UNCLASS]

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

PD-AAA-762-B1

CAPITAL ASSISTANCE PAPER

Proposal and Recommendations
For the Review of the
Development Loan Committee

5180098

ECUADOR - SMALL ENTERPRISE LOAN

AID-DLC/P-918

UNCLASSIFIED

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

UNCLASSIFIED

AID-DLC/P-918
June 15, 1970

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: Ecuador - Small Enterprise Loan

Attached for your review are the recommendations for authorization of a loan in an amount not to exceed $5,100,000 to assist in financing the costs of Borrower's program of financial and technical assistance to small enterprises.

This loan proposal is scheduled for consideration by the Development Loan Staff Committee at a meeting on Friday, June 19, 1970.

Rachel C. Rogers
Secretary
Development Loan Committee

Attachments:
- Summary and Recommendations
- Project Analysis
- ANNEXES I-XII

ECUADOR - SMALL ENTERPRISE LOAN

TABLE OF CONTENTS

TABLE OF CONTENTS (Cont.)

ECUADOR - SMALL ENTERPRISE LOAN

SUMMARY AND RECOMMENDATIONS

1. Borrower: The loan will be made to the Government of Ecuador acting through the Ministry of Industry and Commerce of the Government of Ecuador. It will specify that the proceeds can only be used for small-scale business development.

2. Amount of Loan: Not to exceed US$5,100,000.

3. Total Cost of Project: In addition to the funds to be made available under the AID loan, eligible participating financial institutions, (PFI's) to qualify for access to AID loan funds, will be required to earmark an amount of funds from their own resources for use by small business applicants. Omitting an estimated $400,000 of the loan proceeds planned for use in financing essential technical assistance programs especially designed to promote project success and $600,000 to be reserved for the Guaranty Fund, $4,100,000 remains for lending to PFI's, which, added to $5,900,000 in PFI resources will result in a total of $10,000,000 in loan capital available to the project during its three-year initial start-up period. The Central Bank has been empowered also to contribute some of its own resources to the Trust Fund, and negotiations are currently underway to obtain a specific commitment which will be included in the loan agreement. To the extent that small business sub-borrowers will be required to invest a reasonable amount of equity capital in order to qualify as sub-borrowers, an additional $2.5 million will be invested in small-scale enterprises supported by this project.

4. Purpose of Project: The project is intended to:

   a. promote development of the small industrial sector;

   b. take advantage of opportunities for forward and backward linkages in the economy otherwise lost because of small markets, limitations on entrepreneural capabilities, and other constraints; and

   c. broaden the industrial base to take advantage of, and respond to, the Andean Group challenge.

By these efforts, the subject sector in turn will be able to contribute more significantly to the country's over-all development. The lending, technical assistance, and guaranty program herein proposed is specifically designed to induce active financial participation by local financial institutions in support of small business enterprises. Assuming an average loan of $15,000 (excluding the special activity described in the following paragraph), it is estimated that approximately 650 small enterprises will obtain assistance under this project over a 3-year period, and that about 4,000 new job opportunities will be created.

The Project also includes an activity which, essentially, is community business development. The activity is discussed in greater detail in Section III H of the loan paper, but in addition to serving the general purposes of the project, it is essentially intended to encourage the growth and expansion of the very small type of business activities needed to accelerate development in the economically backward urban areas, principally of Guayaquil.

Examples of the types of barrio enterprises which might qualify particularly well for financing under this activity are light metal stamping (e.g. hinges), construction material fabrication (concrete blocks and quality bricks), furniture making, and small scale manufacture of school uniforms (which are required to be worn by all children).

It is intended to set aside $250,000 for this pilot sub-project. If it proves out its value, as the Mission strongly believes will be the case, a significantly larger loan program for this special purpose may emerge.

5. Background of the Project: As credit facilities in Ecuador developed, it became increasingly evident that the GOE and other credit assistance programs in support of medium-large scale industries had sufficiently demonstrated the credit-worthiness of the institutions supporting such industries to enable them to successfully enter world money markets. Small industries (which in the opinion of the USAID and its consultants are also credit-worthy) still had little access either to loans at reasonable terms or to technical assistance. Since adequate credit on reasonable terms in the amounts required by small business was inadequate, the small entrepreneur's only recourse was to use the facilities of the commercial banks or suppliers credits. Such credit generally is for very short term, usually six months, and not in excess of a year. The cost of such funds, including interest and other fees, ranges in the neighborhood of 16-18% per annum.

6. Project Description: The project contemplates the establishment of a special fund in the Trust Department of the Central Bank of Ecuador which can be used by qualified local participating financial institutions (PFI's), including commercial banks, to supplement their own resources in making loans to small entrepreneurs, who, in the past, have not been regular clients of such indtitutions.

A portion of the AID loan will be set aside in the Trust Fund to enter into guaranty arrangements with the PFI's to induce a greater degree of PFI participation than would otherwise be possible. To the extent that the Trust Fund assumes risks of losses under the Guaranty program, it will be responsible for risk analysis and risk management. The USAID is currently negotiating with the Central Bank to obtain a commitment of its own resources to this program. Hopefully the commitment will permit the use of such resources to cover the costs of administering the Trust Fund operations. If Central Bank agreement is not obtainable, the cost of managing the Trust Fund will be borne from an over-ride of interest charges to the PFI borrowers of up to one percent and from the guaranty fee to be charged.

About $150,000 of the AID loan proceeds will be used by the Trust Fund to finance the services of CENDES and other qualified firms and individuals to assist small scale borrowers in evaluating their projects, in preparing loan applications to the PFI's, in negotiating for the loan and in providing technical, management, marketing and other appropriate assistance to sub-borrowers as necessary. The fee charged the sub-borrowers for these services will be capitalized by the PFI's to relieve sub-borrowers of the full burden at a point in time of their operation when it is most difficult to bear. Payments to the PFI's would create a revolving fund mechanism for financing future technical assistance. Responsibility for deciding what types of assistance a sub-borrower requires will rest primarily with the PFI Lender. Methods proposed for assuring that the Lender will discharge this responsibility are discussed elsewhere in this paper.

Because the existing PFI's do not now assume the types of risks contemplated under this program and the program is designed to encourage such risk assumption, it is anticipated that the PFI's will require technical assistance training and orientation to assist them in gearing up to the special type of lending operations planned by this loan.

7. Alternate Sources of Financing: Ex-Im Bank, the IDB and the World Bank have all expressed non-interest in financing this project. Local and foreign private credit institutions are not likely to provide the concessional terms required.

8. Country Team Views: The country team considers the economic and social benefits estimated to flow from the project to be substantial, and endorses it. Of particular interest is the contribution the project can make to political development by expanding the base of the private sector so that its influence on public policy can be maximized to the benefit of the industrial labor force, trade, and commerce.

9. Statutory Criteria: All statutory criteria have been met. (See Exhibit A for details).

10. Issues: None

11. Recommendation: Authorization of a loan to the Ministry of Industry and Commerce of the Government of Ecuador for an amount not to exceed five million one hundred thousand dollars ($5,100,000) to capitalize the proposed Trust Fund at the Central Bank. Terms of the loan would be the most liberal permitted by the FAA, i.e., 40 years, 10 year grace period with interest at 2% during the grace period and 3% thereafter. The Trust Fund will relend the AID loan proceeds to the PFI's at rates and terms commensurate with the risks assumed by the PFI's.

A. Conditions Precedent to Disbursement

1) Prior to the first disbursement, the Trust Fund shall submit to AID evidence that it is legally empowered to make loans under the terms and to the types of clients envisaged by the Program.

2) Prior to committing or disbursing funds the Trust Fund shall submit for AID written approval:

a) A detailed administrative and policy manual setting forth all pertinent lending policies, procedures and criteria to be applied in making the Trust Fund resources available to PFI's for relending; and

b) Evidence that it has available adequate staff and other personnel necessary to assure an effective and efficient operation of the Fund's activities, particularly those of a Guaranty nature.

B. Covenants

1) The Borrower through the Trust Fund will prohibit the use of the AID loan for refinancing sub-borrower debts.

2) Three months prior to the end of the first and second year of operations, the Trust Fund shall prepare and discuss with USAID and in consultation with PFI's the experiences and results of operations to date and reach agreement on any changes in policies, directions or other pertinent matters required to assure fulfillment of the goals of the project.

3) The Trust Fund will maintain appropriate segregated accounts for the loanable funds, the Guarantee Fund, and the Technical Assistance Fund, and shall report to AID as specified in pertinent Implementation Letters.

4) In all Trust Fund operations, financing will not be permitted in situations in which less than 20% of sub-loan funding is provided from PFI's own resources, nor in which less than 20% of risk of loss is borne by the PFI.

12. Project Committee:

Carl A. Bischoff, Jr., Chairman, Capital Resources Development Officer
Charles S. Blankstein, Assistant Director for Economic Development
Clarence Zuvekas, Mission Economist
Richard J. Greene, Assistant Director for Social Development
Edward Felder, Capital Development Advisor (AID/W)
Bruce Berry, Financial Analyst
George K. Fitch, Industry Officer
Mario A. Gómez de la Torre, Counsel

SECTION I - BORROWER AND BACKGROUND

A. The Borrower and the Executing Agency

1. The Borrower is the Ministry of Industries and Commerce of the Government of Ecuador. The functions and operation of the Ministry are summarized in Appendix III. However, for convenience hereinafter, the Trust Fund of the Central Bank is referred to as the Borrower.

2. The Executing Agency will be the Trust Fund established within the Trust Department of the Central Bank of Ecuador.

B. Scope and Authority of the Borrower

The Central Bank of Ecuador was established as a semi-public institution in 1927. It was organized with the assistance of one of the Kemmerer missions which provided monetary, fiscal, and banking advice to a number of Latin American countries between 1923 and 1931. The stock of the Bank was initially owned by the country's commercial banks and by the general public, with participation of the former being mandatory. In addition to its note-issue and fiscal-agent functions, the Bank was also empowered to regulate the cost and amount of credit and to act as lender of last resort. 1/

The first reorganization of the Bank, carried out by Ecuadorean experts, occurred in 1937,

> 'in order to broaden its field of operations and clarify the scope of its activities. The Bank's capital was increased, and savings and mortgage banks were admitted as stockholders. The Council of Administration was enlarged to include representatives from agriculture, commerce, and industry, and was given greater freedom of action in the granting of rediscounts and advances. At the same time, a limitation was placed on the Bank's operations with the public, reflecting the growing importance of its responsibilities in the formulation of monetary policy'. 2/

A second reorganization of the Bank occurred in 1948, with the assistance of economists from the U.S. Federal Reserve System and the Federal Reserve Bank of New York,

> 'A new charter provided for the creation of a Monetary Board which assumed the powers and functions of the

1/ Frank Tamagna, Central Banking in Latin America (México: Centro de Estudios Monetarios Latinoamericanos, 1965), pp. 41-43.
2/ Ibid., p. 47.

Administrative Board with respect to monetary, credit, and exchange policies. In this new Board there was provided broader representation from Congress, the economic and development ministries, the National Economic Council, and the National Welfare Institute, and the economic and banking interests of the coastal and the mountainous parts of the country. The capital, which had been formerly shared by the government, the commercial banks, and others, was concentrated in two groups, government and domestic banks'. 3/

Changes of a less fundamental nature have occurred since 1948. At present, 93 percent of the subscribed capital of the Bank is owned by private banks. The membership of the 9-man Monetary Board is now composed of the following:

Minister of Finance
Minister of Agriculture
Minister of Industry and Commerce
Representative of the National Legislature
Representative of the Private Banks of the Coast
Representative of the Private Banks of the Sierra
Representative of the Chambers of Agriculture
Representative of the Chambers of Commerce
Representative of the Chambers of Industry.

In addition to its normal central banking operations, the Central Bank engages in direct lending operations with the general public. Most of this lending is for the financing of future export operations, usually with a commercial bank guaranty. Direct lending for industrial activities is also done. Banking operations are conducted through the main office in Quito and through branches in eleven other cities.

The authority of the Central Bank to undertake and discharge the functions and responsibilities contemplated hereunder for the Trust Fund is being examined and any actions required will be a condition precedent to any disbursement under the loan. A substantially similar operation under the Land Sale Guaranty Agreement has been approved.

. Organization and Management of the Borrower

The Trust Fund Department is in the process of being organized

3/ Ibid., p. 49.

and staffed. It will manage a variety of trust funds such as the one proposed herein: the land sale guaranty fund, the agricultural diversification fund, and others later to be assigned. So far, only the head of the Fund has been selected. The eminent qualifications of this man (See Annex IV) in investment banking represent the best assurance that he will insist on the selection of the best available qualified supporting experts to direct Trust Fund operations. He presently contemplates the employment of a highly qualified individual to assist him in managing the small industry investment portfolio of the Trust Fund. The small industry division chief in turn will be assisted by an appropriate staff of loan and guarantee officers and clerical personnel. In the final analysis the best hope of efficient management of the Trust Fund rests in the confidence the USAID has that the Central Bank is a well-managed operation.

D. Experience of the Borrower in Development Activities

The Central Bank and Monetary Board have traditionally followed a conservative monetary policy, which in large measure has been responsible for the relatively stable internal and external value of the sucre. On the other hand, monetary policy has sometimes been too restrictive, thus holding down the rate of economic growth. In the last few years, however, the Bank has become less interested in stabilization for its own sake and more interested in development. One example of this interest is the S/270 (approximately $13.5) million credit that it made available to the BNF in 1969 to help finance agricultural diversification in marginal banana zones over a three-year period. A $4 million World Bank Livestock Loan is currently administered by the Central Bank. Another expression of the Bank's interest in development is the recent approval by the Monetary Board of the Trust Fund to administer the AID Land Sale Guaranty Loan approved in early FY 1970. The Trust Fund is also expected to administer the present loan as well as other development loans.

The Central Bank is one of the strongest financial institutions in Ecuador, if not the strongest. It has been relatively free of political pressures from the central government, and indeed has exerted a moderating influence on government fiscal policy. Despite the fact that the majority of its members are from the private sector, the Monetary Board has tended to act responsibly, though sometimes belatedly, during monetary and foreign-exchange crises. This is in part due to the fact that the private-sector interest groups represented on the Board are affected differently by proposed policy changes. The Bank has a good core of professional staff personnel, and turnover is fairly low because of a relatively high salary schedule.

Thus, while the Central Bank has not yet had any experience with the Trust Fund mechanism, it has had some experience in the last few years with development programs. This experience will help serve as a base for the operations of the Trust Fund.

SECTION II - THE PROJECT

A. History and Background

The GOE's special interest in providing supporting assistance to artisans and small industries dates back to the establishment of the Servicio Cooperativo Interamericano de Artes Manuales in 1954. Subsequently, with the reorganization of the Development Credit System in 1964 into the Banco Nacional de Fomento, credit from a public institution was made available to artisans and small industries to attain the goals set forth in the overall economic development program (1964-73). To accomplish this mission the BNF organized itself into two divisions: Banking Credit and Supervised Credit.

The first AID loan, for industrial development was made to the Comisión de Valores on July 20, 1962. It extended a $5,000,000 loan for industrial credits, of which $350,000 was designated for loans to artisans and small industrialists. A number of different technical assistance projects financed by AID also contributed substantial support to expanding the base of industry in Ecuador. Additionally, AID's $3,000,000 loan in January 1966 was an important contribution to the establishment of COFIEC, Ecuador's first private development bank.

Thus it is clear that AID's interest in the industrial growth of the economy of Ecuador has been of sustaining nature over a period of more than eight years. However, while AID financed projects, not only in the industrial sector but also in Agriculture, have emphasized assistance to artisans and medium and larger producers, little has been done to aid the small entrepreneur.

When numerous AID-financed studies pointed up the opportunities for increasing the gross national product, opening up new jobs, and increasing incomes in the small industry area of the private sector, an analysis was made to identify the major barriers to realizing these potentials. The results emphatically indicated the primary needs to be a substantial expansion of credit at reasonable terms and the up-grading and modernization of productive and management capability of the small entrepreneur.

The segment of industry to be assisted under this proposal, described as "small enterprise", is made up of those productive establishments (many are sole proprietorships) which have assets valued at up to $50,000, employing 5 to 50 persons, requiring loans of up to $25,000, and not having access to credit assistance at reasonable terms. Because the clientele demand among this group is considered larger than the resources to be made available through this project, it is reasonable to predict that most applicants for loans will be those already engaged in business and desirous of modernizing, expanding, or diversifying their activities. In other words, it is unlikely that many applicants wishing to start up new business will be accomodated, (other than in the community business activity), particularly since the implementation scheme for the loan contemplates sub-lending by PFI's which will be required to participate in the financing by assuming a portion of the risks.

Prior and subsequent to submission and approval of the IRR, continuing discussions have been held with key officers of the PFI's with a view to assessing their individual and collective interests in the proposed program, the degree of participatory interest existing, and the terms under which such participation might be forthcoming. Given the highly competitive nature of the banking and investment field, substantial agreement was found that PFI participation was most likely to occur if all of the institutions had a common fund offering concessionary financing which they could approach when seeking to participate in financing activities not normally of interest to them. It became obvious also that the fund management would have to be in the hands of an organization with integrity and a reputation of non-discrimination. The establishment of a Trust Fund at the Central Bank appeared the best answer.

While the specific policies and procedures to be used for the Trust Fund have not yet been formulated, there is mutual agreement between the Central Bank, the USAID, and the PFI's that maximum flexibility of operations should be an objective until an experience base is established.

B. <u>Country Team Views</u>

The Country Team considers this project fully consistent with U.S. objectives in Ecuador and recommends authorization of the proposed loan.

C. Alternative Sources of Financing

The Ex-Im-Bank, IBRD and IDB have all expressed no interest in financing this project. Other external sources of financing are not likely to make financing available at a cost which will permit the satisfaction of the objectives of the project. Country contributions are expected to be substantial in the form of PFI participation with their own resources as well as the resources to be committed as equity by sub-borrowers. The GOE is presently undergoing a fiscal crisis and is incapable of committing any resources to this project. Every effort will be made during loan negotiation to seek the involvement of Central Bank resources as a supplement to the financial plan now envisioned. Prospects of obtaining such involvement are promising at this time.

SECTION III - PROJECT ANALYSIS

A. Relationship to Existing Credit Sources

The proposed project is designed to induce the participation of various in-country credit sources. For that matter, external credit, public or private, bilateral or international, hopefully will seek participation in the program by offering lines of credit or loans to the Trust Fund once the usefulness and solvency of the Fund mechanism have been demonstrated. This eventuality will open up new financial markets in support of small industry development and expansion. In other words, the Trust Fund mechanism will operate with sufficient flexibility to permit it to pioneer the development of a diversified capital market capable of mobilizing credit for small business.

B. Present Central Bank Credit Programs

Annex IV contains the Central Bank's Comparative Balance Sheet and Income together with pertinent general comments regarding the Bank's credit and other operations.

C. Descriptions of Other Credit Programs

See Annexes V, VI, VII, and VIII.

D. Characteristics and Goals of the Project

By working at the upper level of the small industry sector, a sector virtually excluded heretofore from development lending and technical assistance, this program can, in its initial years, select the best projects from this large area of production. Much of the proposed activity will be with existing industries which are decapitalized or need to modernize their equipment; thus modest injections of capital can produce rapid results in stimulating new production and employment and increased use of local raw materials. Similar programs in other LDCs have shown higher returns per loan dollar than any other AID activity, i.e., annual increased production of one to two times the value of the loans, and new employment at a cost of $2,000 per job. Other benefits include developing rural industry, thus helping to reduce migration to the urban centers; providing new markets for agricultural products; benefiting medium- and large-scale industry through provison of a stable supply of intermediary products; and drawing a larger share of the population into the process of economic development. Loans are non-inflationary, as they result in rapid production of goods.

Repayments of loans, most of which will be short- and medium-term, will be used for the establishment of a revolving fund to provide continued assistance after the initial seed capital has been introduced. Similarly, the loan seeks to provide long-term benefits by permanently strengthening the ability of financial institutions and technical assistance organizations to deal with the small-industry sector.

Basically the proposed program is intended to combine technical assistance with appropriate credit facilities to make possible for small enterpreneurs the procurement of needed capital goods to replace outworn or inefficient equipment or to establish, expand or improve production, and to up-grade or modernize production methods, management, and marketing. It should be pointed out here that while the proposed project was developed as a major thrust to improve and expand small productive industrial enterprises, it is not contemplated to exclude essential service and other types of business enterprises when they are important parts of improving and strengthening the performance of small producers; e.g., transport, storage, etc.

For the first time, it may be possible for small enterprise to have access to a capital market where they may obtain as a part of a single package short-, medium-, and long-term loans to finance fixed asset acquisitions, raw material purchases, and inventories of finished products, as well as specialized technical and management consulting services tailored to their particular needs. Since sub-borrower acceptance of necessary technical assistance will be a condition of granting the loan in all cases where the PFI has recourse to the Guaranty Fund, the program offers prospects of considerably strengthening the capability of the small industry community. Where the PFI assumes the entire risk of the loan, it will be free to decide whether or not a firm needs technical assistance.

Consideration was given to having the Trust Fund evaluate the sub-borrower's technical assistance needs on an individual case basis, but this was considered unnecessary. Since the PFI's will be competing for funds at a low cost not elsewhere available, the Trust Fund can indicate that a high loss rate by a PFI would seriously jeopardize that institution's continuing eligibility to draw down its revolving line of credit with the Trust Fund. This threat is considered adequate protection for the Guaranty Funds.

An important characteristic of the proposed program is the deliberate thrust it makes to induce existing ICI's to participate more actively in small business development. The seed capital made available to assist in the initial capitalization of the country's two industrial development banks (CV/CFN and COFIEC) has been so successful that both have established sufficient credit-worthiness to be able to obtain capital in foreign markets. Thus they have been able to satisfy, without further AID assistance, the demands of the medium- and large-scale borrowers, representing the CV/CFN and the COFIEC established clie teles. It is now intended to demonstrate to these institutions that with similar success in aiding small business they can be induced to expand this activity. Hence it is expected that by the end of the three-year period the PFI's will substantially increase the percentage of their own resources which they make available to the small entrepreneurs and on terms which are not dicriminatory.

The loan is also designed to encourage the Banco Nacional de Fomento (BNF) to shift out of relatively unproductive small loans to artisans into larger loans to small industrialists who have greater potential for expansion.

Moreover, the inclusion of essential service industries in the program also for the first time will demonstrate the advisability of the financing agencies developing their own investment programs in a manner which will tie together production and marketing. Eventually it is to be hoped that such investment programs will bring together necessary financial assistance in support of all key steps in the production and marketing processes. Ideally the goals should be to assist the suppliers of the inputs of the indigenous raw materials required by industry, the storage and movement of such materials to their processing plants, their use in producing finished products, and the forward movement and marketing of the end products.

Since different types of financial institutions tend to specialize in financing only certain elements of the production and marketing cycle, the proposed system may be a major step in the direction of encouraging more of these institutions to coordinate their individual lending programs so that they are compatible and mutually supporting.

An expanded and more efficient industrial sector will not only bring Ecuador into a better competitive position within the Andean Common Market, but contribute to increased foreign exchange earnings or savings as well. An energetic, healthy, growing industrial community is less likely to agitate against the Common Market.

Not to be overlooked in considering the goals of the program, is the contribution it will make in promoting the growth and strengthening of a middle class which, while enjoying a better standard of living, can participate more fully in the political and social life of Ecuador. In the final analysis, the broadening of the political and social base is the best insurance for responsible government.

E. <u>Size of Program</u>

The size of the program is the product of credit demand and the capacity of the financial institutions to evaluate and manage risks. There is no question that the effective demand for credit of the type contemplated herein substantially exceeds the resources expected to be available for these purposes. A recent sample survey conducted by the USAID (see Annex III) X has indicated that the credit gap for small manufacturing enterprises (defined as those factory-industry establishments employing between 5 and 49 workers) amounted to $11,174,000 for machinery purchases alone. Of this amount $7,174,000 is believed to represent the value of machinery purchases which small industrialists would be willing to make in the United States and Latin America.

The study also estimated that there was a credit gap of $11,315,000 for raw material purchases. Of this amount approximately $6,348,000 is thought to be available from in-country stocks. This leaves almost $5,000,000 in foreign-exchange credits which would have to be provided to satisfy raw materials requirements.

The study shows, therefore, that the gap between credit needs and those which can be expected to be satisfied from currently available resources is $11,174,000 for machinery and $11,315,000 for raw materials, or a total of $22,489,000, of which over $12 million represents a foreign exchange requirement. Even if we assume the attractiveness of the AID money could induce the PFI's to match dollar for dollar, there would still remain a substantial gap. And these estimates do not include working capital needs other than for raw materials.

The major limitation on the size of the program as proposed in this Paper is the capacity of sub-borrowers to qualify their projects for loans on the one hand, and, on the other, the ability of the PFI's to absorb the additional work involved by adding the AID resources for some PFI's to undertake a recruiting and training program to gear up for the new volume of business resulting from this project.

F. Eligibility of PFI Borrowers

As indicated earlier, flexibility will be the keynote of the program. Detailed eligibility criteria will be developed by the Trust Fund, and will satisfy the USAID's requirements before disbursement of the loan. A condition precedent to this effect will be included in the loan agreement. So far, agreement exists that the PFI's must demonstrate genuine support for the program in a tangible way by agreeing to participate in risk-sharing. Since it is impossible to anticipate the nature of projects for which financing may be sought, or the identity of their sponsors, it would be a mistake to establish a fixed percentage of risk a PFI must take on each and every project. The lending criteria must be flexible enough to encourage those institutions to take all forms of risk, low, medium, and high. To do so, a variable interest rate to the PFI's may be a useful technique to persuade them to assume larger risks than normal. In other words, it is hoped that terms will be established in such a way that profit potential will be related directly to risk assumption. Then, too, since the program is designed to invite the widest degree of participation by any qualified organization, the eligibility requirements must be set so as to attract financing by legitimate sources of local funds.

