Mergers in Microfinance:
Twelve Case Studies

A Companion Resource for
Tying the Knot:
A Guide to Mergers in Microfinance

Elissa McCarter
CRS Technical Advisor in Microfinance
Mergers in Microfinance: Twelve Case Studies

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Tying the Knot:
A Guide to Mergers in Microfinance

Elissa McCarter
Catholic Relief Services (CRS), founded in 1943, assists the poor and disadvantaged outside the United States. CRS works to alleviate human suffering, promote the development of people, and foster charity and justice in the world. CRS assists the poor solely on the basis of need, not creed, race or nationality, and maintains strict standards of efficiency and accountability. CRS currently operates in 87 countries and territories and supports microfinance activities in 33 countries.
Acknowledgements

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<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>Asala</td>
<td>Palestinian Women’s Organization</td>
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<td>BSP</td>
<td>Philippines Central Bank</td>
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<tr>
<td>CEE</td>
<td>Central Eastern Europe</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
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<tr>
<td>CFO</td>
<td>Chief Financial Officer</td>
</tr>
<tr>
<td>CORDAID</td>
<td>Consortium on Relief and Development Aid (Netherlands)</td>
</tr>
<tr>
<td>CRS</td>
<td>Catholic Relief Services (USA)</td>
</tr>
<tr>
<td>FIE</td>
<td>Centro de Fomento a Iniciativas Económicas (Bolivia)</td>
</tr>
<tr>
<td>FONDESIF</td>
<td>Financial System Development and Productive Sector Support Fund (Bolivia)</td>
</tr>
<tr>
<td>FORA Fund</td>
<td>Merged entity of Opportunity International partners in Russia</td>
</tr>
<tr>
<td>GE</td>
<td>Goviin Edhlel (non-bank financial institution in Mongolia prior to merger)</td>
</tr>
<tr>
<td>GGLS</td>
<td>Group Guaranteed Lending and Savings (lending methodology used by Save the Children/US)</td>
</tr>
<tr>
<td>GM</td>
<td>General Manager</td>
</tr>
<tr>
<td>GTZ</td>
<td>Deutsche Gesellschaft für Technische Zusammenarbeit (German Technology Fund)</td>
</tr>
<tr>
<td>Kamurj</td>
<td>Bridge microfinance program (CRS Armenia)</td>
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<tr>
<td>LID</td>
<td>Local Initiatives Department, World Bank (Bosnia &amp; Herzegovina)</td>
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<tr>
<td>LIP</td>
<td>Local Initiatives Project, World Bank (Bosnia &amp; Herzegovina)</td>
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<tr>
<td>M&amp;A</td>
<td>Mergers and Acquisitions</td>
</tr>
<tr>
<td>MDF Kamurj</td>
<td>Kamurj Microenterprise Development Fund (Armenia)</td>
</tr>
<tr>
<td>MEDA</td>
<td>Mennonite Economic Development Associates (Canada)</td>
</tr>
<tr>
<td>Micro-F</td>
<td>Micro-Fund microfinance program (SC Armenia)</td>
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<tr>
<td>MIS</td>
<td>Management Information System</td>
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<td>MFI</td>
<td>Microfinance Institution</td>
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<tr>
<td>NGO</td>
<td>Non-Governmental Organization</td>
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<tr>
<td>Acronym</td>
<td>Description</td>
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<tr>
<td>NIS</td>
<td>Newly Independent States</td>
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<tr>
<td>OI</td>
<td>Opportunity International</td>
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<tr>
<td>OMB</td>
<td>Opportunity Microfinance Bank (Philippines)</td>
</tr>
<tr>
<td>PFF</td>
<td>Private Financial Fund (legal entity for MFI in Latin America)</td>
</tr>
<tr>
<td>PRODEM</td>
<td>Fundación para la Promoción y Desarrollo de la Microempresa (Bolivia)</td>
</tr>
<tr>
<td>RS</td>
<td>Republika Srpska</td>
</tr>
<tr>
<td>SBEF</td>
<td>Superintendency of Banks and Financial Institutions</td>
</tr>
<tr>
<td>SC</td>
<td>Save the Children (USA)</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium Enterprise</td>
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<tr>
<td>TPC</td>
<td>Thanakea Phum Cambodia (CRS Cambodia)</td>
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<tr>
<td>TPP</td>
<td>Thanakea Phum Project</td>
</tr>
<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
</tr>
<tr>
<td>WC</td>
<td>Working Capital (USA)</td>
</tr>
<tr>
<td>XAC</td>
<td>Golden Fund for Development (non-bank financial institution in Mongolia prior to merger)</td>
</tr>
</tbody>
</table>
Glossary of Key Terms

Achieving scale – Reaching large numbers of clients, which usually results in increased outreach and efficiency.

Arrears rate – Measures the loan payments past due as a percentage of the total loans outstanding.

Asset transfer – A means of accomplishing a merger by transferring assets from one or more legal entities to another, whether by grant or sale. This includes the transfer of tangible assets such as moveable equipment, vehicles, and real property; and intangible assets such as cash, deposit accounts, contract rights (such as leasehold interests), and loans.

Community bank – A group of borrowers, similar to a village bank, usually in urban areas where the term "community" rather than "village" is more applicable.

Contingency funds – The amount of extra money set aside to pay unforeseen costs, in this case, during a merger process.

Client retention – Measured by the number of clients who continue to borrow, usually expressed as a percentage of total active clients.

Delinquency – Refers to the health of a loan portfolio; a general state where there are payments past due or defaults (unpaid loans), which will adversely affect lending operations.

Due diligence – The systematic investigation of another organization's legal, financial, and operational status.

Financiera – A type of microfinance company, similar to a Private Financial Fund, found in several countries in Central and Latin America, for example Paraguay and El Salvador.

Internal account lending – A practice commonly found in village banking methodologies where internal savings are collected and distributed among members in a village bank as "internal loans," in addition to the "external loans" received from a microfinance institution.

Loans written-off – Loans considered non-recoverable after a period of time.

Localization – The process by which an international organization transfers its programming to a local body within the country in which it operates.
**Merger** – The legal act of combining two or more separate entities into one entity with a single governing body.

**Portfolio at Risk** – Measures the loans outstanding which have one or more payments past due as a percentage of the total loans outstanding.

**Post-merger integration** – The process of streamlining systems, staff, procedures, and operations after the official transfer of assets from one entity to another entity.

**Private Financial Fund (PFF)** – A type of commercial finance company established in Bolivia that is allowed to provide money transfers, offer foreign exchanges services, receive savings and time deposits, and contract obligations with second-tier institutions. It is restricted from offering checking accounts, foreign trade operations, equity investments, and security placements.

**Reserve fund** – A portion of money set aside by borrowers to protect against possible future repayment problems or emergencies.

**Self-sufficiency** – The situation whereby income covers costs, including operational and financial costs. Commonly identified among microfinance institutions as a chief aim to ensure long-term programming.

**Solidarity lending methodology** – A lending approach in microfinance that uses small groups, usually of 5-10 people, who provide mutual guarantees of one another’s loans.

**Strategic plan** – A document that spells out key decisions that need to be made before a merger can take place. It assigns roles and responsibilities for a due diligence team and prioritizes the major strategic and financial issues that need to be resolved.

**Sweat equity** – The amount of time burden that staff experience, in this case during the planning and integration process of a merger, which adds a significant unseen cost to an institution.

**Transition plan** – Also called an "Integration Plan" or an "Action Plan." A document that summarizes any key decisions made after the Strategic Plan and details any outstanding issues and activities with provisional deadlines for completing the activities.

**Village banking methodology** – A microfinance lending approach that uses larger groups (often 20-50 people, broken into smaller solidarity groups of 5 people) that provide a double level of guarantee for one another’s loans.
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In 1999, two microfinance operations in Armenia, run respectively by Save the Children (SC) and Catholic Relief Services (CRS), found themselves in an increasingly competitive, limited, and dwindling market. There were more than 15 other microfinance programs operating at various levels in a range of geographic areas in a country where economic stagnation, mass emigration, and a constant influx of aid monies continued to shape the development landscape. As more and more players entered the market, SC and CRS risked losing the substantial investments they had made to date. Rather than going head-to-head, SC and CRS decided to put their heads together: in September 2000, SC and CRS officially merged their microfinance operations into one local institution, now known as the Kamurj Microenterprise Development Fund (MDF Kamurj).

As former manager of CRS’s program, I began to document the painful yet rewarding experience of the merger process in Armenia, from start to finish, with the fervent belief that the merger trend would hit the industry sooner or later and that other practitioners might benefit from the lessons we were learning. However, during the development of *Tying the Knot: A Guide to Mergers in Microfinance*, it became clear that it was impossible to draw broad lessons and credible guidelines for future mergers from just one case alone. Fortunately, during the initial research period, several other cases of microfinance mergers at various stages of development emerged. Thus, in an attempt to capture and

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disseminate to others a small but increasing body of knowledge among practitioners in the field, the idea for this companion resource to *Tying the Knot* was born.

The number of recent studies and publications on the "merger & acquisition phenomenon" indicates that mergers and acquisitions continue to define and reshape the markets in the banking, business and, increasingly, nonprofit sectors—why not the microfinance industry as well?

Indeed, Armenia is not alone. The twelve case studies presented in this book demonstrate that mergers are already taking place in the microfinance world. In countries with a longer history of microfinance—such as Bolivia—or in less populous countries where the potential number of clients is limited—such as Bosnia—microfinance organizations are being forced to consider some form of consolidation in order to reap the potential benefits of cost savings, efficiency, access to markets, and ability to achieve scale and self-sufficiency. When many microfinance institutions (MFIs) target similar clientele, share similar missions, offer similar financial products, and operate in limited markets, achieving scale and long-term sustainability can pose a huge challenge. While mergers are not the solution for everyone and not all mergers succeed, there can be great value in building stronger institutions by linking up with competitors.

**About This Book**

This book is intended to be a companion resource to *Tying the Knot: A Guide to Mergers in Microfinance*, which provides a detailed set of guidelines and lessons learned based on the experience of Save the Children and Catholic Relief Services in Armenia. The case study model used in this book was first developed in order to create a framework for analyzing mergers, comparing experiences, and identifying the critical elements for success as a way to inform and reinforce the guidelines set forth in *Tying the Knot*. As such, it is closely interrelated with *Tying the Knot*; however, it may also be used as a stand-alone resource.

The case studies follow a similar format to the Armenia case in
Tying the Knot and are divided into six sections to allow for easier comparison:

- **Background**
  Summary of each merging organization’s history, country context and lending environment, and principle reasons for (or against) the merger.

- **Merger Negotiations**
  How the idea of the merger evolved, who initiated it, the main parties involved, and potential resistance to the merger that either party faced.

- **Legal Structure**
  Types of legal structures possible for microfinance activities in the given country, principle reasons for the type chosen for the merged entity, and how the legal transfer process worked.

- **Planning**
  Key decision makers, implementers, and process for pre-merger strategic planning and post-merger integration.

- **Timeline**
  Planned versus actual timelines for the merger process, major phases, and rough timeframe for each step.

- **Lessons Learned**
  Principle lessons learned, issues that could have been handled more easily, and advice for others considering a merger in the future.

**Research Methodology**

The primary data for the case studies was collected through an initial survey and through ongoing correspondence between the author and key staff involved in the mergers. With the exception of the Fora Fund case study—which was written solely by a key staff

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2 See Annex 1: Microfinance Merger Profile.
person—the case studies were written primarily by the author, or co-written with key staff, based on the information provided and verified through an iterative communication process.

**Brevity**

As in *Tying the Knot*, the primary audience for this book is practitioners; therefore the case studies have been kept brief for easier reading by busy people. The case studies also vary significantly in the amount of detail provided. In some instances, this is because the merger is still in its early stages; in other instances it reflects the time constraints of key people involved and the limited availability of information. For the same reasons, some information contained in these case studies—particularly the portfolio statistics and the current status of the merger—may be somewhat dated at the time of publication. Therefore, it is important to recognize that the focus of the book is more on the process of mergers rather than on the concrete results they achieved. In most cases, the key staff involved agreed to leave their contact information in case readers have further questions about the progress of a particular case.

**Selection Criteria**

Research to identify other mergers was conducted through formal and informal channels—the Devfinance listserv, CRS’s internal listserv, and the author’s personal contacts in CRS, USAID, Freedom from Hunger, and ACCION; and often by word of mouth, which facilitated access to needed information and further contacts. The selection of case studies was based on respondents’ willingness and availability.

The list of cases is by no means complete. In at least three instances, key players in ongoing mergers preferred not to have their cases included for fear of upsetting the balance at an early stage in their merger processes. At the time of publication, there could well be many more microfinance institutions in the process of merging than are represented here.
Sequence

The first 10 cases are examples of successful mergers (with the exception of Enlace, which was still in the process of defining its final structure at the time of publication). The final two cases (11 and 12) from Bolivia are examples of merger "failures": the merger negotiations of FIE and PRODEM ultimately broke down; and the merger process that led to the establishment of Eco Futuro did not bring about the intended results. Both cases have been included to highlight the many difficulties encountered during mergers, and also to demonstrate that even when a merger fails, those involved often remain positive about the potential for mergers. No one from either case indicated that they wouldn’t willingly consider a merger again in the future.

The case studies in this book illustrate that with careful consideration, the right foundation, strong leadership, and well-managed integration, a merger can be a desirable strategic move toward building stronger institutions and ensuring permanent financial services for the poor.
Case Study 1

FORA Fund, Russia

Stacie Schrader*

* Country Director, Opportunity International Russia, and Chairperson of FORA Fund.

Background

Opportunity International (OI) pioneered lending operations in Russia in 1993. At the time, enormous changes were taking place in the country, leaving it in a state of flux with many services lacking financing or discontinued altogether. As a result, OI determined that the best way to begin microfinance activities was to localize operations, building on the experience and influence of local Russian boards of directors. From 1993 to 1997, OI formed five Russian organizations through a small representative OI office in Nizhny Novgorod, Russia.

During this time, on the global level, the objectives and capacities of microfinance organizations were changing. Increasingly, they were emphasizing large client numbers (more than 10,000) and profitability. Moreover, the Opportunity International network was instituting changes that favored building a few large institutions rather than many local organizations. In 1998, the financial crisis in Russia further reinforced the need to consolidate resources as ruble-based portfolios were significantly decapitalized.

Merger Negotiations

In 1998, the regional staff of OI decided to initiate dialogue on consolidation. A business plan was prepared and circulated to the board members and staff of the five Russian organizations. In September 1999, OI-Russia and its five partner organizations agreed on a plan for consolidation.
The goals of consolidation were to:

- collectively reach significantly more clients
- streamline operations in order to increase viability and profitability
- increase professional development opportunities for staff
- increase stakeholders’ control over assets
- attract more financing and political support.

Some board members resisted the merger, but with further information and discussion, they agreed. The more deeply rooted resistance came from directors of some of the partner organizations. They were concerned about their loss of autonomy and power—and possibly their jobs.

Negotiations were initiated by Stacie Schrader, OI’s Russia Country Director, and Ken Vander Weele, then Eastern European Regional Director for OI. Negotiations initially focused on the five Russian organizations, but eventually included other global OI support partners as they became founders of the new fund. The board chairs and directors participated in correspondence and meetings.

**Legal Structure**

Opportunity International created a new fund into which the five existing organizations (with their various legal structures) merged, transferring their assets and staff. Initially, OI referred to the process as "consolidation." As the legal format became clearer, this changed to "merger."

**Planning**

The OI Country Director wrote a business plan, which was used to generate dialogue and clarify options. The business plan was revised and updated before the merger took place.

The staff of OI-Russia and the directors of partner organizations also did a great deal of planning together in the months leading up to the merger. All worked with an external
consultant to create the organizational structure and met one week each month for five months to write an operations manual for FORA Fund, the chosen name of the future merged entity. As the corporate identity of FORA grew, integration continued at the headquarters and in the regional offices.

To conduct due diligence prior to the merger, all partners were audited annually by Russian auditors. Upon the merger’s completion, Ernst and Young conducted an internal control review of FORA.

**Timeline**

The merger of FORA took two years from inception to physical and legal conclusion, but the process of building a common corporate culture continues. Below is an outline of the major dates and events:

- **October 1998** Merger idea conceived
- **August 1999** Business plan circulated
- **November 1999** Plan approved by board chairs
- **April 2000** FORA founders gather
- **May–October 2000** Organizational structure and operations manual written
- **July 2000** FORA legally registered
- **July–Dec 2000** Assets transferred to FORA
- **Oct 2000** Staff transferred to FORA; lending begun
- **January 2001** Merger completed: all assets are on FORA’s balance sheet and all operations are run out of FORA

**Lessons Learned**

Although the merger was legally very complex, and although it was extraordinarily difficult to keep all of the people involved moving forward with confidence, the results today demonstrate that the enormous expenditure of energy and time in pursuit of the merger was worthwhile. In FORA’s first year of operation, its clients
and portfolio tripled, and significant financing was arranged, which would not have been possible under the former organizational configuration.

Of course, problems arose. Due to resistance from their directors, two partner organizations did not participate. Branches of FORA now successfully operate in those regions.

Below is a summary of the key lessons learned during the FORA merger, according to OI-Russia Country Director Stacie Schrader:

a) Keep your time frame tight, especially in the initial stages.
   One drawback during the merger process was that I was on maternity leave from March to June 1999, and this lag allowed difficulties to emerge.

b) Be very clear from the beginning; listen and respond to people’s concerns, but have your plans well thought-out, continually assure people, and be a leader.

c) In general, people are frightened of change—this is particularly true of those who live in very unstable environments. I underestimated people’s fear of change and what that fear could make them do.

d) Expect to increase your budget during the merger process, even if budget reduction is one of your ultimate goals.

e) Bring in outside consultants to help rethink assumptions and add human resources to what is a complex process.

f) Anticipate a long process of cultural integration, even if operations achieve integration more quickly.

As a consequence of the merger, FORA has emerged as a leader in Russian microfinance. Rapid growth in client numbers and improved portfolio quality testify that FORA is now equipped to serve more clients, thereby enabling them to grow economically, socially, and spiritually.

