UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID/KAMPALA.
Agency for International Development
Washington D.C. 20521 - 2190.

UGANDA ADDRESS:
USAID Mission to Uganda
P. O. Box 7007, Kampala, Uganda

31 OCT 1996

Mr. Basil Wanzira
Program Manager
FOCCAS
Plot # 49, Republic Street
P.O. Box 907
Mbale, Uganda

Subject: Private Enterprise Support, Training and Organizational Development (PRESTO)
Project Agreement No: 940-0406-G-00-6001-00

Dear Mr. Wanzira:

Pursuant to the authority contained in the U.S. Foreign Assistance Act of 1961, as amended, the U.S. Agency for International Development (hereinafter referred to as "USAID" or "Grantor") hereby awards to the Foundation for Credit and Community Assistance (FOCCAS), (hereinafter referred to as "FOCCAS" or "Recipient"), the sum of $50,000 to provide support for a small and micro-enterprise credit and training development program in Mbale and Tororo Districts, as described in Attachment 1, entitled "Schedule" and Attachment 2, entitled "Program Description."

This agreement is effective as of the date of this letter and shall apply to commitments made by the Recipient in furtherance of program objectives during the period beginning with the effective date and ending October 31, 1998. USAID shall not be liable for reimbursing the Recipient for any costs in excess of the obligated amount.

This agreement is made to FOCCAS, on condition that the funds will be administered in accordance with the terms and conditions as set forth in Attachment I, entitled "Schedule", Attachment II, entitled "Program Description", Attachment III, entitled "Standard Provisions", Attachment IV, entitled "Grantee Certifications" and Attachment V, entitled "Financial and Operational Performance Reporting", and Attachment VI, entitled "Microenterprise Development Policy Guidance".

Please sign the original and each copy of this letter to acknowledge your receipt of the grant, and return the original and all but one copy to the Mission Director.

Sincerely,

Donald Clark

Donald B. Clark
Mission Director

Attachments:
I. Schedule
II. Program Description
III. Standard Provisions
IV. Grantee Certifications
V. Financial and Operational Performance Reporting
VI. Microenterprise Development Policy Guidance

ACKNOWLEDGED:
Foundation for Credit and Community Assistance (FOCCAS)

By: ____________________
Basil W. Wanzira

Title: Program Manager

Date: 5/11/96

A: GENERAL FISCAL DATA

1.	Total Estimated USAID Amount:	$50,000
2.	Total Obligated USAID Amount:	$50,000
3.	Cost Sharing Amount (Non-Federal):	N/A
4.	Project Number:	940-0406
5.	USAID Project Office:	General Development Office
6.	Tax I.D. Number:	N/A
7.	CEC Number:	N/A
8.	LOC Number:	N/A

B. SPECIFIC

1.	PIO/T Number:	N/A	-
2.	Appropriation:	726/71021	726/71021
3.	BPC:	DDV6-96-29617-KGII	GDV6-96-21617-KG13
4.	PFAR Code:	DP	-
5.	Earmark Number:	P965043 - $25,000	P965046 - $25,000
6.	Grant Number:	940-0406-G-00-6001-00	940-0406-G-00-6001-00
7.	Element Number:	07	07
	Funding Source:	USAID/Washington, G/EG/MIP	USAID/Uganda

Attachments:

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7.	CEC Number:	N/A
8.	LOC Number:	N/A

B. SPECIFIC

FUNDS AVAILABLE
USAID KAMPALA, UGANDA
DATE 10/16/96

1.	PIO/T Number:	N/A	-
2.	Appropriation:	726/71021	726/71021
3.	BPC:	DDV6-96-29617-KGII	GDV6-96-21617-KG13
4.	PFAR Code:	DP	-
5.	Earmark Number:	P965043 - $25,000	P965046 - $25,000
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7.	Element Number:	07	07
	Funding Source:	USAID/Washington, G/EG/MIP	USAID/Uganda

FOCCUS - Uganda Credit with Education Program
Projected Budget for FY 1997 (July 1, 1996 through June 30, 1997)

Budget Line Item	FOCCAS	FFH	UNICEF	USAID (Prime Fund)	UNDP	Other	Project TOTAL
OPERATING COSTS							
Personnel							
Salaries			12,000			43,200	55,200
Benefits			1,120		5,000		6,120
Local Consultants					7,500		7,500
Local Consultant Travel					4,420		4,420
Temporary Help					500		500
Sub-total			**13,120**		**17,420**	**43,200**	**73,740**
TRAVEL							
Staff allowances					4,740		22,060
Fuel, Oil & Vehicle Repairs					23,420		23,420
Sub-total					**28,160**		**45,480**
TRAINING							
Staff training & materials			3,400		4,760		16,060
Participant Training & materials					1,600		5,600
Credit Association Training				1,350			1,350
Sub-total			3,400	1,350	6,360		21,660
OFFICE COSTS							
Printing & Duplicating					900		1,195
Professional fee			725		1,900		2,625
Supplies			800		1,960		2,760
Bank Charges					540		540
Equipment Repairs & Maintenance	360						360
Insurance					3,575		3,575
Office Rent	600					4,860	5,460
Office Maintenance	594						594

Budget Line Item	FOCCAS	FFH	UNICEF	USAID (Prime Fund)	UNDP	Other	Project TOTAL
Office Equipment & Furniture	2,000				2,875		4,875
Sub-total	3,554		1,525		11,750	4,860	21,689
COMMUNICATION			1,000		1,955		3,265
Sub-total			1,000		1,955		3,265
Interagency Meeting/Conference			2,500				
Sub-total			2,500		2,500		5,000
					2,500		5,000
FINANCIAL COSTS							
Capital Needs					111,310		111,310
Cost of Funds	6,155						6,155
TOTAL OPERATING COSTS	**9,709**		**21,545**		**179,155**	**48,060**	**288,294**
CAPITAL PURCHASES							
Four-wheel Drive vehicle			28,000				28,000
Motorcycle system					52,000		52,000
Computer System						6,500	6,500
Sub-total							86,500
DIRECT TECHNICAL ASSISTANCE							
Consultant Fees	5,000	5,000			24,120	20,000	58,395
Consultant Travel	2,500	2,500					19,580
Consultant Travel and Fees				12,650			12,650
Sub-total	**7,500**	**7,500**		**12,650**	**24,120**	**28,680**	**77,975**
~~Overhead @ 20%~~ audit and monitoring			2,500	10,000	16,585	22,498	51,583
CREDIT FUNDS				26,000			26,000
Sub-total				26,000			26,000
TOTAL	**17,209**	**7,500**	**52,045**	**50,000**	**272,160**	**105,738**	**$ 504,652**

Total Funding Approved as of June 20, 1996
UNICEF - $ 25,000 (for Calendar Year 1996)
UNDP - $ 300,000 (for Calendar Year 1996 although grant per ... is likely to be extended due to delay in the release of funds)
FOOD FOR ALL - $ 6,000 (for Calendar Year 1996 with possible renewal for Calendar Year 1997)

ATTACHMENT I

SCHEDULE

A. Purpose of Agreement
The purpose of this Agreement is to provide support for the program described in Attachment II to this Agreement entitled "Program Description."

B. Period of Agreement
The effective date of this Agreement is the date of signing. The estimated completion date of this Agreement is October 31, 1998.

C. Amount of Award and Payment
1. USAID hereby obligates the amount of $50,000 for purposes of this Agreement.

2. Payment shall be made to the Recipient in accordance with the procedures set forth in Annex 1 of Attachment III, "Payment - Periodic Advance."

D. Budget
The following is the Agreement Budget. Revisions to this budget shall be made in accordance with Attachment III, Standard Provisions "Revisions of Grant Budget." A detailed budget is at Attachment I. A.

	Cost Element	Total $ U.S.
1.	Training	14,000
2.	Credit Funds	26,000
3.	Audit and monitoring	10,000
	Total	50,000

E. Reporting and Evaluation

1. Program Reporting
The Recipient shall submit quarterly, an original and one copy of a financial and operational performance report to the Private Sector Officer, Plot Number 42 Nakasero Road, P.O. Box 7007, Kampala. Reports shall include the information requested in Attachment V, entitled "Financial and Operational Performance Reporting" and shall follow reporting guidelines listed in Attachment VI, entitled "Microenterprise Development Policy Guidance", Annex entitled "Minimum Reporting for Microfinance Institutions" and "Microfinance definitions".
In addition, as USAID deems appropriate, regular assessment of this program shall be carried out.

2. Financial Reporting
The Recipient shall submit an original and two copies of monthly expenditure reports to USAID/Uganda's Controller at Plot Number 42 Nakasero Road, P.O. Box 7007, Kampala. Expenditure reports shall be in keeping with Attachment III, Standard Provisions

entitled "Payment - Periodic Advance and Annex 1 to Attachment III entitled "Sample Expenditure Report."

In addition, quarterly summary reports will be submitted to Mr. Jim Gohary, Private Sector Officer, or his designee, at Plot Number 42 Nakasero Road, P.O. Box 7007, Kampala. The financial reports shall note, by budget cost element, the amount budgeted, the amount expended during the reporting period, cumulative expenditures and funds remaining. The format of these reports will be as follows:

Line Item	Budget	Expenditure This Quarter	Cumulative Expenditure	Balance

The Grantee will submit a "Financial Status Report" (SF 269) showing total disbursements, total advances received and any balance remaining within 90 days of the expiration date of the Grant.

F. Title to Property
Title to property at the end of this Agreement shall be with the Recipient. If the Recipient does not continue operating in Uganda after the end of this Agreement, non-expendable property financed under this Agreement shall be returned to USAID/Uganda. The Recipient shall procure all commodities, but USAID/Uganda will assist with customs clearance.

G. Authorized Geographic Code
The authorized geographic code for procurement of goods and services under this grant is A.I.D. Geographic Code 935.

H. Cost Sharing
The Recipient agrees to provide non-USAID matching funds in an amount not less than $17, 209 in support of the program described in Attachment II.

I. Credit Fund Reflows
All credit funds plus interest received under this Agreement must be re-invested in a revolving credit fund.

ATTACHMENT II

PROGRAM DESCRIPTION

BACKGROUND
The U.S. Agency for International Development (USAID) supports Microenterprise development to advance its strategic objective of expanding economic opportunity and access for the poor especially those operating or working in microenterprises. Microenterprise finance is an integral component of the Missions economic growth strategic objective (SO). USAID/Uganda has four key strategic objectives. The economic growth SO is focused on *"increasing rural household incomes"*. Within this SO there are three Results Packages:

RP1:	Increased use of Financial Services by Rural Businesses
RP2:	Increased Production & Marketing of Agricultural Products
RP3:	Improved Enabling Environment for Business

The first Results Package is specifically designed to address the lack of availability and use of financial services by rural microentrepreneurs. It is anticipated that through the Private Enterprise Support Training and Organizational Development (PRESTO) initiative, increased household incomes for the target group will be attained by increasing the use of financial services by both rural and urban MSEs to improve productivity and growth of their enterprises. By improving the productivity of households whose primary or secondary source of income is non-farm private enterprise, these households will derive more income from their businesses. The larger MSMEs will also be able to expand their businesses and employ more people.

Although the PRESTO Project Grant Agreement was signed by USAID and the Government of Uganda on July 4, 1995, the overall technical assistance package will not be in place before November 1996. The USAID Mission has identified the need to implement a few early actions to enable microfinance intermediaries with the capacity to achieve outreach and attain sustainability rapidly to benefit from the technical assistance that will be available under PRESTO. To this end, the Mission has received support from the Program for Innovation in Microenterprise (PRIME) Fund to build the capacity of microfinance intermediaries to expand their programs. During the last two years, approximately sixteen new microfinance institutions have entered the Ugandan market to provide financial services. With the assistance of the G/EG/MD (Microenterprise Development Office), USAID/Uganda has identified two NGOs as able to reach broad outreach and achieve financial sustainability in a relatively short period of time.

The Foundation for Credit and Community Assistance (FOCCAS), will implement a microfinance with education program in partnership with Freedom from Hunger (FFH), an American PVO based in Davis, California. Freedom from Hunger developed the Credit with Education model in 1989 and has implemented seven such programs successfully worldwide. FFH continues to provide ongoing direction and technical assistance to FOCCAS. FOCCAS established its Credit with Education Program Office in Mbale in September, 1995. In November the same year, an orientation workshop for NGOs working in the Tororo and Mbale Districts, potential donor agencies and representatives of the Government of Uganda was held.

In February, 1996 FOCCAS and FFH trained ten field agents to begin implementation of the program. FOCCAS has received 12 motorcycles from the UNDP, a station wagon and funds for their Field Agent orientation training from UNICEF. FOCCAS staff from the Resource Coordination Office in Nevada and FFH staff from the International Center in California shall utilize part of the $50,000 grant from USAID to provide technical assistance and refresher training to the ten Field Agents to enable them to conduct surveys and establish 192 Credit Associations in Tororo and Mbale Districts. The Credit with Education model is highly developed and FOCCAS expects to reach 5,760 borrowers and attain operational sustainability within two years.

PROGRAM OUTPUT

1. The establishment of FOCCAS as an independent, rural financial institution of scale.

In order to build its organizational capacity and expand its lending and training program, FOCCAS will:

(i) Carry out feasibility and baseline studies
(ii) Select and orient communities.
(iii) Train, inaugurate and monitor the performance of 192 Credit Associations.
(iv) Adapt the FFH Credit with Education replication package to the target area.
(v) Initiate longitudinal case studies of program clients.
(vi) Evaluate the pilot phase.
(vii) Select areas in eastern Uganda for expansion and replication.
(viii) Recruit, hire and train two Local Operations Unit (LOU) Coordinators for Mbale and Tororo.

Impact indicators:

(1) FOCCAS will begin the implementation of a financial services program by creating 80 Credit Associations of between 25 to 30 women and men, reaching 2,400 new clients in Tororo and Mbale Districts during the first year and will have, in the second year, 192 active Credit Associations, reaching 5,760 clients.

(2) FOCCAS will conduct 4,000 participatory learning sessions approximately 50% of which will focus on issues related to health, nutrition, child spacing, family planning, AIDS/HIV prevention and action for community development in the first year and will, by the end of the second year, have conducted 9,600 participatory learning sessions.

(3) FOCCAS will disburse $26,000 to its identified clients for credit.

(4) In total, the FOCCAS program will benefit 10,880 clients and family members in the Tororo and Mbale Districts during its first year and 26,112 clients and family members.

IMPLEMENTATION

In July 1996, the Uganda Credit with Education Program was initiated in Mbale and Tororo Districts. Systematic, on-going expansion will continue within those two districts and begin to include other districts by the third year. Within each district, Credit with Education Local Operations Units

(LOUs) will be established. Each LOU will be an independent administrative unit for which revenues and costs will be easily planned, managed and measured. FOCCAS projects that each LOU should achieve full cost recovery within two years.

PROGRAM SUSTAINABILITY

FFH will provide the support to enable FOCCAS to establish financially viable program operations which fully recover costs, including administration, financing borrowed funds, and provisions for loan losses, as well as maintaining the purchasing power of capital to finance the program.

FOCCAS expects the Uganda program to demonstrate the same high repayment rates of nearly 100% as the seven Credit with Education programs implemented by FFH in Mali, Ghana, Burkina Faso, Thailand, Bolivia, Honduras and Nigeria. Risk management is a priority. Comprehensive financial management systems have been developed and include the end-of-cycle evaluation which assesses Credit Associations' management capability, rate of on time repayment of loan installments, and Credit Association solidarity.

A dual loan guarantee system at the level of the Credit Association and five to six member Solidarity groups within the association and rapid intervention for any late payments also promote high repayment rates. FOCCAS will charge a nominal interest rate of 12% per cycle which is 36% per annum and have incorporated in their projections an inflation rate of 10%, a number higher than the current GOU figure of 7%. Average loan sizes will range between $57 - $136 and there is a mandatory savings requirement for the Credit Associations.

CREDIT

Loan repayment reflows plus interest received under this Agreement will be re-invested by FOCCAS in a revolving credit fund.

ATTACHMENT V

FINANCIAL AND OPERATIONAL PERFORMANCE REPORTING

A. PORTFOLIO AND OUTREACH

	1 Qtr	2nd Qtr	3rd Qtr	4th Qtr
1. Number and amount of loans outstanding at beginning & end of reporting period (b)Number of active loan clients at beginning & end of reporting period				
2. Number & amount of loans disbursed during reporting period				
3. Number and amount of small saver deposit accounts at beginning & end of reporting period. Show compulsory & voluntary savings separately e.g. V.S. C.S.				
4. Arrears (on loans outstanding basis). Unpaid balance of loans with payments overdue aging or arrears report, covering for example, 60, 90 days & 1 year 1 - 30 days 31 - 60 days Over 61 days				
5. Net amount (after recovery) written off during period				
6. Percentage of female clients or borrowers				
7. Monthly on time repayment				
8. Number of staff (e.g. those involved with savings & credit activities)				

B. INTEREST RATE POLICY

9. Effective annual interest rate paid by clients (incorporating all required fees, & calculated on a declining balance basis), both nominal & real. Effective rate paid to savers.				
10. Local annualized 90-day Treasury Bill rate*				
11. Local annual inflation rate (give source)				

** indicate the exchange rate used in US $ or Ushs.*

C. INCOME AND EXPENSE INFORMATION

INCOME				
12. Interest & fee income from loans (excluding accrued uncollected interest on non-performing loans)				
13. Income from investments				
14. Other operating income from financial services				
EXPENSES				
15. Staff expenses (salaries and benefits)				
16. Other administrative expenses (includes depreciation)				
17. Addition to reserve (not a loss yet)				
18. Interest & fee expenses (itemized by source of funds)				
NET OPERATING PROFIT				
19. Non-operating income				
20. Non-operating expenses				
21. Donations				
21a. For operating expenses				
22b. Capital contribution (identify purpose e.g. loan fund, equity, fixed assets)				

D. BALANCE SHEET INFORMATION

ASSETS				
23. Cash on hand and in banks				
24. Mandatory reserves				
25. Short term investments				
26. Loans outstanding (must match indicator 1, above)				
27. Less: Loan loss provisions				
28. Net portfolio outstanding				
29. Long term investments				
30. Fixed Assets				
31. Other Assets (suspense accounts)				
32. TOTAL ASSETS				

LIABILITIES				
33. Savings & time deposits from target group clients (must match indicator 3, above)				
34. Other deposits				
35. Loans from Central bank				
36. Loans from other banks				
37. Other short term liabilities				
38. Other long term liabilities				

EQUITY				
39. Paid in equity (shareholders)				
40. Donated equity				
41. Retained earnings				
42. Other capital accounts				
43. Current year profit or loss				
44. TOTAL LIABILITIES AND EQUITY				
ANALYTIC PERFORMANCE INDICATORS				
45. Administrative Efficiency*				
46. Personnel Efficiency* *(reference pg.21 CGAP)*				
47. Portfolio at risk/Delinquency rate				
48. Operational Self-sufficiency				
49. Adjusted Return on Operations				
50. Loan Loss Rate *(reference pg.23 CGAP)*				

CERTIFICATION REGARDING DRUG-FREE WORKPLACE REQUIREMENTS

Instructions for Certification

1. By signing and/or submitting this application or grant agreement, the grantee is providing the certification set out below.

2. The certification set out below is a material representation of fact upon which reliance was placed when the agency determined to award the grant. If it is later determined that the grantee knowingly rendered a false certification, or otherwise violates the requirements of the Drug-Free Workplace Act, the agency, in addition to any other remedies available to the Federal Government, may take action authorized under the Drug-Free Workplace Act.

3. For grantees other than individuals, Alternate I applies.

4. For grantees who are individuals, Alternate II applies.

Certification Regarding Drug-Free Workplace Requirements

Alternate I

A. The grantee certifies that it will provide a drug-free workplace by:

(a) Publishing a statement notifying employees that the unlawful manufacture, distribution, dispensing, possession or use of a controlled substance is prohibited in the grantee's workplace and specifying the actions that will be taken against employees for violation of such prohibition:

(b) Establishing a drug-free awareness program to inform employees about--

(1) The dangers of drug abuse in the workplace;

(2) The grantee's policy of maintaining a drug-free workplace;

(3) Any available drug counseling, rehabilitation, and employee assistance programs; and

(4) The penalties that may be imposed upon employees for drug abuse violations occurring in the workplace;

(c) Making it a requirement that each employee to be engaged in the performance of the grant be given a copy of the statement required by paragraph (a);

(d) Notifying the employee in the statement required by paragraph (a) that, as a condition of employment under the grant, the employee will--

(1) Abide by the terms of the statement; and

(2) Notify the employer of any criminal drug statute conviction for a violation occurring in the workplace no later than five days after such conviction;

(e) Notifying the agency within ten days after receiving notice under subparagraph (d) (2) from an employee or otherwise receiving actual notice of such conviction;

(f) Taking one of the following actions, within 30 days of receiving notice under subparagraph (d)2), with respect to any employee who is so convicted--

(1) Taking appropriate personnel action against such an employee, up to and including termination; or

(2) Requiring such employee to participate satisfactorily in a drug abuse assistance or rehabilitation program approved for such purposes by a Federal, State, or local health, law enforcement, or other appropriate agency;

(g) Making a good faith effort to continue to maintain a drug-free workplace through implementation of paragraphs (a), (b), (c), (d), (e) and (f).