Operations of the Trust Fund will be governed by regulations issued under the authority of the Monetary Board. Certain types of operations of the Fund, particularly longer-term participations with private commercial banks, may require certain technical statutory changes. Such changes are within the authority of the Permanent Legislative Committee, which is empowered to act with full powers of the legislative branch when the Congress is not in session, with certain exceptions not applicable in the instant project. Changes in legislation can be handled rapidly by the Committee. As the project is supported by the GOE, the Central Bank, and the banking community, and as there is no apparent opposition to any technical changes in the law which might arise, it can be stated with full confidence that any change in law which may be sought would be obtained promptly and without difficulty.

G. The "Barrio Enterprise" Activity

The $250,000 to be made available by the GOE to the Ecuadorean Development Foundation for a pilot project in development of "barrio enterprises" will serve the general loan objective of expanding the base for more rapid development of the industrial sector of the economy, but its special justification stems from the needs of Ecuador's urban poverty areas, particularly in Guayaquil.

Economic progress in Ecuador's low income urban areas (known as barrios suburbanos) is dangerously slow in the face of rapidly growing urban populations (6% per annum in Guayaquil). Unemployment and underemployment are also growing rapidly. (This of course is a major current preoccupation of development experts throughout Latin America and the underdeveloped world.) The national and municipal governments can afford to do very little for the barrios suburbanos. Few barrio enterprises can obtain credit even at usurious rates (average 8% a month). Discontent in the barrios is growing rapidly, and along with it the frequency of disturbances and the threat of terrorism and revolution. If this growing discontent is not to result in social upheavals, more must be done to create visible progress in the barrios. The most effective way of doing this would be to increase the levels of economic activity of barrio residents, thus increasing income and employment. The USAID is also concerned about other remedial measures, such as urban planning, provision of sites and services for low-cost housing, and organization of communities for self-help purposes. However, increase in the level of economic activity is perhaps the most important and direct part of USAID urban development strategy, since it creates income with which most of the other needs of the area can be met, rather than relying on government to meet these needs. It also has greater multiplier effects.

The effort is, of course, experimental. There is not sufficient experience in promotion of "barrio" enterprise in Latin America to assure success. However, investigations by a USAID contract expert, experienced in development of community enterprise in the United States and Latin America, as well as with the examples of the more successful community programs in the U.S., indicate that, with the proper technical assistance, substantial benefits can result from such a program.

The program will be thoroughly evaluated to determine the effectiveness of the techniques employed. The Mission has an evaluation officer as well as a U.S. contractor working with Ecuadorean assistants in project evaluation. "Before and after" data will be gathered from a representative sampling of borrowers and from a control group which is not participating in the project to determine the economic impact of the project on the borrowers and the community (creation of new business, rate of business expansion, rate of creation of new employment, etc.). The relative effects of credit and of the various types of technical assistance will be evaluated to determine the critical factors in promoting more rapid growth of business activity in this type of situation. If the experiment is successful it can offer an important tool for attacking the problems of urban areas which are among the most grave and urgent that AID faces in Latin America.

Private banks and the regular intermediate credit institutions are not prepared to deal with most barrio enterprises. The size of the loans commonly required is too small and the amount of technical assistance needed is too great for these institutions to operate at an acceptable level of profit in this field. It would also require a special increase in their staff and supervisory role which they are not prepared to undertake at this time. It is for these reasons that the credit would be extended to the Ecuadorean Development Foundation (EDF).

An affiliate of the Pan American Development Foundation, EDF is in effect a public service organization concerned with providing credit for development purposes to individuals and groups which are not able to obtain credit at reasonable rates of interest. In addition it has sources of income outside of interest on its loans, namely contributions of capital (in some cases in the form of land) and working funds from individuals and companies which are interested in supporting national development in this fashion. EDF provides the necessary administration and related technical assistance for such loans. More detailed information on EDF is provided below and in Annex VIII.

1. <u>Beneficiaries of the Project</u>

The beneficiaries of the $250,000 fund for barrio enterprises will be businesses and business associations operating in urban poverty areas, principally in Guayaquil. To qualify for a loan the borrower must be unable to obtain it at a reasonable rate of interest from another source. Loans will be made to commercial and service enterprises as well as manufacturing ones. However, the loan must facilitate expansion of an existing business or establishment of a new one, and not merely meet existing needs without growth. Traditional artisan-type handicrafts will not be eligible for loans. Also, loans will be for less than $10,000 (i.e. for amounts less than those to be made available under other credit operations financed under this loan), thus in effect focusing on smaller concerns expected to have fixed assets valued at up to about $10,000. Since the demand for such loans will far exceed the amount of money proposed to be made available, it will be possible to exercise selectivity amoung prospective borrowers to assure maximum growth potential.

Many of the borrowers will already be in business, others will be setting up new businesses. In both cases substantial technical assistance will be provided to assure sound investments, business management, and production techniques. (See section L below.) In some cases loans will be extended to business associations for sub-lending to their members, as approved by EDF. In such cases the associations will be responsible to EDF for repayment of the loan. Such loans will serve the secondary purpose of strengthening associations concerned with facilitating the growth of business in the barrios..

2. Credit Operations

EDF will be permitted to draw down loan funds from the Trust Fund on request, as needed to extend loans to the beneficiaries of this portion of the project. EDF will assume full responsbility for repayment to the Trust Fund.

EDF in turn will lend to individual enterprises at a rate of 12% per annum and to business associations at 10% per annum. The difference between the rates will be in recognition of the risk assumed by the associations and their contribution to administration of the loans and to provide them with a source of income for their activities. Approval of the USAID contract representatives working in the Barrios will be necessary for all loans extended by EDF under this project.

3. Technical Assistance

Technical assistance for barrio enterprises will be extensive since some beneficiaries will be new enterprises and most will be of a lower level of business sophistication than that of sub-borrowers under the main part of the AID loan. Assistance will be provided in planning use of the loan and in managerial and (to a lesser extent) production techniques. The goals of this assistance will be to assure to the greatest extent possible that the businesses affected will be operating on a sound basis and that the people involved in them, especially at the entrepreneurial-managerial level, are developing skills which will make them more effective participants in the economic growth process.

This technical assistance will come from four sources: 1) the USAID contract team, consisting of a U. S. contractor with experience in development of barrio enterprises as well as extensive experience in Latin America with low-income groups, and an Ecuadorean professional assistant; 2) EDF, which will provide the additional services of an economist-accountant, an assistant accountant, and a field worker (especially for this loan, in addition to their existing staff of 6 full time and 4 part time (from 40% to almost 100%) professional employees); 3) the members of EDF, consisting of 99 Ecuadorean and foreign banks and companies which contribute funds to EDF, and many of which will be prepared to offer technical assistance to enterprises financed under the barrio enterprise loan; and, 4) CENDES, though CENDES involvement will be less frequent in the case of these small borrowers than in that of the category which will be the target of the bulk of the funds under the AID loan.

H. Terms of Sub-loans

The PFI's will be permitted to apply their usual terms, with the Trust Fund terms serving as leverage to persuade the PFI's to liberalize terms for sub-borrowers needing, and deserving of, more liberal treatment. A major objective of the project is to encourage the PFI's to add small business enterprises to the clientele lists.

I. Administration of the Trust Fund

1. Purposes and Functions of the Trust Fund

This Paper has discussed at some lenght the nature of the Trust Fund and PFI operations as one of lending and relending, respectively, and the upgrading of small business management, productivity, and marketing practices. In point of fact the program is one of changing and improving the attitudes existing between the managers of credit institutions and small industry borrowers. Through the widest range of types of financing mechanisms and the use of AID-financed incentives, it is proposed to induce credit managers to abandon current negative attitudes towards small loans to small business enterprises or their insistence upon extraordinary collateral and security demands in addition to premium charges for such loans, and to regard such borrowers as important members of the business community.

In pursuit of the foregoing objective, the project has been designed in such a fashion that the Trust Fund management will have available a wide range of tools with which project sublending activities can be shaped not only to assure that the sub-borrowers will receive an appropriate mix of financial resources, but also to assure that, over time, the appropriate incentives and inducements are available to draw the financial community into the business of servicing the smaller-business sector. Thus the Trust Fund management will be empowered to vary cash contributions, security, other risk distribution elements, equity participation by PFI's and scheduling of repayments by the PFI to the Trust Fund.

Above all, the costs of participation by the Trust Fund in any given operation will be varied from zero to as much as the money market will bear. Thus, the Trust Fund management, by profit inducement, by absortion of risk, and by other means, will have a wide range of economic tools to achieve the objectives of the loan project, to go along with the powers of persuassion and prestige of the Central Bank, the most important and best-managed financial institution in the country.

a. <u>Purposes of the Trust Fund</u>

The Trust Fund will serve two main purposes:

1) As allocation mechanism (no one institutions could handle all the requirements of small business enterprises in the country--nor should any one institution do so in light of the objective of moving the entire financial community in the direction of doing business with smaller enterprises). The Trust Fund provides a mechanism for allocation of funds in appropriate amount to a large number of individual banking institutions, while maintaining the control over the amounts of funds moving to particular sub-sectors, geographical areas, and other destinations of the total funds; and

2) As sophisticated mechanism for the distribution of risk and profit of participating financial institutions in light of:

   (i) money market conditions;

   (ii) the desirability of sub-projects in terms of their nature, security available, capabilities of entreprenours, and other considerations;

   (iii) attitudes of bankers and inducements needed to motivate changes in those attitudes to achieve project objectives (noting that, by close contacts with the banking community, Trust Fund officials can sense what attidudinal changes are possible in any given time frame and can apply incentives to encourage those changes). This permits banks to participate in the program while pursuing their own regular policies, but within an institutional environment which provides flexibility for inducing PFI's to change their policies rather than attempting to force changes upon these organizations;

   (iv) the need for encouraging combined financing of smaller businesses by commercial banks and financieras. (E.g., the availability of Trust Fund facility may make it feasible for a financiera to provide medium-range financing, and for commercial banks to provide working-capital on a short-term basis, with the Trust Fund standing ready to cover possible gaps in the overall financing scheme for a given subproject. A commercial bank may be unwilling to extend short-term credit of any longer than 6 months for working-capital. A financiera may be interested only in medium-term financing, but be unwilling to undertake such financing unless there is some assurance that short-term working-capital will be available for longer than six months. Assuming the commercial bank refuses to roll over a short term credit and the borrower could not obtain funds elsewhere, the financiera might consider the medium-term financing excessively risky without this coverage. The Trust Fund role in such a situation might be to guarantee the commercial bank's extension of the working-capital loan, offer its rediscount facilities to the commercial bank, or even fill the gap by making a direct working-capital loan to the PFI's sub-borrower.)

The philosophy of the Trust Fund operation is to assure authority of the Fund to carry out a wide range of financial operations in order to promote loan projects' objectives. It should be emphasized that the Trust Fund functions not only as a mechanism for allocation of funds, but as a highly flexible management device to take advantage of conditions within the money market, opportunities for promotion of small businesses, and the resources of the Trust Fund and participating financial institutions so as to achieve the objectives of the Fund.

b. Powers and Functions of the Trust Fund

The Trust Fund will be empowered to carry out various types of operations, including but not limited to, the following:

1) lending to PFI's for purpose of relending to small business;

2) guarantying loans made by PFI's to smaller businesses;

3) agreeing to lend to PFI's with respect to small business operations at some time in the future, should particular events take place (here what is envisioned is the type of

situation where the Trust Fund agrees to pick up a small business loan if the PFI which provided that amount in the first instance finds it necessary to discount the paper).

4) Rediscount of small business paper held by PFI (although this should be limited to commercial paper issued in support of new operations).

5) Financing equity investments by PFI's in small businesses (provided that the Trust Fund can assure itself that the participation in equity by the PFI is not abusive of the interests of the small entrepreneur).

With respect to any given operation, the Trust Fund management will be authorized to manipulate a series of variables which the Trust Fund management in its best judgment considers appropriate to achieve the objectives of the loan. The variables include the following: cash contribution; security provided by the borrower or third parties; equity participation by PFI; method of repayment by the PFI to the Trust Fund (amortization, payment of principal at end of term, etc.); the degree of administrative control by the Trust Fund and Trust Fund charges to PFI (and therefore PFI profit) in any given participation or other operation. Thus, cost item can be viewed not merely in terms of cost but also in terms of incentive.

Each of the foregoing variables can be applied individually or in combination with respect to any given operation by the management of the Trust Fund. The result is a broad range of possible interest spreads (and therefore profit margins), and ranges of risk absorption which may be applied as appropriate in any given case. The tables in Annex IX show the effect on earnings potential of a series of variables. That is, the percentage of contribution between the Trust Fund and the PFIs are varied between 75-25, 65-35, 25-75, and 20-80; and the rediscount rates, between 3%, 4%, and 5%. Furthermore, the method of PFI amortization to the Trust Fund loan is varied. As reflected in Annex IX, the result is a range of possible earnings in terms of true interest from 14% to 95%.

It is unlikely that the extremes of profit reflected under some of the assumptions would ever be utilized. The tables in Annex IX merely illustrate the degree of leverage which will be available to the Trust Fund to achieve its objectives.

The following sub-sections will describe each of the various variables which may be manipulated by the Trust Fund, and the policies and objectives sought to be achieved in each case.

The various possibilities discussed should be considered in light of the overall scheme. A major objective is to create a capital market for small business lending which now does not exist. The function of allocation of profit and risk inherent in any market mechanism must in effect be called into existance in order to initiate the process of providing credit to the small business sector.

The small business loan project in its totality creates a capital market by means of interventions, on both the supply and demand sides. The Trust Fund, with its high degree of flexibility, provides a sophisticated mechnism through which funds can be brought into this important area at given price levels which can then be reduced by marginal changes in Trust Fund policy over time so as to eliminate windfall profits to participating financial institutions while assuring a reasonably steady flow of resources for project objectives.

2. Use of Variables as Trade-Offs

a. Cash Contribution

The basic variable to be manipulated by the Trust Fund management is that of the percentage of cash contribution provided for any given sub-project by the PFI and, reciprocally, by the Trust Fund. The purpose of the loan being to maximize the flow of private resources into the small business sector, it is desirable that the cash participation in any given operation by any PFI be maximized. As a minimum "floor", no less than 20% of any lending operation would be provided by the PFI or PFIs involved. In order to induce

PFIs to make larger percentages of contribution to a particular subproject, the Trust Fund will be empowered to charge the PFI less for a given dollar of Trust Fund participation when the PFIs contribute more than 20% of the total of a particular operation. Thus, to take an example (assuming a simple operation not involving problems of security, equity participation or the like), suppose that a given loan of S/100,000 is proposed. Assuming a current interest rate to sub-borrowers of 12%, the gross earning to the PFI will be S/12,000 annually. If the PFI takes a minimum 6% spread on the operation its minimum earnings would be S/6,000. That minimum return could be earned with a minimum participation of 20% (or S/20,000), with the trust fund providing S/80,000. If the Trust Fund charges 7% on 80,000 as a charge for its participation of 80% or S/5,600, the PFI must be content with earning S/12,000 minus S/5,600 (charged by the Trust Fund), or S/6,400. However, it will be open to the Trust Fund management to reduce the charges of the Trust Fund to zero as an incentive to the PFI to increase its percentage contribution. Thus, for example, if the PFIs put up 50% and the trust fund 50%, the Trust Fund might charge only 2% for its contribution. If the Trust Fund takes only S/1,000, then the PFI's gross earnings on the operation are S/11,000. Thus the percentage gross earnings to the PFIs can be manipulated to promote high return on contribution and to induce greater contribution by PFIs.

b. <u>Methods of Repayment of Trust Fund Contributions by the PFI to the Trust Fund</u>

Another variable which the management of the Trust Fund will be empowered to manipulate will be the methods of repayment to the Trust Fund for any particular lending operation. While, as a practical matter, Trust Fund lending operations with PFI's will not be handled on an individual basis for purposes of analysis, the assumption will be made in the following discussion that each project is a separate transaction between the Trust Fund and the PFI.

The net earnings on invested capital which a PFI earns with respect to any transaction is of course a function not only of the interest spread earned on the entire operation, but also the amount paid by the PFI to the Trust Fund for the money borrowed by the PFI for that operation, and the time at which the repayment must be made. To take a simple case, if the contribution is on a 50-50 basis and repayments by the sub-borrower are attributed first to the PFI contribution and then to the Trust Fund contribution, the effective earnings rate to the PFI on its 50% contribution is substantially higher than if the repayments by the sub-borrower were attributed on a 50-50 basis as paid to the Trust Fund and to the PFI. This relationship of timing of repayment by the PFI to the Trust Fund can be expressed in terms of the difference between a lump sum payment by the PFI of principal at the end of the term to the Trust Fund as opposed to an amortization on a regular basis of the PFI--Trust Fund lending operation. By making adjustments in the schedule of repayments of any given operation the Trust Fund can leverage the profits of the PFI very substantially. (See Annex IX.)

Manipulating the variables of contribution, charges to the PFI for Trust Fund contributions, and timing of repayments to the Trust Fund by the PFI provide the Trust Fund with a broad range of variables to manipulate to create cash incentives to enter into particular sublending operations.

Allocation of Risk

Another set of variables exists, perhaps equally important, on the risk side of the equation. In certain cases PFIs may be more concerned with sharing or eliminating risk than with a high rate of return. It is of course true that from time to time projects will be presented to PFI's which are simply not bankable. But it must also be recognized that excessive conservatism may exist in certain cases. Furthermore, conversations by Mission personnel with various PFI managerial personnel indicate that it is often the case that PFI personnel are perfectly willing to undertake certain risks on what are considered very sound projects, but that extremely conservative boards of directors will from time to time refuse to enter into operations unless security for the loan is absolute. It is precisely this type of policy which we are attempting to change over time through the mechanism of this loan project. How risk on small business lending operations can be shared, spread, or fully absorbed by the Trust Fund is described in the following paragraphs. In general, the policy will be to attempt to maximize the risks undertaken by the PFI in a given operation. To this end, any absorption of risk by the Trust Fund will be paid for at variable rates by the PFI.

It is often the case that a problem faced by a smaller businessman is not so much one of presenting a desirable project to a financial institution or the ability to pay the interest rates involved but rather the security for the loan which a bank requires. Banks and financieras in Ecuador, as in so many areas of the world, are extremely conservative in this respect. During the intensive review, Mission personnel were informed by certain financieras that they would be very much interested in working with smaller businesses (and indeed have on numerous ocassions) but only when complete security coverage is available to them. The security requirement is one which is absolute with certain institutions. Thus, it was pointed out by some officials that otherwise excellent projects have been refused because the security available was not adequate to cover the full amount of the loan, despite the complete confidence of the institution that the project would work and the loan would be repaid. One of the functions of the Trust Fund would be to cover extraordinary risks.

While it might be argued that the policy of the financieras involved is wrong and that pressure should be put on financieras to change their policies, it is the view of the Mission that attitudes toward complete and, indeed, excessive security coverage can only be changed over time, and that it would be pointless to attempt to force policy changes to achieve this objective. The Mission specifically rejects the notion that there is any leverage available with banking institutions to make funds available for lending under conditions involving less than their current minimal security requirements. The better financial institutions, the ones that the Mission is interested in bringing into the small business sector, would simply reject the policy and refuse to do business with the Trust Fund. Thus we would lose in these cases the very benefits of institutional competence which the project seeks to take advantage of.

The usual security requirements demanded by financial institutions in Ecuador are 100 to 150% coverage of the loan proceeds by assets which can be realized-upon quickly. It is not necessarily the case that banks insist upon mortgages, liens, and similar claims to obtain such coverage. Co-signature loans or signature guarantees are commonly used when the borrower or guarantor of the borrower is well enough known to the bank or financiera to satisfy their desire for protection. In addition to this type of "personal loan", financieras will obtain mortgages on real estate buildings, and other assets which can be quickly realized-upon. Bankers have indicated that they do not ordinarily desire to be placed in a situation of having to realize on security which is not readily saleable. Thus, substantially more outside security would be required for a specialized piece of machinery for which no ready market exists than for, let us say, vehicles, lathes, drills, or other readily marketable items.

Financieras are particularly wary of situations in which they would be called upon to operate a business in order to realize upon security. As a result of these policies, which are not at all unreasonable in principle but seem on ocassions to be carried to unfortunate lengths, the small businessman who is not very well connected in the community finds it impossible to obtain anything but short-term, high-interest credit from banks.

The Trust Fund will respond to this problem by agreeing in appropriate cases to guarantee certain loans to the extent that the sub-borrower has been unable to put up security adequate for the requirements of a particular banking institution. This type of operation is particularly delicate from a number of points of view. To the extent that a PFI accepts the risk of default under a small business lending operation, Trust Fund review and approval of the operation need be only minimal. But once guaranty questions arise, an analysis of the soundness of the project by the Trust Fund would be required. Furthermore, an analysis must be made of the security itself, as well as of the project. For example, a PFI, though adequately covered with security provided by the borrower, might wish to "reinsure" itself through the Trust Fund. This is not necessarily undesirable, but it places the Trust Fund in a position of undertaking operations which may limit its resources available for other operations. It certainly is not the objective of the Trust Fund to assist PFI in becoming more conservative in lending policies. But the "reassurance" may in certain cases induce the PFIs to move into areas which they otherwise would not have considered with any amount of security backing.

Once again, in this area the Trust Fund would be empowered to provide guaranties of small business loan operations at charges ranging from zero to as high as any given PFI is willing to accept.

The flexibility involved extends not only to the amount of participation or guaranty, but also to the timing of the guaranty. Thus, the Trust Fund might provide high percentage guaranty in the first year when presumably the risk is the greatest, scaling down its guaranty over time to zero. Thus, risk of loss can gradually be shifted from the Trust Fund to the PFI. However, in no event will financing be permitted in which less than 20% of the risk of loss is borne by the PFI.

Summary:

Each of the variables described above have been examined in isolation. In actual practice, two or more variables may be applied in any given operation. In this fashion an extraordinary degree of flexibility in terms of risk, profit to the PFI, and rapidity of operations can be achieved. (See Annex IX.)

3. Equity Participation

During the intensive review, an interesting proposal was made by the manager of a leading financiera concerning the financing of equity participation by PFIs in small business. This is one of the organizations which has placed very strong emphasis upon security. Various examples were given of attractive projects which had to be abandoned because of excessive debt-equity ratios and inadequate security availabilities. He suggested that he had proposed in certain cases that an equity participation be taken by his organization. In at least one case, this was done with successful results. However, while he was prepared to consider this type of operation on other ocassion, he had encountered considerable resistance among more conservative members of the management of this organization. He suggested that, were the Trust Fund empowered to finance equity participations, at the risk of the financiera, this type of operation might be carried out more often.

There are significant advantages to be gained from facilitating equity participation by banks and financieras in smaller business operations. First of all, very constrained debt-equity ratio situations can be substantially relieved if additional equity can be raised in this fashion. Secondly, significant benefits can be obtained in terms of assuring sound management if the interest of the bank or financiera goes beyond repayment of loans as such.

Thirdly, the small business enterprise can often be benefited substantially by the close working relationships which develop where stock is owned by financieras. Fourthly, the financieras themselves become beeter acquainted with the problems of smaller businesses and gain a better "feel" for the types of new opportunities which become available to small business enterprise.

On the other hand, it must be recognized that there are possibilities for abuse in the situation. A bank or financiera might insist on "a piece of the action" when straight lending would be entirely appropriate. The closeness of relations with a financing organization may not be necessarily the best thing for any particular entrepreneur. While on balance the advantages of facilitating equity participating by banks and financieras seem far and away to outweigh the potential dangers, the Project Committee has concluded that the dangers are sufficient that such operations should be reviewed by the Trust Fund on a case-by-case basis to assure that abuses do not take place. Once again, the cost of money for such an operation to any PFI would be subject to determination by the management of the Trust Fund, in accordance with the objectives of the loan.

4. <u>Trust Fund Review Responsibilities</u>

All of the foregoing variables imply another: a degree of administrative review and control by the Trust Fund with respect to any given operation. In cases where the PFI absorbs the major risk of loss, the Trust Fund function need be no more than to determine whether or not the project meets basic loan criteria. Where Trust Fund guaranties or acceptances of risk in whole or in part are involved, presumably the Trust Fund will review project soundness in considerably more detail. Similarly, in cases of equity participation financing, the Trust Fund must assure itself that no abuse of the entrepreneur on the part of the PFI takes place.

Implied in these relationships is not only the degree of review and control as such, but also the question of time for processing. It may well be that an important incentive for participating financial institutions to take greater risks themselves would be the very difference in review and control and time elapsed involved with respect to any given situation.

J. Processing Sub-loans

Since a number of different PFI's are expected to participate in the Trust Fund operation, it is not possible or necessary -- to describe the procedures employed by each in processing sub-loans. Essentially, they all use conventional loan application and review procedures including appropriate credit checks. For example once a loan is granted by the CV/CFN the following disbursement methods take place:

When a loan is approved, the borrower pays a 1% commitment fee on the unused balance, until the loan is fully drawn down. On raw materials loan components the CV/CFN either requires the borrower to provide evidence that he bought the materials, or pays the actual bills on presentation by the supplier. On fixed assets or capital equipment, the CV/CFN uses the Letter of Credit in favor of the supplier. On building construction loans component whether building is performed by a contractor or by the borrower himself, the CV/CFN makes inspections of work progress and issues checks in accordance with the payment provisions of the sub-loan agreement.

CV/CFN closely controls disbursement on its loans, although private banks often do not and simply hand the borrower a check. CV/CFN, like other banks, charges interest beginning on the day of the first drawdown, and only on the amounts disbursed.

K. Technical Assistance

1. Description of the Technical Assistance Program

The Technical Assistance aspect of this project is designed to improve the capability of PFI's successfully to manage this program. It is also directed to the goal of improving the capability of the smaller entrepreneur to effectively manage and expand a business enterprise. In addition it is an important measure of protection for the Trust Fund.

A characteristic of the small-industry sector is that access to credit at reasonable terms is traditionally denied to borrowers due to their inability to provide full security coverage for loans. Precisely for this reason there will be recourse to the Guaranty Fund in cases where the sub-project sponsor can come up with no more than 60% or 80% of the security required and the PFI is unable or unwilling to take a risk on the balance. The risk to the Trust Fund is balanced mainly by the desire of the PFI's to maintain as good as possible a record on loan utilization with the Trust Fund in order to qualify for further participation in the program. But technical assistance to the sub-borrower is also important for the protection of loan funds, since experience with banks and with management techniques is very limited at the small industry level.

a. Technical Assistance to PFI's

At the PFI level, technical assistance will be provided to increase the competence of sub-managers, loan officers, and inspectors. This aspect of the technical assistance program follows the recommendations of the October 1969 report by Benjamin Spiro,1/ contracted by USAID to provide guidance for this project.

