

FINAL REPORT

EVALUATION OF THE FINCA/NIS REGIONAL TECHNICAL ASSISTANCE PROGRAM

Submitted to:

U.S. Agency for International Development

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LIST OF ACRONYMS

ACDI/VOCA	Agricultural Cooperative Development International Volunteers in Overseas Cooperative Assistance
CAMFA	Central Asia Micro-Finance Association
CD	Country Director
CGAP	Consultative Group to Assist the Poorest
DA	Development Associates
E&E	Europe and Eurasia Bureau (USAID)
FSS	Financial Self-Sufficiency
FINCA	Foundation for International Community Assistance
GAAP	Generally Accepted Accounting Principles
IFC	International Finance Corporation
MFI	Micro-Finance Institutions
MIS	Management Information System
NICRA	Negotiated Indirect Cost Rate Arrangement
NIS	New Independent States
OI	Opportunity International
OSS	Operational Self-Sufficiency
SEL	Small Enterprise Loan
TA	Technical Assistance
USAID	US. Agency for International Development
VB	Village Banking
VBCF	Village Bank Capital Fund

EXECUTIVE SUMMARY

INTRODUCTION

FINCA (the Foundation for International Community Assistance) was founded in 1984 with the goal of raising the incomes of the poor through "village banking programs". FINCA manages 20 such micro-credit programs throughout the world. These programs currently serve over 171,000 small-scale entrepreneurs.

Under its NIS (New Independent States) regional technical assistance program, FINCA has established a network of seven regional micro-finance affiliates. Two of these affiliates are located in Russia (at Tomsk and Samara). The others are located in Kyrgyzstan, Armenia, Georgia, Azerbaijan, and Kosovo. Two new affiliates are to be started up in the near future in Tajikistan and Uzbekistan, if funding permits. The regional hub was founded in 1997 in Tbilisi, Georgia. It was moved to Moscow in early 2000 at the encouragement of USAID to increase the efficiency of service to MFI affiliates located in the NIS region.

THE PURPOSE OF THE EVALUATION

FINCA submitted a proposal to USAID on July 17, 2002, seeking an additional \$646,500 in grant funds from USAID to support its NIS regional program in FY2003. As funding for FINCA is now entering its fourth year, USAID believed it important that an outside evaluation of the performance of the program be undertaken to ensure that the funding being requested is needed and would be well spent.

The primary purpose of the evaluation is to assess the efficacy and usefulness of the approach being taken by FINCA in providing management and technical assistance services to its NIS micro-finance institutions through a regional hub located in Moscow. Specifically, the issue of whether a Moscow hub is needed to enable FINCA to operate successfully in the NIS region was central to the evaluation.

THE EVALUATION METHODOLOGY

The Team began its evaluation with consultations in Washington, receiving technical direction from the USAID E&E/EG Office and a briefing from FINCA Headquarters staff. The Team then traveled to Moscow and met with the Regional Director and staff working at the FINCA/Moscow hub, to assess its operations. The four members of the Team were then split into two groups and conducted interviews with affiliate staff. Particular emphasis was given during Team interviews to assessing:

- ▶ The overall "value added" of the Moscow hub in serving its affiliates;
- ▶ The efficiency and cost-effectiveness of the hub's operations; and
- ▶ The extent to which the hub has provided specific services to its affiliates.

Following its field visits, the members of the Team returned to Moscow and began the process of drafting a report of the evaluation, including a summary of their findings and conclusions and a set of recommendations.

THE ORGANIZATION AND MANAGEMENT OF THE HUB

In addition to the Regional Director, NIS hub staff members include (1) an Administrative Assistant, (2) Legal Analyst/Policy Advisor, (3) Regional Finance/Internal Controls Manager, (4) Regional Financial Products/Credit Specialist, (5) Local Accountant, Regional Financial Analyst, (6) Regional MIS/Conversion Project Manager (a position that is presently vacant), and (7) a Regional Internal Auditor who is presently housed in the hub office and administratively supported by the hub, but who reports directly to FINCA Headquarters in Washington DC.

The principal operational objective of the Moscow hub is to facilitate the start-up of new regional affiliate lending programs and to provide management oversight and technical assistance services to programs under expansion. In addition, the hub conducts training activities and coordinates the sharing of "best practices" information and "lessons learned" among the affiliates.

Hub staff members provide a broad range of services to affiliates. Collectively, they assist affiliates in preparing and monitoring business plans, and in making financial projections and annual operating plans. The Regional Director is responsible for assisting in the recruitment of Country Directors and Finance Managers, and in providing them management training to ensure that they can effectively do their jobs.

As warranted, Headquarters staff specialists provide the hub and regional affiliates with back-up support and expertise in the areas of transformation management, product development, legal counsel, policy and regulatory advocacy, and organizational systems development

A SUMMARY OF THE TEAM'S MAJOR FINDINGS AND CONCLUSIONS

A. REGARDING THE OVERALL "VALUE ADDED" OF THE MOSCOW HUB IN SERVING ITS AFFILIATES

1. The strategic plan evolved by the hub to guide its operations is sound and is being implemented effectively

NIS affiliates indicated that they are being provided by the hub with the services they need to enable them to serve their clients, grow their portfolios, and keep their portfolios at low levels of risk while continuing to expand lending operations in their respective locations. A key issue is whether the rapid expansion experienced in recent years can be sustained. Given the apparent efficiency and effectiveness of hub operations, the Team believes that it can.

2. *The value added services provided to affiliates are built into the structure of the strategic plan and are accordingly being provided systematically through implementation of the plan*

These services include: (1) comprehensive training provided to Country Directors, Finance Managers, Credit Supervisors and Credit Officers; (2) the development of business plans for affiliates; (3) marketing and customer service training for affiliate loan officers and supervisors; (4) the dissemination of new product profiles; and (5) the expert services provided to affiliates by the hub's legal analyst/policy advisor; finance and internal controls manager; and the regional products and credit specialist

3. *There is a steady demand by affiliates for the hub's services, which is being met satisfactorily*

The affiliates draw on the technical services of the hub quite frequently. The regional products and credit specialist has traveled to Armenia six times within the past two years to provide support. The hub legal analyst/policy advisor recently assisted the Kyrgyzstan affiliate in lobbying for passage of a Kyrgyzstani law on micro-finance institutions. He is now being used by the affiliate on registration and taxation issues. During the past six months, the hub has provided assistance to its Armenia and Georgia affiliates to minimize the impact of their loss recently of the tax exemption status that they had been enjoying.

4. *The NIS affiliates appear to be generally satisfied with the hub's performance and the support services that it has provided to date*

Team interviews with staff of the seven affiliate MFIs (Micro-Finance Institutions) being served by the hub indicated that they are satisfied with the hub's performance, and provided Team members with documentary examples of the various kinds of services that had been rendered.

5. *A variety of approaches are being successfully employed by the hub to disseminate lessons learned and best practices*

Examples of these approaches include the development and utilization of model micro-credit products; the effective spread of the expertise provided in product development through affiliate sharing arrangements; and the replication among affiliates of the proven methods used to generate trust among clients.

B. REGARDING THE EFFICIENCY AND COST-EFFECTIVENESS OF HUB OPERATIONS

1. *The hub has built an effective management base in the NIS Region and has become an efficient operation by ensuring that executive and staff members are well trained and by promoting the use of cost-effective approaches and methods in their business management operations*

Rather than hiring specialists in each affiliate program, the hub has one policy and regulatory expert for the region, a strategic planning and finance specialist, and a management specialist. This avoids expensive redundancies in staffing and effort. There is considerable potential for

FINCA to leverage the use of existing hub staff as several affiliates enter the third and more advanced stage of their development as MFIs.

2. *Financial sustainability of the current operational structure is feasible*

The sustainability of the current operational structure is contingent upon the current fee structure, timely access to commercial funding, and potential improvements in the regulatory environment of affiliate host countries. Through continued efforts to reduce costs, an expected increase in hub revenues resulting from an increase in the sustainability fee being paid to the hub by affiliates, and the continued portfolio growth of its affiliates, the hub expects to be financially self-sustainable by FY 2006. Four of FINCA's seven existing NIS affiliates are financially self-sufficient at present.

3. *Sustainability of the hub is an appropriate objective*

The hub has important training and management functions that are critical to the success of affiliate operations. It has developed and is implementing a business model that suits the way FINCA operates. It is the source of vested experience relevant to the way that FINCA operates and has become the NIS region's engine for spreading "best practices".

4. *The team's assessments of the levels of institutional sustainability achieved by the hub and its affiliates were indeterminate*

The hub is being developed as an integral component of FINCA International, as are its affiliates. All affiliates are local entities of varying forms but continue to be branches or subsidiaries of FINCA International. To be useful, such assessments would have to be undertaken against a backdrop of the overall operations of FINCA International.

5. *FINCA has had moderate success to date in diversifying the sources of funding for its NIS program*

The IFC is providing technical assistance to the FINCA affiliate in Kyrgyzstan during its transformation and proposes to take up to a \$1.0 million equity stake in the commercial operation. In Kosovo, FINCA has borrowed \$1.1 million from KfW, the German Development Bank. FINCA has increased the amount of fee-based income earned by the hub from \$200,000 in all of 2000 and 2001, to \$318,000 in fiscal 2002. The Eurasia Foundation has also provided funds. Fees paid by affiliates for hub services presently account for approximately 40% of the hub's funding.

6. *Currently there are no feasible alternatives to the FINCA regional hub model that would be more viable and cost-effective in the long run*

The team considered two alternative models to the hub. These included establishing an even more decentralized structure in which the functions of the hub would be moved out to the regional affiliates. The Team concluded that it would be difficult under this model for affiliates to attract and retain the same level of qualified technical services personnel who were as well attuned to MFI developments throughout the region as the hub. The second option considered would involve moving the hub to a lower-cost NIS regional location. However, it was noted that

the hub had been moved from Georgia to Moscow at the request of USAID to increase the efficiency and efficacy of its operations.

C. REGARDING THE EXTENT TO WHICH THE HUB HAS PROVIDED SPECIFIC SERVICES TO ITS AFFILIATES

The Team found the hub to be highly efficient in using a minimal but very experienced staff that is providing a sustained level and range of high quality professional and technical services to its affiliates, services that are not generally readily available in field locations

1. *The services provided by hub staff members have generally been adequate in meeting the technical assistance needs of the affiliates, with the exception that there is currently a vacancy in the MIS slot*

The MIS position will likely be filled once the pilot installation of the new Management Information System (known through its Spanish acronym as SIEM), which is scheduled to begin in Kyrgyzstan and Azerbaijan in 2003, has been completed. The hub has been notably responsive in developing alternative financial products and in modifying its village banking methodology and products to meet the specific needs of the affiliates.

2. *The hub has been effective in sharing information and lessons learned about new hub products and methodologies among regional affiliates*

The hub assiduously shares "best practices" and "lessons learned" with other programs through the Country Director conferences it convenes once a year; through semi-annual product updates; and through periodic "mail outs".

3. *The hub has actively supported the expansion of regional affiliates*

Such support is based on requirements the affiliate must fulfill in order to expand its operations. These include the submission of an expansion proposal, a marketing analysis, outreach projections and an agreed time frame for expansion. The hub's financial services specialists also visit the area to be added and assist in market analysis.

4. *The hub has been aggressive in providing technical assistance services to affiliates to assist them in installing portfolio management and office administrative systems*

Regional technical staff members have assisted the affiliates in the past in installing accounting, portfolio management, and office administrative systems. They will also be available to provide assistance to the affiliates in the forthcoming installation of the SIEM system.

5. *The hub has been active in conducting audits of the affiliates using an independent auditor*

The Regional Internal Auditor conducts comprehensive annual internal audits of each affiliate. Four affiliates were examined in the last six months of 2002. In addition, the Regional Internal Auditor trained Georgia affiliate internal auditors in December 2002, and new internal affiliate auditors in Kosovo during August of 2002 and in Samara in February 2003.

- 6. The hub has been in the forefront of efforts to promote reform of the legal and regulatory environment for non-bank financial institutions in Russia and the NIS region; however, with the exception of Kyrgyzstan these efforts to date have had limited impact***

In Russia, FINCA has been instrumental in catalyzing a working group on policy reform, which is engaged in efforts to improve the country's fragmented regulatory environment. It has also been instrumental in developing a close working relationship with the Russian State Duma, and has encouraged its affiliates to promote similar relationships with law-making institutions in the NIS. In spite of these efforts, the Team found that the array of legal and regulatory issues facing FINCA and other MFIs in Russia and the NIS region are not being resolved.

- 7. The hub is providing a broad array of legal and regulatory services to its NIS affiliates but except for Kyrgyzstan the legal and regulatory issues facing FINCA and other MFIs in Russia and the NIS region are not being resolved. The involvement of outside agencies other than NGOs will likely be needed to resolve them***

Some of the more prevalent constraints to MFI development include the unnecessary regulation of lending by Central Bank officials, interest rate ceilings, overly burdensome tax structures, and restrictions on forms of registration for non-profit micro-finance institutions (MFIs). In Kyrgyzstan, the FINCA affiliate employed the services of an outside law firm and with hub assistance was able to bring the considerable influence of the IFC to bear in resolving the legal and regulatory issues that were impeding its effort to evolve into a quasi-banking institution.

- 8. An adjustment seems warranted in the interest charged to low-income borrowers in several affiliate countries***

Competition for clients is increasing in several affiliate countries. Such competition is good for the micro-finance industry in those countries and should lead to a reduction in interest costs to clients. Maintaining high interest rates for low-income borrowers appears to be the policy for FINCA affiliates at present but the believes that it should not become, in the view of the Evaluation Team, a substitute for encouraging greater operating expense control.

THE TEAM'S RECOMMENDATIONS

The Team's recommendations are based on its findings, and the conclusions that it reached regarding those findings as cited above.

- 1. As to whether USAID should provide additional grant funds to support the technical assistance operations of the NIS hub***

As indicated above, there is a steady demand by affiliates for the hub's services. The hub has contributed significantly to building a sustainable network of MFI institutions in the NIS Region, and it has been in the forefront of efforts to promote reform of the legal and regulatory environment for non-bank financial institutions in Russia and the other affiliate countries. NIS affiliates have indicated that they are satisfied with the hub's performance and the support that it

has provided them to date. Currently, there are no feasible alternatives to the FINCA regional hub that would be more viable and cost-effective in the long run

Accordingly, the Team recommends that USAID assistance to the hub be continued to avoid a sharp interruption in its forward momentum. Any assistance should, however, be conditioned upon FINCA's agreeing to dramatically improve operating expense ratios and loan to asset ratios. Self-sufficiency targets should be tempered with efficiency targets in order to provide more competitive financial services.

2. *Regarding the need cited above to accelerate ongoing efforts to improve the legal, regulatory environment in affiliate countries*

It is essential that these efforts be accelerated to accommodate FINCA's transformation plans for its NIS affiliates.

The Team recommends that steps be taken by USAID and U.S. Embassy staff, as appropriate, to ensure that concerted efforts are brought to bear on behalf of the micro-finance community to accelerate ongoing efforts to improve the legal, regulatory environment in affiliate countries

Secondly, the Team has noted that USAID/Russia awarded funds to FINCA to build a "best-practices" micro-finance institution in Samara. As part of the funding award, a sub-agreement was drawn up with experts from Ohio State University (OSU) to initiate an innovative micro-finance policy reform program in Russia. The principal focus of the policy reform program was to improve the operating and regulatory environment for micro-entrepreneurs and micro-finance institutions in Samara.

The Team recommends that steps be taken by USAID to ensure that the "lessons-learned" in Samara are being incorporated in the micro-finance policy reform programs being pursued by other FINCA affiliates in the NIS region.