B. The grantee shall insert in the space provided below the site(s) for the performance of work done in connection with the specific grant:

Place of Performance (Street address, city, country, state, zip code)

Foundation for Credit and Community Assistance
Plot #49, Republic Street, P.O. Box 907
Mbale, Uganda.

Alternate II - Not applicable

By: ______________________

Typed Name: Basil W. Wanzira

Title: Program Manager

Date: 25/9/1996

CERTIFICATION REGARDING LOBBYING

Certification for Contracts, Grants, Loans, and Cooperative Agreements

The undersigned certifies, to the best of his or her knowledge and belief, that:

(1) No federal appropriated funds have been paid or will be paid, by or on behalf of the undersigned, to any person for influencing or attempting to influence an officer or employee of any agency, a Member of Congress, an officer or employee of Congress, or an employee of a Member of Congress in connection with the awarding of any Federal contract, the making of any Federal grant, the making of any Federal loan, the entering into of any cooperative agreement, and the extension, continuation, renewal, amendment, or modification of any Federal contract, grant, loan or cooperative agreement.

(2) If any funds other than Federal appropriated funds have been paid or will be paid to any person for influencing or attempting to influence an officer or employee of any agency, a Member of Congress, an officer or employee of Congress, or an employee of a Member of Congress, in connection with this Federal contract, grant, loan, or cooperative agreement, the undersigned shall complete and submit Standard Form LLL, "Disclosure Form to Report Lobbying", in accordance with its instruction.

(3) The undersigned shall require that the language of this certification be included in the award documents for all sub awards at all tiers (including subcontracts, subgrants, and contracts under grants, loans, and cooperative agreements) and that all sub recipients shall certify and disclose accordingly.

This certification is a material representation of fact upon which reliance was placed when this transaction was made or entered into. Submission of this certification is a prerequisite for making or entering into this transaction imposed by Section 1352, Title 31, U.S. Code. Any person who fails to file the required certification shall be subject to a civil penalty of not less than $10,000 and not more than $100,000 for each such failure.

By: ____________

Typed Name: Basil W. Wanzira

Title: Program Manager

Date: 25/9/1996

CERTIFICATION REGARDING DEBARMENT, SUSPENSION, AND OTHER RESPONSIBILITY MATTER-- PRIMARY COVERED TRANSACTIONS

(1) The prospective primary participant certifies to the best of its knowledge and belief, that it and its principals:

(a) Are not presently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from covered transactions by any Federal department or agency;

(b) Have not within a three-year period preceding this proposal been convicted of or had a civil judgement rendered against them for commission of fraud or a criminal offense in connection with obtaining, attempting to obtain, or performing a public (Federal, State or local) transaction or contract under a public transaction; violation of Federal or State antitrust statutes or commission of embezzlement, theft, forgery, bribery, falsification or destruction or records, making false statements, or receiving stolen property;

(c) Are not presently indicated for or otherwise criminally or civilly charged by a governmental entity (Federal, State or local) with commission of any of the offenses enumerated in paragraph (1)(b) of this certification; and

(d) Have not within a three-year period preceding this application/proposal had one or more public transactions (Federal, State or local) terminated for cause or default.

(2) Where the prospective primary participant is unable to certify to any of the statements in this certification, such prospective participant shall attach an explanation to this proposal.

By: ______________________

Typed Name: Basil W. Wanzira

Title: Program Manager

Date: 25/9/1996

ASSURANCE OF COMPLIANCE WITH LAWS AND REGULATIONS GOVERNING NONDISCRIMINATION IN FEDERALLY ASSISTED PROGRAMS

FOCCAS (hereinafter called the "Applicant")

hereby assures that no person in the United States shall, on the bases set forth below, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under, any program or activity receiving financial assistance from AID, and that with respect to the grant for which application is being made, it will comply with the requirements of:

(1) Title VI of the Civil Rights Act of 1964 (Pub.L. 88-352, 42 U.S.C. 200-d) which prohibits discrimination on the basis of race, color or national origin, in programs and activities receiving Federal financial assistance,

(2) Section 504 of the Rehabilitation Act of 1973 (29 U.S.C. 794), which prohibits discrimination on the basis of handicap in programs and activities receiving Federal financial assistance,

(3) The Age Discrimination Act of 1975, as amended Pub. L. 95-478), which prohibits discrimination based on age in the delivery of services and benefits supported with federal funds,

(4) Title IX of the Education Amendments of 1972 (20 U.S.C. 1681, et. seq.) which prohibits discrimination on the basis of sex in education programs and activities receiving Federal financial assistance (whether or not the programs or activities are offered or sponsored by an educational institution); and

(5) AID regulations implementing the above nondiscrimination laws, set forth in Chapter II of Title 22 of the Code of Federal Regulations.

If the Applicant is an institution of higher education, the Assurances given herein extend to admission practices and to all other practices relating to the treatment of students or clients of the institution, or relating to the opportunity to participate in the provision of services or other benefits to such individuals, and shall be applicable to the entire institution unless the Applicant establishes to the satisfaction of the AID Administrator that the institution's practices in designated parts or programs of the institution will in no way affect its practices in the program of the institution for which financial assistance is sought, or the beneficiaries of or participants in such program.

This assurance is given in consideration of and for the purpose of obtaining any and all Federal grants, loans, contracts, property, discounts or the Federal financial assistance extended after the date hereof to the applicant by the Agency, including installment payments after such date on account of applications for Federal financial assistance which were approved before such date. The applicant recognizes and agrees that such Federal financial assistance will be extended in reliance on the representations and agreements made in this Assurance, and that the United States shall have the right to seek judicial enforcement of this Assurance. This Assurance is binding on the Applicant, its successors, transferees, and assignees, and the person or persons whose signatures appears below are authorized to sign this Assurance on behalf of the Applicant.

By: ______________________

Typed Name: Basil W. Wanzira

Title: Program Manager

Date: 25/9/1996

REQUIRED AS APPLICABLE STANDARD PROVISIONS FOR
NON-U.S., NONGOVERNMENTAL GRANTEES
UNDER GRANTS AWARDED AND ADMINISTERED
BY AN AUTHORIZED USAID CONTRACTOR

APPENDIX 4B

The following standard provisions are required to be used when applicable. Applicability statements are contained in the parenthetical statement preceding the standard provision. When a standard provision is determined to be applicable in accordance with the applicability statement, the use of such standard provision is mandatory unless a deviation has been approved in accordance with Paragraph 1E of Chapter 1 of **USAID** Handbook 13. Each grant is required to have a payment provision. Check off the provisions which are to be included in the grant. Only those standard provisions which have been checked off are included within the grant.

1.	Payment - Periodic Advance	______
2.	Payment - Cost Reimbursement	______
3.	Air Travel and Transportation	X
4.	Ocean Shipment of Goods	______
5.	Procurement of Goods and Services	X
6.	USAID Eligibility Rules for Goods and Services	X
7.	Subagreements	______
8.	Local Cost Financing	X
9.	Patent Rights	______
10.	Publications and Media Releases	X
11.	Nondiscrimination in Federally Assisted Programs	______
12.	Regulations Governing Employees	______
13.	Participant Training	______
14.	Voluntary Population Planning	______
15.	Protection of the Individual as a Research Subject	______
16.	Negotiated Overhead Rates - Provisional	X
17.	Title To and Use of Property (Grantee Title)	______
18.	Title To and Care of Property (U.S. Government Title)	______
19.	Title To and Care of Property (Cooperating Country Title)	______
20.	Cost Sharing (Matching)	X
21.	Public Notices	______

3. AIR TRAVEL AND TRANSPORTATION (JUNE 1993)

(This provision is applicable when any costs for air travel or transportation are included in the budget.)

(a) The grantee is required to notify the ~~project officer~~ **Contractor** of the proposed itinerary for each planned international trip financed by this grant, by providing the name of the traveller, purpose of the trip, origin/destination (and intervening stops), and dates of travel, as far in advance of the proposed travel as possible, but at least three weeks before travel is planned to commence. International travel, as provided for in the grant, is authorized unless otherwise disapproved by the ~~project officer~~ **Contractor** in writing prior to the commencement of travel. At least one week prior to departure, the grantee shall notify the cognizant U.S. Mission or Embassy, with a copy to the ~~project officer~~ **Contractor** of planned travel, identifying the travellers and dates and times of arrival.

(b) Travel to certain countries shall, at USAID's option, be funded from U.S.-owned local currency. When USAID intends to exercise this option, USAID will, after receipt of advice of intent to travel required above, either issue a SF 1169, Government Transportation Request (GTR), which the grantee may exchange for tickets, or USAID will issue the tickets

(2) Foreign air carrier service is preferred by or is more convenient for the agency or traveler; or

(3) Service by a foreign air carrier can be paid for in excess foreign currency, unless U.S. flag air carriers decline to accept excess or near excess foreign currencies for transportation payable only out of such monies.

(f) Except as provided in paragraph (b) of this section, U.S. flag air carrier service must be used for all Government-financed commercial foreign air travel if service provided by such carriers is available. In determining availability of a U.S. flag air carrier, the following scheduling principles should be followed unless their application results in the last or first leg of travel to or from the U.S. being performed by a foreign air carrier:

(1) U.S. flag air carrier service available at point of origin should be used to destination or in the absence of direct or through service to the farthest interchange point on a usually traveled route;

(2) Where an origin or interchange point is not served by U.S. flag air carrier, foreign air carrier service should be used only to the nearest interchange point on a usually traveled route to connect with U.S. flag air carrier service; or

(3) Where a U.S. flag air carrier involuntarily reroutes the traveler via a foreign air carrier the foreign air carrier may be used notwithstanding the availability of alternative U.S. flag air carrier service.

(g) For travel between a gateway airport in the United States (the last U.S. airport from which the traveler's flight departs or the first U.S. airport at which the traveler's flight arrives) and a gateway airport abroad (that airport from which the traveler last embarks enroute to the U.S. or at which the traveler first debarks incident to travel from the U.S.) passenger service by U.S. flag air carrier will not be considered available:

(1) Where the gateway airport abroad is the traveler's origin or destination airport, and the use of U.S. flag air carrier service would extend the time in a travel status, including delay at origin and accelerated arrival at destination, by at least 24 hours more than travel by foreign air carrier:

(2) Where the gateway airport abroad is an interchange point, and the use of U.S. flag air carrier service would require the traveler to wait six hours or more to make connections at that point, or delayed departure from or accelerated arrival at the gateway airport in the U.S. would extend the time in a travel status by at least six hours more than travel by foreign air carrier.

(h) For travel between two points outside the U.S. the rules in paragraphs (d) through (f) of this section will be applicable, but passenger service by U.S. flag air carrier will not be considered to be reasonably available:

(1) If travel by foreign air carrier would eliminate two or more aircraft changes enroute;

(2) Where one of the two points abroad is the gateway airport (as defined paragraph (g) of this section) enroute to or from the U.S., if the use of a U.S. flag air carrier would extend the time in a travel status by at least six hours more than travel by foreign air carrier including accelerated arrival at the overseas destination or delayed departure from the overseas origin as well as delay at the gateway airport or other interchange point abroad; or

(3) Where the travel is not part of a trip to or from the U.S.; if the use of a U.S. flag air carrier would extend the time in a travel status by at least six hours more than travel by foreign air carrier including delay at origin, delay enroute and accelerated arrival at destination.

(i) When travel under either paragraph (g) or (h) of this section involves three hours or less between origin and destination by a foreign air carrier, U.S. flag air carrier service will not be considered available when it involves twice such travel time or more.

(j) Nothing in the above guidelines shall preclude and no penalty shall attend the use of a foreign air carrier which provides transportation under an air transport agreement between the United States and a foreign government, the terms of which are consistent with the international aviation policy goals set forth at 49 U.S.C. 1502(b) and provide reciprocal rights and benefits.

(k) Where U.S. Government funds are used to reimburse the grantee's use of other than U.S. air flag carriers for international transportation, the grantee will include a certification on vouchers involving such transportation which is essentially as follows:

"CERTIFICATION OF UNAVAILABILITY OF U.S. FLAG AIR CARRIERS"

I hereby certify that the transportation service for personnel (and their personal effects) or property by certificated air carrier was unavailable for the following reason(s): (State appropriate reason(s) as set forth above)."

(l) International Travel

(1) As used herein, the term "international travel" includes travel to all countries other than travel within the home country of the traveler.

(2) The grantee will be reimbursed for travel and the reasonable cost of subsistence, post differentials and other allowances paid to employees in an international travel status in accordance with the grantee's established policies and practices which are uniformly applied to federally financed and other activities of the grantee. The standard for determining the reasonableness of reimbursement for overseas allowance in the Standardized Regulations (Government Civilians, Foreign Areas), published by the U.S. Department of State, as from time to time amended. The most current subsistence, post differentials, and other allowances may be obtained from the ~~grant officer~~ **Contractor**.

(m) This provision will be included in all subagreements and contracts which require air travel and transportation under this grant.

(END OF STANDARD PROVISION)

4. OCEAN SHIPMENT OF GOODS (JUNE 1993)

(This provision is applicable when goods purchased with funds provided under this grant are transported to cooperating countries on ocean vessels whether or not grant funds are used for the transportation.)

(a) At least 50% of the gross tonnage of all goods purchased under this grant and transported to the cooperating countries shall be made on privately owned U.S. flag commercial ocean vessels, to the extent such vessels are available at fair and reasonable rates for such vessels.

(b) At least 50% of the gross freight revenue generated by shipments of goods purchased under this grant and transported to the cooperating countries on dry cargo liners shall be paid to or for the benefit of privately owned U.S. flag commercial ocean vessels to the extent such vessels are available at fair and reasonable rates for such vessels.

(c) When U.S. flag vessels are not available, or their use would result in a significant delay, the grantee may request a determination of non-availability from the USAID Transportation Support Division, Office of Procurement, Washington, D.C. 20523, giving the basis for the request which will relieve the grantee of the requirement to use U.S. flag vessels for the amount of tonnage included in the determination. Shipments made on non-free world ocean vessels are not reimbursable under this grant.

(d) Vouchers submitted for reimbursement which include ocean shipment costs shall contain a certification essentially as follows:

"I hereby certify that a copy of each ocean bill of lading concerned has been submitted to the U.S. Department of Transportation, Maritime Administration, Division of National Cargo, 400 7th Street, S.W., Washington, D.C. 20590, and that such bills of lading state all of the carrier's charges including the basis for calculation such as weight or cubic measurement."

(e) Shipments financed under this grant must meet applicable eligibility requirements set out in Handbook 1, Supplement B, Chapter 7.

(f) This provision will be included in all subagreements which will finance goods to be shipped on ocean vessels.

(END OF STANDARD PROVISION)

5. PROCUREMENT OF GOODS AND SERVICES (JUNE 1993)

(This provision is applicable when goods or services are procured
under the grant.)

The grantee may use its own procurement policies and practices for the procurement of goods and services under this grant, provided they conform to all of USAID's requirements listed below and the standard provision entitled "USAID Eligibility Rules For Goods and Services".

(a) General Requirements:

(1) Recipient Responsibilities. The standards contained in this section do not relieve the recipient of the contractual responsibilities arising under its contract(s). The recipient is the responsible authority, without recourse to USAID, **or the Contractor,** regarding the settlement and satisfaction of all contractual and administrative issues arising out of procurements entered into in support of an award or other agreement. This includes disputes, claims, protests of award, source evaluation or other matters of a contractual nature. Matters concerning violation of statute are to be referred to such Federal, State or local authority as may have proper jurisdiction. (NOTE - new to A-110)

(2) The grantee shall maintain a written(?) code or standards of conduct that shall govern the performance of its officers, employees or agents engaged in the awarding and administration of contracts using USAID funds. Conflicts of interests situations involving employees, officers or agents or their immediate families shall be avoided. The grantee's officers, employees or agents shall neither solicit nor accept gratuities, favors or anything of monetary value from contractors or potential contractors. Such standards shall provide for disciplinary actions to be applied for violations of such standards by the grantees' officers, employees or agents.

(3) All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest ~~or~~ as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work,

invitations for bids and/or requests for proposals ~~should~~ shall be excluded from competing for such procurement. Awards shall be made to the bidder or offeror whose bid or offer is responsive~~/responsible~~ to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. Solicitations shall clearly establish all requirements that the bidder or offeror ~~must~~ shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so.

(4) All grantees shall establish procurement procedures that provide for, at a minimum, the following procedural requirements:

(i) ~~Proposed procurement actions shall follow a procedure to assure the avoidance of purchasing unnecessary items.~~ Recipients avoid purchasing unnecessary items. (.44a1) (NOTE - lease/purchase alternatives not mentioned in SP)

(ii) Solicitations for goods and services shall be based upon a clear and accurate description of the technical requirements for the material, product or service to be procured. Such a description shall not, in competitive procurements, contain features which unduly restrict competition. (NOTE - new A-110 more detailed)

(iii) Positive efforts shall be made by the grantees to utilize U.S. small business and minority owned business sources of supplies and services. Such efforts should allow these sources the maximum feasible opportunity to compete for contracts utilizing USAID funds. The grantee shall to the maximum extent possible provide the following information to the Office of Small and Disadvantaged Business Utilization, USAID, Washington, D.C. 20523, at least 45 days prior (except where a shorter time is requested of and granted by the Office of Small and Disadvantaged Business Utilization) to placing any order or contract in excess of ~~$25,000~~ the small purchase threshold:

(A) Brief general description and quantity of goods or services;

(B) Closing date for receiving quotations or proposals; and

(C) Address where solicitations and specifications can be obtained.

(iv) The type of procurement instruments used, e.g. fixed price contracts, cost reimbursable contracts, purchase orders, incentive contracts, shall be determined by the grantee but must be appropriate for the particular procurement and for promoting the best interest of the program involved. In those instances where a cost type contract authorizes a fee, a fixed amount will be used in lieu of a percentage of cost.

(v) Contracts shall be made only to responsible contractors who possess the potential ability to perform successfully under the terms and conditions of a proposed contract. Consideration shall be given to such matters as integrity, record of past performance, financial and technical resources or accessibility to other necessary resources. Contracts shall not be made to firms or individuals whose name appears on the "Lists of Parties Excluded from Federal Procurement and Nonprocurement Programs." USAID will provide the grantee with copy of this list upon request.

(vi) All proposed sole source contracts or where only one proposal is received in which the aggregate expenditure is expected to exceed $10,000 shall be subject to prior approval by an appropriate official within the grantee's organization.

(vii) Some form of price or cost analysis should be made in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, and market prices, together with discounts.

Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability and allowability.

(viii) Procurement records and files for purchases in excess of $10,000 shall include the following:

(A) Basis for contractor selection;

(B) Justification for lack of competition when competitive offers are not obtained;

(C) Basis for award: cost or price.

(ix) A system for contract administration shall be maintained to ensure contractor conformance with terms, conditions and specifications of the contract, and to ensure adequate and timely followup of all purchases.

(b) Each contract and subcontract shall contain in addition to provisions to define a sound and complete contract, the following contract provisions as well as any provision within this grant which requires such inclusion of that provision. Whenever a provision is required to be inserted in a contract under this grant, the grantee shall insert a statement in the contract that in all instances where USAID is mentioned the grantee's name shall be substituted.

(1) Contracts in excess of $10,000 shall contain contractual provisions or conditions that will allow for administrative, contractual or legal remedies in instances in which contractors violate or breach contract terms, and provide for such remedial actions as may be appropriate.

(2) All contracts in excess of $10,000 shall contain suitable provisions for termination by the grantee including the manner by which termination will be effected and the basis for settlement.

In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

(3) All negotiated contracts over $10,000 awarded by the grantee shall include a provision to the effect that the grantee, USAID or their duly authorized representatives, shall have access to any books, documents, papers and records of the

(5) Contracts, the principal purpose of which is to create, develop or improve products, processes or methods; or for exploration into fields that directly concern public health, safety or welfare; or contracts in the fields of science or technology in which there has been little significant experience outside of work funded by Federal assistance, shall contain a notice to the effect that matters regarding rights to inventions and materials generated under the contract are subject to the regulations included in these grant provisions. The contractor shall be advised as to the source of additional information regarding these matters.

(END OF STANDARD PROVISION)

6. USAID ELIGIBILITY RULES FOR GOODS AND SERVICES (JUNE 1993)

(This provision is applicable when goods or services are procured under the grant.)

