- PD-ABK-423

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# INVESTMENT OPPORTUNITY PROPOSAL

FINANCIERA IBERO-AMERICANA S.A. -- FINIBER

and

FINANCIERA DE GUAYAQUIL S.A. -- FINANQUIL

ECUADOR

US$3,000,000 (US$1,500,000 Each)
Loan/Guarantee Facility

Office of Investment
Bureau for Private Enterprise

July 11, 1986

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CHAPTER I

# PROJECT DESCRIPTION

## A. Summary

Early in 1984, PRE was asked to visit Ecuador and to assist the Mission in redesigning the Agroindustrial and Non-traditional Export Project so that the funding would be channeled through the private financial institutions rather than through the National Financial Corporation (CFN), the Government-owned finance company. In consulting with the private financial sector, it became obvious that the system was in dire need of external trade credit lines, inasmuch as all the existing traditional correspondent banking relationships were frozen pending the renegotiation of the foreign debt.

Furthermore, it was easily determined that the local financial markets were almost paralyzed by interest rate ceilings that effectively precluded placements in an environment of the rate of inflation exceeding substantially those ceilings. It was consequently decided that, apart from assisting the Mission in restructuring its own agro-industrial program, PRE would offer from its own Revolving Fund a guarantee facility to one financiera from Quito and Guayaquil each, thus covering both distinct markets of Ecuador, to be used initially for confirmations of Letter of Credit for imports, and eventually to guarantee Financial Certificates and, preferably, medium-term development bonds to be issued by the two institutions in the Quito and Guayaquil capital markets after the needed legislation has been passed to correct the existing distortions in the financial marketplace.

The PRE intervention proposed in July 1984 and implemented in the course of FY 1985 has had significant ongoing policy dialogue implications. Two actions stand out: the channeling of the USAID Mission's agro-industrial lending program, designed to encourage non-traditional exports, through the Ecuadorean private financial institutions rather than the state-owned National Finance Corporation (CFN); and Resolution 214 of the Monetary Board of December 1984, almost totally freeing up the interest rate ceiling to conform to market conditions. On the fiscal side, a step in the right direction was taken by taxing interest on financial instruments at a flat rate of 8%. Considerable work remains to be done, particularly in the field of capital markets and privatization, as well as on removing the remaining advantages of government financial instruments over those of the private financial institutions.

The design of the original PRE intervention was predicated upon two basic assumptions: that small and medium agro-industrial businesses located in rural areas of Ecuador, with less than US$300,000 equivalent in fixed assets, excluding land and buildings, neither (1) have had access to foreign exchange with which to finance needed production inputs on a short-term basis; nor (2) were they going to have access over the foreseeable future to medium- and long-term credit denominated in local currency to finance startup or expansion activities.

The above assumptions are still substantially valid, although progress has been made on both counts, particularly on accessibility to trade credits. First, Ecuador has only recently began to recapture its creditworthiness with the international banking community, following the agreement with IMF and the subsequent successful renegotiation and rescheduling of the Paris Club debt with respect to the past due 1984 and the 1985-87 prinicipal repayments. Thus, access to hard currency credit has been gradually restored to the local financial institutions, albeit confined almost exclusively to the slow resumption of the trade-related lines of credit within their correspondent banking network. The small- and medium-sized agro-industrial businesses targeted by the original PRE facility are not partaking of this slow restoration of external trade credit in relation to their potential demand. As a result, what scarce foreign exchange is available continues to be rationed through (a) the official markets to meet mostly public sector priorities, including the servicing of the interest on its external debt following the "sucretization" of the same; and/or (b) through the parallel market to service the priorities of the larger, more creditworthy private sector firms. Second, the maintenance of the unrealistic domestic interest rates -- both for savers and borrowers -- has been substantially corrected, although what domestic credit is available will continue to be rationed to the most creditworthy borrowers to the virtual exclusion of small businesses.

The unfortunate aspect of the above assessment is that small businesses frequently are more efficient employers per unit of capitalization than larger firms; and when located in rural areas, provide virtually the only check to the unfortunate pattern, evident in Ecuador as well as elsewhere in the developing world, of migration from rural to commercial centers by people in search of jobs.