3. *Regarding the need to bolster hub advocacy efforts and the staff resources needed to enable the hub it to contribute more effectively to improvement of the legal and regulatory environment in affiliate countries*

The hub will need to bolster the legal services that it provides to affiliates if it is to significantly enhance their efforts to foster legal and regulatory reform in the NIS region. Support for these lobbying efforts by USAID and by the US Embassy, on behalf of the micro-finance community, should be brought to bear where warranted.

The Team recommends that a concerted plan of action be developed by the parties involved to bolster ongoing lobbying efforts.

4. *Regarding the need for the hub to change its interest rate policy*

As noted above, maintaining high interest rates for clients appears to be the policy for FINCA affiliates at present; however, it should not become a substitute for encouraging greater operating expense control. The interest rates charged to clients should be determined on the basis of the costs of serving clients and on relevant market factors in an affiliate's area of operation.

The Team recommends that the hub be tasked by USAID to undertake a review of the impact that its interest rate policy is having on affiliate lending operations to ensure that it is not becoming a substitute for encouraging greater operating expense control.

5. *Regarding the need for the hub to work with affiliates to increase their loan to asset ratios and to reduce their operating expense ratios*

Data compiled by the evaluation team indicate that affiliate variance in the productive usage of assets ranges from a low of 29% to a high of 83%. This condition may be an indication that loan products need further development and diversification to meet demand. Deploying more of affiliate assets in sound loans would improve the efficiency of affiliates and increase the percentage of productively earning assets. The hub also needs to assist the affiliates in reducing their operating expense ratios that, in the Team's view, are presently too high.

The Team recommends that USAID monitor the hub's efforts to encourage the more productive use by affiliates of their assets.

6. *Regarding the need for the region's financial system to produce an automated budget to actual performance report with variances on a year to date basis*

This would assist the Country Directors and hub personnel in quickly identifying variances in anticipated progress. Offices that provide USAID quarterly status reports under grant agreements all report actual performance against projected. The Monthly Status Reports provided by all affiliates to the hub provide status updates, but do not set forth performance versus projected performance.

The Team recommends that the USAID monitor the hub's efforts to implement this recommendation.

EVALUATION OF THE FINCA/NIS REGIONAL TECHNICAL ASSISTANCE PROGRAM

I. INTRODUCTION

Over the past ten years, the Europe and Eurasia (E&E) Bureau of USAID has supported a variety of micro-enterprise programs throughout Eastern Europe and the New Independent States (NIS). While there are differences among these varied programs, the goal of sustainability based on "best practices" has been a common theme. The FINCA/NIS Regional Technical Assistance Program is one of these programs. The E&E Bureau works closely with two other USAID offices in the oversight of these programs, i.e., the Office of Micro-enterprise Development, and the Office of Private and Voluntary Cooperation (PVC), which manages the Matching Grant Program for micro-finance development activities being implemented by USAID in conjunction with U.S. PVOs.

A. BACKGROUND ON FINCA AND THE FINCA/NIS REGIONAL TECHNICAL ASSISTANCE PROGRAM

FINCA (the Foundation for International Community Assistance) was founded in 1984 with the goal of raising the incomes of selected poor inhabitants through "village banking" programs. FINCA manages 20 such micro-credit programs throughout the world. These programs currently serve over 171,000 small-scale entrepreneurial clients.

FINCA presently operates micro-credit programs in five NIS countries within the E&E Region, and has established a network of seven regional micro-finance institution (MFI) affiliates under its NIS Regional Technical Assistance Program. Two of these affiliates are located in Russia (at Tomsk and Samara). The other five are located in Kyrgyzstan, Armenia, Georgia, Azerbaijan, and Kosovo. In addition, two new affiliates are to be started up in the near future in Tajikistan and Uzbekistan, if funding permits. FINCA's micro-credit activities in the region are focused primarily on educated women who have lost their jobs in the formal sector and on women with low incomes who are pursuing self-employment as a strategy for survival. FINCA affiliates currently serve approximately 45,000 such clients in the NIS/E&E region.

While FINCA's clients in the NIS program are mainly women, the percentage of men in the program is higher than in other regions (including Kosovo, 28% were male as of November 2002). FINCA's clients are among the poorest served by small business and micro-enterprise institutions in the NIS, as evidenced by the low average size of its loans (\$299 as of November 2002 including Kosovo, and \$237 as of that date excluding Kosovo).

1. *The role of the FINCA "hub" office located in Moscow in implementing the NIS Regional Technical Assistance Program*

Over the past three years, FINCA has provided technical assistance to its MFI affiliates through a regional "hub" office located in Moscow. The regional hub, which was founded in Tbilisi, Georgia in 1997, was moved to Moscow in 2000 at the request of USAID. From FY 1999-2002, the U.S. State Department's Office of the Coordinator for NIS Assistance provided over

\$2 million in funding to FINCA to support the operations of the hub. The funding was channeled through USAID. FINCA submitted a proposal to USAID on July 17, 2002, seeking an additional \$646,500 in grant funds for FY 2003, to support the Moscow hub's operations. As indicated in the proposal, the funds will enable the hub to continue to provide specialized technical assistance to FINCA affiliates in the NIS region.

2. *The organizational restructuring undertaken by FINCA in 2002*

FINCA undertook a restructuring in 2002 that changed the relationships between its Headquarters office located in Washington, D.C., and the three FINCA regional hubs that have been established in Moscow, Guatemala City (Latin America) and Kampala (Africa). It also changed the relationships between the regional hubs and regional affiliates, inasmuch as FINCA eliminated the Programs Department that had been operating at the Headquarters office, and transferred program management responsibilities for regional affiliates to the three regional hubs. The impact of the restructuring on the relationships between Headquarters and the Moscow hub, and the Moscow hub and its NIS regional affiliates were taken into account during the evaluation.

B. THE PRIMARY PURPOSE AND PRINCIPAL OBJECTIVE OF THE EVALUATION

The primary purpose of the evaluation was to assess the efficacy and usefulness of FINCA's approach in providing management and technical assistance services to its NIS/MFI affiliates through the regional hub in Moscow. The principal objective of the evaluation was to assess the operational and developmental impact being achieved throughout the region as a result of the assistance provided to affiliates by the hub. As funding for FINCA is now entering its fourth year, USAID believed it important that an outside evaluation of the performance of FINCA'S NIS program be undertaken to ensure that the funding being requested, if granted, was needed and would be well spent.

The issue of whether a Moscow hub is needed to enable FINCA to operate successfully in the NIS was considered to be central to the evaluation. In addition, the findings and recommendations of the evaluation are to be taken into consideration by USAID in deciding the level of future support to be provided to the FINCA hub, as well as to other similar regional micro-enterprise management and technical services centers operating around the world.

C. THE EVALUATION METHODOLOGY

The Team began its evaluation with consultations in Washington, receiving technical direction from the USAID E&E/EG Office and a briefing from FINCA Headquarters staff. The Team then traveled to Moscow and met with the Regional Director and staff working at the FINCA/Moscow hub, to assess its operations. The four members of the Team were then split into two groups, one of which visited the two FINCA affiliate offices located in Russia (Tomsk and Samara) and the affiliate office in Kyrgyzstan (Bishkek). The other group visited the FINCA affiliate offices located in Armenia (Yerevan) and Georgia (Tbilisi). In addition, the USAID Caucasus Regional Mission arranged for the FINCA Azerbaijan Country Director and a USAID representative from Baku to travel to Tbilisi to meet with members of the Team.

During its interviews with affiliates, Team members sought to assess the extent to which the affiliates had benefited from the technical and consultative services provided by the hub. Particular emphasis was given during team interviews and throughout the evaluation to assessing:

- ▶ The overall “value added” of the Moscow hub in serving its Russia and NIS affiliates;
- ▶ The efficiency and cost-effectiveness of the hub’s operations;
- ▶ The extent to which the hub has provided specific services to its affiliates.

Following its field visits, the members of the Team returned to Moscow and began the process of drafting this report of the evaluation, including a summary of their findings and conclusions and a comprehensive set of recommendations.

II. AN OVERVIEW OF THE MOSCOW HUB’S OPERATIONS

The principal operational objective of the Moscow hub is to facilitate the start-up of new regional affiliate lending programs and to provide management oversight and technical assistance services to programs under expansion. In addition, the hub conducts training activities and coordinates the sharing of “best practices” information and “lessons learned” among the affiliates. Regular site inspections are conducted and local personnel are rotated periodically within the region for capacity building and experience sharing purposes. Occasionally the hub, in conjunction with the Country Directors, arranges exchanges of affiliate personnel with FINCA’s two other regional hubs.

A. THE ORGANIZATION AND MANAGEMENT OF THE HUB

As shown in the Organization Chart attached hereto as Exhibit 1, in addition to the Regional Director, NIS hub staff members include (1) an Administrative Assistant, (2) Legal Analyst/Policy Advisor, (3) Regional Finance/Internal Controls Manager, (4) Regional Financial Products/Credit Specialist, (5) Local Accountant, Regional Financial Analyst, (6) Regional MIS/Conversion Project Manager (a position that is presently vacant), and (7) a Regional Internal Auditor who is presently housed in the hub office and administratively supported by the hub, but who reports directly to FINCA Headquarters in Washington DC.

Hub staff members provide a broad range of services to affiliates. Collectively, they assist affiliates in preparing and monitoring business plans, and in making financial projections and annual operating plans. The Regional Director is responsible for assisting in the recruitment of Country Directors and Finance Managers, and in providing them management training to ensure that they can effectively do their jobs. In addition, she systematically monitors their performance in fulfilling grant agreements and in implementing corresponding budgets.

The Regional Financial Products/Credit Specialist assists affiliates in conducting market research, in testing new credit and savings products, and in developing marketing plans for those products. In addition, she oversees the local regional expansion efforts undertaken by affiliates, which generally involves developing a budget, and undertaking new market area research, client surveys, and assessments of the potential viability of proposed new branch offices.

The hub's Regional Finance/Internal Controls Manager and Regional Financial Analyst help affiliates to install and maintain accounting, portfolio management, and office administrative systems. Similarly, the Legal Analyst/Policy Advisor advises Country Directors, and assists his advisory counterparts in affiliate countries regarding the requirements for creating a favorable legal and policy environment for their respective lending programs.

As warranted, FINCA Headquarters staff specialists provide the hub and regional affiliates with back-up support and expertise in the areas of product development, transformation management, legal counsel, policy and regulatory advocacy, organizational systems development and FINCA Headquarter's Transformation Manager is currently leading the transformation project being undertaken in Kyrgyzstan, with assistance from the hub.

B. THE HUB'S STRATEGIC OBJECTIVES AND CURRENT STRATEGIC PLAN

As cited in briefing materials provided to the Team and as set forth in its current strategic plan, the hub's strategic objectives are as follows:

- ▶ Best practices and prudential norms will be implemented at all affiliates
- ▶ All affiliates will be working at optimum management efficiency
- ▶ All affiliates will receive appropriate information technology
- ▶ All new and existing affiliates will be expanded under principles of economic feasibility
- ▶ MFIs will be working under positive regulatory environments
- ▶ The hub will achieve independence from donor funding
- ▶ One of the affiliates will be transformed into a regulated institution
- ▶ The hub will achieve long-term sustainability

Under the plan, regional affiliates are to receive the technical assistance services that they need from the hub, or from outside sources when warranted. This will enable them to serve their clients, grow their portfolios, keep low levels of their portfolios at risk, and continue to expand lending operations in their respective regional locations, thereby increasing program outreach.

The Regional Director confirmed during an interview with Team members that one of the key strategic objectives that she has set for the Moscow hub, is to reach full financial sustainability by FY 2006 through the payment by affiliates of fees to the hub for services rendered. In addition, she envisions transforming at least one FINCA Affiliate MFI into a regulated institution that will be independent from donor funding by exploiting non-traditional sources of financing.

C. THE HUB'S FOUR KEY OPERATIONAL OBJECTIVES

In its five-year outlook, the NIS hub has four key operational objectives that it proposes to achieve. These are:

- ▶ To build sustainable programs in 11 countries in the region, of which 8 will reach operational and financial sustainability;
- ▶ To strengthen the hub's capacity to provide technical assistance services to affiliates in the region;
- ▶ To develop a business model for the hub and the capacity to implement it, that will enable the hub to recover core operating costs from fees and earned income

- ▶ To re-engineer the Village Banking model.

In order to achieve these objectives, the Regional Director indicated that she is attempting to diversify the hub's funding sources and is seeking to establish new financing arrangements for NIS affiliates by creating linkages with equity investors. Currently, FINCA is partnering with the International Finance Corporation (IFC) in efforts to transform FINCA Kyrgyzstan into a regulated formal financial institution that will operate on a commercial basis. The IFC is providing technical assistance to FINCA during the transformation and will take an equity stake in the commercial operation. The transformation of FINCA Kyrgyzstan will be the first of its kind for a FINCA affiliate in the NIS region and signals a new direction for the regional program.

D. INSTITUTIONAL AND OPERATIONAL INNOVATIONS THAT ARE BEING PURSUED

USAID/Russia awarded funds to FINCA to build a "best-practices" micro-finance institution in Samara. As part of the funding award, a sub-agreement was drawn up with experts from Ohio State University (OSU) to initiate an innovative micro-finance policy reform program in Russia. The policy program seeks to improve the operating and regulatory environment for micro-entrepreneurs and micro-finance institutions in Samara. If successful, the "lessons-learned" from the program will be used to replicate the program in other countries of the NIS. The hub director is responsible for the execution of the overall Cooperative Agreement for this activity through which the funds were awarded, and for the implementation of the Policy Component of the program

In collaboration with the rest of the regional network, the NIS hub will continue to design and implement innovations to the Village Banking model. Foremost among the activities being undertaken in the NIS region are efforts to meet the changing needs of clients by introducing more flexibility in loan credit products. For example, FINCA Azerbaijan is testing a progressive lending product that will separate groups that are in their third or fourth cycle into two groups: (1) larger loans and (2) traditional step credit loans. The affiliate will also test a larger small enterprise loan (SEL) which is targeted to micro-entrepreneurs with larger businesses and more complex financial needs.

E. THE TECHNICAL SERVICES PROVIDED BY THE HUB TO ITS AFFILIATES

The technical services provided by the hub to its affiliates are presented in some detail in Section III.B below, which summarizes the "value added" by the hub in serving its affiliates. In general, as noted earlier, regional hub staff members spend considerable time and effort training, assisting, and monitoring affiliate staff in management, accounting, policy, procedures, reporting, and lending methodologies.

F. THE NIS REGIONAL TECHNICAL ASSISTANCE BUDGET FOR FY 2003

The NIS Regional Technical Assistance Budget for FY 2003 was included in the FINCA proposal submitted to USAID in July 2002 and is attached hereto as Exhibit 2. As shown in the Budget, grant funding is projected to cover some two-thirds of program costs in FY 2003. The

additional \$646,500 in grant funding being requested from USAID for FY 2003 would cover over one-half of the expected costs of the program in FY 2003.

G. NIS REGIONAL TECHNICAL ASSISTANCE FINANCIAL PROJECTIONS

A copy of the hub's current regional technical assistance projections (see Exhibit 3) shows that a subsidy of around \$308 thousand will be needed to cover NIS regional technical assistance financing requirements in 2003. This is in addition to \$473,000 from MGIII and other grants. The projections show a modest surplus emerging in FY 2006.

A key element in the NIS hub's long-term financial sustainability plan for the regional technical assistance program is to cover an increasing share of the regional program's costs through the fees generated from technical services provided by the hub to regional affiliates. The majority of the fees collected by the hub are generated through the services that it provides to regional FINCA affiliates, although a small percentage is derived from micro-finance institutions outside of the FINCA Network. As reflected in Exhibit 3, the hub is anticipating that if current growth trends hold, fees paid to the hub for its services should be sufficient to sustain the regional technical assistance program by FY 2006.

