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**E**



Enabling the rural poor  
to overcome poverty

## **President's report**

### **Proposed loan and grant to the Kingdom of Lesotho for the**

### **Rural Financial Intermediation Programme**

Executive Board — Ninety-First Session  
Rome, 11-12 September 2007

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For: **Approval**

## **Note to Executive Board Directors**

This document is submitted for approval by the Executive Board.

To make the best use of time available at Executive Board sessions, Directors are invited to contact the following focal point with any technical questions about this document before the session:

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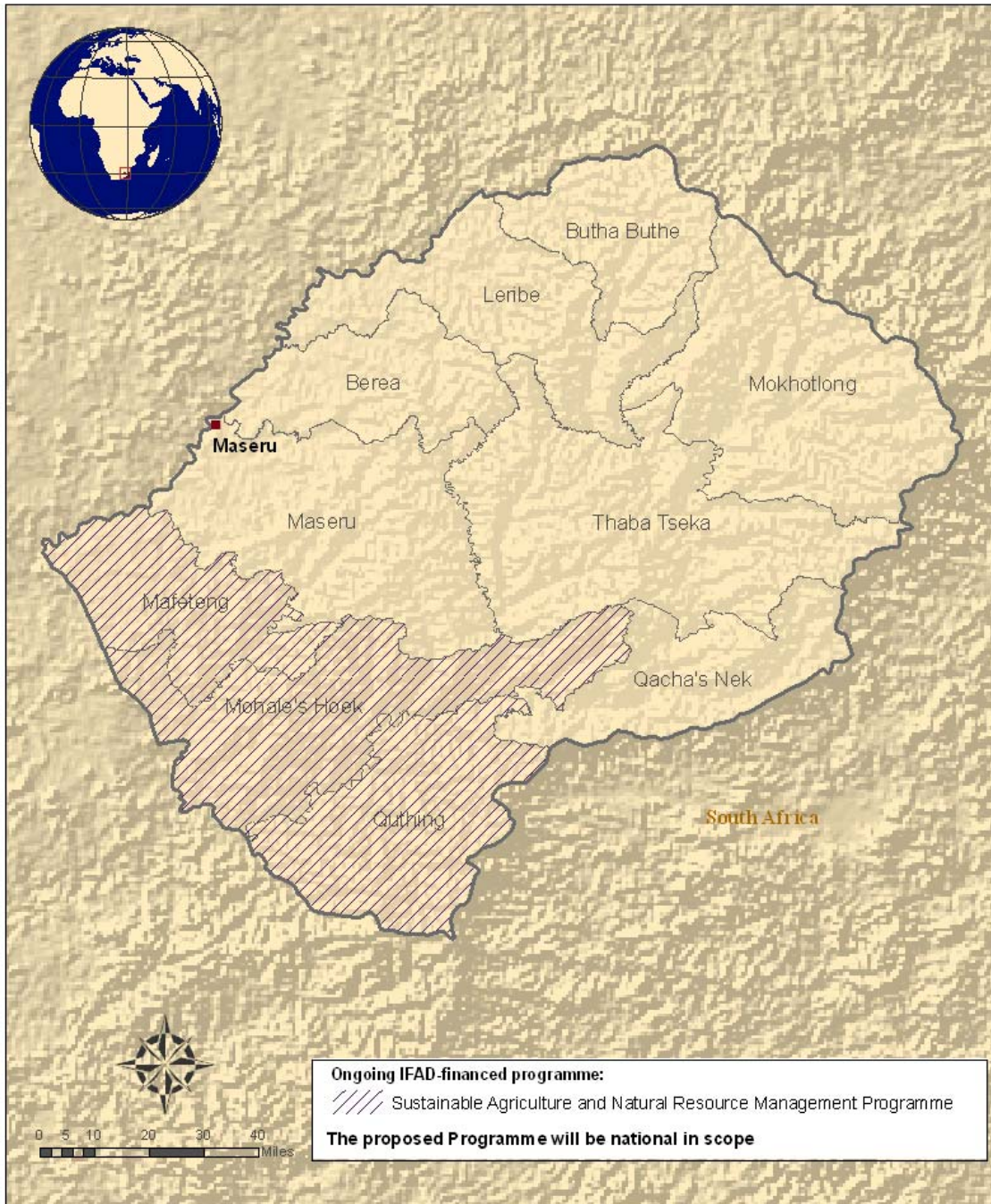
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## **Recommendation for approval**

The Executive Board is invited to approve the recommendation for the proposed loan and grant to the Kingdom of Lesotho for the Rural Financial Intermediation Programme, as contained in paragraph 36.

