CASE STUDY
FINANCIERA FUNDESER
NICARAGUA

Supporting Fundeser's transformation into a regulated Financiera

A "capital plus" approach combining investment, governance guidance, support to the Board of Directors and matching grants for technical assistance to drive the transformation process of one of the most resilient MFIs in Nicaragua

rural impulse II by Incofin IM

incofin INVESTMENT MANAGEMENT

Financiera Fundeser ¡Crezcamos Juntos!

About Incofin Investment Management (Incofin IM)

Incofin IM is an international impact investor focused on mid-market private equity and debt investments in emerging markets. The investments target rural and agriculture focused financial institutions and producer organizations or other SMEs serving the agricultural value chain. Currently, Incofin IM has more than 750 M USD under assets, serving 156 different clients in 47 countries all around the world.

In accordance with its mission and vision, Incofin IM pursues a "double bottom line" approach, with financial and social outcomes on an equal footing. Incofin IM's investment philosophy espouses a "capital plus approach" providing investments and following it up with matching grants to fund technical assistance (TA) services that support partner investees in enhancing their operational, financial and social performance. In terms of TA, Incofin IM has raised 7.6 M USD in grants, which have supported 44 financial institutions in 32 countries around the world.

At year-end 2015, 64 TA projects were launched covering 8 different areas of intervention. The development of new financial products, operational strengthening and alternative delivery channels are the leading topics supported by Incofin IM.

Incofin IM has a strong investor base, particularly among European institutional investors, Development Finance Institutions (DFI) and German and Belgian retail investors. Amongst its cornerstone donors: Incofin IM includes the Agence Française de Développement, the European Investment Bank, the Multilateral investment Fund, BIO, FMO, KfW, and many others.

About Rural Impulse Fund II (RIF II)

Rural Impulse Fund II (RIF II) is a closed-ended investment company with variable capital, organized under the laws of Luxembourg as a société d'investissement à capital variable – fonds d'investissement spécialisé, managed by Incofin IM. The Fund was incorporated for a period of 10 years to be counted from its incorporation (18 May 2010) and it is backed by leading public and private financial institutions.

RIF II aims to be the worldwide reference for rural microfinance and invests in financial institutions in emerging markets. The Fund follows the ground-breaking achievements of the Rural Impulse Fund (RIF I), the world's first microfinance facility to specialise in commercially viable rural microfinance institutions.

From inception RIF II foresaw the establishment of a TA Facility to support RIF II Investees in enhancing their financial, operational and social performance and to provide better services to their rural clients. The RIF II TA Facility was launched in 2010. At the end of 2015, the Facility had raised 5.4 M USD to support 31 financial Institutions in 24 different countries.

The main achievements of the RIF II TA Facility include: i) 15 MFIs developing/rolling out new products, ii) 5 institutions exploring alternative delivery channels to reach rural areas, iii) 2 Greenfield projects (in Zambia and Congo RDC) supported plus 2 MFIs guided throughout transformation processes, and iv) two learning events, one in SSA and one in CIS region were successfully organized.

CONTENT

1. INTRODUCTION

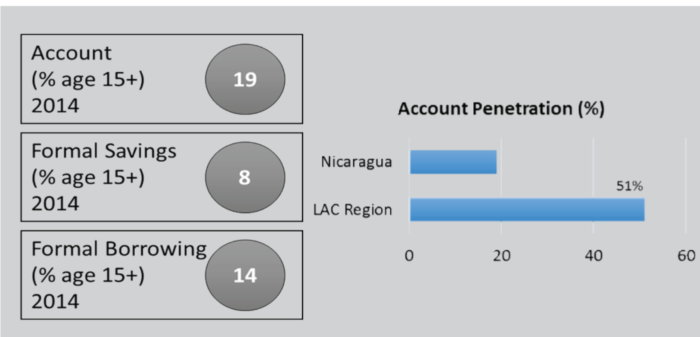
'Nicaragua has the lowest rate of banked population in all of Latin America and the Caribbean'

Over the past five years, Nicaragua has stood out for maintaining economic growth levels above the average for Latin America and the Caribbean (LAC). In 2011, growth had to around 5% and for 2016 the GDP growth forecast is 4.2%.

Nevertheless, Nicaragua remains one of Latin America's least developed countries, where access to basic services is still a daily challenge. Poverty, although steadily declining in recent years, remains high at around 30%, particularly in rural areas
.

Nearly four years after the "No Pago" movement forced a crisis in Nicaragua's microfinance sector, the sector is growing again, reaching an annual rate of 12% in 2015. At the same time, MFIs are beginning a gradual and cautious return to agriculture after having retreated from the sector when the government counselled cattle ranchers not to repay loans and the "No Pago" Movement began.