As for the sustainability of the Moscow hub itself, like FINCA headquarters the hub finances itself through a non-profit business model. Currently, it is covering its costs in part from grants and in part from fees. Grants from USAID have to date been the major source of its funding. This is borne out in a Mock Financial Statement for the hub for FY 2002, which was prepared for the Team and which is attached hereto as Exhibit 4. As indicated in the Mock Statement, USAID grant funding accounted for 60 percent of hub revenues in FY 2002, while hub fees accounted for the balance. If FINCA lending operations in the NIS region expand as expected, however, revenues accruing to the hub from affiliate fees will also increase and should be adequate to meet hub expenses and assure its sustainability for some years to come.

III. THE TEAM'S FINDINGS REGARDING THE VALUE ADDED BY THE HUB IN SERVING ITS AFFILIATES

A. THE WAYS IN WHICH THE HUB ADDS VALUE TO THE OVERALL OPERATIONS OF NIS AFFILIATES

To a large extent, the ways in which the hub adds value to the overall operations of NIS affiliates emanate from the effective management base that the Regional Director has built in the NIS Region by ensuring that executive and staff members are well trained, and by promoting the use of cost-effective approaches and methods in their business management operations. In addition to the management and financial training provided by the hub to Country Directors, Finance Managers, Credit Supervisors and Credit Officers, these cost-effective approaches and methods include:

- ▶ The marketing and customer service training provided to affiliate loan officers and supervisors to increase client satisfaction, facilitate client trust, and lower the number of client drop-outs;
- ▶ The regular dissemination of new product profiles, business plans and test plans among affiliates;

- ▶ Comprehensive training on annual operating plans and bi-annual planning and budgeting;
- ▶ Improvements and upgrades to the NIS network's (MIS) Management Information Systems which will include, in FY 2003, the proposed installation of new software for selected affiliates;
- ▶ The assistance provided to affiliates in dealing with local tax issues; and
- ▶ Fund-raising assistance to the affiliates.

In addition, the hub sponsors and participates in events and activities through which it adds value to the services that it provides. For example, together with several other NGOs, the hub has been successful in forcing amendments to the tax code in Russia that will allow certain interest expenses to be deducted by MFI clients, making MFI services more competitive. Hub staff members have also prepared a manual of organizational forms of registration in Russia with a description of each form and a summary of its administrative and tax consequences.

B. THE EXTENT TO WHICH THE HUB HAS PROVIDED "VALUE ADDED" SERVICES TO ITS AFFILIATES

1. Value added services provided by the hub to its affiliate in Tomsk

During the past two years, the hub's Regional Financial Products/Credit Specialist has provided field training to credit officers and assisted affiliate staff in Tomsk regarding the start-up of a new credit program. In addition, she introduced a new product that had been developed by another affiliate for the SEL (Small Enterprise Loan) line, reviewed the affiliate's BDG (Business Development Group) policies, and visited several outlying regions in the environs of Tomsk and Novosibirsk to assess the potential for new loan clients in these regions. The Regional Director of the hub has, for some time, been providing management and policy support to the Tomsk affiliate.

2. Value added services provided by the hub to its affiliate in Samara

Hub staff members have been involved in providing services to its affiliate in Samara since inception of the FINCA program there. The Regional Finance Products/Credit Specialist has been heavily involved in a number of these activities. The Regional Director and the hub's legal advisor have played key roles assisting the affiliate in modifying the existing regulatory environment in Samara to meet the needs of the micro-finance sector.

In 2000, the hub provided training for loan program managers and helped affiliate staff with the development of a budget for the next financial year. Since then, it has provided information on the reasons that loan clients drop out; provided materials on the line of credit products being provided in Georgia that might be offered in Samara; sent Project Profiles to show the kinds of products that other affiliates are offering; provided information on the training available for new product development in micro-finance; provided a list of the questions that Kyrgyzstan loan managers ask their potential loan officers during interviews; provided Samara a copy of the Kyrgyzstan affiliate's marketing plan for possible use in developing its own plan; and has kept the affiliate regularly informed on upcoming micro-finance seminars.

3. *Value added services provided by the hub to its affiliate in Kyrgyzstan*

The FINCA affiliate in Kyrgyzstan became profitable in 1998, and has been able to fund itself from interest earnings since January 2000. Nevertheless, it still looks to the hub for various technical assistance and management support services. The experience in Kyrgyzstan underlines the importance of the hub in providing services to an affiliate that is entering the third and "transformation" stage of affiliate development, having passed successfully through the "start-up" and "expansion/self-sufficiency" stages.

The hub services most commonly provided to Kyrgyzstan, relate to the affiliate's need to fulfill FINCA's monthly accounting and financial reporting requirements. In August of 2002, the affiliate's Finance Director attended a training program at the hub to further improve her understanding of FINCA'S current financial reporting requirements.

Kyrgyzstan is also in need of more sophisticated accounting and portfolio management MIS systems. With almost 20,000 active clients, the labor-intensive Excel-based systems that it had developed and are currently using are no longer adequate. The Country Director indicated that he is looking forward to receiving hub assistance when the new SIEM system that is being installed as scheduled in 2003.

The Country Director also noted that he and his staff are benefiting from the periodic updates on "new product innovations" and the "product profiles" that he receives from other affiliates, a practice initiated by the hub. He said that he was particularly interested at present in being kept informed through hub updates of the SEL credit line that is being piloted in Georgia. If it is successful and looks promising for Kyrgyzstan, he intends to enlist the hub's Financial Products/Credit Specialist to coordinate the transfer of the best practices and lessons learned from the pilot testing experience in Georgia, to Kyrgyzstan. The hub specialist had also assisted affiliate staff in creating a marketing plan for Kyrgyzstan in 2002, and is currently involved in helping to monitor the plan.

A second new product presently being looked at for Kyrgyzstan (and for the NIS region as a whole) is agricultural lending. Through the auspices of the hub director, an expert on agricultural lending was located and a grant arranged through the IFC, enabling the affiliate to undertake and pay for a study on the demand for agricultural lending in Kyrgyzstan. The study is currently underway.

The services of the hub legal advisor were called upon for assistance in setting up a lobbying effort for the passage of a Kyrgyzstan law on MFIs (Micro Finance Institutions). Inasmuch as the legal codes in Kyrgyzstan and Russia are similar (they were both under the same system during Soviet rule and Kyrgyzstan is now following Russia's lead in reforming its legal environment), the hub's legal advisor proved to be very helpful during the lobbying process. Now that the law has been passed, he is providing assistance to the affiliate regarding registration issues and related tax matters.

FINCA Kyrgyzstan has also often utilized and is currently utilizing, the considerable commercial experience of the hub's Regional Director. Through regular e-mails and weekly discussions, the Country Director has found her "commercial perspective" to be of particular value in regards to the ongoing transformation of the Kyrgyzstan program. In fact, according to him, her advice and

perspectives regarding the operations of FINCA and her grasp of global "lessons learned" have been invaluable.

4. *Value added services provided by the hub to its affiliate in Armenia*

The hub's Regional Financial Products/Credit Specialist has traveled to the FINCA/NIS affiliate in Armenia six times within the past two years to provide assistance to affiliate staff. On two occasions this involved assisting the Operations Manager in managing the affiliate's overall program during the Country Director's absence. During the other visits, she helped to develop a new bonus system for credit officers and supervisors; provided training on the bonus system; helped to prepare the documentation needed to submit interest rate reduction proposals; introduced a new SEL line that had emerged from the 2001 SEL Managers Conference; undertook a periodic review of the affiliate's loan policies and procedures; provided assistance in implementing modifications to loan policies and procedures, and provided assistance in performing market studies and in dealing with arrears.

Additional assistance was provided by the hub's Regional Finance/Internal Controls Manager who, over the past six months helped to minimize the tax impact on the Armenia and Georgia affiliates of their transition from being exempt from having to pay local taxes under a bilateral agreement, to their current status of having to pay local taxes. She was also instrumental in developing mechanisms that could be used by the affiliates to minimize the taxes that they had to pay. In November 2002, she traveled to Armenia to review the controls that had been set up in the Finance Department as recommended in the affiliate's annual Internal Audit report.

5. *Value added services provided by the hub to its affiliate in Georgia*

The Country Director said that she considered "the responsiveness of the hub." to be "a value added service" provided to the affiliate. Having worked previously for another NGO, she said that she found a notable difference in the responsiveness that characterizes FINCA's hub-based support system, compared to the head office-based mode of support used by her former firm. As an example, she noted that the NIS Regional Director had worked on site with the affiliate twice during the past three months, an occurrence that would not have been cost effective if done from the head office. She pointed to the assistance that the Regional Director gave to filing financial reports as being of particular value and importance to her and her staff.

In June 2001, the hub's Regional Finance Manager traveled to Georgia to undertake a diagnostic pre-SIEM installation visit. She then made a second trip in December 2002 to review tax issues with local tax advisors, and to incorporate GAAP principles in the Georgian record keeping system as required by a recent change in the affiliate's tax status. The Georgia affiliate was also visited by the hub's Regional Financial Products/Credit Specialist who introduced a new SEL line that had emerged from the SEL Managers Conference held in June 2001.

The Regional Internal Auditor trained Georgia's internal auditors during an internal audit there in June and July of 2002. The Regional Auditor returned to Georgia in December of 2002 at the Country Director's request to conduct further training of the affiliate's internal auditors.

6. Value added services provided by the hub to its affiliate in Azerbaijan

Since the end of 2000, the Baku Office has been implementing the FINCA Southern Area Expansion Project funded by the Caucasus Regional USAID Mission. Each of the quarterly reports sent to the Mission since the inception of the program has identified one or more instances of support received from the Moscow hub. This is in addition to numerous interactions with the hub's Financial Services staff. In fact, the Azerbaijan operation would likely not exist today were it not for the support and intervention of the Moscow hub. Two major support initiatives by the hub were instrumental in extricating the affiliate from two very difficult situations, as indicated below.

FINCA lending operations began in Azerbaijan in 1998, but lending was suspended halfway through the first year due to onerous new tax regulations that made it prohibitively expensive. Through legal assistance provided by the hub (which was then located in Tbilisi, Georgia) a limited license for lending was secured from the Central Bank. FINCA was the first NGO in Azerbaijan to obtain this license and others soon followed. This value added service to the affiliate also provided value added for other credit NGOs in Azerbaijan.

In 2001, the affiliate experienced severe personnel problems and needed to let go of a large number of staff. The Country Director left and an existing employee filled the position on an interim basis. Dismissed staff encouraged borrowers to not repay loans. Support and mentoring by the hub's Regional Director to the interim Country Director was instrumental in overcoming this disruption in affiliate operations. USAID staff responsible for monitoring the FINCA Program readily acknowledged the value provided by the Regional Director in resolving this situation.

7. Value added services provided by the hub to its affiliate in Kosovo

The Regional Finance/Internal Control Manager conducted a 1-day training session for the Kosovo affiliate's Finance Manager in November 2001, and a 5-day training session in May 2002. The Regional Internal Auditor trained new internal auditors for the affiliate in August 2002.

C. THE MARKET DEMAND AMONG THE NIS AFFILIATES FOR MOSCOW HUB SERVICES

The NIS affiliates draw on the technical services of the hub quite frequently. As mentioned earlier, the Regional Financial Products Manager has traveled to Armenia six times within the past two years to provide support. The most commonly used hub service being requested by FINCA Kyrgyzstan is assistance in fulfilling FINCA International monthly accounting and financial reporting requirements. It also expects to receive hub assistance in the near future in arranging the installation of more sophisticated accounting and portfolio management MIS systems.

1. The level and types of network support that a start-up micro-finance institution requires as opposed to the level and type of support that an established affiliate requires

Team interviews with hub staff and country directors indicate that there are perceptible differences between the level and types of network support that a start-up MFI requires compared to those that an established one does. The start-up phase is considerably more labor intensive thus affiliates at this stage normally require a higher level of technical and managerial assistance from the hub and other affiliates in all areas of operation, including management oversight and operational support services; training, financial products and development services; internal controls, finance and accounting services; and policy, regulatory and legal services. In effect, a broad variety of services are required just to get the affiliate up and running. Tomsk is a prime example of a start-up affiliate that is moving towards a second more expansive, self-sufficient phase of operations.

Affiliates in the more expansive, self-sufficient phase, generally require a declining level of technical assistance and management support inputs until they become virtually self-sufficient at which point they require only minimal amounts of such inputs from the hub or other affiliates. Secondly, the inputs needed are mostly financial product development services that will enable the affiliate to continue to serve its clients with new products as they grow and develop. Samara is a good example of an affiliate at this stage of development.

Once an affiliate has become an established MFI, and is on the verge of being transformed into a more complex and commercialized institution with a more sophisticated mode of operation, it again needs a higher level and broad range of support from the hub, including more advanced internal controls and finance and accounting services, as well as a higher level and broader range of policy, regulatory and legal services. Kyrgyzstan, which is at mid-stream in its transformation process is an example of this type of affiliate.

D. THE EXTENT TO WHICH THE AFFILIATES ARE SATISFIED WITH THE HUB'S PERFORMANCE

Team interviews in Tomsk, Samara, and Kyrgyzstan indicated that the affiliates in these locations are quite satisfied with the hub's performance and with the support that it has provided them to date. The Team was presented with documentary examples of the kinds of services that had been rendered. These are included in Section III.B above. The Georgia and Azerbaijan affiliates indicated that they were also satisfied. Georgia and Azerbaijan are affiliates that have not yet achieved financial self-sufficiency and therefore need to draw on the services of the hub more often. The Armenia affiliate is satisfied with hub services, but has less need for its services due to being a more mature and self-sufficient affiliate and one that maintains tight control of its operating expenses.

E. THE WAYS IN WHICH AFFILIATE PROGRAMS HAVE BENEFITED FROM THE SERVICES OF THE HUB

1. *There appears to be a notable difference between those MFIs that have received assistance from the Moscow hub and those that have not received such assistance*

Team members noted during the evaluation what appears to be a notable difference in the time it takes for an affiliate to reach Financial Self-Sustainability (FSS) between MFIs that have received assistance from the Moscow hub and those that have not received such assistance. FINCA International Global Statistics published in November 2002 show Armenia and Kyrgyzstan to be at comparable levels of Financial Self Sufficiency (FSS), as indicated in the chart below. However, the Kyrgyzstan affiliate has been operating for almost 8 years (its program was started in 1995) and Armenia only 4 years (its program was started in 1999). Samara, which started in 1999 and which has received considerable hub assistance, has already nearly reached FSS. Likewise, Tomsk has reached 69 % FSS after operating less than 2 years, and is well on the road to becoming financially self-sustaining in the not too distant future. As noted below, the NIS affiliate in Tomsk has benefited extensively from the "lessons learned" and "best practices" disseminated by the hub. This is due in large part to the fact that the Moscow hub has been very active in training staff members in Tomsk and has thereby been able to provide guidance based on the experience of other affiliates in all facets of program operations.

These developments seem to imply that while FINCA Kyrgyzstan did achieve great results in both client outreach and financial self-sufficiency rather quickly, it likely would have reached these results even earlier had it been able to draw on services that are now being provided to affiliates by the Moscow hub. It should be noted that the NIS regional hub was originally established in Tbilisi, Georgia in 1997, and was subsequently moved to Moscow at USAID's request.

Other factors also pertain, however, including the extent of access to potential clients and the availability of adequate lending resources, e.g., USAID grant funds. Kyrgyzstan did not perform much worse than affiliates that have received hub support. In fact, it reached financial self-sufficiency in three years, as did Armenia and Kosovo. Kyrgyzstan's first three years' results were 21%, 60% and 113% respectively, vs 5%, 38% and 56% for Samara. Tomsk at 24% and 69% in the first two years is only marginally above comparable Kyrgyzstan performance.

From its brief and cursory analysis, the Team has concluded that further research in this area maybe warranted and should be undertaken to confirm that affiliate programs do benefit from the services of the hub, and to measure as feasible the benefits of its being located in Moscow.