1) Technical Assistance to the BNF

The BNF has had four years of experience with a supervised small industry loan program (crédito de capacitación). Capacitación in this case means helping a small, marginal firm acquire a capacity for growth, mainly through the provision of new machinery and equipment or through assistance with an expansion plan. The BNF has made 1,248 loans under this program totalling S/98 million ($5 million). It also conducted a 2-week, full-time training course in December 1968 for 35 inspectors from its (then) 35 branches, covering all aspects of small industry loan analysis, approval, and follow-up. The BNF used to contract services of International Development Services to provide guidance in this program.

The technical assistance program under the present loan provides the BNF with the contract services of a consultant advisor for two years; one-month training visits for key BNF sub-managers and officials of the capacitación program to observe the successful supervised small industry credit program administered by the Caja Agraria, Industrial y Minera in Bogotá, Colombia; and an intensive training program of one month in the head

1/ Benjamin Spiro Associates, Inc., "A Program for the Development of Small Scale Industry in Ecuador" (October 1969), ditto.

office of the BNF in Quito for branch-office sub-managers, loan officers, and inspectors. This program is based upon the suggestions contained in an earlier report by Benjamin Spiro.2/ This course will be conducted by BNF staff personnel and specialists from CENDES, the Institute of Technological Research, INERHI, the Centro de Ejecutivos, etc.

2) Technical Assistance for Other Participating Financial Institutions

Similar assistance and training is to be provided to other PFIs, including a training visit for a group of PFI loan managers to observe the Colombian program, also for one month; a one-month intensive training course in loan supervision in Guayaquil for PFI loan officers and inspectors; and consultant advice and direct supervision by the 2-year contract advisor.

b. Technical Assistance to Sub-Borrowers

CENDES, the Ecuadorean Development Center, has been supported by AID since 1962 and has earned an excellent reputation. It has a staff of over 80 economists and engineers, plus 6 AID-financed foreign advisors, in its branches in Quito and Guayaquil. Its Division of Technical Assistance provides a full range of diagnostic management and consultant services to small industry in Ecuador. It is planned to use CENDES staff to provide assistance to sub-borrowers, when necessary, both in the preparation of loan applications under this program and in follow-up visits for loan supervision and control of use of loan funds.

A small sum under this loan is reserved to assist CENDES set up a special training program for selected consulting staff who will provide services to sub-borrowers.
Mr. Alwyn Young, an Advisor in the CENDES office in Guayaquil, has prepared the curriculum for this course, a consultants' handbook, and a set of procedures for plant visits stressing technical, financial, and marketing aspects of small industry projects (See Annex XI).

2/ "Credit with Technical Assistance to Small Scale Industry in Colombia" (October 1964), pp. 11-14.

The Centro de Ejecutivos (Management Institute) was founded initially as a branch of CENDES in 1962, but is now independent and self-supporting from its own revenues. It is located in Guayaquil, and has conducted a total of 224 management courses for 6,800 participants, including middle-management staff, personnel officers, technical staff, secretaries, etc. A branch in Quito was established but did not prosper due to poor direction; however, efforts are now being made to revive the Quito Center.

The Centros will be able to provide technical assistance to associations of small industrialists and artisans which have been organized by the Ministry of Industries and Commerce in a number of the major cities of Ecuador. Four such organizations have been established to date, and plans call for the establishment of an additional four. These associations are potentially useful in contributing to the success of the proposed Small Industry Loan Program. Basic, condensed courses in management should be given to key personnel of the associations. The Centro de Ejecutivos in Guayaquil is now preparing such a course, which includes most of the major elements of management (accounting, plant maintenance, personnel, labor relations, etc.). This course will be given five nights a week to each of the eight associations by a travelling team provided by the Centro. The course is preceded by one month of preparation and home study. It will be repeated a year later both to refresh initial participants and to train new association members. The loan will cover the cost of these courses, which will be given free.

2. Details of the Technical Assistance Program for Sub-Borrowers

a. General

Technical assistance to the sub-borrower will include (1) help in the preparation of the loan application, checking of security, and evaluation of the feasibility of the project and (2) follow-up activities after a loan is made, including plant visits, checking of loan utilization and project progress, provision of assistance on technological matters as needed, etc. For each activity, CENDES or other specialized consultants such as auditing firms will be used as required at the request of the PFI. A 1% fee will be charged for each type of assistance. Technical assistance will be optional (at the discretion of the PFI) when the PFI assumes the entire risk of a loan. However, both types of technical assistance will be required when there is recourse to the Guaranty Fund.

Technical assistance begins when a potential client is identified either directly by CENDES or by reference from a PFI. The first step is a preliminary review of the small businessman's project. This preliminary review will be carried out by CENDES or another consulting firm if the PFI is not in a position to provide this service.

To be considered for the program, loan applicants must meet the following criteria:

(1) The enterprise must be under the complete control of a full-time manager making day-to-day decisions for his business. A family business run by a member of the family who does not have absolute powers to make positive decisions, introduce changes, and make improvements, or a partnership where decision-making responsibility is shared with non-working partners, will not be considered for the program.

(2) The enterprise must have growth potential and be able to survive adjustments made necessary by the Andean Common Market.

Once CENDES or another consultant has approved a project, it will begin to work with the client in a comprehensive program of technical assistance beginning with the preparation of the application and working through the implementation of the program until the final payment of the loan. Throughout this involvement, the dual aspects of management consulting and management education will be maintained as essential elements of the consultant's activity.

In the preparation of the application for a project as well as in the continuing technical assistance after the granting of the loan, consultants will use a specially prepared consultant's handbook, which is presently being revised by Mr. Alwyn Young, CENDES advisor in Guayaquil, to meet the specific conditions of the Ecuadorean situation. This handbook defines a large number of activities to be carried out in three main management areas: marketing, finance, and production. The consultants' handbook is written in a manner that permits a logical sequence to be followed in the systematic application of management development techniques. The three first items from each of the main management areas are described in Annex XI to illustrate the application of the techniques to be employed.

b. Cases in Which the PFI Does Not Use the Guaranty Fund

If the PFI decides to assume the entire risk of a subloan--i.e., if it decides not to seek recourse to the Guaranty Fund--it will be free to determine whether or not an applicant needs technical assistance in preparing a loan application and/or follow-up technical assistance. In many cases this technical assistance will be provided by CENDES or some other organization. Even if the technical assistance consultants recommend loan approval, however, the final decision on credit-worthiness will be taken by the PFI.

For loans provided by the BNF, most of the necessary technical assistance can be provided by the Bank's own staff. The BNF has experienced personnel who have undergone training courses in the management of small industry loans with technical assistance elements. Additional loan officers will be added to this staff as needed. All of these personnel will be able to take advantage of additional training courses funded under the Loan.

If the BNF refers the applicant to CENDES or anoth.. consultant, a fee of 1% of the proposed loan amount will be charged. This amount will be payable in cash to the consultant only in cases in which the sub-loan is approved by the BNF. This charge may, by agreement between the BNF and the sub-borrower, be paid in cash or capitalized under terms of the sub-loan. In cases in which the loan is not approved, neither the applicant nor the PFI will be liable for consultants' fees.

For follow-up plant visits and technical assistance after loan approval, the BNF may, in cases where technical problems are beyond the capabilities of its own inspectors, request that CENDES make the plan visits normally handled by BNF staff. The charge for these services will be 1% of the loan value. In cases where this charge will be necessary, the BNF will so inform the borrower in advance.

Other PFI's will also decide whether technical assistance is required, either in the preparation of loan applications, or, following approval of the loan, in plant visits and follow-up on loan utilization. However, since most PFI's do not have the experience, trained staff, and branch offices available to the BNF, it is expected that they will have recourse to CENDES or other outside technical assistance more often than the BNF, at least in the initial year or two of project operation. Fees for technical assistance will be for the same amounts and payable in the same manner as described above in the case of the BNF. These PFI's may require not only outside help in the preparation of acceptable loan applications, but also help in checking of credit-worthiness and security position of sponsors, especially in regions outside of Quito and Guayaquil.

Prospective applicants will be identified not only by the PFI's, but also by CENDES, which has a list of prospects for small industry loans as a result of its studies of Andean Market projects, feasibility studies, and contracts made by the CENDES Promotion Division. In such cases CENDES will be authorized to charge the sub-borrower an acceptable fee for project preparation. Once such a project is accepted by a PFI, the same arrangements for plant visits and follow-up established above will be made, i.e., at the PFI's option these may or may not be required and may be handled by the PFI itself, CENDES, or another consultant.

c. Cases in Which the PFI has Recourse to the Guaranty Fund

In cases where a sub-borrower is not able to provide full security coverage for his proposed loan, and the PFI decides to have recourse to the Guaranty Fund, technical assistance to the sub-borrower will not be optional, but required. The Trust Fund, to which these cases will be referred, will have CENDES or another consultant make visits to applicants for an initial assessment of project feasibility and credit worthiness. Favorable assessments will be followed by assistance in the preparation of revised applications. If a loan is then eventually not granted, the sub-borrower applicant will not be required to pay for the assistance given by the consultant, and the cost of this assistance will be debited to a special technical assistance fund in the Central Bank (described below). If a loan is granted, the sub-borrower will pay a 1% fee to the consultant. In addition, follow-up assistance by CENDES or another consultant, including plant visits and reports on the progress of loan utilization, will be required. These services will also be paid for with a fee of 1% of the face value of the loan.

3. Costs of the Technical Assistance Program

The costs of special advisors and courses associated with the loan total $100,000. These are as follows:

a. A contract specialist in small industry credit is needed for two years:

   (1) to set up sub-loan criteria, application forms, sub-loan approval procedures, follow-up forms, etc.;

   (2) to assist the BNF in reorganizing its supervised credit department by strengthening the technical assistance element;

   (3) to visit all field branches of the BNF in order to assess capabilities of sub-managers and field loan officers; and

   (4) to monitor for USAID the small industry loan program and organize the inter-relationships between the Central Bank Trust Fund and the PFIs. $60,000

b. Five fellowships for a one-month stay in Colombia for the manager and four regional deputy managers of the BNF's credit-with-technical-assistance department for small-and medium-scale industries (to be based on the present supervised credit program). Training will be carried out in the relevant department of the Caja de Crédito Agrario, Industrial y Minero in Bogotá, Colombia. $ 3,000

c. Five fellowships for a one-month course at the Caja in Bogotá for selected participants from private banks. $ 3,000

d. One industrial credit specialist to organize and conduct, with the assistance of the five BNF deputies mentioned above, an intensive training course for the specialized staff of the BNF, including loan branch bank officers and inspectors. This will be a one-month course, to be held in Quito. The training course will be repeated in Guayaquil for participants from other PFI's. This short-term specialist would be needed for four months. $12,000

e. A four-week, full-time training course, as described in (d.), and following the curriculum outlined in the 1964 Spiro report for Colombia (page 12), will be given for loan officers of the BNF main office and the 37 branch offices. Costs include fees for instructors from CENDES, the Institute of Technological Research, the Centro de Ejecutivos, etc. $ 2,800

f. A course identical to that described in (e.) for loan officers from other participating PFI's. $ 2,800

g. Management courses will be given by the Centro de Ejecutivos of Quito and Guayaquil to key personnel of eight small-industry associations (in Cuenca, Esmeraldas, Riobamba, Ambato, Ibarra, Tulcán, Quito, and Guayaquil). These associations have insufficient funds to pay the usual S/600 fee per participant for these courses. The Centros would send a team to each location with audiovisual equipment, and the costs would be defrayed by the Loan. This activity also benefits the Centro in Guayaquil and provides an incentive for the quick reestablishment of the inactive Quito Centro. The Guayaquil Centro is now fully capable of tailoring special courses for these groups in accounting, plant maintenance, production control, bookkeeping, financial management, human relations, etc. $ 4,000

h. A course identical to that described in (g), to be given one year later. $ 4,000

i. A grant will be made to CENDES for recruiting and training technical assistance advisors for the supervised small industry credit program. Costs will include training course expenses, duplication, stationary, equipment. (See Annex XI.) $ 8,400

TOTAL $100,000

In addition to the above, a fund of $150,000 will be set aside from the Loan to provide technical assistance to sub-borrowers who must be referred to the Guaranty Fund due to lack of full security coverage. As stated above, this assistance will be obligatory and will not be charged to the applicant unless a loan is approved. The funds reserved for this purpose are sufficient to cover consultant costs for approximately 1,000 projects over a 3-year period. However, as only loan applications which are not eventually approved will qualify for use of this fund, it is estimated that in more than half the cases the consultant fee required will be paid by the sub-borrower. Thus it is the itent of the Mission that the $150,000 constitute in part a reserve for possible additional technical assistance activities which the loan contract consultant may deem necessary for the advancement of the projec This fund will remain in a separate account in the Trust Fund, and final utilization will be determined by the Loan Committee.

SECTION IV - ECONOMIC ANALYSIS

A. Relationship of Project to Economic and Social Developm

1. Recent Trends in the Manufacturing Sector[1]

From 1960 to 1968, Ecuador's manufacturing sector grew at an average annual rate of 5.5 percent, compared with 4.5 percent growth rate for the economy as a whole. This represents a significant improvement over the situation in the 1950's, when, despite a more rapid overall growth rate (4.9 percent), the manufacturing sector grew at an average annual rate of only 4.7 percent.

The factory sub-sector (industria fabril) now accounts for approximately two-thirds of value added in manufacturing, as the artisan sub-sector has decrease substantially in importance from 44.2 percent in 1961 to 32.5 percent in 1968. Applying these percentages to total manufacturing product, the annual rate of growth of the artisan sub-sector in the period 1961-1968 is seen to be only 1.8 percent, while the factory sub-sector grew by 9.2 percent annually, thus accounting for almost 90 percent of manufacturing growth during this period.

As in most other Latin American countries, employment in manufacturing is growing considerably less rapidly than output. In factory manufacturing, even if the current rate of increase were equal to that of manufacturing output, the number of new jobs created annually would still be only a few thousand, given the low absolute level of employment in manufacturing (47,629, according to the 1965 Census of Manufacturing, or just under 3 percent of the total labor force). Employment in artisan manufacturing (an estimated 188,200 in 1966) has at best been static an may well have declined in the last 10-15 years.

Data on real wages show that average wages and salaries in factory manufacturing have risen by less than one percent annually since 1957, compared with an average annual increase in per-capita national income of 1.4 percent.

1/ For a more detailed analysis, see Clarence Zuvekas, Jr., "Recent Trends in Ecuador's Manufacturing Sector" (January 1970), mimeo.

The outlook for growth of the manufacturing sector in the next few years is clouded by the balance-of-payments pressures which have forced the government since late 1968 to adopt import and credit restrictions that have prevented a recovery of the industrial growth rate, which has slowed since 1965. These pressures, caused primarily by a fall in export earnings, are likely to continue until 1973, when Ecuador is expected to begin exporting large quantities of petroleum.

2. The Challenge of Andean Economic Integration.[2/]

The industrial growth rate must be increased, and industrial development policies reoriented, if Ecuador is to meet the challenge of Andean economic integration. With both Colombia and Chile pushing hard to make this regional integration effor successful, and with the Ecuadorean government regarding it as a coming reality, the Andean Group must be taken quite seriously at this time --certainly must more seriously than LAFTA. This means that, although the overall level of imports may have to be tightly controlled through 1972, import policies must be revised to further discourage imports of consumer goods and imported inputs to highly import-intensive industries, and to encourage the development of export-oriented industries and productivity increases in light low-import-intensive consumer goods industries threatened by competition from other Andean Group countries.

Most seriously threatened are probably the textile and the footwear and clothing industries, which together accounted for 14.7 percent of value added and 27.4 percent of employment in large manufacturing establishments in 1965. Many of the smaller firms in these industries are likely to fold as a result of greater competition, and most of these are probably not worth salvaging. Still, there are some that can be made competitive if technical assistance and bank credit on reasonable terms can be made available. In addition, Ecuador should take advantage of its favorable position with respect to certain activities within each of these branches of industry.

In addition to textiles and footwear and clothing, other industries likely to be hard hit by competition are the

2/ See Charles R. Gibson, "Ecuadorean Import-Substitution and Industrial-Exporting Policies and Andean Economic Integration" (May, 1970), mimeo.

metal, metal products, machinery, and equipment industries. Given the small size of the Ecuadorean market, these industries, which often require relatively large-scale operations, are of only minor importance in the Ecuadorean economy: in 1965, CIIU branches 34 through 38 together accounted for only 4.6 percent of value added by large industrial establishments. In the larger Andean countries, a larger domestic market has permitted more extensive development of these branches of industry. Moreover, these contries have must better domestic supplies of industrial raw materials needed by these industries than does Ecuador. Thus they would seem to be in a better position than Ecuador to produce these items, and may displace some current Ecuadorean production. Still, there will be some cases in which Ecuador can competitively satisfy its own domestic needs in these areas and perhaps also produce for export to other Andean Group countries.

With regard to the development of other import-substitution industries, the best possibilities appear to be in paper and paper products, tobacco, food products, and chemicals. The industries with great export potential seem to be wood products, furniture, and food products.

Detailed studies of industrial development prospects in Ecuador by DeBeausset, Gibson, CENDES, and others will be made available to PFI's to assist them in establishing guidelines for their industrial lending activities. These studies should help prevent PFI's from financing investments that do not appear to be in a favorable competitive position vis-a-vis the other Andean Group countries.

3. Credit and Technical Assistance

Medium and large-scale manufacturing enterprises now have adequate access to credit from the two financieras, the CV/CFN and COFIEC. Both of these institutions, established with AID seed capital loans, have succeded in attracting loans and lines of credit from international lending agencies and from private sources sufficient to meet the demands of medium and large-scale enterprises. The CV/CFN and COFIEC, together with CENDES, are also in a position to provide most of the technical assistance needed by these firms.

Small-scale industry, however, does not have access either to the credit or to the technical assistance it needs to increase its output and productivity and thus meet the challenge of Andean economic integration. The present loan proposal has been designed to meet these critical needs, which are described in more detail elsewhere in this paper.

B. Benefits Expected from the Project

1. Economic

Small industry occupies an important role in the industrial development of the country, and Ecuador's successful response to the challenge of Andean economic integration will depend to a large degree upon productivity improvements in small manufacturing establishments. The 1965 Census showed that 93.5 percent of the factory-industry establishments in that year employed less than 50 workers, and that these accounted for 24.1 percent of the total value added in factory manufacturing. Many of these small establishments are in the textile industry and in the footwear and clothing industry, which are seriously threatened by competition. Others are in the food products, furniture, and wood products industries, where there is good export potential for many products. Credit and technical assistance are vitally needed for these and other industries.

DeBeausset has identified small industrial loan opportunities (US$25,000 or less) in more than 300 activities totalling $17.7 million and involving more than 1,200 enterprises.3/ While these figures are probably too optimistic4/ they provide a good detailed list of the possibilities for investment by small industrial enterprises producing for both the domestic and the export market.

3/ Val de Beausset, "Ecuadorean Small Enterprise Development" (January 1970), ditto. See also de Beausset's earlier report, "Ecuador: Preparing for Andean Subregional Common Market" (October 1969), ditto.

4/ For a discussion of the de Beausset's reports, see Clarence Zuvekas, Jr., "A survey of Credit and Technical Assistance Requirements of Small Industrial Establishments in Ecuador" (May 1970), mimeo. (See Annex X.)

The present loan seeks to make an important contribution toward relieving the credit shortage that now exists for small manufacturing enterprises. Given the size of the credit gap (see Section III-E), this loan should supplement, rather than compete with, the $800,000 made available for small industrial lending under the new IDB loan to the BNF and under the $3.0 million line of credit made available to COFIEC by the Export-Import Bank. The administrative capacity of the BNF and COFIEC is sufficient to enable them to participate in the AID loan as well as to take advantage of these other loans.

Experience in Colombia, Taiwan and elsewhere has indicated that a one-dollar injection of credit into an existing small enterprise can have a payoff of one dollar and more in annual additions to the value of production by that enterprise. If this occurs in Ecuador, disbursement of the entire loan could increase annual production by approximately $10 million, or roughly three percent of the estimated total value of production by factory industry in 1970. The direct increase in employment resulting from this expansion of activity is expected to be as much as 4,000. Furthermore, considerable stimulus will have been given to the development of a strong group of medium-scale entrepreneurs.

2. Social/Political

The difficulties experienced by small businessmen in expanding and improving their operations not only represent a drag on the economy as a whole, but also have important social and political consequences. The capacity for growth within the middle class is materially limited by the serious obstacles now blocking one of the classic routes to middle-class status, that is, small business activities. An important counterweight to the easily radicalized lower class has thus had little opportunity to develop as a political force, as market forces in Ecuador presently function in such a way as to screen out too many potential candidates for growth and leadership. Ultimately, the political interest of those who might have joined the middle class but are precluded from doing so by lack of access to the wherewithal lies with those groups advocating radical solutions to the country's social and political problems.

On another level, the capacity of Ecuador to develop in the face of the special challenges of the 1970's is severely restricted in social, political and economic terms because of the lack of a broader base of enterpreneurial activity. The most serious challenge in this respect is presented by Andean economic integration. The economic need for a more efficient and dynamic industrial sector has been treated elsewhere in the paper, but the international political consequences of Ecuador's ability or failure to rise to the Andean Group challenge also deserve serious consideration. Experience has shown that countries incapable of competing effectively in international markets have caused serious problems for the international community. Countries in the process of "losing out" have often exhibited unpredictable and perhaps irrational behavior in the international arena. More serious yet is the possibility that failure to meet the Andean Group challenge may threaten the survival of Ecuador as an economically viable entity. The simple truth if that Ecuador has no alternative but to grow in order to survive. The critical bottlenecks constraining the capacity to grow must be dealt with on pain of far more difficult problems to be dealt with in the future by the international community.

C. Central Bank Lending Policy

To the extent that the proposed loan provides new monetary resources to the Central Bank through the Trust Fund mechanism, there exists the possibility that the Central Bank's Trust Fund operations might have an inflationary impact by expanding the total amount of credit to the private sector. Even if the entire amount of the loan represented a new addition to the total volume of credit outstanding, however, the resulting increase in credit would be very minor, especially since disbursements would be spread over a three-year period.

In the face of continued heavy lending to the Central Government, the Central Bank will probably keep a tight rein on credit expansion to the private sector in order to limit total credit expansion. At the same time, the Central Bank is expected to continue encouraging a shift by the banking system as a whole out of commercial lending and into agricultural and industrial lending. Such a shift did in fact occur in 1969, and the present loan should provide an incentive to bring about an additional redistribution of lending in favor of the industrial sector.

D. Balance of Payments Impact

The credits under this program are intended to encourage the production of goods which can compete effectively with imports at home and in the Andean Common Market. To the extent that this is the case, the resulting foreign exchange earnings or savings will improve the GOE B/P position. With respect to the proposed impact on U. S. B/P, the USAID does not consider it significant.

E. Impact on the U. S. Economy

It is not contemplated that the production resulting from credits provided under this loan will compete in any significant way with U. S. manufacturers; hence a negative impact on the U. S. economy is not expected. On the contrary, where U. S. manufacturers can compete with other western hemisphere suppliers, there will be a favorable impact on the U. S. economy.

SECTION V - FINANCIAL ANALYSIS

A. Financial Plan by Source and Use of Funds (in $000)

1. Source of Funds

PFI Contributions		AID	1st Year	2nd Year	3rd Year
1,500	BNF	1,500	400	500	600
250	CV/CFN	1,000	250	350	400
150	COFIEC	750	200	250	300
750	Commercial Banks	750	200	250	300
250	EDF	250	75	75	100
3,000	Guarantee Fund	600	100	400	100
	Technical Assistance	250	150	50	50
5,900		5,100	1,375	1,875	1,850

2. Use of AID Funds

	$	L. C.	Total
Equipment & Other Fixed Assets	2,000	750	2,750
Working Capital	1,000	1,100	2,100
Technical Assistance	75	175	250
	3,075	2,025	5,100

The above financial plan is based upon discussions with the PFI's. The BNF has indicated its willingness to match dollar for dollar AID funds. In the case of the other development banks, it is assumed that their general expression of participation interest will result in a "go slow" policy, increasing their participation as their confidence in the program grows. Since the commercial banks are now engaged in providing credit assistance to small industry on a short-term basis, here it is assumed that with the availability of the AID loan they will be induced to match the AID funds and liberalize their terms by perhaps extending slightly longer maturities for working capital needs. The leverage of the Guaranty Fund is expected to induce additional PFI lending without collateral or perhaps with only partial security at a ratio of 5 to 1 or $3,000,000.

B. Financial Analysis

1. Central Bank

The Trust Fund will make available proposed loan funds in the amount of $4,600,000 to qualified financial institutions wishing to participate under the proposed program. A Trust Fund will be established by the Central Bank for the purpose of discounting notes and collections. Financial statements on the Central Bank are given in Annex IV. The Central Bank is accepted as a sound and strong organization. As a matter of fact, it is the "backbone" of the financial system in Ecuador. Net profit has shown good growth during the period under review. Approximately 75% of its total income in 1969 was from Interest while approximately 77% of its expenses were classified as General Expenses.

2. Participating Financial Institutions

Financial statements on institutions who have indicated a willingness to participate under this program are given in Annex V, VI, VII, and VIII. In addition to these institutions it is anticipated that several commercial banks will also participate. BNF, CV/CFN, and COFIEC have loans from AID, and their implementations have been satisfactory. These institutions are audited annually by independent public accoutants, and no serious problems have been reported. The EDF was organized in May 1968 and has not had time to establish an operational trend. Basically, its operating expenses are financed by donations and its loan funds come from donations and loans from the Pan American Development Foundation. It has not been audited by an independent public accounting firm and this will be a requirement if it uses any of the proposed loan funds.

C. Financial Status of Participating Financial Institutions

See Annexes V, VI, VII, and VIII.