USAID has continued the policy dialogue with the new administration of President Febres Cordero on liberalization of interest rates on special financial certificates and other instruments issued by the private financial institutions in general, and finance companies (financieras) in particular.

This was substantially accomplished, as indicated previously, with respect to interest rates and taxation. In practical terms, however, finance companies have lagged substantially behind the commercial banks in placement of special certificates in the market: as shown in Attachment D, as at April 30, 1986, the finance companies have placed a total of 650 million Sucres ($4 million equivalent) vis-a-vis a total of 41 billion Sucres ($250 million equivalent) placed by the commercial banks. Clearly, the investors opt for commercial banks' paper because of the larger institutional and asset backing for the paper, apart from fundamental perceptions of liquidity favoring the banks over financieras due to the very nature of their respective asset and liability sides: commercial credit vis-a-vis project finance, demand deposits and current accounts versus neither.

Both the banks' and the financieras' special certificates, issued under Resolution 214, are thus far the only two instruments that the Monetary Board and the Superintendency of Banks have allowed to be placed at market rates without prior approval. The return on other, "ordinary" certificates and bonds allowed under the basic legislation governing financial institutions, continue to be subject to previous approval by the Monetary Board, although the intent of the revised law is that interest rates on deposits should follow market conditions, while the lending margin is fixed at 400 basis points. As a consequence, financieras have been unable to place "ordinary" certificates as freely as they may issue "special" certificates on discount basis, while, like in the case of bonds described below, "ordinary" certificates would have to be issued at the currently "maximum" rate of 23% regardless of the term.

Despite the increase in the nominal interest from 16% to 23%, due to the fixed rate interest coupon and uncertainties about determining the appropriate discount in terms of perceived yields sought by the investors, financieras have been unable to place significant amounts of fixed-rate Guaranteed Bonds in the 5 to 10-year range. Apart from the term and fixed rate features, an additional handicap facing private financieras in the placement of fixed rate bonds is that the only substantial takers are the Social Security Fund and private pension funds while, for example, the insurance companies are expressly prohibited from investing in private sector financial instruments, a market reserved for Government paper. This market must be opened to private debt instruments, particularly developments bonds of this type, and strong recommendation to that effect is included in a series of findings that the Mission is about to submit to the Government.

As a matter of fact, one of the rationales for the original PRE facility was that the new Administrtion of President Febres Cordero was to prepare a bill, for consideration by the opposition controlled Congress, to approve (1) the issuance by the private financial institutions of tax exempt bonds, an activity reserved then and now for the public sectors issuers gathering local currency resources for longer term; and (2) a program to provide the necessary economic incentives for private financial institutions to lend to small and medium-size businesses, as defined previously, at rates that are at least 500 basis points above decreed interest rate ceilings in effect throughout the life of the program.

Upon approval of these measures by the Congress, PRE was to convert its Escrow Guarantee Account into a capital market guarantee and market support facility by providing bond holders with either a 50% guarantee on all paper outstanding during the life of the program, or guaranteeing specific separate issues to be placed alongside matching issues of direct short- or medium-term instruments by the institution in question.

B. The Project

Following the recent visit by PRE staff to Ecuador, the two financial institutions involved -- FINIBER of Quito and FINANQUIL of Guayaquil -- agreed to apply to the Superintendency of Banks and the Monetary Board for authorization to issue specific series of so-called Guaranteed Bonds for a term of five years, and at an interest rate to be originally fixed and readjusted periodically in accordance with a special ruling by the Monetary Board. FINIBER has furthermore agreed to do the same with respect to the issuance of Special Financial Certificates outside the current legal limit equal to the institution's capital and reserves.

1. PRE would lend each institutin $1.5 million, which would be used as in the original facilities, for the purchase of US Treasury securities in the secondary market that would be, in turn, deposited in an Escrow Account administered by a US bank and serving as guarantee for local currency issues of Bonds and/or Financial Certificates through a stand-by letter of credit opened for that purpose by the US bank and confirmed by a local Ecuadorean banking institution.

