

Finca Perù– Perù

Social Rating with Survey

A

Finca Peru was constituted as civil association in 1993 with the aim of improving the socio-economic condition of the low income population of Peru, women in particular. The strong commitment to the original mission has been preserved over the years also thanks to the charismatic role of the members of the founding family.

Operations are carried out in regions of Ayacucho, Lima and Huancavelica, with an increasing penetration in rural areas, presenting a more severe poverty profile.

Pioneer of village banking in Peru, the MFI has been maintaining a strong focus on the promotion of saving and on training as means to improve the living conditions and to empower the target clients.

Besides village banking, backbone of the operations, solidarity group loans and individual loans were introduced to increase the flexibility of the credit supply.

Legal Form	NGO
Year of inception	1993
Area of intervention	Urban, semi-urban and rural
Credit methodology	Village banking
Financial service	Credit
Non-financial service	Training, saving promotion

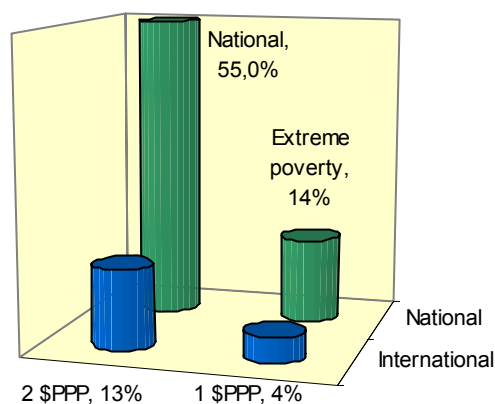
Social indicators	mar-07
Female staff	68%
Staff turn-over ratio	22%
Real portfolio yield*	67%
Rural area, (no. clients)	17%
Financed business in informal sector	86%
Female clients	92%
Female clients head of household	27%
Clients without primary education completed	18%
Members of HHs	4,8
Members contributing to household income	2,5
Households owning dwelling	69%
Clients without acc. improved water source	22%
Clients without access to improved sanitation	30%
Clients without electricity	4%
Clients without previous access to credit	64%
Households without current / savings account	83%
Households without current / debit card	88%
Average disbursed loan on GNI pc	8%
Average disbursed loan amount, US\$	265
Net client exit rate	46%
PAR30	0,7%

For more details refer to annex 2

Number	Mar-07
Active borrowers	8,494
Active village banks	369
Gross outstanding portfolio	1,323,073
Branches	3
Total staff	84



Clients below poverty lines



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AREA	Main results of the social rating	
Social performance management system	↑	Mission clear and up-dated, well reflecting the institutional social goals
		Very good dissemination of the mission among the staff and strong social commitment of the BoD
		Strategy in line with the mission, presenting formalized SMART objectives
		MIS tracking the individual accounts of each village bank member and the internal arrears of the banks' internal lending operations
		Products designed to match the target clients' characteristics
		Human resource systems aligned to the social mission
	↓	Partial translation of the social objectives into targets
		Monitoring system of the client profile and quality of the services not fully exploited
		Room for improvement in consolidation, analysis and reporting of information related to the progress towards social goals
Social responsibility (SR)	↑	Noteworthy participatory approach, resulting in good communication and team cohesion, especially at the headquarters
		Priority given to training and saving as vehicles of women empowerment and improvement of clients' lives
		Large size of saving and credit operations performed within village banks
		Good overall performance in terms of consumer protection
	↓	Improvable management of the risk of clients' overindebtedness, especially related to internal loans within village banks
		Some foreign currency risk affecting clients
Outreach	D E S C R I P T I O N	Quite limited coverage of the national territory
		Operations concentrated in poorer areas
		17% of clients in rural areas
		Quite small breadth of outreach
		Overall good depth of outreach
		92% of women clients, 18% of clients without primary education completed
		Poverty incidence higher or in line with national average: 55% of recent client HHs below national poverty line; 14% below extreme poverty line; 13% below \$2 a day; 4% below \$2 a day
		Access to basic services higher than national average: 30% of client's HHs without flushed toilets inside house; 22% without public piped water system; 4% without electricity
		Rather limited access to financial services
Quality of the services	↑	Integration of training and saving promotion to the provision of credit
		Good service delivery system, especially appreciated in rural areas
		High satisfaction with respect to training, empowerment and saving promotion
	↓	Limited variety of credit products offered
		Loan amount not always adjusted to clients' repayment capacity
		Repayment schedule partially matching clients' cash flow
		Cost of credit perceived as high by clients
		High client drop out rate, mainly related to internal default

Some of the outreach results refer to recent clients (see annex 1). ↑ positive elements of analysis ↓ negative elements of analysis

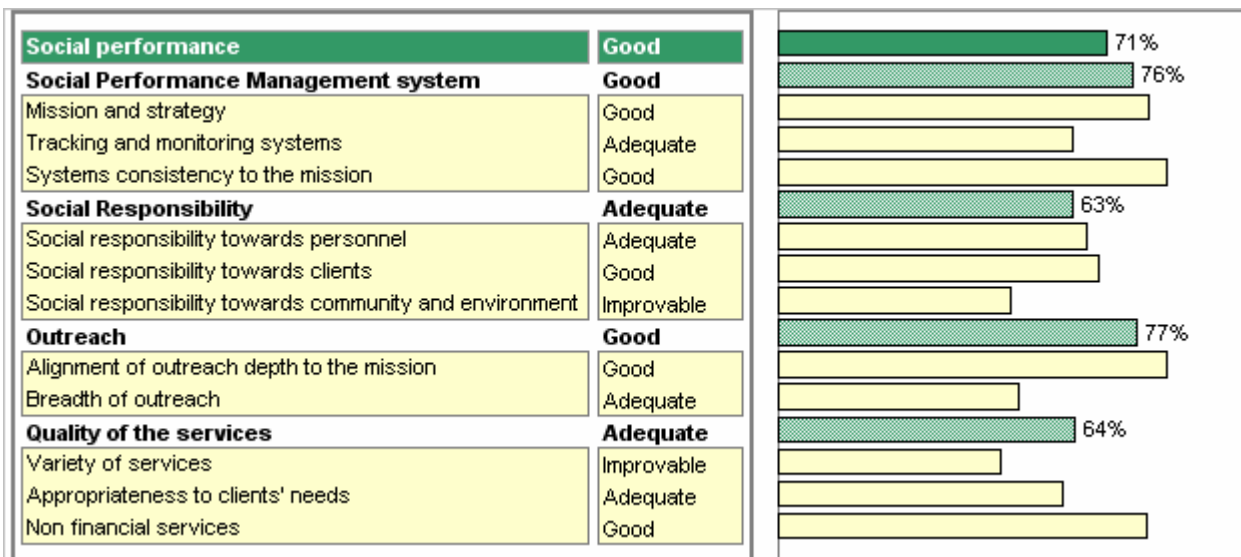
Final opinion

The sound social commitment of the BoD and of the management team, coupled with the good strategy in place and the alignment of the village banking methodology to the mission, constitute the main pillars of the good social performance management system. The tracking system allows monitoring the individual position of each village bank member; however, its potential for monitoring the social profile of clients is not fully exploited.

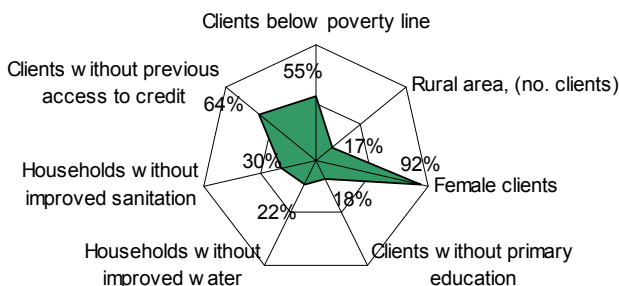
The social responsibility towards the personnel is adequate and translates in a good and participatory labor climate, while the interest for community and environment are not currently translated in specific actions. On the other hand, the remarkable social value of education and saving promotion in village banks and the good transparency of operations demonstrate a good degree of social responsibility towards clients, even if a risk of over-indebtedness is present.

Due to the moderate number of clients and to the geographical concentration of operations, the outreach breadth of Finca results intermediate. On the other hand, the depth of outreach is good, resulting from the presence in areas with sever socio-economic conditions and a poverty incidence among clients higher than the national average.

The quality of the services is affected by the limited variety of services, while the general conditions of the products offered result in line with the clients needs, especially as far as customer service and delivery system are concerned. The quality of the non-financial services offered is good, being the fostering of savings, provision of training and the added value of empowerment and promotion of values highly appreciated by clients.



OUTREACH DESCRIPTION



Outreach	Depth	Breadth
	Poverty index	No. of clients
FINCA Peru	55%	8.494
Benchmark*	45%	10.661
	medium-high	medium-small

*Depth: national poverty index. Breadth: median no borrowers of MFIs in LAC (MIX 2006)

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1. Institutional presentation

Institutional profile

FINCA Peru was constituted as civil association in 1993 under the initiative of the Lanao Flores family with the aim of improving the socio-economic condition of the low income population of Peru, women in particular. **Pioneer of village banking** in Peru during the 90s, Finca Perú has maintained the same core lending methodology along the years. The village banking model has been adapted to the urban and rural context.

Operations are coordinated from the headquarters in Lima and carried out through a network of branches located in Ayacucho (Huamanga), Lima and Huancavelica; while in Ayacucho and Huancavelica village bank meetings take place in Finca Perú premises and financial transaction are handled in cash, in Lima meetings take place in members' houses and payments are realized through bank transactions.

As of March 2007 the number of active clients and the gross portfolio were equal to 8,494 and 1,323,073 respectively. Besides village banking, which concentrates the large majority of portfolio, solidarity group loans and individual loans were introduced to increase the flexibility of the credit supply.