D. Repayment Prospects

Prospects of repayment depend upon two considerations: (a) the capacity of the PFI's to service their debt to the Trust Fund and (b) the capacity of the GOE to service the external debt represented by this loan.

PFI Debt Service Capacity

The capacity of the PFI's to service debt is evident in the financial statements of the principal PFI's set forth in Annexes V, VI, VII, and VIII.

GOE Debt Service Capacity

Ecuador's debt-service/commodity-export ratio has averaged only 10.3 percent during the period 1965-1969, as indicated by the data in the following table:

Year	Debt Servicing			Commodity	Debt Service as a % of
	Amortization	Interest	Total	Exports	Commodity Exports
1965	10.0	4.6	14.6	180.7	8.1
1966	10.8	5.3	16.1	186.5	8.6
1967	11.7	6.0	17.7	200.4	8.8
1968	16.8	7.4	24.2	210.7	11.5
1969 (e)	18.6	8.0	26.6	188.1	14.1

(e) Estimate

Source: Banco Central del Ecuador, Memorias Anuales and unpublished data.

The rise in this ratio in 1968 was attributable primarily to an increase in amortization payments by both government and non-government enitities, but the 1969 rise--to 14.1 percent--is a reflection primarily of a fall in export earnings. Exports are expected to continue to be sluggish through 1972, after which they should rise substantially as a result of petroleum exports beginning in 1973.

Meanwhile, the burden of debt-servicing in the near future seems to be quite modest, as shown by the following table which estimates debt-servicing requirements on the public debt outstanding as of December 31, 1968:

Public Debt Servicing, 1969 - 1979 1/
(millions of dollars)

Year	Interest	Amortization	Total
1969	8.0	17.0	25.0
1970	8.2	18.9	27.1
1971	8.0	21.6	29.6
1972	7.1	20.5	27.6
1973	6.4	20.8	27.2
1974	5.5	19.8	25.3
1975	4.8	18.2	23.0
1976	4.2	16.4	20.6
1977	3.5	16.1	19.6
1978	2.9	10.9	13.8

1/ Interest and amortization on foreign public debt outstanding (including undisbursed loans) as of December 31, 1968. Repayment terms for loans totalling $6.4 million are not available.

Source: IMF, Ecuador - 1969 Article XIV Consultation (February 4, 1970). Part II, Table 34, p. 62. (Based on data from the IBRD and the Banco Central del Ecuador.)

The contracting of new loans, of course, will add to debt-servicing requirements, but if Ecuador places primary reliance on borrowing from official rather than private sources, the additions to debt servicing should be quite modest in the medium of the favorable grace periods offered by official lenders.

As a result of improved export performance after 1973, and if only modest additions are made to debt servicing, the debt-service/commodity-export ratio, after a slight increase in 1971 and 1972, should fall to about 10.5 percent in 1974:

Year	Total Debt Servicing	Commodity Exports	Debt Service as a % of Commodity Exports
1970	29.0	210.0	13.8
1971	32.0	205.0	15.6
1972	32.0	205.0	15.6
1973	33.0	250.0	13.2
1974	33.0	315.0	10.5

Source: USAID estimates.

Ecuador has traditionally had a good record for meeting its loan repayment obligations and no special problems with the dollar repayment of the proposed loan are anticipated.

The GOE, as the Borrower, is responsible for repayment of the loan according to the terms of the Loan Agreement. The ultimate responsibility for maintenance of value will be borne by the GOE which may make arrangements with the Central Bank to deal with MOV problems which arise in connection with sub-loans if appropriate.

E. Loan Terms

This loan is not being "two-stepped" for the reason that the Central Bank is a governmental entity with a maximum of flexibility, which the Mission feels to be in a position to exert influence within the GOE, as well as with the Ecuadorean public, toward the objectives of our program in this country. While, under other circumstances, relinquishing of the two-step option might seem to be a form of "locking-in" U.S. resources to a single purpose, the Mission feels that, in this case, the opposite effect will be achieved. Availability of these resources will be lodged in one of the broadest-gauged entities in Ecuador, notably immune to political pressures, soundly managed, and, now, development minded.

The Mission is strongly of the persuasion that, in this instance, passing along to the Central Bank the advantages of the most favorable A.I.D. concessional lending terms, not resorting to the two-step device, will add to the flexibility and effectiveness of the loan.

Justification of Concessionary Terms

This proposal calls for granting the loan to the GOE on the most concessionary terms available, 3% for 40 years with a 10 year grace period during which interest will be 2%. The nature of the financial problems facing the Ecuadorean Government has been referred to previously. The Government is presently facing a serious budgetary crisis and it is anticipated that critical needs for government expenditures will continue to absorb financial resources available to the government well into the future. While substantial improvements in certain elements of the GOE financial picture are anticipated during the next decade, the requirements for financing will probably continue to outrun available resources through the end of the century. All AID previous financing in Ecuador in recent years had been on the most concessionary terms available and other international lending institutions pursue a similar policy. On the basis of the foregoing, the Loan Committee has concluded that this loan should be made on the most concessionary terms possible.

F. Sub-Loan Terms

As indicated earlier in this paper, the PFIs will be permitted to apply to sub-borrowers a wide range of terms both with regard to interest changes and maturities, depending upon the risks they assume. The Trust Fund will also employ the same variables in determining its terms in extending credit to PFI's or rediscounting PFI financial paper.

SECTION VI - IMPLEMENTATION PLAN

The following schedule establishes within a time frame the critical events which must occur if the program results are to be achieved on a timely basis:

FY 70	June 1970	Authorization
FY 71	September 1970	Agreement Signed and Implementation Letter Issued
	December 1970	Conditions Precedent Satisfied
	January 1971	First Disbursement Made
FY 74	September 1973	Loan Fully Disbursed.

Funds should be disbursed as follows:

PFI	Estimated Local Contribution	AID Loan	AID Loan Drawdowns 1st Year	2nd Year	3rd Year
BNF	$1,500,000	$1,500,000	$ 400,000	$ 500,000	$ 600,000
CV/CFN	250,000	1,000,000	250,000	350,000	400,000
COFIEC	150,000	750,000	200,000	250,000	300,000
Commercial Banks	750,000	750,000	200,000	250,000	300,000
EDF	250,000	250,000	75,000	75,000	100,000
Guaranty Funds	3,000,000	600,000	100,000	400,000	100,000
T. A.	-	250,000	150,000	50,000	50,000
Totals	$5,900,000	$5,100,000	$1,375,000	$1,875,000	$1,875,000

Disbursement Procedures

1. Local Cost Expenditures

Disbursement will be made by the USAID to the Trust Fund of the Central Bank for a) the local currency portion of all eligible sub-loans made or re-discounted by the Trust Fund from PFI's participation in the program; b) all eligible local currency expenditures for technical assistance; c) and appropriate amount, consistent with sound liquidity and banking practices, for all eligible local currency loans made by PFI's and guaranteed by the Trust Fund.

Reimbursement will be in accordance with usual AID procedures, upon presentation of documentation mutually acceptable to AID and the borrower. Such requirements will be the subject of an Implementation Letter.

2. Establishment of Revolving Funds

In order to initiate operations, the USAID will advance funds in the appropriate amounts to the Trust Fund of the Central Bank so as to establish revolving funds for financing the functions under a, b, and c, in (1) above.

3. Dollar Expenditures

Upon request by the borrower, AID will issue appropriate commitment documents in order to finance the eligible dollar costs of the project. The borrower may at his option make direct reimbursement from his own resources for eligible items under the project and seek reimbursement from AID by presentation of the usual documentation. Payments under the guaranty function of the Trust Fund will be made on the basis of claims honored by the Trust Fund as guarantor. Where AID funds are used by the Trust Fund in its discounting operations, eligibility requirements will be the same as in the case of forward-funding transactions. Procurement of AID-funded goods and services will meet AID's then-current Capital Project Guideline requirements.

C E R T I F I C A T E

I hereby certify to the Administrator of the Agency for International Development that to the best of my knowledge and belief Ecuador possesses both the financial and human resources effectively to maintain and utilize the project to be undertaken pursuant to the terms of the AID loan proposed in this paper for Small Enterprise Assistance by the Government of Ecuador and the United States of America. In so certifying I have taken into account the utilization of similar projects in Ecuador previously financed or assisted by the United States, and I have more particularly taken into account the demonstrated capability of Ecuador to effectively utilize development projects of this nature.

5/28/70
Date

R Minges
Robert J. Minges
Director
A.I.D. Mission to Ecuador

June 15, 1970

CHECKLIST OF STATUTORY CRITERIA

(Alliance for Progress)

In the right-hand margin, for each item write answer or, as appropriate, a summary of required discussion. As necessary, reference the section(s) of the Capital Assistance Paper, or other clearly identified and available document, in which the matter is further discussed. This form may be made a part of the Capital Assistance Paper.

The following abbreviations are used:

FAA - Foreign Assistance Act of 1961, as amended by the Foreign Assistance Act of 1968.

App. - Foreign Assistance and Related Agencies Appropriations Act.

MMA - Merchant Marine Act of 1936, as amended

COUNTRY PERFORMANCE

Progress Towards Country Goals

1. *FAA §.208; §.251(b).*

A. Describe extent to which country is:

(1) Making appropriate efforts to increase food production and improve means for food storage and distribution.	The Government of Ecuador has placed high priority on agricultural activities, although its efforts have been hendered by serious fiscal problems.
(2) Creating a favorable climate for foreign and domestic private enterprise and investment.	Legislation favorable for private enterprise and investment is in force and being improved; the private sector is healthy and active in Ecuador.

(3) Increasing the public's role in the developmental process.	The Government of Ecuador is elected by the people in accordance with the Constitution of 1967, the Central Government and the Provincial and Municipal Governments are responsive to the needs of the population within the limits of budgetary restraints.
(4) (a) Allocating available budgetary resources to development.	Despite the budgetary restraints, and inefficiencies in the establishment of priorities in public sector expenditures the budgetary resources allocated to development is significant.
(b) Diverting such resources for unnecessary military expenditure (see also Item No. 18.) and intervention in affairs of other free and independent nations. (See also Item No. 17.)	Ecuador and its Government are not diverting budgetary resources for unnecessary military expenditures.
(5) Willing to contribute funds to the project or program.	The GOE has expressed willingness to contribute funds to the project consistent with the budgetary restraints.

(6) Making economic, social, and political reforms such as tax collection improvements and changes in land tenure arrangements, and making progress toward respect for the rule of law, freedom of expression and of the press, and recognizing the importance of individual freedom, initiative, and private enterprise.	The rule of law, freedom of expression and of the press exists in Ecuador. These rights are guaranteed by the Constitution. Individual initiative and private enterprise are encouraged and estimulated.
(7) Adhering to the principles of the Act of Bogota and Charter of Punta del Este.	Ecuador is signatory and adheres to the principles of the Act of Bogotá and Charter of Punta del Este.
(8) Attempting to repatriate capital invested in other countries by its own citizens.	Attempts constantly being made in Ecuador to repatriate capital invested in other countries. Ecuador has a relatively sound climate for investment.
(9) Otherwise responding to the vital economic, political, and social concerns of its people, and demonstrating a clear determination to take effective self-help measures.	The GOE appears to have good intentions, but its performance has been limited.
B. Are above factors taken into account in the furnishing of the subject assistance?	Yes.

Treatment of U.S. Citizens

2. *FAA §.620(c). If assistance is to government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) debt is not denied or contested by such government?*	It has not been determined that the GOE has taken any steps which require the application of the sanctions prescribed by this Section.
3. *FAA §.620(e)(1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing-ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?*	It has not been determined that the GOE has taken any steps which require the application of the sanctions prescribed by these Section.
4. *App. §.106. If country attempts to create distinctions because of their race or religion among Americans in granting personal or commercial access or other rights otherwise available to U.S. citizens generally, what steps (will be) (have been) taken during loan negotiations to influence elimination of such distinctions?*	Ecuador does not take such action.

5. *FAA §.620(o); Fishermen's Protective Act. §.5. If country has seized, or imposed any penalty or sanction against, any U.S. fishing vessel on account of its fishing activities in international waters,*

Since January 1, 1968, arrest incidents have been reported as follows: March 20, 1968, 1 boat; August 7, 1968, 4 boats; December 10, 1969, 1 boat; [illegible] June 18, 1969, 1 boat; February 14, 1970, 1 boat. Protests have been lodged with the GOE.

a. has any deduction required by Fishermen's Protective Act been made?

Although there have been four seizures of U.S. fishing vessels by Ecuador that could qualify as requiring deductions, claims by two have not been submitted to the Department of State as yet and the other two claims are provisionally pending action during negotiations with Chile, Ecuador and Peru to reach a practical solution to the fisheries problem.

b. has complete denial of assistance been considered by A.I.D. Administrator?

The Loan will not be authorized unless the A.I.D. Administration considers denying assistance to the GOE and determines nevertheless to permit the authorization.

Relations with U.S. Government and Other Nations

6. *FAA §.620(d). If assistance is for any productive enterprise which will compete in the U.S. with U.S. enterprise, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?*

It is not contemplated that the proposed assistance will result in competition in the U. S. with U. S. enterprise.

7. *FAA §.620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action, of U.S. property?*

The GOE has always protected and tried to prevent damage or destruction by mob action of U. S. property.

8. *FAA §.620(l). If the country has failed to institute the investment guaranty program for the specific risks of expropriation, inconvertibility or confiscation, has the A.I.D. administration within the past year considered denying assistance to such government for this reason?*	**Ecuador has instituted such a program.**
9. *FAA §.620(q). Is the government of the recipient country in default on interest or principal of any A.I.D. loan to the country?*	No.
10. *FAA §.620(t). Has the country severed diplomatic relations with U.S.? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?*	No.
11. *FAA §.620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearage taken into account by the A.I.D. Administrator in determining the current A.I.D. Operating Year Budget?*	Ecuador is currently in the process of making necessary payment for arrearages to the UN. It is expected that this payment will be made during the next few weeks. The Administrator has also authorized continued assistance to Ecuador in accordance with FAA §. 620(a).
12. *FAA §.620(a); App. §.107(a) and (b). Does recipient country furnish assistance to Cuba, sell strategic material to Cuba, or permit ships or aircraft under its flag to carry cargoes to or from Cuba.*	No.

13. *FAA §.620(b). If assistance is to a government, has Secretary of State determined that it is not controlled by the international Communist movement.*	The Secretary of State has determined that Ecuador is not controlled by international Communist movement.
14. *FAA §.620(f), App. §.109. Does recipient country have a communist government*	No.
15. *FAA §.620(i). Is recipient country in any way involved in (a) subversion of, or military aggression against, the U.S. or any country receiving U.S. assistance, or (b) the planning of such subversion or aggression.*	No.
16. *FAA §.620(n); App. 107(b) and 116. Does recipient country furnish goods to North Viet-Nam or permit ships or aircraft under its flag to carry cargoes to or from North Viet-Nam?*	No.

Military Expenditures

17. *FAA §. 620(s). What percentage of country budget is for military expenditures? How much of foreign exchange resources spent on military equipment? How much spent for the purchase of sophisticated weapons systems? (Consideration of these points to be coordinated with PPC/MAS.)*	The Military bu 12% of the GOE amount of forei in military equ other developme used for milita country's resou to military degree that feres with

18. *App. §.119. How much spent by country during current U.S. fiscal year for sophisticated military equipment purchased since January 1, 1968? Has corresponding amount been deducted from current OYB, or is the weapons purchase determined by the President to be important to U.S. national security? (Responses to these questions to be coordinated with PPC/MAS.)*	Ecuador has not purchased sophisticated military equipment since January 1, 1968.

CONDITIONS OF THE LOAN

General Soundness

19. *FAA §.201(d). Information and conclusion on reasonableness and legality (under laws of country and U.S.) of lending and relending terms of the loan.*	The terms and conditions of the loan are considered reasonable and consistent with the laws of Ecuador and the United States.
20. *FAA §.251(b)(2); §.251(e). Information and conclusion on activity's economic and technical soundness. If loan is not made pursuant to a multilateral plan, and the amount of the loan exceeds $100,000, has country submitted to A.I.D. an application for such funds together with assurances to indicate that funds will be used in an economically and technically sound manner.*	The activity is considered economically and technically sound and the GOE has submitted an application for the Loan.

AID 1240-2 (4-70)

21. *FAA §.251(b). Information and conclusion on capacity of the country to repay the loan, including reasonableness of repayment prospects.*

The borrower has made an application for this assistance and has provided assurance to indicate that the funds will be used in an economically and technically sound manner. The Borrower is considered capable of repaying the Loan.

22. *FAA §.611(a)(1). Prior to signing of loan will there be (a) engineering, financial, and other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?*

All necessary plans for the project including a reasonably estimate of the cost to the U. S. of the assistance have been prepared.

23. *FAA §.611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purposes of loan?*

Amendments to the Ecuadorean Law of the Monetary System and the General Banking Law may be required to permit participation of the private banks in the lending program contemplated under the loan. It is expected that these amendments could be passed prior to signing of the Loan Agreement.

24. *FAA §.611(e). If loan is for capital assistance, and all U.S. assistance to project now exceeds $1 million, has Mission Director certified the country's capability effectively to maintain and utilize the project?*

The Mission Director's certification appears in Annex I of the Loan Paper.

25. *FAA §.251(b). Information and conclusion on availability of financing from other free-world sources, including private sources within the United States.*

On the basis of appropriate inquiry, it appears that the activities proposed for financing under this loan cannot be financed from other sources.

Loan's Relationship to Achievement of Country and Regional Goals

26. *FAA §.207; §.251(a). Extent to which assistance reflects appropriate emphasis on; (a) encouraging development of democratic economic, political, and social institutions; (b) self-help in meeting the country's food needs; (c) improving availability of trained manpower in the country; (d) programs designed to meet the country's health needs, or (e) other important areas of economic, political, and social development, including industry; free labor unions, cooperatives, and voluntary agencies; transportation and communication; planning and public administration; urban development; and modernization of existing laws.*

The project is indirectly related to the criteria indicated in (a), (b) and (d), since it will finance the expansion of small enterprises in Ecuador that will promote availability of trained manpower as indicated in (c) and will encourage development of other economic, political and social areas, including small handicraft industries and the formation of artisans and small entrepreneurs cooperatives.

27. *FAA §.209. Is project susceptible of execution as part of regional project? If so why is project not so executed?*

28. *FAA §.251(b)(3). Information and conclusion on activity's relationship to, and consistency with, other development activities, and its contribution to realizable long-range objectives.*

The project is clearly consistent with other development activities in Ecuador as reflected in the project description and contributes to reliable long-range objectives.

AID 1240-2 (4-70)

29. *FAA S.251(b)(7). Information and conclusion on whether or not the activity to be financed will contribute to the achievement of self-sustaining growth.*

As reflected in the paper the activity will contribute to the achievement of self-sustaining growth in Ecuador.

30. *FAA S.281(a). Describe extent to which the loan will contribute to the objective of assuring maximum participation in the task of economic development on the part of the people of the country, through the encouragement of democratic, private, and local governmental institutions.*

The project will contribute directly to the states objectives as it will provide production credit to small and medium-size industrial entrepreneurs, thus assuring wide participation in the economic development of a numerous sector of the population through the cooperation of the private and public sector institutions concerned with the project.

31. *FAA S.281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.*

As reflected in the Loan Paper the project meets all the stated criteria.

AID 1240-2 (4-70)

32. *FAA §.601(a). Information and conclusions whether loan will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.*	This project will clearly encourage the efforts of Ecuador relating to criteria a), b), c), d) and e).
33. *FAA §.619. If assistance is for newly independent country; is it furnished through multilateral organizations or plans to the maximum extent appropriate?*	Not applicable.
34. *FAA §.251(h). Information and conclusion on whether the activity is consistent with the findings and recommendations of the Inter-American Committee for the Alliance for Progress in its annual review of national development activities.*	The activi recommendations of CIAP.
35. *FAA §.251(g). Information and conclusion on use of loan to assist in promoting the cooperative movement in Latin America.*	The project will assist the promotion of the cooperative movement in Latin America since numerous cooperatives formed by artisans, small industrial shops and small entrepreneurs will benefit with the credit resources mobilized by the project.

36. *FAA §.209; §.251(b)(8). Information and conclusion whether assistance will encourage regional development programs, and contribute to the economic and political integration of Latin America.*

This project is indirectly related to regional activities. It will assist Ecuador to strengthen its position in the Andean Pact and LAFTA area.

Loan's Effect on U.S. and A.I.D Program

37. *FAA §.251(b)(4); §.102. Information and conclusion on possible effects of loan on U.S. economy, with special reference to areas of substantial labor surplus, and extent to which U.S. commodities and assistance are furnished in a manner consistent with improving the U.S. balance of payments position.*

The proposed loan will not have an adverse effect on the U. S. economy or areas of labor surplus.

38. *FAA §.601(b). Information and conclusion on how the loan will encourage U.S. private trade and investment abroad and how it will encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).*

U. S. private trade and investment abroad will be indirectly encouraged through the development of additional possibilities via the import component of this loan.

39. *FAA §.601(d). If a capital project, are engineering and professional services of U.S. firms and their affiliates used to the maximum extent consistent with the national interest?*

Yes. They will be so used.

40. *FAA §.602. Information and conclusion whether U.S. small business will participate equitably in the funnishing of goods and services finance by the loan.*

The Loan Agreement will contain the standard provisions to insure that U. small business will participate equital in the furnishing of goods and service financed under the Loan.

41. *FAA §.620(h). Will the loan promote or assist the foreign aid projects or activities of the Communist-Bloc countries?*

No.

42. *FAA §.621. If technical assistance is financed by the loan, information and conclusion whether such assistance will be furnished to the fullest extent practicable as goods and profes- sional and other services from private enterprise on a contract basis. If the facilities of other Federal agencies will be utilized, information and conclusion on whether they are particularly suitable, are not competitive with private enterprise, and can be made available without undue interference with domestic programs.*

Assistance will be furnished to the fullest extent practicable as goods and professional and other services from private enterprises on a contract basis.

AID 1240-2 (4-70)

43. *FAA §.252(a). Total amount of money under loan which is going directly to private enterprise, is going to intermediate credit institutions or other borrowers for use by private enterprise, is being used to finance imports from private sources, or is otherwise being used to finance procurements from private sources.*

Funds under proposed loan will go to intermediate credit institutions for subloans, guarantees, rediscount operations and technical assistance of small private entrepreneurs.

Loan's Compliance with Specific Requirements

44. *FAA §.201(d). Is interest rate of loan at least 2% per annum during grace period and at least 3% per annum thereafter?*

Yes.

45. *FAA §.608(a). Information on measures to be taken to utilize U.S. Government excess personal property in lieu of the procurement of new items.*

The loan agreement will provide for compliance with excess property procurement regulations.

46. *FAA §.604(a); App. §.108. Will all commodity procurement financed under the loan be from U.S. except as otherwise determined by the President?*

Commodity procurement will be from U. S. and Western Hemisphere countries south of Canada except Cuba, as determined by the new untying policy established for Latin America.

47. *FAA §.604(b). What provision is made to prevent financing commodity procurement in bulk at prices higher than adjusted U.S. market price?*	The loan agreement will provide for compliance with bulk commodity procurement regulations.
48. *FAA §.604(d). If the host country discriminates against U.S. marine insurance companies, will loan agreement require that marine insurance be placed in the U.S. on commodities financed by the loan?*	Yes.
49. *FAA §.604(e). If off-shore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity?*	The project does not contemplate the off-shore procurement of any agricultural commodity or products.
50. *FAA §.611(b); App. §.101. If loan finances water or water-related land resource construction project or program, is there a benefit-cost computation made, insofar as practicable, in accordance with the procedures set forth in the Memorandum of the President dated May 15, 1962?*	Not applicable.
51. *FAA §.611(c). If contracts for construction are to be financed, what provision will be made that they be let on a competitive basis to maximum extent practicable?*	No construction contracts will be financed under the Loan.

52. *FAA §.620(g). What provision is there against use of subject assistance to compensate owners for expropriated or nationalized property?*	Appropriate provision will be included in the loan agreement to insure that the funds of the proposed loan will not be used to compensate for expropriated or nationalized property.
53. *FAA §.612(b); §.636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized to meet the cost of contractual and other services.*	As reflected in the financial plan, maximum feasible local contributions have been sought and obtained.
54. *App. §.104. Will any loan funds be used to pay pensions, etc., for military personnel?*	
55. *App. §.111. Compliance with requirements for security clearance of U.S. citizen contract personnel.*	These requirements will be complied with.

56. *App. §.112. If loan is for capital project, is there provision for A.I.D. approval of all contractors and contract terms?*

The loan agreement will provide for compliance with this requirement. Thus A.I.D. will approve all contractors and contract terms to be financed under the proposed loan.

57. *App. §.114. Will any loan funds be used to pay U.N. assessments?*

No.

58. *App. §.115. Compliance with regulations on employment of U.S. and local personnel for funds obligated after April 30, 1964 (Regulation 7).*

Not applicable, as the project to be financed under the proposed loan does not involve construction contracts.

59. *FAA §.636(i). Will any loan funds be used to finance purchase, long-term lease, or exchange of motor vehicle manufactured outside the United States, or any guaranty of such a transaction?*

No.

60. *App. §.401. Will any loan funds be used for publicity or propaganda purposes within U.S. not authorized by the Congress?*

No.

AID 1240-2 (4-70)

61. *FAA §.620(k). If construction of productive enterprise, will aggregate value of assistance to be furnished by U.S. exceed $100 million?*	No.
62. *FAA §.612(d). Does the U.S. own excess foreign currency and, if so, what arrangements have been made for its release?*	No. The U. S. does not own excess foreign currency.
63. *MMA §.901.b. Compliance with requirement that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed with funds made available under this loan shall be transported on privately owned U.S. flag commercial vessels to the extent that such vessels are available at fair and reasonable rates.*	The loan agreement will provide for compliance with the 50 per centum U. S. flag shipping requirement.