Sources:
Except for minor editing changes, this case example was written and prepared by Stacie Schrader, OI Russia Country Director and Chairperson of FORA Fund, Stacieschrader@cs.com, 2001.
Case Study 2
Thaneakea Phum Cambodia
Elizabeth Abrera, Mike Spingler*, and Elissa McCarter

*Elizabeth Abrera–TPC Director, Mike Spingler–TPC Operations Manager

Background

The Thaneakea Phum Project (TPP) was initiated in 1994 by Catholic Relief Services’ Cambodia Program and exemplifies one of CRS’s principal strategies for alleviating poverty through rural reconstruction. The village banking project was implemented with funding support from the McKnight Foundation, the United States Agency for International Development (USAID), Development Capital (DevCap), and CRS private funds. The principal goals of the project were:

• to reach some 40,000 poor rural women
• to increase access to rural financial services for the poor, particularly women
• to strengthen the institutional capacity of the local NGO community and the Ministry of Rural Development in microfinance best practices
• to increase awareness of enabling policies for microfinance among government policy makers, regulators, donors, and the NGO community.1

TPP village banking operations are focused in eight provinces through six local NGOs and two CRS direct retail branch offices. CRS provides each local NGO/branch with technical assistance, loan capital, and an administrative subsidy on a declining basis over four years. At the end of four years, it is expected that each

1 Jean Gilson and Mark Pierce. Thaneakea Phum/Cambodge Transformation Plan, Internal publication by Catholic Relief Services, Baltimore, Maryland, 2000.
NGO/branch will have achieved or neared operational self-sufficiency.²

As of December 31, 2000, CRS/TPP served 25,845 active clients through 729 village banks, at an outstanding portfolio of US$937,603. CRS/TPP also provided savings facilities to 25,842 savers at US$304,899. Through operations in 158 communes in eight provinces, the program disbursed a cumulative 121,635 loans, amounting to US$6,036,612.³

Table 1: Growth in MFI Operations 1996-2000

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<td>ACLEDA</td>
<td>36,670</td>
<td>60,860</td>
<td>+66%</td>
<td>2,651,493</td>
<td>16,888,695</td>
<td>+529%</td>
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<tr>
<td>PRASAC</td>
<td>37,000</td>
<td>34,882</td>
<td>-6%</td>
<td>3,200,000</td>
<td>3,340,167</td>
<td>+4%</td>
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<tr>
<td>EMT</td>
<td>19,800</td>
<td>73,352</td>
<td>+270%</td>
<td>600,000</td>
<td>2,749,914</td>
<td>+358%</td>
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<tr>
<td>CRS</td>
<td>2,339</td>
<td>25,845</td>
<td>+1005%</td>
<td>80,739</td>
<td>937,603</td>
<td>+1061%</td>
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<tr>
<td>WRI/CCB</td>
<td>6,000</td>
<td>5,250</td>
<td>-13%</td>
<td>238,765</td>
<td>518,696</td>
<td>+117%</td>
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<td>Sub-Total</td>
<td>101,809</td>
<td>200,186</td>
<td>+96%</td>
<td>6,770,997</td>
<td>24,235,075</td>
<td>+258%</td>
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<tr>
<td>All Others</td>
<td>69,278</td>
<td>170,465</td>
<td>138%</td>
<td>1,753,933</td>
<td>5,104,720</td>
<td>191%</td>
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<tr>
<td>GRAND TOTAL</td>
<td>171,087</td>
<td>370,651</td>
<td>113%</td>
<td>8,524,930</td>
<td>29,339,795</td>
<td>244%</td>
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In 2001, the NGO microfinance sector in Cambodia reached 370,651 clients, representing approximately 17 percent of all households, with approximately $29.3 million in loans outstanding. ACLEDA and EMT represent the market leaders, maintaining 36 percent of client outreach and a remarkable 64 percent of total loans outstanding.

² Ibid.
³ Elizabeth O. Abrera and Mike Spingler, Case Study Notes for Establishing National Structures in Microfinance, Catholic Relief Services Cambodia, 2001.
To support the expansion of rural credit and savings services, the government enacted the Law on Banking and Financial Institutions on November 18, 1999. It also issued a Prakas (statute) on the licensing of Specialized Banking Institutions (SBIs) and Microfinance Institutions (MFIs). These laws mandate the registration and licensing of entities involved in credit provision and savings activities by the NBC—the National Bank of Cambodia (the Central Bank). Given the size of its portfolio and the depth of its outreach, the CRS Thaneakea Phum Program is one of five to seven major NGO operators in Cambodia that is expected to transform its operations into a regulated MFI.4

The passage of the Financial Institutions Law, after almost five years of parliamentary discussions, has rendered moot the plans of the TPP to become an apex lending institution to NGO credit operators, as the law prohibits this option. Moreover, the draft NGO law would bar organizations solely involved in credit and savings/microfinance activities from being considered NGOs. The logic behind this initiative assumes that financial services provision is a for-profit undertaking and that NGOs, in contrast, are nonprofit organizations. Uncertainty regarding the legal identity of NGOs as

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4 Ibid.
credit service providers made the decision to spin off CRS branch operations difficult.⁵

With TPP growing and the NBC looking to develop a strong rural financial sector, it became increasingly clear that CRS needed to address the challenge of institutionalizing or transforming the program if it wished to continue to emphasize poverty lending in Cambodia and assist some 40,000 clients.⁶

**Merger Negotiations**

Anticipating these emerging developments, CRS/Cambodia initiated discussions with the program branches and partner organizations starting in 1998. These discussions focused on defining the institutional structure and strategic approach that would be most appropriate and effective for addressing the changing legal environment and the growing demands of the program. Through various meetings, summits and consultancies, CRS and the partners reached an agreement that the best possible option for institutionalization was to merge the operations of the branches and local NGO partners into a single, locally incorporated entity (a limited liability company). This local entity would then apply for a license with the NBC as an MFI.⁷

What remained to be finalized, however, was a shared vision for the merger. Several NGO partners were reluctant to commit to the merger:

- The partners cited the absence of a clearly articulated proposal that they could review.
- They also cited concerns that the merger would result in loss of their identity, autonomy, and decision-making authority.
- Some multisectoral NGOs were concerned about breaking up their programs.
- The partners had achieved varying degrees of sustainability, and the more profitable ones were concerned

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⁵ Ibid.
⁶ Ibid.
⁷ Ibid.
that, in a merger, they would be burdened by less profitable operations.

• Likewise, better-performing partners were concerned about the implications of less-performing partners having equal input into management decisions.  

Taking these valid concerns into consideration, a CRS internal consultancy team endeavored to assist TPP in clarifying related management and policy issues and in putting a proposal in front of all of the partners so that they might make a better-informed decision regarding the merger and, ultimately, the transformation into TPC.

The following anticipated benefits drive the effort to merge TPP’s operations into a regulated MFI (a process that is ongoing):

1. Ability to fulfill the organization’s original mission of providing sustainable and effective services to the poor in larger numbers; and the ability to expand into more underserved areas, enabled by secured funding (from refinancing, loans, and equity investors).

2. Improved chances to achieve economies of scale—in terms of consolidating planning and management information and financial administration systems, as well as enhancing internal and security controls necessary for the efficient management of a regulated MFI.

3. Improved chances for becoming a premier microfinance institution in Cambodia with the capacity to provide a wide array of financial services that cater to the needs of low-income households in a more efficient and sustainable manner.

4. Improved viability and sustainability of financial service delivery to the poor. By merging into a single local entity, TPC will be in a better position to manage geographical, credit and natural risks as well as competition to which small NGO operations are very vulnerable.

8 Jean Gilson and Mark Pierce, Thaneakea Phum/Cambodge Transformation Plan.
5. Increased job security resulting from a clearer delineation of responsibilities and accountabilities per job description, better policies, and functioning systems and procedures that take into account legal and regulatory requirements.⁹

Legal Structure

The legal structure proposed for the TPC MFI involves incorporating as a limited liability company that will then seek a license as a regulated MFI from the Central Bank. There is a statute that provides for the establishment of microfinance institutions within the Financial Institutions Law of Cambodia (the equivalent of a General Banking Act.). The draft Association Law covering NGOs in Cambodia does not allow for registration of institutions engaged in credit and savings activities as NGOs, the rationale being that credit and savings activities are for-profit banking activities.

Thus, TPC will be a direct provider of financial services as the merging NGO partners become branch offices of the national entity. Governance will be handled by a Board of Directors and an Executive Management Committee.¹⁰

Planning

TPC did not receive the final go-ahead from CRS headquarters until December 2000, and it is still in the very early stages of establishing a national structure. The merger proposal was presented to the partners in January 2001, and partners committed to the merger in February. A systems review was completed in April 2001 through a two-week formal CRS assessment. As of December 2001, a working draft of the business plan was still under review and TPC’s legal and banking advisor were in the process of drafting the articles of incorporation.¹¹

⁹ Ibid.
¹⁰ Elizabeth O. Abrera and Mike Spingler, Case Study Notes for Establishing National Structures in Microfinance.
¹¹ Ibid.
Timeline

TPC began in late 1998 to discuss the various institutional options available to ensure its long-term growth and sustainability. The initial discussions, while informative, were based on "what if" scenarios as the Financial Institutions Law was still a proposal and had not yet been enacted. CRS staff were also engaged in significant advocacy work for the microfinance sector in Cambodia. TPC was working to persuade the government to be flexible as to MFIs’ institutional structures, and to allow non-bank institutions such as NGOs, cooperatives, foundations, and others to be included among MFIs.

Moreover, there was no clear-cut policy within CRS regarding the institutionalization of microfinance programs. As a donor NGO, CRS is also grappling with the changing microfinance environment; consequently, after more than two years, the discussion and approval process for this idea continues.

Lessons Learned

CRS/TPC’s management recognize that one of the major barriers during the merger process was selling the idea of a locally-incorporated MFI that is majority-owned by CRS to top management at CRS headquarters. The Cambodia program was more directly operational than most CRS programs, which generally implement through local partner organizations. This is due in large part to the fact that the local NGO community in Cambodia as a whole is not mature, having emerged only in the early 1990s as a collection of grassroots institutions. Local capacity and education levels are also limited as a result of almost three decades of war and civil strife.12

Other lessons learned during the TPC merger and transformation process to date include the following:

- Merging the operations of local NGO partners into a single entity is far more difficult than simply transforming branch operations.

12 Ibid.
• Resolving the question of majority ownership of the institution by CRS and the influential shareholder rule was difficult and time-consuming.

• Lack of local capacity to manage a regulated financial institution requires an extensive amount of training and technical assistance to build capacity, and a costly investment in "professionalization" of services.

Based on the experiences of everyone involved in the TPC merger, the key suggestion that emerges for institutions in other countries considering similar moves is to know and realize that it can be a long and arduous process. It is challenging and exciting—but also, at times, frustrating.13

Sources:
3. Correspondence with Elizabeth Abrera, CRS Program Manager and TPC Director, crstpc@bigpond.com.kh, October 2001.

13 Ibid.
Case Study 3

Enlace/Catholic Relief Services, El Salvador

Elissa McCarter

Background

Enlace is a microfinance program operating under the management and auspices of the El Salvador country program of Catholic Relief Services (CRS) and a consortium of local Salvadoran organizations. In 1991, as part of a national reconstruction agenda, CRS granted funds to local organizations to help start village banking programs in some of the country’s most war-affected areas. These organizations, many offering varied social services, were able to implement programs on a limited scale. In time, however, CRS concluded that a specialized institution was needed to ensure the permanence of services and to address poverty on a national scale.1

CRS agreed to provide leadership in the management of a pilot direct retail microfinance project, consisting of two CRS branch offices in semi-urban areas outside San Salvador. In addition to cash investment, two CRS partner organizations subsequently transferred some of their loan portfolios (and therefore their client base) to CRS to manage from its branch locations. The plan called for CRS and its partners to create a formal financial institution that would eventually extend services throughout El Salvador. This process of gradual consolidation was long and often fraught with problems and delays. Enlace partners continue to define the final institutional structure and merger or portfolio transfer arrangement.2

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2 Michael J. Gent, Case Notes on Transformation of Enlace, prepared for Catholic Relief Services, 2001.
Merger Negotiations

As early as 1996, CRS articulated its argument for consolidating several NGO partners into one MFI. Since NGOs were not *financieras* (MFI entities licensed in El Salvador), their microfinance operations were unlikely to be sustainable in the long term. A new, amalgamated MFI could achieve greater scale, lower its operating costs, have greater impact, and eventually offer lower interest rates to clients. According to CRS staff in El Salvador, the NGOs initially were excited about the concept and expressed "total agreement" with what was being proposed. The initial idea was to open "windows" in NGO operations where:

- NGOs would offer complementary non-financial services
- the new institution would incorporate the best NGO banks and attempt to rehabilitate others not in too bad shape.
- Those NGOs that didn’t make the cut would continue their operations alone.³

By the end of 1996, the participating institutions formally approved this new vision and discussed the project action plan, the role of a consultative board in supporting the new MFI, and the role of NGOs in providing non-financial services as part of the process. Seven NGOs signed a letter agreeing to participate in the feasibility study, provide information to consultants, and work jointly with CRS to create the new MFI. These NGOs were: ASALDI, ASEI, ALFALIT, CREFAC, PROCOMES, FUNDEMUN, and PRODECOSAL.⁴

However, before each NGO’s inclusion in the new MFI, its community banks and portfolios had to meet criteria for soundness. Initially, the main criterion was interest income earned, followed by portfolio quality. In the majority of cases, Enlace did not include village banks from NGOs with portfolio quality problems.⁵

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Criteria for "transferability" of community banks to new MFI

Banks must:
1. Be active, analyzed over the previous three cycles
2. Maintain repayment rate of 98% within 30-60 days (within the cycle)
3. Maintain savings average of 20% of total loan over a period of three cycles
4. Have a minimum of 15 members
5. Use community bank methodology
6. Have an average loan size under US$300
7. Use CRS’s process of self-evaluation
8. Have a membership that is 70% women


Legal Structure

The proposed structure for Enlace is a regulated *financiera* in El Salvador. As a founding organization, CRS intends to promote a diversified ownership structure for the new entity, including experienced local actors as well as international partners. The initial projected ownership structure of the new institution reflects an approximate 50-50 share between local and international owners, with CRS eventually limiting its participation to 25 percent.

Currently, regulations of the Central Bank of El Salvador stipulate a minimum capital requirement of US$1.2 million in equity to capture savings from clients. An additional capital investment of $2.8 million for formally regulated savings and credit institutions would allow Enlace to capture savings from the general public. Enlace plans to raise a total of $3 million in capital investment to meet legal requirements and support the institution’s initial start-up phase. New capital will come in the form of diversified ownership through increased investment of local non-governmental

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6 Enlace, *Business Profile for Investors*. 
organizations, a local Catholic-based foundation, international financial institutions, individuals, and a financial commitment from CRS for the equivalent of 25 percent of the initial capital base, or $750,000.\footnote{Ibid.}

The formal Board of Directors will be elected by the shareholders as part of the transformation process. This Board is expected to be comprised of a maximum of ten members, allowing for shareholders with investments between 10 and 20 percent, with representation on the board proportional to shares. Local organizations are projected to hold up to seven seats; CRS will maintain two seats; and a representative from international institutional investors will hold one seat.\footnote{Ibid.}

**Planning**

By late June 1997, seven NGO partners were still committed to the project, although only five agreed to turn over their portfolios; ASEI and FUNDEMUN agreed to invest cash instead. After Enlace completed its evaluations of each NGO, it purchased portfolios from three of the NGOs and made an offer on a fourth NGO that did not go through. In the end, only two out of the three NGOs—ASALDI and CREFAC—transferred portfolios. Even though very few clients were transferred, orienting them to Enlace’s methodology and expectations proved to be a major hurdle.\footnote{Michael J. Gent, *Case Notes on Transformation of Enlace*.}

According to former CRS manager and founder of Enlace Sharon D’Onofrio, "We found early on the most difficult part of the deal was trying to place a monetary value on an outstanding portfolio whose value and risk rating changed daily. The buyer (Enlace) of course thought that it was assuming risk so it should pay less. The seller (the NGO) made the point that Enlace was buying more than a portfolio of loans—it was buying tried and true clients with a future value exceeding the current value of the loan. Nevertheless, what Enlace had in its favor was that in every successful case, the NGOs and/or a donor behind them had an
interest in investing in Enlace’s equity. Without that common element, I am not sure how easily it would have been pulled off. Also, frankly, neither group was trying really to make a profit. The key was trying to conserve a client group, passing them from one organization to another and recognizing that transaction in dollars and cents.”  

Once the purchase was made, Enlace staff took over the approved community banks of each NGO selected, and in some cases also hired some of the NGOs’ credit officers. However, D’Onofrio stressed the importance of the fact that the transfer of staff was not part of the deal: "We simply said we would be open to interview them, but no guarantee was given.”  

**Timeline**

Since Enlace’s loans were short term (not exceeding six months), the transfer of clients was easiest at the renewal stage, not during the loan cycle. The basic steps were:

**Phase One:**

1. First assessment of portfolio value and risk rating
2. Field analysis—meetings with groups, analysis of the consistency of service methodology and group organization
3. Selection of groups for transfer
4. Training of groups for transfer (during cycle)

*During this phase, the selling NGO managed the collection process and recovered the loan principal and interest.

**Phase Two:**

5. Analysis of new loan application
6. Disbursement of new loan by Enlace
7. Transfer of funds to Enlace by NGO for value of new loan amount to group.

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10 Correspondence with Sharon D’Onofrio, former CRS Technical Program Manager, El Salvador, shdonofrio@yahoo.com, October 2001.
The transfer process itself could take six months as each group renewed its loan contract, moving from the NGO to Enlace. The transfer of funds from the NGO to Enlace to fund these disbursements was made in installments. Because Enlace was not incorporated at that time, it recognized these "investments" as loans convertible to equity. They were represented as liabilities on the balance sheet but calculated in future equity projections for the company.\textsuperscript{12}

**Lessons Learned**

According to D’Onofrio, there were both advantages and disadvantages to this system. "The overall disadvantage was that it takes longer. We had to be intimately involved with the NGO for several months. The advantage to the system was that it takes away the problem of valuation and helped Enlace minimize risk. The selling NGO was very motivated to recover loans, knowing this would be capital for its investment. At the same time, Enlace could orient new clients to its methodology in a reasonable time frame and take only those groups that, through its own observation and analysis, it deemed credit worthy."\textsuperscript{13}

As mentioned previously, estimates of the amounts to be transferred were grossly overstated due to NGO reporting systems that yielded inaccurate information: the spreadsheet financial reporting systems in use did not provide accurate numbers for clients, arrears rates, etc., which made the valuation process and monitoring difficult and at times erroneous. In addition, some NGOs did not understand all the implications of what was being proposed. They expected continuing cash flow from microcredit operations, albeit in the form of dividends on the value of the portfolio they would turn over to the new MFI as an investment. But this did not happen.\textsuperscript{14}

The concept was that portfolios transferred to Enlace would then leave the NGOs to either close down or continue their

\textsuperscript{12} Michael J. Gent, *Case Notes on Transformation of Enlace*.