2. The new loan agreement would also provide that the existing L/C confirmation line be left intact and operative for the duration, i.e., the original two-year cutoff date would be waived. In addition, the usage of the confirmation line would be modified to include pre-export finance utilization for the period between the placing of the export order by the foreign importer, which is usually accompanied with a down-payment remitted to Ecuador, and shipment; the difference between the down-payment and the total

value of the export is currently covered in cash or equivalent by FINIBER or FINANQUIL, inasmuch as the importer's bank will not take the country risk, and will pay against shipping documents only. This practice obviously immobilizes important resources of the financieras, so that the extension of the escrowed Guarantee Fund for use in pre-export finance would free up these resources for use internally in support of the small-and medium-sized agri-business clientele that the PRE Guarantee Fund seeks to serve. The financieras would undertake to provide periodic accounting both to PRE and the Mission of the end use of these resources that would have otherwise remained tied up in guarantee of pre-export finance. See Attachment E for breakdown of FINIBER'S utilization of the L/C confirmation facility. FINANQUIL's will be available for the IP although they have started to use it several months after FINIBER.

3. During the preparation of the IP, conversations will be held in Ecuador with the appropriate parties to determine the desirability and real stic possibilities of earmarking a part of the Guarantee Facility to back a market support activity in the secondary trading, or perhaps add a special facility for that purpose. For example, and in order to provide orderly market support for secondary trading in these issues, twenty percent of the Escrow Account would be specifically segregated to guarantee a special overdraft facility in local currency equivalent at the same Ecuadoren banking institution, that would be placed at the disposal of the Quito and Guayaquil Stock Exchanges to settle

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any negative balances in the "buy" and "sell" operations in these issues in the course of the regulatory "settlement period". Local bank charges for the use of the overdraft facility would be for the account of the Stock Exchange members "making market" in these issues, with the Stock Exchange itself possibly rebating to the members its own fees on such "negative" trading balances.

However, it is anticipated that this will probably be left out of this particular operation, while the principle will continue to be considered in larger, Mission-funded, or even multi-donor supported projects in the general area of capital markets developments.

CHAPTER II

RELATIONSHIP AS THE PROPOSED PRE FACILITY
TO DEVELOPMENT NEEDS, USAID STRATEGY,
AND PROGRAMMING EMPHASIS

A. Development Needs

1. The major development needs of Ecuador over the CDSS (1984-86) period have been output increases in agriculture (food, exports, raw materials) and industry (at all scale levels), increased exports in all major categories (petroleum, agricultural commodities, and manufactures), and a more equitable distribution of development benefits. Meeting these needs requires structural adjustments and presupposes the success of the GOE stabilization initiated in 1983. As discussed in Chapter III, these objectives have been substantially accomplished, although the oil price slump has subsequently created important disequilibria in the basic conditions that will probably delay the hoped for results.

The import substitution strategy combined with the short-lived oil boom of the mid-1970s left Ecuador with an economy in which public sector interventions in private markets are many, and where competitiveness and productivity are low. Structural adjustment to enable improved distribution will require a reduction in market interventions which create a capital bias (thus reducing employment) and institutional improvements to increase the efficiency and effectiveness of the GOE's revenue and basic service capacities. The major constraints to meeting these development needs (output, exports, distribution) over the CDSS period have been:

Policy. The principal policy constraints are those related to exchange rates and prices; trade (quantitative restrictions, tariffs and foreign exchange allocations); subsidies (e.g., fuel prices were at less than 50% of international prices); negative real interest rates; and legal and administrative requirements for productive, particularly export oriented, firms.

Institutional. Ecuadorean organization -- both public and private -- lack the capacity to conceive and implement the policies and programs which support socioeconomic development goals; to coordinate development activities; and to mobilize effectively domestic resources. Human resource deficiencies at management and technical levels are a principal cause of weak organizations. Finally, deeply rooted socioeconomic structures and attitudes limit the opportunities for women and minorities to participate in and share the benefits of development.

Technology. In manufacturing, undervalued capital and import replacement marketing strategies have led to excessive capital utilization and high import intensities in production units not in line with relative actor proportions. Conversely, in agriculture and related fields technology levels are generally low. The technology within the most dynamic private sector area (shrimp) has been based on extending production over wide areas and is incompatible in the long run with public and private sectors to access and develop technology, including technologies related to improved management.