ROLE OF THE MINISTRY OF INDUSTRIES AND COMMERCE IN DEVELOPMENT LENDING PROGRAMS

The Government of Ecuador is responsible for the implementation of economic development programs, and to help finance these programs has the authority to con act loans with other countries or international organizations. The administrative organization of the country provides that the cabinet Ministries are in charge of the execution and implementation of those programs and accordingly are authorized to represent the GOE for the purpose of contracting loans required to finance development programs, subject to the approval of the Congress and the Committee for Foreign Financing.

In the case of industrial development programs, the Ministry of Industries and Commerce has the responsibility for contracting foreign loans. This authority is derived from Supreme Decree No. 2681, published in the Official Register No. 378 of November 20, 1964 which created the Ministry of Industries and Commerce. Article II of this Decree states:

> The Ministry of Industries and Commerce will perform the following functions to promote industrial and commercial development.
>
> Formulate and direct industrial and commercial policies and execute and control the application of programs in fields such as industry, commerce, fishing, energy resources, mining, tourism and artisan production and marketing.
>
> The Ministry will also exercise all other attribu- ns, rights and duties assigned to it by the law internal regulations.

CENTRAL BANK OF ECUADOR:

GENERAL COMMENTS;
BALANCE SHEETS;
INCOME STATEMENTS;
BIOGRAPHIC RESUMES

General Comments

Although the Central Bank does offer some commercial services, its main function is to act as a financial agent of the Government of Ecuador.

In effect, its assets and liabilities, other than those applicable to banking operations, belong to the Government of Ecuador. For instance, the balance sheet reflects the country's gold supply as an asset and it shows the local currency in circulation as a liability.

As a banking institution the Central Bank makes loans to and discounts notes or loans for the public, National Development Bank, private banks, official government entities and the National Treasury.

Data for 1969 were not available but from 1965 to 1968 the credits of the Central Bank, by sector, excluding the loans to banking institutions and including the Government loans, were as follows:

	Commercial	Industrial	Agriculture	Others
1965	66.5%	21.3%	4.4%	7.8%
1966	59.7%	16.8%	4.6%	18.9%
1967	65.8%	14.3%	5.9%	14.0%
1968	57.7%	16.0%	3.8%	22.5%

SOURCE: Banco Central del Ecuador, 1967 and 1968 Memorias.

During the period 1965-1967 the kinds of credit operations included:*

	1965 %	1966 %	1967 %
Banking acceptances	34.0	32.4	37.8
Advances to Exporters	29.6	29.3	25.1
Rediscounts	10.8	10.6	15.5
Advances	9.2	12.4	12.9
Discounts (GOE)	11.5	11.7	5.7
Direct Loans (Public)	4.9	3.6	3.0
	100.0	100.0	100.0

* Includes credit to the Banco Nacional de Fomento and private banks; excludes credit for future exports and use by the Central Government of the Central Bank overdraft facility.

SOURCE: Banco Central del Ecuador, 1967 Memoria. No similar data is contained in the 1968 Memoria, the last to be published.

Assuming that the above trend continued through 1969, the discount and rediscount portion of the portfolio should remain at approximately 22%. This indicates that the major portion of the bank's operations is not in the discount and rediscount area.

The Central Bank has the authority to operate publicly in cities where there are no other banks established, and it has a branch in Tulcán which provides checking and loan services to that city.

Comments on the Comparative Balance Sheets

1. Examination of the Comparative Balance Sheetsindicates that total assets increased 98% from 1965 to 1969 by an amount equivalent to $173.8 million. Over the same period the receivables from the National Treasury rose 285%, equivalent to $87.4 million. Accordingly, the increase in assets of the Central Bank is attributed mainly to this receivable. At the same time, Payables to the National Treasury rose by 256%, an amount equivalent to $25.5 million. The net receivable from the National Treasury as of December 31, 1969 was $78.3 million compared to $19.6 million as of December 31, 1965.

2. The total net worth showed a minor increase from 1965 to 1969; however, in 1967 loans to the public were charged off in the amount of $561,000 and in 1969 the amount of $1 million was charged off against the Special Reserve account.

3. Due to the nature of operations of the Central Bank the usual ratios cannot be developed; however, the ratio of total debt to net worth rose from 34.6:1 to 65.6:1 over the period reviewed.

4. Total liabilities increased 101% from 1965 to 1969 by an amount equivalent to $173.5 million. The increase was uniform over all liabilities and the exact cause could not be pinpointed.

Comments on the Comparative Income Statements

1. The Bank has shown good profitability growth from 1965 to 1969. Total income and expenses increased by 21% while net profit increased 42% by an amount equivalent to $59,000.

2. It has been the policy of the Bank to distribute the net profit each year to its share holders.

3. In January 1970 the Bank increased its interest rates charged to banking institutions, the National Development Bank and the public from 0.5 to 2% depending on the type of loan and the borrower.

CENTRAL BANK OF ECUADOR

Comparative Balance Sheet

December 31, 1965 to December 31, 1969

(Thousands of Dollars)
(Official Rate of Exchange S/18.18 to $1 Used)

ASSETS	1969	1968	1967	1966	1965
International Assets					
Bank Owned Assets					
Physical Gold	21,885	25,970	16,946	10,890	11,042
Foreign Currency	35,241	24,425	46,896	44,812	30,152
Other Assets in Foreign Currency	3,342	731	65	1,278	1
Investments in Foreign Currency	3,758	5,143	4,550	3,559	4,303
Total Bank Owned Assets	64,326	56,269	68,457	60,539	45,498
Investment in the International Monetary Fund					
Gold and Currencies	6,189	6,189	6,189	6,189	4,951
Sucres	18,564	18,564	18,564	18,564	14,851
Total Investment in the International Monetary Fund	24,753	24,753	24,753	24,753	19,802
Total International Assets	89,079	81,022	93,210	85292	65,300
International Monetary Assets					
Cash and Cash Items	4,156	3,552	2,016	1,776	1,014
Guaranty Bond - Metallic Money	4,067	4,067	4,067	4,067	4,067
Total Internal Monetary Assets	8,223	7,619	6,083	5,843	5,081

UNCLASSIFIED

	1969	1968	1967	1966	1965
ASSETS (Cont.)					
Other Internal Assets					
Receivables					
Private Banks	4,543	5,290	4,833	2,362	4,[illegible]
Development Bank	26,358	14,689	12,558	11,911	11,919
National Treasury	113,768	59,831	41,613	46,334	29,551
Official Entities	17,817	14,352	9,603	10,007	12,958
Public Loans	45,369	39,149	30,201	32,155	30,925
Total Receivables	207,855	133,311	98,808	102,769	89,439
Securities					
Private Banks	1,298	226	226	241	267
National Treasury	414	11	11	1,188	683
Official Entities	794	178	51	51	53
Total Securities	2,506	415	288	1,480	1,003
Deferred Assets	11,434	11,829	10,300	5,678	5,665
Other Assets	32,159	21,162	17,751	12,741	10,976
Total Other Internal Assets	253,954	166,717	127,147	122,668	107,083
TOTAL ASSETS	351,256	255,358	226,440	213,803	177,464

UNCLASSIFIED

	1969	1968	1967	1966	1965
LIABILITIES					
International Liabilities					
External Obligations in Foreign Currency	7,761	11,103	1,093	2,283	3,286
Internal Obligations in Foreign Currency	5,809	4,682	3,928	3,131	2,948
International Monetary Fund Obligations	36,882	24,257	34,827	35,643	25,742
Total International Liabilities	50,452	40,042	39,848	41,057	31,976
Monetary Obligations					
Monetary Values in Circulation	103,035	94,994	82,099	78,357	72,060
Monetary Deposits					
Private Banks	52,517	36,448	31,885	29,828	23,486
Development Banks	4,285	4,283	3,063	3,741	2,361
National Treasury	9,145	3,235	2,727	2,391	2,620
Official Entities	11,398	8,788	2,018	1,023	1,257
Public	4,528	2,989	3,477	4,611	5,211
Total Monetary Deposits	81,873	55,743	43,170	41,594	34,935
Total Monetary Obligations	184,908	150,737	125,269	119,951	106,995
Other Internal Obligations					
Private Banks	787	1,045	1,040	805	718
Development Banks	75	100	35	10	27
National Treasury	26,282	9,244	17,776	15,283	7,329
Official Entities	7,723	7,259	5,972	3,626	3,849
Public	57,715	29,021	22,868	20,125	14,002
Reconstruction and Development Bank	-	-	-	-	247
International Development Bank	5,927	5,481	3,187	3,380	2,616
International Development Association	579	579	579	579	579
Total Other Internal Obligations	99,088	52,729	51,457	43,808	29,367

	1969	1968	1967	1966	1965
LIABILITIES (Cont.)					
Other Liabilities	11,531	6,013	4,662	3,856	4,146
Total Liabilities	345,979	249,921	221,236	208,672	172,484
CAPITAL AND RESERVES					
Paid in Capital					
Class A Shares (Participating Banks)	1,589	1,496	1,284	1,114	1,077
Class B Shares	114	114	114	114	114
Total Paid In Capital	1,703	1,610	1,398	1,228	1,191
Reserves					
Legal Reserve Fund	1,409				
Special Reserve	1,956	4,036*	3,634*	3,758*	3,649*
Revaluation	10	10	14	-	-
Profit	199	181	158	145	140
Total Reserves	3,574	4,227	3,806	3,903	3,789
Total Capital and Reserves	5,277	5,837	5,204	5,131	4,980
TOTAL LIABILITIES, CAPITAL AND RESERVES	351,256	255,358	226,440	213,803	177,464

*Breakdown between Legal Reserve Fund and Special Reserve prior to 1969 unavailable.

CENTRAL BANK OF ECUADOR

Comparative Income Statement

as of December 31

(Thousands of Dollars)
(Official Rate of Exchange of S/18.18 to $1 Used)

	1969	1968	1967	1966	1965
Income					
Interest	5,304	4,549	3,985	3,872	3,526
Commissions	402	357	321	352	417
Exchange	1,201	1,154	950	791	732
Recoveries	47	168	5	32	82
Real Estate Income	20	23	31	31	32
Miscellaneous Profits	84	146	116	91	1,029
Total Income	7,058	6,397	5,408	5,169	5,818
Expenses					
Interest	681	127	1	1	45
Commissions	237	265	252	158	65
General Expenses	5,275	4,419	4,165	3,707	3,244
Amortization and Depreciation	245	689	122	811	540
Real Estate Maintenance	14	12	8	7	5
Special Reserve	352	402	437	110	1,529
Employees Reserve Fund	-	275	247	217	193
Miscellaneous Expenses	55	27	18	13	57
Total Expenses	6,859	6,216	5,250	5,024	5,678
Net Profit	199	181	158	145	140

CURRICULUM VITAE OF ECON. JOAQUIN ZEVALLOS M.

NAME:	ZEVALLOS, Menéndez, (Surnames) Joaquín (First Name)
NATIONALITY:	Ecuadorean
AGE:	
MARITAL STATUS:	
EDUCATION:	University - University of Guayaquil, Faculty of Economic and Administrative Sciences (Degree of Economista)
PRESENT POSITION:	General Manager, Central Bank of Ecuador (since July 1969)
PAST POSITIONS:	- Manager, National Development Bank (BNF) - Commercial Counselor, Ecuadorean Embassy in London - Permanent Representative of Ecuador to the International Coffee Office - Professor, Faculty of Economic and Administrative Sciences, University of Guayaquil - Delegate of Ecuador to Various International Meetings.

CURRICULUM VITAE OF ECON. JUAN F. CASALS M.

NAME: CASALS Martínez, Juan Federico
(Surnames) (First Names)

NATIONALITY: Ecuadorean

AGE:

PLACE OF BIRTH:

MARITAL STATUS:

EDUCATION: Secondary School: Colegio San José de Guayaqui:
(Bachiller in Modern Humanities)
University - University of Guayaquil, Faculty of Economic and Administrative Sciences (Degree of Economista)

SPECIALIZED STUDIES AND SEMINARS:

In Ecuador

- II Latin American Center for Training in and Application of Agr cultural Statistics, organized by FAO and Central University in Quito.

- Intensive Training Course in Agricultural Economics, organized by FAO, the National Development Bank, the National Planning Board, and Central University in Quito.

Overseas

- Complete course given by the Interamerican Center of Economic and Financial Statistics (CIEF), sponsored by the Inter-American Statistical Institute (IASI) and the University of Santiago in Chile.

- International Agrarian Economics Course of the Interamerican Institute of Agricultural Sciences (IICA) for the Andean Zone in Lima, Perú.

- Training scholarship in Agrarian Policies, sponsored by the FAO and the Central Bank of Ecuador, in various universities and institutions in Italy, Spain and Portugal, with observations in Mexico, Guatemala, Costa Rica, Venezuela, Brazil, Uruguay, Argentina and Chile.

- II Latin American Seminar on Land Problems, organized by FAO in Montevideo, Uruguay.

- High-Level Seminar for Latin American Executives in Agrarian Reform and Agricultural Development, organized by the OAS and the Italian Government in Rome.

PRESENT POSITION: Technical Sub-Director of the Department of Economic Research of the Central Bank of Ecuador. Direct and supervise the work of the following specialized divisions: Monetary Studies, Fiscal Studies, Balance of Payments, Special Studies, National Accounts and Statistics. Conduct studies and analyses of various economic and financial matters as required by the General Manager of the Bank and the Monetary Board, which is the regulating body for the national economy.

Have been designated General Coordinator of the I Meeting of Central Banks of the countries of the Agreement of Cartagena.

PAST POSITIONS:

- Chief of the Special Studies Division of the Economic Research Department of the Central Bank of Ecuador.

- Technical Advisor, National Colonization Institute (INC).

- Executive Sub-Director and Chief of the Technical Department of the INC.

- Executive Director, INC.

- Technical Advisor, National Planning Board.

- Executive Director, Ecuadorean Institute of Agrarian Reform and Colonization (IERAC).

- Faculty of Central University in Quito: Professor of Agrarian Policy in the School of Social Sciences of the Faculty of Law and Social Sciences; Professor of Agrarian Economics in the Faculty of Economic and Administrative Sciences.

- Consultant, Technical Department of the Inter-American Development Bank (IDB), Washington, D. C.

- Coordinator of the Interdisciplinary Team of Experts in charge of the Evaluation Study of IDB Colonization Policy.

- Representative of the IDB on the CIDA (Interamerican Committee for Agricultural Development) Advisory Group.

SEMINARS AND CONFERENCES ATTENDED:

- Official Delegate of Ecuador to the International Coffee Conference, United Nations, New York.

- Delegate to the VII and VIII FAO Regional Conferences for Latin America, held in Rio de Janeiro and Viña del Mar; on both occasions acted as President of the Agrarian Reform Commissions.

- Rapporteur, Rural Development Commission of the First Expert-Level CIES Meeting in Buenos Aires, Argentina.

BOOKS AND PUBLICATIONS:

- "La Estructura Agraria del Ecuador," <u>Revista Interamericana de Ciencias Agrícolas</u> (Pan American Union)

- "La Estructura de Tenencia de la Tierra en el Ecuador y la Programación de la Reforma Agraria," National Planning Board, Quito.

- "Síntesis de la Estructura Agraria de los Estados Unidos," <u>Revista de Ex-Becarios del Gobierno de los Estados Unidos</u>.

- "Apuntes de Economía Agraria", <u>mimeo</u>.

- "El Desarrollo Económico del Ecuador y su Estructura Agraria," ICIRA-IERAC.

- Numerous articles in newspapers and magazines.

GUEST LECTURES:

- Have given lectures in various universities and cultural institutions in Ecuador and in other countries.

TRAVEL IN FOREIGN COUNTRIES:

Besides knowing well all of Ecuador, have visited in and known almost all countries in Latin America, the exceptions being Haiti and the Dominican Republic. Have also studied and made observation trips in Italy, Spain and Portugal; other countries visited in Europe are Austria, Switzerland, West Germany, the Netherlands, Belgium, France and Luxemburg.

Besides having stayed two years in Washington, while working with the IDB, and having visited New York on various occasions, have had the opportunity to travel through many states of the union at the special invitation of the U.S. Department of State.

BANCO NACIONAL DE FOMENTO

Use of Previous AID Funds

Under AID Loan 518-L-014 to the Comisión de Valores/Corporación Financiera Nacional (CV/CFN), a total of $350,000 was reserved for a special lending program for artisans and small industrialists. This program was administered by the Banco Nacional de Fomento (BNF). Of the total of $350,000 assigned for the program, $336,309.20 was made available for loans and the remaining $13,690.80 was used to finance a contract with International Development Services.

The loan funds for this activity were disbursed between June 1965 and November 1966, a period of approximately 18 months. Loans were made to firms in 13 of the country's 19 provinces. No breakdown is available regarding the distribution of loan funds between artisans, on the one hand, and small industrialists, on the other, since criteria to make the distinction were not available. Nevertheless, it seems clear from the average amount of the loan ($667) and from the types of activities financed (see Exhibit A) that most of the recipients were not engaged in factory manufacturing. Some, indeed, were engaged in service activities (which nevertheless qualified them as "artisans" under Ecuadorean law).

Of the total amount provided under this program, 61.7% financed raw-material and working-capital requirements; 37.8% financed machinery and equipment purchases; and 0.5% financed construction. Raw-material and working capital loans were generally made for one or two years, while loans for the purchase of machinery and equipment were made for periods of up to seven years. The BNF has indicated that there was no serious repayment problem with loans made under this program.

Even given the minimal supervision provided by the BNF under the program, it is clear that it was quite costly in terms of administrative expenditures per dollar loaned. Moreover, many of the loans were not developmental in nature, but merely served to maintain a given level of business operations. In the last few years, the BNF has recognized that such loans should have a relatively low priority, and it has been revising its supervised credit program for artisans and small industrialists by making fewer loans at higher average amounts, primarily for projects that will increase production and improve productivity.

SUMMARY OF SUB-LOANS MADE BY THE BANCO NACIONAL DE FOMENTO

UNDER AID LOAN 518-L-014 TO ARTISANS AND SMALL INDUSTRIALISTS

Loan Purposes	Number of Loans	CIIU Activity Code	Total (Sucres)
Tailoring	58	24	659,916
Shoemaking	71	24	777,520
Carpentry	51	26	599,126
Seamstress	51	24	273,814
Bakery	28	20	178,740
Weaving	18	23	88,775
Cabuya Sacks	38	23	445,850
Mechanical Repairs	38	39	576,060
Saddlery	16	29	150,280
Cabinetmaking	7	26	72,340
Tanning	4	29	30,000
Hat Making	6	24	80,000
Concrete Blocks or Pipes	7	39	198,700
Cloth	6	24	39,600
Jewelry	12	39	101,400
Cabuya Thread	6	23	37,800
Flour Mills	8	20	148,740
Soft Drink Coolers	3	20	19,800
Belt Making	2	29	8,700
Brick Shop	2	39	3,100
Watchmaker	2	39	6,000
Stockings	4	24	20,500
Coffee Grinding	7	20	45,500
Typography	3	28	102,000
Steel Beds	2	35	23,000
Wood Industry	2	25	220,000
Tinware	3	35	11,500
Food Products	1	20	100,000
Lime Refining	3	39	92,000
Cattle Food	3	39	140,000
Liquors	2	21	250,000
Unrefined Brown Sugar	2	20	59,000
Bedcovers	2	39	12,000
Shirts	1	24	15,000
Paint	2	39	7,000

Loan Purposes	Number of Loans	CIIU Activity Code	Total (Sucres)
Toys	1	39	20,000
Photo Engraving	1	39	45,000
Photography	1	39	5,000
Wood & Ivory Carving	2	39	26,340
Radio	2	39	21,500
Chemicals	2	31	92,800
Tapestries	1	39	13,400
Hairdresser	1	39	18,000
Pottery	1	39	4,000
Carbon Masks	1	39	6,500
Carpets	2	39	50,000
Plastic Purses	1	39	29,900
Brooms	1	39	5,000
Sausage Processing	2	20	70,000
Adhesive Tape	1	39	7,600
Heel Makers	1	24	2,600
Cheese Processing	1	20	7,600
Hemp Sandals	1	24	1,800
Ammunition	1	39	15,000
Mattresses	1	39	1,800
Lard	1	30	1,400
Ponchos	1	24	20,000
Barber	1	39	3,000
Chalk	1	39	5,000
Knitting	1	23	2,000
Vulcanization	1	39	8,000
Handbags	1	39	30,000
Starch	1	20	6,000
	504		6,114,101

Summary of Sub-Loans by CIIU Activity

CIIU Activity Code	Activity	Number of Loans	Total	Per Cent
20	Food Products	54	637,680	10.4
23	Textile Manufacturers	63	574,425	9.4
24	Footwear and Apparel	200	1,890,750	30.9
25	Wood and Cork	2	220,000	3.6

CIIU Activity Code	Activity	No. of Loans	Total	Per Cent
26	Furniture & Accesories	58	671,466	11.0
28	Printing Presses	3	102,000	1.7
29	Leather	22	188,980	3.1
31	Chemicals	2	92,800	1.5
21	Beverages	2	250,000	4.1
35	Metal Products	5	34,500	0.6
39	Other	93	1,451,500	23.7
		504	6,114,101	100.0

Sub-Loans by the Banco Nacional de Fomento under AID

Loan 518-L-014, Classified by Amounts

Amount of Loans (Sucres)	Number of Loans	Amount (Sucres)	Percent of Total Loan Amount by Size
150,000	1	150,000	2.5
120,000	1	120,000	2.0
100,000	3	300,000	5.0
90,000	22	180,000	2.9
80,000/90,000	4	322,000	5.3
60,000/80,000	8	503,000	8.2
50,000/60,000	2	106,000	1.7
40,000/50,000	8	341,000	5.5
30,000/40,000	15	480,000	7.9
20,000/30,000	24	570,000	9.3
10,000/20,000	110	1,600,000	26.2
8,000/10,000	35	305,000	5.0
5,000/8,000	119	625,000	10.2
3,000/ 5,000	100	370,000	6.0
2,000/ 3,000	42	104,000	1.7
1,000/ 2,000	26	36,000	0.6
Under 1,000	4	2,000	0.0
	504	6,114,000	100.0

BANCO NACIONAL DE FOMENTO

Balance Sheet

as of November 30, 1969

(Exchange Rate S/18.18 = US$ 1)

(Thousands of Dollars)

ASSETS	
Cash on Hand and in Banks	13,846
Banking Loans	55,822
Training Loans	6,904
Other Receivables	4,926
Investments in Commercial Properties	16,746
Real Estate, Furniture and Office Supplies	3,684
Other Assets	4,298
Deferred Assets	2,509
Total Assets	108,735
LIABILITIES	
Monetary Deposits	11,669
Miscellaneous Deposits	1,646
Other Short-Term Obligations	2,509
Loans	46,737
Debentures	1,633
Other Liabilities	5,167
Deferred Liabilities	4,419
Capital and Reserves	34,553
Surplus	402
Total Liabilities	108,735

COMISION DE VALORES-CORPORACION FINANCIERA NACIONAL

(CV/CFN)

Lending Activities

An AID loan of $5.0 million to the CV/CFN was authorized in May 1962. Since then, the CV/CFN has obtained foreign loans and lines of credit totalling more than $24 million. These include lines of credit from West Germany, Switzerland, Italy, Colombia, France, Spain, the Netherlands and Poland, and loans from the IDB, IBRD, and IFC. A new IDB loan for $7.5 million was recently signed.

The CV/CFN make its first loan in August 1963, and through March 30, 1970 had approved 147 loans totalling S/723 million (approximately $40.1 million). Fifty percent of the loans were for projects using local raw materials to meet 75% or more of their total raw-material requirements. Actual loan disbursements through the end of 1969 totalled S/450 million ($24.8 million). At the end of March 1970, 52 loans for S/377 million ($20.7 million) were under study, including projects involving the industrial processing of the production from 5,000 hectares each of pine (for pulp), rubber, and rapeseed.

COMISION DE VALORES-CORPORACION FINANCIERA NACIONAL

Balance Sheet

as of June 30, 1969

(Exchange Rate S/18.18 = US$1)

(Thousands of Dollars)

ASSETS	
Cash	383
Securities	
Government of Ecuador Bonds	11,822
Municipal Bonds	3,362
Other Bonds	157
Shares	796
	16,137
Interest Receivable	1,415
Prepaid Expenses and Other Assets	246
Loans Receivable	
Government of Ecuador	3,859
Industrial Loans	20,597
Small Industry Loans	957
Other	1,294
	26,707
Land, Building, Furniture and Equipment, at cost	422
Less - Accumulated Depreciation	(253)
	169
	45,057

LIABILITIES

Loans Payable	
Banco Central del Ecuador	6,328
Agency for International Development	4,785
Interamerican Development Bank	2,966
Swiss Banks	320
	14,399
Other Liabilities (Short-Term)	418
Total Loans Payable and Other Liabilities	14,817
Deferred Income	
Unearned Bond Discount	1,400
Unearned Interest	44
	1,444
Capital and Undisbursed Earnings	
Capital:	
Authorized $27,503	
Paid-In	25,498
Undisbursed earnings:	
Appropriated - reserve for contingencies	3,298
	28,796
	45,057

COMISION DE VALORES-CORPORACION FINANCIERA NACIONAL

Statement of Income and Unappropriated Undistributed Earnings

For Year Ending June 30, 1969

(Exchange Rate S/18.18 = US$1)

(Thousands of Dollars)

Income	
Interest	3,070
Amortization of Bond Discount	224
Other	42
	3,336
Expenses	
Interest and Commissions	455
General and Administrative	651
Depreciation	19
	1,125
Net Income for the Year	2,211
Transfer to Paid-In Capital	(1,100)
Transfer to Reserve for Contingencies	(1,111)
Unappropriated Undistributed Earnings at end of year	- 0 -

CORPORACION FINANCIERA ECUTORIANA DE DESARROLLO (COFIEC)

Lending Activities

An AID seed capital loan of $3.0 million was authorized in June 1966. Since then COFIEC has obtained the following lines of credit:

1.	The Fidelity Bank	$ 500,000
2.	Manufacturers Hanover Trust Co.	$1,000,000
3.	Continental Bank International	$1,000,000
4.	Banco de Londres y Montreal Ltda.	$ 200,000
5.	Handelsbank in Zürich	$ 100,000
6.	Wells Fargo Bank	$ 500,000
7.	Banca Nazionale de Lavoro	$2,000,000
8.	Eximbank	$1,500,000
		$6,800,000

Through the end of 1969 COFIEC had disbursed 908 loans for a total of S/788 million ($43.3 million).

