee this year. PAMF primarily acts as a microfinance database and as a rating agency, helping institutions, such as the CSBF to understand how to rate MFI risks and the Bank of Africa (BOA) to make sound MFI refinancing decisions. PAMF collects information from all regulated MFIs and conducts an analysis on the information, which is adapted to the various methodologies used by the variety of MFIs in the country. It has helped to standardize reporting and improved transparency of MFIs. PAMF has also worked with UNDP and World Bank to put a \$2 million loan guarantee in place to encourage MFI refinancing. However, BOA was the only bank that participated and it was already doing MFI refinancing prior to the existence of the guarantee fund. So, while it is difficult to argue that this guarantee fund helped to demonstrate market potential for MFI refinancing, it did arguably help the BOA to better assess their MFI refinancing portfolios. In fact, BOA is currently considering not lending to AECA or OTIV when their loans come up for renewal because of the increasing risks they are seeing in these organizations. The guarantee fund and BOA have experienced 100% repayment rates on all refinancing, however this is mostly due to the fact that the MFIs have strong incentives to repay to keep the credit line open. PAMF also works with the CSBF to help determine in which cases it should make regulatory changes and when it might be better to wait.

Mr. Theoret explained that the microfinance sector is experiencing increasing portfolio quality problems, which have nothing to do with last year's political crisis, but instead reflect the governance problems. Loan losses increased from 5% at the end of 2001 to 15% at the end of 2002, which is a significant jump. The problems are mostly related to the common governance problems faced by mutualist MFIs, namely the problem of too many net borrowers influencing the policy and credit decisions more in their interests than in the interest of the institution or members as a whole. In addition, there tends to be too much nepotism, especially within solidarity groups, allowing too many relatives to be co-borrowers in the system. The MFIs need training on governance and internal control and need to make sure credit decisions are done in a uniform manner.

Regarding potential partnerships for the CEM, Mr. Theoret expressed an interest in having PAMF train the CEM on how to analyze MFIs to make good refinancing decisions and said he has already trained a number of CEM staff. PAMF is now in the process of designing its future projects as Madagascar was just recently selected by UNDP to receive continued support.

4.3 AFD

The Association Française de Développement has supported three microfinance institutions by giving them grant funds for the capital loan fund and to cover operational costs, such as staff salaries. It has supported Adéfi, which is a replica of ACEP in Senegal. While it is officially a mutualist MFI, it is not structured as a typical MFI. It has a few owner/members that together are essentially large shareholders of the cooperative. It has been very successful and currently has a repayment rate of 98% and is 100% financially self-sufficient despite the fact that it doesn't mobilize savings. AFD has also supported Vola Mahaso, a non-mutualist MFI similar to the Caisses d'Epargne Villagoises du Pays Dogon in Mali as it received technical assistance from the Centre International de Développement et de Recherche (CIDR). Finally, AFD has supported CECAM, the large mutualist MFI that offers agricultural credit and savings services to rural villages. AFD does not plan to continue its support for CECAM after 2005, when CECAM is supposed to be self-sufficient, indicating AFD's commitment to developing commercial microfinance and exiting when no longer needed.

Annex 1 – Work Plan Results, Indicators, Tasks, Milestones and Timeframe

Result 1: The CEM is provided with the guidance and supporting research/analysis needed to undertake commercial partnerships to expand its rural savings outreach.

Indicators	Tasks	Who	When
1.A. A set of recommendations developed that identifies potential CEM partners in selected pilot zones ¹ and describes optimal partner profiles to enable the CEM to implement additional commercial partnerships in areas served by their other provincial branches.	1. Meet with CEM to assess its expansion strategies and objectives.	AC, AE, JT, TR, USAID, CEM	2/11/03-2/14/03
1.B. A set of recommendations developed that identify: <ul style="list-style-type: none"> ▪ types of operational and/or functional relationships/linkages that should be featured in identified potential partnerships for the CEM. ▪ respective operational responsibilities among partners; ▪ likely profitability of potential partnerships and/or the advantages to the CEM in choosing one partner or another; ▪ appropriate products, services, and innovations; and 	2. Develop a set of criteria for potential partnering with the CEM, including factors such as: <ul style="list-style-type: none"> ▪ unmet demand for savings services ▪ profitability ▪ amount of investment required ▪ control of operations/reputation ▪ geographic location and coverage ▪ financial strength of potential partner ▪ management and governance ▪ complementarity of vision, institutional culture and infrastructure ▪ acceptable division of roles and responsibilities and related costs ▪ types of transactions/products and their volume over time 	AC, AE, USAID, CEM	2/11/03-2/14/03

¹ Fianarantsoa Province and one other area of future USAID program focus.