Many of the major policy constraints are the subject of discussion between the GOE and the major donors, and since 1983 many key policies began to be addressed, for instance under the IMF Agreement and its annual renewal negotiations. However, the medium-term expectation is that the economy will continue to operate with markets restricted by significant public policy interventions. Sectoral level constraints -- policy, institutional, and technology -- remain largely unaddressed, and present the major obstacles and the major opportunities for USAID efforts for achieving structural adjustment over the CDSS period.

B. USAID Strategy

Overall Objectives. USAID's program strategy in Ecuador over the CDSS period will support the process of structural adjustment. While stressing production and productivity gains through increased and better focused private sector activities, USAID's strategy will include efforts to improve the distribution of opportunities and social sector activities to maximize the development impact of economic growth. Given the relative size of the Mission's program, compared to other donors and as compared to the scope of Ecuador's development constraints, USAID's efforts will be targeted on key sectors in which the Mission has a clear comparative advantage. Within these sectors, activities will be focused on resolving selected policy, institutional, and technological constraints and promoting private sector participation.

The basic development goals of A.I.D. in the LAC region are to achieve per capita growth rates of 2.5%, to increase employment and productivity, and to raise the levels of basic social indicators for men and women. USAID's program emphasis on increasing the output and competitiveness of the economy's productive sectors while simultaneously increasing the efficiency and effectiveness of the basic social services will contribute directly to meeting the LAC regional goals. Key indicators of satisfactory progress in Ecuador (and the comparative LAC regional goals) would be: (1) productivity increases of at least 2.5% per year (identical); (2) an annual increase in agricultural sector output of 5% (regional target is 3.3%); (3) a growth of urban employment of 3.5% per year (identical); (4) a reduction in population growth to 2.4% (regional target is 1.9%, Ecuador's current rate is 2.9%); and (5) a reduction in mortality for infants and children by 15% (identical).

USAID's strategy will:

-- Stimulate the private productive sector and assist it to expand and diversify into more competitive activities, thereby strengthening Ecuador's base for long-term growth.

-- Improve the efficiency and cost effectiveness of development programs directed at the poor, and simultaneously increase the mobilization of domestic resources.

-- Help mitigate the damage to the productive base and to social infrastructure caused by the 1983 flooding.

C. Program Composition and Emphasis

To best address the continuing needs for structural adjustment during the CDSS period, USAID's program will emphasize programs in the productive sectors. Major attention will be directed at agriculture, including natural resource utilization, and selected private sector initiatives. Energy will also be included because of its underlying importance to the required structural adjustments; but only a small portion of USAID program resources will be allocated to energy.

Agriculture is of primordial importance because of its large employment function and the potential for growth in production of food, agro-industry inputs, and export commodities. Activities are planned early in the CDSS period to address the GOE's and the private sector's policy analysis and formulation constraints. Activities to stimulate private sector investment in agro-industries are also planned for implementation during the first half of the CDSS period. At the same time, USAID will improve and strengthen private sector agricultural service delivery structures, initially through pilot efforts. These activities are expected to help generate follow-on efforts of larger scale impact during the second half of the CDSS period. Also during the last half of the CDSS time frame, USAID expects to be involved in strengthening the agricultural education system in order to address underlying human resource constraints.

Utilization of Ecuador's productive natural resources, e.g., forestry and shrimp, represents important potential for employment and foreign exchange. Without improved management capability, Ecuador risks losing the full advantage of these resources. USAID's existing Forestry Sector Development project will help address some of these issues; successful project implementation during the first half of the CDSS period will likely lead to a major follow-on effort to promote private sector forestation and wood products manufacture in the last part of the decade. Beginning in FY 84, USAID will jointly fund an S&T-applied research effort on coastal management resources. The project's major focus will be Ecuador's burgeoning private sector shrimp industry. These initial efforts could lead to a subsequent bilateral project designed to improve the technology and management of this resource, an important earner of foreign exchange.