CORPORACION FINANCIERA ECUATORIANA DE DESARROLLO (COFIEC)

Balance Sheet

as of December 31, 1969

(Exchange Rate S/18.18 = US$1)

(Thousands of Dollars)

ASSETS

Current Assets	
Cash	1,292
Loans Receivable	4,361
Advances on Loans in Process	1,247
Amounts Due on Bank Acceptances	118
Investments in Industrial Companies - at cost	103
Interest Receivable and Other Receivables	324
Prepaid Interest and Other Prepaid Expenses	21
Amounts Due on Letters of Credit	1,881
Total current assets	9,347
Other Assets	
Loans Receivable - due after 12 months and over	4,095
Investments in new enterprises - at cost	372
Office furniture and equipment and vehicles, at cost less accumulated depreciation	126
Real Estate - at cost	297
Deferred Expenses	83
Total other assets	4,973
TOTAL ASSETS	14,320
Contingent Assets - Loans receivable guaranteed to foreign banks	9,509
TOTAL	23,829

LIABILITIES AND
STOCKHOLDERS' EQUITY

Current Liabilities	
Letters of credit outstanding	1,881
Notes payable to foreign banks	1,554
Other payables	996
Current portion of long-term debt	198
Amounts due on notes receivable discounted	142
Bank acceptances payable	118
Total current liabilities	4,889
Deferred Income	
Unearned interest	514
Unrealized exchange gains	77
Unearned commissions	10
Total deferred income	601
Long-Term Debt	4,770
Allowance for Doubtful Accounts	176
Stockholders' Equity	
Authorized capital $3,960	
Capital stock issued and outstanding	3,141
Legal reserve	59
Special reserve (available for distribution)	273
Retained earnings	411
Total Stockholders' equity	3,884
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	14,320
Contingent liabilities - Loans guaranteed to foreign banks	9,509
TOTAL	23,829

CORPORACION FINANCIERA ECUATORIANA DE DESARROLLO (COFIEC)

Statement of Income and Retained Earnings

For the Year Ended December 31, 1969

(Exchange Rate S/18.18 = US$1)

(Thousands of Dollars)

Revenues	
Interest Income	1,063
Commisions earned	
On Loan guarantees and from other sources	404
Technical assistance	98
Investment income	9
Gain on sale of investments	1
Miscellaneous income	5
Total revenues	1,580
Expenses	
Interest	484
Salaries & other compensation	280
General and administrative expenses	147
Taxes, other than on income	22
Commissions	26
Depreciation and amortization	20
Insurance	6
Miscellaneous losses and expenses	6
Total expenses	991
Income from Operations	589
Provision for Doubtful Accounts	(81)
Employees' Profit Participation	(72)
Provision for Income Taxes	(25)
NET INCOME - RETAINED EARNINGS AT YEAR END	411
Retained Earnings at the Begining of the Year	339
Appropriations Made	
Transfer to special reserve - net	213
Payment of stock dividend	61
Transfer to Legal Reserve	42
Bonuses paid to executives, employees and directors' fees	23
Total appropriations made	339

ECUADOREAN DEVELOPMENT FOUNDATION - GUAYAQUIL:

ORGANIZATION STRUCTURE AND FINANCIAL OPERATIONS

The Ecuadorean Development Foundation (EDF) is a private,non-profit foundation which began operations in May 1968 with branches in Quito and Guayaquil. It provides credit for development purposes to businesses and community organizations which have difficulty obtaining credit from commercial sources at reasonable rates. The discussion that following concerns only the Guayaquil branch of the EDF.

The members of EDF-Guayaquil are 99 Ecuadorean and foreign banks and companies (including, for example, the Bank of America and Grace & Co.) which contribute capital and operating funds and technical assistance to the EDF. (See Exhibit A for complete list of members.)

EDF-Guayaquil has a Board of Directors consisting of businessmen and executives who are listed in Exhibit B. The loan committee of the Board of Directors approves each loan extended by EDF.

The active management of EDF consists of the following: 1) an Executive Director, a position presently held by a businessman who has been Director of the National Development Bank and the National Banana Directorate; 2) a deputy who analyses loans and supervises the field workers; 3) two field workers who analyze businessess and work with borrowers; 4) a part-time accountant who spends about 40% of his time on EDF work; 5) one assistant accountant; 6) two part-time assistant accountants who spend about 40% of their time on Foundation business; 7) one collector who works almost full time for EDF,; 8) a full-time Peace Corps Volunteer (PCV) with a BA in economics who works as a special assistant to the Executive Director; 9) a PCV with a BA in economicsand sociology who works with the USAID contract advisor as a field worker; and 10) a PCV engineer who is available for consultation on engineering matters.

The following personnel will be added to the Foundation management resources in the event that the barrio enterprise program is approved: 1) an economist-accountant, 2) another assistant accountant, and 3) another field worker. In addition, a USAID contract advisor who is a specialist in creation of barrio enterprises, with substantial experience in Latin America, would work virtually full time on this project, as would his Ecuadorean professional assistant yet to be hired. Finally, as indicated elsewhere, the members of EDF will provide technical assistance to borrowers and the Foundation.

As is clear from the above, EDF-Guayaquil is not a banking institution but rather a public-service organization which concerns itself with borrowers who do not have access to adequate bank credit. It is concerned not merely with extending credit, but also with developing the capacity of borrowers to use credit effectively. Since it is not dependent on interest on its loans for income, but is supported by both monetary contributions and voluntary technical-assistance services from its members, it is capable of providing considerably greater technical assistance in connection with small loans than a bank.

Financial Operations

In its two years of operations EDF-Guayaquil has made 463 loans for a total of $113,347. The average size of its loans has been $345. Over 90% of its loans are currently made to small businesses.

There have been defaults so far on only $670 or 0.6% of the total amount loaned. Repayments totalling $46,456 have been made to date, and thus defaults as a percentage of repayments amount to 1.4%. Of the $66,891 in loans currently outstanding $8,389 or 12.5 are delinquent; almost half of this amount is delinquent by less than 90 days. Such a low default rate may well be due to the small size of loans extended by EDF to date as well as the Foundation's limited experience.

The main source of funds for EDF-Guayaquil is the contributions of its members, who thus far have provided a total of $48,333. This does not include a recent grant of land conservatively valued at $350,000. A total of $39,331, or 81.4% of the cash contributions by members, has been spent for operating expenses while the rest has been used for loans. Regular pledged monthly contributions by members for operating expenses and loans are currently at the rate of $30,000 per year.

The second most important source of funds for EDFhas been the Pan American Development Foundation, which has contributed $43,680 in loan funds as well as technical assistance.

EDF-Guayaquil is prepared to match the AID loan contribution with $250,000 of its own funds, partly from sale of the land mentioned earlier and partly from additional contributions (probably in loan form) raised from its members. It is also prepared, if necessary or desirable, to obtain guarantees from its members to the GOE of 20% of the total amount to be made available to EDF-Guayaquil under the AID loan.

EDF - GUAYAQUIL: MEMBERSHIP LIST

C.O.F.I.E.C.
Empresa Eléctrica del Ecuador, Inc.
Industrial Jabonera Ecuatoriana
Créditos Económicos
Luis Vallejo Araujo S. A.
Crnel. Agustín Albán Borja
Banco Industrial y Comercial
Importadora "El Rosado"
Revista "Vistazo"
E. Maulme C. A. de Comercio
Banco La Previsora
Ingenio San Carlos
Ingenio Valdez
Banco de Guayaquil
Fábrica de Cigarrillos "El Progreso"
Diarios "El Universo"
Cía. de Seguros Ecuatoriano Suiza
Compañía de Cervezas Nacionales
Cautivo Empresa Petrolera Ecuatoriana C. A.
Créditos Mercantiles C. A. del Ecuador
Cap. César Monge Serrano
Compañía General de Comercio y Mandato
Comercial Importadora Continental Cía Ltda.
Publicistas Sudamericanos S. A.
Banco de Descuento
Richard O. Custer
Ing. Santiago Peré Cabanas
La Ferretera C. A.
Fábrica "La Universal"
John Wynne
Cordelería Nacional
Banco La Filantrópica
La Cemento Nacional C. A.
Antonio Martínez Velasco
Mecanos S. A. C.
Federico Heinert Rivas
Ramón Fernández F.
Hans G. Jacobstal
La Nacional Compañía de Seguros Generales S. A.
Compañía Anónima Mercantil
Ing. Edmundo Valdez Murillo
Importadora Zoher Cía Ltda.
Carlos Bacigalupo Ojeda
Acromax S. A.

Víctor Miraglia
Molinos del Ecuador C. A.
Fábrica de Aceites y Velas "La Favorita" S. A.
Compañía Anónima Balda Ind. Merc.
Textiles "San Antonio"
Comercial Intaco S. A.
Fábrica Automática de Envases S. A. (FADESA)
Diario El Telégrafo
First National City Bank
Juan H. Kruger S.A.C.
F.E.R.T.I.S.A.
Compañía Ecuatoriana de Seguros
Ernesto Amador Icaza
Banco de Londres y Montreal Ltdo.
Celoplast S. A.
Víctor Aníbal Velasco
Arturo Stacey Saa
Carlos Roggiero Bravo
Industrias de Concreto Roca C. A.
Refrescos S. A.
Metropolitan Touring
La Reforma
Organizaciones Suceso Cía Ltda.
Grace & Cía (Ecuador) S. A. Comercial
Industria Cartonera Ecuatoriana S. A.
Pinturas Ecuatorianas S. A.
Cía Comercial Briz Sánchez S. A.
Rheem del Ecuador
Solubles Instantáneos C. A.
Tenería "Guayas"
Oleica S. A.
Casa Moeller Martínez C. A.
Agrícola Balao S. C.
Bank of America
Crown Cork del Ecuador
Lubricantes y Tambores del Ecuador C. A. (LYTECA)
Electro Ecuatoriana Sociedad Anónima Comercial e Industrial
Guayaquil Bottling Company
Joyerías "Luxe"
Petróleos Gulf del Ecuador
Comercial Vladimir Lerque
VICESA
Cemaplast S. A.
Fábrica de Clavos Guayas

Gerónimo Oneto y Cía.
Esteban Quirola
Almacenes de Prati C. Ltda.
TIA S. A.
Transoceánica C. Ltda.
Banco Holandés Unido
Productos Latinoamericanos S. A.
Trobana S. A.
Automotores y Anexos S. A.
Guillermo Pareja Rolando

EDF-GUAYAQUIL: BOARD OF DIRECTORS

Captain César Monge S.	President - National Beer Company C. A.
Mr. César Durán Ballén	Executive Vice-President COFIEC (Ecuadorean Financial Corporation)
Mr. Juan José Villaseca	Manager - Ecuadorean Industrial Soap Manufactory S. A. President - Automatic Manufactory of Containers S. A. President - Industry of Tin Plate Containers.
Mr. Heriberto Orcés	Special Advisor - Gulf Petroleum of Ecuador C. A. President - Ecuadorean Mills C. A. Director - Anglo-Ecuadorean Inc. President - National Insurance Company "Sucre" C. A.
Mr. Xavier Alvarado	General Manager - Graphic Arts Senefelder C. A. Ltda. Director - National Publishers S. A. Director - T.V. Ecuadorean Corporation.
Mr. Fernando Anduze	President & General Manager - Electric Enterprise of Ecuador, Inc.
Mr. Fernado Avilés Estrada	Manager - South American Publicists S. A. Chief, Public Relations - Aerial Tourism Salvac. Chief, Public Relations - Ford Motor Co. Police Intendant of Guayas Province.
Mr. Ernesto Jouvín Cisneros	Financial Manager - Lithography & Press "La Reforma" President - Paper Manufactory "La Reforma". President - American Tropical Sugar Mill (AZTRA)
Mr. Félix Changkuo	Consul General - Nationalist China. Counseller, Overseas Ministry, Nationalist China Manager - Continental Rice Mill Cia. Ltda. Manager - Predios Rústicos Continental. Vice-Governor - District G Lions of Ecuador

Mr. Rafael Ferretti B.	Manager-Owner - Metropolitan Touring S. A. President - Chamber of Commerce - Guayaquil. Functional Senator for Commerce for the Litoral and Archipiélago de Galápagos Member - Cantonal Board of Potable Water.
Mr. Carlos Pérez Perasso	Deputy Director - Newspaper "El Universo".
Eng. Edmundo Valdez M.	Manager - Valdez Sugar Mill Co. S. A. Manager - National Molasses Compantу. Director - Bank of Guayaquil Director - "La Nacional" Insurance Co.
Mr. Werner Pellehm	Manager - Ecuadorean Fertilizers S. A. Manager - Juan H. Kruger S. A. C. Manager - Banafibra of Ecuador S. A.
Mr. Francisco Manrique	Manager - Industrial & Commercial Bank.
Mr. Jutfallah Kozhaya	President - Textile "San Antonio" S. A.
Mr. Guillermo Pareja R.	Manager-Owner - Lotizadora "Mapasingue".

ECUADOREAN DEVELOPMENT FOUNDATION - GUAYAQUIL

Balance Sheet

as of June 30, 1969

(Exchange Rate S/18.18 = US$1)

(Dollars)

ASSETS		
Cash		29,778
Office Supplies		38
Receivables		
Loans	26,492	
Advance to Employees	84	
Other Receivables	358	26,934
Fixed Assets (Net)		
Office Furniture and Fixtures	2,208	
Office Remodeling	245	
Land	350,000	352,453
Other Assets		107
Total Assets		409,310
LIABILITIES AND NET WORTH		
Current Liabilities		
Withholding Taxes	115	
Accrued Taxes	427	
Accrued Social Security Taxes	879	
Accrued Interest Payable	2,141	3,562
Loan Payable (PADF)		23,418
Other Liabilities		330
Net Worth		
Donated Surplus	372,474	
Earned Surplus	9,526	382,000
Total Liabilities and Net Worth		409,310

ECUADOREAN DEVELOPMENT FOUNDATION - GUAYAQUIL

Income Statement

For Year Ending June 30,1969

(Exchange Rate S/18.18 = US$ 1)

(Dollars)

Income	
Donations	29,096
Interest	206
Total Income	29,302
Expenses	
Salaries	9,915
Travel Expenses	1,650
Advertising	1,239
Maintenance of Office Equipment	28
Communications	311
Rent	853
Depreciation	153
Utilities	539
Banking Charges	7
Office Supplies	756
Local Travel	556
Professional Fees	25
Entertainment	113
Transportation Expenses	252
Office Cleaning	44
Electric Installation	168
Travel Abroad	348
Social Security	998
13th Salary	887
Vacation	316
Reserve Fund	96
Messengers	67
14th Salary	254
Taxes and Contributions	531
Miscellaneous	403
Total Expenses	20,509
Net Income	8,793

PARTIAL AND PRELIMINARY RESULTS OF A SURVEY OF SMALL BUSINESS CREDIT NEEDS IN THE BARRIOS SUBURBANOS OF GUAYAQUIL

A USAID contract advisor, assisted by short-term contract personnel and a Peace Corps Volunteer, has been conducting a survey to determine the types, availability, and cost of credit available to small business enterprises in the barrios suburbanos of Guayaquil. The study is approximately 50 percent complete at this time. It also attempts, through random sampling techniques, to provide a breakdown of the types and relative importance of the various industrial and commercial activities in the barrios. At the same time, the contractor has been attempting to identify those interviewees who have the best potential for business expansion and organizational development.

Two hundred one interviews have been conducted to date. It is estimated that these 201 firms account for no more than three percent, and perhaps less than two percent, of the total number of small barrio enterprises. Preliminary projections, based on the 201 interviews, place the total number of small barrio enterprises at approximately 9,400.

Of the 201 persons selected for interviews, only 10 refused to be interviewed. Eighty-four expressed a strong interest in some kind of barrio-wide commercial and business organization through which technical assistance, credit, and marketing assistance could be secured, while 117 (including those who refused to be interviewed) had no interest in such an organization.

Sixty of the interviewees are presently using credit of some kind, while an additional 119 are not using credit but either need it or would like to be able to use it. The remaining 22 have little or no need for credit. Among those not using credit but needing it, the most frequent reason given for non-use of credit was that its high cost makes it economically unproductive to borrow for the purpose of expanding or improving business operations.

The survey sought to identify two types of credit needs: (1) short-term operating capital for salaries, supplies, etc. and (2) medium- and long-term credit requirements for machinery, equipment, etc. It was found that the average firm requires an operating-capital loan of S/3,000 (approximately $150) four times a year. Medium-and long-term capital requirements were estimated to be S/25,000-35,000 ($1,250-1,750) per firm.

The estimated 9,500 barrio enterprises may be divided into two groups: (1) those firms which could use credit primarily to expand their operations and provide additional goods and services and (2) those which would be expected to use credit primarily to reduce their costs without expanding their operations. It is tentatively estimated that 960 firms in the first--and highest-priority--category are presently in a position effectively to use credit from an institution such as the EDF. Short-term capital requirements for these firms would imply a need for credit resources of $144,000 per year (i.e., $150[1] x 960), while medium and long-term credit requirements would amount to $1,440,000 (i.e., $1,500 x 960). In other words, total credit requirements just for the highest-priority firms amount to $1,584,000, or more than three times the amount of the proposed AID-financed activity in barrios suburbanos to be administered by the EDF.

1/ The $150 loan, would in effect be renewed every three months.

DISCOUNTED RATES OF RETURN TO PARTICIPATING FINANCIAL INSTITUTIONS ON SMALL BUSINESS LOANS

One of the problems in Ecuador, as in most developing countries, is the marshalling of capital resources for the expansion of credit to marginal enterprises. This problem is not solved through the mere extension of AID loans at favorable terms. What is needed is leverage whereby the AID inputs serve to stimulate indigenous capital to seek investment alternatives among the marginal, less creditworthy entrepreneurs.

We have developed several models which we believe illustrate what can be done to induce traditionally conservative money lenders to participate, either through direct lending or risk-sharing, in the expansion of credit to small business.

While the models we have developed assume a rediscounting operation, a similar effects could be expected from direct lending by a central fund to intermediate credit institutions.

In our models we assumed that all loans would be made at 12% per annum on a discount basis for a five-year term. Considered as variables were the portion of the loan that could be rediscounted, the rate at which the rediscounting could be accomplished, and the terms of repayment of the rediscounted note by the intermediate credit institutions to the central fund. As the "mix" was varied, a discounted rate of return on the PFI's own cash investment (i.e., excludes that portion of the loan which is rediscounted)was calculated.

In the first model we present an extreme set of assumptions, where 75% of the loan is rediscounted at 3% and yields an effective rate of return of 95% when a lump-sum payment is made to the Trust Fund at the end of 5 years; 55% with partial amortization; and 39% when straight line amortization of the rediscounted loan is used.

In the second set of assumptions, where 65% of the loan is rediscounted at 4% and with no amortization of the rediscounted loan until the 5th year, a discounted rate of return of some 78% is obtained. When the amortization payments are varied by making fixed annual payments with a final lump sum payment in the fifth year and straight-line constant amortization the return drops to some 31% and 25% respectively. Under such favorable rediscounting terms lenders should be encouraged to make loans to small enterprises and could be reasonably expected to assume the entire risk on both their own inputs as well as the rediscounted portion.

The third model varies only the rediscount rate to 5%, and with the same repayment patterns the discounted rates of return are some 54% with no payment to the Trust Fund until the fifth year, 29% with partial payments and a lump sum in the fifth year, and 25% when straight-line amortization is used.

The fourth model assumes that only 20% of the loan is rediscounted, at 3%, and, with one payment at the end of the fifth year, produces a rate of return of 15%; and 14% with straight-line amortization. Since a smaller portion of the loan is rediscounted, a more favorable rate is given as the incentive to the lender to invest more of his own capital. An additional incentive to risk-sharing could be introduced in these lower ranges. That is, if the lender rediscounts less than half of the loan, some suitable "mix" could be found whereby the Fund would assume the risk on the rediscounted paper.

The fifth model is based upon a 25% rediscount at 3%, and yields rates of return of 17% with the single payment and 15% with straight-line amortization.

MODEL I 75% Discounted at 3%

EXAMPLE A. No Amortization of rediscounted loan until fifth year

Gross Investment	Discounted Investment	Net Investment	Gross Income	Discount Charges	Repayment by Sub-Borrower	Repayment to Trust Fund	Net Cash Flow
100,000	75,000	25,000	12,000	2,250	20,000	-	29,750
			9,600	2,250	20,000	-	27,350
			7,200	2,250	20,000	-	24,950
			4,800	2,250	20,000	-	22,550
			2,400	2,250	20,000	75,000	(54,850)
Rate of Return 95%			36,000	11,250	100,000	75,000	49,750

EXAMPLE B. Partial amortization rediscounted loan and lump sum payment fifth year

Gross Investment	Discounted Investment	Net Investment	Gross Income	Discount Charges	Repayment by Sub-Borrower	Repayment to Trust Fund	Net Cash Flow
100,000	75,000	25,000	12,000	2,250	20,000	10,000	19,750
			9,600	1,950	20,000	10,000	17,650
			7,200	1,650	20,000	10,000	15,550
			4,800	1,350	20,000	10,000	13,450
			2,400	1,050	20,000	35,000	(13,650)
Rate of Return 55%			36,000	8,250	100,000	75,000	52,750

EXAMPLE C. Straight line amortization

Gross Investment	Discounted Investment	Net Investment	Gross Income	Discount Charges	Repayment by Sub-Borrower	Repayment to Trust Fund	Net Cash Flow
100,000	75,000	25,000	12,000	2,250	20,000	15,000	14,750
			9,600	1,800	20,000	15,000	12,800
			7,200	1,350	20,000	15,000	10,850
			4,800	900	20,000	15,000	8,900
			2,400	450	20,000	15,000	6,950
Rate of Return 39%			36,000	6,750	100,000	75,000	54,250

MODEL II 65% Discounted at 4%

EXAMPLE A. No amortization of rediscounted loan until fifth year

Gross Investment	Discounted Investment	Net Investment	Gross Income	Discount Charges	Repayment by Sub-Borrower	Repayment to Trust Fund	Net Cash Flow
100,000	65,000	35,000	12,000	2,600	20,000	--	34,600
			9,600	2,600	20,000	--	32,200
			7,200	2,600	20,000	--	29,800
			4,800	2,600	20,000	--	27,200
			2,400	2,600	20,000	65,000	(45,200)
Rate of Return 78%			36,000	13,000	100,000	65,000	78,600

EXAMPLE B. Partial amortization rediscounted loan, lump sum payment fifth year

100,000	65,000	35,000	12,000	2,600	20,000	10,000	19,400
			9,600	2,200	20,000	10,000	17,400
			7,200	1,800	20,000	10,000	15,400
			4,800	1,400	20,000	10,000	13,400
			2,400	1,000	20,000	25,000	(3,600)
Rate of return 31%			36,000	9,000	100,000	65,000	62,000

MODEL II 65% Discounted at 4%

EXAMPLE C. Straight line amortization of rediscounted loan.

Gross Investment	Discounted Investment	Net Investment	Gross Income	Discount Charges	Repayment by Sub-borrower	Repayment to Trust Fund	Net Cash Flow
100,000	65,000	35,000	12,000	2,600	20,000	13,000	16,400
			9,600	2,080	20,000	13,000	14,520
			7,200	1,560	20,000	13,000	12,640
			4,800	1,040	20,000	13,000	10,760
			2,400	520	20,000	13,000	8,880
Rate of Return 26%			36,000	7,800	100,000	65,000	63,200

MODEL III 65% Discounted at 5%

EXAMPLE A. No amortization of rediscounted loan until fifth year

Gross Investment	Discounted Investment	Net Investment	Gross Income	Discount Charges	Repayment by Sub-borrower	Repayment to Trust Fund	Net Cash Flow
100,000	65,000	35,000	12,000	3,250	20,000	-	28,750
			9,600	3,250	20,000	-	26,350
			7,200	3,250	20,000	-	23,950
			4,800	3,250	20,000	-	21,550
			2,400	3,250	20,000	65,000	(45,850)
Rate of Return 54%			36,000	16,250	100,000	65,000	54,750

MODEL III 65% Discounted at 5%

EXAMPLE B. Partial amortization rediscounted loan lump sum payment fifth year

Gross Investment	Discounted Investment	Net Investment	Gross Income	Discount Charges	Repayment by Sub-borrower	Repayment to Trust Fund	Net Cash Flow
100,000	65,000	35,000	12,000	3,250	20,000	10,000	18,750
			9,600	2,750	20,000	10,000	16,850
			7,200	2,250	20,000	10,000	14,950
			4,800	1,750	20,000	10,000	13,050
			2,400	1,250	20,000	25,000	(3,850)
Rate of Return 29%			36,000	11,250	100,000	65,000	59,750

EXAMPLE C. Straight line amortization of rediscounted loan

100,000	65,000	35,000	12,000	3,250	20,000	13,000	15,750
			9,600	2,600	20,000	13,000	14,000
			7,200	1,950	20,000	13,000	12,250
			4,800	1,300	20,000	13,000	10,500
			2,400	650	20,000	13,000	8,750
Rate of Return 25%			36,000	9,750	100,000	65,000	61,250

MODEL IV 20% Discounted at 3%

EXAMPLE A. No amortization of rediscounted loan until fifth year

Gross Investment	Discounted Investment	Net Investment	Gross Income	Discount Charges	Repayment by Sub-borrower	Repayment to Trust Fund	Net Cash Flow
100,000	20,000	80,000	12,000	600	20,000	-	31,400
			9,600	600	20,000	-	29,000
			7,200	600	20,000	-	26,600
			4,800	600	20,000	-	24,200
			2,400	600	20,000	20,000	1,800
Rate of Return 15%			36,000	3,000	100,000	20,000	113,000

MODEL V 25% Discounted at 3%

EXAMPLE A. No amortization of rediscounted loan until fifth year

Gross Investment	Discounted Investment	Net Investment	Gross Income	Discount Charges	Repayment by Sub-borrower	Repayment to Trust Fund	Net Cash Flow
100,000	25,000	75,000	12,000	750	20,000	-	31,250
			9,600	750	20,000	-	28,850
			7,200	750	20,000	-	26,450
			4,800	750	20,000	-	24,050
			2,400	750	20,000	25,000	(3,350
Rate of Return 17%			36,000	3,750	100,000	25,000	107,250

Note: With straight line amortization rate of return is 15%.

