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IFAD

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REPORT AND RECOMMENDATION OF THE PRESIDENT

TO THE EXECUTIVE BOARD ON A PROPOSED

COUNTRY-SPECIFIC GRANT

TO THE

**SAVINGS AND CREDIT UNION NETWORK OF
THE UNION OF THE COMOROS**

IN SUPPORT OF THE

SAVINGS AND CREDIT UNION NETWORK CAPACITY-BUILDING PROGRAMME

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**REPORT AND RECOMMENDATION OF THE PRESIDENT OF IFAD
TO THE EXECUTIVE BOARD ON A PROPOSED COUNTRY-SPECIFIC GRANT TO
THE SAVINGS AND CREDIT UNION NETWORK OF
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I submit the following Report and Recommendation on a proposed country-specific grant to support the Savings and Credit Union Network Capacity-Building Programme of The Union of the Comoros, in the amount of USD 350 000 for a three-year period.

I. COUNTRY CONTEXT

1. The Comoros archipelago is situated in the Mozambique Channel, 200 km north-east of Madagascar and 300 km east of Mozambique. It comprises four islands, of which three – Grande Comore (Njazidja), Anjouan (Nzwani) and Mohéli (Mwali) – constitute The Union of the Comoros, which became independent in July 1975. A fourth island, Mayotte, remained under French administration. The Comoros is one of the world's poorest countries, with a per capita gross domestic product of USD 257. Agriculture is the most important sector, providing employment for 70-80% of the population and accounting for 40% of gross national product. Remittances and international assistance play an important role in the economy, and represent a significant positive inflow for the country's balance of payments. Like many other small-island economies, the Comoros is handicapped by its isolation, lack of clear-cut territorial boundaries and the very small size of its domestic market. Limited transportation links and institutional constraints have so far prevented the country from establishing meaningful inter-island trading. A new Constitution has been drawn up and was endorsed by 70% of the population in a referendum held in December 2002; local elections were held in April 2004. The country is highly indebted, and has been working with the World Bank to access debt relief under the Debt Initiative for Heavily Indebted Poor Countries (HIPC).

2. **IFAD assistance.** IFAD has financed four loan operations in the Comoros for a total commitment of SDR 9.25 million; the two earlier projects closed with only 57% of committed funds disbursed while the two more recent projects have both disbursed around 95%. The Pilot Agricultural Services Project, cofinanced with the World Bank, closed in 2003, and the last project in the portfolio will be closing in December 2004.

3. **Programme development.** IFAD prepared a country strategic opportunities paper (COSOP) for the Comoros at the end of 2001 and recommended that grant financing should be made available to support the activities of non-governmental organizations (NGOs). The COSOP also stated IFAD's priority of providing further support for the development of microfinance operations. IFAD prepared a follow-on project in 2002, but the Government asked that the project not be submitted to the Executive Board. The Government was reluctant to incur further indebtedness because of the ongoing HIPC Debt Initiative discussions and the lack of a framework for fiscal decentralization. In 2003, the Government informed IFAD that it would not be borrowing funds to finance development activities for the foreseeable future, and that it expected not to be able to review this position before 2006.

II. BACKGROUND

4. **Project achievements.** The Support to Economic Grass-Roots Initiatives Project, financed by an IFAD loan of SDR 2.45 million, was approved in 1994 and reached completion on 30 June 2004. The project had two components: (a) development of microenterprises for adding value in rural areas; and (b) development of savings and credit unions to offer appropriate financial services to the rural population. The performance of the project's rural finance component has been remarkable. Twelve savings and credit associations have been established, known by their French acronym as MECKs (*mutuelles d'épargne et de crédit Ya Komor*). These MECKs have some 22 000 members and have succeeded in mobilizing over USD 9.4 million in savings. The success of MECKs in mobilizing savings is due to the paucity of financial institutions (only two commercial banks and one other microfinance operator – the Sanduk Network – operate in the country) and the high level of remittances from abroad. The experience gained clearly demonstrates how putting in place financial services can encourage savings. This is evidenced by the fact that initial deposits by MECK members were extremely small (equivalent to USD 5-10) but have rapidly grown with contributions from family members working abroad, and now average about USD 450 per member. MECKs are also providing credit to their members, equivalent to about 50% of the savings mobilized by the individual MECKs. The draft project completion report has concluded that the most notable success of the project has been the establishment of institutions for rural finance.