\textsuperscript{13} Correspondence with Sharon D’Onofrio.

\textsuperscript{14} Ibid.
business support and training services—but not, in other words, to continue lending operations. For CRS, this was a way to improve efficiencies in the credit operations that it supported. Instead, several of the NGOs continue to exist and to date, CRS has not successfully made the argument that it would be to their advantage to run all of their credit programs through Enlace. In fact, some have been successful in getting more money after they transferred their portfolio to Enlace. Moreover, CRS had proposed early on to do some institution building with the participating NGOs to help them make a successful transition into sustainable non-credit programming. This also failed to bring about the expected results, since there was neither funding nor the long-term will to conduct the capacity-building process credibly.\textsuperscript{15}

In the end, CRS decided not to continue pursuing the portfolio purchase strategy since it did not serve as a principal source of equity or growth for Enlace. According to CRS El Salvador Country Representative Rick Jones, the strategy of purchasing only good portfolio was critically flawed, and the quality of the NGOs’ portfolios was not sufficiently attractive to justify pursuing this strategy. The NGOs wanted to retain their good portfolio to continue generating income, and Enlace was not in a position to provide returns on capital to compensate the NGOs for lost revenue. As a result, they continued to seek new funding from outside sources to stay in the microfinance business, in some cases competing in Enlace’s own market later.\textsuperscript{16}

Thus, Enlace is still in the formation process, and negotiations among CRS, its partners, and potential investors continue. As of September 2001, Enlace was serving 9,726 active clients (81.8 percent women) through 568 borrower groups, and had an outstanding loan portfolio of US$1.2 million. \textsuperscript{17}

\textsuperscript{15} Ibid.
\textsuperscript{16} Correspondence with Rick Jones, CRS El Salvador Country Representative and Enlace President of the Board, rjones@crs.netcomsa.com, January 2002.
\textsuperscript{17} Correspondence with Gabriel Gaitan, Enlace Director, ggaitan@crs.netcomsa.com, January 2002.
Sources:

1. Correspondence with Sharon D’Onofrio, former CRS Technical Program Manager, El Salvador, shdonofrio@yahoo.com, October, 2001.

2. Correspondence with Gabriel Gaitan, Enlace Director, ggaitan@crs.netcomsa.com, January 2002.

3. Correspondence with and written case notes prepared by Michael J. Gent, External Consultant for CRS, gent@canisius.edu, November-December 2001.

4. Correspondence with Rick Jones, CRS El Salvador Country Representative and Enlace President of the Board, rjones@crs.netcomsa.com, January 2002.

Case Study 4
Opportunity Microfinance Bank, Philippines
Elissa McCarter

Background

Opportunity Microfinance Bank (OMB) was created by five partner organizations which, in December 2000, agreed to form a single national microfinance bank in the Philippines. In May 2001, the Central Bank of the Philippines approved the license for the bank—the first license for a microfinance-oriented thrift bank ever issued in the Philippines. These five partner organizations each retained representation on the board as investors in the new bank. They are:

Opportunity International Network (OI). The Opportunity International Network has 48 partners working in 31 countries, of which 42 are implementing partners in 25 countries and six are support partners in six countries. As of September 2001, the Network was serving 284,341 clients, with an outstanding portfolio of US$40.6 million and an average client loan size of US$196.

Alalay sa Kaunlaran sa Gitnan Luzon, Inc. (ASKI). Based in Cabanatuan City and operating in Central Luzon, ASKI was founded in 1986. As of December 2000, ASKI was serving 11,080 clients with a portfolio of US$850,000 in the province of Nueva Ecija and surrounding areas. ASKI offers a community mortgage program and helps clients establish savings and emergency funds.

Kabalikat para sa Maunlad na Buhay, Inc. (KMBI). Servicing Metro Manila since 1986, KMBI has been operating in Mindanao since 1999. As of December 2000, it was serving 15,880 clients with a portfolio of US$1.11 million in Metro Manila, Bulacan, South Cotabato (Mindanao), and Sarangani (Mindanao) provinces.
**Taytay sa Kauswagan, Inc. (TSKI).** Based in Iloilo City and servicing the Visayan region since 1986, TSKI operates in the provinces of Antique and Iloilo on the island of Panay and on the island of Guimaras. As of December 2000, TSKI was serving 15,257 clients with a portfolio of US$1.2 million.

**Daan sa Pag-unland, Inc. (DSPI).** Servicing Bataan and surrounding provinces in Central Luzon, DSPI was founded in 1994. As of December 2000, it was serving 4,371 clients with a portfolio of US$246,480. While its primary focus is microfinance, it has also been active in the provision of entrepreneurial skills training and leadership development in the Bataan area.¹

In addition to these five merging partners, OMB has two investors that have committed resources to the merger effort. These are:

**Alliance of Philippines Partners in Enterprise Development (APPEND).** Registered in 1991, APPEND is the largest network of microfinance NGOs in the Philippines. APPEND supports its affiliates through provision of technical services and resources locally and through linkages to the international microfinance community globally.

**Opportunity Microfinance Investments Fund LTD.** A United Kingdom-based, open-ended global fund owned by the Opportunity International Network members and managed by the Opportunity International Network Investment Services Group. Opportunity Microfinance Investments finances equity positions in microfinance banks and formal financial institutions. It plans to raise a projected 30 percent of the overall equity requirements of OMB.²

To date, two other APPEND partners, namely Hagdan sa Pag-Uswag Foundation, Inc. (HSPFI) (based in Cagayan de Oro City), and Talete King Panyulong, Inc. (TPKI) (based in Pampanga), have expressed their intention to join the bank at an opportune time.³

² Ibid.
³ Ibid.
According to Paul Honeyman, Asia Manager of the Opportunity International Network Investment Services Group and current OMB Board Member, the merger was driven by a desire to expand on a national scale, coupled with a need to legitimize client deposit services necessary to build up the NGOs’ capital base.

The largest obstacle to national expansion was capital. As NGOs, that capital was only available through what was observed to be a decreasing supply of grants and one primary provider of debt. To access capital markets and provide deposit services to the poor, a bank was needed. Unlimited funding might have led to many setting up their own banks on their own terms. However, funding available for capital was limited, management information systems costs required economies of scale, and regulatory requirements of setting up multiple banks would run counter to the vision to achieve national scale. That decision to merge was made in recognition [that] much autonomy would be lost both to Philippines Central Bank regulators and to each other.4

In sum, the principal reasons for the OMB merger were threefold:

1. There was a common vision for national outreach to achieve economies of scale.
2. There was a need to legalize savings deposit services through obtaining a banking license.
3. There was limited available capital, given a decreasing supply of donor funding, which made it more difficult for NGOs to go it alone.

**Merger Negotiations**

Negotiations were initiated as early as 1998; however, they did not develop substantially until late 2000. In a consultation meeting held in May 2000, the nine APPEND partners reached certain agreements that were critical to moving the process forward. The partners agreed to the establishment of a single bank for the network—an arrangement in which all partners would participate in a Thrift Bank. They also agreed that, given the limitations of smaller

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4 Correspondence with Paul Honeyman, Asia Manager of the Opportunity International Network Investment Services Group, PHoneyman@opportunity.org.au, January-February 2002.
partners, mechanisms would be put in place to enable them to participate at a later time. ⁵

Still, the negotiation process was loosely defined, and those involved in the process evolved with changes in APPEND as the country network office and with Opportunity International. By late 2000, the key people involved in facilitating the process were the CEO of APPEND (the country network office), the OI/US Asia Regional Manager, and the Head of the Opportunity International Network Investment Services Group. ⁶

The plans for OMB made significant progress in August 2000, when APPEND, and specifically its leader, Noel Alcaide, became a champion of and the lead player in the commercialization process. (Prior to that point, it was projected that one or several of the implementing NGOs would lead the process. While this might have made sense given that the implementing NGOs were the ones with the experience and initiative, and the resources to invest in the bank, it never materialized.) With over 20 years’ experience in microfinance, and currently serving as APPEND President and CEO and as OI’s Regional Director for the Philippines, Alcaide brought to the process his deep experience with the Network, and the vision, credibility, and integrity that were crucial to move the process forward. ⁷

APPEND led the process until December 2000, when a CEO was selected to lead the new bank. According to Honeyman, this was the most critical piece of puzzle: “The selection of Dr. Ricardo Jumawan as Chairman/CEO was fully supported by every stakeholder in the process. His agreement to head up the bank solidified the commitment of all in December of 2000. To say his vision, leadership, and drive were instrumental in the bank’s opening its doors only eight months later in August of 2001 would be an understatement.” ⁸ In the end, Dr. Jumawan did not continue to lead the bank as CEO; however, he did play a critical role at the time of the merger.

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⁵ Adapted from the merger questionnaire results, written by Paul Honeyman, Noel Alcaide, and Ricardo Jumawan, February 2001.
⁶ Ibid.
⁷ Ibid.
⁸ Correspondence with Paul Honeyman.
Resistance to the Merger

One of the complications of the merger was the fact that there were two separate issues it had to address: 1) the conversion to a formal financial institution and 2) the consolidation of several autonomous NGOs. As OI’s Senior Vice President of Policy and Research, Susy Cheston, stated, “Some resistance took the form of classic issues related to merger and consolidation, but the question of if and how to form a bank was also a matter of discussion and negotiation over a long period of time.” It was important for OI to evaluate formalization carefully without losing sight of its faith-based mission to reach the poorest and enable them to transform their lives. According to Cheston, OI measures its success against a "triple bottom line" of outreach, financial sustainability, and holistic transformation, meaning that it is client-centered and seeks to enable clients to transform their lives economically, socially, spiritually, and politically. This was an important element of the merger debate. 9

Key reasons for resistance included NGOs’ concerns over loss of autonomy and uncertainty of income streams following the bank’s formation; concern about NGOs’ level of ownership in the bank; and general apprehension about change. It was important to share the vision and communicate mutual expectations to decrease initial resistance; however, with merger implementation, new undercurrents of resistance began to appear:

At this stage we were looking not as much at the bank as a whole but at the value of what each investor brings to the bank. Here resistance is not openly spoken, and it arises from the different sizes and balance sheets of the participants. The investor in the weaker financial position may be the one needing the most change, may be least likely to implement needed changes, and ultimately is least willing to recognize their own weaker financial position. Who is resisting depends on what is at stake. Some board members of investing NGOs have been able to easily make the transition to thinking as shareholders in the bank. Others have not. Executive

9 Correspondence with Susy Cheston, Opportunity International Senior Vice President, Policy & Research, scheston@opportunity.org, January-February 2002.
Directors of NGOs investing in the bank continue to protect the interests of their own individual institutions; however, many have been contracted as Vice Presidents in key functional areas of the bank too. Each recognizes [that] his or her future, either with the bank or their respective NGOs, depends on their ability to adequately look after the best interests of the bank.\[^{10}\]

**Due Diligence**

Due diligence was not formally conducted during the OMB merger for two reasons: First, all investing partners had been providing quarterly reports to Opportunity International Network and APPEND for a number of years, so there was already a significant degree of transparency and familiarity with the financial and portfolio quality status of each merging NGO. Second, it was determined that transfer of assets from the NGO to the bank would be done by letting the NGO portfolio expire and having the bank issue new loans. This allowed for easier implementation of the new banking database as no old loans were entered into the system. It also ensured that good portfolio transitioned to the bank, as only loans fully repaid would be eligible for new credit under the bank\[^{11}\].

**Legal Structure**

Opportunity Microfinance Bank is organized under the Philippines thrift banking law and is fully compliant with Philippines banking regulatory standards, providing clients with access to a full range of microfinance services, including savings deposits.

Opportunity International Network put forward investments in equity and in seed grants to meet the initial capital requirements. Ownership after initial capitalization is as follows:

\[^{10}\] Correspondence with Paul Honeyman.

\[^{11}\] Adapted from merger questionnaire results, Honeyman, Alcaide, Jumawan.
Planned Ownership Structure for OMB

<table>
<thead>
<tr>
<th>Organization</th>
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<td>Opportunity Network</td>
<td>30.5%</td>
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<tr>
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<td>KMBI</td>
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<tr>
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<td>ASKI</td>
<td>13.9%</td>
</tr>
<tr>
<td>DSPI</td>
<td>11.4%</td>
</tr>
</tbody>
</table>

Source: OMB Business Plan (Draft version: June 11, 2001)

According to Honeyman, the terminology applied to the formation of OMB was "integration" and "merger," though it would be better described as a consolidation under a new structure. "Part of the complexity of the integration process from the start is that the target legal structure is different from the existing legal structures to be merged. As such, the first step was a thrift banking license for a new bank, and once the new bank was created, only then did the merging parties begin to focus on the merger aspect." 12

Planning

Pre-merger strategic planning was done primarily by the President of APPEND, with some support provided by Opportunity International Network via the Investment Services Group Asia Manager. Post-merger integration planning remains ongoing and has become the key task of the Chairman/CEO of OMB.

The business plan developed for OMB allows for the transition to take place in three stages, in recognition that consolidation into a single regulated financial structure would require Central Bank approval at every step of the process.

1. Portfolio and Deposits. Each NGO will extinguish all client loans and use cash proceeds to first pay down debt owed to depositors and to commercial providers. Cash for deposits is transferred to OMB as OMB assumes the liabilities of the

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12 Correspondence with Paul Honeyman.
savings/capital build-up previously held by the four partners. The remaining cash balance belongs to the NGO, which will then determine what amount it keeps for itself or invests in OMB through purchase of shares. As each NGO loan is paid off, new loans will be issued by OMB and processed by the same staff that had originally worked for the NGO. New loan releases would generally be consistent with what the loan release size would have been had it been a subsequent loan provided by the NGO. New loans are ready for release as soon as the NGO loan is fully paid, and are conditional upon a client’s successful repayment record.

2. Personnel. Staff are transferred to the bank payroll prior to extinguishing client loans. The monthly employment costs of that employee are then charged back to the NGO based on the percentage of NGO branch portfolio outstanding. Upon completion of the loan, no further employee obligations are borne by the NGO.

3. Transition Process. First, the management information system (MIS) is enabled for the branch. OMB then hires the NGO’s employees and assumes reasonable employee contract obligations associated with supporting that branch, plus any accrued reserves held by the NGO toward future employment compensation associated with services rendered to date. Employees undergo a short orientation to the new MIS, procedures, and loan contract policies associated with the bank, so they are equipped to explain those procedural and policy changes to clients as they distribute materials associated with it.\(^\text{13}\)

According to Alcaide, this process will be further expanded as OMB and the APPEND partner NGOs work toward their target goal of one million active clients in five years (2002-2006):

The APPEND NGOs are to act as hatcheries for opening up new lending branches for OMB in areas selected by OMB. The newly opened lending branches will utilize the existing OMB methodology, systems, and MIS. This is, however, an interim arrangement. The

\(^{13}\) Correspondence with Paul Honeyman.
long-term role of the NGO will be to develop OMB’s clients through business development and transformation services. This is embodied in a five-year APPEND National Plan that was adopted by OMB and the APPEND partners during the fourth quarter of 2001.14

**Timing**

The time frame for the OMB merger has been relatively quick, taking less than eight months from the initial agreement to operations start-up of the new bank as follows:

- from agreement on forming the bank to license application: 2 months  
- from license application to approval/operations startup: less than 6 months

However, the time frame for completing the merger process is not yet known. According to Honeyman, it may be as short as 12 months or as long as 36 months, depending primarily on Philippines Central Bank approval:

The most significant obstacles to the merger process in the Philippines are legal—a bank is required to be profitable for a year before it can legally be allowed to set up new branches, and a moratorium on new branches is still in place. It is only because of new microfinance banking guidelines within the Philippines that a new banking license could be acquired, and it is with these new guidelines that OMB will be allowed to expand. However, there is some ambiguity in what the Philippines Central Bank will finally allow in terms of speed of expansion or integration. This depends on whether OMB is treated as a new bank or as four microfinance institutions with experience ranging from five to fifteen years.15

The tentative timeline of events as per the OMB business plan is as follows:

- December 2000—Memorandum of Agreement signed by Opportunity International, APPEND, ASKI, DSPI, KMBI,

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14 Correspondence with Paul Honeyman.  
15 Ibid.
and TSKI to form a national-scale microfinance thrift bank with initial capitalization of PHP 58.1 million.

- May 2001—License to organize and use five collection and disbursement points approved by the Central Bank of the Philippines.
- June 2001—Head office completed, MIS installed, initial capitalization secured, and bank registered with Philippines Securities and Exchange Commission.
- July 2001—License to operate approved by BSP (Central Bank), bank inaugurated, integration of KMBI Manila operations with bank initiated.
- December 2001—Integration of KMBI Manila operations with bank completed.
- Oct 2001 to June 2002—Application submitted to BSP for branch license in Mindanao, integration of General Santos operations with bank using collection and disbursement points completed.
- March to June 2002—Bank’s operational viability achieved and profitability demonstrated to BSP in order to submit for approval of new bank branches.
- July to December 2002—BSP approval secured and integration completed of regional bank branches in Cabanatuan, Iloilo, and Bataan, using NGO branch offices as collection and disbursement points.16

Lessons Learned

The top priority at OMB and a key word of advice for others is to "pursue any opportunity to speed up the consolidation process if and where possible. At OMB, reducing any obstacles to consolidation has been a high priority from the inception of the plan." Other lessons learned from the OMB experience include: 17

1. Timing is essential. Initially, some NGO partners were hazy about the idea of establishing a bank. However, the NGOs that had scaled up were forced to wrestle with it once

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16 OMB Business Plan.
17 These lessons have been adapted from the merger questionnaire results, written by Paul Honeyman, Noel Alcaide, and Ricardo Jumawan, February 2001.
confronted with the reality of their situation: their funding limitations helped them realize that, as NGOs, they could only go so far; that a bank was needed to pursue the scale-up goal; and that setting up a bank for the network was the best strategy to maximize limited resources and move forward with expansion. Because they saw the urgency of forming a bank, it was easier to convince them that a network bank was a better and more efficient way of delivering goods.