The three productive sectors chosen for A.I.D. private enterprise interventions are agro-industry, nontraditional exports, and small-scale enterprise. Agro-industry accounts for many of those nontraditional exports for which Ecuador exhibits a comparative advantage, are of special interest because of the potential for domestic value added and for structural linkages with other sectors of the economy. Small-scale enterprise interventions offer the possible additional benefit of widening the distributive base of the market economy while, at the same time, achieving goals of employment (the cost of creating a job in small-scale industry) and capital formation, especially among women heads of households. In addition, USAID will support human resource development activities to address management, skills, and behavioral constraints which cut across all three productive areas. Human resources for the private sector have been identified in Ecuador as a limiting factor to increases in output and productivity and success in this area would increase the potential for long-term impact.

CHAPTER III

# THE ECONOMY

## A. Background

The downturn than began in the first half of 1982, was initially arrested in mid-1983 when a stand-by agreement was reached with IMF, and the sucretization program completed that provided fo: a new basis from which to deal with both the foreign debt service and the recapitalization of the productive sectors in the economy without increases in inflation. Central in this scenario was the inability of private financial institutions to mobilize credit, while the public sector institutions appeared to have decided advantage through (1) their ability to issue tax-exempt securities and (2) tap the Central Bank's rediscount windows channeling external multilateral funds, including AID.

With the election of the new administration of President Febres Cordero, and despite the initial opposition control of the legislature, further progress was made in correcting the imbalance in favor of the public sector in the financial markets during 1984, culminating in Resolution 214 of the Monetary Board freeing up substantially the interplay of interest rates, although total tax exemption for private sector instruments was not achieved completely.

The economic adjustment program launched by the new Government at the beginning of 1985 succeeded in slowing down internal demand while, on the other hand, stimulating exports and reducing imports. The rate of increase in the GNP was slowed down as well, reducing inflation to almost tolerable levels, while reduced consumption actually allowed capital formation to keep up the upward trend started in 1984.

On the finance side, the combination of the elimination of the preferential exchange rate and the renegotiation of the external debt resulted in a significant reduction of the current account deficit in the balance of payments. Despite increases both in oil-related fiscal income and disbursements of long term credits, public sector accounts could not come any closer to balance as they did in 1983-1984. On the other hand, the rate of inflation was significantly reduced as a result of austere monetary policies, despite the liberalization of agricultural prices and elimination of subsidies. Also, after four years of sustained erosion in minimum wage, the trend was reversed and an actual increase in real terms was registered, albeit at the expense of slight increase in unemployment.

While oil production received top priority in resource utilization, there was disappointing reduction in total agricultural output despite considerable increase in the total output of exportable crops such as bananas, coffee and cocoa; this was partially brought about by the drought in the high country. Shortage of larvae also affected negatively production of shrimp. On the positive side, manufacturing activity reversed the downward trend of the two previous years, which also occurred in the construction sector. However, the over-all public sector deficit is believed to have increased substantially from below 0.5 percent in 1983 and 1984 to perhaps 2.2 perent in 1985, despite substantial increases in fiscal income from both the oil derivatives and other more traditional sectors; it is still far from 6.5 and 7.2 percent deficits in 1982 and 1981, but the trend must be broken again.

In financial markets, interest on deposts in excess of one million Sucres was freed up, which was immediately reflected in substantial placements of commercial banking certificates which reached a full estimated 25% of the money supply, before they tapered off towards the end of the year due to bank-induced lowering in rates offered. This combined increase in private savings and public sector balances with the Central Bank helped in maintaining anti-inflationary credit policies.

On the external accounts side, the substantial decrease in the current account deficit was accompanied by a likewise impressive surplus in the trade account, the highest in ten years. On the other hand, the moderate current account deficit was easily financed with the reduced capital account surplus and new IMF advances, so that the end result was an actual increase in international reserves of $107 million.

## B. Current Outlook

The authorities continued to pursue free market economy policies in the implementation of the IMF-approved one-year program launched on March 11, 1985. The financial program was designed to consolidate the accomplishments of the 1983-1984 measures, with the main targets being to bring the balance of payments into equilibrium, achieve a surplus in the non-financial public sector budget, and reduce inflation to 20 percent. The foreign exchange market was to be consolidated into one free market following the unification of the three-tiered system at the beginning of 1985. Foreign investment received encouragement through the revision of the Decision 24 of the Andean Pact that henceforth allows full or majority foreign ownership of any business that exports more than 80% of its production, including removal of any restrictions on profit repatriation.