# Map of the programme area

Kingdom of Lesotho  
Rural Financial Intermediation Programme



The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

Map compiled by IFAD

## Kingdom of Lesotho

### Rural Financial Intermediation Programme

#### Financing summary

<b>Initiating institution:</b>	IFAD
<b>Borrower:</b>	Kingdom of Lesotho
<b>Executing agency:</b>	Ministry of Finance and Development Planning
<b>Total programme cost:</b>	US\$10.7 million
<b>Amount of IFAD loan:</b>	SDR 2.85 million (equivalent to approximately US\$4.35 million)
<b>Amount of IFAD grant:</b>	SDR 2.85 million (equivalent to approximately US\$4.35 million)
<b>Terms of IFAD loan:</b>	40 years, including a grace period of 10 years, with a service charge of three fourths of one per cent (0.75 per cent) per annum
<b>Contribution of borrower:</b>	US\$1.2 million
<b>Contribution of programme partner:</b>	US\$0.5 million
<b>Contribution of beneficiaries:</b>	US\$0.3 million
<b>Appraising institution:</b>	IFAD
<b>Cooperating institution:</b>	Directly supervised by IFAD

# Proposed loan and grant to the Kingdom of Lesotho for the Rural Financial Intermediation Programme

## I. The programme

### A. Main development opportunity addressed by the programme

1. The majority of the people of Lesotho have neither reliable nor regular access to financial services. Many rural households depend on the services of informal local groups and moneylenders. Indeed, most of the poor rural population, when they need to borrow, have little option but to resort to borrowing from the informal sector at exorbitant interest rates, or from relatives or friends. As a consequence, rural poor people are unlikely to seek loans for anything other than desperate emergencies. As regards saving services, the rural poor need more accessible deposit facilities, in terms of both physical access and terms and conditions. The programme will seek to improve access to efficient financial services by the rural poor by developing member-based financial institutions, extending outreach of formal financial institutions and strengthening their linkages with informal and semi-formal institutions, within the context of a more enabling environment.

### B. Proposed financing

#### Terms and conditions

2. It is proposed that IFAD provide to the Kingdom of Lesotho a loan in the amount of SDR 2.85 million (equivalent to approximately US\$4.35 million), on highly concessional terms, and a grant in the amount of SDR 2.85 million (equivalent to approximately US\$4.35 million) to help finance the Rural Financial Intermediation Programme. The loan will have a term of 40 years, including a grace period of 10 years, with a service charge of three fourths of one per cent (0.75 per cent) per annum.

#### Relationship to the IFAD performance-based allocation system (PBAS)

3. The allocation defined for the Kingdom of Lesotho under the PBAS is US\$8.71 million over the 2007-2009 PBAS cycle.

#### Country debt burden and absorptive capacity of the State

4. Lesotho's nominal external debt declined from 82 per cent of GDP in 2002/03 to 47 per cent of GDP (US\$694 million) in 2005/06, as a result of the combined effects of limited new borrowing, an appreciation of the exchange rate, and the early repayment of non-concessional loans in 2005. The recent debt sustainability analysis indicated that Lesotho's debt burden is likely to remain below relevant indicative thresholds and the country faces a moderate risk of debt distress.

#### Flow of funds

5. Funds will be disbursed to a special account to be opened in the name of the Ministry of Finance and Development Planning at the Central Bank of Lesotho. From this account, funds will be disbursed to a programme account to be opened by the Ministry of Finance and operated by the programme coordination unit.