2. Leadership is key. As former CEO Ricardo Jumawan indicated, the turning point in the establishment of the bank is assumption by one key partner (e.g., APPEND) of the leadership, followed by an invitation to other partners to join. OMB was looking at one or a combination of the (implementing) partners to act as the principal in setting up the bank, with others joining later, but this did not work, as partners perceived this as a takeover by one partner of the others. They asked APPEND (the network organization) to lead, based on the credibility of its leaders and its perceived lack of vested interest in controlling any of the partners.

3. Financial backing is crucial. Because of the financial constraints the NGO partners faced, the preference was to establish a rural bank, which required a smaller capitalization, despite regulations restricting a rural bank’s geographical expansion. The financial backing of OI made the partners more comfortable with the establishment of a thrift bank, which would require greater capitalization but would result in less regulatory restriction on expansion.

4. Favorable banking regulations are important. Prior to its establishment, the key players of OMB (the Executive Directors of the participating NGOs, the APPEND President, and a banking consultant) had visited CARD rural bank (an NGO-turned-rural bank). Upon scrutinizing its operations, they understood the difficulty CARD Bank had faced, and continues to face, in reconfiguring its microfinance operations to conform to the Central Bank’s regulation. Consequently, the OMB players decided that, rather than replicate CARD Bank, which acquired a regular rural banking license, they would establish OMB as a thrift bank with guidelines specifically suited for microfinance operations; the amendments in the Philippine Banking Law of 2000 led to the inclusion of microfinance-oriented banks, and the resulting
Central Bank circulars defining the formation of microfinance-oriented banks have provided OMB with the legal foundation for establishing the bank despite the moratorium on opening new banks. However, further advocacy and lobbying is needed, both at the Central Bank and in Congress, to hasten the development of further favorable guidelines. These would include legislation ultimately leading to the recognition of MFIs as a special class of banks, separate and distinct from the current classifications (i.e., rural, thrift, commercial, and universal type banks).

5. Continual selling of the vision is imperative. From inception to actualization to operationalization of the merger of the NGOs into OMB, the partners have to be sold on the idea that doing things together through OMB will achieve more than the sum of what they can do individually. The continual challenge is to persuade partners that sharing ownership of their operations with others will result in greater outreach and impact. This is where the need to have a much larger vision—e.g., the goal of serving one million clients, or the goal of having a national impact—is crucial. It enables them to see a greater goal than their individual aspiration. As former CEO Ricardo Jumawan put it, "Build a larger vision, big enough to accommodate their individual vision, and build a bigger structure to house their vision." 18

Sources:


2. Correspondence with Ricardo B. Jumawan, former Chairman and Chief Executive Officer of Opportunity Microfinance Bank, February 2002.

3. Correspondence with Noel Alcaide, Opportunity International Regional Director for the Philippines, APPEND President and CEO, NAlcaide@opportunity.org, February 2002.


5. Correspondence with Susy Cheston, Opportunity International Senior Vice President, Policy & Research, scheston@opportunity.org, January-February 2002.

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18 Correspondence with Ricardo B. Jumawan, former Chairman and Chief Executive Officer of Opportunity Microfinance Bank, February 2002.
Case Study 5

ACCIÓN USA & Working Capital, Massachusetts

Elissa McCarter

Background

ACCIÓN USA was established in 2000 as a non-profit subsidiary of ACCIÓN International, which was founded in 1961 to address poverty in Latin America’s cities. In 1991, concerned about growing income inequality, unemployment and urban alienation in American cities, ACCIÓN adapted its microlending model to the USA and started a program in Brooklyn, New York.¹

Today, ACCIÓN USA and its network of Associates programs constitute the largest microlender in the country, with support services in 24 cities and towns in the United States, including Albuquerque, New Mexico; Atlanta, Georgia; Brooklyn, New York; Chicago, Illinois; San Antonio, Texas; and San Diego, California. ACCIÓN USA’s mission is to make access to credit a permanent resource to low- and moderate-income small business owners in the United States. By providing small or "micro" loans to men and women who have been shut out of the traditional banking sector, ACCIÓN helps build their businesses and increase their incomes. To date, ACCIÓN USA has lent $40 million to 6,000 low-income owners of small businesses in the United States.²

Working Capital (WC) is a Cambridge, Massachusetts-based nonprofit that provides small loans to low-income business owners with no other access to commercial credit. Founded in 1990, Working Capital directly serves entrepreneurs in greater Boston, Worcester, Springfield and Lawrence, Massachusetts, and in Rhode Island; and through affiliates in Gloucester and Brockton,

¹ www.accion.org.
² Ibid.
Massachusetts. Since its inception, Working Capital has made more than 3,000 loans totaling $4.4 million to more than 1,700 self-employed men and women throughout New England.³

Merger Negotiations

According to the CEO of ACCION USA, Bill Burrus, the organization first explored the possibility of a merger with Working Capital nearly three years ago:

New England had always been an attractive market and it appeared to be a good strategic fit. However, at the time, Working Capital was a much different organization than it is now and was suffering from having grown too quickly. Although there were several meetings, some of which included board members from both sides, ultimately we determined that corporate cultures were too distinct and the financial troubles of WC made [a merger] less desirable for ACCION.⁴

Since this initial phase, the two organizations maintained contact and continued to cooperate on an informal basis through shared trainings and technical assistance. Particularly when Working Capital began to move away from group lending and toward individual lending, ACCION USA staff assisted with product development. In early 2001, ACCION USA began to reconsider its national strategy and shifted to direct implementation as well as working through its associates. Part of the strategy considered the possibility of mergers with another lending organization, and the question again arose of why ACCION USA did not establish operations in the New England area. This made ACCION USA look once again at Working Capital as a potential partner. By this point, conditions at Working Capital had changed drastically.⁵

As Burrus stated, "[Discussing the merger option] was easier this time around because there was already a precedent from three years ago and we know each other well. There was also a new

⁴ Telephone interview with Bill Burrus, ACCION USA President and Chief Executive Officer, September 2001.
⁵ Ibid.
CEO, Jim Kaddaras, who had introduced changes related both to the methodology as well as to the financial health of the organization. I invited Jim to lunch, we discussed the idea, and he asked me to develop a term sheet that would lay out the intentions from ACCION’s perspective."

ACCION USA’s Vice President of Lending Operations Livy Parsons added that the merger was a logical move, providing both organizations with an opportunity to boost the scale of their microlending operations, pool human and financial resources, and improve efficiency and long-term sustainability. Working Capital also was moving away from smaller solidarity group loans and toward an ACCION USA-style methodology of larger individual loans.

The principal reasons for the merger include:

• Shared mission and goals—Both ACCION USA and Working Capital served low- and moderate-income entrepreneurs who have been shut out of the traditional banking sector because of a poor credit history, a lack of credit history, or the small size of their business.

• Greater outreach and social impact—Combining resources and staff would enable ACCION/WC to offer more loans to microentrepreneurs, thus widening social impact.

• Self-sufficiency—The merger would give both organizations the opportunity to move closer to a shared goal of building a nationwide microlending program that, by reducing administrative costs, can one day operate free of donor funding.

• Strategic fit—ACCION USA to date had a "gentleman’s agreement" with Working Capital to avoid lending operations in the areas where Working Capital was established. The merger would allow for ACCION USA’s entry into New England markets.

6 Ibid.
7 Telephone interview with Livy Parsons, ACCION USA VP of Lending Operations, September 2001.
8 Correspondence with Bill Burrus.
Legal Structure

As of October 1, 2001, Working Capital officially merged with ACCION USA and subsequently was dissolved as a separate non-profit organization. All assets, liabilities, and staff were transferred to ACCION USA, so that former Working Capital staff resigned from WC, were immediately rehired with new employment contracts, and became the New England regional office of ACCION USA with its former WC branch offices across the region. The Board of Directors of Working Capital was converted into a regional advisory council.9

Planning

From the initial term sheet that ACCION USA submitted to Working Capital as a proposal for the merger, both CEOs developed a memorandum of understanding (MOU), reviewed by legal counsel on both sides. It was at this point that the MOU and proposals were taken to the boards of directors. According to Burrus, both boards were very supportive of the process. The only area that might have derailed the process was WC’s concern over staffing positions, and particularly over where WC’s CEO Jim Kaddaras would fit in. There was no room for additional senior management at ACCION USA without the organization becoming top-heavy. Fortunately, both Kaddaras and ACCION International expressed interest in creating a position at ACCION International for Kaddaras to work in the international arena. Through a series of discussions, a specific position was crafted that nicely fit Kaddaras’s interests and qualifications as well as the needs of ACCION International.10

In terms of other staffing issues, ACCION USA and WC worked together through each position to identify any redundancies; the merger agreement stated explicitly who would be rehired. All WC staff moved over to ACCION USA. There were two potentially redundant positions—CFO and Director of Resource Development. As it turned out, for reasons independent of the

9 Correspondence with Bill Burrus.
10 Ibid.
merger, both individuals in these positions left WC before the merger took place.\footnote{Ibid.}

Once the MOU was signed, both parties began a process of due diligence which involved a review of audited financial statements and lending documents, site visits, and legal investigations. Legal counsel was brought in early to begin working on the possible forms of consolidation as per US law, as well as the legal operating structure of each organization. All key lenders and donors to Working Capital and ACCION USA, such as the Ford Foundation and the Community Development Fund Institutions (CDFI), were notified early on in the process as well.\footnote{Ibid.}

**Timeline**

Merger negotiations officially started in the first quarter of 2001; the merger became official on October 1, 2001. According to Burrus, "We expect the post-merger integration process to be fairly easy, since the two organizations know each other well, our missions are similar and our lending methodologies are increasingly similar." Near the end of September 2001, ACCION USA held a workshop with WC staff to identify any differences or areas of knowledge within WC operations that ACCION staff should know. Integration will involve "a blend of both sides after taking the best principles from each organization." \footnote{www.accion.org}

**Lessons Learned**

Burrus was optimistic about the merger process to date and did not see any real hurdles:

I think we did it pretty well. I say this not because we were experts in how to implement a merger, but because there was a strong willingness on both sides, a lot of good faith, and mutual respect which allowed us to get over the humps. Three years ago, when we had first considered the idea with WC, I don’t think it could have ever worked. WC was feeling vulnerable, had internal problems, and so it might have felt at a disadvantage. That could have caused a
difficult process. But now, both organizations are working from a position of strength. So internally, the process was easy.\footnote{Ibid.}

The real difficulty that ACCION USA experienced was external: dealing with donor funds. Donors of WC were receptive to the idea of the merger from the start. But the documentation required to transfer loan obligations from WC donors (the Ford Foundation and CDFI) to ACCION USA turned into a legal headache. Burrus states that "this was more complicated than we expected, and it took a lot of time to get the approvals we needed in order for the transfer to take place."\footnote{Ibid.}

Sources:

1. www.accion.org
4. Telephone interview with Bill Burrus, ACCION USA President and Chief Executive Officer, September 2001.

\footnote{Ibid.}
Case Study 6
Asala, West Bank/Gaza
Elissa McCarter

Background

Asala (Palestinian Businesswomen’s Association) is a local non-governmental organization that strives to empower women by increasing their opportunities to become successful business owners and managers by providing them with sustainable financial services and business support. Asala has been providing individual loans to women since 1997, when it was first established under the name Center for Women’s Economic Projects (CWEP), with the help of Oxfam/Quebec. It developed a capable staff, a performing portfolio and an institutional structure designed for permanence. By August 2000, Asala employed seven people and provided services to 225 clients in the West Bank and Gaza with an outstanding portfolio of more than US$1 million.¹

Catholic Relief Services/Jerusalem, West Bank and Gaza (CRS/JWBG) began implementing a group lending program in Gaza in June 1999. In the one-year period that followed, CRS trained six staff members, developed policies and systems, and established a portfolio of 500 clients with an outstanding loan value of more than $70,000.²

The Palestinian territories have a population of 3.2 million people separated into two distinct areas—the West Bank and Gaza. Until the Intifada began in 1988, economic conditions were improving and poverty rates were decreasing. The financial sector is relatively well developed. More than 30 international and local banks operate in the territories and provide a full range of services,

² Ibid.
though normally to middle- to upper-income people and businessmen.³

The microfinance sector has seen a significant amount of activity over the past five years and involves non-governmental organizations, the United Nations Works and Relief Agency (UNWRA), and some banks. Five or six NGOs provide microfinancial services, though few have reached broad scope. With the number of programs, there is significant competition in both the individual and group-lending sectors. However, it is expected that, over the next few years, there will be a winnowing effect in the microfinance sector, with some programs either closing or joining activities with other programs. The regulatory environment is relatively hands-off, allowing banks and NGOs to lend and collect payments with few restrictions. Formalization for NGOs is difficult—banking laws require large amounts of equity ($12 million) for establishment, and there are no provisions for intermediate financial entities.⁴

**Merger Negotiations**

At the time negotiations over a possible merger began, CRS/JWBG had a firm start with its small retail group-lending program (loans of $125-$1,100) in Gaza, albeit with limited funding. By April 2000, despite good performance, CRS/JWBG had not secured any outside funding, and prospects for such funding were slim. A search began for a local partner that could take over the program’s portfolio. CRS compiled a list of potential partners and began to contact them to see if they were interested. At the same time, Asala was in the process of transforming into a local organization and was looking for a technical support provider to help it through the process and identify opportunities to diversify its products. A partnership made sense to both organizations, and negotiations began for Asala to take over the CRS group lending portfolio and staff, and for CRS to provide technical support and limited funding.⁵

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⁴ Adapted from the merger questionnaire results, written by Tim Nourse, November 2001.
Tim Nourse, the CRS Microfinance Program Manager at the time, contacted Reem Abboushi, the Executive Director of Asala, in June 2000. They discussed the benefits and disadvantages of the merger and the sustainability of the individual or group lending programs. Initially, CRS was concerned about the performance of Asala’s individual lending program and its commitment to sustainability. Asala, especially its board, was concerned that CRS would threaten its status as a new independent NGO and tie Asala to overly ambitious expansion targets. At the time, Asala was still a project of Oxfam/Quebec and did not have an official board (although people had agreed to serve on the board once the organization was registered). Asala’s director discussed the issues with Oxfam/Quebec and those who were to become board members to get their approval to proceed with the development of a new business plan.6

In the end, both organizations saw significant advantages to working together. For CRS to institutionalize its program, given funding constraints, it determined that an existing microfinance institution to absorb and expand the group-lending product was the best solution. Asala provided a sustainable institutional framework to absorb and expand the program. For Asala, CRS’s group-lending product would diversify its services, allow it to serve poorer clients, and give it access to CRS’s technical and fundraising assistance.7

The principle reasons for the merger can be summarized as follows:8

For CRS:
- A local partner would allow portfolio and staff to be transferred intact.
- Asala had the basic expertise and infrastructure to absorb and expand the group lending product.
- The transfer would allow CRS to get out of direct lending, while continuing to support the sector.

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6 Ibid.
7 Correspondence with Tim Nourse, CRS Regional Technical Advisor and former CRS/JWBG Microfinance Program Manager, timnourse@aol.com, November-December 2001.
8 Adapted from merger questionnaire results, Tim Nourse.
For Asala:

- Absorbing the group lending portfolio would allow Asala to make staffing changes to improve efficiency.
- Group lending was a new product line that would help Asala serve a population it was largely unable to serve with its larger individual loans.
- Partnering with CRS would provide Asala with technical expertise from an organization with substantial experience in microfinance.

Planning

A business plan and memorandum of understanding (MOU) were developed together by the CRS manager and the Asala director. This served as a guideline for roles/responsibilities and the transfer process. Instead of a separate post-merger plan, Asala developed work plans to accompany the business plan that covered the details of integration planning. A copy was distributed to all staff members.\(^9\)

One issue that came up was portfolio quality, due to the adverse effects of the latest escalation of violence. When the business plan and agreement were first drafted, the CRS portfolio had 0.5 percent arrears and 1.0 percent portfolio at risk (PAR); Asala’s individual portfolio had 4 percent arrears and 12 percent PAR. Due diligence consisted of looking at audited financial statements and MIS to determine the accuracy of the information on portfolio quality. There was no formal external audit of the portfolio on either side, though in retrospect both parties agreed that it would have been a good idea, if only to confirm an accurate base of information from which to start the merged entity. Despite the problems with portfolio quality and the lack of a formal audit, both sides decided to move forward. According to former CRS manager Tim Nourse, "The problems with Asala’s individual portfolio seemed surmountable, and during the Intifada we had already been working together for four months. We were comfortable with each other; and waiting would not have changed anything, since the two

\(^9\) Ibid.
organizations had already made a commitment. The difficulties associated with the Intifada were just bad luck and could not have been avoided."\(^{10}\)

For final approval of the transfer process, CRS followed a normal proposal development, review, and approval process in line with its exit strategy for the microfinance project. The Asala director consulted with the board and the Oxfam/Quebec Program Manager, and they agreed to enter into the partnership.\(^{11}\)

**Timeline**

Asala signed an agreement with CRS in February 2001 to absorb the CRS group-lending program and Gaza staff. It took approximately three months to discuss the merger and to develop a business plan and an MOU. The MOU was not signed for another four months, since Asala’s registration procedures were delayed.\(^{12}\)

The integration process occurred in two phases. The first phase involved training Asala Gaza staff and general management in group lending procedures. This took four months (September-December 2000). The second phase involved Asala taking direct managerial responsibility for the program with close CRS supervision. This took six months (January-June 2001). During this time, all CRS-issued loans were also completely repaid and replaced with new Asala-issued loans, thus completing the full transfer of the portfolio. Today, CRS continues to provide technical assistance, and Asala conducts all lending operations.\(^{13}\)

**Lessons Learned**

According to Asala and CRS staff, the merger process worked well overall. The initial "getting acquainted" period helped to ensure that all the staff members on both the CRS and Asala sides knew their counterparts and responsibilities before the formal transfer was made.\(^{14}\)

The biggest problems had to do with personality and staff

\(^{10}\) Correspondence with Tim Nourse.
\(^{11}\) Adapted from merger questionnaire results, Tim Nourse.
\(^{13}\) *Ibid.*
\(^{14}\) *Ibid.*
conflicts, which Asala management considered a normal part of the process of adjusting to any big changes in an organization. For example, the former CRS Operations manager, who became a technical advisor to the merged entity, subsequently had no managerial responsibilities and experienced a few problems with staff as both adjusted to this new role. It simply took time for loan officers to gain trust in new management, and for the former operations manager to step back from her implementation role. This experience underscored the importance of work plans and written job descriptions that state clearly the changes in and expectations for new or altered positions. As Tim Nourse stated, "To be frank, there’s little that you can do to avoid these issues. Staff have difficulty adjusting to new management and new roles. Although it was at times a problem, I don’t think it was at a level that was more than normal. What is key, though (and I think what we did), is that the upper-level management on both sides provide a unified front to lower-level staff regarding expectations and actions. The Asala director and I discussed the issues enough and agreed on things such that there were no different signals sent by each organization."  