The idea that saving and education are necessary tools to complement credit and achieve change in the target population is deeply rooted in the institutional culture. The civil association is not allowed to collect savings from the public, but plays a promoting role of the saving mobilization within village banks. The liquidity constituted by mandatory and voluntary savings and by the intermediate payment of Finca Perú loans¹ is in turn circulated among the bank members in the form of internal loans: the interest paid on credit (2% in Lima and 3% elsewhere) is internally distributed to the savings' holders according to the relative amounts.

In the first 5 years of operation, the growth and development of the organization has been supported by the Inter-American Foundation, Rotary International, ADEX-USAID/MSP, among others. The origins of Finca Peru are closely related to Finca International: the membership lasted until 2003, when Finca Peru decided to quit, but a relation is kept through the honorary participation of a member of Finca International to the BoD of the civil association.

In the late 2006 a grant agreement was signed between Freedom from Hunger and Finca Perú to support the start-up phase of the expansion to the rural areas of Huancavelica (WARI project).

The active participation to the Gender Commission constituted within the network COPEME² is worth mentioning. Being a civil association, Finca Perú is also member of the PROMUC consortium, which associates various MFIs committed to reaching the low-income population.

Financial performance outlook

The financial and operating performance of Finca Perú is overall good, based on a consolidated methodology and good management. The future evolution may be challenged by the increasing funding

expenses, and by some rigidity of the cost structure which may impede the reduction of prices face to the increasing competition. The provision of saving promotion, education and the burden management of the internal account are reflected in the high operating expense ratio (64%); however, the portfolio yield (69%) is currently high enough to counterbalance this effect, resulting in positive levels of profitability (ROE equal to 5.7%). The endogenous competition generated by the internal lending activities of village banks, essential to accomplish the social aims of Finca Perú, has been somehow limited the portfolio growth in the last years (5% in 2005, 24% in 2006 and 18% in the period April 2006 –March 2007).

Finca Peru	Dec-05	Dec-06	Mar-07
Outstanding portfolio, US\$	1,075,299	1,431,864	1,323,073
Active borrowers	7,221	8,000	8,494
Active village banks	301	345	369
Branches	3	3	3
Staff	63	77	84

Financial Indicators	Dec-05	Dec-06	Mar-07
PAR 30	0.5%	0.6%	0.7%
Write-off ratio	0.8%	0.0%	0.0%
Restructured loans	0.0%	0.0%	0.0%
Risk coverage ratio ^a	298%	250%	287%
Portfolio yield ^a	71.7%	71.0%	69.0%
ROE ^a	10.7%	10.0%	5.7%
ROA ^a	10.1%	9.2%	5.0%
Staff productivity (borrow.)	115	104	101
L0 productivity (borrow.)	328	242	230
L0 productivity (portfolio, US\$)	48,877	43,390	35,759
Operating expense ratio ^a	61.2%	60.6%	64.2%
Funding expense ratio ^a	0.6%	0.8%	2.5%
Provision expense ratio ^a	0.1%	0.4%	0.2%
Debt/Equity ratio ^a	0.1	0.1	0.2

^aPlanet Rating, data as of April 2007.

¹ Finca Perú loans installments are due monthly, while the village bank schedule of Finca Perú loan repayment requires borrowers to make weekly payments.

² Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Micro y Pequeña Empresa.

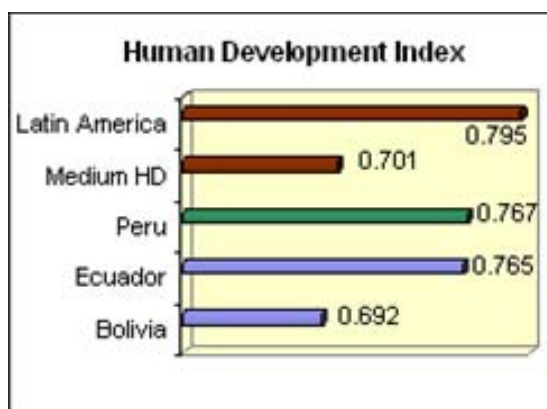
2. Context

Socio-economic context

After a long period of **economic crisis** and almost two decades of **internal political violence**, Peru is currently experiencing a process of democratic consolidation.

With a human development (HD) index worth **0.767**, Peru is considered among the medium HD countries, higher than Bolivia and comparable to Ecuador.

Compared to the income peer group (lower-middle income, with 0.768 HDI) Peru presents a similar HDI, while it shows a worse performance than the one of the Latin America and Caribbean region (HDI worth 0.795), mainly due to the poorer GDP index.



Human development (HD)	Peru	Latin America & Caribbean	Medium HD
Population (millions)	28	551	4.423
GNI per capita (PPP\$)	6.070	8.782	4901*
GNI per capita (US\$)	2.650	3.576	1494*
HDI	0,77	0,80	0,70
life expectancy index	0,76	0,80	0,71
education index	0,87	0,87	0,74
GDP index	0,68	0,74	0,65

WB estimation 2006, Human Development Report 2007/2008 (data for 2005). *GDP per capita

Peru still faces **high levels of poverty and inequality** (Gini index equal to 0.43 in 2004). In 2006, almost half of the population lived below the national **poverty line**, and **16%** were **extremely poor** (see annex 1 for details on poverty lines). Notwithstanding the sustained economic growth registered in the last years, the **progress** in reducing poverty has been **slow**, due to growth through capital-intensive natural resource extraction industries alongside historical economic volatility.

The huge **economic inequality** is evident in the regional distribution of poverty: the wide difference between **rural** (69%) and **urban** (31%) areas is reflected in the higher poverty incidence registered in the **Highlands** and **Amazon region** (63% and 57%, respectively), while **Lima** and the **coast** present a significantly better picture (24% and 29%).

Poverty incidence	Urban	Rural	Peru
National poverty	31%	69%	45%
National extreme poverty	5%	37%	16%
Poverty headcount ratio at \$1/day (PPP)			11%
Poverty headcount ratio at \$2/day (PPP)			nr

Instituto Nacional de Estadística e Informática (INEI) 2006 and WB 2005

Access to public services such as **health care**, **education**, and **social protection** is low among the poor, indigenous groups, and in **rural** areas.

According to a study of UNDP (Achieving Millennium Development Goals in Peru), it is **unlikely** that Peru will **achieve** some of the Millennium Development Goals (MDG), especially the ones which are **poverty related**, unless income redistribution measures and specific social policies are put in place.

In particular, the 2015 target in terms of national poverty incidence is 27.3%, almost half of the current

MILLENNIUM DEVELOPMENT GOALS		Latin America & Caribbean	Lower middle Income	Peru	2015 target Peru'
Extreme poverty and hunger	Malnutrition prevalence, weight for age (children < 5)	43%*	12%	7%*	5.4%
	Poverty headcount ratio at \$1 a day (PPP)	na	na	11%	na
	Undernourishment prevalence (% of population)	24%	11%	12%	na
Universal primary education	Literacy rate, youth total (% of people ages 15-24)	74%	96%	97%	100%
	School enrollment, primary (% net)	78%	93%	97%	100%
Gender equality	Ratio of girls to boys in primary and secondary education	87%	99%	103%	100%
	Ratio of young literate females to males (% ages 15-24)	83%	98%	98%	100%
Child mortality	Mortality rate, under-5 (per 1,000)	114	48	27	23
Environmental sustainability	Improved water source (population with access)	75%	82%	83%	88%
	Improved sanitation facilities (population with access)	38%	57%	63%	78%

World Bank, Millennium Development Goals (MDG). 'Achieving MDG, 2004, UNDP Perú. Data referred to 2005. *2000

incidence (45%). The UNDP study shows that, even in the best scenario, the **undernourishment** reduction target will not be achieved in 2015. However, the overall comparative picture shows **better indicators** for **Peru** than for the **Latin America** and **Caribbean** region, particularly in child mortality, and a substantial **alignment** with the situation of **lower-middle income** countries.

The **labor market** is characterized by **high unemployment** (19% (2004)- and **high informality**. It is estimated that one of every two active Peruvians works in the informal sector: the low levels of formal employment can be attributed to burdensome business registration and tax procedures.

Microfinance sector

With a large demand, a **favorable regulatory framework** and a dynamic and **diversified supply**, the microfinance sector of Peru is one of the most developed of the region.

The supply side is composed of a variety of actors, including non-regulated and regulated MFIs. Regulated MFIs operate under the “General Law of the Financial System” and are supervised by the Superintendence of Banking and Insurance companies (SBS).

The consolidated **microfinance portfolio**, including the banking system, can be estimated over **US\$ 3 billions** at the end of 2006³.

The **banking sector** plays a large role in the industry: the interest shown initially by **MiBanco** and **Banco del Trabajo** has been increasing during recent years. As of December 2006 the total micro-enterprise portfolio of banks was worth US\$ 836 M (29% of the microfinance sector portfolio).

Beside the specialized banks, as of December 2006 the **regulated sector** is composed of:

- 4 “Empresas financieras” -Financieras-
- 13 “Cajas municipales de ahorro y crédito” –CMACs-;
- 12 “Cajas rurales de ahorro y crédito” –CRACs-;
- 13 “Entidades para el desarrollo de la pequeña y micro empresa” -Edpymes-;
- 164 credit and saving cooperatives⁴ –CACs-.

Among the **regulated non-banking MFIs**, the largest market shares are held by the **CMACs** (33%), **Financieras** (15%) and by the **CACs** (13%), while the Edpymes- and the CRACs account for smaller shares of the consolidated portfolio (7% and 6%, respectively).

