

AIRGRAM

DEPARTMENT OF STATE

5540 5180098-3
5180098006

PD-AAA-763-A1 UNCLASSIFIED
CLASSIFICATION

For each address check one ACTION | INFO
X

DATE REC'D. 10 p.

TO - AID/W TOAID A-02

DISTRIBUTION

ACTION

LA

INFO.

1, 2, 3, 6, 8

PPC

FM

RS

ES

SER

FLD

C

CALL

CPS

CPP

CT

CMgt

OA

GC

GCLA

GCFLD

XMB-1

TRSY-2

STATE-5

FROM - USAID/Ecuador

SUBJECT - Final Evaluation, Loan 518-L-034
Small Enterprise Assistance

REFERENCE .

This report records the results of the final in-house evaluation of the Small Enterprise Assistance Loan. Since the Loan is fully disbursed, the report does not lead to any specific action recommendations but rather is offered for its general interest to future program planning.

1. Background

The Loan was authorized on 6-29-70 to provide credit resources and technical assistance to small business enterprises through a Trust Fund Mechanism in the Central Bank, which was established on 12-28-70. A 23-month delay occurred between the authorization date and date of loan signature (5-16-72) due to a number of factors, the most important being that the Trust Fund concept was practically copied from the Mexican model, without any kind of "adaptability" measures; and when it was put into practice it did not function for the simple reason that it was inadequate to the situation in Ecuador. CPs to Initial Disbursement were met on 12-4-72 (Implementation Letter No. 3), and the date of first disbursement (\$300,000 advance) was on 1-16-73. The enactment of Presidential Decree No. 374 of 4-5-73 (1) changed the Central Bank structure from Trust Fund to Financial Funds, (2) moved the technical unit from the Central Bank to the Ministry of Industries, (3) created internal lines of short-term credit, and (4) imposed portfolio distribution requirements on private banks. These changes were the result of having found out the impossibility of applying the Mexican model to the local realities.

As USAID-GOE mutually agreed disbursement targets to date had not been met, nor was a program mounted to utilize a \$250,000 loan component fo

PAGE 1 OF 10 PAGES

DRAFTED BY: <i>[Signature]</i>	OFFICE: O/DP	PHONE NO.	DATE: 3-12-79	APPROVED BY: <i>[Signature]</i>
O/DP: NVela/gfl				Joe J. Sconce, AAO

AID AND OTHER CLEARANCES

O/DP: PMaldonado <i>[Signature]</i>	O/CAP: MUIrsh <i>[Signature]</i>
-------------------------------------	----------------------------------

UNCLASSIFIED
CLASSIFICATION

\$550,000

Guayaquil pilot project, USAID deobligated ~~\$550,000~~ of the original \$5 million loan amount by Implementation Letter No. 4 dated 3-24-75. USAID-GOE negotiations (June-October, 1975) to further restructure the Loan resulted in (1) agreement upon a revised series of loan disbursement targets, (2) an Amendment to the Loan Agreement, (3) a revision of Annex No. 1 to the Agreement, Description of the Project, and (4) extension of the Loan's TDD to 6-30-77 (Implementation Letter No. 9 of 1-29-76). Finally, the Loan was fully disbursed in April, 1977.

2. Project Goals

The Project Goals, as stated in the CAP, were:

- (1) "To make an important contribution toward relieving the credit shortage that now exists for small manufacturing enterprises,"
- (2) "Development of a strong group of medium-scale entrepreneurs,"
and
- (3) "To provide long-term benefits by permanently strengthening the ability of financial institutions and technical assistance organizations to deal with the small industry sector."

The Project had a long-run effect on credit availabilities. IDB is currently providing nonreimbursable technical assistance to small enterprises in the amount of \$364,000, with GOE participation amounting to \$185,000. An IBRD credit for small agroindustry assistance in the amount of \$3.1 million is now being implemented.

The post-loan period replication of Loan benefits, including job creation and the production-enabling effect of expanded and modernized facilities (see No. 6 - Available Indicators), is expected to continue, contributing to a vigorous, growing middle-class of small industrial entrepreneurs, and the stabilizing influence that it implies.

The Project also had a long-run effect on the support of financial and TA institutions to this sector (see No. 5 - Evolution and Experience Regarding the Loan Disbursing Mechanism).

It is clear that the effects of the Loan have been in the direction desired; and from a survey of sub-borrowers receiving subloans, it is undeniable that the subloans have had a dramatic effect on the lives of participating small entrepreneurs (see Section 6 - Available Indicators).

3. Purposes and Achievements of Loan

A. Purposes

The purposes of the Loan Project, as stated in the CAP, were:

- (1) "Provide modest injections of capital to produce rapid results in stimulating new production and employment and increased use of local raw materials,"
- (2) "Participate (small entrepreneurs) more fully in the political and social life of Ecuador," and
- (3) "Combine technical assistance with appropriate credit facilities."

