Annex D
Statement of Work

Credit Activities: Lending Microenterprises and to Small- and Medium- Sized Business

The contractor will undertake two credit activities for small- and medium-size (SME) business and for micro enterprises. USAID's judgment is that capable local lending organizations do not exist. Contractor should therefore prepare itself to assume an SME lending responsibility in a short time period. Contractor should report within two weeks of arrival in country regarding how it will carry out direct management. With the explicit agreement of USAID, the contractor will itself establish and manage the processes and procedures to extend credit to small and medium-sized enterprises in areas of the countries(y) to be determined jointly with USAID. Nonetheless, from the beginning Contractor should prepare itself eventually to spin off the lending activity. Sustainability of the program should be considered as a key component in establishing the institutional vehicle

That is, Contractor will identify or establish a micro-credit lending facility. The facility will extend loans to micro-entrepreneurs ($50-$10,000) based on best-practice micro lending experiences (e.g., group lending). Sustainability should be considered in choosing the mechanism.

BACKGROUND – SME LENDING

The largest and most urgent challenge that any new government faces is revitalizing the economy and creating new jobs. High unemployment reflects a dire state in the productive sector, particularly where there are large, socially owned enterprises involved. The need for new job creation will only increase when workers are laid off from these firms as they are restructured for privatization, or liquidation. Credit availability is key to revitalizing the economy. The region's capital stock has been seriously depleted and there has been virtually no investment in plant and equipment for many years.

There exists however, the opportunity to create a vibrant private sector. Historically, small and medium size enterprises have been successfully engaged in trading activities, agribusiness, light manufacturing, and a variety of other sectors. This program will address these opportunities.

PURPOSE – SME LENDING

The primary objective of any initial activities is to create rapid employment generation in a productive and growing private sector.

STATEMENT OF WORK - SME LENDING

USAID will immediately establish within three-month a start-up program (with the potential for expansion and extension) to support rapid employment generation in the region through loans and business advisory support to eligible, creditworthy private enterprises. The Small Business Lending (SBL) program will provide quick disbursing financing for eligible businesses.

USAID will fund the establishment of a revolving loan fund that will be held in trust by the contractor until the end of the contract at which time USAID will make a determination whether to grant the fund in part or in whole the institutions implementing this activity. The contractor will propose to USAID a sub-agreement concerning the trust and the management of these funds.

The initial term of this program is one year: a performance review will be conducted after nine months and, based upon program effectiveness and the availability of funds, the project may be extended and expanded. The SBL program will work closely with other USAID Mission development programs.

In developing the SBL program activities, the contractor will identify capable local lending institution(s). The contractor will give due consideration to Islamic financial institutions for participation in the program if there are such institutions and if there is a demand for their services. If local institutions are not prepared to undertake small business loans and if in the view of the contractor and USAID, local institutions cannot be adequately prepared to assume and SME lending responsibility in a short time period, then, with the explicit agreement of USAID, the contractor will itself establish and manage the processes and procedures to extend credit to SMEs. Sustainability of the program should be considered in choosing the implementation mechanism. If there is a demand for Islamic lending, a separate segregated fund may be established.

Reports and other Products – SME Lending

The contractor, will indicate how they would propose to: (a) establish the loan fund (logistics, documentation and licensing, flow of funds etc.); (b) manage the loan fund (origination, analysis and approval, documentation, disbursal and collection and loan monitoring); (c) audit and monitor the portfolio and respond to non-compliance or non-payment; (d) conduct training of local national counterparts; and, (e) divest/transfer the portfolio at close of project.

For indicative purposes, suggested loan parameters would be \$5,000 to \$250,000, with an average size loan of \$75,000. While final lending parameters will ultimately be set by USAID, the contractor should propose the parameters (tenor, rate, loan size, etc.) of the lending facility. Eligible borrowers would be required to be: (a) private or privatizing registered businesses; (b) capable of demonstrating a high likelihood of repayment (primary and secondary source of payment); have the potential for near term employment generation; and, (c) not be in conflict with other USAID eligibility criteria (tobacco/alcohol, war crimes, related, etc) which are yet to be determined.