The **non-regulated MFIs** are **NGOs** that have been focusing on the lower end market segment of clients, accounting for only 1% of the microfinance portfolio as of December 2006.

NGOs are not subject to the regulation and supervision of the SBS; however, some of them, including Finca Perú, take part to the self-regulation and audit initiative promoted by COPEME. It is worth mentioning that NGOs are required by the Peruvian law to charge clients with a value added tax worth 19%, additional to the interest and fees received by the MFIs.

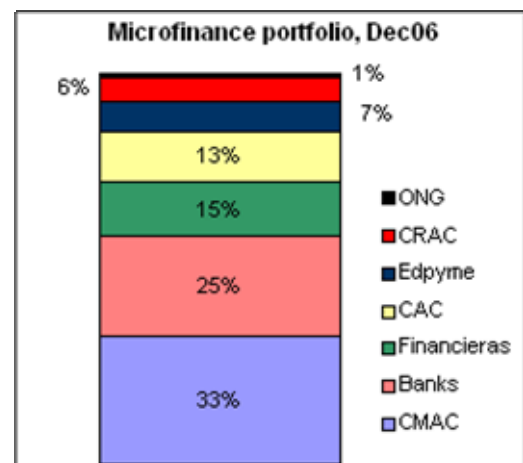
Overall, the **target clientele** of banks is limited to the urban upper segment, while NGOs have been focusing on the lower end market. CMACs and Edpymes have an intermediate target, mainly urban with guarantee.

The Peruvian microfinance sector is characterized by a large difference in microfinance penetration between urban and rural areas. On the **urban side** the **growing competition**, especially aggressive from the banking system, is driving down interest rates and exposing the sector to the **risk of over-indebtedness**. On the contrary, in **rural** areas, due to higher transaction costs, higher risk and state subsidy tradition affecting the repayment culture, the presence of regulated MFIs is very limited and the microfinance demand remains **widely unattended**.

As of now, the **state-owned Banco de la Nación** and **Agrobanco** have played a positive role allocating microfinance fund to MFIs, as apex institutions. However, should the latter provide direct subsidized loans to the rural sector, the unfair competition may be accompanied by a deterioration of the repayment culture.

The well developed **local network Copeme** is supporting microfinance institutions, both regulated and non-regulated, with technical assistance, training and lobbying activities.

Four **Credit Bureaus** are currently available in the sector, even if information is not perfectly up-dated: the Superintendence of Banking and Insurance companies (SBS) database and three private ones -Informa, Certicom and Infocorp.



³ Sources for microfinance sector portfolio analysis: SBS, Microfinance Report December 2006 (COPEME).

⁴ They are supervised by the Superintendence of Banking and Insurance companies or by the National Cooperative Federation of Peru but they have no authorization to mobilize public resources.

3. Social Performance Management system

Mission and Strategy

MISSION STATEMENT:

“Contribute to the self esteem of women living in a condition of economic and social disadvantage in Peru, helping the integrated development of their human capabilities. We promote their entrepreneurial spirit, the strengthening of their social discipline and the daily practice of the values of equity, solidarity, respect, responsibility and honesty.

To fulfil the mission through the village banking program, Finca Peru: strenathens human values. provides credit with education and teaches to save.”

The current mission statement of Finca Perú is included in the official yearly reports starting from 2004, while the one presented in the business plan covering the period 2003-2007 is an older version. Even if the current mission is quite up-dated and reflects well the institutional aims, the new business plan, which is under construction, will be taken as an opportunity to rethink the formulation.

The target population is well identified, with an explicit focus on **disadvantaged women** and a strong emphasis on the fact that poverty is a condition which can be

SOCIAL VALUES:
Equity
Solidarity
Respect
Responsibility
Honesty

Social Goals (SG)	Key words in mission statement
SG1: Reaching target clients	<ul style="list-style-type: none"> women living in a condition of economic and social disadvantage
SG2: Meeting clients needs	<ul style="list-style-type: none"> strengthens human values, provides credit with education and teaches to save
SG3: Creating changes	<ul style="list-style-type: none"> contribute to self-esteem; helping integrated development of human capabilities promote their entrepreneurial spirit, the strengthening of their social discipline and the daily practice of values

changed, and not an ineluctable characteristic of people. The manner how Finca Perú is meant to meet clients’ needs may be better organized in the strategic declaration: providing **credit with education and teaching to save** is cited in an additional statement and could be included in the core mission. The intended changes in women’s life are defined in terms of

self-esteem and valuation, **development of human capabilities** and practice of the **values** of equity, solidarity, respect, responsibility and honesty.

Also due to the very good systems (see systems consistency section) for disseminating the social mission within the organization, **staff adherence to social mission** appears to be **very strong**. The charismatic figure of the CEO, Mrs Iris Lanao Flores, representing the founding family approach, keeps the management team motivated and committed to the social added value of Finca Perú operations.

It is also worth to notice that the mission declaration and the values promoted by Finca Perú are systematically mentioned in official documents, a part of which is circulated among staff and clients. Yet, the frequent staff meetings at branch level are taken as opportunities to refresh the mission and to reinforce its central role in daily operations.

Being a non-profit association, Finca Peru has no owner. Each two years the highest governance body of the civil association – General Assembly - elects the **Board of Directors**. The BoD meets frequently and is supportive for management in decision taking; however, up to date **it does not rely** on a complete set of **tools to monitor the progress in achieving the mission**.

Nonetheless, the **BoD is strongly committed** to Finca Perú **social goals**: financial self-sufficiency is not disregarded, but it is intended as a mean to give continuity to the achievement of the mission, and not as a goal in itself. The historical membership of the current Directors and the guidance role covered by the president⁵ are likely to allow **maintaining the founders’ social orientation** also after the foreseen enlargement of the governing body, which is meant to increase the alignment to the governance best practices.

Considering both internal and external factors, the **risk of mission drift** is **low**. In 1998, when the legal framework of the EDPYME was established, Finca Peru considered transforming into a regulated financial institution, which would have brought the additional advantage of being externally recognized as an organization subject to the regulation and supervision of the SBS. However, together with other issues, the

⁵ Mr Mario Aquiles Lanao Flores, cofounder of Finca International and father of the CEO.

concern related to the **shift of priority from social to financial goals** ultimately led to the decision of **keeping the non-for profit legal form** and to adhere to the self-regulation scheme set by COPEME (see context).

The business plan for the period 2003-2007 presents a **formalized translation of the strategy into SMART**⁶ objectives (presented in the box). Overall, the **strategy** in place to achieve Finca Perú's social goals is **good**, even if there is room for improvement at the level of translation of social objective in measurable and quantifiable targets.

1. Strengthen the institutional capacity
2. Enlarge the service coverage and quality
3. Ensure transparency minimizing risk
4. Strengthen clients' capacity

The overall **adherence to the mission** is reflected in the clear social orientation of general and specific objectives, including:

1. Impact evaluations;
2. Client exit measure and assessment, development of new financial products (life insurance);
3. Internal control system for village banks;
4. Entrepreneurial management training for clients, fair and workshops to promote clients' products and know-how sharing.

Some **objectives** are translated into precise **targets**, including: growth in clients and village banks, PAR 30 and internal village banks' arrears (respectively <5% and <3%), members ought to receive entrepreneurial management training and other trainings and calendar for fair and workshops.

However, there is some room for improvement in the formulation effectiveness of the following targets: clients in rural areas, members' savings, capacity development (ex: % of members who took part to village bank committee over a period of time), quality of the service and client retention.

The specific planning of training activities is decentralized: each loan officer is responsible to set an agenda and realize the activity during the village banks' meetings, allowing a good flexibility of the system. However, given the constant evolution of the training modules and issues of interest, a more coordinated organization at branch level could be useful to keep control over the execution of the plans and to enhance the harmonization and improvement of the training services. Indeed, the charge of training coordination has recently been created and assigned, for the Ayacucho branch, to a supervisor.

In addition to the formalized social objectives, the more general strategic guidelines of Finca Peru present a remarkable alignment to the institutional mission.

- **Recent expansion in rural area:** starting from October 2006, the strong social orientation of the BoD has led to the expansion to the rural areas of Ayacucho and Huancavelica, with a severe poverty profile. Moreover, the expansion to some communities was helped by the Wari project, supported by Freedom from Hunger (FFH). Given the very poor infrastructure, limited availability of adequate human resources and scale of some markets served, the cost of operations conducted in rural areas and in the region of Huancavelica is not fully covered by the revenues. Nonetheless, given the priority attached to reaching target clients, Finca Perú does not consider to discontinue the service in those areas. Beyond the start-up support received by FFH, Finca Perú plans to cover, if necessary, the net losses generated where the outreach is deeper through part of the net gains generated elsewhere, putting de facto in place a **cross-subsidization strategy**, which would be worth formalizing to set control over the situation.
- The **targeting strategy** in place is mainly geographical: even if general guidelines are established in the credit manual⁷, new clients are not strictly selected on the basis of individual characteristics. Targeting consists in providing the service in specific areas of the country, where the concentration of target clientele is high: semi-urban areas of Lima, urban and rural areas in the Ayacucho and Huancavelica regions. More generally, the criterion applied to the expansion to new areas is twofold: poor socio-economic conditions -high poverty incidence, limited access to basic and financial services- and minimum feasibility standards – political stability and size of economic activity-. The presence of these conditions is checked through preliminary market studies.
- The **strategy to achieve change** in clients' lives and to empower women associates the promotion of saving and training to credit. Indeed, the instrumental role of financial performance to reach social goals is reflected in the promotion of village banks' savings, which rotate generating an alternative source of credit for members. Members' savings generate high operating costs and represent a strong competition for Finca Perú (lower interest rate); however they are strongly promoted because of their potential for improving clients' lives. Similarly, training is a fundamental pillar of the institutional philosophy, being the space for learning and interacting critical for empowerment, and having

⁶ SMART stands for: specific, measurable, achievable, realistic, time-bound.