(a) Ineligible and Restricted Goods and Services: If USAID determines that the grantee has procured any of the restricted or ineligible goods and services specified below, or has procured goods and services from unauthorized sources, and has received reimbursement for such purpose without the prior written authorization of the grant officer, the grantee agrees to refund to USAID the entire amount of the reimbursement.

(1) Ineligible Goods and Services. Under no circumstances shall the grantee procure any of the following under this grant:

(i) Military equipment,

(ii) Surveillance equipment,

(iii) Commodities and services for support of police or other law enforcement activities,

(iv) Abortion equipment and services,

(v) Luxury goods and gambling equipment, or

(vi) Weather modification equipment.

(2) Ineligible Suppliers. Funds provided under this grant shall not be used to procure any goods or services furnished by any firm or individual whose name appears on the "Lists of Parties Excluded from Federal Procurement and Nonprocurement Programs."

USAID will provide the grantee with this list upon request.

(3) Restricted Goods. The grantee shall not procure any of the following goods and servies without the prior written authorization of the grant officer:

(i) Agricultural commodities,

(ii) Motor vehicles,

(iii) Pharmaceuticals,

(iv) Pesticides,

(v) Rubber compounding chemicals and plasticizers,

(vi) Used equipment,

(vii) U.S. Government-owned excess property, or

(viii) Fertilizer.

(b) Source, Origin, and Nationality: The eligibility rules for goods and services based on source and nationality are divided into two categories. One applies when the total procurement element during the life of the grant is over $250,000 and the other applies when the total procurement element during the life of the grant is not over $250,000. The total procurement element includes procurement of all goods (e.g. equipment, materials, supplies) and services. Guidance on the eligibility of specific goods or services may be obtained from the grant officer. USAID policies and definitions on source (including origin and componentry) and nationality are contained in Chapter 5 of USAID Handbook 1, Supplement B, entitled "Procurement Policies."

(1) For DFA funded grants or when the total procurement

element during the life of this grant is valued at $250,000 or less, the following rules apply:

(i) The authorized source for procurement of all goods and services to be reimbursed under the grant is USAID Geographic Code 935, "Special Free World," and such goods and services must meet the source (including origin and componentry) and nationality requirements set forth in Handbook 1, Supp. B, Chapter 5 in accordance with the following order of preference:

(A) The United States (USAID Geographic Code 000),

(B) The Cooperating Country,

(C) Selected Free World countries (USAID Geographic Code 941),

(D) Special Free World countries (USAID Geographic Code 935).

(ii) Application of Order of Preference: When the grantee procures goods and services from other than U.S. sources, under the order of preference in paragraph (b)(1)(ii) above, the grantee shall document its files to justify each such instance. The documentation shall set forth the circumstances surrounding the procurement and shall be based on one or more of the following reasons, which will be set forth in the grantee's documentation:

(A) The procurement was of an emergency nature, which would not allow for the delay attendant to soliciting U.S. sources,

(B) The price differential for procurement from U.S. sources exceeded by 50% or more the delivered price from the non-U.S. source,

(C) Compelling local political considerations precluded consideration of U.S. sources,

(D) The goods or services were not available from U.S. sources, or

(E) Procurement of locally available goods and services, as opposed to procurement of U.S. goods and services, would best promote the objectives of the Foreign Assistance program under the grant.

(2) When the total procurement element exceeds $250,000, (unless funded by DFA), the following applies: Except as may be specifically approved or directed in advance by the grant officer, all goods and services financed with U.S. dollars, which will be reimbursed under this grant must meet the source (including origin and componentry) and nationality requirements set forth in Handbook 1, Supp B, Chapter 5 for the authorized geographic code specified in the schedule of this grant. If none is specified, the authorized source is Code 000, the United States.

(c) Marine Insurance: The eligibility of marine insurance is determined by the country in which it is placed. Insurance is placed in a country if payment of the insurance premium is made to and the insurance policy is issued by an insurance company located in that country. Eligible countries for placement are governed by the authorized geographic code, except that if Code 941 is authorized, the Cooperating Country is also eligible. Section 604(d) of the Foreign Assistance Act requires that is a grantee country discriminates by statute, decree, rule, or practice with respect to USAID-financed procurement against any marine insurance company authorized to do business in the U.S., then any USAID-financed commodity shipped to that country shall be insured against marine risk and the insurance shall be placed in the U.S. with a company or companies authorized to do marine insurance business in the U.S.

(d) Ocean and air transportation shall be in accordance with the applicable provisions contained within this grant.

(e) Printed or Audio-Visual Teaching Materials: If the effective use of printed or audio-visual teaching materials depends upon their being in the local language and if such materials are intended for technical assistance projects or activities financed by USAID in whole or in part and if other funds including U.S.-owned or U.S.-controlled local currencies are not readily available to finance the procurement of such materials, local language versions may be procured from the following sources in order of preference:

(1) The United States (USAID Geographic Code 000),

(2) the Cooperating Country,

(3) Selected Free World countries (USAID Geographic Code 941),

(4) Free World countries (USAID Geographic Code 899).

(f) Special Restrictions on the Procurement of Construction or Engineering Services: Section 604(g) of the Foreign Assistance Act provides that USAID funds may not be used for "procurement of construction or engineering services from advanced developing countries, eligible under Geographic Code 941, which have attained a competitive capability in international markets for construction services or engineering services." In order to insure eligibility of a Code 941 contractor for construction or engineering services, the grantee shall obtain the grant officer's prior approval for any such contract.

(g) This provision will be included in all subagreements which include procurement of goods or services over $5,000.

(END OF STANDARD PROVISION)

8. LOCAL COST FINANCING (JUNE 1993)

(This provision is applicable when the total estimated procurement element for the life of the grant is valued over $250,000 and the grant is not funded under DFA.)

(a) Financing local procurement involves the use of appropriated funds to finance the procurement of goods and services supplied by local businesses, dealers or producers, with payment normally being in the currency of the cooperating country.

(b) All locally financed procurements must be covered by source and nationality waivers as set forth in USAID Handbook 1, Supplement B, Chapter 5 with the following exceptions:

(1) Locally available commodities of U.S. origin, which are otherwise eligible for financing, if the value of the transaction is estimated not to exceed $100,000 exclusive of transportation costs.

(2) Commodities of geographic code 935 origin if the value of the transaction does not exceed the local currency equivalent of $5,000.

(3) Professional services contracts estimated not to exceed $250,000.

(4) Construction services contracts estimated not to exceed $5,000,000.

(5) Commodities and services available only in the local economy (no specific per transaction value applies to this category). This category includes the following items:

(i) Utilities including fuel for heating and cooking, waste disposal and trash collection;

(ii) Communications - telephone, telex, fax, postal and courier services;

(iii)Rental costs for housing and office space;

(iv) Petroleum, oils and lubricants for operating vehicles and equipment;

(v) Newspapers, periodicals and books published in the cooperating country;

(vi) Other commodities and services and related expenses that, by their nature or as a practical matter, can only be acquired, performed, or incurred in the cooperating country, e.g., vehicle maintenance, hotel accommodations, etc.

(c) All procurements under grants financed with DFA funds and grants with procurement elements of $250,000 or less are subject to the guidance provided under standard provision "USAID Eligibility Rules for Goods and Services."

(d) Ineligible Goods and Services: Under no circumstances shall the grantee procure any of the following under this grant:

(1) Military equipment,

(2) Surveillance equipment,

(3) Commodities and services for support of police or other law enforcement activities,

(4) Abortion equipment and services,

(5) Luxury goods and gambling equipment, or

(6) Weather modification equipment.

(e) Ineligible Suppliers: Funds provided under this grant shall not be used to procure any goods or services furnished by any firm or individual whose name appears on the "Lists of Parties Excluded from Federal Procurement and Nonprocurement Programs." USAID will provide the grantee with this list upon request.

(f) Restricted Goods: The grantee shall not procure any of the following goods and services without the prior written authorization of the grant officer:

(1) Agricultural commodities,

(2) Motor vehicles,

(3) Pharmaceuticals,

(4) Pesticides,

(5) Rubber compounding chemicals and plasticizers,

(6) Used equipment,

(7) U.S. Government-owned excess property, or

(8) Fertilizer.

(g) If USAID determines that the grantee has procured any of the restricted or ineligible goods and services specified in subparagraphs (c) through (e) above, or has received reimbursement for such purpose without the prior written authorization of the grant officer, the grantee agrees to refund to USAID the entire amount of the reimbursement.

(h) This provision will be included in all subagreements where local procurement of goods or services will be required.

(END OF STANDARD PROVISION)

10. PUBLICATIONS AND MEDIA RELEASES (JUNE 1993)
(This provision is applicable when publications are financed under the grant.)

(a) USAID shall be prominently acknowledged in all publications, videos or other information/media product funded or partially funded through this grant, and the product shall state that the views expressed by the author(s) do not necessarily reflect those of USAID. Acknowledgements should identify the sponsoring USAID Office and Bureau or Mission as well as the U.S. Agency for International Development substantially as follows:

"This [publication, video or other information/media product (specify)] was made possible through support provided by the Office of ________________, Bureau for ________________, U.S. Agency for International Development, under the terms of Grant No. ___________. The opinions expressed herein are those of the author(s) and do not necessarily reflect the views of the U.S. Agency for International Development."

(b) Unless the grantee is instructed otherwise by the cognizant technical office, publications, videos or other information/media products funded under this grant and intended for general readership or other general use will be marked with the USAID logo and/or U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT appearing either at the top or at the bottom of the front cover or, if more suitable, on the first inside title page for printed products, and in equivalent appropriate location in videos or other information/media products. Logos and markings of co-sponsors or authorizing institutions should be similarly located and of similar size and appearance.

(c) The grantee shall provide the USAID project officer and POL/CDIE, Room 215, SA-18, Washington, DC 20523-1802, with one copy each of all published works developed under the grant and with lists of other written work produced under the grant.

(d) In the event grant funds are used to underwrite the cost of publishing, in lieu of the publisher assuming this cost as is the normal practice, any profits or royalties up to the amount of such cost shall be credited to the grant unless the schedule of the grant has identified the profits or royalties as program income.

(e) Except as otherwise provided in the terms and conditions of the grant, the author or the grantee is free to copyright any books, publications, or other copyrightable materials developed in the course of or under this grant, but USAID reserves a royalty-free nonexclusive and irrevocable right to reproduce, publish, or otherwise use, and to authorize others to use the work for Government purposes.

(END OF STANDARD PROVISION)

16. NEGOTIATED OVERHEAD RATES - PROVISIONAL (JUNE 1993)

(This provision is applicable to all grantees who have an established provisional overhead rate.)

(a) An overhead rate shall be established for each of the grantee's accounting periods during the term of this grant. Pending establishment of a final rate, provisional overhead payments shall be at the rate(s), on the base(s), and for the period(s) shown in the Schedule of this grant.

(b) The grantee, not later than 13 months after the close of each of its accounting periods during the term of this grant, shall submit to the grant officer a proposed final rate(s) for the period, together with supporting cost data. Negotiation of final overhead rate(s) by the grantee and the grant officer shall be undertaken as promptly as practicable after receipt of the grantee's proposal.

(c) The results of each negotiation shall be set forth in an amendment to the grant and shall specify (1) the agreed upon final rate(s), (2) the base(s) to which the rate(s) apply, nd (3) the period for which the rates apply. The overhead rate amendment shall not change any monetary ceiling, grant obligation, or specific cost allowance or disallowance provided for in this grant.

(d) To prevent substantial over or under payment, the provisional or billing ratesmay, at the request of either party, be revised by mutual agreement, either retroactively or prospectively. Any such revision of negotiated provisional rates provided in this provision shall be set forth in an amendment to this grant.

(e) Any failure by the parties to agree on any final rate(s) under this provision shall be considered a dispute within the meaning of the standard provison of the grant, entitled "Disputes".

(END OF STANDARD PROVISION)

17. TITLE TO AND USE OF PROPERTY (GRANTEE TITLE) (MAY 1986)

(This provision is applicable only when the Government vests title to property in the grantee.)

(a) Title to all property financed under this grant shall vest in the grantee.

(b) The grantee agrees to use and maintain the property for the purpose of the grant.

(c) With respect to property having an acquired value of $1,000 or more, the grantee agrees to report such items to the grant officer as they are acquired and to maintain a control system which will permit their ready identification and location.

(d) Within thirty calendar days after the end of the grant, the grantee will provide a list to the grant officer of each item that has an appraised value of $1,000 or more with a detailed proposal of what the grantee intends to do with that property. If the grant officer does not respond within 120 calendar days, the grantee may proceed with the disposition of the property. However, if the grantee uses the property for purposes other than those of the grant or sells or leases the property, USAID shall be reimbursed of tis share of the property unless the grant officer authorizes AID's share of the income from selling or leasing the property to be used as program income. This share is based upon the percentage of AID's contribution to the grantee's program. If USAID paid 100% of the grantee's costs, then USAID would receive 100% of the selling cost less a nominal selling fee of $100.

(END OF STANDARD PROVISION)

19. TITLE TO AND CARE OF PROPERTY (COOPERATING COUNTRY TITLE) (NOVEMBER 1984)

(This provision is applicable to property titled in the name of the cooperating country or such public or private agency as the cooperating country government may designate.)

(a) Except as modified by the Schedule of this grant, title to all equipment, materials and supplies, the cost of which is reimbursable to the grantee by USAID or by the cooperating country, shall at all times be in the name of the cooperating country or such public or private agency as the cooperating Government may designate, unless title to specified types or classes of equipment is reserved to USAID under provisions set forth in the Schedule of this grant; but all such property

20. COST SHARING (MATCHING) (JUNE 1993)

(This provision is applicable when the grantee is required to provide a matching share or to cost share.)

(a) For each year (or funding period) under this grant, the grantee agrees to expend from non-Federal funds an amount at least equal to the amount or percentage of the total expenditures under this grant specified in the schedule of the grant. The schedule of this grant may also contain restrictions on the application of cost sharing (matching) funds. The schedule takes precedence over the terms of this provision.

(b) Eligibility of non-Federal funds applied to satisfy cost sharing (matching) requirements under this grant are set forth below:

(1) Charges incurred by the grantee as project costs. Not all charges require cash outlays by the grantee during the project period; examples are depreciation and use charges for buildings and equipment.

(2) Projects costs financed with cash contributed or donated to the grantee by other non-Federal public agencies (may include public international organizations or foreign governments) and institutions, and private organizations and individuals, and

(3) Project costs represented by services and real and personal property, or use thereof , donated by other non-Federal public agencies and institutions, and private organizations and individuals.

(c) All contributions, both cash and in-kind, shall be accepted as part of the grantee's cost sharing (matching) when such contributions meet all of the following criteria:

(1) Are verifiable from the grantee's records;

(2) Are not included as contributions for any other Federally assisted program;

(3) Are necessary and reasonable for proper and efficient accomplishment of project objectives;

(4) Are types of charges that would be allowable under the applicable Federal cost principles;

(5) Are not paid by the Federal Government under another grant or agreement (unless the grant or agreement is authorized by Federal law to be used for cost sharing or matching);

(6) Are provided for in the approved budget when required by USAID; and

(7) Conform to other provisions of this paragraph.

(d) Values for grantee in-kind contributions will be established in accordance with the applicable Federal cost principles.

(e) Specific procedures for the grantee in establishing the value of in-kind contributions from non-Federal third parties are set forth below:

(1) Valuation of volunteer services: Volunteer services may be furnished by professional and technical personnel, consultants, and other skilled and unskilled labor. Volunteer services may be counted as cost sharing or matching if the service is an integral and necessary part of an approved program.

(i) Rates for volunteer services: Rates for volunteers should be consistent with those paid for similar work in the grantee's organization. In those instances in which the required skills are not found in the grantee's organization, rates should be consistent with those paid for similar work in the labor market in which the grantee competes of the kind of services involved.

(ii) Volunteers employed by other organizations: When an employer other than the grantee furnishes the services of an employee, these services shall be valued at the employee's regular rate of pay (exclusive of fringe benefits and overhead costs) provided these services are of the same skill for which the employee is normally paid.

(2) Valuation of donated expendable personal property: Donated expendable personal property includes such items as expendable equipment, office supplies, laboratory supplies or workshop and classroom supplies. Value assessed to expendable personal property included in the cost (matching) share should be reasonable and should not exceed the market value of the property at the time of the donation.

(3) Valuation of donated nonexpendable personal

property, buildings, and land or use thereof:

(i) The method used for charging cost sharing or matching for donated nonexpendable personal property, buildings and land may differ according to the purpose of the grant as follows:

(A) If the purpose of the grant is to assist the grantee in the acquisition of equipment, buildings or land, the total value of the donated property may be claimed as cost sharing or matching.

(B) If the purpose of the grant is to support activities that require the use of equipment, buildings, or land; depreciation or use charges for equipment and buildings may be made. The full value of equipment or other capital assets and fair rental charges for land may be allowed provided that USAID has approved the charges.

(ii) The value of donated property will be determined in accordance with the usual accounting policies of the grantee with the following qualifications:

(A) Land and buildings: The value of donated land and buildings may not exceed its fair market value, at the time of donation to the grantee as established by an independent appraiser; and certified by a responsible official of the grantee.

(B) Nonexpendable personal property: The value of donated nonexpendable personal property shall not exceed the fair market value of equipment and property of the same age and condition at the time of donation.

(C) Use of space: The value of donated space shall not exceed the fair rental value of comarable space as established by an independent appraisal of comparable space and facilities in a privately owned building in the same locality.

(D) Borrowed equipment: The value of borrowed equipment shall not exceed its fair rental value.

(f) The following requirements pertain to the grantee's supporting records for in-kind contributions from non-Federal third parties.

(1) Volunteer services must be documented and, to the

extent feasible, supported by the same methods used by the grantee for its employees.

(2) The basis for determining the valuation for personal services, material, equipment, buildings and land must be documented.

(g) Individual expenditures do not have to be shared or matched provided that the total expenditures incurred during the year (or funding period) are shared or matched in accordance with the agreed upon amount or percentage set forth in the schedule of the grant.

(h) If at the end of any year (or funding period) hereunder, the grantee has expended an amount of non-Federal funds less than the agreed upon amount or percentage of total expenditures, the difference may be applied to reduce the amount of USAID funding the following year (or funding period), or, if this grant has expired or been terminated, the difference shall be refunded to USAID.

(i) Failure to meet the cost sharing (matching) requirements set forth in paragraph (a) above shall be considered sufficient reasons for termination of this grant for cause in accordance with paragraph (a) entitled "For Cause" of the standard provision of this grant entitled "Termination and Suspension".

(j) The restrictions on the use of USAID funds set forth in the standard provisions of this grant are applicable to expenditures incurred with USAID funds provided under this grant. Except for the requirements of this standard provision, the restrictions set forth in the standard provisions of this grant are not applicable to costs incurred by the grantee from non-Federal funds. The grantee will account for the USAID funds in accordance with the standard provision of this grant entitled "Accounting, Audit, and Records"; however, in the event of disallowances of expenditures from USAID grant funds, the grantee may substitute expenditures made with funds provided from non-Federal sources, provided they are eligible in accordance with all the standard provisions of this grant.

(k) Notwithstanding paragraph (b) of the standard provision of this grant entitled "Refunds", the parties agree that in the event of any disallowance of expenditures from USAID grant funds provided hereunder, the grantee may substitute expenditures made with funds provided from non-Federal suources provided they are otherwise eligible in accordance with paragraph (b) of this provision.

(END OF STANDARD PROVISION)

MICROENTERPRISE DEVELOPMENT[1]

The U.S. Agency for International Development (USAID) supports microenterprise development to advance its strategic objective of expanding economic opportunity and access for the poor -- specifically, the many poor people who operate or work in microenterprises. Ultimately, USAID's microenterprise development efforts are aimed at helping reduce poverty among microenterprise owners, workers, and their families. This guidance is intended to ensure that USAID's support for microenterprise development makes the greatest possible contribution to these goals. Although the guidance applies to all types of microenterprise development activities, its primary focus is on those in the area of *microfinance development* -- efforts to improve poor microentrepreneurs' access to financial services. Microfinance development efforts comprise a substantial majority of all microenterprise development activities, both within and outside of USAID. Although the guidance highlights some of the lessons of experience for program and institutional design, it is not intended as a technical guide in these areas: Missions planning microenterprise development activities should consult with technical offices in USAID/W and/or other sources of expertise to ensure that their efforts conform to best practice.

In June 1994, USAID launched a microenterprise initiative designed to make microenterprise development a better-established part of USAID's economic growth efforts. Under the Microenterprise Initiative USAID committed itself to four principles in designing and implementing microenterprise programs: (1) maintaining focus on women and the very poor, particularly through support for poverty lending; (2) helping implementing organizations reach greater numbers of people; (3) supporting institutional sustainability and financial self-sufficiency among implementing organizations; and (4) seeking improved partnerships with local organizations in the pursuit of microenterprise development. This guidance is intended to be consistent with these principles, but Missions should consult the Microenterprise Initiative directly for further details. USAID/W technical offices can provide further information on the Microenterprise Initiative and other relevant parameters.