FINCA Moscow Hub: Financial* Self-Sufficiency (FSS) by Affiliate

Affiliate:	(Annual For Fiscal years ending August 31)				
	1998	1999	2000	2001	2002
Armenia		8%	49%	124%	194%
Azerbaijan	0%	69%	36%	68%	59%
Georgia	12%	67%	73%	77%	107%
Kyrgyzstan	113%	87%	148%	162%	163%
Samara		5%	38%	56%	91%
Tomsk				24%	69%
Kosovo			6%	55%	104%

The Kyrgyzstan affiliate was operational in 1996 and 1997 with FSS of 21% and 60% respectively. FINCA defines Financial Self-Sufficiency as operating income / (operating expenses (including financial expenses and loan reserves) plus an adjustment for inflation on equity).
Source: FINCA Financial Records

2. *A comparison between the benefits of the hub for its affiliates in Russia versus those in Kyrgyzstan and the Caucasus*

From its brief visits to affiliate locations, the team was not able to perceive any appreciable differences, based on their geographical boundaries, in the extent to which affiliate programs in Russia have benefited from the services of the hub compared to those being implemented in Kyrgyzstan and the Caucasus. However, as indicated above in Section III.B, there do appear to be significant differences based on affiliate needs for assistance and the extent to which these needs are met.

F. THE SUCCESS OF THE HUB IN DISSEMINATING LESSONS LEARNED AND BEST PRACTICES THROUGHOUT THE REGION

Examples of hub success in disseminating “lessons learned” and “best practices” include the development and utilization of model micro-credit programs; the increased advocacy assistance being provided to effect improvements in the policy, legislative, and regulatory environment in affiliate countries and to facilitate the development of micro-finance institutions; the support and expertise provided in the area of product development through sharing arrangements; and the trust gained by clients through their success in fulfilling their modest financial needs through FINCA loans.

As the most recent start-up program, the NIS affiliate in Tomsk has benefited extensively from the “lessons learned” and “best practices” disseminated by the hub. This is due in large part to the fact that the hub has been very active in training staff members in Tomsk and has thereby been able to provide guidance based on the experience of other affiliates in all facets of program operations. The initial set of loan products promoted in Tomsk were based on the experience gained from their use by other affiliates in the region, particularly by Samara which was the first FINCA affiliate established in Russia. This cooperation continued as the new program director in Tomsk received training in Moscow from hub staff to gain a regional focus, and in Samara to get the benefits of localized hands-on training from a successful FINCA affiliate.

This assistance by the hub was extended to all aspects of FINCA/Tomsk operations, and included the creation of a bonus system for loan officers, the negotiation of lease agreements, registration and tax issues, and advice concerning interactions with USAID and the need to fulfill USAID reporting requirements. The Tomsk Program Director described the hub as a "well of knowledge" that he felt free to tap whenever he needed assistance or information regarding any aspect of the affiliate's lending activities.

FINCA/Samara has also benefited considerably from the lessons learned and best practices disseminated throughout the region by the hub. An example that stands out is the new SEL credit line product that was pioneered by Georgia and is now being implemented in Samara with hub assistance. By not having to reinvent the wheel, FINCA Samara has saved a lot of time and is better able to focus on serving its clients and on expanding to new regions. The Samara Program Director told Team members that he considers the hub to be a "clearing house of information and history" to be used by FINCA Samara in its further development.

With the help of USAID funding, FINCA has created in Kyrgyzstan a model micro-finance institution for the NIS region. This has led to the establishment of a trained core group of local employees that can be easily relocated to other affiliates in the NIS, to help in establishing and managing micro-finance programs at these locations. The Deputy Director currently assigned to the affiliate in Tomsk was formerly a member of the affiliate staff in Bishkek. In effect, the hub is using this approach to transfer best practices and lessons learned in Kyrgyzstan directly to another FINCA affiliate in the NIS region.

FINCA International assistance is currently being provided to selected affiliates worldwide to transform them into regulated micro-finance institutions. This will enable these institutions to receive deposits and intermediate savings and to thereby greatly expand their operations. Moscow hub staff will be involved in the proposed transformation of its Kyrgyzstan affiliate beginning in FY 2003, and plans to use the experience gained through this endeavor to undertake similar transformations in other locations in future years.

Lessons learned and best practices are also being disseminated through other mechanisms. For example, internal controls and finance and accounting services are being disseminated to affiliate Finance Directors through finance training seminars. FINCA Azerbaijan will be testing a progressive lending product that will separate groups that are in their third or fourth cycle of borrowing into two groups: larger loans and traditional step credit loans. The affiliate will also test a larger small enterprise loan that is being targeted for use by micro-entrepreneurs with larger businesses and more complex financial needs.

G. THE EXTENT TO WHICH THE HUB IS CONTRIBUTING TO THE ESTABLISHMENT OF A SUSTAINABLE NETWORK OF MFI INSTITUTIONS IN THE NIS REGION

The services provided by the hub, including management oversight and operations support services, financial products and development services, internal controls, finance and accounting services, and policy, regulatory and legal services have been instrumental in promoting a sustainable network of FINCA affiliates in the NIS Region.

The monthly monitoring of operational and financial sustainability by the hub has been useful in measuring affiliate progress toward reaching financial self-sufficiency. The absolute level is important, but steady progress is even more important. As shown above in Section III.E.1, four of the seven affiliates currently operating in the NIS region had technically achieved financial self-sufficiency as of the end of Fiscal 2002. The USAID standard is for MFIs to achieve full financial sustainability within seven years of initially receiving USAID assistance.

H. THE LEVEL OF NETWORKING THAT HAS DEVELOPED AMONG THE FINCA AFFILIATE MFIS WITHIN THE NIS

A good deal of consultation takes place between the hub and the NIS affiliates and among the affiliates within the NIS region. This is done largely through teleconferencing and e-mail exchanges, and through periodic reporting. The hub sponsors yearly Country Program Director meetings. In addition, as noted earlier, efforts are made to ensure that experiences from one program are translated into solutions for programs throughout the region. Special marketing efforts are made to ensure that new products developed in one country are shared with others to be tested and implemented if successful. A newly developed SEL program in Georgia was used to train staff from all affiliates within the NIS on SEL lending techniques. Newly recruited Country Directors are generally placed at an affiliate other than the one to which they will be assigned, for initial break-in and cross-training purposes.

The hub also facilitates intra-regional exchanges whereby specialists from one affiliate location are placed in other locations to provide training and to disseminate lessons learned. Loan supervisors from Azerbaijan were trained in Samara and the Deputy Director from Samara was sent to Georgia for training. Kyrgyz nationals are currently working in the Moscow hub, filling the positions of Regional Credit Specialist and Regional Internal Auditor. Kyrgyz nationals were also engaged as Operations Managers during the start-ups of the Tomsk and Kosovo affiliates

IV. THE TEAM'S FINDINGS REGARDING THE EFFICIENCY AND COST-EFFECTIVENESS OF THE HUB'S OPERATIONS

A. THE EFFICIENCY AND COST-EFFECTIVENESS OF THE HUB'S MODE OF OPERATION VIS-À-VIS ITS AFFILIATES

The Team found the hub to be efficient and cost-effective in that it is using a minimal but highly experienced staff to provide sustained levels of professional and technical services that are not generally available in field locations, except at extremely high prices. Rather than hiring specialists in each affiliate program, FINCA has one policy and regulatory expert for the region, a strategic planning and finance specialist, a management specialist, and a management information system specialist. This avoids expensive redundancies in staffing and effort. In addition, given the experience and program background knowledge vested in them, there is considerable potential for FINCA to leverage the use of existing hub staff as the NIS affiliates enter the third stage of their development as MFIs.

B. THE FINANCIAL PERFORMANCE OF THE VARIOUS MICRO-FINANCE INSTITUTIONS SUPPORTED BY FINCA

FINCA Kyrgyzstan is currently financially self-sustainable, as are Armenia, Georgia, and Kosovo. Samara is rapidly approaching that goal. The 3% fee charged to affiliates, which will shortly be raised to 3.5%, is considered to be realistic and has not hampered operations in affiliates to date. In fact, the Country Director in Kyrgyzstan indicated that he would not have a problem with paying more than the current 3% fee, or even the proposed 3.5% fee, although he acknowledged that too high a fee could affect the long-term prospects of profitability for the newly transformed commercial entity that the affiliate is in the process of becoming. The fee is recorded by affiliates as an operating expense and is therefore part of their operating expense ratio. With its current portfolio yield of more than twice its operating expense ratio, Armenia has also hardly noticed the expenditure

C. THE FINANCIAL SELF-SUSTAINABILITY OF THE HUB AND THE AFFILIATES

The hub is not financially self-sustainable at present. Through its continued efforts to reduce costs, however, and given the pending increase in hub revenues from fee collections (to 3.5 % of the average outstanding portfolio of affiliates) and the continued growth of affiliate portfolios, the hub expects to become financially self-sustainable by FY 06. Moreover, if FINCA lending operations in the NIS region expand as expected, revenues accruing to the hub from affiliate fees will also increase and should be adequate to assure its sustainability for some years to come.

Accordingly, the Team considers sustainability of the hub to be an attainable objective and a feasible one, inasmuch as the hub constitutes a valuable institutional asset in an area where MFI lending structures are in the nascent stages of development. According to hub data, the total value of loans outstanding for affiliates in the NIS region more than tripled between February 2001 and November 2002.

As for the financial sustainability of the NIS affiliates, the situation in Azerbaijan warrants some attention. During its field visit, the Team was informed that competition to the FINCA affiliate in that country is increasing. Moreover, the competition there has access to cheap funds and appears to be more interested in disbursing funds than in recovering them. Such situations distort local markets. The answer for a lending operation in that kind of a situation is to become as efficient as possible, thereby enabling services to be provided at lower cost.

An interview with the Country Director in Armenia indicated that there was reluctance on the part of the hub to reduce interest rates as aggressively as he had requested to become more competitive. This may reflect a desire by the hub to register income that would permit higher aggregate profitability to be shown by consolidating affiliate data. At the same time, it was likely that not reducing the rates could diminish the affiliate's competitiveness in the local village loan market.

Competition is generally regarded as good for the micro-finance industry and normally leads to reduced interest costs to clients. Accordingly, the Team believes that FINCA should be encouraged to take a lead role in setting the standards in an area, rather than being forced to match rate reductions by others. In order to accomplish this, the hub needs to assist affiliates in

becoming more efficient. Maintaining higher interest rates for clients should not be a substitute for operating expense control.

This issue of the comparatively high interest rates being charged to borrowers was raised during a Team interview in Bishkek. The issue there has to do with the fact that the low-level loan market rates charged in country are lower than black market rates, though higher than the rates charged by banks, although banks don't lend to this market due to the fact that micro lending is labor intensive. FINCA intends to continue serving its main target group, i.e., lower-income clients who are seeking short-term loans of up to \$10,000.

Another means to improve the efficiency of affiliates is to increase the percentage of productively earning assets. This means deploying more of affiliate assets in sound loans. FINCA suggests 90% as a loan to asset ratio, but this may be difficult to achieve. Still, affiliates fall far short of this benchmark. Data compiled by the evaluation team indicate that affiliate variance in the productive usage of assets ranges from a low of 29% to a high of 83%. This could be the result of seasonal variances in demand. However, the ratios were generally unchanged from the end of FY 2002 (Aug. 31) through the end of December.

Low loan to asset ratios may indicate that significant amounts of cash are being held by affiliates. Some argue that unused funds in the affiliates could be shifted to funding for running the hub. From a purely numerical perspective, there is at this time sufficient cash on hand in the affiliates to fund hub operations. The cash represents a mixture of profits (substantial in the case of Kyrgyzstan) and donor-provided funds (loan capital) that are tied to a particular country or program. A case might be made that affiliates that have reached financial self-sufficiency should be paying more in fees to the hub than those that have not. This action would increase the already high operating expense ratios. Even affiliates that have achieved financial self-sufficiency have operating costs that could be further reduced. In reference to profits, such as for the Kyrgyzstan affiliate, there will be downward pressure on interest rates as competition enters the market. Additionally, as this affiliate completes the transition process to a regulated financial institution, it will lose the tax-exempt status that it held under the Bilateral Agreement, thereby reducing its net earnings.

Accordingly, while it may appear inconsistent for FINCA to be requesting more grant funds for hub operations while large amounts of loan capital funds lie unused in affiliates, the funds cannot simply be shifted to the hub, inasmuch as they are tied to agreements that were signed for each program and, in the case of Georgia and Armenia, are the result of the recent closeout of a regional project with ShoreBank. This was a one-time occurrence, and over the next year loan demand is expected to reach a level that will fully utilize the funds.

The Village Bank Capital Fund (VBCF) that FINCA International maintains helps to safely hold some of the surplus loan funds being generated by the affiliates. However, converting local currencies into dollars and then transferring the funds outside of a country can be costly and is often restricted. Accordingly, this mechanism of temporarily investing affiliate funds doesn't necessarily provide higher returns and is not as rewarding or useful as it might otherwise be.

Having low loan to asset ratios is an unusual situation for an MFI. Often, programs have such demand that they are limited in disbursements to their current collections. The hub should consider working with affiliates to increase their loan to asset ratios. The impact would be most

dramatic in Azerbaijan, Tomsk and Georgia. This condition may also be an indication that the loan products being offered by affiliates need further development and diversification to meet demand. Increasing loan to asset ratios could help to expedite and ensure that affiliates attain financial self-sustainability.

An alternative method of improving the profitability and sustainability of the hub and its NIS affiliates would be to increase the cost efficiency of their operations. One measure of relative efficiency is the ratio of Operating Expenses to Loans Outstanding. FINCA's affiliates are reporting a range of 54% to over 120% for this ratio. Some of this variability is due to the size and age of the affiliates, with the larger and older programs being more efficient. The remainder is attributable to how they are organized and how they conduct their business. A thorough activity-based costing (ABC) analysis could improve these ratios.

D. THE PROGRESS BEING MADE BY FINCA IN DIVERSIFYING ITS FUNDING SOURCES

With respect to the progress being made by FINCA in diversifying its sources of loan capital, FINCA has an arrangement with the International Finance Corporation (IFC) through which the IFC will provide up to \$1 million of loan capital for Kyrgyzstan. In Kosovo, FINCA has borrowed \$1.1 million from KfW, the German Development Bank. Additionally, as provided by FINCA, the amount of fee-based income earned by the hub increased from \$200,000 in all of 2000 and 2001, to \$318,000 in fiscal 2002.

Regarding operating funds for the hub, the Finance Manager reported that there are six sources of funding in addition to fees being charged the affiliates: These are the following:

- ▶ Matching Grant III (USAID Washington)
- ▶ Samara Project (USAID Moscow)
- ▶ Tomsk Project (USAID Moscow)
- ▶ Samara Policy Initiative (USAID Moscow)
- ▶ Azerbaijan (the former USAID Caucasus regional project with ShoreBank)
- ▶ IFC (for the Regional MIS conversion activity)

The USAID Washington Matching Grant III represents the largest source.

E. THE LEVELS OF INSTITUTIONAL SUSTAINABILITY ACHIEVED BY THE HUB

The issue of the institutional sustainability of the hub, as well as the institutional sustainability of the affiliates, needs to be viewed within the context of the Matching Grant III Contract of September 2000, and the related Detailed Implementation Plan of March 2001. While those two documents highlight improved efficiency and financial sustainability for the hub and its NIS affiliates, neither indicates that these institutions are to be developed as sustainable stand-alone institutions with local boards of directors. In fact, in the Implementation Plan, FINCA indicates that all affiliates are local entities of varying forms but continue to be branches or subsidiaries of FINCA International. Accordingly, no indicators or targets have been established regarding local governance. Costs and initiatives to develop local boards were not envisioned. In fact, the hub is being developed as an integral component of FINCA International, as are the affiliates.

Evaluating the institutional sustainability of the hub and its affiliate institutions on this basis would not be very enlightening.