#### Supervision arrangements

6. The programme will be directly supervised by IFAD.

#### Exceptions to IFAD General Conditions for Agricultural Development Financing and operational policies

7. No exceptions are foreseen.

## **Governance**

8. In accordance with the financing agreement, good governance will be assured through competitive bidding for contracts and through transparent administrative and financial procedures. Procurement of goods and services beyond a certain threshold will be subject to prior review and approval by IFAD. An annual audit will be undertaken by the Office of the Auditor General, whose capacity has proved to be satisfactory for past and ongoing projects.

## **C. Target group and participation**

### **Target group**

9. The primary target group is made up of rural poor households with a member(s) who has actual or potential capacity to generate income through economic activities. The target group will include, in particular, smallholder farmers engaged in crop or livestock production with some marketable surplus, those who receive occasional remittances from other household members or relatives, retrenched mineworkers who have resettled in rural areas, landless households with sporadic wage employment opportunities, households headed by women (especially de jure woman-headed households) and unemployed young people.

### **Targeting approach**

10. The economically active poor will benefit from improved access to financial services, for instance, capital for investment, while the less productive poor will be helped to build up their savings gradually. This inclusive targeting approach will be promoted through (i) training of capacity builders of member-based financial groups to ensure that those service providers not only have technical capacity but also are sufficiently poverty-oriented and equipped with the necessary skills to identify and work effectively with the poor; (ii) development of products and services accessible and responsive to the needs of the poor; and (iii) close monitoring of beneficiary profiles and adjustment of the targeting strategy as necessary.

### **Participation**

11. The target group will participate mainly through informal and semi-formal member-based financial groups, which will be strengthened by the programme. With a view to ensuring good governance and organizational sustainability, capacity-building of these groups will target both management-level staff and group members, so that members are empowered to hold management accountable for performance and results.

## **D. Development objectives**

### **Key programme objectives**

12. The overall goal of the programme is to alleviate poverty, increase income and contribute to overall economic development. The programme objective is to enhance, on a sustainable basis, access by the rural poor to efficient financial services.

### **Policy and institutional objectives**

13. The programme will support the development of an enabling policy and institutional framework to facilitate the efficient and sustainable provision of rural financial services and promote competition. A sound regulatory and supervisory framework will be put in place for non-bank financial institutions, and the capacity of the Central Bank of Lesotho to supervise these institutions effectively will be strengthened.

### **IFAD policy and strategy alignment**

14. The proposed programme is in line with the IFAD Strategic Framework 2007-2010, and the strategic objective of ensuring that poor rural people have access to and the skills and organization to take advantage of a broad range of financial services. The



programme is also consistent with the principles and approaches of other IFAD policies, in particular those of the IFAD Rural Finance Policy.

## **E. Harmonization and alignment**

### **Alignment with national priorities**

15. The programme is aligned with the Government's policy and strategy documents (including the poverty reduction strategy), which emphasize the importance of increasing employment and income generation through economic growth, and identify improved access to financial services as critical for poverty reduction.

### **Harmonization with development partners**

16. The Government recently set up a Financial Sector Steering Committee consisting of representatives of the public and private sectors. The role of the committee is to review activities and progress pertaining to financial sector development and reform and to provide guidance. As such, it has been involved in the design process of the proposed programme, and other initiatives by development partners in the sector. Development partners supporting or planning initiatives of direct or indirect relevance (such as the Millennium Challenge Corporation and the World Bank) have been consulted during programme preparation and kept abreast of progress by IFAD and/or the committee.

## **F. Components and expenditure categories**

### **Main components**

17. The programme has four components: (i) development of member-based financial institutions (20 per cent of programme costs); (ii) development of formal financial institutions for rural outreach (34 per cent); (iii) development of an enabling environment (29 per cent); and (iv) programme coordination (17 per cent).

### **Expenditure categories**

18. The programme's expenditure categories are: vehicles (4 per cent of programme costs); equipment and materials (5 per cent); training and workshops (24 per cent); technical assistance in the form of national technical assistance (2 per cent) and international technical assistance (22 per cent); studies (8 per cent); contracts for service provision (5 per cent); post office refurbishment facility (4 per cent); and recurrent costs, consisting of salaries and allowances (21 per cent), and operation and maintenance (4 per cent). About one quarter of the budget for salaries and allowances will be financed by the Lesotho Post Bank (LPB).