Section I lays out the basic parameters of the USAID microenterprise development program, including definitions, operational goals, and the range of activities USAID includes under the term "microenterprise development." Section II provides guidance for USAID assistance to microfinance programs, emphasizing the need to (1) ensure that assisted programs maintain a focus on the target population and (2) encourage their steady movement toward full financial sustainability as a means to achieve large-scale impact and institutional viability. Section II also spells out reporting requirements applicable to all USAID-assisted microfinance programs; Mission and USAID/W responsibilities for measuring program results; country and organizational characteristics affecting the prospects for program success; and guidelines on structuring assistance to microfinance institutions. Section III provides parallel guidance for assistance to organizations providing only non-financial assistance, Section IV for assistance to those offering both financial assistance and non-financial services.

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[1]This guidance supersedes Policy Directive 17, issued October 10, 1988.

SECTION I: DEFINITIONS, GOALS, AND OTHER PROGRAM PARAMETERS

I.A. DEFINING CHARACTERISTICS OF MICROENTERPRISES. Throughout the developing world, millions of poor families derive an important share of their income from *microenterprises*: tiny, informally organized business activities other than crop production.[2] Common examples include vending on the streets and in market stalls; simple agro-processing operations like rice husking; handicraft production; simple repair services; and a wide variety of other low-technology, labor-intensive activities. Many microenterprises involve only one person, the owner-operator or "microentrepreneur." Many others involve unpaid family workers, while yet others include paid employees. USAID limits the term "microenterprise" to firms with ten or fewer employees, including the microentrepreneur and any family workers.

For purposes of USAID policy, the second defining characteristic of a microenterprise is its low level of assets or income -- both of the business and of those working in it. USAID's microenterprise development efforts are specifically aimed at enterprises owned by and employing the poor,[3] including those facing particular socioeconomic disadvantages that contribute to their poverty. In many developing countries, poor women, who represent a majority of microentrepreneurs and who often depend heavily on income from microentrepreneurial activities, face a wide range of such disadvantages. Female microentrepreneurs represent a group of special concern to USAID. Refugees and ethnic minorities represent other groups that may be especially disadvantaged. Missions should ensure that the assistance they report under the heading of "microenterprise development" flows to programs that effectively focus upon the business activities of the poor, and should give particular preference to programs that reach poor female microentrepreneurs.[4]

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[2]Many farmers operate microenterprises as sidelines and/or during the off-season. Effective lenders to microenterprises generally do not attempt to restrict the uses of funds by borrowers; as a result, microfinance does not have neat boundaries.

[3]Enterprises owned and operated by middle- or high-income people, such as professional partnerships or small consulting firms, are not eligible for support under USAID microenterprise development programs, regardless of the size of those enterprises.

[4]As made clear below, Missions should not encourage microenterprise programs to apply means-testing in screening clients. Rather, the most successful microenterprise programs tailor their services to fit the requirements of the poor. An important example is the provision of small loans, using "collateral substitutes" rather than formal collateral to encourage repayment.

I.B. DEVELOPMENTAL CONTEXT. To a large extent, widespread microentrepreneurship is simply a reflection of a low level of economic development. In the process of development, some microenterprises will grow and move into larger size categories, while many others will disappear as their owners and workers find higher-paying jobs in larger firms -- including some with "micro" origins. Yet others will stay tiny and labor-intensive, but the incomes of their owners and workers increase as rising demand bids up the prices of their services. In the long run, the prospects for satisfactory microenterprise performance and for the emergence of microentrepreneurs from poverty are closely linked to the growth prospects of the local and national economies in which they operate.

In the meantime, microenterprises in almost all developing countries face a wide variety of constraints that limit their growth and the incomes they yield to owner-operators and employees. Microenterprises in most countries face severely limited access to institutional credit, savings facilities, and other financial services. They must rely instead on a narrow range of services offered by moneylenders and other informal sources, often at very high prices. Microentrepreneurs face many non-financial constraints as well, and for many these pose more daunting barriers to improved enterprise performance and household income.[5] For example, the limited education of most microentrepreneurs, together with their lack of exposure to improved production techniques and business practices, tends to limit the productivity of their operations. Likewise, microentrepreneurs tend to be poorly informed about market opportunities.

In addition to the overall level of economic development, other aspects of the economic environment can add to the number of households seeking incomes from microentrepreneurship, and make it harder for existing microentrepreneurs to emerge from poverty. Workers losing their jobs in larger firms as a result of economic crisis undertake microentrepreneurial activities as a means to survive in countries lacking a formal social safety net. In addition, microenterprises proliferate in some countries because of policy, regulatory, and institutional constraints to the formation of small and medium enterprises. Restrictive labor codes and/or minimum wages, costly and complex procedures for obtaining business licenses, excessive taxes, zoning restrictions, and a host of other constraints can cause firms to

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[5]For example, Liedholm and Mead recently conducted surveys among microentrepreneurs in six Southern and East African countries, in which the respondents were asked to identify the most serious constraints to the performance of their enterprises. Although microentrepreneurs in three of the six countries identified problems of working capital, credit, and other financial matters as their most serious constraint, those in two countries ranked "problems relating to demand" as more serious, and those in one country pointed to "problems relating to inputs." See Carl Liedholm and Donald C. Mead, "The Structure and Growth of Microenterprises in Southern and Eastern Africa" Evidence from Recent Surveys." GEMINI Working Paper No. 36, USAID, March 1993.

remain in the "informal" economy where they largely escape the direct impact of policies and regulations.

This overview suggests that an effective strategy for addressing the problems faced by poor microentrepreneurs requires a balance between efforts to relieve the immediate constraints that inhibit their emergence from poverty and efforts to address the underlying policy, institutional, and market conditions that lead to widespread microentrepreneurship.

I.C. OPERATIONAL GOALS OF USAID MICROENTERPRISE DEVELOPMENT EFFORTS: IMPROVED POLICIES AND DEVELOPMENT OF EFFECTIVE SERVICE PROVIDERS. To advance its strategic objective of expanding economic access and opportunity for the poor, USAID works to (1) improve the policy and market environment in which microenterprises operate and (2) improve the performance and outreach of organizations that directly provide financial services and non-financial assistance to microenterprises. As a major element of these efforts, USAID -- along with many other donors, host country governments, and non-government organizations (NGOs) -- focuses particular attention on microentrepreneurs' limited access to institutional credit, savings facilities, and other key financial services. USAID works to address this constraint by fostering the development of viable financial institutions offering unsubsidized,[6] high-quality financial services to poor microentrepreneurs. This emphasis on *financial* services reflects relative confidence in the cost-effectiveness of the program approaches that have been developed to deal with financial constraints. Likewise, USAID supports improvements in host country financial sector policies to improve microentrepreneurs' access to financial services. This focus represents one aspect of USAID's broader efforts to promote a more competitive financial system capable of serving the needs of all segments of society.

I.C.1. Policy Dialogue. A wide range of host country policies affect the economic opportunities faced by microenterprises. For purposes of analysis, these policies can be divided into (1) those that affect the availability of financial services to poor microentrepreneurs and (2) those that affect microentrepreneurs through other channels, including the demand for their outputs, the availability and price of non-financial inputs, the institutional and regulatory environment in which they operate, social and cultural restrictions they may face, and the emergence of better income-earning opportunities for microenterprise owners and workers elsewhere in the economy. In each case, some policies affect microenterprise performance directly and specifically, while others affect a wide variety of firms, including microenterprises.

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[6]For purposes of this guidance, a financial institution is said to be providing financial services on a "subsidized" basis if the interest and fees collected from clients for those services fail to cover the institution's full long-run costs (see Section II.C.)

In designing a microenterprise development strategy, the Mission should start with a relatively broad look at the wide range of potential policy constraints to microenterprise development. Where this analysis reveals complementary policy reforms needed to provide fertile ground for the development of microenterprises and/or of the institutions that support them, the Mission should consider the feasibility of addressing these constraints as part of its overall strategy. In some cases, these may include policy areas too broad to be included under the specific heading of microenterprise development.

In contrast, in reporting their level of funding for microenterprise development, Missions should ensure that any policy dialogue efforts included in this category are directed toward policy changes that can be shown to advance directly the interests of microenterprises and microentrepreneurs, such as policy changes to improve microenterprise access to financial services.

I.C.1.a. Financial sector policies. Many policy reforms needed to achieve an efficient and competitive financial system will work to the benefit of microentrepreneurs and other traditionally underserved segments of society. For example, interest rate ceilings can reduce the availability of credit to microenterprises and other small borrowers, by preventing potential lenders from charging the higher rates needed to cover the costs of making small loans. Informal government pressure to hold interest rates below market-clearing levels can have much the same effect, though less visibly. Although a formal or informal waiver from interest rate ceilings may be sufficient to allow a specific Mission-assisted institution to reach financial sustainability, the removal of interest rate ceilings will often be necessary to encourage banks and other formal financial institutions to pursue microenterprises and other small borrowers as customers.

Another potential area of financial policy dialogue concerns the supervision and prudential regulation of financial institutions that accept deposits to fund microenterprise lending. Such institutions, like other formal financial intermediaries, will tend to face periodic crises unless they have the benefit of competent independent supervision and prudential regulation. The very limited body of experience to date in the regulation and supervision of microfinance institutions (MFIs) precludes more than a few general guidelines in this area.

(1) The financial dynamics of MFIs differ from those of conventional banks in several ways that impinge on the appropriate standards for their supervision. For example, loan delinquency rates in well-run MFIs tend to be lower than those in commercial banks; however, MFIs' delinquency rates can be much more volatile than those of commercial banks. Furthermore, MFIs operate with higher costs and spreads than banks, so a given level of delinquency will hurt an MFI's cash flow more severely than it will hurt a bank's. These considerations indicate that MFIs should be limited to lower debt-to-equity ratios than required for conventional banks, at least until the supervisory authorities have gained a clear picture of the long-term performance of their portfolios.

(2) On the other hand, it may be appropriate for the supervisory authorities to adjust their standards for rating the quality of outstanding loans, so that they do not unduly penalize MFIs for their reliance on alternatives to conventional collateral in motivating loan repayment.

(3) Reporting requirements on individual loans should probably be less onerous for the tiny loans made by MFIs than for the larger loans made by conventional banks. Likewise, bank examiners might review a proportionally smaller sample of outstanding loans than when examining a conventional bank.

(4) The different technical requirements needed to exercise effective supervision over MFIs compared with mainstream banks suggest that it may be desirable in some settings to establish a separate division of the financial superintendency to handle MFIs, or to delegate that responsibility to a separate entity with the necessary technical skills.

(5) Supervisory authorities should *not* be encouraged to regulate MFIs less cautiously because of their social purpose.

Efforts to increase the overall level of competition in the financial sector are too broad and indirect to be reported as microenterprise development activities, but can help increase the incentive for formal financial institutions to cultivate new types of customers, including small and microenterprises. The degree of financial sector competition may be important as a background factor in choosing between a microfinance development strategy that emphasizes strengthening specialized MFIs and one that seeks to encourage private financial institutions to reach down to the micro market (see Section II.G.2.c.)

Inflation reduces the real interest rate available to lenders and the incentives to make high-cost small loans wherever formal or informal interest rate ceilings remain in place; higher inflation usually also entails more variable inflation, greatly complicating the problem of setting appropriate interest rates on loans and savings accounts. Finally, MFIs have noted a sharp drop in the demand for loans when nominal lending rates are raised to keep real rates constant in the face of higher inflation -- perhaps reflecting potential borrowers' own increased uncertainty about the real rate they will pay on such loans. Bringing inflation under strict control is thus critical to the development of microfinance. However, the breadth of inflation's impact on the overall economy makes program efforts in this area too general to be reported under the heading of microenterprise development.

Finally, Missions should note carefully that the nature of financial markets makes it particularly likely that financial policy distortions intended to help poor people and/or microenterprises will produce minimal benefits -- at least for the intended beneficiaries -- and substantial unintended costs. As a result, Missions should urge the elimination of subsidized credit to small and microenterprises by government-owned financial institutions, as well as the removal of requirements that banks channel a specified share of their lending toward small and micro firms. Missions should strongly resist measures aimed at repressing moneylenders, pawnbrokers, and other informal sources of financial services: despite some shortcomings, such informal sources of credit serve a vital role as lenders of last resort to the poor, and can often provide short-term credit more quickly and with lower transaction costs than any other source. In all cases, the aim should be to foster conditions under which financial services can flow toward microenterprises in response to market forces, and to expand the range of financial options available to microentrepreneurs.

I.C.1.b. Non-financial policies. Non-financial policy constraints on microenterprises tend to be country-specific and sometimes hidden from view, but they are no less important as a result. Missions undertaking microenterprise development activities should attempt to identify major non-financial policy barriers to the success of their own program efforts and to microenterprise development in general, and seek to address these barriers where feasible. The following illustrative list suggests some country experiences that may apply elsewhere; USAID/W technical offices can provide a more comprehensive set of examples. Likewise, workshops with host country experts can help to identify local non-financial barriers to microenterprise performance.

- Poorly defined access to space in urban markets can expose vendors to harassment and demands for payoffs from police and to ejection by physical force by other vendors.

- Inheritance and property laws can make it difficult for women to obtain title to business property.

- The collection of value-added taxes from larger but not small or microenterprises can place the latter at a competitive disadvantage as suppliers to larger firms.

- Discretionary allocation of foreign exchange and/or import licenses usually places small and micro firms at a serious disadvantage in gaining access to imported inputs.

At one level removed from these direct impacts, a wide range of non-financial policies can exert strong but indirect impacts on the microenterprise sector. Policies affecting the performance of the agricultural sector -- which maintains close linkages to the rural microenterprise sector in many countries -- deserve special mention in this category. The wide range of policy, regulatory, and institutional barriers to the growth of small and medium enterprises inhibit the ability of microenterprises to grow out of the micro range. Subsidized provision of services such as power, water, and telephones reduces providers' cash flow and their ability to invest in additional capacity, making new connections hard to get -- especially by tiny firms.

Ultimately, any policy change that contributes to more rapid, sustainable growth of the host country economy will tend to benefit microenterprise owners and workers, through stronger growth in demand for their outputs and the creation of higher-paying job opportunities elsewhere. For example, trade liberalization and the adoption of competitive exchange rates can help stimulate the growth labor-intensive manufacturing for export, a particularly important source of growth in wage employment of low- and semi-skilled workers, including women. While policy efforts at this level are far too general to be included under the heading of microenterprise development, it is useful to recognize these underlying linkages.

Finally, as in the case of financial policies, Missions should discourage the use of market-distorting policies intended to favor small and microenterprises, such as subsidized provision of public utility services, preferential access to licenses, or the reservation of specified goods or services for production by small and micro firms. Such policy distortions tend to be ineffective in achieving their objectives, and whatever benefits they create tend to be captured by those with political influence rather than by the poor.

I.C.2. Development of Organizations Providing Services to Microenterprises. Most USAID funding for microenterprise development moves through the intermediation of, and in partnership with, a wide range of "implementing organizations," which provide financial services and/or non-financial assistance to improve the performance and incomes of existing microenterprises, and/or to help poor people launch new microenterprises.[7] USAID assists such organizations to help them improve their performance, expand the scale of their operations, and extend those operations to include new services or to reach new groups of clients. In contrast, USAID does *not* provide direct assistance to individual microenterprises. USAID's support for implementing organizations seeks to achieve several goals:

I.C.2.a. Deep outreach: poverty lending and reaching very poor microentrepreneurs. Many microenterprise development programs attempt to serve very poor microentrepreneurs, and/or encourage very poor people to set up new microenterprises. USAID refers to such programs as poverty lending programs, and describes them as achieving "deep" outreach. USAID's support for poverty lending, elaborated in Section II, reflects the priority USAID places on reaching very poor microentrepreneurs. A program's focus may be exclusive (i.e., all clients are very poor) or mixed (i.e., service to the poorest stratum is blended with service to a somewhat higher stratum of microenterprises.) As smaller loan sizes tend to involve higher costs per client, it is more difficult to achieve financial self-sufficiency while serving the very poor. Programs that exclusively target the very poor must seek creative methodologies and often must charge higher interest rates and fees. Programs that serve a broad spectrum of microenterprises can spread their costs across loans of larger average size, and thus have more leeway in reaching financial viability. Several top-performing microenterprise programs that serve a mixed clientele reach large absolute numbers of the very poor, because their financial performance has allowed them to achieve significant scale (broad

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[7]This category includes both non-profits (NGOs) and for-profits (such as banks) and, occasionally, government-owned organizations.

outreach.) Whether the focus is exclusively upon the poorest or mixed, USAID supports efforts that seek and achieve greater depth of outreach.

I.C.2.b. Broad outreach: reaching large numbers of the poor. For USAID's microenterprise development activities to make a significant contribution to poverty reduction, they must be capable of achieving "broad outreach," i.e., reaching *large numbers* of the poor. Roughly a third of the population of the developing countries -- well over a billion people -- were living on less than $1 a day in 1990.[8] This figure included well over half the population of Sub-Saharan Africa and South Asia, over a quarter that of Latin America and the Caribbean, and 15 percent of the huge population of East Asia. While few precise figures are available, studies typically estimate that as many as a third of poor households participate in microenterprise activities. These estimates suggest that the number of poor people depending on income from microenterprises (including family members) reaches well into the hundreds of millions worldwide. Under these circumstances, only those activities with the potential to affect tens or hundreds of thousands of microenterprises can make a plausible claim to play a significant role in reducing national or world poverty. Given the scarcity of USAID financial and managerial resources, it is essential to consider an intermediary's potential for scale in allocation decisions.

I.C.2.c. Emphasis on female microentrepreneurs. USAID's microenterprise development program places particular emphasis on assisting female microentrepreneurs. In many developing countries, poor women face especially limited access to assets, education, and training. Partly as a result, poor women tend to be heavily concentrated in particularly low-paying micro-entrepreneurial activities such as petty trading, where they in turn suffer especially limited access to financial services and information on market opportunities. Likewise, female-headed households tend to be heavily concentrated in the lower end of the income distribution; many of these households rely on income from microenterprise activities for their survival. USAID views microenterprise development as an important means to help break these vicious circles, and encourages support for programs that make special efforts to assist female microentrepreneurs. As a means of targeting women, Missions should encourage the development of services that meet the specific requirements of female microentrepreneurs, rather than the exclusion of men. As a minimum standard, all programs must be both formally and effectively open to women to be eligible for USAID support. To help ensure that its microenterprise development program effectively reaches female microentrepreneurs, USAID requires that key program outreach data be reported on a gender-disaggregated basis (see sections II.E. and III.A.1).

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[8]World Bank estimates, based on 1985 prices and exchange rates reflecting the relative purchasing power of currencies. Equivalent to $1.38 at 1994 prices.

I.C.3. Organizational Eligibility. Many types of organizations provide services to, or otherwise work to advance the interests of microenterprises, including:

- local non-government organizations (NGOs) specializing in microenterprise development, including those sponsored by U.S.-based private voluntary organizations (PVOs);
- microenterprise development units of NGOs and PVOs with broader programs;
- business associations of microentrepreneurs;
- credit unions;
- village banks;
- private banks, including those established by NGOs as well as windows created by private financial institutions to handle business with microenterprises;
- government-established agencies; and
- specialized banks or finance companies.

USAID imposes no rigid restrictions on the types of organizations eligible for USAID assistance. Rather, the Mission should judge a particular organization's potential to use USAID assistance effectively on the basis of its performance -- its current effectiveness in providing key services to the target population and its commitment to further improvement. The standards to be used in assessing organizational performance are spelled out in Sections II-IV, along with principles for selecting organizations likely to meet these standards. USAID funding should *only* be provided to an organization that either (1) has already established a performance record that justifies confidence that it will meet the performance standards set forth in Sections II-IV, or (2) is a new start headed by an experienced management team whose past performance justifies confidence that the new organization will attain those program performance standards.

Finally, Missions should recognize that the great majority of government microenterprise development programs have been dismal failures, but that this category includes a few spectacular successes as well. As a result, Missions should exercise a general preference for working through private implementing organizations, but may consider assistance to government financial institutions or other programs whose record demonstrates a clear determination to avoid the typical pitfalls of public ownership and to achieve the performance standards set forth in this guidance.[9]

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[9]These pitfalls include (1) a lack of concern with financial performance, in such forms as poor loan recovery, insufficient loan screening, and interest rates set too low to cover the full costs of providing credit; (2) a "soft budget constraint" that permits reliance on budget transfers or infusions of central bank credit to compensate for poor financial performance; and (3) excessive operating costs and limited incentives for staff performance, encouraged by overstaffing, the provision of civil service status to the organization's workers, and high staff salaries relative to local incomes.