Indicators	Tasks	Who	When
<ul style="list-style-type: none"> ▪ strengths and weaknesses of each potential partnership option. 	<p>3. Meet with the following institutions to identify potential partners that meet the criteria:</p> <ul style="list-style-type: none"> ▪ Post Office ▪ Association Professionnelle des Institutions Financières Mutualistes (APIFM) ▪ Microfinance institutions (MFIs) and other credit unions ▪ Other financial and retail institutions that operate in rural areas ▪ Projet d'Appui a la Microfinance (PAMF) 	AC, AE, Post Office, APIFM, FENU, PAMF, MFIs, etc	2/13/03-2/21/03
	<p>4. Meet with donors to assess their current and future support of rural finance and their impact on potential partnering options for the CEM.</p>	AC, AE, World Bank, UNDP, AFD	2/13/03-2/21/03
	<p>5. Collect information and analyze potential partners identified against criteria</p>	AC, AE	2/15/03-3/21/03
	<p>6. Conduct field visits to assess validity of information and conduct a “reality check” on potential options for partnering with the CEM</p>	AC, AE, TR	2/14/03-3/21/03
	<p>7. Draft written recommendations for possible partnerships and provide supporting documentation and analysis to be included in the Final Report</p>	AC, AE	3/24/03-3/28/03

Result 2: USAID is provided with the requisite analytical information for addressing legal and regulatory policy issues, as applicable to the Madagascar context, in a manner congruent with microfinance “best practices.”

Indicators	Tasks	Who	When
2A. A set of recommendations about how USAID should encourage the evolution/reform/improvement of supervisory/regulatory policies and practices for microfinance in a manner that promotes a) the restoration of CEM services in areas formerly covered by Post Office windows, and b) the expansion of commercial microfinance services in rural areas.	1. Meet with CEM and Central Bank officials, as well as microfinance organizations to assess key legal, regulatory and supervisory constraints related to commercial partnering with the CEM in rural savings mobilization.	AC, AE, JT, TR, USAID, CEM, Ministry of Finance, Central Bank, BAO/BTM, CSBF, APIFM, PAMF, MFIs	2/11/03-2/21/03
	2. Draft summary of issues that hinder potential commercial partnering for the CEM to expand rural finance services to be included in the Final Report.	JT, TR	3/24/03-3/28/03
2.B. A set of recommendations about how USAID should encourage the development of competitive financial markets and commercial microfinance at the donor coordination and policy-making level.	3. Meet with Central Bank officials as well as microfinance organizations to assess legal, regulatory and supervisory constraints hindering expansion of commercial microfinance	JT, TR, Central Bank, APIFM, PAMF, MFIs	2/11/03-2/21/03
	4. Meet with various donors to assess their understanding of the legal, regulatory and supervisory constraints and their current and projected projects aimed at addressing such constraints	AC, JT, TR, Donors (World Bank, UNDP, among others)	2/11/03-2/21/03
	5. Analyze constraints to determine potential policy, legal or regulatory changes that could be made to encourage the expansion of commercial microfinance	JT, TR, Central Bank, APIFM, PAMF, MFIs, Donors	2/13/03-3/21/03

Indicators	Tasks	Who	When
	6. Draft Position Paper including recommendations for possible policy, legal and regulatory changes that could be made to stimulate competitive markets for commercial microfinance, with specific recommendations on USAID should support these recommendations.	JT, TR, AC (review and edit)	3/24/03-3/28/03