Nourse also explained that they kept staff informed by giving them all the related documents regarding the transfer, and by communicating with them on a daily basis. The two managers met weekly to discuss progress. “Besides oral communication, we drafted job descriptions and work plans so that staff knew what was expected of them.”

Other lessons learned during the Asala/CRS merger were:

1. Transfer during good periods, not bad ones. Asala and CRS did not have an alternative to conducting the transfer during the Intifada, and the lower portfolio quality and restrictions on movement that resulted made the transfer much more difficult. Asala staff members were a little resentful that they were handed the program during a difficult period when repayment

15 Correspondence with Tim Nourse.
16 Ibid.
and client discipline was low. The Intifada also caused movement restrictions such that management had difficulty visiting the branches often.\textsuperscript{17} This, of course, made solving problems more difficult. Nonetheless, Asala’s case is proof that a merger is possible even under the most difficult conditions. Despite this, the merger has been relatively smooth and the overall program performance has improved since the merger, despite the Intifada and the harsh economic conditions.\textsuperscript{18}

2. Involve all staff in the planning and transfer processes. Most CRS and Asala staff were involved from the outset, thus ensuring that all parties supported the merger. It also helped that Asala and CRS/JWBG were small, so there was no need to set up formalized structures. The two managers worked out the basic ideas with staff input, and put them into a draft business plan. Staff from both CRS and Asala (including a board members) were involved in the review and revisions of the final business plan.\textsuperscript{19}

3. Involve board members. Asala’s board of directors were involved in the merger process, but they were not as actively involved in the details of the process as might have been desired in order for them to have greater understanding and influence during the process.\textsuperscript{20}

Sources:
2. Correspondence with Reem Abboushi, Asala Executive Director, asala@palnet.com, November-December 2001.
3. Correspondence with Tim Nourse, CRS Regional Technical Advisor and former CRS/JWBG Microfinance Program Manager, timnourse@aol.com, November-December 2001.

\textsuperscript{17} Adapted from merger questionnaire results, Tim Nourse.
\textsuperscript{18} Correspondence with Reem Abboushi, Asala Executive Director, asala@palnet.com, November-December 2001.
\textsuperscript{19} Adapted from merger questionnaire results, Tim Nourse.
\textsuperscript{20} Correspondence with Reem Abboushi.
Case Study 7

World Bank Local Initiatives Project, Bosnia & Herzegovina

Elissa McCarter

Background

The Local Initiatives Project was designed in 1996 as part of the assistance provided by the World Bank for the post-war recovery and economic reconstruction of Bosnia and Herzegovina (B&H). The implementation of the Local Initiatives Project was entrusted by the governments of both entities of B&H—the Federation B&H and the Republika Srpska (RS)—to the Local Initiatives Departments (LIDs). Regardless of their administrative separation, both LIDs, which function under the entities’ Foundations for Employment and Training, cooperate daily on project implementation with the main goal of creating a strong, sustainable microfinance sector in B&H.¹

The Local Initiatives Project had three goals:

1. To provide urgent assistance to economically disadvantaged segments of the population, through distribution of 10,000 loans ranging from 500 DEM to 10,000 DEM, to help them implement their own business ideas so they can generate income and increase employment and self-employment.

2. To build institutional capacity for the establishment of strong and self-sustaining microfinance institutions that will be able to provide services to the target clients on a long-term basis.

3. To support the creation of an appropriate legal-regulatory framework for non-banking financial institutions.²

² Ibid.
During 1996, LID signed agreements with 17 NGOs (12 in the Federation of B&H and five in the RS) that had been providing microcredit services under the umbrella of the LIP. LID provided a loan fund for the partner organizations, granted funds for operational expenses, and provided technical assistance.

Following the project’s 1998 mid-term audit, it was concluded that most of the partners had viable portfolios and good repayment levels, but certain organizations showed some signs of weakness in institutional development and lack of understanding of the mission of microfinance. It became clear that some would not be able to survive on a long-term basis without additional subsidies.³

On the basis of the mid-term audit’s findings, LIP management decided not to renew contracts with nine organizations (two in the RS and seven in the Federation of B&H). The eight partner organizations which received renewed funding agreements were: ⁴

1. AMK Posusje (since January 01, 2001: MIKRO AMK Posusje)
2. BOSPO Tuzla (since January 01, 2001: MI BOSPO Tuzla)
3. LOK Sarajevo (since February 02, 2001: LOK Micro Sarajevo)
4. MC/SEA Tuzla (since January 01, 2001: Partner Microcredit Organization Tuzla)
5. Sunrise Sarajevo (since January 01, 2001, Micro Sunrise Sarajevo)
6. Benefit Sarajevo-Lukavica
7. Mikrofin Banja Luka
8. Sinergija Banja Luka

An idea of the scale and impact of this project in B&H can be gleaned from the fact that disbursements carried out by LID’s partner organizations in 2000 made up 70 percent of all microcredit loan disbursements carried out in the country that year.⁵

³ Correspondence with Mirzet Ribic, LID Director B&H, m.ribic@bih.net.ba, October-December, 2001.
⁴ Correspondence with Aida Soko, LIP Program Officer B&H, a.soko@bih.net.ba, October-December 2001.
Merger Negotiations

The partner organizations that failed to renew funding began merger negotiations with those that did renew funding agreements. The two organizations in RS that LID stopped financing were closed. Out of the seven unfunded organizations in B&H, two continued to operate independently without LIP assistance: Aldi Gorade and World Vision/EKI. The remaining five merged with other partner organizations, which renewed contracts with LID (with the exception of World Vision/EKI, which operated independently and absorbed Vrelo Mostar.) These were:

1. NBR Modrica (which became part of LOK Micro Sarajevo)
2. Plavi Most (which became part of LOK Micro Sarajevo)
3. Business Centre Travnik (which became part of LOK Micro Sarajevo)
4. Lori Oraje (which became part of Sunrise Sarajevo)
5. Vrelo Mostar (which became part of World Vision/EKI)

Three years later, one of the organizations that continued to work independently, Aldi Gorade, still exists but still depends on subsidies. The other, EKI Sarajevo (World Vision), is currently one of the largest microcredit organizations in B&H and is again eligible for funding during the next phase of LIP II, which is in its preparatory stage. According to Mirzet Ribic, Executive Director of LID for Federation of B&H, EKI Sarajevo strongly emphasizes that suspension of the agreement with LID opened its eyes, and thereafter it undertook decisive moves toward cooperation with parent organization World Vision to build up a strong organization with assets of more than 10 million DM.

Legal Structure

Because all partner organizations were obligated to return funds to the LID, they could not count on the LID funds during the merger.

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6 Correspondence with Aida Soko.
7 Ibid.
8 Correspondence with Mirzet Ribic.
Those that completed the merger could only count on their own funds and funds from other sources. As a result, the process of merging in B&H was more a takeover than a true merger. The acquiring organizations in almost all cases assumed not only staff, portfolio, and other assets, but also the merging organization’s debt to LID. Ninety per cent of these funds were returned after one year.\(^9\)

All partner organizations that renewed agreements, including those that absorbed other organizations, are now registered in accordance with the Law on Microcredit Organizations (MCO) that was adopted in June 2000 with LID assistance. Seven of eight organizations reached full operational and financial sustainability, while one MCO showed a serious lack in its institutional development, and is now under special treatment of the LID of the Federation of B&H.\(^10\)

**Planning**

While LID of B&H, as part of its technical assistance role, was available to assist in the negotiation and consolidation process, most of the planning and procedures were conducted by the staff of the merging organizations. The LID was most heavily involved when questions of debt transfer arose, since LID funding took the form of a loan, to be repaid at the end of the funding agreement.\(^11\)

**Timeline**

The consolidation process in B&H took place between June 1999 and March 2000. Generally the activities were completed quickly, since all of the partner organizations knew one another due to intensive and shared technical assistance within the project. Moreover, due to the uniform methods for recording data and reporting to LID, the due diligence process was quick, as the organizations that took over the others were able to assess their performance quickly. According to Aida Soko, on average the consolidation process before actual integration did not take more

\(^9\) Ibid.
\(^10\) Ibid.
\(^11\) Ibid.
than three months, and the post-merger integration was also quite easy to implement, since all of the organizations had experience in microfinance, had received the same technical assistance, and therefore shared similar organizational procedures.\textsuperscript{12}

One exception was the merging of Plavi Most into LOK Micro. The merger was particularly advantageous to LOK, according to its management, because Plavi had used solidarity group methodology and LOK individual methodology. LOK was able to capitalize on Plavi’s knowledge and diversify its portfolio, organizing former Plavi staff to train its own staff and adding this methodology to its other field offices.\textsuperscript{13}

\section*{Lessons Learned}

World Bank and LID management have expressed satisfaction with the results to date of the project in B&H. As of June 30, 2000, when LIP officially closed, instead of the expected 10,000 loans, 50,261 loans had been disbursed, totaling 148,374,538 KM. Of the eight microcredit organizations funded by LID, seven are operationally sustainable and four are financially sustainable as well. Each of the organizations possesses a highly skilled staff, an accounting system, and a quality loan tracking system.\textsuperscript{14}

However, there have been criticisms that LIP management is to blame for the success or failure of the MCOs it supported. LIP’s approach was to cover all of B&H by funding a geographic spread of humanitarian and development organizations, which then launched microcredit operations in those areas. By purposely funding many organizations in a small country like B&H, where only so many providers realistically can exist over the long term, LIP actually created microcredit programs and then dissolved some of them shortly thereafter. But according to LID Executive Director Ribic, “These conclusions that are related to funding or stopping of funding have not been the decisive ones for future development of MCOs.”\textsuperscript{15} He supports his position by pointing to the fact that some unfunded

\begin{footnotes}
\item[12] Correspondence with Aida Soko.
\item[13] \textit{Ibid.}
\item[14] Correspondence with Mirzet Ribic.
\item[15] \textit{Ibid.}
\end{footnotes}
MCOs still managed to succeed without World Bank funding, and that one funded MCO is not performing well. LID Monitoring Manager Aida Soko likewise stated her belief that "consolidation was expected within the project but it would have happened independently of our decisions about financing or not financing the partner organizations."\textsuperscript{16}

Ribic added that

I, personally, expect further consolidation of microcredit organizations in B&H, but that process needs to be developed as a consequence of full understanding of MCO and to be an integral part of their strategic plan and should not, by any means, be imposed from outside. In this sense, LID management has a sensitive role to play in encouraging the processes, but without pressure and with a highly professional attitude in communicating with MCOs.\textsuperscript{17}

\textbf{Sources:}

1. Correspondence with Braco Erceg, LIP Director RS. berceg@iname.com, October-December 2001.
2. Correspondence with Mirzet Ribic, LID Director B&H. m.ribic@bih.net.ba, October-December, 2001.
3. Correspondence with Aida Soko, LIP Program Officer B&H. a.soko@bih.net.ba, October-December 2001.

\textsuperscript{16} Correspondence with Aida Soko.
\textsuperscript{17} Correspondence with Mirzet Ribic.
Case Study 8
XacBank, Mongolia
Elissa McCarter and Ganhuyag Chuluun

Background

XAC (pronounced "hass") is the symbol of eternity and the sun in Sanskrit; it also represents three words that translate as "Golden Fund for Development." XAC is a microlending company with a non-bank financial institution license from the Central Bank of Mongolia. XAC has been operational since September 1998, and is the first registered microfinance company in Mongolia, licensed by the Central Bank in 1999. As of October 2001, XAC had 17 branches in both urban and rural areas, with a portfolio of 5,500 clients, 75 percent of whom are women, and an average loan size of US$250. With 100 employees, XAC disbursed 1,500 loans each month and maintained 0.5 percent portfolio at risk (PAR) more than one day. Approximately 60 percent of loans support the trading sector.

Goviin Edhlel (GE), translated as "Gobi Start," was a small-and medium-enterprise (SME) lending operator with five branches in Gobi province. Also licensed by the Central Bank as a non-bank financial institution, GE had 170 clients, an average loan size of US$2,500, 40 employees, and 0 percent PAR. Approximately 40 percent of loans support the trading sector.

The main competitor for both companies was the Agricultural Bank of Mongolia.

Merger Negotiations

In September 2000, Ganhuyag Chuluun, the Executive Director of XAC, and Stephen D. Vance, Chairman of GE, came to the conclusion that a merger of the two was the optimal way forward in an environment of mounting competition. The principle reasons for
the merger were complementary missions and strategic fit, since both organizations operated in different, non-overlapping geographic areas and offered complementary services: micro and SME loans.

As a result of the merger, "XacBank" will be able to cover all provinces of Mongolia by 2002, offer a full package of financial services to its existing client base, and expand those services to Mongolia’s remotest areas and its most marginalized peoples, including nomadic herders. As part of the merger initiative, the companies are also developing and piloting a franchising system of financial services through savings and loan cooperatives.

The process slowed somewhat due to a management change at GE in January 2001, and it took another three months for GE to decide in favor of the merger. Once this agreement was reached, intensive negotiations began internally and then reached out to include the external shareholder and stakeholder communities of both organizations. During this period, both sides developed mid-term plans and identified appropriate management structures for a new merged entity.

There was no significant resistance to the merger, but some time was required for shareholders to make up their minds. Due diligence was conducted after both companies were evaluated by a third party, internal auditors, and other relevant staff.

An interesting point that arose in the merger was the issue of having two CEOs. Because the spirit of the merger was that of equals and the two former directors of XAC and GE brought to the table complementary skills and images—one with a microlending background and knowledge of the local community, and the other with professional banking and international experience—the board chose to establish each as "co-CEO" of XacBank. According to Ganhuyag, "We recognized that [two CEOs] will contribute to the healthy merger process and stable development of the bank. So far our experience shows that we made the best decision possible under the given circumstances. Under other conditions this is probably not a good idea. But we also recognize that this structure is not a long-term solution."1

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1 Correspondence with Ganhuyag Chuluun, former Executive Director of XAC and co-CEO of XacBank, ganhuyag.ch@xacbank.org, January 2002.
Legal Structure

The planned legal transaction for the merger will involve swapping shares of XAC for GE assets, so that GE will become a holding company. Both parties are in the process of finalizing the post-merger business plan and expect to complete the merger by the end of 2001, simultaneous with an upgrade in status from non-bank financial institution to commercial banking license.

Timeline

Although it is still early in the merger process, to date the process has taken approximately eight months since negotiations began. What follows is a summary of the length of time for each phase in the XAC-GE merger:

- first contact to initial negotiations – 1 year
- negotiations to shareholder initial consensus – 2 months
- shareholder approval to letter of intent – 2 months
- letter of intent to merger agreement – 2 months
- operationalization of the merger with receipt of a banking license – 2 months

The newly-created XacBank expects that streamlining of operations will last until June 2002.

Lessons Learned

While it is still too early to reach any conclusions, Ganhuyag stated that "staff morale is something that requires extra effort since the merger process tends to create lots of tension at all levels." ²

Sources:
1. Correspondence with Ganhuyag Chuluun, former Executive Director of XAC and co-CEO of XacBank, ganhuyag.ch@xacbank.org, January 2002.
2. www.xac.mn ; www.xacbank.org

² Ibid.
Case Study 9
Financiera Confia, Nicaragua
Elissa McCarter

Background

Chispa was created in 1990 by Mennonite Economic Development Associates (MEDA) to provide urban microcredit and training to microentrepreneurs in the city of Masaya, Nicaragua. Its long-term goal was to become a privately held, full-service bank serving Nicaragua’s micro and small business communities. From its central office in Masaya, Chispa gradually expanded to 13 offices in other towns and cities across the country. Major financial supporters have included the United States Agency for International Development (USAID), the Canadian International Development Agency (CIDA), the Canadian Food Grains Bank, and Canadian counterpart funds through the Nicaraguan Government’s Ministry of External Cooperation.¹

By 1998, Chispa had become profitable in a microfinance sector in Nicaragua that included more than 30 NGO-led microfinance programs.² Since its inception in 1990, it had disbursed a total of US$28.3 million through 72,800 loans with nearly 6,000 active clients.³ However, it still lacked two things in order to achieve the goal of becoming a privately held bank: a banking license and private investor capital.⁴

¹ www.meda.org.
⁴ Kim Alter, et al.
Chispa was incorporated as a Foundation in January of 1998 as a first step in the process of being transformed into a regulated financial institution capable of mobilizing savings. At the same time, Chispa started to look for potential partners in this endeavor. These partners included:

**INTERFIN**, S.A., a licensed Nicaraguan *financiera* with a commercial loan portfolio of US$12 million, 750 clients, and equity capital of $2 million owned by Nicaraguan individuals.

**PROFUND** Internacional, S.A., a Costa Rica-based investment fund of which the main shareholders are InterAmerican Development Bank, Central American Bank for Regional Integration, and Calmeadow, among others.