Despite a return to normalcy, Nicaragua has the lowest banked population ratio in the entire LAC region, corresponding to only 19% of the adult population having an account in a financial institution .



[1] http://www.worldbank.org/en/country/nicaragua/overview
[2] http://datatopics.worldbank.org/financialinclusion/region/latin-america-and-caribbean

'Reaching excellence in rural Microfinance'

After twelve years operating as local NGO specialized in providing rural microfinance services, the Fundación para el Desarrollo Socioeconómico Rural (Fundeser) launched itself on a challenging and intense path to transform into a regulated MFI while maintaining its initial rural foot print. Fundeser remained committed to its rural strategy despite, the "No Pago" movement's strong impact in rural areas and destabilizing effect on Fundeser's own operations. As a result of the movement portfolio arrears increased which resulted in significant financial losses and a shrinking of the equity base. Fundeser reacted by deciding to transform into a regulated entity and to attract specialized microfinance investors to strengthen the financial position of the institution. A goal that was realized when the Financiera was established in October 2014.

At the end of 2015, Fundeser managed 22 branches, employing 286 staff members, actively supporting a portfolio of 36 M USD and 20,233 clients, of whom more than 70% live in rural areas and work in the agricultural sector.

Financiera Fundeser targets rural areas offering primarily individual loans for microenterprises focusing on agriculture and livestock activities. Indeed, in line with its mission: "to contribute to the social and economic development of small and medium agricultural producers and micro entrepreneurs", more than 50% of if its total portfolio accounts for agricultural and cattle loans.

Financiera Fundeser continues to pursue it goal to achieve operational excellence while being a client-focused Institution with remarkable social performance. The Financiera status should provide the ability to expand the scope of products and services that the company will offer to its clients.

RIF II Investment & TA, i.e. the Capital Plus Approach

The Investment

- Fundeser has been a client of Incofin IM since 2006. In 2013, a Senior Bridge-Loan from RIF II was approved to support the portfolio growth strategy of Fundeser prior to its transformation into a regulated MFI. An Equity Investment to provide initial capital for the new financial entity was approved in 2012 and materialized in 2014.
- Two capital increases from RIF II have been approved: one in 2015 and one in 2016 in order to sustain the portfolio growth target rates of 39% in the coming 5 years.

Governance Participation

- Despite being a minority shareholder, RIF II through Incofin IM staff has played an active role in the "Transformation Committee", a committee acting similarly to a Board of Directors and providing strategic guidance throughout the transformation process.
- As a shareholder, RIF II appointed Incofin IM Regional Director for LAC as member of the Board of Directors (BoD) in order to drive the realization of the development goals of Financiera Fundeser.

Technical Assistance (TA)

- Between 2012 and 2015, several grants amounting to 200,000 USD were assigned by Incofin IM (thanks to the support of BIO, FMO and RIF II own Contribution).
- The grants were used for TA services provided by external consultants to support Fundeser in its transformation into a regulated MFI. The TA intervention of RIF II focused on organizational development and strengthening of Fundeser's human capital.

Table of Events

1993	Fundeser starts as "PRODAGROS", Sustainable Agricultural Development Programme funded by the European Union, the Government of Austria and CARITAS. PRODAGROS provided technical assistance and credit to rural producers and it laid the conceptual and technical bases for FUNDESER.
2000	Fundeser NGO is established as spin-off of PRODAGROS, in charge of providing microfinance services to rural entrepreneurs and smallholder farmers.
2004 2008	Fundeser registers fast growth and enters into an expansion. stage. At the end of 2008, it serves 32,835 clients with a loan portfolio of 21.5 M USD.
2009 2011	The Global Financial Crisis and the "No Pago" crisis disrupt financial markets. Fundeser experiences a decrease by 50% of its loan portfolio, a ROE of - 80%, PAR 30 at 29% (2010), write-off at 26% (2011), financial losses of 2.5 M USD and increase in leverage from 7 to 14.
2012 2014	Fundeser engages in a transformation process from NGO to Financiera. An Equity Investment from RIF II to support Fundeser transformation is approved. Fundeser benefits from several grants from RIF II TA Facility, along with other donors.
2014	Fundeser obtains the license to operate as a regulated Non-Banking Financial Institution (NBFI) Financiera. RIF II is a shareholder of Financiera Fundeser.
2015	Fundeser has 36 M USD loan portfolio and is serving 20,233 clients.