Milestones and Deliverables

Milestones/Deliverables	Tasks	Who	When
Informal debriefing with USAID upon arrival	Prepare questions and discussion points for meeting with USAID	AC, JT, AE, TR, NA, USAID	2/20/03
Formal debriefing with USAID	Prepare presentation of findings and recommendations for USAID	AC, JT, AE, TR, NA, USAID	4/23/03
Implementation plan developed	Determine team work flow and schedule; draft and submit implementation plan to USAID for approval	AC	2/27/03
Draft Position Paper	Refer to tasks related to result #2	JT, TR (AC review and edit)	4/4/03
Draft Final Report	Refer to tasks related to result #1	AC, AE	4/11/03
Final Report	Refer to tasks related to result #1	AC, AE	4/28/03

Implementation Schedule

Missions for Expatriate Advisers	Personnel	Dates
Initial assessment mission	Anita Campion, Jacques Trigo, Abraham Elison, Thierry Rajaona (through FTHM subcontract)	Feb. 10-22, 2003
Follow-up fact-finding mission and field research	Anita Campion and Thierry Rajaona	Feb. 16-18 (AC in Fianarantsoa); March 3-5 (TR in Fort Dauphin)
Mission to complete tasks	Anita Campion	Mid April, 2003

Annex 2 – Statement of Work

1. SUMMARY STATEMENT

This task order has two related purposes. One is to study how the *Caisse d'Epargne de Madagascar* (CEM) should establish networks of partnerships to expand access to their savings services. The other is to inform USAID/Madagascar about issues related to the enabling environment for microfinance, with particular attention to financial regulation/supervision policies and mechanisms. The objectives for the Contractor under this task order are to provide the analytic information and guidance needed to a) assist the CEM in expanding its geographic coverage through innovative, mutually profitable partnerships, and b) inform USAID about legal and regulatory constraints in the development of commercial microfinance in rural areas as well as alternative approaches and policies for overcoming them.

2. PROBLEM STATEMENT/DISCUSSION/JUSTIFICATION

a. PARTNERSHIP ASSESSMENTS

USAID/Madagascar concurs that such a study would help to address a critical need for increasing access to basic financial services in rural and peri-urban areas. The CEM maintains a traditional role as a provider of universal access to savings services. It ensures this with a negligible minimum opening deposit requirement. Although recently the CEM was legally transformed into a *Société Anonyme*, the special enabling law does not require the immediate disengagement of the State. Since the CEM is perceived by key Government authorities as the savings bank for civil servants and "defavored" savers, there is no expectation that the institution will abandon this social responsibility in the short term.

Currently the CEM's 15 operational, full-service branches are located in towns and do not perform outreach operations. With the elimination of Post Office service points, access to CEM services is now generally limited to clients who live in proximity to branches generally located in urban centers. For the other savers, the cost of transport and time required for travel has greatly reduced their access to CEM services.

The CEM's request for assistance and financing in conducting this study reflects the institution's recognition of this problem and a desire to overcome it. However, as the State progressively disengages from the CEM in favor of private sector participation, the issues of cost control and profitability will become more important to shareholders. Outreach operations, which can be expensive, must be designed carefully in order to assure their sustainability. Hence this study will need to ascertain if partnering with third-party establishments is a feasible, cost-effective way to recover (at least) the geographic coverage lost when the Post Office quit offering CEM services.

Assuming commercial partnering is deemed an appropriate, potentially cost-effective approach, the study will need to inform the CEM how partnerships should be built. It will also analyze the

potential for a significant increase in access to rural credit services that such partnerships might facilitate. In USAID's view, an important consideration for building mutually beneficial commercial microfinance partnerships is the governance and financial health of potential partners. These and other due diligence factors will provide the basis for the recommendations about partnership-building in a "Final Report," and will help guide the CEM in forging future partnerships outside two areas to be piloted/studied under this task order.