⁷ Women with limited resources, children depending on her income, with a small business, entrepreneurial spirit but no access to alternative source of credit.

translated so far in a high frequency of meetings. However, to preserve financial performance and improve productivity, the frequency will gradually be diminished from weekly to biweekly, and the average number of members per village bank will be increased.

Given these general guidelines, Finca Perú **growth strategy** has been **moderate**: the external and internal competition, as well as the model and areas of operation, limit the potential for breath of outreach. Beside the creation of new village banks, the growth of portfolio is planned to derive from a slight increase in the average loan size of older members (from US\$ 200 to 250).

MIS, tracking and monitoring systems

Also considering the high complexity of providing adequate information base for the village banking methodology, the system that Finca Perú has in place to track and monitor social performance is overall quite good. The major strength of the locally developed system “Cautivo” is the capability to track the individual accounts of each village bank member and the internal arrears of the banks’ internal lending operations. However, the consolidation of some of the information needs manual processing.

SG1 Finca Peru collects socio-economic data of clients like age, civil status, gender, number of children, education, location and business (sector and registration). This potential is not fully exploited since data are not processed and analyzed. The system tracks the rural/urban location of clients; however, this relevant factor for target characterization does not currently rely on a rigorous definition, being the result of considerations about the density of population, access to basic services, infrastructure and distance from towns. Moreover, clients are classified according to the characteristic of the place where village bank’s meetings take place and not according to the place where clients live, leaving room for the underestimation of rural members.

The information system does not currently rely on specific poverty measures to monitor the stratification of clients according to the degree of socio-economic disadvantage of their condition. However, as it was programmed in the business plan, a study on the poverty profile of clients, the satisfaction the services and their impact was conducted by Finca International in 2006.

SG2 The monthly management reports produced at branch level present the number of **drop-out clients**⁸, of new members and re-entering clients. The **main reasons** of drop out are also described, even if the “default” reason, which is prevailing, is not further investigated. Desertion monitoring is one of the priorities of Finca Perú, but also due to the difficulties in building an adequate measure of drop-out, the branches’ data is not consolidated yet in a synthetic indicator of desertion. Branches’ report also include a description of the **training** activities performed; given the importance attached to training and the constant evolution of the activities, a higher level of detail would help keeping control on the progress in providing these non-financial services. Similarly, the crucial role of members’ savings calls for a more consolidated analysis of their evolution over time.

The **quality management system** presents at the same time positive elements and a relevant unexpressed potential. The information collected through the valuable channel of village banks’ meetings (including at the end of each loan cycle) may find a more effective use if it was systematically consolidated in reports, shared in participatory staff meetings and analyzed at branch and general level to propose improvements in the service provided. The partial use of the information and the absence of systematic channels to answer to the raised issues may discourage clients and loan officers from providing and collecting quality information in the long run. However, the presence of a person in charge of social performance, encompassing the development of products tailored to clients’ needs, is a relevant advantage in terms of coordination and responsibility. The systematic inclusion of service quality in branch staff meetings may extend Finca Perú participatory approach to this aspect of performance.

Additionally to the already mentioned Finca International study, focus groups with clients are performed based on specific investigation needs.

SG3 Finca Perú attaches a large importance to impact monitoring: in 2006, in addition to the impact/satisfaction study conducted by Finca International, the impact of business training on clients was assessed by GRADE⁹. Moreover, is worth mentioning that last year Finca Perú, together with other members of the village banking roundtable (ADRA, Manuela Ramos, PRISMA y Promujer), participated to a study conducted by GRADE on the total level of indebtedness of clients (including loans from other organizations) using the INFOCORP database. The active participation in the

⁸ Equal to the number of clients who finish one cycle and do not renovate their membership in the following one.

⁹ Grupo de Análisis para el Desarrollo.

gender commission of COPEME and several other gender initiative at regional level (see chapter about social responsibility), witness the large interest of Finca Peru to monitor impact with a gender perspective. However, nothing has been done so far in terms of putting in place a specific monitoring system.

System's consistency

- The design of Finca Perú **products** -village banking and, to a lesser extent, group and individual methodology- is specifically aimed at **facilitating the access to credit to the primary target**, represented by the lower income layer of female population. Indeed, the solidarity scheme of guarantee, the small minimum loan size, the meeting attendance required and the education philosophy is suitable to attract the target clientele. At the same time, the **village banking methodology** results in a target upward pressure proceeding from the evolution of village banks, which try to attract better off new members. Finca Perú is aware of this phenomenon, which is partly compensated by the selection of new clients with the desired characteristics to form new village banks. The service delivery model, partly consisting in loan officers moving to the communities for meeting, can be considered as a strategic measure to reach a certain segment of the target, particularly in rural area, whose access would otherwise be much more difficult.
- Finca Perú commitment to integrate a social performance management system into the operations is reflected in the fact that **one person** at the headquarters is **in charge of social performance**. This position was created to establish the procedures and conduct activities like focus groups and survey on clients, revision and dissemination of the mission, training on social performance. Moreover, one of the supervisors in Ayacucho has recently been assigned the task of **coordinating training activities**, even if the relative job description is still under development. The current **bonus system** is focused on productivity, efficiency and quality of portfolio. The presence of **internal arrears** as a parameter and the more severe penalization of low portfolio quality introduced in the new scheme demonstrate a good responsibility towards clients. Staff appraisal includes a detailed section about the compliance to Finca Perú values. The methods for **mission dissemination** are very good:
 - Training sessions are introduced and oriented towards the mission, and in 2004-2005 specific workshops were dedicated to understanding the mission.
 - The recruitment strategy in Finca Perú generally consists in selecting new loan officers among the clients, also based on the degree of identification of the personal mission to the institutional one. This, coupled with the “teaching culture” which crosses the organization at various levels, starting from village banking meeting, results in a good dissemination of the mission and social values among loan officers. Inception is also adequate, focused on the mission, institutional history, culture and values.

4. Social Responsibility

Social responsibility towards personnel

As of March 2007 Finca Perú staff is composed of 84 members. The gender orientation of the target and the recruitment policy (field staff is chosen among the best clients) are reflected in the over-representation of female staff members, 68% as of March 2007. Female managers are also relatively more (60%) than the male ones.

Staff turn-over has been quite large in the last years, following an up-ward trend and reaching **22%** in the period April06 – March07. However, it is worth considering that the fraud case detected in Huanta in the second half of 2006 resulted in the firing of the staff involved, explaining the turn-over registered in management and the higher rates in the last two periods. In general, staff turn-over is concentrated in the category of loan officers, partly reflecting the difficulty in hiring adequate human resources (especially in the region of Huancavelica) and in finding

strong enough social commitment. The relatively higher turn-over of female staff is due to the concentration of female staff in the position of loan officers and to resignations based on family reasons.

In **2005** an important effort was done in **assessing the labor climate**, reviewing the organizational chart, job descriptions and training needs thanks to the support of an external consultant, resulting in an adequate level of formalization of procedures. However, the personnel satisfaction **monitoring is not performed systematically** and in the medium term the size of operations and geographical extension may call for a dedicated position of human resource manager.

In general, the social responsibility demonstrated by Finca Perú towards its staff is **good**: good participatory working environment and social value, improvable training opportunities; starting from 2005, a set of tools was introduced with a focus on human talent and participatory methods. However, the generally higher level of human resource management at the headquarters is quite marked, mainly due to the improvable performance of branch managers in this respect.

- **Remuneration and contractual conditions:** the salary level offered in Finca Perú is not high in absolute terms; however, it is important to consider the limited academic degree of the field staff, chosen among the best clients and whose capabilities are internally developed. The personnel is in the payroll and receives the benefits established by the law, among which paid vacation, social security and year-end bonus. The bonus system was simplified to make it comprehensible by the staff and increase its transparency; not only the personnel directly involved in financial operations participates to the system, but also the administrative staff.
- **Additional benefits:** the main non-monetary benefit is the high social value attached to working in Finca Perú. The constant stress put on the mission results in a good cohesion of the staff and ultimately in a strengthened motivation of the employees. In this respect it is worth mentioning the “Loan officers’ Decalogue”, which contains a formalized list of the main principles that should guide LO’s conduct. Moreover, internal loans are available.
- **Staff participation, training and development:** one of the main strengths of Finca Perú’s working environment is the participatory approach, resulting in good communication and team cohesion, especially at the headquarters.
Training is an institutional focus and the information/capabilities acquired by participants are supposed to be disseminated among other staff members who may benefit from it; however, the number of direct training opportunities is still quite limited for the majority of staff. Also thanks to the top management focus on human development, the management team at the headquarters has been developing a noteworthy coaching attitude, which is likely to be crucial for the internal development of branch managers. The periodic “leaders’ meetings”, which include the management of the headquarters and branches, as well as LO supervisors, reflect the effort done in the direction of communication, team working, motivation and development of leadership skills.
- **Staff performance management:** the staff performance appraisal conducted at the end of the year is adequate, including an evaluation session comprising values and competences, and a development plan based on the identified areas of improvement. It is worth mentioning that the assessment comes from the direct supervisor, from peers and from collaborators/clients.