June 15, 1970

A SURVEY OF CREDIT AND TECHNICAL ASSISTANCE REQUIREMENTS OF SMALL MANUFACTURING ESTABLISHMENTS IN EC''ADOR

Prepared by:

Clarence Zuvekas, Jr.
Economic Advisor
USAID/Quito
Quito, Ecuador
May 1970

PREFACE

Although there is widespread agreement that there is a critical shortage of medium- and long-term credit for small manufacturing establishments in Ecuador, the extent of the shortage has been difficult to determine. Since several recent studies have tended to overestimate the potential credit demand by small industry,* it was decided to conduct a sample survey of small manufacturing establishments in order to obtain a more realistic estimate of credit requirements for this category of firms. Although this survey encountered a number of serious statistical problems, it is believed that it still provides a reasonable estimate of the amount of credit that could be absorbed by small industrial establishments.

A second purpose of the study was to obtain some idea of the technical assistance needed by small industrialists in various phases of their operations. Without such assistance, the potential benefits of medium- and long-term credit cannot be fully realized.

The survey was directed by Dr. Clarence Zuvekas, Jr., USAID Economic Advisor. Valuable assistance in the design of the questionnaire was provided by Mr. Hayes Keeler, USAID Social Research Advisor and by Dr. René Benalcázar and Econ. Carlos Fuseau of the BNF. Trial interviews were carried out with approximately fifteen small industrialists in Quito in order to test the questionnaire. The trial interviews were conducted by Messrs. Zuvekas, Keeler, and Fuseau and Econ. Vicente Novillo of the BNF. As a result of the trials, the questionnaire was revised. The full survey was then carried out, with the intereviews

---

* The term "small industry" as used in this study refers only to manufacturing establishments.

being conducted by Mr. Fernando Mora and Mr. Jorge Tulcanaza. Mr. Mora also assisted in the tabulation of the results of the questionnaires. The sample was selected with the kind cooperation of Lcdo. Francisco Páez of the Junta Nacional de Planificación and Mr. Jorge Vaca Cruz of the Ministerio de Industrias y Comercio.

I INTRODUCTION

For several years there has been a widespread impression that small manufacturing establishments--which may be defined as those employing between 5 to 49 employees--have lacked credit for the improvement and expansion of their operations. Although credit for working capital needs is generally available from private banks, the terms of such credit--interest and charges totalling up to 16 - 18% annually and repayment periods frequently of six months or less--are such as to provide little incentive for borrowing. A more serious bottleneck, perhaps, is the lack of medium- and long-term credit available to small manufacturing establishments. Most of these establishments are too small to be served by Ecuador's two development banks[1/] and many are too large to qualify for loans under the supervised industrial credit program of the Banco Nacional de Fomento (BNF). Virtually no long-term credit is available from commercial banks or from the Central Bank.

Although there is little doubt that there is a critical credit gap for small manufacturing establishments, it is difficult to determine the size of this gap. Recent rough estimates, however, indicate that it is quite large.

A study by Benjamin Spiro Associates[2/] estimates that foreign-exchange requirements alone for new and existing small manufacturing enterprises in the next 4 - 5 years amount to approximately $17 million, or almost $11 million more than is

1/ The Comisión de Valores-Corporación Financiera Nacional (CV/CFN), the public development bank, and the Corporación Financiera Ecuatoriana de Desarrollo (COFIEC), the private development bank.

2/ Benjamin Spiro Associates, "A Program for the Development of Small Scale Industry in Ecuador," Report Prepared for the USAID Mission in Quito, Ecuador, October 1969, ditto., pp. 14-16.

available to small industry under existing foreign loans. Medium- and long-term credit requirements for local purchases are estimated to amount to an additional \$12.5 to \$25.0 million over the same period, but the local banking system is judged unlikely even to meet working capital needs, let alone begin to satisfy medium- and long-term requirements.

Another recent study, by Val de Beausset, examined potential small-industry expansion in Ecuador in the context of Andean Subregional Integration.[3] De Beausset identified potential small-industry investment opportunities in more than 300 activities totalling \$17.7 million. This figure does not include working capital requirements, nor does it take into account replacement needs.

Both the Spiro and de Beausset studies tend to overestimate the amount of credit that will be required for small manufacturing enterprises in the next few years. The Spiro figures are based upon the National Planning Board's goal of establishing 460 new small and medium-size enterprises (those employing up to 49 workers) between 1969 and 1973. De Beausset's list of activities indicates a potential for investment in more than 1,200 new and existing enterprises. Even if sufficient credit were available, it is doubtful that sufficient enterpreneurial talent presently exists to take advantage of all these opportunities.

Nevertheless, small industry could undoubtedly expand much more rapidly if the supply of credit were increased. Both de Beausset and Spiro agree that lack of credit is a major bottleneck to the expansion of small industry. De Beausset concludes, for example, that

> The lack of available loaning capability for the small industry

---

3/ Val de Beausset, "Ecuadorean Small Enterprise Development," January 1970, ditto. See also de Beausset's earlier report, "Ecuador: Preparing for Andean Subregional Common Market," October 1969, ditto.

> sector is the main single factor that not only causes a lag in further major development but also will result in a weak position for Ecuador in the Andean Subregional Common Market unless it is stimulated.4/

Spiro estimates that

> only 490 of the 1,000 small-scale enterprises have received financial assistance from the three main financial institutions /during the period July 1964 - June 1969/.
>
> Undoubtedly the commercial banks have also made some financing available, but it will have been largely for the marketing of finished products.
>
> It can safely be assumed that more than half of Ecuador's real small scale industries received little if any financial assistance from the banking system, even though most of them have accounts with commercial banks and are known by the banks.5/
>
> The considerations which precede lead us to suggest to AID a program of action which would:
>
> a) make resources available to bridge the gap in foreign exchange resources for small and medium-scale industry development, . . . 6/

4/ De Beausset, "Ecuadorean Small Enterprise Development," *op. cit.*, p. 25.

5/ Benjamin Spiro Associates, Inc., "A Program for the Development of Small-Scale Industry in Ecuador," *op. cit.* pp. 2-3. The 1,100 figure for the number of small industrial enterprises is based upon the 1965 Census figures for firms employing 5-49 employees, which are considered as artisan enterprises.

6/ *Ibid.*, p. 16.

Since the above studies appear to overstate the need for credit by small industry, it was decided that a survey should be undertaken in order to provide a better idea of the credit needs of small industrial establishments. In addition, it was thought that interviews with small industrialists would provide some indication of the kinds of technical assistance needed by this group of enterpreneurs.

The results of this survey, together with an estimate of the amount of credit available from other sources, indicate that there is a credit gap for machinery purchases of $11.2 million and a gap for raw-materials purchases of an additional $11.3 million. The methodology, results, and conclusions of the survey are described in the following sections.

II METHODOLOGY AND METHODOLOGICAL PROBLEMS

A. Defining "Small Industry" and Determining Its Importance to the Economy

Definitions of "small industry" vary considerably from one Latin American country to another. The most common criteria used are employment and capital, with sales also used as an indicator in some countries. In Ecuador, the Artisan and Small Industry Development Law defines small industrial establishments as those whose fixed assets (exclusive of land and buildings) are valued at less than S/.200,000 (US$11,000).7/ However, no real distinction is made in the law (and in the application of its benefits) between small industry and artisan enterprises. A recent ECLA survey of small industry development in Latin America finally settled on employment as the most useful criterion for comparative purposes. Specifically, a small industrial establishment was defined as one employing between 5 and 49 workers.8/ This same definition was utilized in the Spiro study in Ecuador, cited above. For purposes of this study it has been found convenient to accept this definition, though with a slight modification as noted below.

The major difficulty in selecting a sample of small manufacturing enterprises was the determination of the universe. The last Census of Manufacturing was conducted in 1965, and was based on the 1964 Directory of Industrial Establishments.

7/ The official exchange rate is currently 18 sucres to the dollar.

8/ "Small-Scale Industry in the Development of Latin America," Economic Bulletin for Latin America, XII, No. 1 (May, 1967), pp. 63 - 103.

The Census considered as factory-industry establishments all firms with five or more employees plus firm with less than five employees but with a monthly income of S/.10,000 or more.

Since the list of firms from the Census data was six years old, it was decided instead to use as a basis for selecting the sample the 1967 Industrial Survey (the latest annual survey data available). The Survey considers as factory-industry establishments those firms meeting one of the following three conditions: (1) seven or more employees; (2) annual production of S/.180,000 or more, and (3) fixed assets of S/.50,000 or more. Since the Survey data do not include some of the smaller non-artisan establishments that would be good potential credit subjects, an additional sample was drawn from the list of small-industry establishments registered under the Artisan and Small-Industry Development Law since 1965, when the law came into effect.

The 1967 Industrial Survey was conducted by a mail questionnaire sent to 902 manufacturing establishments. Although the questionnaire attempted to achieve 100 per cent coverage of survey-defined factory-manufacturing establishments, it is known that the actual number of establishments qualifying under this definition exceeded 902. Most of the firms excluded, however, were probably relatively small in size, so it is probably safe to assume that those receiving questionnaires accounted for more than 90 percent of the total value added in factory manufacturing. Of the 902 questionnaires sent, 836 were returned. Some firms not returning questionnaires were temporarily or permanently out of production, though others simply declined to provide information. Of the 836 questionnaires returned, 773 were found to be usable. These 773 firms probably accounted for about 85 percent of value added by the survey-defined factorv-manufacturing establishments in 1967.

For those firms with less than 50 employees, it will be assumed that the Survey accounts for 80 percent of the value added by firms of this size qualifying for exclusion in the Census. In other words, we are assuming that 20 percent of the value added by firms with less than 50 employees but meeting the Survey requirements was accounted for by firms missed by the Survey.

Given liminations of time and finances, it was decided to restrict the survey to the cities of Guayaquil, Quito, Cuenca, and Ambato. Since these cities accounted for 633, or 81.9 percent,of the 773 establishments in the 1967 Survey, this restriction is not a very serious one. It was decided that 70 firms would be selected from the 1967 Survey data and an additional 30 firms from those registered under the Artisan and Small Industry Development Law.

The main sample was chosen from the files of the Planning Board, which had separated the individual 1967 Survey questionnaires into provincial file folders. For each folder, the questionnaires were arranged in numerical order by CIIU 9/ 4-digit industries. From the folders for the provinces of Guayas, Pichincha, Azuay and Tungurahua, of which the four cities noted above are respectively the provincial capitals, firms with 50 or more employees and those located outside the provincial capitals were eliminated. This left a total of 489 firms. A random sample of these establishments was taken as follows: beginning with the fifth firm (the number five been picked out of a hat containing the numbers one through seven), every seventh firm was selected for an interview. Since the selection was done by provinces, this procedure resulted in a selection of 69 rather than 70 firms.

9/ Clasificación Industrial Internacional Uniforme.

An additional sample was taken from the list of small industries (as opposed to artisan enterprises)10/ registered under the Artisan and Small Industry Development Law. Of the 213 enterprises in the four provices of Guayas, Pichincha, Azuay and Tungurahua, a total of 34 were eliminated: 24 because they were also covered by the 1967 Industrial Survey; 7 because they were located outside the capital cities, and 3 because they are no longer in existence. This left a total of 179 enterprises, in which employment ranged from 1 to 48.

This supplementary sample was chosen in a manner similar to the main sample. For each province, every sixth firm beginning with the fifth was selected for an interview. This procedure resulted in the selection of 28 rather than 30 firms.

The Ministry's list is not complete, however, since many eligible small enterprises have not registered under the Law for purposes of receiving tax and other benefits. It is curious, for example, that only 33 firms in Guayas province are registered, compared with 106 in Pichincha, although there is a greater volume of industrial activity in the former province than in the latter.

We had earlier estimated that the 1967 Industrial Survey accounted for 80 percent of the value added in 1967 by firms with less than 50 employees qualifying as factory industry under the Survey definition. We shall now assume that the Ministry's list (excluding firms also included in the Survey) accounts for an additional 12 percent.11/ This leaves 8 percent unaccounted for either by the Survey or by the Ministry.

10/ The distinction between artisan and small-industrial establishments is made by the Ministry of Industry and Commerce on the basis of the degree of manual vs. mechanical operations used in the manufacturing process.

11/ Disregarding the fact that some of the firms on the Ministry's list would not meet the Survey requirements for "factory industry," even though the Ministry regards them as non-artisan enterprises.

Consideration must also be given to the new firms established in the period 1968-1970. It will be assumed that in 1970 the value added by these firms will represent 10 percent of the value added in 1970 by the firms established in earlier years.

B. Problems Encountered in Conducting the Interviews

Although a total of 97 interviews were to have been conducted, only 84 usable questionnaires were obtained. It was intended to establish a procedure for selecting a substitute firm whenever it was not possible to obtain an interview with a firm selected in the sample, but the project director unexpectedly had to leave the country before a system for selecting substitute firms was established with the interviewers. When he returned, the interviews for Guayaquil, Cuenca, and Ambato had been completed, and it was not feasible to make a second trip to these cities to obtain substitute interviews. Fortunately, though, the interviewer for these cities was able to make five acceptable substitutions (fourteen were needed) on his own.

In Quito substitute interviews were obtained in all cases (twenty) where it was not possible to obtain an interview with a firm selected in the initial sample. Substitute firms were selected to conform as closely as possible to the employment level and 4-digit industry classification of the initially selected firms.

In addition to the nine cases where substitute interviews were not obtained, four completed questionnaires were not usable. Of these, two represented firms with 50 or more employees at the present time (all had had less than 50 at the time of the 1965 Census); one involved a firm that was a state enterprise; and one represented a firm that was a retail establishment, thus indicating a faulty Census classification.

The following table summarizes the reasons for which only

84 usable questionnaires were obtained:

	No. of Firms Initially Selected	No. of Cases Where Substitute Interviews Not Obtained	Unusable Questionnaires	Total No. of Usable Questionnaires
Guayaquil	33	6	1	26
Quito	48	-	2	46
Cuenca	8	1	1	6
Ambato	8	2	-	6
	97	9	4	84

Although substitutions were required in a total of 34 cases, only 25 substitutions were in fact made. These were necessary for the following reasons;

16 because the firm selected in the sample no longer exists or could not be located

13 because the proprietor declined to give information

5 because of the absence of the proprietor or other person who would be able to provide the desired information.

III RESULTS OF THE SURVEY

A. Introduction

The survey was conducted in February and March, 1970. The questionnaire used for the interviews is reproduced in the Appendix. It was kept simple so that most of the information could be obtained in an informal, conversational manner. The interviews generally lasted between 45 minutes and one hour. The results of the 84 usable interviews are summarized in the sections that follow:

B. Current Investment

1. Land and Buildings. Of the 84 firms for which usable questionnaires were obtained, 42 owned their own land and buildings, and 42 were located on rental property. For those firms owning their own property, the average value of land and buildings per firm was S/.870,000. Firms owning their own land and buildings were, on the average, considerably larger than firms renting their property, with average employment being greater by about one-third and the average value of machinery almost four times higher.

2. Machinery. The value of the machinery owned by the 84 firms was S/.52,391,000, or an average of S/.623,000 per firm. The range was from S/.8,000 to S/.4,000,000. These figures exclude one shoemaker who did not own his own machinery and did not know the value or age of the machinery he was using.

   The average age of the machinery in the individual firms (excluding the shoemaker) was 7.8 years, and in 29 firms, accounting for 42.5 percent of the total value of machinery, the machinery was at least ten years old. Thus there would seem to be a fairly strong replacement demand for machinery.

The proportion of existing machinery purchased in the U.S. was 51.9 percent, a higher figure than expected. The second most important source of machinery was West Germany with 26.1 percent, followed by Italy with 8.8 percent.

3. Raw Materials. The intention of the questionnaire was to obtain an estimate of the value of current raw-materials inventories. Although not all firms would be expected to have "normal" inventory levels on hand, a snapshot of 84 firms in various branches of economic activity should have yielded a rough approximation of average investment in raw-materials inventories by the 84 firms.

Unfortunately, this was not made sufficiently clear to the interviewers, who in most cases obtained data on annual raw-materials consumption. Since not even all the data were in this form, little use can be made of the figures obtained, except to note that annual raw-materials consumption by the 84 firms exceeds S/.50,000,000.

More than half of the raw materials consumed were Ecuadorean (52.8 percent). The U.S. accounted for 38.7 of raw-materials imports, followed by West Germany with 23.0 percent and Great Britain with 14.2 percent. Latin American countries accounted for 16.2 percent of raw-materials imports.

4. Employment. Total employment in the 84 firms was 1,342, or an average of 16.0 workers per firm. In those firms surveyed in the 1967 Industrial Survey, the average increase in employment between 1967 and 1970 was 3.2 workers. In the case of those firms registered under the Artisan and

Small Industry Development Law at various times since 1965, the average increase in employment was 1.0 workers.

C. Additional Investment Desired

1. Land and Buildings. The 84 firms estimated their future requirements for new investment in land and buildings to be a total of S/.34,120,000, or S/.406,000 per firm. Estimated future requirements ranged from zero (32 firms) to S/.4,000,000.

   Although the interviewers were asked to consider only realistically planned expansion, relocation, or purchase of presently rented property--as opposed to dreams or wishful thinking--some of the estimates appear to include the latter. Therefore, we have adjusted the figure for new investment in land and buildings downward to S/.15,759,000, or S/.218,000 per firm. The adjustments were made on an individual-case basis, taking into account the estimated purchase price in relation to such factors as the firm's net profits; whether or not the owner stated he would help finance the purchase with past savings; adequacy of basic services in the present location; additional machinery desired; previous credit use; etc.

2. Machinery. This is perhaps the most important figure which the Survey sought to obtain. The 84 firms reported that they would like to purchase machinery costing a total of S/.66,572,000, or S/.793,000 per firm (including an estimated S/.300,000 for one firm which did not know the value of the machinery it wished to purchase). The range was from zero (9 cases) to S/.5,000,000. Adjusting downward as before to obtain a more realistic estimate of feasible purchases, we would put the demand for future investment in machinery by the 84 firms at S/.38.981,000, or S/.464,000 per firm.

U.S. machinery accounted for 60.9 percent of the total value of the machinery desired, again a higher figure than expected. West Germany was in second place with 24.5 percent, followed by Italy with 5.2 percent.

3. Raw Materials. As in the case of current raw-materials utilization, estimates of additional demand for raw materials were usually obtained on an annual-consumption basis. The 84 firms reported that they would like to increase raw-materials consumption by approximately S/.85 million, or 170 percent, over present levels. A more realistic figure would probably be S/.35 million, or an increase of 70 percent, and even an increase of this magnitude would probably take about five years to achieve.

   Of the total of S/.85 million in additional raw materials desired, 56.1 percent would come from Ecuador. The U.S. would account for 47.2 of imported raw materials, followed by West Germany with 26.3 percent and Argentina with 10.3 percent.

4. Employment. The increase in employment estimated by the 84 firms to result from the desired expansion in their operations totalled 743 or 8.8 workers per firm, an average increase of 55 percent. We would adjust this figure downward to 539, or 6.4 workers per firm, which would represent a 40 percent increase. The full effect of such an increase in employment would probably not be felt for at least five years.

D. Previous Use of Credit

Of the 84 firms interviewed, 71 reported having used credit at one time or another in the past. Twenty-six firms reported that they used credit regularly, generally for puchasing raw materials. Of the 13 firms not using credit, 8 gave as reasons the fact that they had sufficient savings; two reported that they lacked collateral; two stated that no credit on reasonable terms was available for small industrialists; and one expressed a fear of not being able to pay back a loan. It is likely that some of the firms claiming to have sufficient savings have utilized suppliers' credits. Twelve of the 13 firms not utilizing credit in the past expressed an interest in doing so in the future. Five firms reported that their credit applications had been turned down: three by private banks for lack of collateral, and two by the BNF, one for lack of palancas and one for unknown reasons.

Only four firms reported receiving credit for the purchase of land and/or construction of buildings. In three of these cases the source of credit was a private bank; in the fourth, it was the BNF. One suspects that the actual number of firms receiving credit for land and buildings was higher. In addition to these four loans, the BNF and the Ministry of Industry and Commerce financed the purchase of a leather factory by a cooperative in Ambato.

Thirty-seven firms reported receiving credit for machinery, with 18 of them having relied on private banks for credits of one year or less. Fifteen firms had received loans from the BNF with repayment periods of up to five years; five had received suppliers' credits for up to four years, and one had received a five-year loan from COFIEC. It is probable that additional firms have used suppliers' credits but did not report them.

Fifty-one firms reported having utilized credit for raw materials. Most of this credit was from private banks: 37 firms had obtained credit from this source, and in no case was the repayment period more than one year; typically it was one year in Guayaquil but only six months in Quito. Ten firms obtained raw-material loans of up to three years from the BNF: 7 received suppliers' credit, generally for six months; and one received a loan from COFIEC.

In the five-year period 1965-1969, the firms interviewed received loans for machinery purchases totalling at least S/.4,100,000. The actual figure was probably higher, since some of the responses to the questions on previous use of credit were not clear. Projections made on the basis of this figure would significantly underestimate total investment by small manufacturing enterprises during this period, since firms established since 1965 would have had made substantial initial investments in machinery, and these firms are under-represented in the sample. At the same time, the relatively small investment in machinery since 1965 provides another indication that there is probably a high replacement demand for machinery by small industrial establishments.

To obtain an idea of raw-materials credit currently demanded, we may make the assumption that all firms which have used such credit do so regularly. Taking the highest amount for such credit received by each individual firm, the raw-materials credit obtained annually by the 84 firms would total at least S/.14,250,000. This estimating procedure may still understate the potential demand for raw-materials credit under existing levels of operation because (1) many firms have not received raw-materials credit for a number of years, since which time their operations have expanded; and (2) most firms probably could effectively utilize more raw-materials credit than they presently obtain, but fail to do so because of a lack of knowledge of how to use credit.

E. Anticipated Future Sources of Credit

All but five firms expressed an interest in utilizing credit in the future, including 12 of the 13 firms not utilizing credit in the past. The table below summarizes the anticipated future sources of financing indicated by the 79 institutions expressing a need for credit in the future.

Anticipated Future Sources of Credit	Land and Buildings (31 firms)*	Machinery (76 firms)*	Raw Materials (79 firms)*
Private Banks	23	32	35
Savings	6	9	29
AID	13	21	23
BNF	10	10	9
Suppliers	-	7	-
COFIEC	6	5	5
CV/CFN	-	2	1
Other	2	-	-
Unspecified	18	24	23

The number of responses is greater than the number of firms expressing an interest in various kinds of credit since some firms listed more than one possible source.

Unfortunately, specific anticipated sources of credit were not always obtained. Thus in a number of instances the sources were given as simply "international credit institutions," "institution," or "external credit." In some cases the firms may have had in mind suppliers' credits, but in other instances they probably hoped to participate in an AID loan.

The fairly large number of firms listing AID as a possible future source of credit is partially explained by the fact that there is a fairly widespread opinion among small industrialists that AID can--or at least should--make loans directly to small industrialists. In other cases the firms have had in mind borrowing from an Ecuadorean institution such as the BNF or a private bank which would be able to secure low-interest AID funds. However, the fact that the BNF was not specified very frequently is an indication of the dissafisfaction with this institution felt by many small industrialists. Thus, even after taking into account the fact that some of firms interviewed would be too large to qualify for BNF lending (or at least for the supervised lending program), there is a clear preference for using private banks rather than the BNF even for machinery credit, even though the latter is available from private banks with repayment terms of no more than one year. One of the major complaints against the BNF is the length of the tramite, a problem the BNF is now seeking to resolve through simplification of application procedures.

F. Basic Services

The firms interviewed were asked to comment on the adequacy of their electric power supply, water supply and working space. The responses were not as informative as was hoped for, since the questions were not specific enough and the intereviewers not given sufficient guidance as to what kind of information to look for.

Seventy-one of the 84 firms interviewed were equipped to utilize three-phase electric power. None of the firms reported any difficulties with electric-power service, though undoubtedly some complaints would have been forthcoming had this specific question been asked.

Only one firm indicated that it did not have its own water supply. As in the case of electric power, there were no complains about adequacy of water-supply service. Again, this specific question should have been asked.

Only 15 firms reported that they had inadequate space, and all but one of these was in Quito. Undoubtedly a number of firms in Guayaquil would have expressed the same opinion had they been asked directly about the adequacy of their present facilities.

G. Accounting Practices

Several questions were asked to determine the extent to which small manufacturing establishments used accounting techniques. The questions on profits were not intended to obtain precise information on profits as such but rather were inserted to provide a check on whether or not a particular firm was utilizing accounting techniques as much as it claimed.

Nineteen of the 84 firms, or almost one-quarter of the total, used no accounting system at all. Of the remaining 65, 31 claimed to use cost accounting. In addition, one firm claimed to utilize cost accounting but not general accounting (!). In fact, it would seem that at most 18 firms (and probably less) utilized some form of cost accounting. There were a number of instances of firms which claimed to use cost accounting but which also stated that their profits were the same on a half-dozen or so different products. On the other hand, a few firms not utilizing cost accounting had a reasonably good idea of the relative profitability of the various items they produced.

H. Marketing Methods

The questions on marketing were added to the questionnaire after the trial interviews revealed that lack of marketing know-how was possibly one of the most serious bottlenecks to the expansion of the small-industry sector. These impressions were confirmed by the survey. For example, some firms producing only for special orders need technical assistance in establishing retail outlets for their products; this change in marketing methods would also involve assistance in product standardization. Other firms do not recognize possibilities for diversifying their output, for example, through the processing of by-products. Still others need assistance in entering or expanding their participation in export markets.