b. ASSESSMENT OF THE LEGAL AND REGULATORY FRAMEWORK

In assessing the potential for partnership-based service expansion, it is important to consider the legal and regulatory framework for microfinance, and particularly licensing practices and policies. For example, any financial services organization should be licensed to perform credit operations but the reality is that only a handful of donor-supported "mutual" networks have been able to obtain such agreements from the government's banking supervision authorities. This is largely because the latter's capacity to systematically monitor the condition of microfinance institutions is weak, but also because useful information about the viability of potential partners is difficult to obtain, non-standardized, and expensive. Supervisory practices are traditionally based on prudential regulation--where the authorities vouch for the financial health of an institution. Non-prudential regulation is not practiced even though such an approach can be an effective tool for monitoring growing networks of smaller entities. The practical effect of all this is that the banking supervision authorities are generally reluctant to issue lending licenses, especially to indigenous microfinance institutions that are not backed by externally supplied technical assistance, training, and investment. This discourages the development and growth of the microfinance sector, leaving much of the population without access to affordable financial services.

The lack of supervisory capacity also considerably increases the risks for CEM to enter into operational partnerships. Without effective financial supervision practices in place, and no supportive monitoring systems for nurturing the growth of indigenous microfinance institutions, the development of operational partnerships would require the CEM to assume a *de facto* role in ensuring that partners' services meet minimum prudential standards. Since the CEM would be unlikely to accept such a responsibility, the potential for establishing partnerships is constrained in the current legal and regulatory context. Therefore this study shall include a thorough analysis of the legal and regulatory framework for microfinance, with particular attention to financial supervision requirements and systems. Such an analysis would not only focus on the cost implications of reporting/managing prudential and non-prudential information, but also on identifying constraints to and opportunities for financial innovation and reform. The results of this analysis shall be presented as a "Draft Position Paper" to be used by USAID in its policy discussions involving other donor organizations and the Government of Madagascar

The Contractor shall provide services under this task order so that they are consistent with the results and indicators described below. In doing so, the Contractor will ensure that all work carried out under this task order contributes to the achievement of Sub-Result 1.1.2, "Expanded Access to Financial Services."

This activity is expected to require two visits of the Team Leader, one visit of the Microfinance Technician, and involve a local expertise to collect and analyze field data, and be completed within a four-month period. During the initial visit, the Contractor's team leader will have the opportunity to provide input into the definitive description of tasks, technical approach, milestones, results and indicators necessary for performance monitoring and for achieving the objectives in Section A.3 above.

3. *EXPECTED RESULTS*

- A) CEM is provided with the guidance and supporting research/analysis needed to undertake commercial partnerships.
- B) USAID is provided with the requisite analytical information for addressing legal and regulatory policy issues, as applicable to the Madagascar context, in a manner that is congruent with the microfinance industry's "best practices."

4. *PERFORMANCE INDICATORS*

A) On the Partnership Assessments (Section A.4.3.A.):

- a. A set of recommendations that identifies potential CEM partners in selected pilot zones² and describes optimal partner profiles to enable the CEM to implement additional commercial partnerships in areas served by their other provincial branches. Illustrative factors to consider would include:
 - Demand for basic savings services in the study areas;
 - Function/role/services of potential partner organizations;
 - Comparative strengths and weaknesses of potential partners;
 - Types of transactions and their volume over time;
 - Geographic/administrative distribution/coverage;
 - Other appropriate due diligence indicators.
- b. A set of recommendations that identifies:
 - The types of operational and/or functional relationships/linkages that should be featured in identified potential partnerships. Such partnerships should result in the sustainable restoration of CEM services in areas formerly covered through Post Office windows. This should also provide the basis for deeper and broader expansion in other areas;
 - Respective operational responsibilities among partners;
 - Likely profitability of potential partnerships and/or the advantages to the CEM in choosing one partner or another;
 - Appropriate products, services, and innovations.

² Fianarantsoa Province and one other area of future USAID program focus.

B) On the Legal and Regulatory Framework for Microfinance (Section IV.3.B)(addressing the issues shown in Annex A).

- a. A set of recommendations about how USAID should encourage the evolution/reform/improvement of supervisory/regulatory policies and practices for microfinance in a manner that promotes a) the restoration of CEM services in areas formerly covered by Post Office windows, and b) the expansion of commercial microfinance services in rural areas.
- b. A set of recommendations about how USAID should encourage the development of competitive financial markets and commercial microfinance at the donor coordination and policy-making level.

Annex 3 - Contact List

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