Staff	Dec-05	Dec-06	Mar-07
Total staff	63	77	84
% Women	70%	70%	68%
% Women in management	100%	60%	60%
Staff turn-over*	14%	19%	22%
male	5%	14%	17%
female	18%	20%	24%
management	0%	22%	22%
loan officers	27%	22%	31%
administrative	7%	18%	17%
general services	10%	10%	10%

*In 2005 it is calculated over the no. of staff as of Dec05

Social responsibility towards clients

The studies conducted in 2006 by Finca International and by GRADE/IPA on the poverty profile and satisfaction of clients and on the impact of business training respectively include some interesting results about the changes occurred in clients' lives:

- The saving balance per member and, subsequently, its remuneration, is higher among old clients than among new ones, with the larger difference registered in Ayacucho
- While old clients in Ayacucho seem to have a larger net income than the new ones, the opposite happens in Lima, possibly due, among other factors, to larger loan sizes and lower percentage invested in business, resulting in a higher relative interest burden.
- The impact of business training on is a general improvement of business knowledge, practices and revenues.

The priority given to **training** and **saving** as vehicles of **women empowerment** and **improvement of clients' lives** demonstrate a socially responsible approach. Direct trainings as well as learning **how to manage a village bank** and sharing experiences among peers are meant to reinforce the **capabilities** and **self-esteem** of members. In particular, the management of the village bank's internal resources by a directing committee is aimed at stimulating the practice of democracy, discipline, leadership and responsibility.

Finca Perú is also very active in social networking, being involved in a number of initiatives and groups ultimately directed to the benefit of its clients and similar targets. The civil association participates to a Peruvian village banks' roundtable together with PROMUC members and is one of the more active promoters of the Latin American village banking Forum. Finca Perú is also member of COPEME and of its gender commission, which drafted in 2005 a set of guidelines for the implementation of gender policy in MFIs.

Proceeding from the growing supply of microcredit, the **risk of over-indebtedness** is a risk affecting the microfinance sector of Peru, mainly depending on the concentration of operations in urban areas. The GRADE study involving Finca Perú and other MFIs, shows that the clients borrowing by different MFIs represent 28% of the total, out of which 60% and 20% have respectively one and two additional active loans. Finca Perú is aware of this risk for its clients; the introduction of individual loans with larger amounts was also the result of the concern for reducing the risk beard by village banks' members.

The risk factor is exacerbated by the additional borrowing opportunities within village banks: even if control systems are in place, a trade-off seems to emerge between the autonomous management of the village banks and its empowerment effect on one side, and consumer protection on the other side. Indeed, leaving the internal loans' approval decision to the bank itself, given the fact that members' decision is based more on savings' balance and trust factors than on business cash flow, translates in high internal arrears rates, reduction of savings and possibly, client exit. The internal arrear rate as of December 2006 was 3.2% and mainly concentrated in Lima (6.8%). However, it is important to consider that, within the village bank, only the sub-group of members who guaranteed the borrower are liable. This problem seems to affect mainly Lima and new clients; in particular, the higher incidence of the problem in Lima may be due to the larger size of loans and the lower interest rate charged on internal loans than in the other regions.

The measures taken by Finca Perú to mitigate the risk of clients' over-indebtedness are improvable:

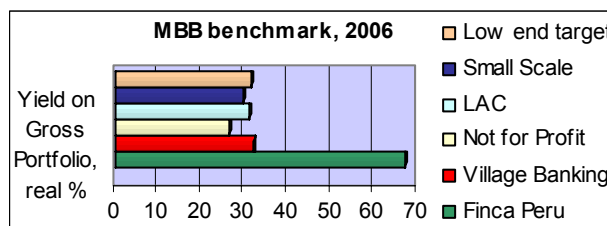
- Policies: not always prudential and not uniformly applied by the field staff¹⁰
- Loan officers: assessment of repayment capacity not always adequate (including visiting clients), especially for larger loans; criteria applicable to Finca Perú loans not replicated dealing with internal loans.
- Supervision: improvable supervisors' performance in monitoring, guidance and follow-up of loan officers' activity, as well as enforcement of rules.

Finca Perú started operations few years after the 80s, when Peru was affected by hyperinflation. For this reason, until recently, credit and saving operations were denominated in US\$. However, due to the current appreciation of the Peruvian S/. respect to the US\$, Finca Perú is in the phase of gradually converting the operations to the national currency, which is in line with the overall preference of clients. If, on one hand, the **conversion to S/. reduces the risk** for clients on the **credit side**, on the other hand, it **may introduce a risk** on the **saving side**. The currency preference of clients is further complicated by the crossed gains and losses arising respectively for borrowers and savers with transactions denominated in US\$, which in this phase is depreciating with respect to S/.. This contrast of interests, coupled by the issue of fixing the internal

¹⁰ If the client is not in arrears in INFOCOR, clients can have up to 5 obligations with other entities; despite the policy, loans are disbursed to old clients in arrears in INFOCOR according to their saving balance.

interest rate -active for savers and passive for borrowers- is intimately related to the village banking methodology¹¹.

Comparing the real portfolio yield of Finca Perú (67%, slightly lower than the nominal one -69%-) with the one of some relevant peer groups, the **cost** charged on clients seems to be **relatively high**. Moreover, clients pay a high rate of taxes on final consumption, correspondent to 19% of the interest amount. However, it is important to remember that village banking and the low target market are normally associated to higher returns, reflecting the higher costs to be covered. Indeed the returns of Finca Perú are needed to cover the **high operating expense ratio** (64% in the period May06 – April 07) related to the **offering of training and saving beside credit**, which is much appreciated by the clients. The ROA in the period May06 – April 07 is limited in absolute terms (5%), and some measures are planned to decrease the operating costs, like the reduction of village banks' meeting frequency from weekly to biweekly.



The overall performance in terms of **consumer protection** is **good**.

- **Disclosure requirements:** the verbal and written communication of credit and saving terms is good, even if only one copy of the contract is issued for the entire village bank; transactions are tracked on members' passbooks and the system in place for the internal control of village bank's liquidity is adequate. The main activities of the bank are collected in "act books" and the main transactions are generally tracked by the directing committee and shown on the posters (one per each village bank) exposed in the physical place of meetings.
- **Lender requirements and prohibition:** the "loan officer Decalogue" can be considered a formalized set of guiding principles for field staff, even if they may be further specified to provide more operational guidelines for interaction and client protection.
- **Client feedbacks:** the methodology entails a close and constant relationship between clients and loan officers, which guarantees to clients an adequate channel of communication; moreover, at each cycle end, village banks are explicitly asked to provide suggestions. Ensuring that this information flows up in the organization and that feedbacks return back to clients represents an area of improvement.
- **Consumer awareness:** education as a mean to increase members' financial awareness is an institutional priority. The rotation of the members who constitute the directing committee and the systematic training provided about the management of a village bank represent very good systems to increase the awareness of financial services' conditions. Nonetheless, maybe due to the relatively low average education of clients, the awareness about credit and saving terms is quite limited, also due to the fact that the sample of clients interviewed joint Finca Perú only recently. 29% of clients know the interest rate charged on Finca Perú loans, 39% their saving balance and 16% know the method for distributing the amount of interest paid on internal loans.

Financial awareness	Urban	Rural	Total
Interest rate	31.0%	22.2%	28.6%
Loan amount	89.5%	93.3%	90.5%
Saving amount	45.8%	13.3%	38.9%
Distribution of internal interest amount	16.9%	13.3%	16.3%

Clients entered between May06-Apr07

Finca Perú demonstrates to be a transparent institution, performing a regular audit of financial statements, global assessments and being open to participate to various types of external studies. At the same time, given the geographical dispersion of operations and the complexity inherent to the methodology applied, the internal audit function may need to be strengthened.

It is also worth mentioning that in Lima operations are going on through bank transactions, while in the other regions they entail cash handling.

Social responsibility towards community and environment

Finca Perú expresses interest for the possibility of integrating into its model a focus of social responsibility towards the larger community and the environment, even if this has not translated so far in specific actions.

As far as the impact on the community is concerned, the already mentioned study conducted in 2006 by Finca International highlights an increase in the volume of products and services bought by clients in the local market, thus contributing to the local development of economic activities.

To date, systems to track and control the environmental impact of Finca Perú and its members' activities are not in place, but the possibility to establish alliances with specialized entities may be explored in the future.

¹¹ In Ayacucho, where the proportion of loans to savings is lower, the internal interest rate was maintained on the level of 3% while in Lima, where there is a larger volume of loans to savings, the interest rate was reduced by clients to 2%.

5. Outreach

Operational areas

Finca Perú has a **quite limited coverage of the national territory**, it covers **3 out of the 25 regions of Peru**.

Activities are coordinated from the headquarters in Lima and carried out through a network of three branches and one local office located in the regions of **Lima, Ayacucho and Huancavelica**; the local office, based in Huanta reports to the branch of Ayacucho.

Most clients (55%) live in Ayacucho (province of Huamanga and Huanta), where operations have originally started.

Overall, the **socio-economic indicators** (poverty incidence and HDI) in the regions where Finca Perú operates are **much worst than the national average**, showing a **high depth of geographical outreach**:

- Finca Perú operations are concentrated in the highlands (sierra), in the **two poorest regions** of Peru: Huancavelica and Ayacucho, accounting together for 73% of active clients and 70% of portfolio;
- Huancavelica is ranking last and Ayacucho third last among the regions of the country on HDI;
- Moreover, the department of Ayacucho was one of the most severely affected by the “Sendero Luminoso” **terrorism**;
- In Lima, where development indicators are better, Finca Perú is increasingly targeting people living in marginalized zones (*cono sur* and *cono este*), where most **immigrants from the highland** are concentrated.

Regions of operation	Poverty	Extreme poverty	HDI	FINCA	
				Active clients	Outstanding portfolio
Huancavelica	89%	72%	0,46	17%	11%
Ayacucho	78%	41%	0,51	55%	59%
Lima	25%	1%	0,72	28%	30%
Zone					
Urban	31%	5%	na	83%	87%
Rural	69%	37%	na	17%	13%
Peru	45%	16%	0,70	100%	100%

Source: INEI 2006 and UNDP 2003

In October 2006, thanks to the alliance with FFH, Finca Perú boosted its **expansion in rural areas**, starting to operate in Huancavelica (It was already operating in the rural area of Ayacucho).