Agreements were concluded with six foreign companies for new petroleum exploration, calling for investments ranging from $50 to $60 million over five years. A new mining law was passed in August that provides for further stimuli in the mining and hydrocarbon sector.

An agreement was reached with the Paris Club countries, restructuring the entire official sector foreign debt guaranteed by the Ecuadorean Government falling due between 1985 and 1987, including the past due principal payments through the end of 1984, on condition that the IMF accords are observed by Ecuador until December 31, 1987. At the same time, the previously concluded agreement with foreign private banks on the refinancing of $4.6 billion owed them was ratified, representing a full 60% of the total foreign debt.

The sudden steep fall in the price of oil close to the end of 1985 resulted in growing pressure upon the free dollar exchange reate on the parallel market, eventually reflected in an official devaluation of 14%, raising the "intervention" rate frc- 95 to 108.50 Sucres. The parallel rate stood around 125 to 135 early in 1986, raising to the current 165-170 just following the mid-term elections. This was accompanied by the increase in legal reserve on deposits of two percent each in February and March; substantial shelving of new investments with heavy import content; shifting resources to project creating jobs, expanding exports, and accelerating drawdowns of precommitted foreign exchange credits primarily from multilateral and other lenders and/or donors. Certain macroeconomic targets were revised to reflect the intervening setback: 1986 GNP will increase by three percent; public expenditure will be reduced 14% and inflation will stand between 22 and 25 percent. This will be made possible through a 14 percent increase in oil production -- up to 325,000 BPD, and an unspecified increase in the export of cocoa, coffee, and shrimp. The dollar cash-flow reducion due to the fall in the price of oil would be also partially compensated for by accelerated drawdowns of multinational project finance credits already approved.

It is the considered consensus, however, that the forthcoming negotiation with IMF for the 1986 renewal of the annual accord will require the adoption of even more stringent reductions in public expenditure in order to keep inflation within the target zone, all of which, in turn, translates into a GNP growth of under 3 percent net. Although the Left has gained ground in the recent mid-term elections, President Febres Cordero is expected to weather the storm by virtue of having assumed the posture of an "independent" President backed by a professional Cabinet. In this he will be helped by the political and economic support he will continue to enjoy from the United States, as well as from a vigorous and imaginative private sector that is diversifying into non-traditional export production.

MAIN INDICATORS (1980 - 1985)

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985[a] |
|---|---|---|---|---|---|---|
| GDP per capita real growth | 1.4 | 1.0 | (-2.0) | (5.6) | 1.0 | 0.8 |
| Inflation (CPI) | 12.8 | 14.7 | 16.3 | 48.4 | 31.2 | 28.0 |
| National savings as % of GDP | 21.2 | 18.9 | 16.5 | 18.5 | 19.2 | 18.4 |
| Gross Investment as % of GDP | 26.1 | 21.6 | 20.2 | 16.6 | 16.4 | 17.0 |
| Savings/Investment gap (as % of GDP) | ( 4.9) | ( 5.7) | ( 3.7) | (1.9) | (2.8) | (1.4) |
| Public sector deficit as % of GDP | ( 6.2) | ( 7.2) | ( 6.5) | (0.4) | (0.4) | (1.5) |
| Public external debt as % of GDP | 30.3 | 31.8 | 40.6 | 48.4 | 53.4 | 45.9 |
| Net monetary reserves (US $ millions) | 906 | 563 | 210 | 151.5 | 170.7 | 195.9 |

[a] estimated

## CHAPTER IV

## THE BORROWERS

"Financiera" is a combination of an investment bank, as defined in the U.S., or merchant bank as defined in the U.K.; and a development bank, as defined internationally. Much the same as in the U.S., Ecuadorean commercial banks cannot engage in equity investments, underwriting of securities and long-term credit operations that are not self-liquidating. These are precisely the activities in which financieras do engage, funding themselves not in the demand deposit and current account market, which are closed to them, but through special re-discount facilities with the Central Bank and other official windows including those replenished by international credit institutions and donor agencies.