The purpose of the Loan, as stated in the revised Annex No. 1 to the Loan Agreement, Description of the Project, was:

"Assist in carrying out a project to consist of: Financing the cost of credit and technical assistance for small business enterprises, with assets (excluding land and buildings) valued at up to the equivalent in Sucres of \$200,000, requiring credits of up to the equivalent of \$100,000.

- a. Credit Resources. AID Loan. The amount of approximately \$4,200,000 shall be made available as medium and long-term credit, and up to 100 percent of eligible credits may be financed by the Loan.
- b. Technical Assistance Resources. AID Loan. Up to \$250,000 of the Loan shall be made available to finance costs of technical assistance, commodities, and services. Any portion of this amount not utilized for costs incurred as of 12-31-74, may thereafter be utilized as credit for eligible enterprises."

B. Achievements

The Loan was fully disbursed in April, 1977, before the revised TDD of June 30, 1977. The revised disbursement targets (Implementation Letter No. 9 dated 1-29-76), were successfully achieved.

1. Credit Resources

The Loan resulted in financing a total of 295 subloans to small enterprises, with total AID credit disbursements

of \$4,311,874.21. In 1976 an extensive survey was carried out of all subloans to that time. The discussion that follows uses data from the survey.

By 1976 the Loan had financed 263 subloans, with corresponding disbursements of \$3,833,110; 84 of these subloans were extended in Quito and Guayaquil (for \$2,161,852, or 56 percent of the total), while 179 were in other areas including rural zones and small cities, such as Portoviejo, Esmeraldas, Ibarra, Cayambe, Santo Domingo, Riobamba, Bahía, Chone, and Ambato. Distributed by geographic zones, 117 subloans were extended in the Sierra (\$1,563,779) and 146 in the Coast (\$2,269,331). Approximately \$12,739 was disbursed for short-term purposes (raw materials) for one subloan in Portoviejo; around \$1,419,110 was disbursed for infrastructure/construction; and \$2,401,260 was disbursed for equipment/machinery financing. The private banks' participation (four institutions) amounted to \$1,312,596, or 34 percent of the total credit disbursed by 1976. AID disbursements through the National Development Bank - BNF (with 22 participating branch offices) amounted to \$2,520,514, or 66 percent of credit disbursements. Small manufacturing industries benefitting from loan-financed credits included makers or processors of metal, plastic products, small appliances, furniture, clothing, and wood products.

2. Technical Assistance Resources

A total of \$136,835.93 was used to finance costs of technical assistance, commodities, and services incurred from the effective date of the Loan Agreement to December 31, 1974, by the Program Office of the Ministry of Industries, Commerce, and Integration. Related bank charges for L/Comm procurement under the Loan amounted to \$1,289.86. (The total AID loan amount was \$4,450,000).

4. Compliance with Covenants of the Loan Agreement

All covenants and warranties have been met to date under the Loan, except for Section 4.10, Reports (see No. 9 - Loan Reporting Requirements). The covenants and warranties are listed as follows:

A. General Covenants and Warranties

1. Section 4.01 - Execution of the Project
2. Section 4.02 - Funds and other Resources to be Provided by Borrower

3. Section 4.03 - Continuing Consultation
4. Section 4.04 - Management
5. Section 4.05 - Taxation
6. Section 4.06 - Utilization of Goods and Services
7. Section 4.07 - Disclosure of Material Facts and Circumstances
8. Section 4.08 - Commissions, Fees, and Other Payments
9. Section 4.09 - Maintenance and Audit of Records
10. Section 4.10 - Reports (see No. 9 - Loan Reporting Requirements, below).
11. Section 4.11 - Inspections

B. Special Covenants and Warranties

1. Section 5.01 - Lending Operations
2. Section 5.02 - Disbursement for Guaranteed Subloans

C. Procurement

1. Section 6.01 - Procurement from other countries.
Procurement from Code 941 Countries of the AID Geographic Code Book, as well as in the U.S.
2. Section 6.02 - Procurement from Ecuador
3. Section 6.03 - Eligibility Date
4. Section 6.04 - Goods and Services Not Financed under the Loan
5. Section 6.05 - Implementation of Procurement Requirements
6. Section 6.06 - Contracts
7. Section 6.07 - Reasonable Price
8. Section 6.08 - Shipping and Insurance
 - (a) Imported goods financed under the Loan shall be transported on flag carriers of any country included in Code 935 of the AID Geographic Code Book.
 - (b) 50-50 shipping requirements
 - (c) Marine insurance requirements
 - (d) Insurance for imported goods
 - (e) AID's financing for ocean freight limited to 90 percent of the ocean freight costs; except that with respect to free-out shipments, AID's financing is limited to 98 percent.
9. Section 6.09 - Notification to Potential Suppliers
10. Section 6.10 - U.S. Government-owned Excess Property
11. Section 6.11 - Information and Marking