As of march 2007, **13% of the portfolio and 17% of clients** are concentrated in rural areas, with a significant part of the clients living in remote and isolated areas. Proportion of rural portfolio and rural clients has constantly grown in the last year and it is expected to further increase in the next future.

The strong social commitment of Finca Perú to reach target clients and poorer areas is also reflected by the fact that, despite operations in rural Huancavelica are not financially self-sustainable because of the severe poverty characteristics of this zone, Finca Perú does not consider to discontinue the service in this area.

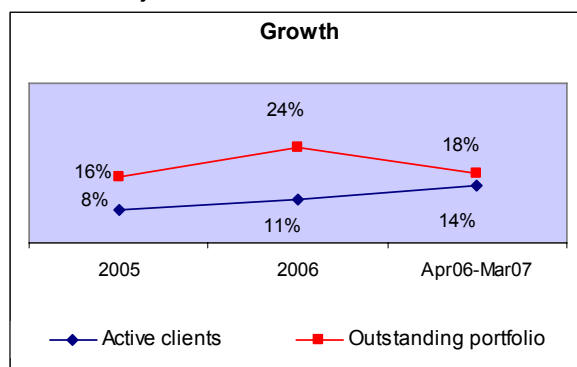
Clients reached

Among the 21 non-regulated institutions (NGOs) affiliated to the national network Copeme, Finca Perú only takes the seventh position in term of clients and loan portfolio. Indeed, with **8494 active clients** and a loan portfolio of **USD 1,323,073** as of March 2007, Finca Perú shows a rather **small breadth of outreach**.

However, it is worth to notice that thanks to the delivery model used by Finca Perú, its clients also have the possibility to **receive loans from the internal village banks savings fund (cuenta interna)**. in 2006, 45,000 internal loans were disbursed for an amount of US\$ 9.8 millions (1.8 times the size of Finca Perú’s disbursements).

As of March 2007, the savings mobilised by clients within the internal accounts amounts to **2,324,727 USD**, almost 1.8 times Finca Perú’s portfolio, with an average balance per client of US\$274.

Credit portfolio growth has been **slow** in the past years, with the exception of 2006, when the gross portfolio grew 24%, mainly due to the expansion in rural areas. Indeed, Finca Perú’s growth strategy has always been very conservative, privileging the provision of a



complete range of services (training, management of the internal account and savings promotion) with a high social impact potential (but higher costs) instead of a faster growth which would increase its profitability.

The overall **depth of outreach** is **good**, with the main socio-economic indicators showing a worse status than the average for Peruvian population, reflecting a **good alignment of results to the mission orientation to disadvantaged and vulnerable people**¹².

SOCIAL VULNERABILITY AND HOUSEHOLD PROFILE

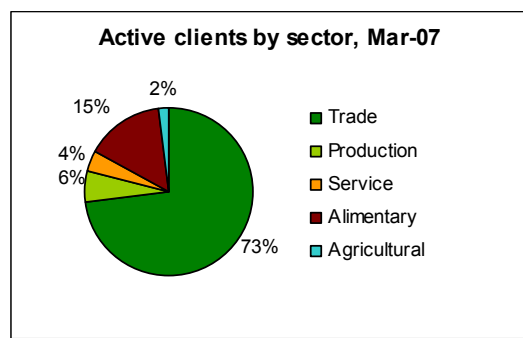
- **Women** represent almost 92% of active clients;
- With an **average age** of 41 years (37 years for recent clients), the majority of clients is **married** (45%) or live in a “free union” (23%);
- 9% of clients do not speak Spanish;
- their level of **education** is quite good, also compared with national average: 6% of clients have never attended school (Peru: 14%), 12% have started but not completed the primary cycle (Peru: 21%), but most of them (27% and 26% respectively) have completed primary and secondary education (Peru: 27% and 19%) and 30% (Peru: 12%) have higher education (of which 12,5% have university degree); Expectedly, the level of education of clients living in rural areas is much worst with 7% of clients without any education, 30% having not completed primary school and only 9,3% with higher education;
- the average **size of the households** (HHs) reached by Finca Perú is 4,8 (average size in Peru = 4), increasing to 5,3 in case of rural clients. Concerning **income sources**, on average 2,5 members (median value = 2) regularly contribute to family income; indeed the majority of HHs (89,7%) have more than a member contributing to HH income, with 26% of HHs having one salaried person among its members;
- Client HHs have on average 1,8 **children** less than 16 years old; 51% of the HHs have one or two children aged less than 16, while 28% have 3 or more. The shares of **household children in primary school age** regularly attending school is 89% (vs. 94,3% for Peru).

GENDER OVERVIEW

- 92% of clients are women;
- 27% of them are head of household
- 26% of women clients are single, 4% are widowed and 1% divorced; 63% of single women clients have children
- 71% of them manage alone the microenterprise for which have taken credit , 26% do it with the support of their husband and 3% are not the owner of the enterprise where they invested their credit.

BUSINESS ACTIVITIES

- The majority of productive activities financed are in the **trade sector** (74%), followed by the service sectors (19%), and small production (6%). Among clients dedicated to services, 15% deal with alimentary preparation. Agriculture only accounts for 2%, but it is expected to grow due to the recent expansion in rural areas (Wari project).
- The bulk of the business activities of clients is **informal**, with 86,2% of clients not having RUC.



ECONOMIC POVERTY

- 55% of client HHs are estimated to be **below the national poverty line**. Poverty incidence is higher than the national average, showing an overall good outreach in depth.
- Outreach to the very poor is lower, with 14% of

POVERTY INCIDENCE	FINCA	FINCA (urban)	FINCA (rural)	Peru
National poverty line	55%	51%	70%	45%
National extreme poverty line	14%	8%	35%	16%
\$1 a day (PPP)	4%	0%	4%	11%
\$2 a day (PPP)	13%	7%	34%	nr

Households of recent clients. See annex 1 for more details.

¹² The information presented hereafter is mainly based on a survey on recent clients integrating, when relevant and available, data from MIS. See annex 1 and 2 for more details.

clients HHs **below the extreme national poverty line** (slightly lower than the national average); As far as international standard are concerned, 13% of clients are below the 2 PPP\$ poverty line (whose value is very similar to that of the national extreme poverty line) and 4% below the 1PPP\$ dollar poverty line.

As far as **food and health security** are concerned:

- Almost 34% of clients declare to have experienced in the last 6 months time of **food shortage** in their HHs (period when money were not sufficient to buy food)
- 35% of client HHs have benefited in the last three months from public food assistance programs (32% of population of Peru benefit from these programs)
- 39% of clients have experienced times, in the last six months, when **revenues were not enough to cover HH health expenses** (this figure can be compared with a 23¹³% at national level)
- 90% of HHs did not have any kind of health insurance (data for Peru: 40%)

ASSETS PROPERTY

Assets property is rather limited:

- 69% of clients households own their **house** (Peru: 77,4%) and an additional 0,5% have bought it, but are still paying for it;
- 36,5% own **land**
- 65,5% have no **telephone** in their house;
- 92,8% of clients do not own any **car**

ASSETS OWNERSHIP	% of clients
House/apartamnet	69,0%
Land	36,5%
cars	7,2%
fix telephone	35,5%

Survey: recent clients. See annex 1 for more details.

ACCESS TO BASIC SERVICES

The access to basic services in Peru is very poor; access conditions to basic services of Finca Perú clients are much better than the average of Peru, but seem to remain serious in absolute terms:

- 30% of client's HHs do not have **flushed toilets** inside their house;
- 22% do not have access to the public piped **water system** (inside their house);

ACCESS TO BASIC SERVICES	FINCA (urban)	FINCA (rural)	FINCA (total)	Peru
Clients without access to public piped water (inside)	18%	35%	22%	31%
Clients without access to flush toilet (inside)	22%	59%	30%	47%
Clients without access to electricity	3%	7%	4%	28%

Survey: households of recent clients. See annex 1 for more details.

- 4% of them do not have access to **electricity**

ACCESS TO FINANCIAL SERVICES

Access to financial services is rather limited, showing a quite good outreach to financially excluded people. However a layer of clients, mostly from Lima, show a good level of bancarisation:

- 64% of clients have **never had access to a credit** from a financial institution before receiving it from Finca Perú, while 11% had received loans from commercial banks, 14% from credit and savings cooperatives and 11% from other MFI;

Access to financial services	% of clients
NO previous access to formal credit	64%
NO savings account (except FINCA)	83%
NO credit card	88%

Survey: recent clients HH. See annex 1 for more details.

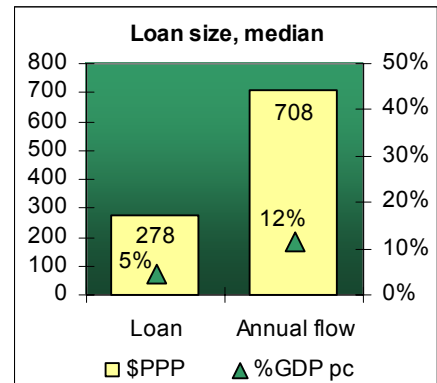
- A minority of clients (12%) owns a credit card; the majority of them live in Lima;
- 83% of clients do not have any saving account apart from the savings collected thanks to village banks, 7% save through commercial banks and 10% through cooperatives

¹³ INEI 2006: 23% of population did not consult medical centre in case of necessity because of lack of money.