TASKS – SME LENDING

The contractor will undertake the following tasks:

1. Establish a loan facility: Undertake all such activities as may be required to establish a loan facility to finance eligible businesses. (Note: loan and interest reflows are intended to be recycled.) The contractor will:
   a. assume responsibility for USAID funds intended for the loan pool
   b. establish and manage an account for loan proceeds
   c. establish agreements with acceptable institution/bank agents to support SBL in loan origination and servicing.
   d. obtain necessary lending permits/licenses as required under law
   e. establish internal audit procedures acceptable to USAID to ensure proper oversight and accountability of the loan funds

2. Manage the loan fund: Set up a loan production unit which will be charged with:
   a. loan origination and assessment of loan applications
   b. loan approval within the established lending criteria
   c. loan documentation (note and credit agreement) and collateral
   d. monitoring and oversight of the loan portfolio
   e. restructuring or collections activities in events of default
   f. periodic reporting as stipulated by USAID

3. Audit and monitor the portfolio and partner institution/bank agents, to:
   a. conduct regular internal audits
   b. conduct regular loan and collateral reviews
   c. provide regular audit reports to USAID

4. Train LPU and partner institution/bank agent's staff: Train LPU local staff in areas of credit analysis, loan structuring, and loan administration.

5. Transfer the portfolio prior to, or at, close of the project (per USAID direction): Develop options for disposition of the loan portfolio and provide recommendations to USAID for the sale or otherwise dispose of the portfolio

6. Coordinate with other donors/IFI lending programs and other USAID contractors and grantees. Contractor will be responsible for coordinating with other lending programs.

Loan Approval and Role of Partner Institutions/Bank Agents. The LPU will be guided by policies, procedures and loan terms and conditions as established by USAID in consultation with the contractor. The LPU will make all lending decisions, although with a strong consultative relationship (and possibly co-approval) by USAID. It is intended that the contractor will work in conjunction with partner institution/bank agents (operating on a fee basis) for loan origination and loan servicing (disbursal and collections), however all loan decisions will be made by the LPU.

Lending Priorities/Requirements - Consideration of loan requests will reflect the priority of generating employment and supporting economic rehabilitation, and as such, will give preference to (a) firms with high employment generation potential; (b) projects which help reactivate existing local productive potential; (c) firms which will utilize domestic inputs and have export potential. Particular areas of focus would be agri-processing, trade, and light manufacturing. As noted in the "Benchmarks, Tangible Results and Level of Effort" section, all loans should show the ability to repay debt from projected free cash flows or the asset conversion cycle in a reasonable period of time and should be supported by a viable secondary source of repayment (collateral or acceptable personal guarantees). As noted, it is intended that this activity work in close cooperation with USAID's development activities and should therefore first seek lending activities and partner institution/bank agents based in the regions targeted by the Mission.

*Risks Associated with Lending*_It is understood that lending in any transitional economy entails a high risk and that not all borrowers will be able to fulfill the initial conditions of loans. However, it is expected that with appropriately structured loans (use of borrowing bases, etc.), clear expectations for repayment, somewhat lower disbursement targets, and tight loan monitoring, delinquency should remain within acceptable levels (5% or less. The SBL program should draw upon lending techniques which feature strong repayment records (abundant guarantees, close interaction with the borrower, frequent debt service, etc.), commercial finance techniques (borrowing base lending, accounts receivable lockboxes, etc.) and should employ a high frequency of audit.

Loan Origination - With the objective of rapid loan disbursement, the LPU should focus early on loan origination - identifying potential candidates and supporting them to prepare loan applications. The intent is to facilitate a flow of applications of potentially viable loan candidates in a manner that will present an accurate representation of current and prospective operations and collateral positions. It is envisioned that loan origination will be done in conjunction with partner institution/bank agents and will be supported by the SBL program. In conjunction with this loan origination function, the LPU will:

- prepare a format for provision of loan requests, including historical and projected financial information, description of operations, markets and management, company registration and incorporation data, collateral and other information as shall be required by the LPU
- establish a process for defining the universe of businesses and identifying high potential loan candidates
- conduct an outreach effort and contact prospective companies to explain the program
- support interested and qualifying companies to prepare business plans and loan requests (although loan requests and projection will obviously not be prepared by the SBL program).

*Drawing Upon Regional Experience*_Contractors should draw upon the experience of other lending programs undertaken by USAID and others in other regions. In particular, contractors should employ successful lending practices and draw upon credit policies and procedures, loan and collateral documentation and operations procedures developed in other countries.

Period of Performance The initial period of performance will be one year. A comprehensive review will be conducted after nine months and, if successful in meeting project objectives and depending upon funding availability, two additional option period of one year each are available to be exercised.