I.C.4. Programmatic Eligibility. The diversity of organizational types is matched by the wide variety of programmatic approaches used to assist microenterprises. Many programs focus on the provision of financial services in forms adapted to fit the needs of microenterprises. For example, microfinance programs offer loans in amounts much smaller than the minimum loan normally available from local commercial banks; the great majority of such programs rely upon some type of "collateral substitute" rather than formal collateral requirements to ensure that poor borrowers repay their loans (see section II.A.2.) An increasing number of microfinance programs and institutions offer savings facilities as well as credit. Some accept (and typically require) deposits only from their own borrowers, while others mobilize savings from the general public.

In addition, many programs provide non-financial assistance to microentrepreneurs, either in isolation or together with financial services. Non-financial assistance spans a wide range of approaches, including basic training aimed at enabling poor people to establish new microenterprises; efforts to link groups of microenterprises to market opportunities at home or abroad; training in production skills; and more intensive assistance in production techniques and marketing, aimed at helping firms shift from low-return to high-return activities as a means to graduate from the microenterprise range into the small or medium range. Finally, organizations have developed a variety of programs that offer credit or other services to encourage participation in activities aimed at achieving goals distinct from microenterprise development, including improved child health and nutrition, environmental improvement, etc.

USAID imposes no direct restrictions on the eligibility of broad program approaches for assistance. Again, the key issue is *results*: the ability of a particular approach to translate limited USAID funding into tangible benefits for large and growing numbers of the target population. This principle implies the need to pay careful attention to the records of different program approaches -- a matter on which the relevant technical offices in USAID/W can provide assistance -- as well as the need to build strong mechanisms for monitoring and evaluating the performance of different approaches.

I.C.5. In Sum. From USAID's perspective, the ideal microenterprise development program is one that translates a given level of USAID support into improved income-earning prospects and other tangible benefits for large and growing numbers of microentrepreneurs. Moreover, the program operates on a financially and institutionally sustainable basis, allowing it to continue providing its services indefinitely without further reliance on support from USAID or other donors. Finally, the ideal program excels in achieving broad outreach (large scale) or deep outreach (service to the very poor), and preferably both. In practice, some tradeoffs may be necessary among these measures of success, while others tend to be mutually reinforcing.

Guidance for Mission support to organizations providing direct services to microenterprises is based upon these principles. The following sections lay out separate guidance for support to organizations providing only financial services, for those providing only non-financial services, and for those providing a mix of financial and non-financial services. In each case, the guidance works back from standards of organizational success to guidelines on structuring USAID assistance so as to improve the prospects that assisted organizations will meet these standards. It then suggests principles for identifying implementing organizations likely to make effective use of USAID assistance and meet the indicated performance standards. Finally, the guidance specifies, for assistance to each type of organization, (1) data requirements needed to measure and guide organizational performance and (2) the division of responsibility between Missions and central technical offices for measuring the results of USAID microenterprise development efforts.

II. GUIDANCE FOR ASSISTANCE TO ORGANIZATIONS PROVIDING ONLY FINANCIAL SERVICES. Traditional financial techniques make it unprofitable for most mainstream financial institutions in developing countries to provide the kinds of financial services needed by microentrepreneurs and other poor people: small working-capital loans, convenient facilities for small savings balances, etc. This situation reflects both economies of scale in making loans and servicing deposits and reliance on collateral to ensure loan repayment. Interest rate ceilings, where present, further reduce bankers' interest in offering small loans at high unit cost. As a result, poor people in most developing countries have to rely upon moneylenders, pawnbrokers, and other sources of informal financial services, who typically offer only a limited range of services (very short-term, very small loans; no savings facilities), enjoy little integration across geographic regions or with other segments of the financial system, and -- partly as a result of these latter limitations -- charge very high interest rates on loans.

Microfinance institutions (MFIs) -- many the outgrowth of donor or NGO microfinance development efforts -- work to correct this situation, offering financial services designed to fit the requirements of microentrepreneurs and other poor people. For example, small loans can help microentrepreneurs take advantage of quantity discounts on their inputs, invest in equipment or facilities to enlarge their sales potential, or cushion the impact of temporary economic setbacks on family consumption. Access to safe and convenient savings deposit facilities can benefit even larger numbers of microentrepreneurs and other poor people, helping them accumulate savings to cover future shortfalls in income, purchase household durable goods, or undertake investments such as education. Access to appropriate financial services may be sufficient to allow some microenterprises to grow substantially, eventually emerging as formal small or medium firms; in these cases, significant growth in employment may result. In other cases, the impact is to allow poor microentrepreneurs to utilize their own and their family's labor more effectively, and to earn a better living as a result.

As previously emphasized, USAID imposes no direct restrictions on the types of organizations or program approaches eligible for its support; performance is what counts. In the case of microfinance programs, recent research highlights a specific and widely applicable standard for assessing program performance. The key finding is that, with very few exceptions, microfinance programs that have vigorously pursued and successfully attained *full financial* *sustainability* -- profitability -- while maintaining their focus on the target population of poor microentrepreneurs have achieved far greater outreach than programs that have provided subsidized credit and relied on continuing donor support to make up the resulting losses.[10] Likewise, financial sustainability provides the basis for institutional viability and continuing program growth. In each of these respects, the pursuit of financial sustainability provides the means to ends lying at the core of USAID's support for microenterprise development, helping maximize the results achieved with that support.

Based on these findings, this guidance requires that, to be eligible for USAID assistance, *every* organization providing financial services must provide a credible commitment to attain full financial sustainability in the medium term, while using USAID assistance to expand the availability of financial services to microentrepreneurs and other poor people.[11] Attaining financial sustainability will invariably require reaching a significant scale of program outreach, and will in turn provide the basis for continued growth in outreach. USAID assistance will generally involve technical assistance to help the organization adopt "best practice" in its operations, including the implementation of an effective management information system (MIS). Where necessary and appropriate, financial support may be provided to help the organization reach a sustainable scale. Organizations that are either unable or unwilling to offer a credible commitment to attain these goals are ineligible to receive USAID microenterprise development assistance.

To date, most efforts to provide financial services to microentrepreneurs have been undertaken by organizations specifically created for that purpose, including many founded by NGOs. Much of what follows reflects this pattern by focusing on means to help such programs grow through the pursuit of financial sustainability. An alternative approach starts from the opposite direction -- encouraging existing, for-profit financial institutions to establish windows to pursue the microenterprise market. In this latter case, the relevant challenge lies in finding cost-effective, market-based, and sustainable means to encourage a focus on microenterprises. USAID encourages experimentation with both approaches. The former builds on existing

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[10]See, e.g., *Maximizing the Outreach of Microenterprise Finance: The Emerging Lessons of Successful Programs*, by Robert Peck Christen, Elisabeth Rhyne, and Robert C. Vogel. September 1994. *Full financial sustainability* and *profitability* mean the same thing, i.e. that revenues from interest and fees cover all of a program's financial and operational costs. The accounting methods needed to calculate the profitability of a donor-assisted financial institution differ somewhat from those applied to private financial institutions, because of the need to properly account for the value of grants or low-interest loans provided by donors. These issues are summarized in Section II.C. and spelled out in detail in the Annex.

[11]This requirement, spelled out in detail in section II.C., also applies to the financial operations of organizations providing both financial services and non-financial assistance. See section IV.

willingness to reach the poor, whiel the latter has the potential for significant outreach, provided that institutional partners with a genuine interest in reaching micro-level clients can be identified. Section II.G.2.c. considers these issues further.

II.A. MAINTAINING PROGRAM FOCUS ON TARGET POPULATION.
USAID support for *any* microenterprise development program requires a clear and continuing focus on providing services to poor microentrepreneurs. Maintaining such a target-group focus generally requires both operational mechanisms and organizational commitment. Effective operational mechanisms for targeting the poor include (1) services tailored to meet the specific requirements of poor microentrepreneurs; and (2) elimination of subsidies, that is, charging prices (e.g., interest rates) that cover the full costs of the services provided. Eliminating subsidies helps combat the strong tendency for subsidized services to "leak" to the non-poor, in response to their influence and/or ability to pay bribes.

II.A.1. Targeting the Poor through Provision of Small Loans/Acceptance of Small Deposits. Almost all microfinance programs use *small loan size* as a key mechanism to target the poor. The underlying assumption is that the smaller the loan, the poorer the set of people willing to go through the loan application process; fewer poor people are presumed to have access to larger loans. USAID central technical offices will carry out field work to provide further empirical support for the assumed correlation between loan size and the economic status of borrowers (see Section II.E.2.b.) Pending the outcome of this research, USAID provisionally accepts loan size as an adequate targeting mechanism, at least in the case of loans offered on an unsubsidized basis -- that is, at interest rates that cover the full long-run costs of providing them.[12]

USAID does not impose a rigid upper limit on the size of loans that qualify as microenterprise lending; rather, organizations that operate credit programs should be expected to carry out market research to determine the range of loan sizes needed to motivate loan demand from the target population.[13] The Annex requires that assisted organizations collect and report specified information on the size distribution of their loan portfolios, to allow average and median (typical) loan size to be estimated and tracked over time. Similar reporting requirements apply to savings accounts, where offered: savings facilities offering very small minimum balances, liquidity, convenient location, and other features useful to the poor can help attract a set of savers will little or no access to alternative savings facilities, making this an additional means to target the poor.

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[12]See section II.G.2.b for further discussion on interest rates.

[13]In particular, note that the loans provided by MFIs in middle-income countries, such as the Newly Independent States (NIS), will typically be larger than those used to target the poor in lower and lower-middle income developing countries.

II.A.1.a. Poverty lending. Poverty lending programs comprise a subset of microfinance programs, using very small loans to reach very poor clients, often with a focus on women. Poverty lending programs are often designed specifically to overcome the cultural barriers affecting the poorest people. USAID uses a reference point of loans with an average balance less than $300 per borrower at 1994 prices as a working definition of poverty lending. Loans under this threshold will be categorically assumed to be reaching the poorest borrowers.

USAID supports the refinement ant spread of poverty lending methodologies. USAID's June 1994 Microenterprise Initiative stated that USAID would devote half of its support for microenterprise programs to poverty lending programs and the poverty-lending portion of mixed programs. A program whose loan portfolio includes a large volume of poverty loans, while achieving the other measures of organizational success spelled out below, will be regarded as particularly successful.

II.A.2. Targeting the Poor through Reliance on Collateral Substitutes. Most poor people -- including most microentrepreneurs -- lack the kind of marketable collateral necessary to obtain traditional bank loans. Instead, most microfinance institutions (MFIs) rely upon some form of *collateral substitute* to ensure repayment of loans to poor borrowers. Collateral substitutes generally fall into one of two categories:

(1) *Group lending*. Borrowers form (or are assigned to) groups, all of whose members must maintain a satisfactory payment record for *any* group member to be eligible for future loans; or

(2) *Character and/or experience-based individual loans*. Typically, the initial loan requires a character reference from a village chief or other person with a stake in maintaining a reputation for probity and sound judgment. Initial loans are very small, but access to gradually increasing loans is assured as long as the borrower maintains a satisfactory repayment record.

Serious issues exist about the relative merits of these different approaches, and this guidance imposes no preference for one over the other. However, reliance upon some form of collateral substitute provides an important means for MFIs to ensure that the poor have access to their services. As a result, a Mission considering providing assistance to a financial institution that does not rely upon a collateral substitute should seek additional evidence that the institution is actually reaching poor customers.

II.A.3. Organizational Commitment. Along with appropriately designed services, an ongoing organizational commitment to provide those services *to the poor* is necessary to ensure that USAID support ultimately leads to a greater flow of financial services (or any other services) to the target population. Without such commitment, MFIs may fall prey to the temptation to abandon the original target population and focus attention upon less disadvantaged clients who are easier to reach using more traditional financial practices.

Nevertheless, while an organization's commitment to the poor is *necessary* for it to receive USAID support, such commitment should never be treated as a *sufficient* condition for eligibility. No degree of commitment can make up for a lack of organizational competence and other ingredients of program effectiveness.

USAID's concern is that organizations receiving its support maintain an effective commitment to include the poor in their service delivery, not that they exclude other groups. For example, a private bank might open a specialized window to provide financial services to microenterprises, while continuing to deal with non-poor customers using traditional banking procedures. This kind of organizational diversification offers many advantages, and USAID encourages it. Nevertheless, in all cases the success of USAID microenterprise development support to any microfinance institution will be judged upon its success in improving the availability of financial services *to poor microentrepreneurs, particularly poor female microentrepreneurs.*

As measures of ex-post success in maintaining program focus upon the poor, women, and other target groups, the indicators specified in section A of the Annex should provide adequate information.

II.B. PROVIDING FINANCIAL SERVICES VALUED BY MICROENTREPRENEURS. The second measure of micro-finance program success is that it provide financial services valued by its poor clients.

II.B.1. Credit. Two key features aimed at meeting the credit needs of microentrepreneurs have already been mentioned: the availability of small loans and reliance upon collateral substitutes. Other loan characteristics that microentrepreneurs typically value include:

(1) reliable access to future loans based on satisfactory repayment of previous loans;
(2) availability of terms that match the enterprise's expenditure patterns and need for working capital -- typically short loan terms;
(3) quick turn-around on loan approvals and a transparent approval process;
(4) minimum transactions cost or "hassle," including local availability, simple application procedures, etc; and
(5) few restrictions on use of funds.

Successful MFIs recognize that most microentrepreneurs' household and business finances are intertwined, and that efforts to restrict their use of funds to specified business purposes are typically futile and counterproductive. Similarly, successful MFIs have learned that project analysis -- a key step in lending to larger enterprises -- imposes prohibitive costs and delays upon microenterprise lending, and have found effective substitutes for it.

II.B.2. Deposit Services. The evidence demonstrates the value that microentrepreneurs and other poor people place on safe, convenient, and liquid deposit facilities for their small savings balances, and many MFIs have developed deposit services to address this need and as a source of finance for their lending operations. The value of savings deposit services offered by many MFIs is likewise affected by the attention paid to convenience, liquidity, security, and acceptable rates of return. Convenience is enhanced through location and hours that minimize the costs of making deposits and withdrawals, and by low minimum balance requirements. Liquidity is reflected in the ability of savers to withdraw their balances on demand. Security is obviously critical, subjecting most efforts to mobilize deposits from the general public to official supervision and regulation and raising serious technical issues addressed separately in Sections I.C.1.a and II.F.

The security, liquidity, and convenience of deposit services provide savers with part of the return to their savings, the remainder being provided in the form of interest. Real deposit interest rates must be competitive with alternative savings opportunities to attract deposits, but the higher unit costs of providing deposit services to poor savers tend to keep the interest rates paid on these deposits significantly below those available to non-poor savers maintaining substantial minimum balances in urban banks. The scope for paying higher deposit rates will depend on the MFI's efficiency in operating its savings program.

These general principles apply to all micro-finance programs. However, in practice the success of any MFI will depend heavily on the effort it puts into fine-tuning its credit and deposit services to fit the particular requirements of the poor people who comprise its potential market, based on careful, well-designed, and continuing market research.

II.B.3. Market Test of the Value of Services. Poor people's willingness to pay for services provides a direct indication of the value they place on those services. Credit programs which cover their full opportunity costs through interest payments and fees paid by borrowers can make a strong claim that the value of the services they offer fully covers the costs of providing those services; similar claims for programs that rely upon continuing donor subsidies are much more speculative. Likewise, the ability of a program to attract a growing volume of voluntary savings deposits clearly demonstrates that its depositors find its deposit services attractive compared with available alternatives. The fact that financially sustainable MFIs satisfy this "market test" is one among several reasons that USAID requires a credible commitment to the attainment of financial sustainability as a condition for all assistance to microfinance institutions.

II.C. FINANCIAL SUSTAINABILITY AND OUTREACH. A *financially sustainable* program is one that collects sufficient revenues to cover the *full opportunity cost* of its activities.[14] Such a program can continue operating indefinitely at a stable or growing scale,

[14]Opportunity costs differ from accounting or out-of-pocket costs by recognizing the value of all resources used in alternative uses -- roughly speaking, their market value. In the context of microfinance, this distinction is important to ensure that the value of funds received

without further support from governments, donor agencies, or charitable organizations. Instead, growth in the program's lending and/or other services can be funded on a commercial basis: through reinvestment of profits, loans from commercial banks, equity from private investors, or -- in the case of licensed financial institutions -- through the mobilization of deposits. For a microfinance program, financial sustainability requires that income from interest and fees charged to borrowers cover (1) the program's operational costs, including salaries and other costs of administration (whether paid by the MFI or received as a donation), depreciation of fixed assets, and losses due to default; plus (2) its financial costs, including both the costs of raising funds through deposits or commercial loans *and* the opportunity cost (including inflation) of any grants or low-interest loans previously provided by donors.[15] A program whose revenues cover its operational costs but not its financial costs has attained *operational self-sufficiency*, a useful interim standard of financial performance.

To paraphrase the principle stated in section I.C.5, the ideal USAID microfinance program is one that translates a given level of USAID support to achieve a sustainable improvement in the availability of financial services to large and growing numbers of microentrepreneurs, including female microentrepreneurs and the very poor. The research cited at the outset of this section strongly suggests that using USAID assistance to encourage the provision of microfinance services on a financially sustainable basis is a far more cost-effective strategy for achieving this goal than an approach that supports the provision of subsidized credit.[16] Although high inflation and certain other conditions can make it harder to reach financial sustainability, that performance goal has been reached in a wide range of economic conditions and social settings. Vigorous pursuit of financial sustainability has helped several MFIs achieve strong and continuing growth in their loan portfolios, reaching hundreds of thousands or even millions of active borrowers. Moreover, these same institutions have also achieved considerable success in the area of deep outreach -- providing credit and savings opportunities to large numbers of the very poor. The rapid growth in demand for small loans at fully cost-covering interest rates, with repayment rates as high or higher than those in formal financial

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through grants or low-interest loans is properly accounted for. The next footnote illustrates this point.

[15]In practice, this opportunity cost adjustment requires adding a cost element equal to the difference between what the MFI actually pays for funds provided by donors or other non-market sources, and what it would have to pay if required to raise the same funds through deposits. For a $1 million donor loan at 2% per year to an MFI in a country where deposit rates are 16%, this adjustment adds (.16-.02)*$1 million = $140,000 to the MFI's cash costs. For a $1 million grant, the adjustment would be (.16-0)*$1 million = $160,000. These adjustments can be very significant for MFIs that depend heavily on donor support.

[16]Christen, Rhyne, and Vogel, *ibid.*

markets, suggests that most poor people value continued, reliable *access* to credit and other financial services more highly than interest rate subsidies on a few short-term loans.

Based on this evidence, this guidance imposes the following requirement:

> Before the Mission signs an agreement to provide assistance to any microfinance institution, the management of the institution must provide the Mission with a credible written commitment to (1) attain full financial sustainability on the MFI's financial service activities within no more than seven years of the initial provision of USAID assistance and (2) use USAID assistance to expand the availability of financial services to microentrepreneurs and other poor people. This commitment must be accompanied by a plan outlining the major steps to be undertaken in the process of achieving this goal, including a realistic timetable for undertaking those steps, and defining periodic benchmarks by which progress toward the goal can be determined.

To reiterate, USAID views financial sustainability not as an end in itself, but as a means to attain large-scale, growing, and sustainable program benefits to poor microentrepreneurs. Financial sustainability is to be pursued in the context of a continuing focus on the poor.

The Mission is responsible for assessing both the organization's commitment to the twin goals of financial sustainability and outreach to the poor, as well as the plausibility of its plan for reaching those goals, availing itself of such support as necessary from responsible USAID/W technical offices.

Several aspects of the preceding requirement require further specification. First, for purposes of satisfying this requirement, *full financial sustainability* refers to the attainment of an adjusted return on operations of 1 or greater, based on the accounting framework laid out in the Annex.[17] Second, seven years should be regarded as the *maximum* to be allowed for reaching financial sustainability, not a target: a program whose current operational and financial situation allows it to attain this goal more rapidly should be strongly encouraged to do so, and the benchmarks used to assess performance and to trigger disbursement of USAID assistance adjusted accordingly. Third, for purposes of this guidance *financial services* encompasses the provision of loans, deposit services, and/or payments services (such as check-cashing or the sale of money orders). Finally, for any program providing both financial assistance and non-financial services, the two sides of the program should be disentangled, and the financial sustainability standard applied to the financial operations side; see Section IV for further discussion of this point.

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[17]Alternative measures of financial sustainability -- such as net profit, return on assets, and subsidy dependence -- can be calculated from the information included in the Annex. Reliance on a particular standard measure of financial sustainability is specified to reduce ambiguity and to ensure comparability across programs.

The *process* of achieving financial sustainability is a technical matter beyond the scope of this guidance. However, MFIs that have reached this goal have generally passed through three stages of development:

Stage 1: The MFI develops a set of financial services that clients demand, along the lines outlined in sections II.B.1. and II.B.2; develops and fine-tunes methods for delivering those services at minimum cost, including both administrative/operational costs and those due to default and/or delayed repayment; and sets interest rates that cover its full expected long-run costs.