III. RATIONALE

5. The achievements of the MECK network need to be consolidated in order to offer decentralized financial services to IFAD target groups as a means of promoting socio-economic development. The microfinance network comprises 12 MECKs, four of which were formed in 2003. The network remains at a relatively early stage of evolution, despite the extremely fast growth in membership and savings mobilized (doubling every year). The fragility of the MECKs is evidenced by the need to computerize their accounting systems, the ongoing need for training MECK committee members as to their roles and responsibilities, and the lack of prudential measures to safeguard savings. Continued efforts are needed to reduce the time delay in credit repayment and to further improve repayment rates, which currently range from 92-100%, depending on the MECK.

6. The Savings and Credit Union Network (*Union des MECKs*) was established in August 2003 to provide technical backstopping and supervision to link individual MECKs into a network so as to spread credit risk and enable economies of scale. The network's director-general was appointed in April 2004 and staff have been selected. The legal framework for the MECKs was approved by the Government in June 2004; it entailed modifying applicable legislation in order for the Central Bank to include microfinance operators. While this is a very positive step towards expanding the availability of financial services in more remote areas of the islands, the network is expected to supervise individual MECKs to ensure the quality of their financial and management procedures, protect savings, and provide technical training for MECK staff and committee members.

7. With the closing of the IFAD-financed project, the network has not benefited from technical backstopping to develop its functions clearly for an activity that is new and for which there is little experience to date in the Comoros. Experience with microfinance operators has shown that eight to ten years are required for operations to reach full institutional sustainability, i.e. the income from branch members fully covers the costs of the umbrella organization. Because of the early level of development of these MECKs, their financial contributions to the operation of the network are expected to be insufficient to cover operating costs in the near future. The support under the proposed grant will aim to strengthen institutional sustainability, but additional support may be subsequently needed, given the time required to reach institutional sustainability.

IV. THE PROPOSED PROGRAMME

8. **Goal and objectives.** The provision of rural financial services is a key tool for mobilizing savings and providing financing in rural areas in the Comoros. The objective of the grant is to promote the institutional sustainability of the MECK network through support to the Savings and Credit Union Network. The specific objectives of the grant over the three-year implementation period are:

- (i) Empower the network by building its technical capacity so that it can play its role in supervision, technical backstopping and advocacy;
- (ii) Support the sustainability of the network by continuing work to develop, strengthen and implement appropriate financial and management procedures, taking into account the need to bring the network to long-term financial viability; and
- (iii) Enable the network to put in place a financial framework to develop income sources from its own activities on the basis of cost recovery and service charges on member contributions.

9. **Target group.** The grant will be accorded to the network to provide services to its 12 member MECKs, which currently have a membership of 22 000. Given the MECKs' rate of growth, it is expected that membership will continue to increase, particularly among MECKs established in the past two years. The target group for the grant will be rural poor people who are members of a MECK.

10. **Grant activities.** The grant will finance activities in support of raising the professional capacity of network staff, raising the professional capacity of individual MECK staff and elected committee members, and providing further technical training for MECK members. The four planned activities are:

- **Institutional strengthening of the Savings and Credit Union Network (component A).** This will include financing the cost of two annual general assemblies and three-monthly executive committee meetings with individual MECKs. Financing will also cover network staff salaries for 36 months.
- **Modernization of the information management system for individual MECKs (component B).** While the closed IFAD project provided technical backstopping for strengthened accounting systems, the growth of savings has been so rapid that these accounting systems are largely overwhelmed. The grant will finance implementation of the last two phases of upgrading the MECK accounting systems as well as the purchase of appropriate computers and software.
- **Supervision and external auditing (component C)** will be provided to respond to the requirements of a rapidly growing and decentralized financial operator. This will include developing and validating network-level financial, and financial risk and management procedures and policies in order to safeguard the savings of members in individual MECKs. The grant will also finance two internal auditors and annual audits by an external auditor for each of the 12 MECKs and the Savings and Credit Union Network.
- **Technical assistance and capacity-building (component D).** Under this activity, technical assistance will serve to: (a) determine the content of training required for individual MECK staff and elected committees; (b) make recommendations with regard to implementation of the new accounting system; and (c) provide the required technical support to the network to articulate its roles and responsibilities clearly.

11. **Specific outputs.** The outputs expected from the grant are as follows:

- (i) Strengthening of the network so that it can take on a supervisory role for individual MECKs, and the establishment of transparent financial procedures to ensure the credibility of the overall network;
- (ii) Consolidation of achievements to date in terms of providing financial services to the poorer strata of the population and financial intermediation in rural areas; and
- (iii) Strengthened professional competencies at individual MECKs and within the network in order to put in place and ensure adherence to standards for sustainable microfinance operations.