Background on the Transformation

In 2012, the Nicaraguan Parliament issued the Microfinance Law with the aim to better regulate the sector. All MFIs operating in the country should fall under the supervision of either the Superintendence for Banks and Financial Institutions (SIBOIF) for regulated MFIs; or the Consejo Nacional de Microfinanzas (CONAMI) for unregulated MFIs. **As is the case with most legislations, unregulated MFIs are not allowed to take deposits from the public and to offer certain types financial services.**

In 2012, Fundeser identified an underserved market of 147,000 smallholder producers without access to financial services whose financial needs accounted for approximately 370 M USD. Fundeser NGO recognized it was serving only a limited part of this potential market and could not expand its outreach under its current legal status, due to limited capital base. In accordance with the mission and vision of the Institution, the transformation was the natural step to provide sustainable inclusive financial services to smallholder farmers and rural entrepreneurs.

In order to transform into a regulated entity, applicants must comply with the strict requirements defined in article 7 of the Law No 561 for Financial Non-Banking Institutions including requisites related to: (i) capital adequacy, (ii) registration of all the legal issue documents and bylaws, (iii) appointment of all directors and executive management, (iv) physical facilities and the management information system, (v) supporting documentation, such as contracts, insurance, manuals and policies and procedures.

> **"The transformation has triggered greater financial soundness for Fundeser, thus enabling the institution to strengthen the ties with national and international funders and creating more opportunities for our rural clients"**
>
> Rene Romero, CEO of Financiera Fundeser

2. Supporting Fundeser's transformation into a regulated Financiera

2.1. THE NEEDS

While still in the process of recovering from the "No Pago" Movement, in 2012, Fundación Fundeser decided to transform into a regulated institution. As part of the process, Fundación Fundeser invited three of its "closest" lenders (Incofin IM, Triple Jump, and Bank Im Bistum) to be part of the transformation project as minority shareholders.

The transformation process would have entailed considerable costs, budgeted at around USD 1.5 M. Additionally, due to the persisting effects of the No Pago crisis, Fundeser had to deal with limited access to funding and high leverage. A capital injection by external investors combined with guidance by international microfinance experts were key conditions to constitute the new financial entity.

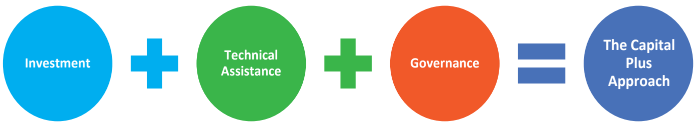
In April of 2013, a first request to incorporate the new Financiera was submitted to the SIBOIF. The request included a feasibility study and a business plan (with detailed projections) of the new entity. Fundeser provided information on the future ownership structure, including relevant information on the future shareholders, as well.

On December 2013, the SIBOIF granted the authorization to constitute the new Financiera Fundeser but the final operating license was conditional to the fulfilment of a series of operational condition precedents. The MFI had a 180-day timespan to fill all the identified gaps. These included, amongst others, a re-organization of the current operational structure in line with the new functions of the Financiera and the subsequent upgrade of all its key staff, the purchase of a new MIS system, and ensuring the adequacy of all branches' infrastructure.

Additionally, Fundeser needed to finalize all legal documents and register the new Financiera (including the capital injection).

2.2. THE ANSWER

2.2.1 The Capital Plus Approach Strategy



The combination of an equity investment, TA and active support at governance level was critical to triggering value creation and to positively impacting Fundeser's financial, operational and social performance. The transformation process entailed multiple challenges, which couldn't be addressed adopting a sectoral approach but required a holistic strategy able to fill the different gaps simultaneously.

2.2.2 On the Financial side:

2012	**RIF II IC Approval of the Equity Investment**
2013	**RIF II Senior Bridge-Loan of 1 M USD**

As liquidity is key to sustain Fundación Fundeser to fund transformation costs and mantain growth, RIF II extends a bridge loan to support the Institution in this crucial phase.

2014	**RIF II 1 M USD Equity Investment**

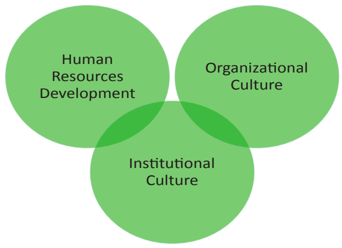
Financiera Fundeser is created with a total capital of 3.18 M USD. Fundación Fundeser transfers assets and liabilities to the new company in exchange for shares. The shares received were valued above the cost of the assets transferred in recognition of its contribution to the new project by the three international lenders. The shareholder structure at the creation of the company was the following: Fundación Fundeser with 51%, RIF II and the other two international investors with 16% each.