Benchmarks, Tangible Results, and Level of Effort – SME Lending

The contractor understands and agrees that achievement of the benchmarks and tangible results are the essence of their contract, and that USAID will judge contractor's success based upon whether or not the benchmarks and tangible results are achieved Tangible Results: During the performance period, the contractor will set up and oversee a Small Business Lending facility to provide rapid disbursement of loans to creditworthy businesses. It is understood that rapid disbursal (it is assumed that the contractor will disburse $38.0 million within 12 months) in combination with difficult business conditions will likely result in some level of delinquency. But contractor should ensure that appropriate measures are taken to: (a) exclude non-creditworthy borrowers; (b) ensure that loans and collateral are correctly documented and pledged, and (c) that sufficient loan structuring and monitoring takes place such that the level of delinquency is at all times under 5 percent. It is expected that contractor will ensure that adequate risk management and internal control procedures are in place to uncover fraud or noncompliance on the part of borrowers or partner institution/bank agents in a timely manner.

The Contractor should provide assumptions of loan volume and timing. For indicative purposes, it is assumed that loans will be in the neighborhood of $5,000 to $250,000, with an average size loan of $75,000. This suggests approximately 110 loans in year one. The following tangible results are presented for indicative purposes only and should be modified, as appropriate:

As a necessary precondition for receiving its award, the MFI will demonstrate a management information system that is fully operational.

Within 30 days of project start:

- A comprehensive work plan to be approved by USAID
- A set of oversight and audit procedures
- Application for a lending license (if required)
- Complete local hire staffing of the LPU
- Identify partner institution/bank agents to support loan origination and servicing

Within 45 days:

- Complete loan projections.
- Establish framework operating procedures operations
- Complete loan and collateral documentation templates
- Establish procedures for collateral perfection
- Conclude servicing agreements with partner institution/bank agents
- Develop a comprehensive origination strategy
- Written articulation of public awareness procedures

Within 60 days:

- Complete credit policies and procedures, loan follow-up and recover policies, accounting systems, loan and collateral documentation, and oversight and audit functions, to be approved by USAID

Within 90 days:
- A minimum of 50 business plans and loan
- Applications prepared and reviewed
- A minimum of 25 loan requests reviewed

Within 180 days:
- A minimum of 200 business plans and loan applications prepared and reviewed
- A minimum of 100 loan requests reviewed
- Commencement of audits

BACKGROUND - MICROLENDING

USAID seeks to implement a sustainable microfinance activity in the region. Focusing on urban areas, the program will establish legally registered and operational microfinance institutions in select urban areas.

The institution will be legally registered under the prevailing laws and regulations of the country. Once registered, however, the fund will adapt the peer group lending methodology of some of USAID's successful microfinance programs, such as the Kazakhstan Community Loan Fund (KCLF). By using tools and methodologies that have been demonstrated as successful, the microfinance program will be able to develop its lending programs rapidly.

In the region, there is a very strong potential for microfinance activities. The region is densely populated and, while the region has undergone significant economic turmoil, the natural resources and infrastructure to support small businesses exists. A microfinance program, using culturally appropriate, sound lending methodologies has the potential to be successful in this region. In the region, there are many microenterprises, many of which would be in need of loan capital.

USAID would apply its basic approach: 1) establish a legally registered and operating organization; 2) identify and train a high quality local staff that takes ownership of the management of the organization; 3) create credit policies and procedures designed to establish operational and financial sustainability; 4) build the funds systems in a manner that is consistent with Central Bank regulations and requirements; 6) draw upon existing, working models for micro and rural finance in the region (including models for Islamic lending); and 7) establish a local board of directors with local leaders that offers the funds' strategic leadership.

All loan officers will be trained. In addition, staff will be trained in financial management systems and a loan monitoring system. This process and structure already has proven to be adaptable and appropriate in regions such as Central Asia.

Over the initial one-year period of implementation, the program will be on track to become a financially sustainable institution. Should both option periods be exercised, as an estimate, the institution could achieve approximately 3,000 active clients, a loan portfolio of $0.8 million with an average loan size of $400. It is expected at the end of year 1 to be on track to achieve operational self-sufficiency in Year 2 of operations.

The team will monitor project results through three basic mechanisms: 1) the loan monitoring system that provides daily updates to the financial status of micro finance institutions; and 2) tracking progress against projections using MICROFIN models.