It is worth mentioning that, among recent clients, most of the savings mobilized through Finca Perú are used to invest in the business activity (50% of clients) followed by investment in children education (16%) and housing improvement (16%).

Loan size analysis

The **average disbursed loan** is USD 265, which is a very small amount, also in terms of % of per capita GDP (8%). The **average loan size** is slightly increasing from USD 224 in 2005 to USD 265 in the last period, with an increasing weight (even if always very limited) of individual loans on total portfolio. The breakdowns of loan size by branches shows that the higher amount are disbursed in Lima (USD 310), where of clients' financial needs are more demanding. The median value of disbursed loans active as of March 2007 is even lower, equal to **USD 156**. The value converted in PPP\$ is 278, which represents a **very low loan size**. This picture is confirmed by the exceptionally low ratio of loan size on per capita GDP (5%);



6. Quality of the services

Variety of services

The variety of Finca Perú financial offer is rather limited at the moment. As a civil association, Finca Perú is not allowed to mobilize savings and its direct offer of financial products is limited to credit. However, one of the main strengths of the quality of services is the integration of training and saving promotion to the provision of credit. Finca Perú is strongly promoting savings collection among its clients and compulsory and voluntary savings allow the creation of the “*cuenta interna*”, a fund owned by members and managed by the elected village bank committees.

Within credit products, in addition to the credit opportunities offered through village banking (borrowing from Finca Perú and from the “*cuenta interna*”), group loans and individual loans, standard and “premium” (seasonal) are also available to the best clients. However, it is worth mentioning that the individual loans are only available to village bank members as a fidelization tool, and that to date they are not offered on a large scale, representing only 9% of the portfolio as of March 2007.

Finca Peru is aware of the improvable variety of its offer and may develop in the future new services like credit for fixed assets and for home improvements, life insurance -in partnership with a specialized company- and technical assistance to foster the rural productive chain.

As mentioned, as an integral part of credit offer, also non financial service are provided (see next paragraphs for details).

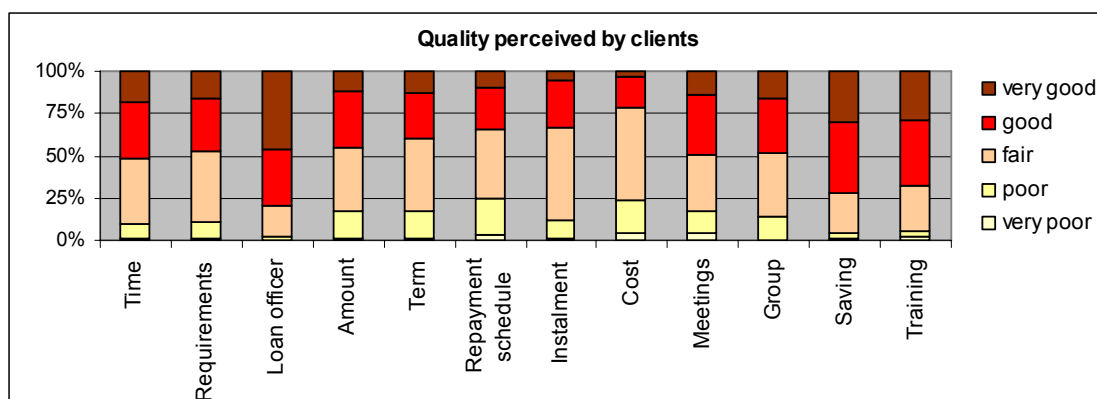
Appropriateness to clients' needs

If on one hand the loan amount and cost of credit present some room for improvement, the **very good customer service**, enhanced by the close **relationship with loan officers** are the main strengths of Finca Perú financial services. It is also worth mentioning that the non-financial services package offered besides credit is often perceived by Finca Perú target clients as a stronger driver of satisfaction than the adequacy of financial services. Indeed, among the most important characteristics identified by clients are saving promotion and training.

The **service delivery model** of Finca Perú is overall good and particularly appreciated by rural clients, whose access is highly facilitated by the fact that meetings take place in rural communities. The documents and procedures to join and apply for a loan are kept at minimum and the time to access a loan is not considered too long.

The **guarantee requirement** for village bank loans consists in the personal guarantee offered by one or more members of the same bank. It is not surprising to find a lower satisfaction with respect to the group liability among clients who experienced severe cases of internal defaults; this is reflected in a higher preference for individual loans where the self-selection of members does not work properly and the risk of over-indebtedness is higher.

- IMPORTANCE RANK:**
Survey on clients
1. Saving
 2. Relation LO
 3. Training
 4. Meetings
 5. Requirements
 6. Loan amount
 7. Time to issue a loan
 8. Group
 9. Loan term
 10. Repayment schedule
 11. Cost
 12. Installment



On the other hand, the satisfaction of Finca Perú target clients about the **frequency of repayment** -weekly or biweekly- is not uniform. On one side, the higher frequency of meetings is appreciated for the ease of repaying small installments, the higher quantity of training received and the larger opportunities to save. On

the other side a part of clients finds difficult to match the repayment schedule to the business cash flow¹⁴. It is worth mentioning that, in an effort to increase the productivity maintaining the core methodology, Finca Peru is promoting the reduction of the meetings’ frequency from weekly to biweekly. Indeed, the lower frequency of meetings is associated with the translation of loans from USD to national currency, which meets the preference of the majority of clients.

The frequent repayments and the relatively short **loan terms** -4, 6 or 8 months- are considered adequate to the overall business profile of target clients, even if they do not match other specific financial needs as for example major home improvements, agriculture and investment in fixed assets.

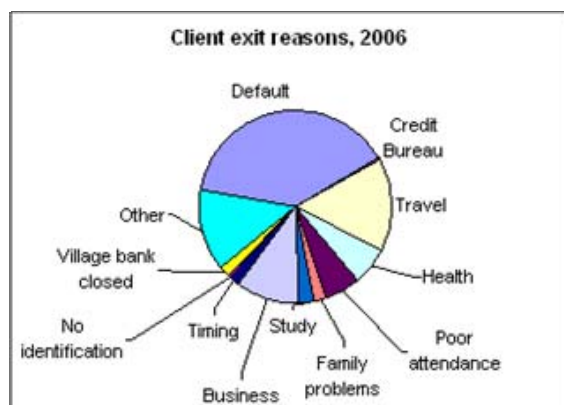
With respect to the **amount of credit**, as already mentioned in chapter four, some concerns arise from the fact that the criterion of saving balance seems to be over-weighted with respect to the one of the household cash-flow. If this is especially true in the internal lending process, it also affects the issue of Finca Perú loans, resulting on one side in the risk of over-indebtedness and on the other side in a partial coverage of the clients’ financial needs.

Another area for improvement of Finca Peru can be identified in the **cost of the services provided**: the interest, fees, and VAT (19%) paid by clients do not vary according to clients’ credit history and the overall cost is higher than the market level. Nonetheless, clients are aware and attach a high value to the competitive advantages of Finca Perú in terms of training, saving promotion and empowerment.

Also due to the high complexity of the village banking model, the client exit rate registered by Finca Perú is rather high, equal to 65% during 2006. The rate can be adjusted to account for

2006	Finca Peru	Ayacucho	Huancavelica	Lima
Client exit rate	68%	76%	61%	53%
Client re-entering rate	22%	28%	31%	7%
Net client exit rate	46%	48%	30%	46%

the phenomenon of clients who re-enter, obtaining a **net client exit rate**¹⁵ worth **46%** in the same period. According to the information available at institutional level, the most frequent reasons of drop-out are internal



default (39% of cases), clients traveling (15%) and business problems (11%). Even if not translating in a poor portfolio performance for Finca Perú due to the members’ contribution, the internal default phenomenon may be worth investigating. Quite unexpectedly, the client exit rate is concentrated in Ayacucho, where operations are relatively more consolidated, and is lower in Lima, which presents a difficult context of operations in terms of competition and over-indebtedness. To sustain retention, Finca Perú organizes public awards of the best clients and provides them with additional individual loans -premium loans-, even if the systems for client retention are improvable.

Non-financial services

As already mentioned, the fostering of savings, provision of training and the added value of meetings in terms of empowerment and promotion of values are highly appreciated by clients.

The saving capacity, coupled with the management of village banks and with the learning process of business discipline and punctuality, is considered by clients to play a central role in building self-esteem.

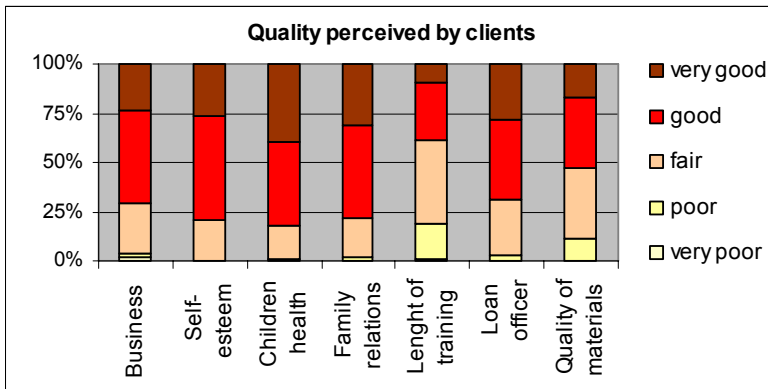
Beside the village banks’ administration training, which is provided to all the members the management committees on a rotational basis¹⁶, a large variety of training modules are gradually offered to the village banks, including business, health, women rights, family and environment. Among the modules, the most appreciated by clients appear to be “children health” and family relations. The demand for business training

¹⁴ Clients’ business turnover is distribute as follows: <1 week for 62% of clients, two weeks for 20% of clients, one month for 15% of clients and other for 3% (Finca International study, 2006).