2015 - 2016	**RIF II capital increase of 1.5M USD**

Due to the faster growth experienced by the company (50% vs 30% projected) and to the new regulations with respect to capital adequacy that the institution did not comply with, Financiera Fundeser approved a capital increase of approx. 4.5 M USD and the acquisition of 2 M USD in subordinated debts. This capital strengthening should provide sufficient capital to support Financiera Fundeser's growth in the coming 5 years.

2.2.3 On the TA side:

RIF II TA Facility funded by the Dutch Development Bank (FMO), the Belgian Development Bank (BIO) and a contribution from RIF II provided a global matching grant of 200,000 USD. The TA intervention focused on the three pillars as described below.



Organizational Structure

- Redesigning the organizational set up of the MFI in view of new processes and functions emerging as a result of the transformation process.
- Reinforcing HR policies and procedures to assure the adequate management of Fundeser's human capital and recruitment processes.

Institutional Culture

- Defining the new institutional strategy and culture of the MFI to define clear goals and to generate commitment and institutional identity of the new Financiera
- Financing the Transformation manager (Ms Susana Barton) in charge of coordinating the transformation process and catalysing all the transformation initiatives including the coordination and support to the transformation committee.

Human Resources Development

- Identifying the main training needs of Fundeser branch staff while empowering HR staff capacities to assess knowledge gaps at institutional level.
- Creating a learning platform by setting-up a comprehensive capacity building program to upgrade MFI branch staff skills in line with new required standards.

Key Indicators	2012	2015
Gross Loan Portfolio (M USD)	11.58	36
Comp. Portfolio Growth	47,29%	
No. of Borrowers	20.832	20.233
Par 30 + rescheduled	1,63%	1,4%
No. of Branches	19	22
No. of Staff	219	289
Operating Expense Ratio	30%	22,6%
No. of loans per LO*	208	189
ROE	43,6%	6,9%
Levarege (incl.Tier 2)	3,1	5.7

*The declining number of clients as well as the number of loans per loan officer has been determined by two main factors:
- Resources and time allocated to the transformation process
- Shift from group to individual lending methodology

2.2.4 On the Governance side:

RIF II through Incofin IM has been deeply involved (i) at the shareholder level and (ii) at the Board of Directors level (BoD):

- At the shareholder level, Incofin IM/RIF II played a leading role in the negotiation and preparation of the constitutive documents of the Financiera. A "Transformation Committee" formed by members of Fundación Fundeser and the potential shareholders was put in place to support and supervise the transformation process while contributing to the alignment of the future investors. Incofin IM/RIF II was actively involved in ensuring that the Shareholders' Agreement and by laws would comply with best practices in terms of Corporate Governance (governance structure, minority rights, protection of the mission, environmental and social commitments).

- At the Board level, Incofin IM/RIF II has been actively taking part to the Board meetings. Over the past three years Incofin IM/RIF II appointed Board member, contributed creating a new Board culture where both financial and social objectives are put at the forefront of each of decision processes.

2.3 THE RESULTS

> **"I've seen the change that occurred in Fundeser. Before I had a group loan, then I had access to an individual loan and I do feel better. Every year, I can grow thanks to this Financiera"**
>
> Carmen Diaz Castro, Cafetalera, Fundeser's client

Fundación Fundeser started operating as a Financiera in October 2014. Over the first months of operations, the efficiency has been affected in terms of operating costs and staff productivity.

In 2015, the MFI has progressively improved: loans per loan officer increased from 148 (2014) to 189 (2015) and operational self-sufficiency moved from 88% (2014) to 103% (2015). The break-even point to recover the costs of transformation was achieved in May 2015.

The core banking management system has been installed and it is working efficiently.

As a result of the Institutional Development process undertaken with the TA, Fundeser has developed a new organizational strategy entailing an institutional organigram, a new manual of organizations and functions where new roles were identified and existing positions systematized according to the new operational requirements. Processes were optimized. Financiera Fundeser can count on updated and fine-tuned HR policies and procedures, especially in terms of selection and recruitment of new staff, induction processes and performance management, in view of further expansions of the Institution.

Fundeser has trained and transferred skills to its branch staff, with a specific focus on the rural branches. A comprehensive learning platform has been put in place. Capacity Building Programmes are in place to promote a continuous learning and upgrading process with different curricula.