## **G. Management, implementation responsibilities and partnerships**

### **Key implementing partners**

19. The lead programme coordinating agency will be the Ministry of Finance and Development Planning, which will work closely with the main implementing partners, namely the Central Bank of Lesotho, the Department of Cooperatives under the Ministry of Trade and Industry, Cooperatives and Marketing, and the LPB. The Ministry of Finance and the implementing partners will contract, or enter into partnerships with, public- or private-sector service providers and NGOs.

### **Implementation responsibilities**

20. The Ministry of Finance will have overall responsibility for programme implementation. A lean programme coordination unit will be established under the Ministry's Department of Private Sector Development and Financial Affairs to undertake day-to-day coordination, financial management, and monitoring and evaluation in close liaison with key implementing partners and service providers.
21. Technical oversight of programme implementation will be provided by a programme coordination committee composed of executive members of implementing partners and collaborating institutions. Coordination of policies, strategies and approaches to

sector development under the programme will be overseen by the existing Financial Sector Steering Committee, as part of its mandate.

#### **Role of technical assistance**

22. High-quality technical assistance will be essential for programme implementation. In particular, technical assistance providers with regional and international expertise and experience will provide the Ministry of Finance, the Central Bank of Lesotho and the LPB with critical support for the creation of an enabling environment, policy and programme coordination, and capacity-building.

#### **Status of key implementation agreements**

23. In addition to the financing agreement, memorandums of understanding will be concluded between the Ministry of Finance and key implementing partners.

#### **Key financing partners and amounts committed**

24. The total programme cost is US\$10.7 million over seven years. The sources of financing are IFAD (US\$8.7 million, or 81 per cent), the Government (US\$1.2 million, or 11 per cent), the LPB (US\$0.5 million, or 5 per cent) and the beneficiaries involved in member-based financial institutions supported by the programme (US\$0.3 million, or 3 per cent).

## **H. Benefits and economic and financial justification**

#### **Main categories of benefits generated**

25. The main benefits expected at the local level are better access by the rural poor to financial services, which will provide the opportunity for greater accumulation of savings and investment in economic activities, and enhance the capacity and management of grass-roots financial organizations. Other important benefits are: increased competition and efficiency of financial service providers and a legislative, regulatory and institutional framework that is more conducive to the development of rural financial services.

#### **Economic and financial viability**

26. It is impossible to predetermine the type or level of productive investment activities that will result from the improved access to financial services; as a consequence financial and economic benefits cannot be projected meaningfully at this stage. However, farm and off-farm enterprise models developed for various likely investments by the rural population in light of production and market opportunities indicate that many loan-financed economic activities are financially viable, especially the horticultural crop production; animal husbandry (e.g. pig, poultry and dairy farming); cultivation of some staple crops (e.g. potatoes and beans); service provision; and small businesses or microenterprises.

## **I. Knowledge management, innovation and scaling up**

#### **Knowledge management arrangements**

27. Since the country's financial sector is underdeveloped, especially with regard to rural and microfinance, there is substantial scope and need for continuous learning and knowledge management. This will be promoted through monitoring and evaluation, stakeholder dialogue and workshops to share experiences and facilitate critical review, analytical studies on selected key issues, and documentation of experiences and lessons and their dissemination by key implementation partners.

#### **Development innovations that the programme will promote**

28. Innovative features of the programme include: (i) development of a regulatory framework for non-bank financial institutions and enhancement of the supervision capacity of the Central Bank of Lesotho; (ii) strengthening of the LPB to transform it into a viable professional banking institution based on sound business principles; and (iii) broadening the scope of support to include informal traditional groups such as burial societies, if and as appropriate. Other innovations will arise from the

support provided to developing innovative financial products and services that are responsive to the needs of the poor.