The question on competition did not yield the hoped-for results, since insufficient information was obtained regarding how the various firms reacted toward their competitors. Nevertheless, some useful information was collected. The great majority of firms reported that they had significant competition, with only four reporting that they had little or no competition. The most common responses to competition reported by the firms interviewed were to improve product quality (19 responses) and to lower prices (12). Three firms stated that they have relied on advertising and the propietors of two other firms said that they were seeking to expand sales through personal visits to potential new clients, another form of advertising. Three firms reported that they reacted to competition by providing better distribution services and two others reported that they had established "good relationships" with their clientele. Only three firms reported that they wished to respond to competition by acquiring new machinery and thus lower their costs of production. However, when asked how they could increase their sales, 19 firms responded that they would rely primarily on acquisition of new or additional machinery. The most frequent response to this question, unfortunately, was rather vague: increasing production. All but two firms stated that their sales could be increased, with 20 firms reporting that they had opportunities to export their products.

Other Observations

It was quite evident from the interviews that for most firms there is a great need for technical assistance in administration and management. Many firms do not know how to use credit effectively, and many do not take advantage of the existing credit facilities available to them from private banks and from the Banco Nacional de Fomento.

With regard to the BNF, it is rather disturbing to note that many small industrialists are very dissatisfied with that institution's current operations. Such sentiments were expressed by ten of the firms interviewed as well as by the Small Industry Associations in the cities where the interviews were conducted. The most common complaints were that loans were too often granted on the basis of political influence and that the loan procedures were too long and annoying. The BNF is aware of these sentiments and has recently taken steps to remedy one of these problems by introducing a much simpler system of loan application and inspection documentation.

IV CONCLUSIONS

A. An Estimate of Credit Demand Based on the Survey

The adjusted requirements for machinery by the 84 firms in the Survey amounted to S/.38,981,000. To project the total machinery requirments by small industrial establishments, our first step will be to divide the above figure into machinery required by firms included in the 1967 Industrial Survey (S/.33,956,000) and that required by firms in the Ministry of Industry and Commerce's list (S/.5,025,000).

We now multiply the first figure by seven, since we selected one of every seven firms in the Survey list with less than 50 employees and located in Guayaquil, Quito, Cuenca, and Ambato. This gives a figure of S/.237,692,000. We now divide this figure by 0.819, the percentage (81.9 percent) of Survey firms in the four cities, to obtain a figure for the country as a whole. 12/ This figure is S/.290,222,000.

Applying the same procedure to the firms in the Ministry's list, multiplying S/.5,025,000 by six give S/.30,150,000. Dividing this latter figure by 0.819 13/ results in a figure of S/.36,813,000.

12/ Assuming that the proportion of firms with less than 50 employees to be the same outside the four major cities as it is in these cities.

13/ The exact percentage of these firms in the four major cities was not determined but it is probably close to the percentage obtained for the firms in the 1967 Industrial Survey.

In making timate for the firms not accounted for in either the ..rvey or in the Ministry's list, we shall assume that the machinery required by these firms bears the same relationship to value added as the machinery required by the firms in the Ministry's list. This means that the machinery required by the unaccounted-for firms amounts to S/.24,542,000, or two-thirds of the amount required by firms in the Ministry's list, since the latter were estimated to have accounted for 12 percent of value added by small industry in 1967 while the firms not on either list were estimated to have accounted for 8 percent.

Summing the above figures, we now have a figure for machinery requirements of S/.351,577,000. Adding 10 percent of this amount (S/.35,158,000) for firms established in the period 1968-1970 and (probably conservatively) estimating an additional 10 percent for firms to be established in the period 1971 - 1973, we obtain a total of S/.421,893,000.

Assuming that 25 percent of this amount will have to be supplied from the individual firms' own funds, this means a total credit requirement for machinery of S/.316,420,000. Approximately 20 percent of this amount, or S/.63,284,000, could probably be obtained through the normal operations of COFIEC and the CV/CFN. An additional S/.50,000,000 could probably be supplied from the BNF's present resources from now through the end of 1973.[14] Substracting these two figures

---

14/ Including use of the $800,000 (approximately S/.14,500,000) available for small-industry loans under the recent $6.0 million IDB loan to the BNF.

from the total credit requirement leaves a gap of S/.203,136,000, or US$11,174,000 (using the official selling rate of 18.18 sucres to the dollar).

For purposes of AID lending considerations, it must be recognized that not all machinery will be purchased in the U.S. or in Latin America. The survey indicated, though, that 64.2 percent of the value of the machinery desired could be purchased in the Americas. This would require credit amounting to US$7,174,000.

This same procedure may now be applied to adjusted annual requirements for additional raw materials, which amounted to an estimated S/.35,000,000 million. Of this amount approximately S/.30,000,000 represents the requirements of the firms in the 1967 Survey, while the firms in the Ministry's list account for approximately S/.5,000,000.

Multiplying the S/.30,000,000 figure by seven and dividing the result by 0.819 yield S/.256,410,000. Multiplying the S/.5,000,000 figure by six and dividing the result by 0.819 gives S/.36,630,000. For the firms not included in the 1967 Survey or in the Ministry's list, the figure is S/.24,420,000. We now have a total of S/.317,460,000. Adding 20 percent for firms established from 1968 through 1973 increases the figure to S/.380,952,000. Substracting 10 percent this time for raw-materials purchases that might normally be financed by COFIEC and the CV/CFN brings the figure down to S/.342,857,000.

Assuming that individual firms will finance 40 percent of their additional raw-materials needs, this means an increase in credit requirements of S/.205,714,000, or US$11,315,000. The survey showed that 56.1 percent of raw-materials needs could be met from Ecuadorean sources, representing additional credit needs of US$6,348,000. The United States and other

Latin American countries would account for another 27.9 percent of additional raw-materials requirements, or US$3,157,000. Probably one-fourth to one-third of these additional requirements could be supplied from existing resources of the BNF and private banks, but the rest would require new sources of financing.

In summary, we have estimated that the credit gap for machinery purchases by small manufacturing establishments amounts to $11,174,000, while credit requirements for additional raw-materials purchases will increase by approximately US$11,315,000 annually once the additional investment has been made. Almost two-thirds of the machinery purchases could be made in the U.S. and Latin America, while almost 85 percent of the raw materials could be purchased in Ecuador, other Latin American countries, and the United States.

B. Technical Assistance

It has been seen that most small manufacturing enterprises are handicapped by inadequate knowledge of a number of important business functions, including management and administration, accounting, use of credit, and marketing. Making additional credit available to these firms on reasonable terms would undoubtedly be of considerable benefit to them, but these benefits would be substantially increased if accompanied by technical assistance.

Providing such technical assistance through formal courses is probably not appropriate for most of these firms. In the first place, the proprietors are generally the only persons who make business decisions, and they would be very reluctant to leave their businesses unattended while they take time out to participate in a training course. Secondly, the educational level of many of the proprietors is such that they would have difficulty in assimilating theoretical and abstract ideas and applying them to their own individual circumstances.

Therefore, it would seem that technical assistance would best be provided through a series of plant consultations by generalist advisors familiar with the various aspects of small manufacturing operations. If specialized assistance is needed, the generalist would be able to suggest to the proprietor the most appropriate source of this assistance. He should also be able, though, to make a preliminary demonstration to the proprietor that the assistance is needed.

APPENDIX - QUESTIONNAIRE

I IDENTIFICATION

Nombre de Empresa
Artículos que Elabora
Nombre del Entrevistado y Cargo que Desempeña
¿Cuándo se Estableció la Empresa - En Qué Año?
¿Cuántos Años de Experiencia Tiene?

II CAPITAL

A. Capital Actual

			Origen (País)
1. Terreno y Edificios	S/.________	(Arrendado___)	
2. Maquinarias	S/.________		________
Edad de la maquinaria	Años________		________
3. Materia Prima	S/.________		________
4. Empleados y Trabajadores	Número: ________		________

B. ¿Cuáles Serían sus Requerimientos? ¿Cuánto?

1. Terreno y Edificios	S/.________	
2. Maquinaria	S/.________	________
3. Materia Prima	S/.________	________
4. Empleados y Trabajadores	Número:________	________

III SERVICIOS BASICOS

1. Energía - ¿Tiene trifásico?
2. Agua
3. Espacio

IV CREDITO

A. ¿Cómo Piensa Financiar el Aumento de su Capital?

1. Terreno y Edificios
2. Maquinaria
3. Capital Circulante

B. ¿Ha Utilizado Crédito en el Pasado?

1. Si ha utilizado crédito
   a. ¿Cuándo?
   b. ¿Para qué?
   c. ¿De dónde consiguió?
   d. Plazos y tasas de interés de los préstamos conseguidos
   e. Cantidades

2. Si no ha utilizado crédito
   ¿Por qué?

C. ¿Fueron Negadas sus Solicitudes de Crédito?

1. ¿Por qué?
2. ¿Cuál Institución?

V CONTABILIDAD

¿Lleva usted una contabilidad general y una contabilidad de costos?
¿Cuáles fueron sus utilidades en el último año?
¿Qué artículo (s) le produce más utilidad?

VI MERCADEO

¿Cuáles son sus clientes?
¿Qué competencia tiene?
¿Tiene oportunidad de aumentar sus ventas?

a. ¿Cómo?
b. ¿Dónde? En el Ecuador_____ En el exterior_____
c. ¿Con los mismos clientes?

¿Qué posibilidades hay de diversificar la producción?

OBSERVACIONES

TECHNICAL ASSISTANCE FOR CONSULTANTS AND SUB-BORROWERS

I. Introduction

Technical assistance for bank officials, consulting personnel (from CENDES and other consulting firms) and sub-borrowers is considered a key element of the entire small-enterprise loan program. This Annex provides details of the proposed training program for consulting personnel and then presents examples of how this training it to be used by the consultants to provide effective technical assistance to sub-borrowers. The proposed training for bank officials has been described adequately in the Loan Paper.

II. Training for Consultants

1. The Need for Training

Consulting personnel will begin to work with small enterprises during the loan application phase, either to help prepare an application or to review an existing application and revise it where necessary. In working with small industrial enterprises, consultants must realize that traditional methods of evaluating the ability of an entrepreneur to use credit effectively are not appropriate. Balance sheets and other financial statements may not exist, credit ratings may not exist, credit ratings may not be available, and the production and marketing processes are considerably different from those in medium-and large-scale enterprises. It is all too easy, then, to render a negative opinion on the credit-worthiness of a small business enterprise because of a lack of "data" on which to base an evaluation of the proposed investment.

In fact, the problem is not really one of an absence of "data" but rather one of ignorance regarding what data to look for. Special training will be necessary to provide the consultant (and the bank loan officer) with the tools necessary to evaluate the growth prospects and credit risk of this type of firm.

2. Type of Training To Be Provided

The special training to be provided personnel of CENDES and other consulting firms will follow an outline prepared by Mr. Alwyn Young, CENDES advisor in Guayaquil. Mr. Young has assisted in the preparation and execution of similar courses in Indonesia and Mexico, and the results of these courses have had a considerable positive impact on the growth of small industrial establishments. A detailed outline of the course to be given in Ecuador is presented below. Also presented are some of the major points contained in a Consultants Handbook which Mr. Young is presently revising and adapating to conditions in Ecuador.

The proposed course outline is based on a 10-week, full-time schedule. The ideal number of participants is 20-24. The course emphasizes the utilization of practical, problem-solving exercises; these activities will be 72% of the total number of programmed hours of instruction. Lectures, readings, and discussions will occupy an additional 23% of the participants' time, with the remaining 5% accounted for by films.

The case-study method utilized in the course differs from the classical method in that there is little interchange between the instructor and the participants during group-activity sessions, which should concentrate on interaction among the participants in the various groups. The instructor's role is to summarize the discussion after students have made their own insights and educated each other through the interchange of ideas. Since each case is a practical exercise in that the results must not only be sold to other groups but also tried out, there is a built-in pressure on participants to think through a problem carefully. Experience has shown that poor results by one group bring on sharp criticism by participants in another group. Ability to withstand such criticism and to profit by it is an important consideration in the selection of participants.

3. Course Details

Curriculum Summary

Opening and Closing Sessions	4 hrs.
Industrial Accounting (all exercises with brief explanation) (only -- no lectures) (programmed instruction methods)	30 - 35 hrs.

Financial Analysis		10 - 12 hrs.
(lectures and reading	5 hrs)	
(exercises	7 hrs)	
Consultants Handbook		23 - 25 hrs.
(group reading and discussion only)		
Ecuadorean Economics, Legislation, Procedures and Statistics.		36- 46 hrs.
(visiting lecturers and discussions)		
Decision Making		3 - 4 hrs.
(introduction through case study)		
Advanced Industrial Management Exercise		100 -125 hrs.
(economic war game based on Grupo) (Andino market area).		
Advanced Industrial Techniques		45 - 50 hrs.
(lectures	3 hrs)	
(practical exercises	47 hrs)	
Factory Productivity Techniques		125 -140 hrs.
(films	15 hrs)	
(lectures	12 hrs)	
(discussions	8 hrs)	
(practical exercises	105 hrs)	
Labor-Intensive Control Techniques		28 - 35 hrs.
(lectures	5 hrs)	
(films	4 hrs)	
(practical exercises	26 hrs)	

<u>Curriculum Details</u>

Key: TE = theoretical exercise
L = lecture
R = group reading (aloud and to each other)
D = discussion
PE = practical exercise based on an actual case history.

Subject	Type of Instruction	Duration
Course Opening	--	2 hrs
Industrial Accounting Exercises (30-35 hrs)		
Marketing budgets	TE	3 hrs
Manufacturing budgets	TE	2 hrs
Manufacturing budgets	TE	2 hrs
The Operating Statement	TE	3 hrs
Cash Flow budget	TE	2 hrs
Other Financial Books	TE	2 hrs
The Balance Sheet	TE	2 hrs
The Profit and Loss Statement	TE	1 hrs
Accounting System test - easy	TE	4 hrs
Accounting System test - complex	TE	5 hrs
Financial Analysis (10-12 hrs)		
Balance Sheet Analysis	L & R	3 hrs
Interfirm Comparisons	L & R	2 hrs
Case Study - Analysis of a manufacturing company's accounts for bank loan appraisal	PE	5 hrs
Using the Consultant's Handbook (23-28 hrs)		
Purpose and Objectives	L & R	1 hrs
Rapid Industrial Enterprise Surveys	L & R	1 hrs
Establishing the Limiting Factor	L & R	1 hrs
The General Information Checklist	L & R	1 hrs
Marketing Information	L & R	3 hrs
Financial Information	L & R	3 hrs
Production Information	L & R	3 hrs
Sectorial Key Limiting Factors	L & R	4 hrs
Report Writing and Graphs	L & R	2 hrs
Loan Appraisal Preparation	L & R	2 hrs
Technical Assistance Services	L & R	2 hrs
Small Scale Industry (4 hrs)		
Economic and Social Importance	L & R	2 hrs
Sector Characteristics	L & R	2 hrs
Ecuadorean Economics, Legislation, Procedure Statistics and Development. (Visiting Local Lecturers) (36-44 hrs)		
General Economic Policy	L & D	3 hrs
Industrial Company Law, Registration	L & D	3 hrs
Foreign Investment Law and Current Trends	L & D	3 hrs

Subject	Type of Instruction	Duration
Labor Legislation and Employment	L & D	3 hrs
Bank Organization	L & D	3 hrs
Credit Facilities	L & D	3 hrs
Import/Export Procedures	L & D	3 hrs
Customs Tariffs and Problems	L & D	3 hrs
National Planning, Development Programs	L & D	3 hrs
International Technical and Financial Aid	L & D	4 hrs
Decision Making		
In-Basket Exercise	PE	3 hrs
Advanced Industrial Management Exercise (100 - 120 hrs)		
Eight periods each representing three months in the life of a company at a critical stage of its existence involving expansion, negotiation with foreign interests and with local banks, financial planning, budgets, marketing and distribution problems, related to the Grupo Andino market area	PE	100 hrs
Evaluation of results by participants using basic industrial ratios and financial trend analysis	PE	20 hrs
Advanced Industrial Techniques (45-50 hrs)	PE	10 hrs
Production Scheduling Exercise	PE	
Operations Research - Economic Lot Sizes	PE	4 hrs
Operations Research - Stock Control	PE	4 hrs
Operations Research - Labor Loading	PE	3 hrs
Operations Research - Machine Interference	PE	4 hrs
PERT	PE	18 hrs
Factory Productivity Techniques (125-140 hrs)		
Introduction	L	1 hrs
Questioning Techniques	D	2 hrs
Operation Chart	PE	2 hrs
Flow Process Charts - Material Movement	PE	2 hrs
Flow Process Charts - Worker Movement	PE	2 hrs
Two-Handed Process Charts	PE	3 hrs
Minimizing Material Waste	PE	3 hrs
Jig and Fixture Design (assembly)	PE	15 hrs
Multi-Activity Charts - Fixture Design(drilling)	PE	10 hrs
Personal Qualities and Social Responsibilities of a Consultant	L	1 hrs

Subject	Type of Instruction	Duration
Social Effects of Industrialization	Films	4 hrs
Layout Using Templates - Wood Work Factory	PE	5 hrs
Layout Using String Diagrams - Metal Furniture	PE	12 hrs
Layout Using String Diagram - Underwear Factory	PE	12 hrs
Operator Training	L & PE	2 hrs
Making a Time Recording	L & PE	7 hrs
Rating	L & PE	6 hrs
Establishing Allowances	L & PE	4 hrs
Establishing an SMV on a Simple Operation	PE	7 hrs
Establishing an SMV for a Drilling Operation	PE	7 hrs
Master Set-Up for Incentives	L & D	2 hrs
Ergonomics	L & Films	2 hrs
Other Work Measurement Techniques	L & D	2 hrs
Statistical Work Measurement	L & Films	3 hrs
Statistical Work Measurement (Textile Weaving)	PE	4 hrs
Production Maintenance	L & Films	4 hrs
Labor Intensive Control Techniques (30 - 35 hrs)		
Bonus Curves	L	1 hrs
Group or Individual Incentives	L	1 hrs
Labor Cost Control	L	2 hrs
O & M Techniques	L & Films	4 hrs
Simplifying Paper Work	PE	4 hrs
Machine Output Control	L	1 hrs
Machine Docket (Textile Spinning)	PE	2 hrs
Machine Controls (Textile Spinning)	PE	2 hrs
Labor Control	L	1 hrs
Worker Dockets (Light Engineering)	PE	2 hrs
Daily Control (Light Engineering)	PE	3 hrs
Compiling Incentive Payments (Light Engineer.)	PE	3 hrs
Compiling Weekly Cost Control	PE	3 hrs
Factory Managers Weekly Meeting (Role Playing)	PE	4 hrs
Closing Session		2 hrs

III. Technical Assistance for Sub-Borrowers

Technical assistance to sub-borrowers will not be confined to traditional consulting and loan-supervision functions. The consultant will also have an important educational function to perform--that of developing the entrepreneurial capabilities of the small businessman.

In carrying out his consulting and educational functions, the consultant will be assisted by a Consultant's Handbook with which he will become thoroughly familiar during his training. The Consultant's Handbook now being revised by Mr. Young to take into account specified conditions in Ecuador will contain guidelines for approximately 200 tasks in three major management fields (marketing, finance, and production) arranged in logical sequence for systematic application to the average small-scale enterprise. Using the Handbook, the consultant will guide the small businessman in the preparation of a loan application to the PFI. Following loan approval, the consultant will continue his consulting and educational activities in order to maximize the benefits made possible by the credit made available to the client. These activities will continue throughout the life of the loan.

Examples of specific tasks are provided below. For each management area, the examples given are the first three tasks listed.

<u>:keting</u>

-Task 1 Question the client and record information on geographical distribution of customers. List all his customers and their addresses. Classify as retailers, wholesalers, distributors or consumers. Buy colored-top pins in six colors. Buy maps of towns, regions, etc. where he sells.

Put pins in the map at points where he sells--one pin for each outlet--using colored pins according to classification. It is likely that maps will show large areas where there are no outlets at all.

Where area coverage is weak, advise the client to put a salesman on a bicycle (do not use a motorized vehicle). The salesman should systematically cover the streets, not making calls but just noting possible shops, stores, etc. that could be outlets.

-Task 2 With the client, add a different color pin to the map for each new possible outlet that has been recorded. Have the client study and classify each possible outlet as to social status, credit worthiness, and function (distributor, wholesaler, retailer, consumer, etc.).

-Task 3 Go through the client's new outlet classifications and remove pins from maps where the outlet has been considered as not suitable. Suggest systematic sales coverage on those possible outlets considered as suitable. Pins are to be changed to the appropriate color daily as actual sales are made.

Note 1 The use of maps and pins is imperative to make client realize how weak his market coverage may be. It gives him a "bird's eye view" of his sales coverage.

Note 2 During 166 in Mexico, the writer was in contact with a small textile knitwear manufacturer employing fifty people. Using the map and pin technique it was possible to demonstrate the company's basic limiting growth factor--too few sales outlets. The firm had only 3 outlets in Mexico City and 50 more in other cities in Mexico. Using the bicycle technique 70 outlets were discovered in Mexico City alone within one month, and another 200 in other cities within two months.

Finance

It should be remembered that during loan appraisal preparation, certain preliminary work in this activity will have been undertaken. A balance sheet and profit and loss statement will have been compiled and some semblance of order placed in the accounts.

-Task 1 List all main accounts, ledgers and books used in the company. Check postings. If double entry is not being used, introduce it. Where accounts are muddled and proper segregation is lacking, talk the problem over with the client, if necessary buy extra ledgers, and start correct postings.

Ensure that a daily ledger is in force. Ensure that a consecutive numbering system is being used for bills received and accounts sent out. If these things are not being done, introduce them.

-Task 2 Follow up on correct consecutive numbering and daily ledger postings, and check the double entry system. Check ledgers to ensure that correct postings are being maintained.

Examine methods of recording issues and yields of materials. If not satisfactory introduce a simple system with minimum paper work, and train the client or control clerk in the use of the system.

How are worker and machine time recorded? Working or idle? If there is no system or if it is not satisfactory, design a simple docket for use where possible by the worker. Train the worker or control clerk in the steps required to record time (to the nearest fifteen minutes).

-Task 3 Follow up on items checked and installed during the second visit. Discuss any problems that have risen in detail with the client. Modify installed procedures where necessary and simplify paper-work where possible. DO NOT TRY FOR SUMMARY INFORMATION YET.

Examine methods of recording production by men and machines. If inadequate, design form and introduce a simple system for recording shift or daily output. Train the control clerk or workers to fill in forms.

NOTE 1: Simple duplicated forms are used for all recording at this stage and until the full system has been developed and refined.

Production

-Task 1 Draw a sketch of buildings, layout of plant, machinery and major equipment using a 1:100 scale.

List principal machines and major equipment showing age and approximate current market value.

-Task 2 List range of products by type, size, color or finish. Examine any sales records available to establish the most popular items. Discuss possibility of future sales for each product.

-Task 3 Continue construction of operation charts for all major products.

Note 1: Before any in-depth examination can be carried out on production processes to improve efficiency, a plant layout and operation charts are essential. They allow a "bird'seye view" to be taken of what is involved in the production process. From these basic tools, other tools are introduced that allow productivity improvement to be introduced with minimum cost and disturbance.

DRAFT LOAN AUTHORIZATION

Provided from: Alliance for Progress Loan Funds
ECUADOR: Small Enterprise Assistance

Pursuant to the authority vested in the Deputy U.S. Coordinator, Alliance for Progress, by the Foreign Assistance Act of 1961, as amended, and the delegation of authority issued thereunder, I hereby authorize the establishment of a loan ("Loan") pursuant to Part I, Chapter 2, Title VI, Alliance for Progress, to the Republic of Ecuador ("Borrower") of not to exceed five million one hundred thousand United States dollars ($5,100,000) to assist in financing the costs of Borrower's program of financial and technical assistance to small enterprises, the Loan to be subject to the following terms and conditions:

1. Interest and Terms of Repayment: Borrower shall repay the Loan to the Agency for International Dvelopment ("A.I.D.") in United States dollars within forty (40) years from the first disbursement under the Loan, including a grace period of not to exceed ten (10) years. The Borrower shall pay to A.I.D. in United States dollars on the disbursed balance of the Loan interest of two (2) percent per annum during the grace period and three (3) percent per annum thereafter.

2. Conditions Precedent to Disbursement:

   (a) Prior to the first disbursement, the Trust Fund shall submit to A.I.D. evidence that it is legally empowered to make loans under the terms and to the types of clients envisaged by the Program.

   (b) Prior to committing or disbursing funds the Trust Fund shall submit for A.I.D. written approval:

      (1) a detailed administrative and policy manual setting forth all pertinent lending policies, procedures and criteria to be applied in making the Trust Fund resources available to ICI's for relending; and

(2) evidence that it has available adequate staff and other personnel necessary to assure effective and efficient operation of the fund's activities, particularly those of a guarantee nature.

3. Other Terms and Conditions

(a) Except for marine insurance, goods and services financed under the Loan shall have their source and origin in the United States or any independent country of the Western Hemisphere south of the United States except Cuba. Marine insurance financed under the loan shall have its source and origin in the United States or any independent country of the Western Hemisphere south of the United States except Cuba, provided, however, that such insurance may be financed under the loan only if it is obtained on a competitive basis and any claims thereunder are payable in convertible currencies.

(b) United States dollars utilized under the Loan to finance local currency costs shall be made available pursuant to procedures satisfactory to A.I.D.

(c) The Loan shall be subject to such other terms and conditions as A.I.D. may deem advisable.

4. Covenants

(a) The Borrower through the Trust Fund shall prohibit the use of the A.I.D. loan for refinancing sub-borrower debts or for granting of personal loans.

(b) Three months prior to the end of the first and second year of operations, the Trust Fund shall prepare and discuss with A.I.D. and in consultation with the ICI's the experience and results of operations to date and reach agreement on any changes in policies, directions or other pertinent matters required to assure fulfillment of the goals of the project.

(c) The Trust Fund will maintain appropriate segregated accounts for the loanable funds, the Guarantee Fund and the Technical Assistance Fund and shall report to A.I.D. as specified in pertinent Implementation Letters.

(d) In all Trust Fund operations, financing will not be permitted in situations in which less than 20% of sub-loan funding is provided from PFI's own resources, nor in which less than 20% of risk of loss is borne on the PFI.

____
Deputy U.S. Coordinator

____
Date