F. THE LEVELS OF INSTITUTIONAL SUSTAINABILITY ACHIEVED BY THE AFFILIATES

As noted above, NIS affiliates in general are not being guided towards becoming sustainable as locally governed institutions. Rather, the emphasis has been on their achieving financial self-sufficiency. Local staff members are well trained in operations, portfolio at risk has been very well controlled, and there has generally been steady progress among the affiliates toward full cost recovery.

In the specific case of Armenia, FINCA is registered as a local foundation. However, no local inhabitants appear to serve as board members. The list of board members for the foundation provided by the Country Director was dated January 2000 and included the previous Armenia Country Director as well as the previous Moscow Hub Director.

The successful adoption in Kyrgyzstan of a micro finance law has brought that affiliate one step closer to being institutionally sustainable and to being locally registered as a Kyrgyzstani organization. As it stands, FINCA Kyrgyzstan is a wholly owned subsidiary of FINCA International and is operating in Kyrgyzstan under the framework of the Cooperative Agreement between the U.S. and the Kyrgyzstani government. A local board of directors does not manage the affiliate and as the Country Director noted, the new transformed FINCA Kyrgyzstan affiliate will operate as a locally registered organization and will be wholly owned and managed by FINCA International, with possible participation in some form by the IFC.

G. THE CONSIDERATION OF POSSIBLE ALTERNATIVES TO THE REGIONAL HUB MODEL THAT MAY BE MORE VIABLE AND COST-EFFECTIVE IN THE LONG RUN

The team considered several alternative models in looking for one that might be more viable and cost-effective in the long run than the regional hub model. These included establishing an even more decentralized structure in which the functions of the hub would be moved out to the regional affiliates. This alternative would allow the affiliates to keep their local focus, but they would lose some of the regional linkages that they now enjoy through interactions with hub staff, such as ready access to appropriate types of the management, training, technical and financial services that are presently vested in hub staff. Secondly, it would be difficult to find, attract and retain the same level of qualified personnel, thus requiring the use of outside experts who may or may not be well attuned to MFI developments throughout the region. Consequently, Country Directors and their associates would likely spend a considerable share of their time looking for needed assistance and less time on operational issues and the day-to-day job of managing their organizations and ensuring that clients are well served.

The Team also considered moving the hub to a lower-cost regional location; however, it was noted that the hub operation had been moved from Georgia to Moscow at the request of USAID to increase the efficiency and efficacy of its operations. Secondly, FINCA itself has recently moved regional programming activities from its headquarters in Washington to Moscow and

other hubs for basically the same reasons. In effect, this alternative option would be a step backward.

The Team noted that the hub will be implementing a series of activities to increase both its own net operating revenues and those of its affiliates (the hub's viability is dependent on that of its affiliates). These activities will include expanding and improving the FAFS; increasing staff productivity and minimizing costs; standardizing affiliate start-up and operating systems, policies and procedures; and increasing both affiliate size and the total number of affiliates. Taken together, these measures should make the current hub model itself more viable and cost-effective in the long run, thereby, perhaps, obviating the need to consider alternative models.

FINCA's configuration is in contrast to that of Opportunity International (OI), a network of MFIs that worked through four regional offices to provide technical services and develop new MFIs. Opportunity International works in 24 countries as opposed to FINCA's 20 and has approximately twice the number of borrowing clients. However, its regional offices provided more generalized services than FINCA's do. In 1999, the organization was faced with a situation whereby its partner MFIs were falling significantly behind its own projections and those of other micro-finance industry leaders. Accordingly, it chose to close the regional offices and to concentrate on providing demand driven services.

V. EVALUATION OF THE SPECIFIC SERVICES THAT THE HUB PROVIDES ITS AFFILIATES

A. MANAGEMENT OVERSIGHT AND OPERATIONAL SUPPORT SERVICES

The regional director of the hub is responsible for assisting in the recruitment of Country Directors and affiliate Finance Managers, and in providing them orientation and training to effectively do their jobs. She also assists affiliates in securing additional funding and commercial lines of credit through formal financial institutions. Operational support services provided by hub financial staff include assistance to affiliates in preparing and monitoring multi-year business plans, financial projections and annual operating plans. Hub technical staff members participate in assessing the legal and regulatory requirements in affiliate countries, in market evaluations, and in the preparation of outreach projections and marketing plans.

1. The extent to which the staffing of the hub is adequate to meet the technical assistance needs of the affiliates

The Team found the services provided by hub staff to be generally adequate in meeting the technical assistance needs of the affiliates, with the exception that there is currently a vacancy in the MIS slot. This position will likely be filled once the pilot installation of a new Management Information System (known through its Spanish acronym as SIEM), has been completed. It is scheduled to take place in Azerbaijan in the first quarter of 2003. A question was raised during one of the Team's interviews, however, whether it might not be more cost effective for MIS technical support to be arranged through local providers at each affiliate site directly with the SIEM system developer in Guatemala rather than being routed circuitously through the hub-based MIS staff member. This is an issue that should be considered as the system is being installed.

The affiliates draw on the hub periodically for assistance in preparing and monitoring annual business plans, expansion plans, financial projections and operating plans. Hub staff members are required to review and critique all plans and proposals before they are submitted to other interested partners, e.g., FINCA headquarters, USAID, etc.

The hub has also assisted affiliates in securing additional funding sources. In fact, the hub director brokered a small interest bearing loan for \$250,000 from FINCA Kyrgyzstan to FINCA Kosovo in the summer of 2002. One Country Director suggested that the hub consider providing assistance to affiliates in proposal writing. As a part of the FINCA effort to diversify funding sources, this service would fit well in the hub support package.

B. FINANCIAL PRODUCTS AND DEVELOPMENT SERVICES

The hub has a product development specialist who assists affiliates in conducting market research and in testing new credit and savings products. She also assists them in developing marketing and expansion plans for those products. New products developed in one country are shared with others to be tested and, if successful, to be implemented. In addition, the product development specialist oversees the regional expansion within each affiliate. This involves budget development, new market area research, client surveys, and ascertaining the viability of opening another satellite office. Hub assistance activities also include researching the needs of clients.

1. The hub's responsiveness in developing alternative financial products and in modifying its village banking methodology and products to meet the specific needs of the affiliates

The hub has been responsive in assisting affiliates by performing market research, assessing the needs of their clients and in testing new credit and savings products. The hub financial services specialist assists affiliates in the design of market surveys, in conducting client satisfaction surveys and by analyzing the results of these surveys. The hub also assists affiliates by tracking and monitoring client drop out through exit surveys, by analyzing the reasons for their having dropped out, and by designing measures to retain clients.

The Tomsk affiliate received hub assistance in researching the potential market in Novosibirsk and in assessing the prospective needs of loan clients there versus the current needs of Tomsk clients. This assistance was instrumental in convincing the USAID to approve an expansion of FINCA lending operations to Novosibirsk. In addition, the Tomsk affiliate had been testing a new product in the fall of 2002 with hub supervision. The test, which began in March, came to a successful end and the new product was signed-off on in October. Also, due to several client deaths, the Tomsk affiliate initiated an insurance product to alleviate the burden of its group clients on having to completely repay the loan of a group member in the case of death. It is being tested with individual clients as well. The product is still in the testing phase.

The Samara affiliate received assistance from the hub in upgrading its market research methods and in assessing the needs of clients. This assistance resulted in the formulation of a new list of questions to be discussed at Client Focus Groups; changes in the form of questionnaire for individual clients at the initial loan interview; development of a questionnaire for individual clients to gauge their interest in credit line products, and a new list of reasons for client exit to be

used by FSOs to increase the level of service and try to retain those clients. The hub's assistance has also resulted in a new product SEL credit line now being tested in Samara, and in changes in the conditions of parallel and seasonal loans.

New credit and savings products initially are only approved on a test or pilot basis after extensive market research of the product has been conducted and a formal proposal for approval has been submitted to the hub. All new products also require approval from FINCA International. The hub acts as an advocate for this approval.

2. *The hub's effectiveness in sharing information and lessons learned about new hub products and methodologies among regional affiliates*

In collaboration with the rest of the network, the NIS hub will be designing and implementing innovations to the Village Banking model. Foremost among the strategies for the NIS is the introduction of more flexibility into the credit product in order to meet the needs of clients. For example, FINCA Azerbaijan will be testing a progressive lending product that will separate groups that are in their third or fourth cycle into two groups: larger loans and traditional step credit loans. The affiliate will also test a larger small enterprise loan, which is targeted to micro-entrepreneurs with larger businesses and more complex financial needs.

The hub disseminates "best practices" and "lessons learned" with other programs primarily through Country Directors conferences held once a year and through mail outs. New products developed in the NIS region include the Small Enterprise Loan (SEL) in Armenia (May 2001), the SEL Credit Line in Georgia (April 2002), and the SEL in Tomsk (March 2002). Currently being tested is the SEL Credit Line in Samara. Currently in the process of design and preparation for testing is the SEL Seasonal Loan in Kosovo, SEL in Azerbaijan, and Rural Lending products in Kyrgyzstan and Azerbaijan.

The hub plays a very active role in adapting loan products to the local environment. This is done through participation in the development of new products and modifying current products as described above. Information and lessons learned in the region are taken into account during this process. These products and changes are formally tracked every 6 months through the hub's Individual Loan Product and Village Banking Product forms. The information about new products and product modifications contained in these forms are then sent to all affiliates for their review. Results of new products tests are shared with all affiliates in the region

C. HUB SUPPORT FOR THE EXPANSION OF REGIONAL AFFILIATES

The hub actively supports and controls the expansion of regional affiliates through its regional expansion procedures. These procedures are requirements that the affiliate must fulfill in order to expand to regions with a satellite office. They include an expansion proposal, marketing analysis, outreach projections and the time frame for expansion. The hub Financial Services specialist also visits new regions for expansion and assists in market analysis including the design of potential client questionnaires in order to survey potential clients.

D. INTERNAL CONTROLS, FINANCE AND ACCOUNTING SERVICES

Regional technical staff members assist affiliates in installing accounting, portfolio management, and office administrative systems

1. *The technical assistance services provided by the hub to affiliates to assist them in installing portfolio management and office administrative systems*

The original portfolio management and office administrative systems used by NIS affiliates were designed in FINCA Kyrgyzstan as it was the first affiliate to be located in the region. These systems are still in use today and are the basis for its monthly reporting to the hub and to FINCA International. The Director of Finance in Kyrgyzstan told Team members that she finds the services of the hub to be invaluable, particularly with regard to the role it plays in serving as a channel for communication between Kyrgyzstan and FINCA International. She also noted that the affiliate's current management systems do promote transparency, but are now too primitive to handle the affiliate's almost 20,000 clients. She said that she is looking forward to the installation of the SIEM system of accounting and portfolio management software.

The hub's Regional Finance Manager has simplified and automated monthly financial reports. This has eliminated manual reentry of much data and has made it easier to read budget to actual reports. The system also needs an automated budget to actual performance report with variances on a year to date basis. This would assist Country Directors and hub personnel in quickly identifying variances in anticipated progress. Offices that provide USAID quarterly status reports under grant agreements all report actual performance against projected. The Monthly Status Reports provided by all affiliates to the hub provide status updates, but do not set forth performance versus projected performance. The Microfin Planning software that has been introduced can help as it can capture cumulative projected versus actual performance.

2. *The extent to which the hub monitors affiliate performance in fulfilling grant agreements and budgets*

For affiliates with active grants the hub monitors the implementation of grant obligations and ensures the fulfillment of all grant budgets and agreements.

3. *The extent to which the hub conducts internal audits of the affiliates using an independent auditor*

The Regional Internal Auditor reports administratively to the hub, but functionally she reports directly to FINCA International in Washington. Internal auditors at each of the affiliates report directly to the Regional Internal Auditor at the hub, although they are supported administratively by the affiliates. These are important distinctions as Internal Audit is separate and distinct from the Regional Finance/Internal Controls function in the hub. In fact, Regional Finance is tasked with assisting affiliates in implementing corrective measures for material citations in internal audit reports.

The Regional Internal Auditor conducts comprehensive annual internal audits of each affiliate. Four affiliates were examined in the last six months of 2002. The audit is conducted following detailed policies and procedures and uses a specific questionnaire that is prepared in advance.

Part of the process includes compliance with grant agreements. The auditor spends about two weeks at each affiliate and works jointly with the local internal auditors at each affiliate. Upon completion of the audit at the hub, the audit report is submitted to FINCA Headquarters for Board review along with copies to the hub and Country Directors.

The Internal Auditor trains internal auditors of the affiliates. For example, many internal auditors in Georgia were previously credit officers. They had a good knowledge of operations related to disbursement and repayment in credit groups, but required knowledge to be able to audit all functions performed by the affiliate. At the request of the Country Director, the Regional Internal Auditor delivered training in December 2002 to upgrade the skills of internal audit personnel in FINCA Georgia. The Internal Auditor also trained new internal auditors in Kosovo during August of 2002 and in Samara in February 2003. The local internal auditors involvement in the annual internal audit also is a training experience.

E. POLICY, REGULATORY AND LEGAL SERVICES

FINCA assists affiliates by conducting legal and regulatory assessments and developing strategies to put into place new laws, policies and regulations that are favorable to the development of a healthy micro-finance program.

1. *An assessment of the extent to which the hub's work in policy, legal and regulatory reform has been successful in promoting a positive legal and regulatory environment for MFIs in the region*

In spite of the FINCA hub's persistent attempts to promote a positive legal and regulatory environment for MFIs in the NIS region, the array of legal and regulatory issues facing FINCA and other MFIs seems almost overwhelming for any advocacy coalition to overcome. Even the best-organized non-governmental organizations, without a forceful and an explicit support of legislative and executive branches of the government, will find their achievements fleeting at best.

In Georgia and Armenia, due to a general lack of lobbying power and coordination of effort, the MFI community has not been able to significantly influence the reform process. This, in turn, has seriously impeded the growth of the MFI industry in these countries. Further concerted support for these lobbying efforts by the Regional Director of FINCA, by USAID, and by the US Embassy on behalf of the micro-finance community, seems to be warranted.

Some of the more prevalent constraints to MFI development include the unnecessary regulation of lending by Central Bank officials, interest rate ceilings, overly burdensome tax structures, and restrictions on forms of registration for non-profit micro-finance institutions (MFIs).

2. *The effectiveness of the Moscow hub's policy work in promoting reform of the legal and regulatory environment for non-bank financial institutions in the NIS and Russia*

In Team discussions with the FINCA affiliate offices in Armenia, Georgia, Azerbaijan and the Russian Federation itself, four problematic factors were identified that could prevent FINCA as well as other MFIs from developing further. These factors include the following, and are the

focus of hub efforts to improve the legal and regulatory environment for non-bank institutions in the NIS and Russia:

- ▶ The lack of a clear policy on the national/federal level to guide regional authorities in respect to micro-finance and co-operative credit for the development of micro or small enterprises and small farmers.
- ▶ Ambiguity in national/federal legislation, which is creating uncertainty as to the legality of credit delivery by non-bank financial intermediaries.
- ▶ Unfavorable tax regimes for micro-finance providers and borrowers.
- ▶ An uncertain medium-term funding perspective for institutions that are not fully self-reliant from the point of view of resource mobilization.

In Russia, FINCA has been instrumental in catalyzing a working group on policy reform, which has successfully advocated for changes to improve a hostile regulatory environment. For this effort, FINCA coalesced a working group of eight local and international NGOs. The group has evaluated the current regulatory environment in Russia and has developed an advocacy plan to address the constraints.

The Moscow hub together with Opportunity International, the Russian Women's Microfinance Network, and Leggem Preferre, successfully lobbied for a change to the Tax Code eliminating the 20% VAT on interest from loans paid by MFI, having noted that banks were exempt. The Hub also prepared a manual of organizational forms of registration in Russia with a description of each form and the administrative and tax consequences for each. In addition, the Hub was successful in forcing amendments to the Tax Code, which will allow certain interest expenses to be deducted by MFI clients, making MFI services more competitive for a client.