**IPC**, a German-based consulting company, and **IMI**, an investment fund affiliated with IPC.

**INTERBANK** – Banco Intercontinental, S.A., one of the largest commercial banks in Nicaragua affiliated with INTERFIN through common ownership, and with a small microcredit portfolio with loan capital borrowed from ProFund.5

**Merger Negotiations**

In 1999, Chispa entered negotiations with Financiera International (INTERFIN) about the possibility of merging operations to create the first micro/small business bank in the country. The merger would bring together four groups of investors into a new merged entity, Financiera Confia. The intent was for MEDA to transfer its wholly-owned Chispa microfinance program into the new entity, Confia. INTERFIN would transfer its lending operations and banking license into the new entity, and IMI and Profund would invest cash in it.6

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5 Joyce Lehman, “CHISPA to CONFIA: A Transformation.”
According to Joyce Lehman, Senior Consultant for MEDA Consulting Group, the stated intent of the merger was to create a new registered bank in Nicaragua that would focus on serving the microenterprise sector, seize an underserved market, and become the strongest competitor in the market. The chief motivations of each party involved were as follows:7

MEDA
- Fulfill the vision of evolving its projects to programs and then to businesses
- Prove that the poor are bankable
- Act according to its fundamental belief that financial activity should be regulated for the protection of the clients
- Meet its need for a Nicaraguan banking license and additional capital, some from Nicaragua
- Provide the new entity with a microcredit operating system and loan portfolio, a multiple-office structure, market knowledge, and capital

INTERFIN
- Meet its need for a new market sector and additional capital
- Provide a bank license and bank operating systems, Nicaraguan capital and depositors to the new entity

PROFUND
- Meet its need to save its unsuccessful investment in Inter-Bank
- Provide capital, international networking, and credibility to the new entity

IPC/IMI
- Establish a long-term relationship with a profitable institution
- Provide technical financial expertise and capital to the new entity

7 Ibid.
INTERBANK

- Meet its need for experienced managers for its microcredit portfolio
- Provide connections to the Nicaraguan Capital Market to the new entity

Legal Structure

Under Nicaraguan law, a commercial entity and an NGO may not legally merge. Thus, the creation of Confia was an operational merger only, not a legal merger. INTERFIN is the surviving entity, having changed its name to Corporacion Nicaraguense Financiera, S.A. Confia (meaning "trust"), and becoming the only regulated financial institution in Nicaragua focused on the microenterprise sector. Chispa as a "shell" entity still exists as an NGO.8

To achieve the merger, Chispa concluded its credit program in December 1999, and in January 2000, Chispa’s loan portfolio, clients, branches, loan officers, and other key staff formed the base for the creation of Confia. INTERFIN requested an extension of its banking license from the Banking Superintendency, and changed its name, and both INFERFIN and Chispa’s portfolios were absorbed into the new institution. The current ownership structure is as follows:9

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>MEDA</td>
<td>41%</td>
</tr>
<tr>
<td>PROFUND</td>
<td>26%</td>
</tr>
<tr>
<td>DOEN HOLLAND</td>
<td>19%</td>
</tr>
<tr>
<td>IPC/IMI</td>
<td>13%</td>
</tr>
<tr>
<td>INTERFIN shareholders</td>
<td>1%</td>
</tr>
</tbody>
</table>

Lessons Learned

The following is a summary of lessons learned and key recommendations based on Joyce Lehman’s presentation at the IV Inter-American Microenterprise Forum in November 2001:10

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8 Ibid.
9 Ibid.
10 Ibid.
1. **Contract for independent and competent due diligence review** of the other partner’s balance sheet and equity value prior to negotiating a merger. The partners discovered later that the INTERFIN balance sheet was significantly overvalued, and as a result, the former INTERFIN shareholders lost the equity they had hoped to receive.

2. **Hire only one CEO.** Do not try to merge by co-running a business. It won’t work. Because the parties were unable to agree on the choice of general manager (GM), a compromise was reached for a transition-period "management partnership" consisting of the former GM of INTERFIN and a former IPC employee. It was difficult to conduct the "internal review" since the former INTERFIN GM and his credit manager did not provide access to the information. In March 2000, the former INTERFIN chief financial officer (CFO) did not report to work for three days and a majority of the parties agreed he should be fired and replaced by the former Chispa CFO. In the subsequent months, the new CFO and her staff worked day and night to document the adjustments required due to the poor quality of the INTERFIN portfolio and other balance sheet items. By August 2000, all former INTERFIN senior management had left the institution, the dual management was discontinued, stock was issued to the new shareholders reflecting the new ownership structure, and at long last, the official step had been taken in the formation of a transparent and efficient financial institution.

3. **Monitor the process closely** despite barriers of distance and language.

4. **Take the steps one at a time, and in order:**
   - Agreement of intent
   - Due diligence review
   - Agreement of financial basis for a merger
   - Preparation of a business plan
   - Shareholders’ agreement
   - Operational merger
5. **Create a new institution, not a continuation of the old.**
   - Spell out a new vision for staff and public
   - Choose a new name and logo
   - Move headquarters to a new location
   - Choose a new CEO from the business, not NGO, community
   - Select key management from outside the local banking circles, preferably from outside the country
   - Make decisions oriented to the needs of the new institution rather than attempting to retain old structures and hierarchies

6. **Recognize that staff members are critical to success.**
   - Treat the staff well—institute basic human respect policies, pay incentives for meeting short-term goals, and profit-sharing plans to engender a long-term commitment
   - Inspire excellence in the staff—strive to create the very best institution, and expect the staff to do their best
   - Dismiss staff who do not fully share the vision of the new institution; you can’t afford them

Today, Confia’s reputation within the banking community is growing and the merger has proved successful, in terms of both performance and high morale among the staff. As of June 30, 2001, Confia serves 12,000 active clients with an outstanding portfolio of US$7.5 million, portfolio at risk less than 2 percent, and an equity base of US$5 million.11

**Sources:**

2. Correspondence with Gerhard Pries, Chief Financial Officer of MEDA and General Manager of Sarona Global Investment Fund, gpries@saronafund.com, January 2002.
4. www.meda.org

11 Ibid.
Case Study 10  
Financiera El Comercio, Paraguay  
Elissa McCarter

Background

Financiera El Comercio was founded in 1976 as a joint-stock company and has been operating for the past 25 years as a financial company in Paraguay. It maintains a diversified portfolio in urban and rural microenterprise as well as small/medium enterprise and corporate business loans. It offers credit cards, debit cards, loans, titles of investment and savings deposit services for its customers. Its signature card, "Credifielco Card," is oriented specifically to the microfinance market for high accessibility to a large number of clients.¹

El Comercio is a member of the Association of Financial Companies of Paraguay (ADEFI) and also participates in the Global Program of Credit for the Microcompany, supported by the InterAmerican Development Bank, Ministry of Industry and Commerce, and Eximbank of Taiwan and Japan.²

In December 1999, El Commercio merged with Financiera EFISA as a means to increase the volume of the company in terms of capital, operations, and outreach. At the time of the merger in November 1999, El Commercio served 11,315 active clients, of which 534 were in the microfinance portfolio, with an outstanding portfolio of US$220,000.³

Financiera EFISA, in comparison, served 5,459 active clients, of which 924 were in the microfinance portfolio, with an outstanding portfolio of US$706,000.⁴

² Ibid.  
³ Correspondence with Teresa Velilla, Executive Director of Financiera El Comercio, teresavelilla@elcomercio.com.py, January-February 2002.  
⁴ Ibid.
Merger Negotiations

Negotiations were initiated in August 1999 by Financiera EFISA. According to El Comercio’s Executive Director, Teresa Velilla, there were four principal factors⁵ that made the merger a logical and desirable move in Paraguay:

1. With the entry of formal banking institutions into the microfinance sector in Paraguay, the increased competition (as a result of the lower rates that formal banks could offer) caused an overall decrease in the total volume of operations that microfinance providers could obtain. In a depressed market such as Paraguay, it is increasingly difficult for small institutions to achieve growth and reach economies of scale necessary for long-term sustainability.

2. There is very high demand for and yet limited supply of capital in Paraguay. Given the current low rate of inflation, the high-volume turnover of very small portfolios is attractive to formal banks.

3. The management of microfinance organizations has reached a critical point in Paraguay. Previously, operational efficiency was not as important for the success of an MFI. Now, given the new competitive environment, gaining highly qualified managers from the banking sector through the merger was crucial to maintaining a competitive edge in the market.

4. The highly competitive urban market required a geographic opening in which new market niches could be developed and expanded. As a result, the former General Manager of EFISA had begun to identify new opportunities, and the idea of a merger became more and more attractive. This person served as the principal intermediary to establish formal collaboration between both institutions.

When asked if there was any resistance to the merger, Velilla responded, "I believe that any merger will always produce some resistance and that this resistance comes from external and internal sources." She noted these as:

⁵ Ibid.
• External: Clients resist the changes in rules and regulations that accompany the transfer to the merged institution.

• Internal: Managers resist relinquishing or reassigning their turf. Personnel in general have a tendency to resist reorganization, new job descriptions, new assignments, and so forth.6

Legal Structure

As both institutions prior to the merger were already regulated, the Banking Superintendency granted permission to El Comercio for the merger to take place. Today, the new institution continues to operate as a regulated, formal financial institution serving 25,000 active clients as of the end of 2001.7

Planning

In order to develop the financial projections for the new institution (which included portfolio, capital, branches, number of employees, projections of portfolio growth, reduction of costs, anticipated yield, etc.), the executive director of each institution prepared a separate set of projections first, and then presented them to their board of directors and shareholders. After this, the executive directors prepared a joint strategic plan that incorporated these individual plans. They also received additional assistance from an external consulting company that was contracted for this specific purpose.8

Timing

The merger process, from its inception to the integration of operations, took just five months: 30 days for the negotiation stage, 15 days for the company/signing of the contract, and the remainder to present all the documentation to the central banking authorities, standardize and reprint materials, adjust computerized systems, and so forth.

6 Ibid.
7 Ibid.
8 Ibid.
Velilla stated that the process was fast "because certain measures were taken to achieve it in a short time. For example:

- We unified portfolio management and signed contracts between the two companies to begin dealing with all customers.
- The Central Bank promoted mergers and thus gave us continuous support during the process.
- There was a good understanding among the directors involved in the merger and they had total support from their shareholders."  

Lessons Learned

According to Velilla, there were two major lessons learned during the El Commercio merger:

The principal lesson learned—and one that was a positive outcome of the merger in Paraguay—is that once the decision is made and parties are convinced of the advantages of merging, complete the process as quickly as possible before any information leaks to the outside or risk losing valuable or critical employees.

Also, during the negotiation process, while each merging institution still maintains control over its own portfolio, the institutions must make sure that those in charge of their respective portfolios remain committed to their work and are there to support and guide the process. Without their support (and even with their support), it is a good idea to bring in a third party to oversee the transition process.

Sources:
1. Correspondence with Teresa Velilla, Executive Director of Financiera El Commercio, teresavelilla@elcomercio.com.py, January-February 2002.
2. www.elcomercio.com

9 Ibid.
10 Ibid.
Background

FIE

Centro de Fomento a Iniciativas Económicas (FIE) was founded in 1985 by five professional Bolivian women as a private, nonprofit institution offering quality financial and non-financial services to the poor. In an attempt to improve the relationship between lenders and the working poor, FIE sought an integrated program to promote the sustainable development of microenterprises and small businesses by offering services that included: credit for working capital and fixed investments, entrepreneurial development technical training, production training, technical assistance in organizational development, quality control technical assistance, marketing advisory services, and financial advice for microenterprise organizations.¹

Since its inception, FIE has operated independently from international networks and donor-initiated microfinance programs. In the first ten years of its operations, FIE disbursed more than US$29.8 million; by 1996, its loan portfolio amounted to US$6.2 million along four credit lines: production, commerce, associations (group), and leasing. It established seven regional offices and three agencies. In March 1998, FIE became a licensed Private Financial Fund in Bolivia.²

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² Correspondence with Pilar Ramirez, President of FIE, mohnster@ceibo.entelnet.bo, November-December 2001.
PRODEM

Fundacion para la Promocion y Desarrollo de la Microempresa (PRODEM) was created in 1986 through the private efforts of Bolivian businessmen and with support from the Calmeadow Foundation and ACCION International. PRODEM started its operations in the capital, La Paz, and by 1991 had expanded to most of Bolivia’s largest cities, extending more than 15,000 loans. Despite its initial success, PRODEM found itself limited by its status as an NGO. In 1991, it decided to create a new commercial bank to which it would gradually transfer its portfolio. As a result, Banco Solidario S.A. (BancoSol) was established in early 1992.3

With BancoSol covering PRODEM’s former urban clientele, PRODEM redefined its mission to provide credit services to smaller cities and rural areas. It transferred its urban portfolio to BancoSol and became a major shareholder with 35 percent ownership. While it originally planned to transfer its rural portfolio to BancoSol as well, PRODEM later revised its strategy and chose to expand its financial operations to rural and secondary cities throughout the country, with the long-term goal of becoming its own bank.4

By the end of 1998, PRODEM Foundation served more than 47,000 clients (65 percent women) through 48 branches (71 percent in rural areas). It held an active portfolio of more than US$24 million and had an average loan size of US$520 in rural and US$620 in urban areas.5 Recognizing the need to create another regulated financial institution in order to offer a wider spectrum of financial services in the rural areas, in 1999 PRODEM successfully constituted a regulated, privately held financial fund, registered under the name of Fondo Financiero Privado—FFP PRODEM S.A.

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4 Ibid.
Portfolio Indicators for FIE and PRODEM

<table>
<thead>
<tr>
<th>Indicator</th>
<th>As of June 30, 2000</th>
<th>As of December 31, 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FIE</td>
<td>PRODEM</td>
</tr>
<tr>
<td>Loan portfolio outstanding</td>
<td>$19,284,430</td>
<td>$20,805,105</td>
</tr>
<tr>
<td>No. of active clients</td>
<td>23,164</td>
<td>28,227</td>
</tr>
<tr>
<td>Average loan size</td>
<td>$833</td>
<td>$1,481</td>
</tr>
<tr>
<td>Number of loans disbursed</td>
<td>62,967</td>
<td>9,429</td>
</tr>
<tr>
<td>Total amount disbursed</td>
<td>$61,110,579</td>
<td>$14,978,446</td>
</tr>
<tr>
<td>Total amount in savings</td>
<td>$10,354,681</td>
<td>$0</td>
</tr>
<tr>
<td>Number of branch offices</td>
<td>14</td>
<td>51</td>
</tr>
<tr>
<td>Women clients</td>
<td>61%</td>
<td>40%</td>
</tr>
</tbody>
</table>

Sources: FIE and PRODEM, February 2002.

The Bolivian Context

Bolivia was one of the first countries in which microfinance activities began; it now has one of the most developed microfinancial markets in the world. However, economic, political, and social crises since 1998 have had repercussions in the microfinance sector, diminishing aggregated demand as well as clients’ capacity to pay. As a result, the microfinance operators in Bolivia today are faced with new needs, and with the challenge to innovate and diversify their services to ensure long-term sustainability and permanence.7

The number of microcredit providers in Bolivia has led to a highly saturated market and over-indebtedness of clients around the country. In addition to increasing the level of arrears, this situation has damaged the relationships of trust and clients’ confidence in the financial system in general. The search for new markets is therefore urgently needed by all MFIs in Bolivia.8

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6 Statistics refer to the period since registration as a Private Financial Fund; FIE since 1998 and PRODEM since 1999.
7 Correspondence with Pilar Ramirez.
8 Ibid.
Merger Negotiations

This highly competitive environment for microfinance in Bolivia provided a window of opportunity for mergers. According to FIE President Pilar Ramirez, "We imagined a union of two very good microfinance organizations, taking what was best in each, and synergizing these into a third excellent financial organization."  

PRODEM’s Chief Executive Officer Eduardo Bazoberry identified four key reasons that a merger made sense for PRODEM and FIE:

1. **The bleak condition of the microfinance industry**, due to the poor economic environment as well as the consumer credit financial institutions that flooded the market with indiscriminate loans, causing microentrepreneurs to become overly indebted

2. **A shared belief** that there is room for only a few microfinance institutions in the market

3. **The need to optimize resources**, taking advantage of economies of scale, lower administrative expenses and greater efficiency

4. **The need to optimize synergies** of PRODEM’s rural-concentrated portfolio and FIE’s urban-concentrated portfolio, increased market coverage, and positioning

According to Ramirez, "There had been talks, in the form of jokes, of mergers or sales among the regulated MFIs, due to the competition we were experiencing. But it was PRODEM, in the person of its CEO, Mr. Bazoberry, who called me to propose the merger. He had done his homework and knew what he wanted from us. We both decided it had to be a very quick process, involving only upper management and our major private investor who was the most reticent about the merger."  

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9 Ibid.
10 Correspondence with Eduardo Bazoberry, CEO of PRODEM FFP, ebazoberry@prodemffp.com.bo, January-February 2002.
11 Correspondence with Pilar Ramirez.
Neither PRODEM nor FIE conducted a formal due diligence. After an initial introductory meeting, the organizations agreed to hire the auditing firm that happened to be auditing both institutions to analyze the value of each organization and produce the financial data to support the merger. The commercial and operations managers reviewed basic things like portfolio, products, services, policies (credit and institutional), and personnel capabilities. According to Ramirez:

This was probably the first mistake we made. Each MFI should have had its own firm for this study. The process, thereafter, was heavily tainted by the initial results of this study, where we understood that cold numbers became more important for PRODEM than technology, know-how, reputation, etc. They basically came up with the present worth of each MFI, the future worth of the merged entity, and how much each MFI contributed to that future worth. Much of this future worth seemed to FIE as wishful thinking and a lot of hot air about new technology PRODEM supposedly was developing.