### **Scaling-up approach**

29. While the proposed programme is national in scope, field-level interventions will begin in the catchment areas of LPB branches that have or are expected to have relatively sizable volumes of business. This will allow for the testing of models, products and approaches for strengthening member-based financial groups and linking them to the formal sector, which can then be scaled up in other parts of the country.

## **J. Main risks**

### **Main risks and mitigation measures**

30. The programme faces three main risks: (i) political interference, which could compromise business principles; (ii) inability of the Department of Cooperatives to improve its structure, ethos and human resource capacity; and (iii) possible collapse of unregulated large-scale operators of non-bank financial services. The first risk will be reduced by the restructuring of the LPB's board of directors, constant policy dialogue and professional guidance by means of technical assistance. The second is expected to be mitigated by focused capacity-building of the Department of Cooperatives and the provision of support based on performance. As regards the third risk, which is largely beyond the control of the programme, possible mitigation measures include: technical assistance through the Central Bank of Lesotho to carefully assess legal options and institutional rehabilitation, where possible; and the raising of public awareness of the nature and potential risks of insufficiently regulated or unregulated large-scale financial service operators.

### **Environmental classification**

31. Pursuant to IFAD's environmental assessment procedures, the programme has been classified as a Category B operation in that it is not likely to have any significant negative environmental impact. A full-scale environmental assessment is therefore not required.

## **K. Sustainability**

32. The key focus of the programme is to improve the viability of participating financial institutions (principally the member-based groups and the LPB) and to develop the necessary support structures and environment to enable these institutions to operate. For capacity-building support, the programme will be cautious in its selection of groups to receive support; eligibility will be based on clear criteria, targets and milestones will be set, and performance closely monitored.

## **II. Legal instruments and authority**

33. A programme financing agreement between the Kingdom of Lesotho and IFAD will constitute the legal instrument for extending the proposed financing to the borrower. Important assurances included in the negotiated agreement are attached as an annex.
34. The Kingdom of Lesotho is empowered under its laws to borrow from IFAD.
35. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD.

### **III. Recommendation**

36. I recommend that the Executive Board approve the proposed financing in terms of the following resolution:

RESOLVED: that the Fund shall make a loan to the Kingdom of Lesotho in various currencies in an amount equivalent to two million eight hundred and fifty thousand special drawing rights (SDR 2,850,000) to mature on or prior to 15 July 2047 and to bear a service charge of three fourths of one per cent (0.75 per cent) per annum, and to be upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

RESOLVED FURTHER: that the Fund shall provide a grant to the Kingdom of Lesotho in various currencies in an amount equivalent to two million eight hundred and fifty thousand special drawing rights (SDR 2,850,000) and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Lennart Båge  
President

## **Important assurances included in the negotiated programme financing agreement**

(Negotiations concluded on 4 September 2007)

### **Gender**

1. The Government of the Kingdom of Lesotho (the Government) will ensure that the Department of Private Sector Development and Financial Affairs of the Ministry of Finance and Development Planning of the Government and other programme parties will strive to improve the gender balance in the operations of the programme, develop targets and processes to achieve those targets as part of a gender strategy, and present reports by the end of each programme year on the achievements towards this end.

### **Support for the transformation of the Lesotho PostBank**

2. The Government declares its commitment to the transformation of the Lesotho PostBank into a viable financial institution with an unrestricted banking license under the supervision of the Central Bank of Lesotho and will at all times actively support and pursue this goal.

### **Lesotho PostBank board of directors**

3. The Government confirms its commitment to restructure the Board of Directors of the Lesotho PostBank to allow for wider private sector representation, and covenants that within twelve (12) months of the effective date at least three (3) members of the Board of Directors will be persons not employed by the Government, who will be appointed following a transparent and competitive process.

### **Outside investment in the Lesotho PostBank**

4. The Government will permit and actively support investment in the Lesotho PostBank by domestic or international private investors.

### **Transfer of financial services**

5. The Government confirms its commitment to carry out an analysis within two (2) years of the effective date of the possibility of transferring financial services currently handled by the Lesotho postal services to the Lesotho PostBank, with necessary resource support.