The Hub also attempts to proactively encourage the adoption of appropriate industry-wide regulatory and legal regimes by developing links with lawmakers and central bank officials and it maintains a role in local MFI organizations and networks to disseminate MFI's best practices and foster MFI advocacy groups.

In order to further strengthen the position of the MFIs in the region, the Regional Director strongly encourages the participation of regional affiliates in local micro-finance associations. Moreover, FINCA/Moscow chairs the Kosovo Micro-finance Association where it has been instrumental in working with local banks on the establishment of a credit rating system. The FINCA affiliate in Azerbaijan also chairs the local Micro-finance Association there.

In order to promote a favorable environment for the MFI sector in Russia, the Moscow hub has developed a close working relationship with the Russian State Duma and is encouraging its affiliates to promote similar relationships with the law-making institutions in their country. The hub was instrumental in organizing the parliamentary exchange on micro-finance between the US Congress and the Russian State Duma in order to establish a dialogue and information exchange on legislative support for the development of the non-bank finance sector as a source of funding for small business.

In addition, the hub has worked on limiting the extensive tax liabilities of FINCA affiliates in Russia, by designing a new form of labor agreement, and by modifying the self-employment

status for FINCA credit officers. The legal advisor has also looked for ways to restructure the legal status of FINCA so as to maximize possible tax advantages for its affiliates.

The hub also acts as a repository of legal and regulatory knowledge for the affiliates and disseminates best practices throughout the industry by being an active participant in various industry conferences, seminars, and round table discussion groups. In April 2002, FINCA participated in the Third All Russian Conference of Small Enterprises. In October 2000, during an International Conference on Financial and Credit Mechanisms for Small Enterprises, the legal advisor for the FINCA Moscow hub participated in discussions and provided recommendations regarding the need for a reduction of the tax burden on MFIs.

3. *The extent to which the other NIS affiliates have benefited from access to the expertise available in the Moscow hub to support their policy, regulatory and legal work*

The hub has focused much of its attention on regulatory issues impacting micro-entrepreneurs and micro-finance institutions in the NIS region, building upon the lessons learned from the FINCA-OSU collaboration. As a result, FINCA NIS affiliates now have host government approval to operate Village Banking programs in countries where the NIS hub provides technical assistance.

a. *Legal and regulatory services provided FINCA Armenia*

The Moscow hub is providing broad legal and regulatory advice on various registration issues for FINCA Armenia, which is registered as a local organization. The hub provided legal advice that was instrumental in developing mechanisms to lower the taxable base and increase deductions for the Armenian affiliate. The hub is also engaged in the review of options to change the status of the Armenian affiliate from a local organization to that of a subsidiary of a foreign legal entity. Changing its status would reduce the tax burden on the operations of FINCA Armenia.

Hub technical support has been provided during the past six months to minimize the tax impact of the transition by the Armenia and Georgia affiliates from the tax exempt status it has been enjoying under a bilateral agreement to local taxed status. The Regional Finance Manager was instrumental in developing mechanisms to minimize taxes.

b. *Legal and regulatory services provided FINCA Georgia*

FINCA Georgia was registered in 1998 as a non-profit fund and an affiliate of FINCA International. FINCA's micro-finance activity in Georgia is classified as lending, hence, licensing by the Georgian National Bank is not required.

Due to the expiration of the USAID Grant Agreement, the Moscow hub's legal advisor is currently engaged in an analysis of the tax consequences of a post-Grant Agreement situation. He is also performing research on tax and fiscal regulations in Georgia as they relate to the operation of FINCA Georgia, as well as an analysis of the country's taxation rules as they apply to the country director's salary.

c. Legal and regulatory services provided to FINCA Azerbaijan

After a difficult start in Baku and invaluable services rendered by the Moscow hub in registering FINCA Azerbaijan as a local organization, the hub and FINCA International have been instrumental in developing mechanisms to lower the taxable base for FINCA Azerbaijan and to increase its deductions. In addition, the hub's legal analyst has just recently completed a review of agreements concluded by the previous Country Director..

The current Director recently received logistical support from the hub in line with his efforts to obtain copies or registration/licensing laws and regulations from other countries such as Kyrgyzstan, on which he proposes to draw in designing recommendations to the government of Azerbaijan. The Moscow hub has also prepared several legal documents for the affiliate, such as Powers of Attorney and various Board of Directors decisions to be utilized by the Country Director. As with other affiliates, the hub monitors legal and regulatory changes on a daily basis in Azerbaijan, and assesses their effects on FINCA Azerbaijan operations.

d. The role played by the Moscow hub in helping to draft a new micro-finance law in Kyrgyzstan

Inasmuch as a private firm was hired to draft the new law, the hub's legal advisor played a very minor role if any in the actual drafting of the law. He did however play a larger role in the lobbying efforts that were undertaken to convince the Kyrgyz government to approve the new law. Now that the law has been passed, his legal services are being used by the affiliate to address registration and taxation issues.

F. MANAGEMENT INFORMATION SYSTEM INSTALLATION AND SUPPORT

During the coming year, the hub will be providing assistance to the four NIS affiliates that have been chosen for installation of the SIEM MIS integrated portfolio and accounting system. The four affiliates are Azerbaijan, Samara (Russia), Kyrgyzstan, and Georgia.

VI. THE TEAM'S CONCLUSIONS

A. REGARDING THE OVERALL "VALUE ADDED" OF THE MOSCOW HUB IN SERVING ITS AFFILIATES

1. *The strategic plan evolved by the hub to guide its operations is sound and adds value to hub operations in being implemented effectively in a timely manner*

Team interviews indicated that, under the plan, NIS affiliates are being provided by the hub with the services they need to enable them to serve their clients, grow their portfolios, and keep their portfolios at low levels of risk while continuing to expand lending operations in their respective locations. A key issue is whether the rapid expansion experienced in recent years can be sustained. The Team believes that the efficiency and effectiveness of the management structure that has been established in the NIS region by the hub indicates that it can be sustained.

2. *The value added services provided to affiliates are to a large extent built into the structure of the strategic plan and are being provided systematically through implementation of the plan*

These services include: (1) the comprehensive training provided to Country Directors, Finance Managers, Credit Supervisors and Credit Officers; (2) the development of business plans for the affiliates; (3) marketing and customer service training for affiliate loan officers and supervisors; (4) the dissemination of new product profiles; (5) the installation of SIEM software in affiliate offices; and (6) the expert services provided to the affiliates by the hub's legal analyst/policy advisor; finance and internal controls manager; and the regional products and credit specialist

3. *There is a steady demand by affiliates for the hub's services, which is being met satisfactorily*

The affiliates draw on the technical services of the hub quite frequently. The regional products and credit specialist has traveled to Armenia six times within the past two years to provide support. The hub legal analyst/policy advisor was called upon recently to assist in lobbying for the passage of a Kyrgyzstani law on micro-finance institutions and is now being used there for registration and taxation issues. During the past six months, the hub has provided assistance to its Armenia and Georgia affiliates to minimize the impact of their losing the tax exemption status they had been enjoying.

4. *The NIS Affiliates are quite satisfied with the hub's performance and the support services that it has provided them to date*

Team interviews in Tomsk, Samara, and Kyrgyzstan indicated that the affiliates located in these countries were very satisfied with the hub's performance, and provided Team members with documentary examples of the kinds of services that had been rendered. The affiliates in Georgia, Armenia, and Azerbaijan indicated that they were also satisfied.

5. *A variety of approaches are being successfully employed by the hub to disseminate lessons learned and best practices*

Examples of these approaches include the development and utilization of model micro-credit products; the effective spread of the expertise provided in product development through affiliate sharing arrangements; and the replication among affiliates of the proven methods used to generate trust among clients.

B. REGARDING THE EFFICIENCY AND COST-EFFECTIVENESS OF HUB OPERATIONS

1. *The hub has built an effective management base in the NIS Region and has become an efficient operation by ensuring that executive and staff members are well trained, and by promoting the use of cost-effective approaches and methods in their business management operations*

Rather than hiring specialists in each affiliate program, the hub has one policy and regulatory expert for the region, a strategic planning and finance specialist, and a management specialist.

This avoids expensive redundancies in staffing and effort. A management information system specialist is being recruited.

There is considerable potential for FINCA to leverage the use of existing hub staff as several affiliates enter the third and more advanced stage of their development as MFIs. This could be accomplished and would be cost-effective; however, it should be noted that the overriding objective of FINCA is to increase the number of loans made to low-income clients, primarily women and priority in the use of staff resources is generally given to achieving that objective.

2. *Financial sustainability of the current operational structure is feasible*

The sustainability of the current operational structure is contingent upon the current fee structure, timely access to commercial funding, and potential improvements in the regulatory environment of affiliate host countries. Through its continued efforts to reduce costs; the pending increase in hub revenues resulting from an increase in the sustainability fee (to 3.5 % of the average outstanding portfolio of affiliates from the present 3%) and the continued portfolio growth of its affiliates, the hub expects to be financially self-sustainable by FY 2006. If FINCA lending operations in the NIS region expand as expected, revenues accruing to the hub from affiliate fees will also increase and should be adequate to assure its sustainability for some years to come. Four of FINCA's seven existing NIS affiliates are financially self-sufficient at present.

3. *Sustainability of the hub is an appropriate objective*

The hub has important training and management functions that are critical to the success of affiliate operations. It has developed and is implementing a business model that suits the way FINCA operates. It is the source of vested experience relevant to the way that FINCA operates. It has become the NIS region's engine for spreading "best practices".

4. *The team's assessments of the levels of institutional sustainability achieved by the hub and its affiliates were indeterminate*

The hub is being developed as an integral component of FINCA International, as are its affiliates. Evaluating the institutional sustainability of the hub and its affiliates, as individual institutions, would probably not be very rewarding. All affiliates are local entities of varying forms but continue to be branches or subsidiaries of FINCA International. To be useful, such assessments would have to be undertaken against a backdrop of the overall operations of FINCA International.

5. *FINCA has had moderate success to date in diversifying the sources of funding for its NIS program*

The IFC is providing technical assistance to the FINCA affiliate in Kyrgyzstan during its transformation and proposes to take up to a \$1.0 million equity stake in the commercial operation. In Kosovo, FINCA has borrowed \$1.1 million from KfW, the German Development Bank. FINCA has increased the amount of fee-based income earned by the hub from \$200,000 in all of 2000 and 2001, to \$318,000 in fiscal 2002.

It should be noted that a key element in the NIS hub's long-term financial sustainability plan for its regional technical assistance program is to cover an increasing share of the regional program's costs through the fees generated from technical services provided by the hub to regional affiliates. The majority of the fees collected by the hub are generated by the services it provides to regional FINCA affiliates, although a small percentage is derived from micro-finance institutions outside of the FINCA Network. As shown in Exhibit 3, the hub is anticipating that if current growth trends hold, fees paid to the hub for its services should be sufficient to sustain its regional technical assistance program from its own resources by FY 2006.

6. *Currently there are no feasible alternatives to the FINCA regional hub model that would be more viable and cost-effective in the long run*

The team considered two alternative models in looking for one that might be more viable and cost-effective in the long run. These included establishing an even more decentralized structure in which the functions of the hub would be moved out to the regional affiliates. This alternative would allow the affiliates to keep their local focus, but they would lose the linkages that they now enjoy through interactions with hub staff such as ready access to the appropriate types of management, training, technical and financial services that are vested in hub staff. The Team concluded that it would be difficult for the affiliates to attract and retain the same level of qualified technical services personnel as the hub, thus requiring the use of outside experts who may not be well attuned to MFI developments throughout the region.

The Team also considered, as an alternative, moving the hub to a lower-cost NIS location. It was noted, however, that the hub operation had been moved from Georgia to Moscow at the request of USAID to increase the efficiency and efficacy of its operations. Secondly, FINCA itself had moved regional programming activities from their headquarters in Washington to Moscow for pretty much the same reasons. All in all, this alternative option would be a step backward.

C. REGARDING THE EXTENT TO WHICH THE HUB HAS PROVIDED SPECIFIC SERVICES TO ITS AFFILIATES

The Team found the hub to be highly efficient in using a minimal but very experienced staff that is providing a sustained level and range of high quality professional and technical services to its affiliates, services that are not generally readily available in field locations

1. *The services provided by hub staff members have generally been adequate in meeting the technical assistance needs of the affiliates, with the exception that there is currently a vacancy in the MIS slot*

The MIS position will likely be filled once the pilot installation of the new Management Information System (known through its Spanish acronym as SIEM), which is scheduled to begin in Kyrgyzstan and Azerbaijan during the first quarter of 2003, has been completed.

The hub has been notably responsive in developing alternative financial products and in modifying its village banking methodology and products to meet the specific needs of the affiliates. The hub's financial services specialist has assisted affiliates in testing new credit and savings products. It has also assisted affiliates in designing market and client satisfaction

surveys, as well as helping to analyze the results of these surveys. It has also helped affiliates obtain information from clients who drop out of their programs, through exit surveys.

2. *The hub has been effective in sharing information and lessons learned about new hub products and methodologies among regional affiliates*

The hub assiduously shares “best practices” and “lessons learned” with other programs through participation in the Country Director conferences that are held once a year; through semi-annual product updates; and through periodic “mail outs”.

3. *The hub has actively supported the expansion of regional affiliates*

Such support is based on requirements the affiliate must fulfill in order to expand its operations. These include the submission of an expansion proposal, a marketing analysis, outreach projections and an agreed time frame for expansion. The hub’s financial services specialists also visit the area to be added and assist in market analysis.

4. *The hub has been aggressive in providing technical assistance services to affiliates to assist them in installing portfolio management and office administrative systems*

Regional technical staff members have assisted the affiliates in the past in installing accounting, portfolio management, and office administrative systems. They will also be available to provide assistance to the affiliates in the installation of the SIEM system.

5. *The hub has been active in conducting audits of the affiliates using an independent auditor*

The Regional Internal Auditor conducts comprehensive annual internal audits of each affiliate. Four affiliates were examined in the last six months of 2002. In addition, the Regional Internal Auditor trained Georgia affiliate internal auditors in December 2002, and new internal affiliate auditors in Kosovo during August of 2002 and in Samara in February 2003.

6. *The hub has been in the forefront of efforts to promote reform of the legal and regulatory environment for non-bank financial institutions in Russia and the NIS region; however, with the exception of Kyrgyzstan these efforts to date have had limited impact*

In Russia, FINCA has been instrumental in catalyzing a working group on policy reform, which is engaged in efforts to improve the country’s somewhat fragmented regulatory environment. It has also been instrumental in developing a close working relationship with the Russian State Duma, and has encouraged its Affiliates to promote similar relationships with law-making institutions in the NIS. In spite of these efforts, the array of legal and regulatory issues facing FINCA and other MFIs in Russia and the NIS region are not being resolved. The involvement of outside agencies other than NGOs will likely be needed.

7. *The hub is providing a broad array of legal and regulatory services to its NIS affiliates but except for Kyrgyzstan the legal and regulatory issues facing FINCA and other MFIs in Russia and the NIS region are not being resolved. The involvement of outside agencies other than NGOs will likely be needed*

Some of the more prevalent constraints to MFI development include the unnecessary regulation of lending by Central Bank officials, interest rate ceilings, overly burdensome tax structures, and restrictions on forms of registration for non-profit micro-finance institutions (MFIs). In Kyrgyzstan, the FINCA affiliate employed the services of an outside law firm and with hub assistance was able to bring the considerable influence of the IFC to bear in resolving the legal and regulatory issues that were impeding its effort to evolve into a quasi-banking institution.

8. *An adjustment seems warranted in the interest charged to low-income borrowers in several affiliate countries*

Competition for clients is increasing in several affiliate countries. Such competition is good for the micro-finance industry in those countries and should lead to a reduction in interest costs to clients. Maintaining high interest rates for low-income borrowers appears to be the policy for FINCA affiliates at present but it should not become a substitute for encouraging greater operating expense control.