By adapting proven methodologies, USAID would establish a sustainable microfinance institution that will create opportunities for income generation and employment throughout the region. The peer group methodology will also facilitate the notion that individuals can work together through solidarity groups to their mutual advantage. In an area of economic disruption, ethnic unrest and insecurity, the ability of groups to function in a mutually beneficial way is a significant step in creating stability. By creating employment and income generating opportunities, the project will also support economic development in the region.

IMPLEMENTATION PLAN - MICROLENDING

A. Introduction

The project will establish a sustainable microfinance institution in the region. The project will be established and begin lending operations within the first three months of project inception. The project will support the development of microenterprises in the region. In particular, activities will:

1. Establish a sustainable microfinance institution operating in accordance with local laws and regulations that help individuals and small enterprises to become established;
2. Generate income and employment through legitimate business activity;
3. Establish peer groups that not only provide training and support to individuals as entrepreneurs, but also which promote group problem solving and conflict resolution. Peer groups will provide specific examples that demonstrate a mechanism for collaboration among individuals and by working together, positive change and individual growth can be achieved.

One model employed by USAID that has been very successful is the one that is operating in Kazakhstan. The methodology and institutional framework for the project will be adapted to the policy and legal environment that exists in the region. The model is flexible enough to accommodate the institutional, registration, and reporting requirements of each country. It can also be adapted to changes in local policies that may be favorable to micro finance operations.

B. Approach to Microfinance Operations

USAID's approach to building local institutions is to find or create legal mechanisms to register the local credit institution. Rather than form partnerships of multiple external institutions, USAID would draw upon the experience of current, successful micro finance programs to help build the program. The program will support the training and staff development of the local staff. The loan monitoring system will be derived from tools developed and used by USAID partners. By creating a local legal entity and supporting it with local consultants and locally adapted services, the program will have immediate independence and a sense of mission. The implementor will register during the first three months of program award. The elements of USAID's approach are as follows:

Provide female-headed households and other rural and urban small-scale businesses with access to credit and training.

- Create credit policies and procedures that will assist the funds to achieve operational and financial self-sufficiency and have the internal management capacity to operate independently within the one year implementation period, and the two one year options, if exercised..
- Implement a group-lending methodology.
- Build the systems to be compliant with Central Bank regulations. This will include the accounting system, loan tracking system, and provisioning. This will be a key strategy to allow possible transformation into a non-banking financial institution -- reporting to the Central Bank -- should that opportunity arise in the future.
- The implementor would demonstrate a strong commitment to building local management capacity. This would require no more than two long-term expatriate advisors. They will supervise the development of a local staff.
- Establish a local Board of Directors consisting of business leaders, lawyers, donors, and NGO representatives to offer strategic leadership.

C. Microfinance Lending Strategy

The basic lending methodology will be small, stepped group loans that gradually teach entrepreneurs how to borrow money while placing few restrictions on group membership. Based on discussions with local traders and mini-businesses, most loans will be made for working capital at two to four months and extend to twelve months for fixed asset loans. No collateral will be required for loans, as individual repayments will be "guaranteed" by the group. Loan sizes will be stepped and start at minimal amounts. It is proposed that these begin at $50-$100 and step up in increments of $100. Clients will need to learn the essence of borrowing and repaying funds before taking larger loan amounts. Teaching clients to understand their own expenses, income, and need for savings will be paramount to the project's lending strategy.

One important aspect of the program will be to offer loan sizes that directly meet the cash/flow needs of the business. That means that within a group, members will be allowed to take different loan sizes and terms. This approach has worked well in Kazakhstan and has served the clients' needs as well as keeping delinquency low. A key element to such a lending approach is *group empowerment*. Groups will be encouraged to self-form among trusted businesses and friends. The implementor will take no role regarding who can participate in a group. Groups will be empowered to make decisions regarding loan sizes and loan terms for each group member and must approve member loan applicants before disbursements can occur. Along with teaching clients about how to borrow, the implementor will teach woman how to save for emergencies. Savings will be required for the business but will also be allowed for family emergencies given the inter-relationship between the two. Groups will be taught the basic concepts of saving small amounts of money each month and setting them aside for future use.