Stage 2: The MFI focuses on scaling up its program, and develops the management tools necessary to do so, in areas such as financial management, staff recruitment, training, and information flows. As it progresses through this stage, the MFI may increasingly gain access to commercial bank loans to fund the expansion of its loan portfolio.

Stage 3: The MFI's financial performance improves to the point where it can fully rely upon private sector sources -- savings deposits, loans from commercial banks or other financial intermediaries, or both -- to support further expansion of its lending activities. In most countries, an MFI must qualify as a full-fledged, licensed financial institution in order to begin mobilizing deposits.

Success in stage 1 typically yields an operationally self-sufficient microfinance program, with a high ratio of clients to staff as well as good control of delinquency and default. The program's growing scale under stage 2 leads to continuing improvements in overall efficiency, as its fixed costs are spread over an ever-larger volume of transactions. Finally, success in stage 3 results in full financial self-sufficiency. At this point, the program no longer needs to depend on further support from USAID or other donors: it can operate on a fully commercial basis, offering investors a return on equity equal to that available elsewhere in the private sector. The profits earned by such an institution can finance further expansion of its lending portfolio, as well as attracting additional equity investment from outside investors. Likewise, those profits encourage other private sector investors to enter the same market in search of the same levels of profitability.

II.D. OPERATIONAL EFFICIENCY. The operational efficiency of a microfinance program -- its success in holding down administrative costs, plus any losses from bad loans -- strongly affects its overall financial performance and its prospects for reaching financial sustainability. Attainable levels of operational efficiency differ according to local circumstances, the methodology pursued by the MFI, and the target group. Nevertheless, for a program to be considered operationally efficient, its annual non-financial costs should be no more than 30 percent of the average value of its loan portfolio after a start-up period of roughly three years. This level should allow programs reaching very poor clients in difficult settings. The cost elements included in this calculation are specified in the Annex.

II.E. EXPECTED PROGRAM RESULTS, MFI PERFORMANCE, AND REPORTING RESPONSIBILITIES.

II.E.1. Expected Program Results. USAID assistance to microfinance institutions is expected to produce the following chain of results:

- the emergence of financially and institutionally sustainable MFIs both capable of and committed to serving the needs of poor microentrepreneurs, leading to
- a sustained expansion in the range, and improvement in the quality of key financial services available to poor microentrepreneurs, and/or a permanent reduction in the price of such services, contributing to
- increased incomes among the microentrepreneurs utilizing those services and their employees, and
- improved household welfare among the families of microentrepreneurs and microenterprise workers.

The extent to which these results are realized will depend on a wide variety of circumstances, only some of which are under the control of any given USAID-assisted MFI. For example, the degree to which the price, quality, and range of services offered by an MFI represent improvements on existing alternatives will partly reflect its own efforts, but will also depend heavily on the competitiveness and level of development of the local informal financial system. Likewise, how much of a difference the availability of improved financial services makes to microentrepreneurs will depend on the severity of all the other constraints they face, matters almost entirely beyond the control of MFIs. Similarly, where improved access to finance does result in increased income for microentrepreneurs, the ultimate impact on household welfare will depend on complex interactions within those households, which may differ from one society to another.

Finally, it must be recognized that the emergence of new sources of financial services will produce losers as well as winners. Traditional sources of financial services may be put at a disadvantage by these developments, reducing their profits and forcing some into other lines of business. This last point reinforces the importance of focusing USAID support on organizations that can be confidently expected to become fully sustainable.

II.E.2. Responsibilities for Reporting Results. The realities of microenterprise finance make it necessary to divide the responsibility for monitoring and reporting results between Missions providing assistance to microfinance organizations and USAID/W technical offices:

II.E.2.a. Missions.[18] Every Mission providing assistance to any organization that offers financial services to microenterprises will be held responsible for monitoring and reporting on two aspects of the results of that assistance: (1) the breadth and depth of the organization's outreach to the poor, as reflected in the size distribution of its loan portfolio (and of its deposit liabilities, where relevant) and the proportion of women among its clients; and (2) the organization's performance as a financial institution, including its progress toward financial sustainability and its operational efficiency. Performance in these two areas will be assessed on the basis of the indicators summarized in the following two sections and detailed in the Annex. These indicators, in turn, are based on information provided by assisted organizations.

USAID officers managing microfinance assistance activities are expected to use these results indicators to track the performance of assisted organizations and to indicate the necessity for intervention if their performance lags. It is incumbent upon these activity managers to verify that assisted institutions are able to supply accurate information. In some cases, improvements in the assisted organization's management information system (MIS) may be necessary to ensure accurate reporting. In such cases, Missions should consider supporting such MIS improvements as part of their assistance package. Finally, Missions may be required to provide additional data as necessary to allow USAID to inform Congress and the public about the Agency's microenterprise development activities.

II.E.2.b. USAID/W. Meanwhile, USAID/W technical offices will carry out research on the direct and indirect impacts of microfinance development efforts that extend beyond the doors of the sponsored financial institutions themselves: These include (1) the extent to which the financial services offered by USAID-sponsored micro-financial institutions represent improvements relative to existing sources of finance available to microentrepreneurs, in terms of types of financial services available, service quality, and price (interest rate); (2) the direct impact of improved access to financial services on microenterprise performance as well as on living conditions within the families of microentrepreneurs and microenterprise workers; (3) the impact of the emergence of new sources of financial services on the local financial system, including changes in the availability and price of financial services offered by informal sources; and (4) empirical evidence on the assumption that loan size is a reliable tool for targeting poorer borrowers. In contrast to the results reporting requirements assigned to Missions, USAID expects these latter efforts to be undertaken on a sample basis, with a view toward strengthening the basis for assessing the *overall* impact of micro-finance development efforts, including, to the extent possible, their impact relative to alternative ways of using the same level of resources.

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[18]These same responsibilities will lie with any USAID/Washington unit providing financial support to MFIs directly (i.e., other than through OYB transfers to Missions.)

II.E.3. Information Reporting Requirement for USAID-Assisted MFIs. To ensure that Missions have the necessary information on which to base their results reporting and their disbursement decisions, USAID imposes the following requirement:

> Every agreement to provide USAID assistance to any microfinance institution must include a requirement that the assisted organization provide USAID, on an annual basis, with a report of its financial and operational performance and outreach which includes all of the indicators specified in Sections A-D of the Annex. This requirement applies whether or not the assisted organization regards financial services as the primary focus of its program.

II.E.3.a. Indicators of outreach and focus on target population. The size distribution of loans and savings deposits and the proportion of female clients provide basic evidence of a microfinance program's outreach and target orientation. Section A of the Annex includes several indicators of outreach. Average (mean) loan size can be calculated from the overall value of the program's loan portfolio (i.e., total unpaid balance on outstanding loans, indicator 1) and the total number of loans (indicator 2). The size of the median (typical) loan is revealed by sorting outstanding loans into quartiles by size (indicator 3) and reporting the largest loan balance in the second quartile; the median loan can differ substantially from the mean in situations where a few large loans pull up the mean. Total small saver deposits and the number of such accounts (indicators 8 and 9) permit the mean deposit account to be calculated. Finally, the percentage of female borrowers (or clients, as appropriate to the program) provides a rough measure of outreach to women.

Missions should carefully monitor these measures for evidence of the MFI's breadth of outreach (numbers of poor people affected); depth of outreach (numbers of the very poor affected); and inclusion of women. In addition to these standardized data, the Mission should occasionally revalidate its initial assessment of the organization's commitment to targeting the poor, based on such circumstantial evidence as the neighborhoods where it offers its services; reliance upon collateral substitutes; etc. Missions should *not* encourage assisted organizations to use means-testing of potential clients or to attempt to track the specific uses to which they put borrowed funds. Likewise, Missions should not require assisted organizations to report on the nature of the microenterprise activities that their clients undertake.

Financial institutions serving both poor and non-poor clients should base their reporting of the required indicators of portfolio and outreach (Annex Section A) on their activities focused on microentrepreneurs and other poor clients.

II.E.3.b. Indicators of MFI financial and operational performance. Sections B-D of the Annex specify indicators of interest rate policy and of financial and operational performance that must be reported by every USAID-assisted institution providing financial services to microentrepreneurs or other poor clients. These comprise the minimum set necessary to allow

USAID (and the MFI itself) to obtain a basic picture of the institution's financial performance and operational efficiency.

Financial institutions serving both poor and non-poor clients may report the indicators in Sections C and D based on their overall financial portfolio, and may draw this information from their standard financial reporting documents. However, the information reported under Section B should in all cases relate specifically to interest rate policy on loans targeted toward poor clients and on savings deposit services focused on the poor.

II.E.4. Use of MFI Performance Information. The information reported under Annex Sections A-E provides the basis for a set of analytic performance indicators described in Annex Section F.[19] Taken together, these indicators allow an assisted organization's performance to be tracked both over time and compared with other organizations. USAID officers charged with managing the assistance activity are expected to use these indicators -- particularly the outreach indicators in Annex Section A and the analytical performance indicators in Annex Section F -- to track the assisted organization's performance relative to the goals negotiated with the Mission, and to consider these elements of performance in disbursement decisions.

Although this guidance requires annual reporting *to USAID* as a minimum standard, a much more important issue is the MFI's own use of financial and operational performance data. To perform effectively, *every* financial institution -- regardless of size or market niche -- must gather information on key aspects of its financial and operational performance on a more or less continuous basis; skillfully analyze that information; and use the results of that analysis to make appropriate adjustments in its operations. Good financial reporting is also indispensable for any organization to gain access to non-donor sources of funding, either through raising deposits (which will require that it provide such information to local banking supervisors) or through borrowing from banks (which will require evidence of the organization's financial performance). Mission staff should pay close attention to (1) the effort the organization puts into gathering financial and operational performance data and (2) the extent to which it uses those data in its decision making, and must consider these factors in its decisions regarding disbursement of USAID assistance to MFIs. Likewise, Missions should encourage MFI management to use analytical performance indicators like those in Annex Section F to obtain a clearer picture of the organization's performance, and should consider the desirability of supporting training and/or other improvements in the organization's MIS capabilities necessary to help them do so.

II.F. POLICY TOWARD SAVINGS DEPOSIT SERVICES. The balance between the benefits and risks of offering deposit services is one of the most difficult and controversial

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[19]The Mission should reach agreement with MFI management as to who will take responsibility for tracking the indicators of the opportunity cost of funds (Annex Section E).

issues in micro-financial development. Some of the benefits have already been emphasized in this guidance: for poor savers, a much more attractive savings vehicle than otherwise available; for microfinance institutions, a means to fund further expansion in lending while reducing reliance upon donor support. Mobilizing savings offers further important benefits to an MFI: it establishes the program as a full-fledged financial intermediary rooted in the community and not just a conduit of external funds. Mobilizing savings from among the community of borrowers can also enhance loan repayment: when borrowers see their neighbors and relatives as the ultimate source of their loans, they may have more incentive to repay than if the credit comes directly from an external donor. Savings can also act as implicit collateral on loans and provide valuable information for screening out poor credit risks. Those without the discipline to save, even in modest amounts, may lack the discipline both to succeed as entrepreneurs and to repay loans.

At the same time, accepting savings also puts a heavy responsibility on the microfinance program. Poor depositors stand to lose their vital savings if the MFI fails due to poor management decisions or simple bad luck -- a risk that is magnified in direct proportion to the MFI's success in leveraging its capital into a larger volume of loans through borrowing or mobilizing deposits.[20] As a result, Missions should discourage assisted organizations -- particularly NGO-sponsored credit programs -- from mobilizing savings from the general public until they have accumulated considerable experience and skill in the management of a credit program.[21] Rather, such organizations should be encouraged to fund their initial drive toward financial sustainability through loans from commercial banks or other financial institutions. A partial USAID guarantee may be provided to help an MFI obtain access to such lending, under conditions spelled out in separate guidance.

II.F.1. Financial Regulation and Supervision. In addition to verifying the financial management capabilities of an organization seeking USAID support for a program that mobilizes savings to fund its lending operations, the Mission should also verify that either (1) the existing institutional and legal framework for the prudential regulation and supervision of financial institutions is adequate to handle the special issues raised by microfinance institutions, or (2) the government is willing and able to make the necessary improvements in

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[20]These risks apply whenever an institution raises funds through *voluntary* savings. Some micro-finance programs require involuntary savings accounts as conditions for receiving loans. Forced savings eliminate many of the risks connected with voluntary savings, but also many of the benefits as well: forced savings may be construed as authoritarian, paternalistic, and lacking economic benefit. Forced savings also raise the effective cost of borrowing and make the cost of credit difficult for borrowers to assess.

[21]Note that this concern does not apply to savings mobilized solely among an organization's own members, such as credit union shares and savings deposits required as a condition for access to loans (forced savings).

the framework in time for the initiation of savings mobilization. If neither of these conditions is satisfied, only plans involving borrowing from other financial institutions should be considered. Missions should carefully avoid contributing to a situation in which poor people's savings are placed at risk through inadequate prudential regulation and supervision. The failure of either or both of these conditions may indicate an opportunity for the Mission in the area of policy dialogue and/or training of bank supervisory staff.

II.G. IDENTIFYING PROMISING OPPORTUNITIES FOR USAID ASSISTANCE. The preceding sections intentionally set high performance standards for organizations offering microfinance services to be eligible for USAID assistance. Missions considering providing such assistance must carefully consider both the country economic environment and the characteristics of potential partner organizations to ensure that these performance standards are likely to be met.

All of the country and organizational conditions identified in this section should be satisfied for the Mission to provide any microfinance institution with the full range of USAID assistance, including capital contributions to bolster the MFI's loan program. In cases where the specified country conditions are not currently satisfied but the Mission judges that they are likely to be satisfied in the foreseeable future (e.g., a transitional period of high inflation reflecting exchange rate adjustment or price decontrol), the Mission may provide such technical and/or commodity assistance as it deems appropriate to programs that meet the indicated organizational conditions. However, no capital contributions should be provided in such cases. In all other cases -- where potential partner organizations fail to satisfy the indicated threshold conditions, or where country conditions are not judged likely to satisfy the necessary conditions in the foreseeable future -- USAID assistance should be limited to advice, literature, and other such low-cost technical assistance to help organizations and host country officials understand the rationale behind USAID's approach to microenterprise finance and the preconditions for USAID assistance.

II.G.1. Country Issues. At the most general level, the benefits that microentrepreneurs are likely to gain from improved access to financial services will depend on the extent to which the overall economic environment is conducive to growth. The more severely the prospects for growth and sustained poverty reduction are constrained by poor overall policies or other factors, the stronger is the rationale for using USAID resources to confront those constraints directly, either prior to or alongside the provision of support to microenterprise development organizations. Missions must also consider specific aspects of the country policy environment to ensure that they will not undermine the success of assisted organizations:

II.G.1.a. Interest rate policy. A microfinance program's ability to achieve financial sustainability depends critically on its ability and willingness to set interest rates and fees on loans high enough to cover all of its program costs. The host country government must provide full and effective freedom for assisted MFIs to set lending rates and fees at full-cost-covering levels. Depending on the context, a formal waiver from existing interest rate ceilings may or may not be necessary to provide the required latitude: practice is what counts. Conversely, even a formal waiver may not be sufficient: a program operating under a waiver within an otherwise repressed financial sector may be subject to pressure to keep its interest rates below full cost-recovery levels to avoid being seen as "exploitative." Before signing an agreement to provide assistance to any MFI, the Mission must determine that the institution has full and effective latitude to set interest rates and fees at full-cost-covering levels.

II.G.1.b. Inflation. Rapid inflation, together with the high variability in inflation that usually accompanies it, greatly complicates the problem of setting appropriate interest rates.[22] Large losses on outstanding loans and on cash balances held in local currency can easily result. To avoid subjecting U.S. assistance to such losses, the Mission should -- as a minimum standard -- avoid entering into an assistance agreement involving capital contributions to support an MFI's lending program under circumstances where there is a strong likelihood that inflation will exceed 50% during any year within the life of the agreement. Likewise, Missions should not disburse such capital contributions during any year when the inflation rate is running above 50%; assistance agreements should reflect this condition. In situations where inflation is below the 50% threshold but nevertheless substantial (e.g., above 20% per year), Missions should attempt to limit any capital contributions to only those MFIs that have established a track record of adjusting lending rates and fees so as to preserve the real value of their assets.[23] Where USG and host country policy permits, the possibility of holding MFI cash balances in U.S. dollars or another hard currency should be explored as a means to protect against inflation-induced losses.

II.G.2. Organizational Issues. A second, equally important set of issues surrounds the identification of organizations likely to make effective use of USAID assistance and achieve the performance standards set forth in preceding sections. Some of these issues can be resolved through a careful examination of data on the current operational and financial performance and target-group orientation of the organization in question, but the Mission will also need to make judgment calls on the organization's willingness and ability to make the changes necessary to succeed.

II.G.2.a. Control over loan delinquency and losses. Bringing loan delinquency and losses under control -- through appropriate incentives for repayment and vigorous pursuit of borrowers who fail to make timely loan payments (or fail to pay at all) -- is an indispensable first step in building an effective microfinance program. As a result, before signing an

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[22]As noted in I.C.1.a, higher rates of inflation also appear to suppress client demand for loans at a given real interest rate, and can thus pose a constraint upon program growth.

[23]Where the Mission is in a position to forecast future inflation rates rather than simply observing past trends, it should take these forecasts into consideration in its disbursement decisions.

agreement to provide assistance to any microfinance institution that is already providing loans, the Mission must determine the MFI has brought loan delinquency and losses under control. As a minimum standard, the MFI must document delinquency rates -- percent of total portfolio in loans with payments over 90 days past due -- below 10% and loan loss rates below 5% in order to qualify for USAID assistance beyond the limited technical assistance cited in section II.G.

II.G.2.b. Full-cost-recovery interest rates and fees. Before signing an agreement to provide assistance to any MFI, the Mission must determine that the institution's management is prepared to charge interest rates and fees on loans that are high enough to cover the program's full long-run costs, on an opportunity-cost basis. Missions and program managers should clearly understand that the rates needed to cover the full costs of making small loans to microentrepreneurs will almost inevitably be *much higher* than rates available on larger loans to the non-poor. Long-run cost levels should be estimated by adjusting current cost levels to reflect *clearly feasible* improvements in operational efficiency and economies of scale. The prospects for such improvements should be conservatively estimated, based on the experience of organizations following similar approaches under roughly similar conditions. In many cases, technical assistance will be needed in estimating long-run costs. Together with information on the likely costs of mobilizing non-donor funds and other cost factors, the lending rate necessary to allow the program to reach full financial sustainability within the expected time horizon can be estimated. USAID officers responsible for managing the assistance agreement should ensure that the MFI has raised lending rates to this level before disbursing any capital contributions to support the MFI's lending program. Moreover, the organization should commit itself to adjusting its lending rates upward as necessary should subsequent experience show that prospective costs were misestimated.

II.G.2.c. "Commercializing" specialized MFIs vs. "downsizing" private banks. In designing its approach to microfinance development and in choosing among potential partner organizations, the Mission should remain sensitive to the merits and challenges of two broad approaches: (1) helping specialized MFIs reach financial sustainability and commercial scale; and (2) encouraging commercial banks and other profit-making financial intermediaries to target poor microentrepreneurs as customers.

In most cases, NGOs have played the principal role in the initial development of microfinance, establishing specialized MFIs for that purpose. Most exhibit a strong and enduring focus on the poor. However, managers and employees of some NGO-founded MFIs may find it very difficult to adapt to the changes in organizational culture necessary to attain profitability: a single-minded pursuit of growth, relentless cost-cutting efforts, strict attention to financial performance, greater reliance on technical skills, etc. Some observers argue that this adaptation requires a fundamental transformation of organizational structure to one owned by shareholders. Although growing numbers of NGO-founded MFIs appear to have successfully met these challenges, the record is too short to allow taking for granted the long-run viability of financial institutions in which no private owners are spurred to diligence by having placed large amounts of personal funds at risk. Finally, helping such an organization attain commercial scale usually requires committing scarce USAID grant funds to enable the program to expand its lending program, even though it may be operating in a setting where credit is not scarce overall, but simply inaccessible to the poor. In these respects, profit-making banks offer a variety of potential advantages, including a commercial outlook and relatively sophisticated financial skills. In addition, they are already operating on a financially sustainable basis, so that they mainly require (relatively inexpensive) technical assistance to move into microfinance, rather than large injections of grant funds. Based on these considerations, Missions should remain open to opportunities for helping profit-making financial institutions expand their range of services to meet the requirements of poor microentrepreneurs.