In Ecuador, the lcoal financial instruments market has been available most exclusively to GOE agencies for all practical purposes, inasmuch as their instruments are the only ones issued on a tax-free basis. One of the main purposes of the original facility was to force a policy dialogue with the new GOE to allow private financieras to issue their own Certificates and bonds on similar tax-free basis.

### A. Financiera Ibero-Americana S.A. -- "FINIBER"

As of March 31, 1986, FINIBER had total assets of $48.5 million, stockholders equity of $2.7 million, converted from Sucres at the rounded-off parallel rate of 170 Sucres per one dollar. It should be noted that in free dollars, total assets have remained unchanged since December 31, 1983, while the stockholders equity went from $3.8 million to $2.7 million. During the same period, the free dollar rate went from 90 to 170 Sucres. Stockholders equity was reduced not due to operating losses, but due to the non-earning portion of assets created by the sucretization program.

FINIBER is wholly owned by private institutions and investors, including one commercial bank, Banco Popular. It is quite customary that the "non-bank" finance and development institutions have links to one commercial bank in the area, so as to complement each other's financial services to their traditional clientele. Banco Popular is believed to control effectively 60% of FINIBER's capital.

Out of the 10 leading private financieras in Ecuador, FINIBER occupies the sixth place in both total assets and stockholders equity. It is considered to be well managed by a highly professional staff headed by Raul Daza Martinez, whose experience ranges from World Bank Task Force working within the Central Bank of Ecuador to Chief Operational Officer of another large finance company FINANSA prior to his position of Chief Executive Officer at FINIBER. The Chairman of FINIBER is Ricardo Crespo, a prominent lawyer, businessman and former Ambassador to the U.S. The external auditors of FINIBER are Price Waterhouse.

B. Financiera de Guayaquil S.A. -- "FINANQUIL"

With total assets of $93 million, and stockholders equity of $5 million at exchange rates prevailing as of March 31, 1983, Financiera de Guayaquil ranks second in equity and second in total assets amongst the 10 leading private financieras in Ecuador. Like in the case of FINIBER, here also we see substantial increase in the total assets/equity ration, essentially due to the sucretization-induced additon of non-earning assets.

FINANQUIL is by far the most important finance company in the Guayaquil area. The province of Guayas, which includes Guayaquil, has been traditionally more important economically than the high plateau of Ecuador in which Quito, the capital, is located. It is true, however, that this relationship in GDP shares of the two areas has been changing slowly but steadily in favor of the "high country" or the "Sierra," although the coastal region centered around Guayaquil remains ahead.

Despite its initial heavy identification with the Banco de Guayaquil group, FINANQUIL has been traditionally developing its own customer base. It is well managed, the staff headed by Miguel Babra Lyon, well known and respected in international banking circles. FINANQUIL is also audited by Price Waterhouse.

C. General

FINIBER and FINANQUIL were chosen as participants in this facility as the result of the following:

1. In early April 1984, the Mission requested assistance in restructuring its Agro-industrial Fund program for implementation through the private financial sector rather than through the parastatal financiera, Corporacion Financiera Nacional.

2. In order to sound out the private financial sector, there were consulted two prominent bankers, one each from Guayaquil and Quito, who also served as the first and second Finance Minister in the first elected Administration following the military era. Neither of the two has any formal direct or indirect interest or connection with either of the participants, other than a small personal shareholding in FINIBER by the Guayaquil banker.

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3. It was found that both participants are well managed, headed by professionals well known and respected internationally. Also, both are quite active in and knowledgeable of the agribusiness sector.

4. The Mission also found the managers of the two quite helpful in its Agro-industrial Fund project, so that this facility which is really quite complementary to the Mission's program has fitted very well into the same, particularly with respect to the policy dialogue that is needed to secure the GOE cooperation in the legislative area.

5. Although all private financieras were formally invited to participate in the implementation of the Agro-industrial Fund set up by the Mission, it is noteworthy that FINIBER and FINANQUIL are by far the most active users of the Fund in an open competitive situation. This would justify PRE's continued support of these two institutions under the program proposed here.