VII. THE TEAM'S RECOMMENDATIONS

In framing its recommendations, the Evaluation Team took special note of the impact these recommendations would have on the continued operation of the FINCA/NIS Technical Assistance Program.

1. *Recommendation regarding the continuation of USAID assistance to hub operations*

As indicated above, there is a steady demand by affiliates for the hub's services. The hub has contributed significantly to building a sustainable network of MFI institutions in the NIS Region, and it has been in the forefront of efforts to promote reform of the legal and regulatory environment for non-bank financial institutions in Russia and the other affiliate countries. NIS affiliates indicated that they are satisfied with the hub's performance and the support that it has provided to date. Currently, there are no feasible alternatives to the FINCA regional hub model that would be more viable and cost-effective in the long run

Accordingly, the Team recommends that USAID assistance to the hub be continued to avoid a sharp interruption in its forward momentum. However, future assistance should be conditioned upon FINCA's agreeing to dramatically improve operating expense ratios and loan to asset ratios. Self-sufficiency targets should be tempered with efficiency targets in order to provide more competitive financial services.

2. *Recommendations regarding affiliate efforts to improve the legal, regulatory environment*

It will be essential that such efforts be accelerated to accommodate FINCA's transformation plans for its NIS affiliates.

The Team recommends that particular attention be given to the situation in Georgia and Armenia, where due to a general lack of lobbying power and coordination of effort, the MFI community has not been able to significantly influence the reform process. This, in turn, has seriously impeded the growth of the MFI industry in these countries. Further concerted support for these lobbying efforts by the Regional Director of FINCA, by USAID, and by the US Embassy on behalf of the micro-finance community, seems warranted and should be provided. USAID/Russia awarded funds to FINCA to build a "best-practices" micro-finance institution in Samara. As part of the funding award, a sub-agreement was drawn up with experts from Ohio State University (OSU) to initiate an innovative micro-finance policy reform program in Russia. The principal focus of the policy reform program was to improve the operating and regulatory environment for micro-entrepreneurs and micro-finance institutions in Samara.

The Team recommends that steps be taken by the hub to ensure that the "lessons-learned" in Samara are being incorporated in the micro-finance policy reform programs being pursued by other affiliates in the NIS region.

3. *Recommendation regarding the need to bolster hub advocacy efforts and staff resources need to be bolstered to enable it to contribute more effectively to improvement of the legal and regulatory environment in affiliate countries*

The hub will need to bolster the legal services that it provides to affiliates if it is to significantly influence their collective efforts to foster legal and regulatory reform in the NIS region. Concerted support for these lobbying efforts by USAID and by the US Embassy, on behalf of the micro-finance community, also seems to be needed. The Team recommends that a concerted plan of action be developed to where warranted by the parties involved and concerned to bolster ongoing lobbying efforts.

4. *Recommendation regarding the need for the hub to change its interest rate policy*

As noted above, maintaining high interest rates for clients appears to be the policy for FINCA affiliates at present; however, it should not become a substitute for encouraging greater operating expense control. The interest rates charged to clients should be determined on the basis of the costs of serving clients and on relevant market factors in an affiliate's area of operation.

The Team recommends that the hub be tasked by USAID to undertake a review of its interest rate policy.

5. *Recommendation regarding the need for the hub to work with affiliates to increase their loan to asset ratios and to reduce their operating expense ratios*

Data compiled by the evaluation team indicate that affiliate variance in the productive usage of assets ranges from a low of 29% to a high of 83%. This condition may be an indication that loan products need further development and diversification to meet demand. Deploying more of affiliate assets in sound loans would improve the efficiency of affiliates and increase the percentage of productively earning assets. The hub also needs to assist the affiliates in reducing their operating expense ratios that, in the Team's view, are presently too high.

The Team recommends that USAID monitor the hub's efforts to encourage the more productive use by affiliates of their assets.

6. *Recommendation regarding the need for the regions' financial system to produce an automated budget to actual performance report with variances on a year to date basis*

This would assist the Country Directors and hub personnel in quickly identifying variances in anticipated progress. Offices that provide USAID quarterly status reports under grant agreements all report actual performance against projected. The Monthly Status Reports provided by all affiliates to the hub provide status updates, but do not set forth performance versus projected performance.

The Team recommends that the USAID monitor the hub's efforts to implement this recommendation.

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EXHIBIT 1

NIS HUB ORGANIZATION CHART

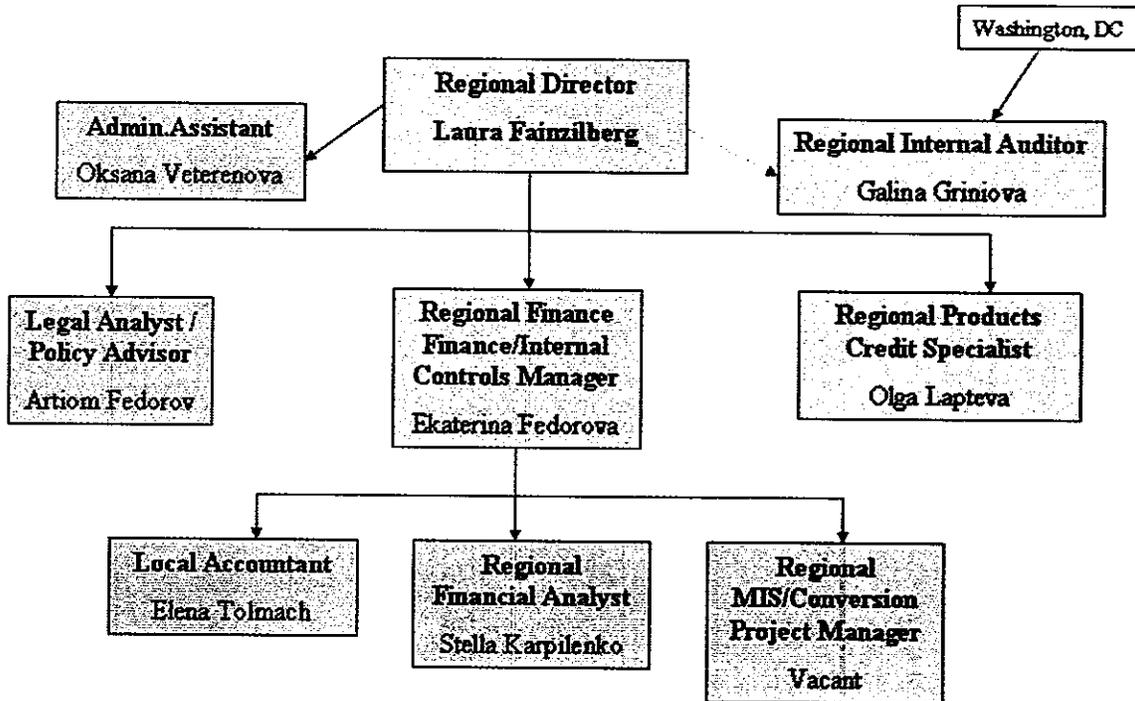


EXHIBIT 2
FINCA INTERNATIONAL
NIS REGIONAL TECHNICAL ASSISTANCE BUDGET FY2003

Item	USG Request	Other Grants	FINCA	Total
<u>Technical Assistance & Mgt.</u>				
Mgt. Information Systems - Installation & Support	32,000		-	32,000
Banking Operations Transformation Services	107,400		100,000	207,400
Mgt. Oversight & Operational Support Services	112,571	84,429		197,000
Policy, Regulatory & Legal Services	8,200		18,200	26,400
Independent Internal Audit Services	600		600	1,200
Financial Products Development Services	22,182	26,400	22,000	70,582
Internal Controls, Finance and Accounting Services	55,806		42,594	98,400
Total TA & Mgt:	338,759	110,829	183,394	632,982
Administrative & Office Support Staff Salaries	17,227		2,573	19,800
Fringe & Insurance Benefits - Local Staff	47,489	8,400		55,889
OFFICE EXPENSES				
Rent	52,964		67,036	120,000
Communications	9,000		9,000	18,000
<u>Conferences/meetings/seminars - Training</u>	-		-	
Moscow	2,500		2,500	5,000
Country Directors	7,500		7,500	15,000
Finance Managers	5,000		5,000	10,000
Employee Recruitment/Relocation	1,000		1,000	2,000
Office Supplies (includes Laptops, office furniture)	12,600		12,600	25,200
Professional services (Legal expenses - policy grant)		6,000		6,000
Professional services (3 conferences) - policy grant		30,000		30,000
Professional services (other)	6,000		6,000	12,000
TOTAL OFFICE EXPENSES	96,564	36,000	110,636	243,200
TRAVEL AND PER DIEM				
Airfare	-	4,135	38,468	42,603
Per diem	-	13,826	38,979	52,805
TOTAL TRAVEL AND PER DIEM	-	17,961	77,447	95,408
Total Direct Costs:	500,039	173,190	374,050	1,047,279
Indirect Costs @ 29.29%	146,461			146,461
Total:	646,500	173,190	374,050	1,193,740

EXHIBIT 3

NIS HUB SUSTAINABILITY PLAN

Regional Technical Assistance Financing Projections - using 3% and 3.5% of LP Outstanding

	FY02 actual	FY03 original	FY03 revised by CDs	FY04 as per NIS HUB proposal	FY05 - using FY02:03 growth pattern	FY06 - using FY02:03 growth pattern	FY02:03 growth
Total Loans Disbursed	46,792,034	55,700,000	62,307,024	69,016,000	91,899,864	122,371,407	133%
Outstanding Loan Portfol	12,671,363	14,502,679	15,772,427	19,193,300	23,890,478	29,737,197	124%
NIS Regional TA Program		1,193,740	1,193,740	993,740	993,740	893,740	
Est. TA Fees Generated		382,112	412,406	611,900	753,966	938,484	
MGIII			300,000				
Other grants			173,190				
Regional Subsidy Needed			308,144	381,840	239,774	-44,744	

	Armenia	Baku	Imishli	Georgia	Samara	Kyrgyzstan	Tomsk	Kosovo	HUB fee collected FY02
	35,638	6,408	4,046	27,608	41,590	127,289	6,550	68,894	318,021

EXHIBIT 4
MOCK STATEMENT FOR NIS HUB

MOCK STATEMENT FOR NIS HUB	
	FY'02
	Sept'01 Aug'02
REVENUES	
MGIII/NIS Funding Revenue*	309,634
MGIII/Corporate	3,949
AID Georgia	966
AID Armenia	-2,406
AID Azerbaijan South	10,107
AID Samara	24,447
Policy Work Russia	85,077
AID Kosovo	2,616
AID Tomsk	40,885
HUB TA fees	318,021
Bank Interest	85
Total Revenues	<u>793,381</u>
COST AND EXPENSES	
Salaries	384,184
Travel	54,229
Consultants	11,769
Communications	18,220
Meetings/Conferences	46,553
Other direct costs	246,846
Total Expenses	<u>761,800</u>
Net profit/(loss) from operations	<u>31,580</u>
Non-operating expenses	
Forex losses	<u>1,183</u>
Net income (Loss)	<u>30,397</u>

*MGIII Revenue adjusted for NICRA change to 49.88% (approved by AID)

EXHIBIT 5

PERFORMANCE INDICATOR TRENDS BY AFFILIATE

Performance Indicator Trend: FINCA Armenia

(For Fiscal years ending August 31)

Armenia	1998	1999	2000	2001	2002
Portfolio at risk ratio:(1.)		0.0%	0.0%	0.0%	1.7%
Portfolio growth (Annual):			407%	626%	54%
Client growth (Annual):			280%	166%	44%
Clients per loan officer (Ave.):		83	158	224	179
Portfolio per loan officer: (2.)		\$6	\$14	\$56	\$48
Loan officers to total staff:		36%	40%	45%	51%
Portfolio yield: (3.)		25%	72%	57%	78%
Operating expense ratio: (4.)		295%	149%	40%	36%

Source: FINCA Records

(1.) Over 30 days (2.) '000 USD (3.) Annual interest & fee income divided by average outstanding portfolio. (4.) Annual operating expenses (excludes loan loss reserves and financial expenses) divided by average outstanding portfolio.

Performance Indicator Trend: FINCA Azerbaijan

(For Fiscal years ending August 31)

	1998	1999	2000	2001	2002
Portfolio at risk ratio:(1.)	0.0%	26.6%	0.1%	10.3%	0.0%
Portfolio growth (Annual):		132%	242%	97%	70%
Client growth (Annual):		458%	58%	66%	42%
Clients per loan officer (Ave.):	39	77	129	172	168
Portfolio per loan officer: (2.)	\$3	\$2	\$9	\$13	\$16
Loan officers to total staff:	40%	63%	57%	41%	41%
Portfolio yield: (3.)	18%	309%	69%	109%	76%
Operating expense ratio: (4.)	354%	443%	186%	147%	120%

Source: FINCA Records

(1.) Over 30 days (2.) '000 USD (3.) Annual interest & fee income divided by average outstanding portfolio. (4.) Annual operating expenses (excludes loan loss reserves and financial expenses) divided by average outstanding portfolio.

Performance Indicator Trend: FINCA Georgia

(For Fiscal years ending August 31)

	1998	1999	2000	2001	2002
Portfolio at risk ratio:(1.)	0.0%	14.9%	3.0%	1.2%	1.8%
Portfolio growth (Annual):	n/a	210%	28%	79%	101%
Client growth (Annual):		254%	24%	32%	31%
Clients per loan officer (Ave.):	184	326	284	236	261
Portfolio per loan officer: (2.)	\$13	\$20	\$18	\$20	\$35
Loan officers to total staff:	43%	33%	40%	46%	46%

Portfolio yield: (3.)	n/a	108%	94%	84%	91%
Operating expense ratio: (4.)	n/a	123%	116%	95%	80%

Source: FINCA Records

(1.) Over 30 days (2.) '000 USD (3.) Annual interest & fee income divided by average outstanding portfolio. (4.) Annual operating expenses (excludes loan loss reserves and financial expenses) divided by average outstanding portfolio.

Performance Indicator Trend: FINCA Kyrgyzstan

(For Fiscal years ending August 31)

	1996	1997	1998	1999	2000	2001	2002
Portfolio at risk ratio:(1.)	4.6%	0.0%	0.6%	0.2%	0.1%	0.5%	0.9%
Portfolio growth (Annual):		417%	156%	34%	86%	71%	20%
Client growth (Annual):	705%	126%	69%	49%	23%	12%	1%
Clients per loan officer (Ave.):	93	155	169	192	149	154	193
Portfolio per loan officer: (2.)	\$2	\$9	\$14	\$15	\$17	\$27	\$41
Loan officers to total staff:	54%	47%	46%	49%	66%	69%	51%
Portfolio yield: (3.)	110%	76%	108%	83%	90%	89%	72%
Operating expense ratio: (4.)	403%	97%	77%	52%	47%	43%	41%

Source: FINCA Records

(1.) Over 30 days (2.) '000 USD (3.) Annual interest & fee income divided by average outstanding portfolio. (4.) Annual operating expenses (excludes loan loss reserves and financial expenses) divided by average outstanding portfolio.

Performance Indicator Trend: FINCA Samara

(For Fiscal years ending August 31)

	1998	1999	2000	2001	2002
Portfolio at risk ratio:(1.)		0.0%	2.3%	0.7%	0.6%
Portfolio growth (Annual):		0%	898%	195%	173%
Client growth (Annual):		0%	565%	64%	75%
Clients per loan officer (Ave.):		13	68	51	72
Portfolio per loan officer: (2.)		\$2	\$11	\$16	\$29
Loan officers to total staff:		53%	43%	48%	39%
Portfolio yield: (3.)		23%	76%	55%	57%
Operating expense ratio: (4.)		556%	189%	90%	55%

Source: FINCA Records

(1.) Over 30 days (2.) '000 USD (3.) Annual interest & fee income divided by average outstanding portfolio. (4.) Annual operating expenses (excludes loan loss reserves and financial expenses) divided by average outstanding portfolio.