### **Refurbishment of rural post offices**

6. The Government confirms its commitment to develop, cofinance and implement a programme to upgrade rural post offices in order to allow the Lesotho PostBank to expand its outreach to these rural areas.

### **Suspension**

7. (a) IFAD may suspend, in whole or in part, the right of the Government to request withdrawals from the loan account, if:
  - (i) IFAD, after consultation with the Government, has determined that the material benefits of the programme are not adequately reaching the target group or are benefiting persons outside the target group to the detriment of target group members; or
  - (ii) the Government has defaulted in the performance of any covenant set forth in the programme financing agreement and such default has continued unremedied for a period of thirty (30) days, and IFAD has determined that such default has had, or is likely to have, a material adverse effect on the programme; or

- (iii) IFAD has given notice to the Government that credible allegations of corrupt or fraudulent practices in connection with the programme have come to its attention, and the Government has failed to take timely and appropriate action to address the matters to the satisfaction of IFAD; or
  - (iv) procurement has not been or is not being carried out in accordance with the programme financing agreement.
- (b) IFAD will suspend, in whole or in part, the right of the Government to request withdrawals from the loan account if the required audit has not been satisfactorily concluded within twelve (12) months of the financial reporting date.

**Condition precedent to withdrawals**

8. After two (2) years from the effective date, no amounts will be withdrawn from the loan and grant accounts to finance expenditures incurred by the Lesotho PostBank, and no transfer shall be made to the Lesotho PostBank, unless and until the Lesotho PostBank has obtained a full banking licence from the Central Bank of Lesotho.

**Conditions precedent to effectiveness**

9. The programme financing agreement will become effective upon the fulfilment of the following conditions precedent:
- (a) the increase of the share capital of the Lesotho PostBank by an amount of five million Loti has been duly authorised and recorded by the Registrar of Companies, and the full amount of such increase has been paid into the accounts of the Lesotho PostBank; and
  - (b) the special account and the programme account have been duly opened; and
  - (c) the professional staff members of the programme coordination unit (i.e. the programme coordinator, the monitoring and evaluation officer, and the financial controller), as well as the chief technical advisor, have been selected; and
  - (d) the programme financing agreement has been duly signed, and the signature and performance thereof by the Government has been duly authorised and ratified by all necessary administrative and governmental action; and
  - (e) a favourable legal opinion, issued by the Attorney General or other legal counsel authorized by the Government to issue such opinion, in respect of the matters set forth in the programme financing agreement and in form and substance acceptable to IFAD, has been delivered by the Government to IFAD.

## **Key reference documents**

### **Country reference documents**

Central Bank of Lesotho, Rural Finance Division (2001). Blue Print for Rural Savings and Credit Groups.

Government of Lesotho. Central Bank of Lesotho Act, 2000

Government of Lesotho. Cooperative Societies Act, 2000

Government of Lesotho. Financial Institutions Act 1999.

Government of Lesotho. Moneylenders Act, 1989 and amendments

Government of Lesotho. Poverty Reduction Strategy 2004/05-2006/07.

Government of Lesotho. Societies Act 1966 and subsequent amendments.

Lesotho PostBank. Strategic Plan.

Ministry of Agriculture / Rural Finance & Enterprise Support Project (RF&ESP, previously supported by IFAD). Rural Financial Needs Assessment Survey 2002.

### **IFAD reference documents**

RUFIP Inception (2006), Formulation (2006) and Appraisal (2007) Reports

Lesotho COSOP (1999)

IFAD Decision Tools for Rural Finance (2003)

IFAD Policy on Rural Finance (2000)

IFAD Policy on Targeting

IFAD Strategic Framework 2007-10

Various IFAD Learning Notes (rural finance, targeting, designing for implementation, gender)

Report on Lesotho Focus Group Discussions (2007, commissioned to FinMark Trust)

RF&ESP Project Completion Report

Administrative Procedures on Environmental Assessment

### **Other miscellaneous reference documents**

Genesis Analytics (2003). Access to Financial Services in Lesotho. FinMark Trust.

International Monetary Fund (2006). Kingdom of Lesotho: 2006 Article IV Consultation – Staff Report.