To achieve one of its goals of reaching female-headed households, the project will work with business start-ups. One start-up business will be allowed in each group to provide these new businesses access to credit as well as a support network. USAID has found that limiting one start-up per group allows for stronger groups and may circumvent potential delinquency issues. The group formation process will take four weeks and will be managed by the loan officers. The goal of the formation process is to provide a structured environment for new clients to learn about the program, set up a system for how the group will work, and become comfortable with group members' businesses. During the group formation process, the loan officer is responsible for visiting each group member's business. This site visit is used to gather key financial data on *each product or service*, such as the frequency and quantity of purchasing, the level of sales, and profit margins. This information, in conjunction with the client's loan application (that contains an income statement and balance sheet), is used to generate simple financial ratios (such as turnover and profitability) that will help management understand the client's strengths and weaknesses.

D. Disbursements and Repayments - Microlending

One of the keys to a successful group-lending program is reaching large numbers of women entrepreneurs. To do this effectively, a program must have clear and efficient methods to disburse loans that are simple for clients and easy for the institution. The program will approve and disburse loans within ten days of their initial receipt. Before disbursement, group members will sign individual loan contracts and amortization schedules that reflect their individual loan. The group's loan officer will be present during the disbursement to facilitate the process. The Group Bookkeeper signs a receipt that she/he received the loan and will go directly to a group meeting to distribute the funds to each member. After receiving their loan from the Group Bookkeeper, individuals sign receipts that will be returned to the organization with the first loan installment. Loan installments will be made every 15 days. Each group will be allowed to develop its own system for collecting installments from its members, however, mandatory meetings will be required twice a month to collect loan installments. Meeting times are usually set the day the repayment is due and the Group Bookkeeper accepts installments from each member.

E. Management, Financial & Information Systems – Micro Lending

The organization will be a locally run and managed institution. Initially, the Chief of Party will be involved in hiring and training local staff with much of the first year devoted to instilling transparent and efficient management practices. For example, new concepts such as group decision-making will be introduced to develop an inclusive, modern management style. It will be management's philosophy to keep staff to a minimum. According to best practices, administrative expenses should be 25% or less of total operational expenses. This benchmark will be monitored to ensure that the institution is running efficiently. The basic management structure will be:

General Director - Responsible for the overall management and supervision of the program. He/she will report directly to the Board of Directors on all finance and management issues.

Finance Department – Will consist of a Chief Accountant to reconcile daily disbursements and repayments and be responsible for tax reporting and making consolidated statistical reports. Cashiers are hired on an as-needed basis as the office grows. Normally one Cashier is needed for the first year or when more than one thousand clients are being served at any location.

Operations Department - Responsible for outreach to the community. Loan Officers are the key staff and manage the group formation process and conduct all client training. Regional Monitors will be hired to oversee the sub-offices.

Branch Managers – Will be hired to manage the two branch activities in the region. They will run their offices as cost centers and have the authority to make all lending decisions. Once the headquarters structure is in place, Branch Managers will be hired.

Systems Department – Responsible for managing loan tracking system and completing daily crosschecks with the accounting system. The Department will consist of one computer specialist and one data entry person for the first year.

Sub-Offices – After the first year of operation, the implementor will begin setting up sub-offices. These sub-offices will serve to reach rural clients that are far from the center and will require conveniently located points to make financial transactions.

A Board of Directors will be established during the first year of operation. This body will oversee the general operations and will provide strategic leadership in terms of expansion plans, policy issues, and fund-raising prospects. The Board will not be involved in the day-to-day management but serve as a resource for the institution. Representatives will come from the business and legal community, NGO bodies, and donors. As the organization expands operations, it will take on a more formal organizational framework to adequately manage its growing staff. In the beginning of year three, a headquarters structure will be established to monitor all branch activities and provide assistance functions that are necessary for all the branches (for example, making consolidated tax reports). The headquarters structure will remain small, consisting of the General Director, Director of Finance, Director of Operations, and an internal auditor.

USAID will fund the establishment of a revolving loan fund that will be held in trust by the contractor until the end of the contract at which time USAID will make a determination whether to grant the fund in part or in whole the institutions implementing this activity. The contractor will propose to USAID a sub-agreement concerning the trust and the management of these funds.