Performance Indicator Trend: FINCA Tomsk

(For Fiscal years ending August 31)

	1998	1999	2000	2001	2002
Portfolio at risk ratio:(1.)				0.0%	0.1%
Portfolio growth (Annual):				0%	411%
Client growth (Annual):				0%	218%
Clients per loan officer (Ave.):				50	67

Portfolio per loan officer: (2.)	\$16	\$34
Loan officers to total staff:	56%	55%
Portfolio yield: (3.)	11%	47%
Operating expense ratio: (4.)	38%	67%

Source: FINCA Records

(1.) Over 30 days (2.) '000 USD (3.) Annual interest & fee income divided by average outstanding portfolio. (4.) Annual operating expenses (excludes loan loss reserves and financial expenses) divided by average outstanding portfolio.

Performance Indicator Trend: FINCA Kosovo

(For Fiscal years ending August 31)

	1998	1999	2000	2001	2002
Portfolio at risk ratio: (1.)			0.0%	0.2%	1.6%
Portfolio growth (Annual):			n/a	644%	83%
Client growth (Annual):			n/a	355%	34%
Clients per loan officer (Ave.):			30	59	78
Portfolio per loan officer: (2.)			\$23	\$68	\$133
Loan officers to total staff:			34%	41%	37%
Portfolio yield: (3.)			n/a	35%	39%
Operating expense ratio: (4.)			n/a	62%	38%

Source: FINCA Records

(1.) Over 30 days (2.) '000 USD (3.) Annual interest & fee income divided by average outstanding portfolio. (4.) Annual operating expenses (excludes loan loss reserves and financial expenses) divided by average outstanding portfolio.

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ANNEX A

REGIONAL EVALUATION

STATEMENT OF WORK

Evaluation of FINCA's NIS Regional Technical Assistance Program

BACKGROUND

Over the past ten years, USAID's Europe and Eurasia (E&E) Bureau has supported a variety of microenterprise programs throughout Eastern Europe and the New Independent States (NIS). While there are differences among these varied programs and approaches, the goal of sustainability based upon "best practices" has been a common theme.

In 1984, the Foundation for International Community Assistance (FINCA) was founded with the goal of raising the incomes of the poor through "village banking programs." FINCA manages 20 such micro-credit programs throughout the world. These programs serve over 171,000 small-scale entrepreneurs. Currently, FINCA operates successful micro-credit programs in six countries within the E&E region, namely Kyrgyzstan, Russia (2 programs), Azerbaijan, Armenia, Georgia, and Kosovo. E&E's Office of Economic Growth is working closely with two other offices in USAID in the oversight of these programs, the Office of Microenterprise Development and the Office of Private and Voluntary Cooperation (PVC), which manages the Matching Grant program with U.S. PVOs.

FINCA activities in the NIS occupy a distinct niche. FINCA's clients, mostly educated women who have lost their jobs in the formal sector, seek either temporary or long-term self-employment as a strategy for survival. In response, FINCA currently serves approximately 30,000 clients. Despite economic uncertainty, FINCA's affiliates have maintained a portfolio at risk below 0.8%, while reaching an increasing number of poor micro-entrepreneurs. In addition, FINCA is working with the IFC to transform its program in Kyrgyzstan into a regulated commercial institution.

Over the past three years, FINCA has provided technical assistance to its USAID-funded microfinance institutions (MFIs) throughout the New Independent States through its "hub" office in Moscow. As background, the Regional Hub was founded in 1997 in Tbilisi, Georgia, and then moved to Moscow in 2000 to increase the efficiency of service. Some of this technical assistance has been supported through Performance Funds, which have been provided to FINCA by the State Department's Office of the Coordinator for NIS Assistance. From 1999-2001, the Assistance Coordinator's Office has provided over \$2 million in funding to FINCA, channelled through USAID, to support the regional hub that FINCA operates in Moscow.

Over the period of U.S. Government funding, FINCA asserts that the assistance has allowed the Moscow hub to disseminate best practices and 'lessons learned' throughout the NIS region and to provide the following main services to its affiliates:

- a) Management Oversight and Operational Support Services – the regional director and team of specialists provide technical assistance to the affiliates to assist with preparation and monitoring of annual business plans, financial projections, and operating plans.
- b) Financial Products and Development Services – hub supports development of tailored financial products through a product development specialist who assists affiliates to conduct market research, test new credit and savings products and develop marketing and expansion plans for those products.
- c) Internal Controls, Finance and Accounting Services – regional technical staff assist affiliates in installing accounting, portfolio management and office administrative systems; hub monitors fulfilling grant agreements and corresponding budgets. An independent auditor in the hub office is responsible for conducting internal audits of FINCA's affiliates.
- d) Policy, Regulatory and Legal Services – hub assists affiliates by conducting legal and regulatory assessments and developing strategies to put into place new laws, policies and regulations that are favorable to the development of a viable microfinance industry. For example, in June 2002 the Moscow hub organized a policy visit of Russian Duma Members to Washington, DC to learn how to develop laws, regulations and institutions that promote micro and small and medium enterprises.

USAID is considering whether to provide an additional \$646,500 in FY 2003 to support the work of the Moscow regional hub. A Technical Evaluation Committee met to review the proposal and recommended that an outside evaluation be performed to analyze the efficacy and efficiency of the Moscow hub. Thus, as funding for FINCA is now entering its fourth year, and since USAID has oversight responsibility for FINCA's microenterprise work with U.S. Government funding, USAID believes that it is important to have an outside evaluation of the performance of FINCA's NIS regional program in FY2003. This evaluation will contribute substantial information on FINCA's network worldwide. Furthermore, the proposed evaluation will add information to the knowledge of 'best practices' in the area of Microenterprise Networks, which is an objective of USAID's Office of Microenterprise Development.

GOAL OF THE EVALUATION

The goal of this activity is to strengthen the ability of the E&E Bureau to alleviate poverty and affect rapid and sustainable economic growth through the implementation of effective, country-specific microenterprise strategies and programs. As such, the activity directly supports the E&E Bureau's strategic objective of promoting private enterprise in the region. Typically, regional funds are dedicated to "best practices" research, evaluation, training, and delivery of practical applications to E&E missions on issues associated with the development of small- and medium-sized enterprises.

The particular purpose of this activity is the evaluation of the usefulness of FINCA's approach in providing regional technical assistance to its NIS microfinance institutions through a regional hub in Moscow. The results and recommendations of the evaluation will be taken into consideration in deciding the level of future USAID support to the FINCA hub, as well as similar such centers.

EVALUATION QUESTIONS

The objective of the evaluation is to determine the impact achieved throughout the region as a result of assistance from the hub. The issue of whether a Moscow hub is necessary for FINCA's successful operations in Russia and as well as its successful operations in the NIS is central to this evaluation. In order to assess this, the evaluation questions are divided into the following three main areas:

- (1) The overall "value-added" of the Moscow hub in serving its Russia and NIS affiliates;
- (2) The efficiency and cost-effectiveness of the hub's operations;
- (3) The extent to which the hub has provided specific services to its affiliates (see below).

While the first two issues are designed to assess broader questions regarding the overall effectiveness of the FINCA hub model, the latter is designed to evaluate the extent to which the FINCA Moscow hub has successfully provided specific services to its affiliates, as FINCA has contended that these services justify further funding of the hub.

The following list of questions is not meant to be exhaustive, but illustrative of issues that shall drive this evaluation:

(1) Value-Added of the Hub in Serving its Affiliates:

- The soundness of the hub's current strategic plan. Is the current structure sustainable? Is sustainability of the hub an appropriate objective?
- To what extent has the hub provided 'value added' services to the affiliates in Tomsk, Samara, Armenia, Azerbaijan, Georgia and Kyrgyzstan?
- How often do the affiliates draw on the technical services of the hub; in other words, what is the market demand for the hub's services?
- How satisfied are the affiliates with the hub's performance?
- What have been the tangible benefits of the Moscow hub for its affiliates in Russia (e.g. Samara, Tomsk) versus Kyrgyzstan and the Caucasus?
- How have the country-level programs benefited from the services of the hub? Have the country-level programs received measurable value added from the hub?
- How successful has the hub been in disseminating lessons learned and best practices throughout the region? What are some specific examples of this?
- How has the hub contributed to promoting a sustainable network of MFI institutions in the region?
- Are there significant differences between these MFIs that have received assistance from the hub and those that have not received such assistance? What factors distinguish these two sets of MFIs?
- What level of networking has developed among the FINCA affiliate MFIs within the NIS? Is there an active exchange of information among the various MFIs?

(2) Efficiency and Cost-Effectiveness of the Hub's Operations

- How cost-effective have the services of the hub been vis-à-vis the affiliates?
- What has been the financial performance of the various microfinance institutions supported by FINCA? Are these MFI operated efficiently? In particular, how has their efficiency been enhanced through the work of the hub?

- Is the goal of financial self-sustainability achievable? Is the 3% fee charged to affiliates realistic?
- To what extent has FINCA made progress in diversifying its funding sources, as agreed to under its matching grant agreement with USAID?
- What level of institutional sustainability has the hub achieved? Does a local board of directors manage the hub? Is the hub a locally registered institution? The same questions would apply for each of the affiliate MFIs.
- Is there a difference between the type of network support that a start-up microfinance institution requires and one that an established affiliate requires? If so, does an established institution still require the services of the hub?
- Are there alternatives to the regional hub model that may be more viable and cost-effective in the long run?

(3) Evaluation of Specific Services That the Hub Provides to its Affiliates

a) Management Oversight and Operational Support Services

- Is the staffing of the hub adequate to meet the affiliates technical assistance needs?
- Is the mix of specialists appropriate for the experience and expertise demanded by the affiliates?
- Have the affiliates drawn on the hub in preparing and monitoring annual business plans, financial projections and operating plans?
- Has the hub assisted affiliates in securing additional funding sources, including through financial institutions?

b) Financial Products and Development Services

- How responsive has the hub been in developing alternative financial products and in modifying its village banking methodology and product to meet the specific needs of the affiliates?
- Specifically, how effective has the hub's performance been in conducting market research, assessing the needs of clients, and testing new credit and savings products?
- How effective has the hub been in sharing information and lessons learned about new products and methodologies among the regional affiliates?
- Has the hub directly supported the expansion of regional affiliates?

c) Internal Controls, Finance and Accounting Services

- Did the hub provide technical assistance to assist its affiliates in installing accounting, portfolio management and office administrative systems?
- Are these finance and accounting systems still in use by the affiliates? Do the affiliates find that these systems promote transparency?
- Does the hub monitor affiliate performance in fulfilling grant agreements and budgets?
- Does the hub perform an internal audit of the affiliates using an independent auditor?

d) Policy, Regulatory and Legal Services

- How successful has the hub's work in policy, legal and regulatory reform been to promote a positive legal and regulatory environment for MFIs in the region?
- How effective has the Moscow hub's policy work been in promoting reform of the legal and regulatory environment for non-bank financial institutions in Russia, and how important is

this policy work for the activities of FINCA/Samara and FINCA/Tomsk?

- Have the other NIS affiliates benefited from the Moscow hub to support their policy, regulatory and legal work?
- For instance, what was the role of the Moscow hub in helping to draft a new microfinance law in Kyrgyzstan?

BACKGROUND MATERIALS

1) FINCA International: "A Proposal In Support of Its NIS Regional Technical Assistance Program", July 17, 2002

2) FINCA quarterly and annual reports from their Russia and NIS country programs.

3) USAID/BHR/PVC FY00 Matching Grant Program, Grant Number FAO-A-00-00-001400. FINCA International: "Balancing Network Sustainability and Client Satisfaction", September 20, 2000 – August 17, 2005

- (a) Detailed Implementation Plan
- (b) Program Description

4) Other sources may be used, to be determined in consultation with E&E/EG.

ANNEX B

INTERVIEWS CONDUCTED

U.S. DEPARTMENT OF STATE

Office of the Coordinator for U.S. Assistance to Europe and Eurasia

Sheila Gwaltney, Director, Country Assistance Affairs

USAID/WASHINGTON

Bureau for Europe & Eurasia

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Barry Lennon, Team Leader, Microenterprise Development Office

Thomas R. Morris, Private Enterprise Officer, Office of Market Transition
Inga Litvinsky, Program Economist,
Donald L. Niss, Office of Economic Growth

USAID/MOSCOW

Paul F. Mulligan, Director, Office of Business Development and Investment
Thomas P. McAndrews, Chief, Microenterprise Management and Training
Alexander S. Sarkisov, Project Specialist, Business Development

USAID/REGIONAL MISSION FOR CENTRAL ASIA

Svetlana Ni, Project Management Assistant, Enterprise and Finance

USAID/YEREVAN

John Caracciolo, MSME Development Advisor

USAID/TBILISI

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Donald L. Richardson, Senior Banking & Finance Advisor, Office of Economic Restructuring

USAID/BAKU

Ms. Rena Effendi, Project Management Specialist, Economic Restructuring & Private Sector Development

FINCA/WASHINGTON

Lawrence Yanovitch, Director of Policy and New Business Development
Marianne Benet, Senior Coordinator for U.S. Government Programs
Andre Simon
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FINCA/MOSCOW

Laura Fainzilberg, Regional Director, NIS and Eastern Europe
Ekaterina Fedorova, Regional Finance and Internal Controls
Olga Lapteva, Regional Finance Products/Credit Specialist
Artem Fedorov, Legal Analyst/Policy Advisor
Galina Griiniova, Regional Internal Auditor

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Valery Chernov, Manager, Legal Department
Irina Fradkova, Strategic Planning Manager
Alexander Sobolev, MIS Manager

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Eleanor Valentine, Program Director, Armenia Legislative Strengthening Program
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A. Jason Evans, National Director, World Vision

Kyrgyzstan

Tatiana F. Parfenova, Vice President for Administration, Head of the Business Administration Program, American University in Kyrgyzst

Moscow

Stephen C. MacLeod, Chief Advisor, Russian Microfinance Center

ANNEX C

REFERENCE DOCUMENTS

FINCA International, Inc.

“A Proposal In Support of Its NIS Regional Technical Assistance Program”. Presented to: USAID Bureau for Europe and Eurasia, Office of Market Transition, July 17, 2002.

“NIS Regional Office, Mission, Vision and Strategic Role”, by Laura Fainzilberg, Regional Director.

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“FI Matching Grant III, Year 2 Annual Report” PowerPoint presentation by Andre Simon

FINCA Moscow

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NIS Hub PowerPoint Presentation by Laura Fainzilberg

NIS Global Statistics, FINCA International

Working Documents, Ekaterina Federova, Regional Finance and Internal Controls

Working Documents, Olga Lapteva, Regional Financial Products/Credit Specialists

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“The Establishment of a Sustainable Micro-Finance Institution in the Kyrgyz Republic”. Final Report, Submitted 30 December 2002.

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USAID Quarterly Report: July – Sept 2002

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Overview PowerPoint Presentation, Timothy Tarrant, Program Director

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USAID Program Description

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Work Plan FY 03

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Azerbaijan Southern Area Expansion Quarterly Reports for 2002.

Minutes, Azerbaijan Microfinance Association, October and November 2002

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FINCA Georgia

Marketing Plan, October 2002

UBC International Tax Advice Letter to FINCA Georgia Director, October 15, 2002

Monthly Status Report, December 2002

Other

"Seven Principles for Improving the Effectiveness of Technical Service Delivery in Microfinance Institutions," Opportunity International Case Study, P. 16, The SEEP Network, 2002.

Monthly Financial Statements, Inception through December 2002, all FINCA NIS Affiliates

Network Analysis Framework , Draft Terms of Reference, February 2003, CGAP