Despite the advantages just cited, Missions must clearly recognize the serious challenges presented by such a "downsizing" approach. First, succeeding in microfinance requires substantial adaptation of traditional financial practices used in dealing with non-poor clients, particularly the development of collateral substitutes appropriate to the economic and cultural setting in which they operate. Second, banks may need to open new branches to reach poor clients. Both steps represent investments which may not be recouped for several years. Third, depending on the cultural and political setting, bank owners may reasonably fear that operating a window lending small amounts to the poor at interest rates several times those charged on larger loans to the non-poor could expose them to a populist backlash, regardless of the advantages provided to their poor customers relative to available alternatives. Finally, in most cases market forces will exert pressure to focus upon the easiest-to-reach, least risky clients, tending to limit deep outreach. Taken together, these barriers tend to limit the circumstances under which profit-making financial institutions will actively pursue the microentrepreneurial market. Two factors likely to contribute to such a shift are (1) a clear demonstration that the local microentrepreneurial market offers opportunities for profit -- typically in the form of a specialized MFI that has achieved profitability and commercial scale; and (2) a highly competitive market for financial services that forces financial institutions to search for new markets. These considerations suggest the need to encourage both NGO and private approaches to microfinance development, as well as the linkage of the policy environment in the broader financial sector to the long-term prospects for the development of microfinance.

Finally, Missions should note that opportunities to support microfinance are not necessarily limited to an either/or choice between NGO-sponsored specialized MFIs and private banks. Rather, they should be alert to opportunities to foster creative partnerships between banks and NGOs, combining the banks' financial management skills and links to broader financial markets with the NGOs' experience among, and focus upon the poor.

II.G.2.d. Participation. To be effective, every microfinance program must ensure that its services are well-adapted to the particular requirements of its potential clients; systematic market research to help guide this process of adaptation is a hallmark of serious program management. In other respects, different approaches to microfinance vary greatly in the extent to which clients are expected to participate in the financial operations of the MFI: At one extreme, credit unions and village banks are operated by the clients/members themselves; at the other, several highly successful MFIs maintain an arm's-length relationship with their clients and insulate their lending decisions from direct influence by borrowers. While recognizing that clients can benefit from participation in the management and operations of microfinance programs, Missions choosing among prospective partner organizations should examine the impact of participation on their respective prospects for attaining broad and/or deep outreach, financial sustainability, and operational efficiency.

In contrast, Missions should ensure that microentrepreneurs are engaged in all phases of the design, execution, and monitoring and evaluation of their assistance activities in support of microenterprise development.

II.H. STRUCTURING ASSISTANCE TO MICROFINANCE PROGRAMS. The USAID strategy toward enhancing access by microenterprises to appropriate financial services is to foster institutional development among organizations that directly provide those services, helping them achieve large scale and full financial sustainability through improvements in operational efficiency and economies of scale. Having reached that condition, organizations should be able to rely principally upon non-donor sources of funding to support further growth. Organizations that do not offer a strong likelihood of reaching that condition should not be assisted in the first place.

II.H.1. Typical Forms of Assistance. In general, USAID assistance to organizations providing microfinance services involves some combination of technical assistance, training, commodities, and/or transitional financial support. In particular,

- Technical assistance will generally be used to help organizations identify ways to improve their operational efficiency, financial management, staff practices, etc. The general aim is to help organizations adopt "best practice" in all areas of their operations, based upon the experience of organizations in other environments.

- Training can help address the scarcity of MFI managers and personnel with an understanding of best practice in microfinance.

- Commodities are likely to include computer hardware, software, and other elements of the management information system needed for financial reporting and effective control over operations.

- Transitional financial support may be needed to help an MFI reach a financially sustainable scale, or to encourage an established financial institution to broaden its operations into microfinance. Typical examples include contributions to cover operational losses during a start-up period, and/or to expand the organization's capital base and thus the potential scale of its lending operations; guarantees on loans to MFIs by commercial banks or other formal lenders; and/or partial guarantees on loans to microenterprises.

II.H.2. Performance-Based Disbursement. The assistance agreement should clearly specify interim performance benchmarks over the life of the agreement, and should provide for tranched disbursements of assistance based upon the achievement of those benchmarks. Consideration for any follow-up grants should similarly be based upon performance during the grant period. Expert TA is likely to be needed in setting the interim performance standards, since the range of international experience and the peculiarities of local conditions must all be taken into account. The Mission should carefully avoid reinforcing failure, or creating the expectation that it will do so. Where performance falls short of expectations, technical assistance to diagnose and help correct problems should be relied upon rather than financial resources to cover up the failure.

II.H.3. Guarantees. Partial guarantees can useful in encouraging established financial institutions to enter into microenterprise lending, by sharing in the perceived risks involved in such lending. Assistance agreements should be structured so that guarantees are phased out over a relatively short period; by the end of this period, the institution should be expected to have developed the necessary skills in microfinance, as well as a realistic estimate of the underlying risks of microenterprise lending. In the meantime, the share of any loan defaults borne by USAID should not be so great as to deter vigorous efforts at loan recovery; in no case should 100 percent guarantees be provided. More generally, Missions should avoid offering guarantees to any financial institution that has not shown a strong motivation to move into the microfinance market; risk-sharing arrangements cannot make up for a lack of such motivation on the part of the institution.

II.H.4. Avoiding Poor Prospects for Microfinance Development. Missions and Bureaus should carefully avoid attempting to force the pace at which an assisted organization expands its volume of services above that shown to be feasible by the experience of similar organizational types in similar settings. Factors affecting the feasible rate of expansion include: the organization's initial size and level of efficiency; its ability to improve operational efficiency; the quality and stability of its governance; its ability to maintain firm control over a decentralized, growing network of branch offices; its ability to recruit, train, and motivate staff; its ability to maintain high repayment rates among a growing set of borrowers, based largely upon an appreciation of the advantages of continuing, reliable access to credit; its ability to convince commercial lenders and/or private savers that it will exercise effective stewardship over their funds; and a host of other factors. The prospects for success in many of these areas can be severely and expensively compromised by efforts to force the program to grow too fast.

For similar reasons, microfinance development efforts should *not* be viewed as an early response to alleviate the large-scale human suffering created by wars, civil conflict, natural disasters, etc. Opportunities for successful microfinance development may present themselves among populations affected by such crises, particularly once social conditions have calmed down and normal economic activity has begun to re-emerge. Nevertheless, such opportunities must be carefully evaluated against the same standards of policy environment and institutional promise discussed elsewhere in this guidance. It is critically important that Missions and Bureaus anticipate and resist pressures to establish and/or scale up credit programs quickly under such circumstances, in an attempt to use microloans as a form of emergency assistance. Bowing to these pressures will inevitably conflict with the basic requirements of building a sound financial institution: careful selection of borrowers with strong prospects for repayment, building a reputation for taking timely repayment seriously, building managerial and staff capabilities to handle the increasingly complex demands of a growing program, etc. Ignoring these requirements in the interest of "moving the money" can easily do lasting damage to the prospects for establishing healthy, sustainable financial institutions both willing and able to serve the poor.

Likewise, Missions should not condition their support of MFIs on expansion into particular "under-served" geographic regions. Many MFIs have paid a heavy price for ill-advised or untimely geographic expansion prompted by the lure of donor funding.

III. GUIDANCE FOR SUPPORT TO ORGANIZATIONS PROVIDING NON-FINANCIAL ASSISTANCE

Most studies of the microenterprise sector stress the importance of non-financial constraints on the growth and prosperity of microenterprises. For many or even most active microentrepreneurs, weak business management and marketing skills and/or limited knowledge of production techniques and market opportunities pose more serious barriers to growth than a lack of finance. In addition, many poor people who might benefit from undertaking microentrepreneurial activities lack the basic skills to get started.

Many microenterprise development programs offer a variety of non-financial services to help microentrepreneurs (and potential microentrepreneurs) overcome such non-financial constraints. They provide training and technical assistance in business management and production skills, as well as help in identifying and developing markets. Training and technical assistance, in turn, range from the most basic help in setting up a new business to training in improved production methods to more sophisticated help in making the transition to small business status; effective organizations take pains to tailor the content of their training/TA to the requirements of their clients. Other organizations work at a systems level rather with individual microentrepreneurs, developing marketing channels, improving technologies, and the like. Finally, some organizations lobby for improvements in the policy environment in which microenterprises operate. Few programs provide only non-financial services; most provide them along with credit, some independently, others as components of a fixed package of services. Nevertheless, this section isolates non-financial assistance for the sake of clarity. As the following section emphasizes, the guidance provided here fully applies to the non-financial operations of mixed programs.

USAID officers should note carefully that, in general, evaluation has not established a high level of cost-effectiveness among non-financial interventions for microenterprises, given currently available methodologies, although there may be some promising models that deserve further investigation. As a result, Missions should exercise caution in supporting such activities, funding them on an experimental basis and ensuring that USAID assistance is linked to a monitoring and evaluation framework sufficient to provide a clear basis for judging whether the benefits achieved through such activities outweigh their costs.

III.A. Expected Results. USAID assists organizations providing non-financial assistance to microentrepreneurs in order to achieve a chain of results that closely parallels that set forth in section II.E for microfinance programs. The only differences lie in the first two links. In the present case, USAID assistance is expected to achieve:

- increased outreach and improved cost-effectiveness of involved in non-financial assistance to microentrepreneurs, whether through direct or system-level inventions; leading to
- increased sales and productivity among microenterprises.

Just as in the case of financial services, these links are expected to result in increased incomes and improved household welfare among microentrepreneurs. Overall results will be a function of the number of clients affected and the resulting changes in enterprise performance and, ultimately, in household incomes and welfare. All other factors held equal, improvements in income and welfare will be viewed as more valuable to the extent they accrue to poorer households.

The critical difference between these results and those expected from assistance to microfinance programs lies in expectations regarding program sustainability and the associated standards for program success. Experience as of this writing gives no basis for expecting most programs to recover the full costs of providing non-financial services from their clients/beneficiaries. Rather, with a few exceptions the general pattern has involved greater or lesser degrees of partial cost recovery, with remaining costs covered by subsidies from donors, governments, and/or NGOs/PVOs.

III.B. Policy on Cost Recovery vs. Subsidies. To the extent feasible, cost recovery is always desirable for the evidence it provides about the value clients place on the services they receive, and may actually enhance that value. Similarly, charging significant user charges in rough proportion to the cost of providing different types of services yields valuable information about which services clients value most. This is particularly true if clients can choose those services they find most useful rather than being offered a fixed package of services on a take-it-or-leave-it basis; USAID strongly encourages this kind of client choice. Finally, greater cost recovery helps stretch USAID support to cover a larger volume of services. As a result, USAID policy encourages the greatest degree of cost recovery consistent with a program's ability to serve its target population.

In general, this means that Missions should expect implementing organizations serving relatively less poor target populations to achieve higher levels of cost recovery. Likewise, assistance should generally be conditioned on efforts by the assisted organization to increase cost recovery over the life of the assistance agreement. On the other hand, very poor clients may not have the cash to pay up-front for even highly valuable services. As a result, Mission funding for the subsidized provision of non-financial services can be appropriate as a means of reaching the very poor, to the extent that the cost-effectiveness of those services can be demonstrated.

III.C. Program Results and Cost-Effectiveness and Reporting Responsibilities. The fact that subsidies will almost always be involved in providing non-financial services means that additional evidence must be gathered on their cost-effectiveness in producing the desired results; the greater the degree of subsidization, the stronger this additional evidence should be. Assistance agreements must require that the assisted organization provide annual reporting on a set of program impact indicators that the Mission determines is sufficient to allow an assessment of the program's cost-effectiveness. Missions should work with assisted organizations to identify appropriate indicators of program impact and cost-effectiveness, and condition assistance on regular reporting on these indicators. Because of the diversity of non-financial services provided by different organizations, the appropriate indicators will tend to be fairly case-specific, and sometimes qualitative. Missions should give strong preference to indicators of changes in the economic well-being of clients that can be clearly related to improvements in the profitability of their enterprises.

USAID/W technical offices will carry out studies of impact of different types of non-financial services on enterprise performance and household welfare of clients, on a sample basis. Again, the aim of the latter is to add to the body of knowledge on "what works," and to strengthen USAID's basis for resource allocation decisions within microenterprise development and between microenterprise development and other approaches to poverty reduction.

III.D. Other Program Performance Indicators. The following highlights other performance reporting areas which may require adaptation from the approach used for financial service programs.

III.D.1. Outreach. The number of clients provided with each type of service must be tracked and reported, on a gender-disaggregated basis.

III.D.2. Focus on the target population. In contrast to financial services, it will generally be necessary to track more qualitative indicators relating to target group focus. Useful indicators include:

- the types of services provided (e.g., level of sophistication of training provided);
- methods used to select clients;
- neighborhoods in which program operates; etc.

In addition, the Mission should gather qualitative information on the organization's governance structure and management relating to its commitment to maintain focus on the poor.

III.D.3. Financial reporting. Financial reporting for a program that offers only non-financial services is considerably less challenging than for a microfinance program. In general, standard budgets, balance sheets, and profit/loss statements should suffice. The organization's different sources of funds, major cost elements, and the extent of subsidies in the provision of its services should be clearly reported. As section IV emphasizes, the same principle applies to the non-financial operations of programs offering both financial and non-financial services, but the latter case requires a clear distinction between the two sides of the program in order to allow the performance of each to be separately tracked.

III.E. Participation. As with support to microfinance institutions, Missions should ensure that microentrepreneurs are engaged in all phases of the design, execution, and monitoring and evaluation of their efforts in support of non-financial assistance to microenterprises. In contrast to microfinance development, Missions should encourage organizations providing non-financial assistance to ensure active participation by their clients/beneficiaries in their own operations, as a means to ensure that such assistance meets the needs of clients/beneficiaries. This form of customer feedback is especially important where cost recovery is limited. Missions should take the degree of participation into account in selecting among potential partner organizations in the area of non-financial assistance.

III.F. Additional principles of non-financial assistance. Studies suggest that training and extension services are more effective in reaching the poorest or smallest enterprises when:

- The training is simple and builds on existing knowledge relevant to microenterprise level needs, keeping in mind the fact that most microentrepreneurs acquire their skills informally;
- They advise or serve as a broker in dealing with government regulations and licensing procedures; and
- Clients are organized into groups or associations, particularly according to trade group, thus reducing the unit costs of reaching them.

Evaluations of relatively successful technical assistance efforts aimed at assisting microenterprises and small scale enterprises indicate a number of common traits:

- Focus on a "single missing ingredient" rather than addressing multiple constraints;
- Targeted to addressing the needs of particular industries and problems, rather than treating all microenterprises as alike;

- Concentrate support on established enterprises, rather than attempting to create new enterprises.

IV. GUIDANCE FOR ASSISTANCE TO ORGANIZATIONS PROVIDING BOTH FINANCIAL AND NON-FINANCIAL SERVICES

Many microenterprise development programs provide both financial and non-financial services to their clients, judging that the latter face both a lack of access to financial services (especially credit) as well as critical constraints on the non-financial side: a lack of business skills, market connections, etc. According to this reasoning, microentrepreneurs will not realize their full potential unless both financial and non-financial constraints are addressed. On the financial services side, almost all such programs provide small loans, while some offer (voluntary or forced) savings facilities as well. As reviewed in section III, non-financial services vary widely according to the socioeconomic environment and the perceived constraints faced by the target population. A different type of mixed program combines credit (and possibly savings) with non-financial services aimed at non-business objectives: training in health and nutrition, family planning, environmental activities, etc. A gray area arises in the case of programs that concentrate on providing financial services, but that take advantage of their contacts with poor borrowers to promote social objectives at little or no cost. Grameen Bank's "Sixteen Decisions" -- e.g., commitments to avoid dowries, boil drinking water, and use pit latrines -- may be seen in this light. Where social messages do not burden or constrain financial service delivery, they may achieve a useful symbiosis.

USAID guidance on assistance to programs providing both financial and non-financial services is based on two simple principles:

First, clients should generally be able to choose which services they need, rather than being offered a fixed package of financial and non-financial services on a take-it-or-leave-it basis. An exception may be appropriate where an organization integrates social messages or similarly limited non-financial assistance with the delivery of financial services, to the extent that it does so without compromising the effectiveness of its financial service delivery. Likewise, an exception may be appropriate where the organization can demonstrate that a particular type of training or other service strongly contributes to loan repayment rates by enhancing the productivity of clients' enterprises. Assertions that such services are needed to ensure loan repayment should be viewed with caution, in view of the high repayment rates achieved by many MFIs that provide only financial services.

Second, each side of the program must meet USAID performance expectations in its own right. For an organization to be eligible for USAID assistance, its financial operations must fully satisfy the requirements for assistance to finance-only programs laid out in section II, including appropriate financial reporting (as detailed in the Annex); a credible commitment to attain full financial sustainability (on financial operations) within seven or fewer years, while maintaining target group focus; minimum standards for default rates and operational efficiency; and so on. Likewise, the non-financial operations of the organization must meet the requirements indicated in section III, including the provision and tracking of acceptable indicators of cost-effectiveness and appropriate levels of cost recovery. As indicated in section III, USAID will consider providing partial subsidies for the provision of non-financial services that address well-defined constraints to microenterprise performance in a cost-effective manner. However, any such subsidies must be transparent in the organization's financial reporting and must be confined to the non-financial side of the program. In particular, assisted organizations may *not* provide loans on a subsidized basis in order to induce participation in activities with objectives other than improved microenterprise performance (e.g., health, environment, democracy, etc.)

Assisted organizations must provide separate financial and program impact reporting for the financial and non-financial sides of their programs, to allow performance in the two sides to be tracked. Implementing this requirement may raise practical problems in allocating program costs between financial and non-financial operations. In general, the direct costs of providing any training or other non-financial service that the organization deems essential to ensuring loan repayment should be included in the costs of the financial side of the program. Pure overhead costs -- such as headquarters buildings and senior staff compensation -- may be allocated between the financial and non-financial sides of the program according to any method that the Mission and program management agree reasonably reflects the relative weights of the program's financial and non-financial efforts. One simple way to do this is to calculate the number of program employees involved full time in the financial side of the program as a proportion of total program staff, and to allocate this proportion of overhead costs to the financial side of the program.

In cases where programs provide, at little or no additional cost, social messages or other limited non-financial assistance alongside financial services, the Mission may judge that it is impractical to require separate financial and results reporting for financial and non-financial program elements. Based on such a judgment the Mission may agree with the managers of the program treat it as a pure financial services program for reporting purposes, following the guidance provided in Section II and the Annex. In such cases all program costs must be included in the program's financial reporting. In making such a judgment, the Mission should consider the nature of the non-financial activities, the extent to which their delivery is closely linked to delivery of financial services, and the apparent share of such activities in the overall costs of the program.

ANNEX: MINIMUM REPORTING FOR MICROFINANCE INSTITUTIONS

Every USAID agreement involving grant or loan assistance or loan guarantees to any institution providing financial services to microenterprises must include a requirement that the MFI provide accurate reporting of the financial and operational performance indicators described in Sections A-D of this Annex, on at least an annual basis. USAID assistance activity managers should base funding decisions on satisfactory performance as measured by these indicators and by the analytic performance indicators described in Section F. The following indicators comprise the minimum raw data that should be reported, together with the simplest of analytic indicators: operating efficiency and return on operations. The intent is to ensure the quality and comparability of data so that financial analysis can be conducted in a way that both USAID and program managers can interpret. For programs providing both financial services and non-financial assistance, these indicators apply to the financial services side of the program. A financial institution serving both poor and no-poor clients may base its financial reporting (Sections C and D) on its overall portfolio. In contrast, indicators of portfolio and outreach (Section A) and of interest rate policy (Section B) must exclusively reflect activities targeted toward microenterprises and other poor people.

A. PORTFOLIO AND OUTREACH

1. Total unpaid balance on outstanding loans to target group, at beginning and end of reporting period.

2. Total number of outstanding loans to target group, at beginning and end of reporting period.

3. The size distribution of outstanding loans to target group, by quartiles: Sort all such outstanding loans by unpaid balance, divide the total number of loans into four equal groups, and report the maximum, minimum, and mean unpaid balance within each group;[1,2]

4. Amount of loans disbursed to target group during reporting period.

5. Number of loans disbursed to target group during reporting period.

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[1]That is, for a program with 1,000 outstanding loans, report the mean unpaid balance on the largest 250 loans, the second-largest 250, and so forth down to the smallest 250 loans.

[2]Some additional information on the size distribution of loans may be needed to satisfy USAID's obligation to report on its support for poverty lending. These requirements are covered in separate guidance.

6. Percentage of female clients or borrowers.[3]

7. Arrears, on a loans-outstanding basis: Report unpaid balance of loans with payments overdue more than 30 days. In addition, provide report on aging of arrears, reporting, for example, the unpaid balance on loans overdue 31-60 days, 61-90 days, and 91 days-one year. As a minimum standard, all loans overdue more than one year should be written off as uncollectible, with stricter standards where the institution judges appropriate.

8. Total amount in small saver deposit accounts, at beginning and end of reporting period. Show compulsory and voluntary savings separately.[4]

9. Number of small saver deposit accounts, at beginning and end of reporting period. Show compulsory and voluntary savings separately.