## Logical framework

Narrative summary	Performance indicators	Means of verification	Assumptions and risks
<b>Goal:</b> Alleviate poverty, increase income and contribute to the overall economic development	<ul style="list-style-type: none"> <li>• Growth in assets of poor rural households</li> <li>• Increase in expenditures of poor rural households</li> </ul>	<ul style="list-style-type: none"> <li>• Bureau of statistics – household income and consumption surveys</li> <li>• Programme baseline survey/impact study, completion report</li> </ul>	<ul style="list-style-type: none"> <li>• Stable macro-economic policy framework</li> <li>• Political stability maintained</li> </ul>
<b>Objective:</b> Enhancing access of the rural poor to efficient financial services on a sustainable basis	<ul style="list-style-type: none"> <li>• No. of poor rural households accessing financial services (directly and indirectly through groups) by gender</li> <li>• No. of newly opened deposit accounts, by gender</li> <li>• No. of loans granted by supported financial institutions (FIs), disaggregated by purpose and gender</li> <li>• Product range offered by supported FIs</li> <li>• Profitability of RF services</li> <li>• Reduced transaction costs in RF services</li> </ul>	<ul style="list-style-type: none"> <li>• CBL statistics</li> <li>• Programme progress, monitoring, evaluation reports</li> <li>• Programme MTR and completion report</li> <li>• Supervision reports</li> <li>• Survey on transaction cost</li> </ul>	<ul style="list-style-type: none"> <li>• Government commitment to policy and financial support for rural/micro finance development.</li> <li>• No political interference into businesses and lending</li> <li>• Stable financial sector and inflation</li> </ul>
<b>Component outcomes</b>			
1. Member-based financial institutions strengthened to provide efficient services to their members in rural and peri-urban areas	<ul style="list-style-type: none"> <li>• No and types of functional and active member-based financial institutions supported under the programme and no of members (by gender)</li> <li>• Trend in reporting against various outreach and financial performance indicators by member-based financial institutions</li> </ul>	<ul style="list-style-type: none"> <li>• Programme progress, monitoring and evaluation reports</li> <li>• Records kept by member-based financial institutions</li> </ul>	<ul style="list-style-type: none"> <li>• No distortion of rural financial markets by donors or government</li> <li>• No political interference in the cooperative sector</li> </ul>
2. Rural outreach of formal financial institutions expanded	<ul style="list-style-type: none"> <li>• No. of clients (groups/individuals) of LPB and other formal FIs having savings account for the first time</li> <li>• No. and total amount of loans under LSL 4000 granted by LPB and commercial banks</li> <li>• No. and locations of LPB and commercial bank branches newly opened outside Maseru</li> <li>• Types of newly developed products targeted at small clients (individuals and groups)</li> </ul>	<ul style="list-style-type: none"> <li>• LPB/commercial bank records</li> <li>• Programme progress, monitoring and evaluation report</li> </ul>	<ul style="list-style-type: none"> <li>• No political interference in LPB operation</li> </ul>
3. Conducive environment and institutional framework for promoting inclusive financial services developed	<ul style="list-style-type: none"> <li>• Support/services to financial coops by Dept. of Coops improved</li> <li>• Improved regulatory frameworks for non-bank financial institutions, coops, moneylenders developed and implemented</li> <li>• Changes in no and types of non-bank financial institutions effectively supervised by the CBL and quality of supervision report</li> <li>• Capacity of local service providers to assist member-based financial groups improved</li> <li>• Policy makers and key stakeholders more knowledgeable about critical issues on micro/rural finance</li> </ul>	<ul style="list-style-type: none"> <li>• Programme progress report</li> <li>• Assessment/evaluation of services by Dept of Coops by financial coops /PCU</li> <li>• Regular supervision report by CBL and Dept of Coops and recommendations/actions taken</li> <li>• Assessment/evaluation of services provided by clients</li> <li>• Workshop reports and evaluation</li> </ul>	<ul style="list-style-type: none"> <li>• Adequate human resource capacity and institutional framework to implement and enforce legislative/regulatory framework and appropriate sanctions</li> </ul>