¹⁵ Client exit rate = No of members who exit during the period / average no of members during the period; Client re-entering rate = No of members who re-enter during the period / average no members during the period; Net client exit rate = Client exit rate - Client re-entering rate. Please consider that the client re-entering rate includes all clients who re-entered during a period, regardless of the length of the “resting” period.

¹⁶ Even if it is not mandatory, the rotation in the composition of the village banks’ management committee is promoted. The committee is composed of a president, a treasurer, and a secretary.

was revealed by a study conducted in 1999 by AIMS¹⁷, while a following study (Dean Karlan and Martin Valdivia, 2006) showed a positive impact of the training on business knowledge, practices and revenues.



Given the lack of a systematic track of the training provided to clients, an exact quantification of the activities carried out is not available; however, it is estimated that more than 50% of active clients received business training as of March 07.

The overall quality of training is quite good, even if improvable.

The modules are proposed according to monthly plans developed by loan officers, while the material is partly provided by FFH and partly developed internally.

internally.

However, the provision of the service does not seem to be fully uniform in Finca Perú, partly depending on the delivery logistic complexity, higher in rural areas and in Lima. With the recently appointed training coordinator for the Ayacucho branch and with supervisors in charge of quality monitoring, the central coordination of activities and the quality control present a good potential of development.

¹⁷ Assessing the Impacts of Microenterprise Services

Annex 1 - Statistics

Poverty lines

The following table presents the value, in local currency, of the national and international poverty lines used to assess the profile of clients.

The national extreme poverty line is defined as the food consumption necessary to satisfy the minimum calorie need. The national poverty line is defined as the expenditure necessary to cover the minimum food and non-food requirements. The determination of non-food requirements is based on the observed relationship between food and total expenditure (Engel coefficient).

The PPI tool used to measure poverty is based on the four lines shown in the table. On the other hand within the IRIS tool poverty is defined as the higher threshold between the national poverty line (with "very poor" defined as the bottom 50% below the national poverty line) or by the \$1/day measure.

Poverty lines adjusted for inflation up to Apr-07

National, daily expenditure pc \$/.	Poverty	Extreme poverty
		6.98
International, daily expenditure pc \$/.	2 PPP\$	1 PPP\$
		3.84

Survey on clients

In order to provide a complete description of the poverty outreach, a survey on recent clients has been realized. Recent clients are defined as those clients with an active status at the date of the evaluation, who took their first loan with the MFI in the 12 months preceding the social rating.

A sample of 195 clients has been selected. Clients were extracted proportionally from anyone of the branches.

The main statistics of the survey on clients are presented below:

Loan size

To increase the relevance of the most commonly used proxy of outreach depth, the loan size analysis includes the following adjustments:

- Dividing the loan size by the GDP per capita
- Expressing the loan size in \$PPP
- Normalizing the loan size to one year term
- Considering not only the average loan size, but also the median and other moments of the distribution (1st and 3rd quartile)

The analysis is based on the disbursed amount of the complete list of loans active as of March 2007.

Loan size	US\$		\$PPP*		% of GDP pc	
	Loan	Annual flow	Loan	Annual flow	Loan	Annual flow
Average	265	720	471	1.279	7,7%	20,8%
Mode	100	299	177	531	2,9%	8,6%
Minimum	0	0	0	0	0,0%	0,0%
First quartile	100	299	177	531	2,9%	8,6%
Median	156	398	278	708	4,5%	11,5%
Third quartile	299	747	531	1.327	8,6%	21,6%
Maximum	11.455	34.365	20.346	61.037	331,3%	11,5%
Standard deviation	391	1.129				

Active loans as of March 2007, amounts disbursed. *Purchasing Power Parity

Annex 2 – Social indicators

March-07

SOCIAL RESPONSIBILITY

<i>Female staff*</i>	68%
<i>Female staff in management*</i>	60%
<i>Staff turn-over ratio*</i>	22%
<i>Portfolio yield*</i>	69%
<i>Real portfolio yield*</i>	67%
<i>National lending rate*</i>	7%
<i>Financial awareness: Interest rate</i>	29%
<i>Financial awareness: Instalment amount</i>	39%
<i>Financial awareness: Interest amount</i>	91%

OUTREACH

<i>Active borrowers*</i>	8.494
<i>Growth in active borrowers*</i>	14%
<i>Growth in outstanding portfolio*</i>	18%
<i>Rural area, (no. clients)*</i>	17%
<i>Financed business in informal sector</i>	86%
<i>Female clients*</i>	92%
<i>Female clients head of household</i>	27%
<i>Clients without primary education completed</i>	18%
<i>Household members in age 6-12 attending school</i>	89%
<i>No. of household members</i>	4,8
<i>No. of members contributing to household income</i>	2,5
<i>% of HHs with at least one salaried member</i>	26%
<i>Clients below the national poverty line</i>	55%
<i>Clients below the national extreme poverty line</i>	14%
<i>Clients below the 2\$PPP/day international poverty line</i>	13%
<i>Clients below the 1\$PPP/day international poverty line</i>	4%
<i>Households experiencing food shortage (last six months)</i>	34%
<i>Households without health insurance</i>	90%
<i>Households owning dwelling</i>	69%
<i>Households owning land</i>	37%
<i>Clients without access to improved water source</i>	22%
<i>Clients without access to improved sanitation</i>	30%
<i>Clients without electricity</i>	4%
<i>Clients without previous access to credit</i>	64%
<i>Households without current / savings account</i>	83%
<i>Households without credit/debit card</i>	88%
<i>Average outstanding loan amount, US\$*</i>	156
<i>Average loan disbursed on GNI pc*</i>	8%
<i>Average disbursed loan amount, US\$*</i>	265
<i>Median loan disbursed (\$PPP) on GDP pc**</i>	5%
<i>Median annualized loan disbursed (\$PPP) on GDP pc**</i>	12%

QUALITY OF THE SERVICES

<i>Net client exit rate*</i>	46%
<i>PAR30 *</i>	1%

Sources: survey on recent clients; *MIS; **Database of active loans. See annex 1 for more details

Annex 3 – Definition of acronyms and indicators

	Acronym / indicator	Definition / formula
Context	HDI	Human Development Index
	GDP	Gross Domestic Product
	GNI	Gross National Income
	WB	World Bank
	FMI	International Monetary Fund
	UNDP	United Nations Development Program
	MDG	Millennium Development Goals
	\$PPP	International dollar, based on Purchasing Power Parity
Social Performance Management system	SG	Social Goal
	SMART	Specific, Measurable, Achievable, Realistic, Time-bound
Social responsibility	Staff turn-over rate	Staff who left during the period / Average staff at in the period
	Portfolio yield	Interest income from portfolio / Average net portfolio
	Real portfolio yield	(portfolio yield – inflation) / (1 + inflation)
Outreach	Average outstanding loan	Outstanding portfolio / number of active loans
	Average disbursed loan	Amount issued in the period / Number of loans issued
	Average outstanding loan on per capita GNI	(Outstanding portfolio / number of active loans) / GNI per capita
	Median loan disbursed on GDP pc	50 th percentile of loans issued in the period / GDP per capita
	Annualized disbursed loan	Amount disbursed * (12 / months of loan term)
	Disbursed loan, \$PPP	Amount disbursed in local currency * \$PPP conversion factor
Quality of the services	Client drop –out rate	(number of active clients at the beginning of the period + number of new (first time) clients entering during the period – clients written-off during the period – number of active clients at the end of the period) / (number of active clients at the beginning of the period)
Financial Performance	Operational self-sufficiency (OSS)	(Financial revenue + Other operating revenue) / (Financial expenses + Loan loss provision expenses + Operating expenses).
	Financial self-sufficiency (FSS)	(Adjusted financial revenue + Other operating revenue) / (Adjusted financial expenses + Adjusted loan loss provision expenses + Adjusted operating expenses)
	Return on equity (ROE)	Net income before donations / Average equity
	Return on assets (ROA)	Net income before donations / Average assets
	Portfolio at Risk (PAR30)	Portfolio at Risk > 30/ Gross outstanding portfolio
	Write-off ratio	Write-off of loans / Average gross portfolio
	Risk coverage ratio (>30 days)	Accumulated reserve / Portfolio at risk >30 days
	Loan loss reserve ratio	Accumulated reserve / Gross portfolio
	Funding expense ratio	Interests and fee expenses on funding liability / Average gross portfolio
	Operating expenses ratio	Operating expenses / Average gross portfolio
	Loan officer productivity – Borrowers	Number of active borrowers / Number of loan officer
	Staff productivity – Borrowers	Number of active borrowers/ Number of staff
	Debt/Equity ratio	Total liability / Equity

Annex 4 – Rating Scale

Rating grade	Definition
AAA	Excellent capacity to effectively translate its mission into practice and to promote social values. Very high likelihood to achieve social goals.
AA	Very good capacity to effectively translate its mission into practice and to promote social values. Very high likelihood to achieve social goals.
A	Good capacity to effectively translate its mission into practice and to promote social values. Very high likelihood to achieve social goals.
BBB	Fairly good capacity to effectively translate its mission into practice and to promote social values. High likelihood to achieve social goals.
BB	Adequate capacity to effectively translate its mission into practice and to promote social values. High likelihood to achieve social goals.
B	Fairly adequate capacity to effectively translate its mission into practice and to promote social values. Reasonable likelihood to achieve social goals.
C	Moderate capacity to effectively translate its mission into practice and to promote social values. Reasonable likelihood to achieve social goals.
D	Inadequate capacity to effectively translate its mission into practice and to promote social values. Low likelihood to achieve social goals.

The rating grade can be corrected with a + or – sign, which implies a slight positive or negative variation respect to the main grade.