10. Number of staff involved with targeted credit and/or savings activities.

B. INTEREST RATE POLICY (see also Analytical Performance Indicators, 49-50 below)

11. Effective annual interest rate paid by target group clients (incorporating all required fees, and calculated on a declining balance basis), in nominal terms.[5]

12. Effective annual rate paid on small savings deposits, in nominal terms.

C. INCOME AND EXPENSE INFORMATION

INCOME:

13. Interest and fee income from loans, on cash basis. Exclude accrued uncollected interest on non-performing loans.

14. Income from investments.

15. Other operating income from financial services.

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[3]For this purpose, the borrower is the person who signs the loan document.

[4] Many programs require clients to deposit minimum amounts or pay into savings funds in order to be eligible for loans.

[5]Information on how to calculate effective interest rates is available from G/EG/MD.

EXPENSES:[6]

16. Staff expenses.

17. Other administrative expenses, including depreciation.

18. Loan losses (extraordinary write-offs). Institutions should provide an explicit statement of the criteria they use in classifying non-performing loans as uncollectible and writing them off. Institutions should be encouraged to set standards that realistically reflect the prospects that delinquent loans will be repaid. As a minimum standard, all loans over one year in arrears should be written off, unless the institution is subject to regulations that require a longer period.

19. Interest and fee expenses, itemized by source of funds.

20. NET OPERATING PROFIT (Sum of items 13-15, minus sum of items 16-19.)

21. Non-operating income.

22. Non-operating expenses.

DONATIONS:

23. For operating expenses.

24. Capital contribution. Identify purpose, e.g., loan fund, equity, fixed assets.

D. BALANCE SHEET INFORMATION

ASSETS:

25. Cash on hand and in banks

26. Mandatory reserves

27. Short-term investments

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[6]Staff and administrative expenses should be those that relate to the provision of financial services. If an institution has significant non-financial activities, it should account for those costs separately, including the proportion of overhead expenses needed to support those activities. Costs paid directly by donors, such as expatriate salaries, should be included.

28. Loans outstanding

29. Loan loss provisions

30. Net portfolio outstanding (item 28 minus item 29)

31. Long term investments

32. Fixed assets

33. Other assets

34. TOTAL ASSETS (sum of items 25-27 plus sum of items 30-33)

LIABILITIES:

35. Savings and time deposits from target group clients

36. Other deposits

37. Loans from Central Bank

38. Loans from other banks

39. Other short term liabilities

40. Other long term liabilities

EQUITY:

41. Paid-in equity (shareholders)

42. Donated equity

43. Retained earnings

44. Other capital accounts

45. Current year profit or loss

46. TOTAL LIABILITIES AND EQUITY (sum of items 35-40 plus sum of items 41-45)

E. INDICATORS OF OPPORTUNITY COST OF FUNDS[7]

47. Local interbank lending rate, stated in annualized terms.

48. Local 90-day CD rate, stated in annualized terms.

49. Local annual inflation rate: percentage change in consumer price index, comparing CPI at end of the institution's financial reporting period vs. CPI one year previous. Give source.

F. ANALYTIC PERFORMANCE INDICATORS

50. Total administrative expenses: Sum of salaries, administration, and loan losses -- indicators 16, 17 and 18).

51. Adjusted financial expenses: Multiply average target-group loans outstanding during the period (average of indicator 1) times the interbank lending rate (indicator 47), the 90-day CD rate (indicator 48), or the inflation rate (indicator 49), *whichever is highest*.

52. Total adjusted expenses. Sum of total administrative expenses (indicator 50) and adjusted financial expenses (indicator 51).

53. Operational efficiency: Divide total administrative expenses (indicator 50) by the average outstanding balance on target-group loans over the reporting period (average of indicator 1). Express as a percentage.

54. Adjusted return on operations: Divide total client revenues (indicator 13) by total adjusted expenses (indicator 52). For purposes of this guidance, an institution with an adjusted return on operations of 1 or greater will be regarded as fully financial sustainable.

55. Loan loss rate: Divide loan losses over the reporting period (indicator 18) by the average value of target-group loans outstanding over the reporting period (average of indicator 1).

USAID expects that every assisted institution -- and the USAID officers responsible for managing the assistance activity -- will actively use such analytic indicators to monitor the institution's financial condition.

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[7]May be supplied by Mission or by institution, as appropriate.

Definitions:

1. Active borrower. A person who currently owes money to the program.

2. Adjusted return on operations. The core measure used by USAID to assess the financial sustainability of a microfinance institution. A value of 1 or greater implies full financial sustainability.

3. Arrears. The value of interest and principal payments owed but not paid on a delinquent loan.

4. Average loan size. The portfolio size divided by the number of active borrowers.

5. Broad outreach. The provision of significant benefits to large numbers of a particular target group.

6. Character and/or experience-based loans. A form of collateral substitute in which the initial loan is very small, but access to gradually increasing loans is assured as long as the borrower maintains a satisfactory repayment record.

7. Collateral substitute. A mechanism for ensuring the repayment of loans other than the provision of formal collateral by the borrower. In the context of microfinance, group lending and character-based (experience-based) lending are the most common forms of collateral substitutes.

8. Deep outreach. The provision of significant benefits to particularly disadvantaged members of a broader target group. In the case of microenterprise development programs, these typically include the poorest microentrepreneurs, female microentrepreneurs, etc.

9. Delinquency. The failure of a borrower to make interest and/or principal payments on time. A delinquent loan is one on which payments have not been made on time.

10. Delinquency rate. The total outstanding principal on loans with payments past due more than a given number of days, as a percent of a financial institution's average loan portfolio (average unpaid balance on outstanding loans.) In the context of this guidance, 90 days past due is used as the threshold of delinquency.

11. Financial costs. The costs of the funds raised by a microfinance institution to cover its lending. Depending on the context, this may include only out-of-pocket interest costs paid to depositors and/or to other financial institutions, or may include as well the opportunity cost of funds received as grants or soft loans from donors, governments, or charitable organizations.

12. Financial regulation(s). The set of rules governing the conduct of financial institutions.

13. Financial services. In the context of microenterprise development, includes the provision of loans, the acceptance of savings deposits, and payments services such as the provision or cashing of money orders, and other similar services useful to low income people.

14. Financial supervision. The examination and monitoring of financial institutions -- usually by government authorities -- to ensure compliance with financial regulations.

15. Financial sustainability. The degree to which an organization collects sufficient revenues from sale of its services to cover the full costs of its activities, evaluated on an opportunity-cost basis.

16. Forced savings. Savings deposited in a microfinance institution as a condition of eligibility for receiving loans. Distinguished from voluntary savings, which are deposited independent of such a condition.

17. Full-cost-recovery interest rates and fees. The level of interest rates and fees needed to cover the full long-run costs of providing a given loan.

18. Full financial sustainability. A situation in which the revenues an organization generates from its clients cover the full (opportunity) costs of its activities, thus allowing it to continue operating at a stable or growing scale without ongoing support from governments, donor agencies, or charitable organizations. When applied to a microfinance institution, full financial sustainability requires that the interest and fees the MFI collects on its lending equal or exceed the sum of its operational and financial costs, with the latter evaluated on an opportunity-cost basis.

19. Full long-run (opportunity) costs. In the context of this guidance, the financial plus operational costs for an organization to provide a given

quantity and quality of services (e.g., credit) once the organization has achieved feasible economies of scale and improvements in operational efficiency, with all costs evaluated on an opportunity-cost basis. Used as a basis for estimating the prices that must be charged for services to allow the organization to reach full financial sustainability. In the case of an MFI undergoing significant growth and/or improvement in operational efficiency, the full long-run costs of providing credit will typically be less than its currently observed costs.

20. Group lending. A form of collateral substitute in which borrowers form groups, all of whose members must maintain a satisfactory payment record for any group member to be eligible for future loans.

21. Implementing organization. In the context of microenterprise development, any government or non-government organization that directly provides financial services and/or non-financial assistance to microenterprises, or that performs other activities intended to improve the environment for microenterprise performance.

22. Loan loss rate. The total principal on loans written off as uncollectible during a particular reporting period, as a percentage of the average unpaid balance on outstanding loans over the same reporting period. In the context of this guidance, all loans past due one year or more must be written off as uncollectible; institutions may set stricter standards.

23. Market test. The principle that the value that people attach to any goods or services provided to them must be at least equal to the amount they are willing to pay for those goods or services.

24. Median. The middle value in a distribution. As applied e.g. to the loan portfolio of a microfinance institution, calculated by arranging its loans from smallest to largest and observing the value of the loan in the middle of that distribution.

25. Microenterprise. A very small-scale, informally organized business activity undertaken by poor people; excludes crop production by convention. For USAID program purposes, the term is restricted to enterprises with 10 or fewer workers, including the microentrepreneur and any unpaid family workers.

26. Microenterprise development. Any activity undertaken by donors, host-country governments, or

non-government organizations to improve the lives of poor people by encouraging the formation of microenterprises and/or the improved performance of existing microenterprises. Also, the overall process of improvement in the performance of microenterprises.

27. Microentrepreneur. The owner-operator of a microenterprise.

28. Microfinance. The provision of financial services adapted to the needs of low income people such as microentrepreneurs, especially the provision of small loans, the acceptance of small savings deposits, and simple payments services needed by microentrepreneurs and other poor people.

29. Microfinance development. A subset of microenterprise development efforts, focusing on extending and strengthening microentrepreneurs' and other poor people's access to appropriate financial services.

30. Microfinance institution or organization. An organization whose activities consist wholly or in significant part of the provision of financial services to microentrepreneurs. Abbreviated MFI or MFO.

31. Non-financial assistance. In the context of microenterprise development, any effort undertaken to improve the performance of individual microenterprises or of microenterprises as a group other than through microfinance. Includes, but is not restricted to: training of individual microentrepreneurs; efforts to link microenterprises with suppliers or markets for their output; the development and extension of technologies for use by microentrepreneurs; and lobbying efforts for improvements in policies and/or institutions affecting microenterprises.

32. Operational costs. That portion of a program's costs that cover personnel and other administrative costs, depreciation of fixed assets, and loan losses.

33. Operational efficiency. The extent to which an organization succeeds in minimizing its operational costs, given the target population with which it is working. Measured by the ratio of the organization's operational costs to the average value of its outstanding portfolio.

34. Operational self-sufficiency. A situation in which an organization generates sufficient revenues from clients to cover all of its

operational costs.

35. Opportunity costs. In general, the value of a given set of resources in their best alternative use. As applied to a microenterprise development program, refers to the market value of the resources used to carry out that program. In particular, calculating the opportunity costs of a program requires that any funds or other resources received in the form of grants or low-interest loans be evaluated according to what the institution would have had to pay for those funds had it raised them in private financial markets.

36. Poverty lending. A subset of microfinance program efforts which use very small loans to reach very poor clients, often with a focus on women. For operational purposes, USAID uses a reference point of loans with an average balance less than the local-currency equivalent of US$300 per borrower at 1994 prices as a working definition of poverty lending.

37. Prudential financial regulation. The subset of financial regulations intended to contribute to the stable and efficient performance of financial institutions, including the protection of depositors' assets.

38. Subsidized credit. The provision of loans on the basis of interest rates and fees that fail to cover the full long-run costs of providing those loans.

ACTION MEMORANDUM FOR THE MISSION DIRECTOR, USAID/UGANDA

FROM: Jim Gohary, Private Sector Officer

SUBJECT: PRIME Fund Grant No: 940-0406-G-00-6001-00 to the Foundation for Credit and Community Assistance (FOCCAS)

Problem: You are requested to (1) approve a $50,000 grant to the Foundation for Credit and Community Assistance (FOCCAS), to provide support for a small and micro-enterprise credit and training development program in Mbale and Tororo Districts, and (2) approve the non-competitive award of the said grant.

A. Background and context of the Grant:

As part of an early-action effort to assist the weaker microenterprise finance NGOs, USAID/Uganda applied to the Program for Innovation in Microenterprise (PRIME) fund, located in USAID/Washington Microenterprise Development Office (G/EG/MED), for funds to assist two local NGOs. One of the NGOs is FOCCAS. We were awarded $50,000 to be divided equally between the two specified local NGOs. PRESTO Project will match this amount with $50,000.

Uganda has seen an explosion of microenterprise intermediaries. The PRESTO Project, which is a five-year effort, intends to work with the strongest of these financial intermediaries in order to expand financial services to large numbers of microenterprises.

The Foundation for Credit and Community Assistance (FOCCAS) is the local affiliate of the American based PVO, Freedom from Hunger, which has since 1989 established a *credit with education* program in six countries of Asia, Latin America and West Africa. The *credit with education* approach integrates financial and educational services to bolster self-help capabilities of women in very poor, rural areas. In the five years since its inception, *credit with education* has been shown to have a profound impact on the ability of participants to improve the well being of their families, including the reduction of chronic hunger and malnutrition.

FOCCAS established its *Credit with Education* model in Mbale in September, 1995. To date, FOCCAS and Freedom from Hunger have trained ten field agents who are ready to begin implementation of the program when funding through this grant becomes available. FOCCAS has also received 12 motorcycles from the UNDP, a station wagon in addition to funds for Field Agent training from UNICEF.

This grant to FOCCAS will kick-start the *credit with education* program in Mbale and Tororo Districts and contribute to achieving the objectives of results package one, *"increasing the use of financial services by rural businesses"* and the overall strategic objective of *"increasing rural household incomes"*.

B. Description of the Grant: The purpose of this grant is to enable FOCCAS to establish 192 community level Credit Associations to provide financial and educational services to 5,760 rural men and women in Tororo and Mbale Districts. The period of the grant is approximately 2 years. The grant will provide credit funds in addition to financing participant training in basic bookkeeping, reproductive and primary health care.

FOCCAS has trained ten field agents and received operational support from two other donors. Freedom from Hunger is ready to provide short term technical assistance. Since its inception, FOCCAS has been engaged in a community sensitization drive in the two districts. All it lacks are credit funds to begin the implementation of the program. The SO 1/RP team does not anticipate any problems of FOCCAS attaining the goal of 5,760 new clients and attaining operational sustainability in two years. Also, by the end of the grant, FOCCAS will be recovering all operating costs and staff will be independently and effectively executing the management of all FOCCAS operations.

C. Grant Negotiations: In early May 1996, FOCCAS submitted an unsolicited proposal to USAID/Uganda for $50,000, to support the initiation of their pilot microenterprise finance activities in the Mbale - Tororo region. During a country visit in early June, 1996, Heather Clark, the PRIME Fund Project Officer from the Microenterprise Development Office in Washington, highlighted FOCCAS as an NGO with the potential to have broad outreach and to achieve financial sustainability in a relatively short period of time given their methodology. However, Ms. Clark noted that under the PRESTO Financial Services Grant (FSG) Program, it would be difficult for FOCCAS to compete for resources with NGOs that have greater experience working in Uganda given its relative recent entry into the microfinance field in Uganda.

Therefore, in an attempt to assist FOCCAS to move forward, the Mission considered funding an unsolicited proposal under the PRIME Fund. Proposal discussions were held between Mr. Basil Wanzira of FOCCAS and Jim Gohary and Jackie Wakhweya of USAID during the months of June, July and August to finalize the FOCCAS proposal. USAID staff consider the proposed costs to be fair and reasonable.

D. PVO Registration: FOCCAS is duly registered with the Government of Uganda as an indigenous non-government organization, to carry out activities in the field of providing the rural poor in Uganda with credit for microenterprise development and education to improve family welfare. Since FOCCAS does not solicit voluntary contributions, it is not classified as a private voluntary organization (PVO) and does not need to be registered with USAID.

E. Grantee contribution: FOCCAS is contributing $17,209, or 25% of the total program cost (see budget breakdown at attachment 1A of the grant).

F. Choice of Instrument: A grant was chosen as the funding mechanism for this activity because the activity was conceived and developed solely by FOCCAS and because FOCCAS possesses the requisite experience to carry out a microenterprise credit program in an independent and fully professional manner. Substantial involvement of USAID is not necessary.

G. Justification for non-competitive award: ADS Section 303.5.3c states that competition is not required for assistance awards based on unsolicited proposals, provided that the SO/RP team certifies that the proposals were not solicited by USAID, that they are unique, innovative or proprietary and that they represent appropriate use of USAID funds to support or stimulate a public purpose.

Justification for a non-competitive award is based on FOCCAS's submission of an unsolicited proposal dated May, 1996. Freedom from Hunger set out over eight years ago to develop, in a business-like way, a new approach to the human tragedy of world hunger. Freedom from Hunger's *credit with education* programs follow microenterprise best practices and provide a combination of financial resources, nutrition and health education to very poor women. *Credit with education* is being implemented through local affiliates in seven countries around the world. FOCCAS, the Freedom from Hunger Uganda affiliate shall support economically active poor women with small working capital loans and shall charge commercial level interest to help finance the program costs. FOCCAS shall also be a key player in providing financial services to poor women in the Mbale - Tororo region of Uganda. The integration of the financial and educational services shall reduce service delivery costs and foster mutual reinforcement of the two services.

The cost reduction and self-financing features of the *credit with education* program allow for potentially massive expansion of the integrated services to reach a much larger portion of people in targeted communities that are at risk of chronic hunger and malnutrition than many other program approaches have aspired to reach. The SO 1/RP team for *"increasing the use of financial services by rural businesses"* is satisfied that this program is unique innovative and shall represent an appropriate use of USAID funds.

H. Grantee's Management Capability: Freedom from Hunger, through its affiliate FOCCAS, has operated the *credit with education* model since 1989 in Mali, Ghana, Burkina Faso, Thailand, Bolivia, Honduras and Nigeria and has demonstrated in those countries that the programs can (i) achieve large scale impact through systematic, on-going expansion; (2) are increasingly self supporting and cost effective; and (3) can be replicated and sustained by local organizations. For a five year program period, Freedom from Hunger will provide FOCCAS Uganda with technical assistance and resources for all phases of implementation out of AID/Washington Matching Grant funds. The Uganda program has the tremendous advantage of benefitting from the cumulative knowledge and experience acquired by the Freedom from Hunger staff in seven other programs worldwide.

A Resource Office in Reno, Nevada provides financial and operational oversight to FOCCAS. A Program Manager resident in Mbale manages a staff of field agents at the local FOCCAS office. The financial, material and human resources required to implement the proposed program both in terms of technical and administrative advice and systems are in place.

Within a few months, FOCCAS has sensitized over 5,000 potential clients in the districts of Tororo and Mbale and mobilized resources from donors for their program. Freedom from Hunger, who will provide technical assistance to the FOCCAS program, has demonstrated considerable expertise in managing activities similar to those proposed for funding through this grant.

The SO 1/RP team expects FOCCAS to implement policies that will lead to early program sustainability. FOCCAS has proposed charging a nominal interest rate of 12% each loan cycle which is 36% per annum. Average loan sizes will be between $57 - $136 with mandatory savings within the Credit Associations. These policies should result in full operational sustainability within two years.

I. Pre-award survey: A pre-award survey carried out by the USAID/Uganda Controller's Office to assess capability to manage USAID funds indicated FOCCAS has adequate financial controls in place.

Authority: Under Re-delegation of Authority 452 you have the authority to negotiate, execute, amend and administer grants and cooperative agreements with non-governmental organizations in an amount not exceeding $100,000. Approving the $50,000 grant to FOCCAS is, therefore, within your delegated authority.

ADS Section 303.5.3c states that the Agreement Officer must agree with the SO/RP team's justification for non-competitive award.

RECOMMENDATION: That you: (1) approve a $50,000 grant to FOCCAS to implement a Microenterprise lending program for poor women in Tororo and Mbale Districts; and (2) approve the non-competitive award of the grant to FOCCAS based on the unsolicited proposal by signing this Action Memorandum and the attached grant letter.

Approved: ____________________

Disapproved: ____________________

Date: ____________________

Attachments: Grant letter and attachments

FOCCAS Grant No: 940-0406-G-00-6001-00 Action Memorandum

clearances:		
DPA:JWakhweya	(in draft)	Date 09/30/96
PSO:JGohary	(in draft)	Date 09/30/96
C/GDO:PFine	(in draft)	Date 10/01/96
PPD:SFine	(in draft)	Date 10/15/96
CONT:KLeblanc	(in draft)	Date 10/16/96
RLA:TFillinger	(in draft)	Date 10/25/96
D/DIR:JHale	JHale	Date 10-30-96

Clearances: FOCCAS Grant 940-0406-G-00-6001-00

DPA:JWakhweya	(in draft)	Date	09/30/96
PSO:JGohary	(in draft)	Date	09/30/96
C/GDO:PFine	(in draft)	Date	10/01/96
PPD:SFine	SF	Date	10/15/96
CONT:KLeBlanc	KL	Date	10/16/96
RLA:TFillinger	(e-mail attached)	Date	10/25/96
D/DIR:JHale	______	Date	______