F. Finance & Management Information Systems - Microlending

The implementor will demonstrate to USAID a Management Information System that is fully operational. This is a precondition that must be met in order to obtain an award. Implementor will install and use appropriate accounting software that is used elsewhere. This software should follow international accounting standards and allow for standardized balance sheet and income statement generation. The use of this software will give management a solid basis from which to control all loan disbursements, installments, income, investments, and other financial activities. It will also provide all the required financial data for tax reporting. In conjunction with the accounting software, management will install a loan tracking system. The loan tracking system will house two types of information. The first is general information about a client's address, business type, gender, ethnic group, and number of employees. This information is input into the system once a loan has been approved. The system also maintains financial information on each client including a current and historical income statement (from which business growth and profits can easily be tracked), current and historical balance sheets (from which changes in equity can be monitored), and all disbursement and repayment information. The loan tracking system is a flexible tool and will provide management with any type of client and financial data requested. This includes critical data on loan officer productivity – in terms of numbers of loans disbursed, new clients, and active portfolio. The system can also generate delinquency information by individual client, loan officer, loan size, loan term, business type, or group. These reports can be made on a daily basis to assist managers in effectively monitoring client and staff activities. The loan tracking system is also designed to provide a counter-check to the accounting system to ensure against internal fraud or potential bribery. The two systems will be kept up-to-date every day and reconciled at the close of business. It will be through this type of risk management strategies from which deliberate as well as unintentional mistakes will be identified.

G. Implementation Plan and Lending Targets – Microlending

The first three months of operation will focus on identifying office space, hiring staff, equipping the office, and registering the organization. It will also be during this time that the implementor will closely cooperate with local government, national banks, advice from other donors to secure registrations and appropriate waivers that will facilitate lending activities. This will include the ability to disburse loans in cash, keep large volumes of cash on-hand, set interest rates higher than the inter-bank lending rate, offer non-collateralized loans, and house client emergency saving funds.

Once the key administrative staff and systems are in place, the objective will be to hire and train loan officers to immediately begin lending. Staff will need to be trained in micro finance technologies, modern management practices, and goal setting. Loan Officers will be the focus of this training as they are the heart of the program and are the critical point of contact with clients. The following steps will be taken to screen, identify, and train new loan officers:

1. Training to loan officer candidates who have passed through an interview process. This training introduces loan officers to the group lending methodology and a participatory decision-making atmosphere. At the end of an initial training, the best candidates are selected for a more intensive training phase.

2. An exam is given to finalists and if they pass, a reference check is made on each candidate.
3. Immediately following the first training, a Business Assessment course is held to teach loan officers how to communicate with clients and learn the basics of business assessment.
4. In addition practical hands-on training is given to each loan officer to introduce them to forms, filing systems, and the requirements of using a computer.
5. A course is to be devoted to completing a thorough market survey of the region. During this period, the region will be delineated into territories so that loan officers adequately cover the city while not competing with each other. These boundaries will be used for the life of the program.
6. An intensive Financial Analysis course is given to introduce the concepts of income statements, balance sheets, and how to make a quick but thorough financial assessment of micro businesses.
7. A course is provided to review in detail the steps of group formation. Further, loan officer candidates practice among themselves conducting information meetings, etc.
8. Finalists are selected among the candidates and are allowed to begin marketing the program and forming groups. This is always done with close supervision from a senior staff member for a substantial initial period.

Once loan officers are trained, the group formation process will begin. A simple flyer will be developed as an informational tool. All marketing, however, will be done on an individual basis through word of mouth. This type of interaction is important in order to build trust and answer questions from potential clients. The first disbursements will take place in the beginning of the second quarter. During the first months of lending, a trainer or branch manager will always be present. The staff will continue to provide hands-on training and guidance as loan officers begin to work with clients and learn the business of micro crediting. The first year will focus on developing a client friendly reputation. The offices will primarily serve residents as well as the surrounding areas. To reach more isolated rural communities, the second year will be devoted to establishing sub-offices to meet growing loan demand and to increase the project's outreach to new locations.

H. Technical Training - Microlending

Over the life of the project, the following training will be conducted:

- *Micro Finance Methodologies Course* – This is a course designed to introduce staff to different micro finance methodologies (group lending, village banking, individual lending), poverty lending technologies, examples of successful world-wide programs, and best practice benchmarks regarding productivity, efficiency, and transparency. This course also introduces the concepts of operational and financial self-sufficiency and how to calculate interest rates (based on C-GAP methods).

- *Delinquency Management Training* - This course is designed to present loan officers and managers with the tools to understand delinquency management and the importance of addressing these issues *before* late repayments occur. This seminar provides hands-on, practical guidance about how to integrate best-practice delinquency management systems into every day work.