5 Capacity Development Programmes are available

1. Capacity Development Programme for Branch Managers
2. Capacity Development Programme for Loan Officers
3. Capacity Development Programme for Operation Assistants
4. Capacity Development Programme for Tellers
5. Capacity Development Programme for Customer Care Officers

Fundeser's branch staff have received extensive Training

21 Tellers
19 Operation Assistants
20 Customer Care Officers
110 Loan Officers
19 Branch Managers

3. LESSONS LEARNED

The transformation into a regulated institution required substantial financial, strategic and governance efforts. RIF II/Incofin IM "Capital Plus Approach" has been able to meet each of these needs through the different type of support provided, namely financial, technical and strategic.

Besides RIF II, other eight Donors supported the transformation process of the Financiera.

Grameen Foundation, Triple Jump, the International Finance Corporation (IFC), DGRV, BIO, CODESPA and the Multilateral Investment Fund (MIF) intervened in nine different strategic initiatives relating to the transformation including enhancing operational efficiency, enhancing the lending methodology and the exploration of innovative technologies, as well as the instalment of the new core banking system. Synergies and a strong alignment over key objectives have been key to allow a fruitful and effective collaboration towards a common goal.

Nevertheless, coordinating nine donors, managing a transformation process (requiring compliance with key requirements), assuring a capital increase and putting in place a new shareholder structure, while keeping and continuing with the daily business of serving around 20,000 clients in remote and underserved areas of Nicaragua has been extremely challenging.

The strong growth of Fundeser following the negative impact of the "No Pago" crisis and its engagement both towards clients and investors represented the greatest lessons learnt. Fundeser opted towards a long term strategy consolidating its performance and transforming into a regulated institution to overcome the crisis. They key elements of the consolidation and transformation required for the institution appropriate adjustments to the institutional strategy, including: (i) attention to efficiency and implementation of risk units, (ii) the set-up of a rigorous credit methodology, including deeper attention to actual client capacity to repay, (iii) client-centric products and customer service, (iv) investment in human capital and staff capacity building, and (v) focus on transparency and governance.

The critical path of Fundeser showed that it is possible to fall down and get-up again, but external and strategic support is needed, together with an excellent and committed management team and funds availability in terms of capital, technical assistance and access to funds.

The involvement of impact investors as Incofin IM in the definition of the strategy has contributed to promote the constant effort of Financiera Fundeser in fostering rural financial inclusion in Nicaragua.

4. THE ROAD AHEAD

Financiera Fundeser continues to focus on achieving operational excellence while being a client-focused Institution with remarkable social performance.

By year 2020, Financiera Fundeser expects to reach a portfolio of 140 M USD by serving more than 60,000 clients while generating a ROA of 4%.

A first step in achieving this goal is to decrease the costs of funding and to expand the spectrum of services offered to its clients by becoming a deposit-taking institution by 2017. At the same time Fundeser will seek opportunities to better serving rural clients as a way of furthering its growth objectives.

With this strategy in mind, Incofin IM through the financial support of the Multilateral Investment Fund (MIF), and in collaboration with Triple Jump and Bank Im Bistum will be supporting Fundeser to develop and set-up a comprehensive saving mobilization strategy. The strategy will address the design of new savings products for rural clients and adopting innovative distribution channels to better reach them.

5. CONCLUSIONS AND ACKNOLEDGEMENTS

Through Financiera Fundeser, RIF II is contributing to foster the financial inclusion of rural entrepreneurs in Nicaragua, this being the ultimate objective and rationale of all efforts of Incofin IM and RIF II investors.

The substantial involvement of RIF II as social-responsible investor and shareholder, the active participation at the BoD and the TA interventions have contributed to build accountability and trust between the parties, thus boosting collaboration and joint efforts to meet a common goal. Sustainability has been the motive and the main result achieved throughout these crucial years.

The investment injected the required capital to transform, thus creating the financial base on which to build the new Financiera. The continuous support at the governance level will continue contributing to a sustainable growth of Financiera Fundeser in the coming years. The TA allowed Fundeser to invest in internal systems and processes, resulting in upgraded institutional architecture and trained staff who were prepared to deal with the new functions and processes. This allowed Fundeser to maintain a rigorous pace of growth even in a changing environment, resulting in greater outreach in the rural areas of Nicaragua.

A special acknowledgment goes to entire team of Fundeser for maintaining their commitment to excellence and growth while engaging in a complicated transformation process and a special mention to its inspiring CEO: Rene Romero.

A special acknowledgement goes to the shareholders of Financiera Fundeser for their confidence and support in this process.

A special acknowledgement goes to Susana Barton, transformation manager, without whom such a fast transformation would have not materialised.

A special acknowledgement goes to all the donors and RIF II TA Facility who supported this successful transformation process, which was completed in less than two years.

This case study has been realized by Incofin IM thanks to the collaboration of RIF II and Financiera Fundeser, who authorized the diffusion of its content.

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