Although FIE was not satisfied with the study, both organizations had agreed to it and decided to give the auditors the benefit of the doubt.12

PRODEM experienced little resistance to the idea of a merger among its private shareholders; and it received "a lot of support from the regulatory entity [Superintendence of Banks] and from multilateral organizations, such as CAF [the Andean Promotion Corporation] and IDB [the Inter-American Development Bank]," according to Bazoberry.13

But FIE encountered resistance, especially from some of its shareholders. Its NGO shareholder felt the merger would lead FIE away from its social service roots and objectives; its international shareholder felt uncomfortable with many of PRODEM’s practices in the rural areas; and its major private shareholder feared losing control in the new entity due to the smaller share package he would hold. In fact, this private shareholder tried to stop the merger

12 Ibid.
13 Correspondence with Eduardo Bazoberry.
negotiations by putting his shares up for sale. According to Ramirez, "It was fortunate for us that FIE NGO was able to buy him out, but we lost a very important investor." Despite this resistance, once FIE shareholders grasped the larger picture of the global trends in microfinance and the highly competitive environment in Bolivia, even the skeptics among them were eventually won over.\(^{14}\)

As negotiations progressed, other problems began to emerge. Due to concerns on FIE’s side, PRODEM and FIE were never able to reach a shareholder’s agreement. Also, FIE believed that PRODEM’s management team was committed to the merger idea but the shareholders of PRODEM Private Financial Fund were not. Ramirez states that:

FIE finally pulled out when it became very clear that the process was turning into a takeover disguised as a merger, perhaps as a way of getting PRODEM’s shareholders to buy in to the deal. With the advantage of time and the experience of the negotiations behind us, the reason we finally pulled away from the merger was that we felt PRODEM was only seeking to make a bigger PRODEM in preparation for applying for full banking status.\(^{15}\)

This was, in fact, one of the lessons learned, according to Bazoberry: "We learned that in the Bolivian market there is little room for equal mergers as such. What could function is just a plain takeover."\(^{16}\)

**Legal Structure**

The planned merger would have taken the form of a "merger by incorporation," where PRODEM would incorporate the FIE operation into its legal corporate status, initially maintaining the Private Financial Fund legal structure, and applying as soon as possible for a full commercial bank license. According to Ramirez, the combined equities of the organizations would have permitted this.\(^{17}\)

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14 Correspondence with Pilar Ramirez.
15 *Ibid*.
16 Correspondence with Eduardo Bazoberry.
17 Correspondence with Pilar Ramirez.
Lessons Learned

The many lessons learned during the PRODEM/FIE merger negotiations differ according to participant. The fundamental reasons that the merger of PRODEM and FIE failed was that they lacked a shared vision and mission, and the clash of their organizational cultures ultimately caused the negotiation process to break down.

As PRODEM CEO Eduardo Bazoberry stated:

It is clear that the merger failed because FIE got cold feet. When an agreement was reached at the highest levels (board of directors) and communicated to the Superintendency of Banks, FIE backed off, claiming that their board did not approve the merger. Their argument was that differences in credit technology, human resources policy, institutional culture and business orientation would not permit the merger. Prodem PFF is now the only entity in Bolivia that has top-of-the line technology—smart cards for savers with fingerprints instead of pin number for added security, and smart ATM machines built by us and interactive with the clients in their own native languages....Plus Prodem PFF offers 15 more non-credit products than any of the other MFIs in only two years since we obtained our license. Our MIS is sold outside Bolivia by our brother company INNOVA. For us, this was an incredible value that we would be contributing to the merger and FIE thought it was only an illusion.18

For FIE President Pilar Ramirez, FIE learned three key lessons during the merger process:19

1. Be clear about intentions from the very beginning to establish a foundation of mutual trust, mutual need, and transparency.

Ramirez, a trained psychologist, articulated a lesson that she learned while working as a psychologist that she did not apply here: “The lesson is: ‘The first session gives a therapist a lot of information on the problem and on the prognosis, so pay

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18 Correspondence with Eduardo Bazoberry.
19 These lessons have been adapted from merger questionnaire results, written by Pilar Ramirez, November 2001.
attention to that first encounter.' It was obvious, in that first encounter, that the problem for PRODEM was how to become a bigger MFI than the one they perceived as their major competitor. The signs for disaster were there, clearly: PRODEM was not interested in FIE as FIE, but what it could give PRODEM to solve its problem. In therapeutic terms, this pointed to a very poor prognosis."

When Ramirez later spoke to someone involved in the Paraguay merger and asked what had convinced her that it would be successful, when everyone else was betting on total disaster, she responded: "The other side was convinced that they needed us, all of us—how we operate, what we know, who we are, who knows us, how we do things, our technology, etc. I felt it from the first conversation."

2. **Acknowledge cultural clashes (poor synergies of the key players) on both an organizational level and a personal level.**

There was a less-stated but very important gender issue involved in the process. The FIE team was composed mostly of women, whereas PRODEM’s team was all men, made up of quite dominant figures and prominent people, including a former president of the country and very wealthy entrepreneurs. According to Ramirez, the merger was not a key priority for them. It was "a drop in the ocean of their financial interests. We should have taken this more seriously and started the dealing with these [investors] directly. It would have saved all of us a lot of time, money and naive illusions."

3. **Ensure that all parties perceive the due diligence process as neutral, fair, and unbiased.**

Although PRODEM and FIE contracted an outside auditor to perform the due diligence, the auditor had worked principally with PRODEM and had a vested interest in a merger process that leaned towards PRODEM’s side. This perception and the fact that the study did not satisfy FIE shareholders led to suspicions that the results were biased. Whether or not these suspicions were well founded, the fact that FIE did not fully trust the results was an immediate barrier to the trust-building process and, in the end, to the merger itself.
Could the merger have worked?

When asked if the merger could have worked, both Ramirez and Bazoberry replied in the affirmative. According to Ramirez:

Yes, it was a fantastic opportunity for the MFI industry. It could have worked if PRODEM would have taken on the risk and challenge of building a new organization from what was best in both our operations, and if FIE would have felt stronger to demand this from the very beginning, instead of trying to accommodate to helping PRODEM solve its problem of size, power, market share, etc. After what I know now, I would have proposed an acquisition from the start, asking PRODEM how much they would be willing to pay for FIE. Who knows what the turn of events would have been.20

Likewise, Bazoberry stated, "I believe that the merger had a lot of value-added elements and it would have worked. The change of mentality to a business-oriented vision is totally relevant and without it mergers are not going to be successful. The business orientation is needed to make an institution big, powerful and efficient in order to maintain over time the possibility of serving the target market in a productive way. [With] no business [there are] no services, no loans, no savings for the unattended inhabitants of Bolivia.”21

Sources:
1. Correspondence with Eduardo Bazoberry, CEO of PRODEM FFP. ebazoberry@prodemffp.com.bo, January-February 2002.
2. www.prodemffp.com
3. Correspondence with Pilar Ramirez, President of FIE, mohnster@ceibo.entelnet.bo, November-December 2001.

20 Correspondence with Pilar Ramirez.
21 Correspondence with Eduardo Bazoberry.
Case Study 12

Eco Futuro, Bolivia

Gonzalo Puente and Elissa McCarter

Eco Futuro was established as a separate entity owned by four NGOs that merged lending operations to form one regulated financial institution in Bolivia. After a three-year process, Eco Futuro was incorporated in May 1999. However, Eco Futuro failed to achieve the results initially expected from the merger. According to the authors of a paper on the formalization process of microfinance in Bolivia that was published recently by the Rural Finance System Project (SFR FONDESIF-GTZ):

Under an independent general manager of Eco Futuro, the idea was that a high-quality team would be formed from the NGOs or the public and gradually Eco Futuro would grow nationwide as a specialized microfinance institution, taking over the clients from the NGOs which would turn to other endeavors. Yet these NGOs...began to backslide on their commitments and continued to provide financial services as NGOs, albeit in different areas. As a result, now two years later Eco Futuro is taking over loan and client portfolios from its member NGOs only in certain ‘commercially viable’ areas.¹

Background

Following the Bolivian government’s approval in 1996 of the

incorporation of Private Financial Funds (FFP), four non-governmental organizations (NGOs), in an act unprecedented in Bolivia, initiated a merger process to create a single regulated and supervised microfinance institution. The organizations were:

**Asociación Nacional Ecuménica de Desarrollo (ANED)** (National Ecumenical Development Association), with 15 years’ experience in microcredit activities, exclusively targets the rural areas that cover a large part of Bolivia. Its operations are small and its microcredit loans address the needs of the most impoverished peasants of the agricultural sector.

**Centro de Investigación y Desarrollo Regional (CIDRE)** (The Regional Research and Development Center), with more than five years’ experience, provides small individual loans to producers in both urban and rural areas in one of the country’s nine regions.

**Fundación para Alternativas de Desarrollo (FADES)** (Foundation for Development Alternatives), with almost 10 years’ experience in individual, association, and group lending methodologies nationwide, focuses 80 percent of its operations on rural micro and small entrepreneurs (mostly farmers and cattle raisers, with a small share dedicated to commercial and service activities).

**Instituto para el Desarrollo de la Pequeña Unidad Productiva (IDEPRO)** (Institute for the Development of the Small Productive Unit), with more than five years’ experience, operates exclusively in urban areas through group and individual loans to micro and small entrepreneurs nationwide.

Once the merger process began, one more shareholder joined the effort:

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2 Private Financial Fund (FFP in Spanish) is the legal term in Bolivia for Microfinance Institutions that are authorized to operate as financial intermediaries under the regulation and supervision of the Banking and Financial Entities Superintendence (SBEF).
Unión Nacional de Instituciones para el Trabajo de Acción Social (UNITAS) (National Union of Institutions for Social Action). UNITAS is a network of approximately 35 NGOs; its objective is to strengthen the institutional capacity of its affiliate organizations. Although UNITAS was a symbolic shareholder, it supported and strengthened the merger initiative because it became an important monetary resource.

Two years after Eco Futuro’s organizational process and writing a new constitution began, the Agencia Suiza para el Desarrollo y la Cooperación (COSUDE) (Swiss Agency for Development and Cooperation) and a group of private entrepreneurs also joined the merger effort.

Merger Negotiations

While each of the four founding NGOs close to achieving financial sustainability was capable of transforming into an FFP independently, they determined that joining forces would be most beneficial for the country and themselves, as long as they became the main FFP shareholders and could retain at least 60 percent of the shares. The justifications for the merger are summarized as follows:

1. The merged entity would enjoy immediate national coverage, operate at both urban and rural levels, offer different credit services, and have real potential to expand the product range (such as savings, drafts, transfers, etc.) to reach markets unserved by traditional banks.

2. The high number of microcredit players in Bolivia, and their still limited coverage and resources, added up to a need for stronger institutions with greater potential for achieving sustainability and broad geographic outreach.

3. The country’s financial system would benefit, since the number of entities entering and exiting the financial system (with the consequent negative effects) would decrease. Financial regulators could focus their efforts on supervising and regulating those that have real potential to penetrate unserved or underserved markets.
4. A broader shareholder base would promote a stronger, more solvent company that would allow the merged entity to achieve economies of scale and would result in larger and more permanent capital returns on investment.

5. Offering more products and wider coverage in their respective markets would allow the NGOs to achieve their common mission of serving the low-income productive sectors, which represent more than 50 percent of Bolivia’s economically active population.

Once the merged FFP was created, the NGOs agreed that they would withdraw from credit activities assumed by the FFP and focus on other activities as each organization might desire. These new roles would translate into the following activities:

- Non-financial services to support the development of micro and small entrepreneurs in urban and rural areas through training, information dissemination, internal and external market orientation, etc.

- Entry to markets outside the merged FFP’s immediate interest. The NGOs could provide credit to new areas according to each organization’s experience and credit methodology. These markets, once mature, could then be absorbed by the FFP or could continue under the NGOs’ activities as Eco Futuro “correspondents.”

- Development of new financial and non-financial products, identified through market research, in areas that would not interfere with the merged FFPS. The NGOs would serve to “pilot test” these new products, which could later be implemented by the FFP.

Legal Structure

To set up an FFP, the Commerce Code in Bolivia requires a minimum of five shareholders. The Superintendency of Banks and Financial Institutions (SBEF) also demands that shares be held by private partners. Identifying shareholders of this type was difficult for Eco Futuro. To create Eco Futuro, each NGO and private shareholder contributed capital based on its own equity or through
credit lines. These credit lines came from either the shareholders' own sources or external financing, with authorization for a regulated entity to manage them. Together they represented the following shareholding structure:

Promoting NGOs ............... 90%
International organization .... 7%
(COSUDE)
Private investors ............... 3%

This base was modified slightly when the Andean Promotion Corporation (CAF) entered the Fund as a shareholder a short time after the entity began operating.

Promoting NGOs ............... 77%
International organization .... 20%
(COSUDE)
Private investors ............... 3%

For the actual portfolio transfer, Eco Futuro adopted a combination of transfer of portfolio in administration and direct sale. These processes are as follows:

The first way—called "Transfer of Portfolio in Administration"—involves the NGO (which ceases financial operations and remains as a shareholder or provides non-financial services) ceding its total portfolio in administration to the Fund, which manages it from then on. The new institution recovers the loans on behalf of the NGO (and is paid a commission for doing so) and awards the next loan (if applicable). In the process the portfolio is weeded out, meaning that the good borrowers are selected. The idea behind this arrangement is that the NGO opens up markets for the new Fund and selects clients. Weak clients remain with the NGO, which continues the work of recovering the loan. In the case of FIE, the overdue portfolio irrecoverability risk remained within the NGO.
The second way—"Direct Portfolio Sale"—involves the NGO selling its portfolio to the Fund for its net value (of provisions). This means that if the provision amount is recovered, it is given back to the NGO as a profit.³

For Eco Futuro, the move from "Transfer of Portfolio in Administration" to "Direct Portfolio Sale" was gradual. However, some NGOs retained parts of their portfolios and continue to offer credit services in regions where Eco Futuro does not yet operate.

The transfer of fixed assets and staff also took place in two ways:

Under the first arrangement, a large part of the NGO’s fixed assets and staff were transferred to the Fund. The NGO’s staff was formally dismissed so that they could be re-hired by the Fund, following an assessment procedure in which few people failed to qualify. The fixed assets (mainly furniture, computers, vehicles and offices) were transferred—rented and/or sold—from the NGO to the Fund...Under the other arrangement, the Fund was subsidized for several months in the form of the NGO’s goods, by lending it the assets at no cost. In another case they had to start from scratch, meaning that fixed assets were purchased and new staff were hired.⁴

Planning

The planning process for merging and incorporating Eco Futuro presented several challenges which fall into two main categories: 1) internal challenges related to the founding NGOs and other investors; and 2) external challenges related to the SBEF and financiers. When the merger process started, the founding NGOs were established institutions with their own personalities, credit technologies, and relatively mature target markets. Trying to align

³ Wiedmaier-Pfister, Pastor and Salinas, 11.
⁴ Ibid., 12.
them within a single financial entity that pursued profit but did not lose sight of social mission was difficult. This also presented a special challenge when it came to attracting new shareholders. To achieve the equity base needed for growth, the FFP would need new investors among the international organizations as well as the private sector. While international organizations generally knew the sector and shared its social mission, it was not easy to convince private investors (individuals or corporations) since there was no existing model for this initiative and the uncertainty level was high. It was important to find investors who knew something about microfinance and whose only priority was not to increase the value of their shares.

Because of this difficulty in attracting private investors with confidence that the merged FFP would achieve success, the SBEF and other potential investors were also uncertain. Although the SBEF had made progress in terms of recognizing this "other half of the Bolivian financial system" and had already granted a license to other FFPs, it still questioned the merger. Even when backed by the reputation of its four founding NGOs, the merged FFP represented in essence a completely new kind of entity for the SBEF.

**Timeline**

As a result of these challenges, it was three years from the start of the merger process (in May 1996) to the granting of the operating license (in May 1999); this didn’t even include the post-merger integration period. The long wait discouraged shareholders, and their discouragement only grew as more time passed.

However, the main effect of the delays on the FFP was financial. The NGOs had planned their contributions to shareholding capital and credit lines for certain dates—about a year after the project started. In actuality, they were requested to make these contributions (particularly credit lines) two or three years later, when market conditions and their activities and commitments with other financing agents had changed significantly. Even though this fact did not alter the amounts committed, it affected the FFP’s projections because not all the resources were available at the times when they were required.
Potential financiers found it difficult to understand the new entity that would result from the merger, in terms of both technical assistance and credit lines. In some cases, this meant that they postponed their offers or that they agreed to provide only small, less risky amounts until they could see the outcome.

Post-Merger Integration

Regarding the newly merged FFP’s start-up operations, the founding NGOs reached a consensus to devise a clear strategy of gradual consolidation and expansion. This reflected the importance that each organization attached to cautious, rational decision-making, timeliness, and effective management. The strategy consisted of three successive steps:

1) Enter mature markets already developed by the NGOs, transferring active portfolios in good standing (that is, leaving aside the portfolios that have arrears or penalties attached or are undergoing judicial procedures for loan default), the clients in these markets, the personnel responsible for their management, and, depending on the case, some fixed assets.

2) Consolidate operations in these markets, i.e., take over existing credit products but also offer new financial products such as savings, drafts, transfers, and other non-financial services: utilities collection (electric power consumption, drinking water and telephone bills); collection of taxes; salary payrolls to companies or institutions; etc.

3) Once activities are consolidated, begin expanding activities in these markets to reach new clients and surrounding communities. This third component of the strategy aims to reduce transaction costs through achieving economies of scale.

However, once the operating license was granted to the FFP and it was poised to begin to operate independently under new management, several problems began to emerge from various quarters:
Shareholders: Once Eco Futuro started operations and began to enter the founding NGOs’ credit markets, some NGOs reneged on their previous agreements. For example, shortly after Eco Futuro started operating, one NGO decided to sell its shares. This meant that it would not transfer any portfolio to the new entity and instead would continue expanding its own credit activities. Also, after transferring part of its portfolio to Eco Futuro, another NGO backed out of the process and decided instead to expand its own microcredit activities. Finally, a third NGO wanted to choose the members of the board of directors and the top executives of Eco Futuro.

The Board: Most of the Eco Futuro board members did not assume an independent position, acting only in the interests of the new financial entity; rather, they pursued the interests of the NGOs they represented. In addition, they concentrated their efforts too heavily on their supervisory role, neglecting the other roles a board should perform.

The Government: The government started to send mixed signals to the microfinance markets where FFPs in general began to operate. Some government actions were politically motivated and promoted the microcredit activities of the NGOs, particularly those specialized in the rural areas, by offering them advantages over FFPs if they operated in the same market. All newly regulated microfinance entities were already at a disadvantage, since accepting regulation meant exposing themselves to more costly and less flexible operating conditions.