5. Evolution and Experience Regarding the Loan Disbursing Mechanism

Taken together with a 1970 World Bank cattle loan and AID Loans L-032 and L-033, the Small Enterprise Assistance Loan was instrumental in establishing the Central Bank facility (the Financial Funds mechanism that altered and adapted the prior Trust Fund mechanism) for the re-discount financing of developmental credits extended by the public and private banking systems. This new facility has successfully mobilized and channeled GOE resources--mostly in the form of short-term lines of credit--to a variety of productive uses in the agricultural, industrial, fishing, and tourism sectors. L-034 thus helped institutionalize an approach to a pressing GOE need, namely the need to open new channels for the movement of Ecuador's resources to developing sectors. The GOE continues to self-improve the effectiveness of its financing facility on the basis of experience with it. The major accomplishment of L-034 has therefore been of an institutional output nature, which is now accomplished.

6. Available Indicators

By the nature of the end-of-project-status targets, it is only possible to observe indicators of the strength of the small industry sector. One such indicator is its expansion throughout 22 cities in Ecuador. There have also been enough subloans (outputs) to warrant attempts at measuring other purpose level benefits such as the extent of expansion or modernization among credit recipients, in terms of percentage increments in production. In 1976 USAID inspected 162 small enterprises from a total of 263 receiving loan-financed credits through that date, or about 60 percent of the AID Loan portfolio in that year. The following are the results of the survey. AID financing in the amount of \$1,074,127 created 66 new small enterprises. The total value of production by these enterprises was \$1,220,940 in 1976. The \$1,158,867 injections of AID credit into 93 existing small enterprises had a payoff of \$3,938,344 as total value of production by those enterprises in 1976. The AID financing increased annual production by \$1,234,262, or 31 percent of the estimated total value of production by expanded industries in that year. It is estimated that 535 new jobs were directly created in the 162 small enterprises reviewed by USAID, both new and existing enterprises (at an average credit investment of \$4,211). Therefore, it may be pointed out that L-034 has effectively contributed as a pioneering effort in the development of small enterprise assistance in Ecuador. According to the National Federation of Small Industries (FENAPI), about 42,000 jobs have been directly created during the last five years (1973/1978) in small industry in Ecuador; investment in assets has amounted to about 200 million dollars in 6,000 enterprises. The above estimates of percentage increments in production and job-creation due to the AID loan are available indicators of benefit incidence at the project purpose level.

Other data from the survey showed that the average percentage of installed capacity being used (equipment/machinery financed under the Loan) was 61 percent. Annual exports of manufactured products from three small enterprises amounted to \$148,000, and the import substitution contribution amounted to \$123,360 for products such as aluminum utensils and stoves. The average increase in utilization of local raw materials was 72 percent.

7. Outputs

Two classes of outputs were considered in the project design. One class was credit and technical assistance to small entrepreneurs. During Loan implementation, \$4,311,874.21 of the Loan was used for medium and long-term credit for eligible enterprises. In addition, Loan funds of \$136,835.93 were used to finance costs of technical assistance, commodities, and services incurred by the Program Office of the Ministry of Industries. \$1,289.86 were for banking charges. In all the total amount of Loan funds attributable to Project activities was \$4,450,000.

The second class of outputs was the establishment of a mechanism through which AID-financed funds could be channeled to small entrepreneurs. This was affectively accomplished (see Sec. 5 - Evolution and Experience Regarding the Loan Disbursing Mechanism).

8. Inputs

On the input level, the AID Loan was fully disbursed (except for the \$550,000 deobligated in 1975) prior to the revised TDD of 6-30-77. The GOE's participation in the Project amounted to the equivalent in Sucres of about \$21 million, which included resources to assist in financing the cost of credit. These resources were made available through the establishment of lines of credit from the Financial Funds Mechanism of the Central Bank; they also included the GOE and participating banks' financing of all short-term credits needed by the eligible enterprises but not financed by the AID Loan. In addition, the GOE's participation in the Project amounted to \$480,000 in resources to finance all operating costs of the Program Office of the Ministry of Industries, Commerce, and Integration, beginning on 1-1-75, and also, all costs incurred by the Central Bank in administering the Loan.

The disbursement of funds from both AID and the GOE initially took longer than was expected for several reasons:

- a. Ineffective System of Dual Credit Approvals by both the Ministry and Participating Banks. The proposal for eliminating this bottleneck was to restructure the process by which credit proposals were reviewed, approved, and subsequently monitored. An agreement signed

on 1-29-76 changed the nature of services performed by the Ministry unit, assigning sole credit decision authority to the participating banks, which retained all credit risks. The Ministry was to maintain responsibilities for the monitoring of loan-financed investments and general follow-up TA. This meant that participating banks went directly to the Central Bank with eligible credits for discount to the AID Loan.