I. Incentive Systems - Microlending

Typically, USAID implements an incentive system for its loan officers that provide an incentive for productivity as well as quality performance. Based on this system, the program will develop its own incentive system for loan officers based on the following indicators:

Number of active loans
- Active portfolio
- Number of loans disbursed in a period
- Portfolio at Risk (in number and volume)

All staff will be evaluated each year and provided a performance-based raise. This raise will be based on achieving individual goals, properly implementing their responsibilities, and performing beyond their job description. Once the program is well established, a group-based bonus package may be devised for branches based on annual indicators set by the headquarters.

J. Lending Targets

The program will have an aggressive strategy to serve the maximum number of clients throughout the region in four years. The successful implementation of this strategy will result in reaching 4,500 clients by the end of year four through a loan portfolio of over $1 million. The majority of these clients will be rural, female heads of households. Efficiency and gender indicators will be monitored hand-in-hand with lending targets to balance growth, effectiveness, and profitability.

K. Building Sustainability - Microlending

The vision of sustainability will be built on the principles of sustainability that incorporates both financial and institutional benchmarks and will take the following measures over the life of the project:

a) Focus on empowering local staff to independently manage the activity.
b) Use trend analysis to monitor key growth, profitability, efficiency, and portfolio activity.
c) Install a computerized accounting system that meets international accounting standards.
d) Hold annual, staff-wide strategic planning meeting to set goals and discuss plans for the following year.
e) Develop a risk management system that includes hiring an internal auditor.
f) Develop the internal capacity to conduct all staff training.
g) Hold regular management meetings to assess quarterly performance and evaluate management's position on its strategic indicators.
h) Conduct regular marketing assessments to determine the need for new products and/or services.
i) Use MICROFIN as a planning tool to assist in making long-term strategic decisions.
j) Obtain donor-donated resources to purchase fixed assets – such as a small office building – to strengthen the equity position. In the long-term, this will provide management with

an equity base to borrow funds and continue its expansion beyond donor funding. This will be accomplished using funds obtained outside of the project.

k) Integrate a policy of team decision-making and internal promotions as a means to retain qualified and committed staff.
l) Constantly develop new tools to provide management with the most up-to-date client information.

In addition to the above-mentioned issues that will be integrated into the day-to-day management, there will be special attention given to client retention. It is commonly recognized that delinquency is a threat to the sustainability of micro finance institutions, however, client desertion's impact is less well understood. When a good client leaves, they take with them future revenues and future client references. It is therefore imperative to understand why they are leaving: were they unhappy with the staff; was the loan amount inappropriate; was the interest rate too high; are they leaving for another program. To understand these problems, the project will conduct an exit interviews with all leaving clients. By consistently monitoring these issues, management will be able to make changes, retrain staff, or make other management interventions to address client concerns. The result of this effort will be higher client retention, quality portfolio growth and increased opportunities for sustainability.

Ultimately, the project must be operationally and financially sustainable. Based upon experience, USAID would expect the program to be operationally sustainable in year 2 of the project. The implementor will continue to monitor program results using several mechanisms: 1) MICROFIN to continue to track results against our projections; 2) the loan monitoring system to provide daily balances of loan portfolio and financial performance; 3) monthly reporting on the performance of our credit projects; and 4) continued monitoring of the microfinance market in the region.

L. Other Sources of Finance

To ensure outreach across the region, management must garner additional resources for lending capital. If additional sources of funding are located, this will facilitate even greater growth in the loan portfolio. To address the lending capital needs of the project, the implementor will undertake various initiatives:

The primary element in attracting additional funds is to establish a local organization that is operating legally in Iraq, which establishes strong local management and an impressive lending history. Once these are established, USAID has found that additional funds can be identified and secured.

M. Activity Monitoring – SME Lending

Project Monitoring will be conducted at three levels. First, using the loan monitoring system, the financial performance will be available on a daily basis. Using MICROFIN, the project team will monitor program activities against the lending targets. Finally, the implementor will collect performance information. These data help to compare the relative performance of each activity against our other projects in other countries. The project team will conduct a monitoring review on a quarterly basis to assess the funds' performance and any issues that may be affecting that performance, as well as appropriate actions to resolve any problems. Monitoring reports will be included in each semi-annual report provided to USAID.