International Organizations: Some international organizations continued providing the NGOs with funding at subsidized interest rates. Others did not support FFPs because they were profit-earning private entities, even if some operated in rural areas (which represented a significant portion of the poorest in the country). This also encouraged the NGOs to continue in the market and to grow, which in itself is not bad, except that the imbalances between regulated and non-regulated MFIs put the former at a serious disadvantage.
Current Status of Eco Futuro

The table below shows the change in clients, operating agencies, and portfolio prior to and after the merger of Eco Futuro.

<table>
<thead>
<tr>
<th>Number of Clients</th>
<th>Number of Agencies</th>
<th>Portfolio (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NGOs</strong></td>
<td><strong>After formalization (March 2001)</strong></td>
<td><strong>NGOs</strong></td>
</tr>
<tr>
<td>(prior to setting up the FFP)</td>
<td></td>
<td>(prior to setting up the FFP)</td>
</tr>
<tr>
<td>88,244</td>
<td>14,556</td>
<td>53</td>
</tr>
</tbody>
</table>


As of August 2001, Eco Futuro had 10 operating agencies (with one additional agency’s authorization by the SBEF pending), approximately 100 credit officers, a portfolio of approximately US$13 million (60 percent urban and 40 percent rural), and more than 18,000 active clients (65 percent women and 35 percent men). The growth projections for 2002 submitted to SBEF were quite moderate, and focused in the short and medium term on the urban areas, due to Bolivia’s current economic crisis.

Lessons Learned

While there were many lessons learned during the three-year process of merging, the following provides a summary of key points:5

- The cost incurred during the three-year, pre-operational stage of the merger, that is, in the process of organizing and incorporating the FFP, amounted to US$500,000. According to a detailed study carried out by GTZ consultants, if the additional expenses that the founding NGOs absorbed (and that permitted the FFP to work in their

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5 Adapted from Puente, Gonzalo. "NGO Mergers to Create a Single Regulated Microfinance Entity: The Experience of Eco Futuro S.A. FFP Bolivian Private Financial Fund." Presented at the IV Inter-American Microenterprise Forum (panel discussion on "Merging: Experiences in Microfinancing Institutions"), Santo Domingo, Dominican Republic, November 14-16, 2001. (Translation arranged by CRS Peru.)
facilities while the company became incorporated) are included, this amount is closer to US$700,000. The amount was paid almost entirely by the founding shareholders according to their shares. Only around one tenth of this amount could be recovered during the first four years of operation, since the SBEF had authorized accounting of a certain amount in assets as "Organization Expenses." The rest would be paid through the dividends generated by the company when it generated profits, from the moment the shareholders agreed to distribute them.

- Since not one but several NGOs were building the FFP, the transition process was not easy. The merger meant that NGOs had to be equally proactive and turn the lead role over to a "third party." This made relations between the NGO and FFP management difficult and tense at times. In addition, the roles that each NGO would play were not always clearly defined. This invited interference from shareholders, directors and executives.

- Since several players were involved in the process, coordination of each NGO's own planning and projections during the transition was complicated. For example, trying to define operation start-up dates, or even worse, modifying a date initially agreed to, was not easy. This had to be managed carefully, taking into consideration that no merging NGO could stop lending operations in one day, and the transition would be completed at different times for each NGO.

- When Eco Futuro received portfolio transfers from two or three NGOs in a region, it would recruit personnel from these NGOs. The differences in the NGOs' organizational cultures, and the differences between them and the personnel coming from banking institutions, created a complex initial configuration of human capital. Managing these cultural differences was made even harder by the fact that some personnel retained ties to their former employers.

- Although microcredit methodologies, whether for group or individual loans, were very similar, each NGO developed and implemented them differently. A simple transfer to the financial entity substantially complicates the administration of credit and increases risk when the entity has to
administer not just two or three products but a whole range of them, each with their particular characteristics.

- The introduction of the new entity in the markets, even if announced beforehand as part of the entry strategy, must be handled carefully. The slightest perception by clients that the former entity will no longer be present can produce defaults or client dropouts that are difficult and costly to correct. For example, particularly in the rural areas, as soon as clients perceived that the NGO would no longer be operating, they assumed that they were no longer in debt to the NGO. In response, Eco Futuro posted a sign that displayed both its name and the name of the NGO, stressing that Eco Futuro was the "new name" of the former NGO but that the current credit terms, personnel, and so on would remain the same.

**Recommendations**

The experience of Eco Futuro suggests the following recommendations\(^6\) for other MFIs in the future:

1. Any shareholder—be it an NGO, private individual, or corporate investor—inolved in a merger to create a regulated financial entity must assume the role of investor exclusively. Even when the balance between profitability and social mission is important, shareholders must act responsibly to ensure maximum profitability and performance for the long-term success of the institution.

2. The integration process (mainly the portfolio transfer) must be well planned and the timing agreed with the supervising entity. This must be completed in the shortest time possible and must include all aspects of the transferring NGO’s operations simultaneously. At the same time, the NGO must have a well-defined business plan stating how it will assume its new role in the particular market where the transfer takes place, as well as in other market areas.

3. The merging parties (former NGOs in Eco Futuro’s case) must set an example for their staff who transfer to the new

\(^6\) Ibid.
entity by committing wholly to it and encouraging their staff to do the same. This means breaking formal ties with staff members and giving full support to the new management of the merged entity. In turn, the new entity must think well ahead to develop intensive training processes for new staff to professionalize its services and establish its own organizational culture.

4. Shareholders must appoint board members who guarantee independence from their individual constituents and respond only to the board’s mandate and therefore to the interests of the new company. Ideally, board members should be independent professionals who are knowledgeable about their businesses and who are paid by the entity. Appointment of a competent chair of the board of directors is fundamental. The chair must be a professional who not only knows the sector, but also clearly knows where the company should aim and can take the rest of the directors in that direction.

5. Top management of the new regulated entity preferably should be professionals with experience in the regulated financial system and with the capacity to lead and build teams of staff that will efficiently manage the new entity. To do so, they need the proactive, decisive, and constant support of the board of directors, especially in the period of the new entity’s consolidation. This does not mean that the board of directors should increase its own supervisory role; however, strong support will ensure better and more efficient internal control mechanisms for building the new institution.

6. The new entity must be able to select its personnel independently of the influence of former directors of merging NGOs and to recruit only the best staff.

7. Rather than waiting until the portfolios are transferred to the new entity, there should be prior standardization of the NGO programs, with the NGOs extending new loans under the terms defined by the merged entity. Unfortunately, during the Eco Futuro merger process, the NGOs did not want to undergo this standardization process, which would have made the transfer easier and more gradual for both Eco Futuro and its clients.
Conclusion

Despite the problems Eco Futuro encountered, and his resignation as its general manager in order to work with another transition project in Mexico, Puente wrote:

I would gladly face another merger because I am convinced that mergers bring more advantages than disadvantages….When the players and management can stay focused on these positive factors throughout the entire planning and integration process, I am sure that disadvantages can be controlled and avoided in most cases. But it requires an ability to take into account lessons learned from others’ experiences, a respect for the complexity of problems that can occur, and an acceptance of the reality of a long and arduous process to make the merger a success.\footnote{Ibid.}

Sources:


Merger Lessons

The case studies presented in this book yielded more lessons than can be captured here; the following summary of key points presents the most important lessons in hopes that they will be useful for future microfinance mergers.¹

Ten Lessons For Mergers

1. Stay True to Mission, Never Lose Sight of Vision

When considering a merger, mission should be a central focus: the merging parties must share not only a common notion of the mission of the merged entity, but also a common vision for what they intend the merger to accomplish.

Fear of losing its mission was a key factor in FIE’s decision to back out of its planned merger with PRODEM. Mission was also at the forefront of discussions in the Philippines over the creation of the Opportunity Microfinance Bank as a regulated, microfinance-oriented thrift bank.

Without a constant focus on the mission and the confidence that the mission is shared by everyone on all sides, conflicts over turf, control, and claiming credit can derail the whole merger process.

2. Build Trust—Before, During, and After

Establishing a foundation of trust is crucial to a merger’s success. Building trust was a major obstacle during the Eco Futuro

¹ The following points have been adapted from the concluding chapter of McCarter, Tying the Knot: A Guide to Mergers in Microfinance.
merger in Bolivia, where former NGO directors were not willing to yield control and place their trust in the new management. It was also a key factor in the breakdown of negotiations between PRODEM and FIE, where a lack of trust gave rise to suspicion and hard feelings that were not easily allayed.

Building trust is challenging; it requires ample time and the willingness to take some chances. There is no way to guarantee a perfect due diligence report, a perfect selection process for new management, a perfect transition and integration process; ultimately, once they have done everything they can to ensure the quality of these processes, the people involved in the merger must give up control and trust each other.

3. Get Buy-in at Every Level

Every person involved in the merger process—from donors, investors and board members to top executives, middle managers and loan staff—should "buy in to" the merger idea. At OMB in the Philippines, this meant that those who initially favored the merger had to commit to persuading those who were more resistant. At Asala in Palestine, it meant engaging all staff in the transfer and planning process to ensure that everyone supported it. At Enlace in El Salvador, getting buy-in was a major pitfall of the portfolio purchase scheme, where the design made sense but the NGOs were more interested in their own survival and did not accept the merger idea in the end. Likewise, at Eco Futuro in Bolivia, some of the NGOs agreed initially to the merger, but then refused to give up control over their portfolios.

4. Find a Leader

Leadership is critical both for the early stages of negotiating the merger and for its successful implementation. Success depends on someone with management and leadership skills and the will to make the merger work. Particularly in the case of mergers that involve setting up a regulated entity, the leader must also have the professional experience that the job demands. The Financiera Confia, Eco Futuro, and OMB cases all underscore the need to choose professionals with experience from the business community,
not the NGO sector, to manage a regulated entity efficiently.

The importance of strong leadership is not limited to the CEO: success often requires the involvement of key figures in international organizations or board members with the influence and the daring to push ahead. At OMB, for example, when one key partner took the helm and led other partners to join, it tipped the balance in favor of the merger.

5. Be Realistic

The amount of time, energy, and work needed to implement a merger can come as an unpleasant surprise. Depending on the type of merger, it can mean handling a number of processes simultaneously: merging, separating from another NGO, registering a new similar legal entity or establishing a different type of legal entity (regulated), and professionalizing services accordingly.

The timelines in the cases presented here varied from as little as five months (El Comercio) to as long as three years or more (Eco Futuro, TPC, FORA Fund). It’s difficult to predict exactly how long things will take, especially in light of the cumbersome bureaucracies that operate in many developing countries. Realistic planning requires the ability to:

- Treat the merger as a separate project in itself.
- Hire someone—from an external source if possible—specifically to help with this mammoth task. Relying only on existing personnel will result in managers and staff members who are overworked and overstressed.
- Establish realistic expectations and realistic timelines (but also ambitious enough to push the process through as quickly as possible).
- Increase the budget to cover the short-term costs associated with the merger.

6. Be Prepared

A merger process is rarely smooth, but it can be made easier with ample preparation. With few examples to follow, the practitioners involved in the microfinance mergers presented here
were forced to figure things out the hard way—by trial and error. The ACCION case states candidly that staff were successful "not because [they] were experts in how to implement a merger, but because there was a strong willingness on both sides...which allowed them to get over the humps." In this and several other cases, the "humps" would have been much smaller had there been more information available and sound advice from those with first-hand experience. Providing this information and advice is the principle purpose of this book.

7. Be Extra Sensitive to Culture—Before, During, and After

Cultural issues can threaten to undermine a merger at every stage. Indeed, cultural challenges arose in 11 out of the 12 cases in this book. For example, the PRODEM-FIE case underscores the need to "acknowledge cultural clashes both on an organizational level and a personal level"; the FORA Fund case warns practitioners to "anticipate a long process of cultural integration, even if operations achieve integration more quickly"; the Financiera Confia case emphasizes the need to "recognize that staff members are critical to success...[and] inspire excellence in the staff"; and the XAC-GE case notes that "staff morale is something that requires extra effort since the merger process tends to create lots of tension at all levels." It is impossible to avoid cultural clashes; the key is to know how to manage them.

8. Communicate, Constantly

A key element of managing the merger process is communication. Communication builds trust, ensures buy-in, and lets everyone know what is happening and what to expect—which is critical to avoiding the fear, uncertainty, and doubt among employees that can breed rumors and misinformation.

At Asala in Palestine, an important lesson was to keep "staff informed by giving them all the related documents regarding the transfer, and by communicating with them on a daily basis." The staff need to know what is expected of them and what they can expect. At FORA Fund in Russia, it was important to "be very clear from the beginning; [to] listen and respond to people's concerns, but [to] have
plans well thought-out, continually assure people, and be a leader."

9. Find a Neutral Outsider to Help

Outsiders can bring objectivity and balance to what is often a very emotional process for the staff involved. For example, the FORA Fund case in Russia notes that "Outside consultants...[can] help rethink assumptions and add human resources to what is a complex process"; and the El Comercio case emphasizes that "it is a good idea to bring in a third party to oversee the transition process."

Using an outsider can be extremely useful at several stages during a merger:

- **First approach**: A known, trusted outsider with both organizations’ best interests in mind can skillfully play matchmaker.
- **Negotiations and planning**: When crucial and controversial decisions are being made, an outsider with experience, expertise, and objectivity will help move things along and keep the merger process on track.
- **Post-merger integration**: An outsider can help avoid staff overload during the complex and demanding integration process.

That said, the outsider must be perceived as a neutral and objective actor in the process. Otherwise s/he will have no credibility and will only harm the process.

10. Maintain Momentum, and Persevere

No matter how much preparation is involved, there will be unexpected obstacles, delays, and surprises along the way. Sometimes momentum is everything: if the process moves too slowly and morale is allowed to slip, the merger can derail entirely.

Some tips from practitioners in this book for maintaining momentum include:

- Take the steps one at a time and in order (Financiera Confia).
- Keep your time frame tight (FORA Fund).
• Pursue any opportunity to speed up the consolidation process (OMB).
• Once the decision is made, complete the process as quickly as possible before any information leaks to the outside, or you may lose valuable or critical employees (Financiera El Comercio).

Learning from Success…and Failure

Positive reports from the mergers nearing completion, such as those in Russia, the Philippines, Palestine, and Paraguay, indicate that microfinance mergers can and do succeed. However, just as important are the two merger "failures" presented in this book—cases that demonstrate that even when a particular merger fails, those involved often remain convinced of the benefits of mergers in general. For example, those involved in both the PRODEM-FIE and Eco Futuro cases were still extremely positive about the potential for mergers in the microfinance industry. As Gonzalo Puente of Eco Futuro stated: "I would gladly face another merger...because I am convinced that mergers bring more advantages than disadvantages. When the players and management can stay focused on these positive factors throughout the entire planning and integration process, I am sure that disadvantages can be controlled and avoided in most cases."

Mergers may well be the wave of the future for the microfinance industry. The practitioners represented in this book provide valuable insight for other microfinance institutions to consider carefully the complexity of mergers, to avoid the pitfalls, and to better position themselves to reap the benefits that mergers can yield.
Microfinance Merger Profile Questionnaire

The following questionnaire was developed in order to gather profiles of various microfinance institutions that have engaged in a merger or other legal form of consolidation with other microfinance operators. Any information received will be appropriately sourced (and sent for editing/review upon request) if included in a forthcoming book on case studies of mergers in microfinance.

In addition, the experiences and lessons from this collection of case studies will provide valuable insights for a larger guidebook on mergers in microfinance, based principally on the case of Save the Children’s and Catholic Relief Services’ merger in Armenia during 1999-2001. The purpose of this guidebook is to draw from lessons learned and to provide practical guidelines for other organizations that might consider a merger in the future.

1. Provide a brief background of the merging organizations involved.
2. Provide a brief description of the lending environment.
3. What were the principle reasons for (or against) the merger?
4. Did you face any resistance from either side? By whom? For what reason?
5. Describe the merger process, for example:
   - Who initiated negotiations?
   - How long did they take?
   - What were the procedures?
   - What type of planning was done, when, by whom?
     (Please attach example plan if possible).
6. What was the timeline for the merger process? What were the major phases and roughly how long did each phase take?
7. How did the post-merger integration process work? Who was responsible? How long did it take? What were the problems experienced?

8. Describe a moment during the merger process that was most difficult and how did you resolve it?

9. What were the major lessons learned from your merger experience?

10. If you could have done anything differently during the merger process, what would it have been and why?

11. Additional comments, suggestions, or ideas?
About the Author

Elissa McCarter has worked for Catholic Relief Services since 1998. She launched the CRS Kamurj Microfinance Program in Armenia and has provided technical assistance to other partner organizations in Armenia and Zimbabwe. Before joining CRS, she worked with women’s self-help groups in Benin and served as a public school teacher in France, where her passion for teaching and training first emerged. She has facilitated workshops in Business Planning for Microfinance, Managing Growth, Market Research and Product Design, Delinquency Prevention, and Training of Trainers. She is a graduate of Vanderbilt University and has a Master’s Degree in International Development from Georgetown University’s School of Foreign Service. She currently lives in Istanbul, Turkey, where she serves as a technical advisor to a local women’s NGO that is establishing the country’s first microfinance institution.
Catholic Relief Services, founded in 1943, assists the poor and disadvantaged outside the United States. CRS works in solidarity with all people of good will to promote human dignity, alleviate human suffering, promote the development of people, and foster charity, justice, and peace in the world. CRS assists the poor solely on the basis of need, not creed, race, or nationality, and maintains strict standards of efficiency and accountability. CRS currently operates in 87 countries and territories and supports microfinance activities in 33 countries.

### CRS Microfinance

#### West Africa
- Benin
- Burkina Faso
- Ghana
- Niger
- Senegal

#### Eastern Africa
- Ethiopia
- Kenya
- Rwanda
- Uganda

#### Southern Africa
- Madagascar
- Zimbabwe

#### Middle East and North Africa
- Egypt
- Jerusalem, West Bank, and Gaza

#### South Asia
- India
- Pakistan

#### South East Asia
- Cambodia
- Indonesia
- Philippines
- Thailand
- Vietnam

#### Europe
- Armenia
- Bosnia-Herzegovina
- Bulgaria
- Croatia
- Macedonia

#### Latin America and the Caribbean
- Bolivia
- Dominican Republic
- Ecuador
- El Salvador
- Guatemala
- Haiti
- Nicaragua
- Peru