- b. Complex Procedure of Partial Discounts. Prior to 1-29-76, the Loan financed not more than 80 percent of eligible subloans on a credit-by-credit basis. This was changed on that date to AID's Loan-funding 100 percent of eligible medium and long-term credits. Participating banks were to finance all short-term credit requirements of the target group. In addition, banks were to cover any difference between the CIF and sales prices of imported equipment/machinery. This meant that, on a global basis, the banks were financing substantially more than 20 percent of target group needs.
- c. Unduly Low Limit on Subloan Size. The previously settled-upon maximum size of eligible credit was \$80,000 (or Sucre equivalent). This was changed by agreement on 1-29-76 to a limit of \$100,000 or Sucre equivalent.
- d. Regulatory Restriction. This bottleneck was a restrictive regulation of the GOE Monetary Board. The Central Bank was unable to discount credits extended at other than 9 percent interest unless special exceptions were legislated. One effect of this restriction was to exclude 8 percent BNF "créditos de capacitación" from financing by L-034. (BNF "créditos de capacitación" were directed toward the marginal segment of Ecuador's small industry sector.) Once this was changed by agreement dated 1-29-76, the Loan was able to benefit small entrepreneurs most needing it.

9. Loan Reporting Requirements

The following reports were required under the Loan:

- a. Quarterly Financial (including Shipping)
- b. Annual Financial

The requirements have not been met to date. USAID received quarterly reports only through June 30, 1974, and has requested the Central Bank to provide the additional reports required. On March 8, 1977 a letter was transmitted to the Central Bank, referring to previous discussions on the requirements of Section 4.10 of the Loan Agreement.

10. Loan Monitoring Responsibilities

USAID's Office of Development Planning was responsible for the overall Loan and its coordination.

As part of the effort to accelerate the utilization of the Loan, the Mission in January, 1976 organized a task force to work with appropriate GOE personnel for the purpose of rapidly identifying bottlenecks to the implementation of this Loan and of Loan 033. This joint team assisted the BNF and private banks in pre-qualifying (not approving) credits and in identifying missing documentation required for the discount of eligible credits to the AID Loan at the Central Bank. This assistance resulted in increased requests for Loan reimbursement. Our assessment is that performance under the Loan thus improved dramatically and increased the flow of subloans to small enterprises.

Since the Loan is now fully disbursed and all project elements are completed, no further field monitoring of this Loan program is deemed necessary. The responsibilities of residual financial monitoring will be AID/W's once AID/W provides a loan amortization schedule to the Borrower.

11. Lessons from Experience

- a. The AID disbursement procedures developed under the Loan reimbursed public and private banks through the Central Bank Financial Funds mechanism for the rediscount financing of development credits. L-034 financed the CIF value of off-the-shelf purchases of imported commodities. This procedure replaced the Letter of Commitment procedure and sped up the successful utilization of the Loan. This is a procedure recommended for future ICI-type projects.
- b. As indicated above (Section 5 - Evolution and Experience Regarding the Loan Disbursing Mechanism), L-034 was instrumental in establishing the Central Bank Financial Funds mechanism for rediscount financing of credits. This financing facility continues to be improved on the basis of experience with it. Assistance to Ecuador may be effectively channeled through this facility to a variety of productive uses in future attempts to reach low income target groups. A lesson for other countries is that the Central Bank can be an effective vehicle for successfully channeling resources to developing sectors. However, it should always be kept in mind that any other country might avoid Ecuador's original mistake of directly adopting another country's trust fund model instead of adapting it to the local realities. In brief, when looking to other countries for experiences in a given development issue, the key is "adaption" rather than "adoption."

- c. The L-034 task was greatly facilitated by the early October, 1975 appointment of a General Manager at the BNF who had had close working knowledge of AID Loan Projects L-032, L-033, and L-034. The improved progress led in turn to a stronger BNF. This pointed out that the human factor, and its training and experience, remain the key element to project success.
- d. With the four measures described in paragraphs a) through d) of Section 8 approved and implemented, performance under L-034 improved and increased the flow of subloan to small enterprises. The lesson from this is that less bureaucratic arrangements make for more efficient implementation, which should be taken into account in future planning of projects of this type.

12. SUMMARY

In summary, the subloans extended by the public and private banking system under the AID Loan were of good quality and have improved the productive capacity of the sub-borrowers. Thus essentially the project purpose was achieved.

PROJECT NUMBER: 5180098		GONZALEZ	
PROCESS	ACTION	DATE	INITIALS
CATALOGUE	✓		JS
ABSTRACT	✓	6/6/79	OBG
FICHE	✓		
COMMENTS: read 5/31/79			

UNCLASSIFIED

048 8008