12. **Implementation arrangements.** The Savings and Credit Union Network was officially recognized by the Government in August 2003 and operates independently of the Government. The IFAD grant will be provided directly to the network, which will be responsible for implementation of the above activities and will report on its activities to IFAD and the Central Bank. During the grant implementation period, the network will begin developing an approach for ensuring the gradual absorption of its operating costs by member MECKs. It will also build a link with the recently set up Rural Finance Learning Centre¹ (established by MicroSave² and the International Centre for Development and Research³) to ensure ongoing support throughout grant implementation; it will furthermore provide consolidated reporting through the Microfinance Information Exchange (MIX) network, which is supported by IFAD as a basic performance monitoring tool in rural finance.

13. **Costs and financing.** The total amount of the grant will be USD 350 000, implemented over three years. Disbursements will be effected on the basis of approved annual workplans and budgets, satisfactory expenditure and financial reporting, and procurement guidelines satisfactory to the Fund. The grant resources will also cover the costs of an external audit firm, which will conduct an audit each year of the network and the 12 individual member MECKs, and will provide IFAD with separate audit opinions for them. The proposed detailed budget is provided in the appendix.

14. **Reporting and supervision.** The network will furnish progress reports to IFAD every six months and will provide a comprehensive end-of-year report. The latter report will include information on the status of activities laid out in the annual workplan and budget, budgetary commitments made to date and their adherence to or variance with the budget, results achieved, and statistics on the network for individual MECKs, broken down by gender. Within the six months following the close of each financial year, the network will also provide IFAD with the external audit reports of each individual MECK and of the network. IFAD will field one supervision mission per year to assess the network's compliance with the annual workplan and budget and to identify successes and difficulties; a specific section of this supervision report will discuss impact. Supervision costs and any related expenses will not be part of the grant proceeds.

15. **Linkages to IFAD strategies.** In line with IFAD's strategic framework, the proposed grant aims to strengthen rural organizations and establish mechanisms to ensure sustainability, while reflecting the priority of the Regional Assessment for Eastern and Southern Africa of promoting the

¹ The Rural Finance Learning Centre is an Internet portal specifically focused on supporting capacity-building in organizations seeking to enhance the effective provision of financial services in rural areas.

² MicroSave is a unique project that promotes the development of savings and other more client-responsive financial services among microfinance institutions.

³ The International Centre for Development and Research is a French NGO created in 1961, whose organizational focus is microfinance integrated with social and economic services.

supply of financial services for the rural poor. In the context of IFAD's Policy for Grant Financing, the grant aims to build the capacity of local partners at the local level (for individual MECKs) and at the national level (through support for improved supervision and service provision by the network). The grant proposal is also in line with IFAD's Policy on Rural Finance, which stresses building long-term institutional and financial sustainability for microfinance operators, and will be linked to IFAD's virtual networks for rural finance.

V. RECOMMENDATION

16. I recommend that the Executive Board approve the proposed country-specific grant in terms of the following resolution:

RESOLVED: that the Fund, in order to finance, in part, the Savings and Credit Union Network Capacity-Building Programme, for a period of three years, commencing in January 2005, shall make a grant not exceeding three hundred and fifty thousand United States dollars (USD 350 000) to the Savings and Credit Union Network of The Union of the Comoros upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented to the Executive Board in this Report and Recommendation of the President.

Lennart Båge
President

APPENDIX

SUMMARY OF PROGRAMME COSTS

Savings and Credit Union Network Capacity-Building Programme (2005-2008)
Tentative Detailed Grant Budget
(USD)

| | |
|---|----------------|
| Component A: Inst. strengthening for Savings and Credit Union Network | 104 300 |
| Director-General salary | 33 000 |
| Deputy Director-General salary | 25 500 |
| Staff salaries | 19 800 |
| Operating costs | 11 000 |
| Inter-island travel | 15 000 |
| Component B: Modernization of the information management system for individual MECKs | 85 100 |
| Furniture | 500 |
| Computers and supplies | 6 000 |
| Software purchases and licenses | 2 000 |
| Information Management System (third and fourth phases) | 76 600 |
| Component C: Supervision and external auditing | 84 000 |
| External audit | 60 000 |
| Salary of internal auditors | 24 000 |
| Component D: Technical assistance and capacity-building | 76 600 |
| International technical assistance | 66 000 |
| Training of elected committees | 10 600 |
| TOTAL PROGRAMME COST | 350 000 |