See Attachments A and B which outline the Price Waterhouse financials as of December 31, 1985, for both institutions. As Attachment C, we are showing comparative ratios for the 11 Ecuadorean private financieras as of March 21, 1986.

## CHAPTER V

## TERMS AND CONDITIONS

LOAN AMOUNT : US $3,000,000

BORROWERS : Financiera Ibero-Americana S.A.
FINIBER, Quito, Ecuador

Financiera de Guayaquil S.A.
FINANQUIL, Guayaquil, Ecuador

Each of the Borrowers will be allocated up to a maximum of US $1,500,000.

LENDER : PRE, Bureau for Private Enterprise

FACILITY : The Loan proceeds will be deposited with a U.S. bank and invested in high quality USG securities that will be placed in a Collateral Account in the same U.S. bank. The Collateral Account will be utilized to guarantee:

Two (2) Standby Letters of Credit, for the Sucre equivalent of US $1.5MM each, issued by the U.S. bank in favor of FINIBER and FINANQUIL respectively, guaranteeing the principal amount of either:

a) Guarantee Bonds (Bonos de Garantia) with a minimum final maturity of 5 years: and/or

b) Financial Certificates (Certificatos Financieros Ordinarios) with a minimum maturity of 360 days,

that FINIBER and FINANQUIL would be placing in the Ecuadorean capital market through and pursuant to registration with the Quito and Guayaquil Stock Exchanges, and pursuant to a specific authorization by the Monetary Board and the Superintendency of Banks allowing for a freely established interest rate in accordance with market conditions, and readjustable semiannually based upon a base rate of reference officially established by the Monetary Authorities of Ecuador. Both the Bonds and the Certificates would be subject to the currently existing flat rate of 8% on interest income to the holders.

TERM : Five (5) years, 2 years grace.

REPAYMENT : Subject to sinking fund or redemption schedule of the Certificates and/or Bonds, the Collateral Account will be reduced between the third and the fifth year in equal yearly repayments.

FEES : a) One-half of a 1% flat, or US $15,000, as general one-time facility fee, payable at closing.

b) Two percent per annum, quarterly in arrears on amounts blocked by the U.S. bank backstopping their outstandings under the Borrowers' bond and/or Certificates issues. The U.S. bank charges for the Collateral Account will be covered from this fee.

The cost of the Standby Guarantee issued by the U.S. bank on Sucre-denominated Bonds and/or Certificates, as well as any customary fees payable to correspondent banks, in Ecuador and abroad, with respect to payment confirmations thereof, will be paid by the Borrowers.

CONDITIONS PRECEDENT TO THE ESTABLISHMENT OF FACILITY : a) Prior to the issuance of any tranches of Sucre-denominated Bonds and/or Certificates, a certified copy of the resolution of the Board of Directors of the issuing Borrower approving such issue; this resolution will also certify that any other required approvals have been obtained from any Governmental and/or Stock Exchange authorities.

b) Evidence that each Borrower will be able to issue Bonds and/or Certificates for twice the face amount of the PRE Facility on terms and conditions (including sinking food arrangements) acceptable to PRE.

c) Evidence that the competent Ecuadorean authority has approved the issuance by the Borrowers of bonds subject to the current flat rate of 8% on the interest earned by the holders.

d) Evidence that the competent Ecuadorean authority has adopted policies which enable interest rates to vary freely on line with market forces, and that interest on Bonds and/or Certificates may be re-adjusted semi-annually in accordance with such market forces.

SECURITY : Beneficial interest in perfected lien and/or any other collateral pledges to the Borrowers under any underlying credit operation involving use of this Standby Guarantee facility to the full extent of such use.

FINANCIAL COVENANTS/ NEGATIVE PLEDGES : To be negotiated and/or determined in the light of, among other:

a) Existing and future regulations as to leverage, financial ratios, etc.;

b) Replenishment of capital funds required as a result of the Sucretization of the foreign debt, and the consequent inflating effect on the Borrower's balance sheets.

OTHER : Interest on securities held in the Collateral Account would be returned to PRE as earned.

Attachment C-1

ECUADOR

**Comparative Analysis of Finance Companies Balance Sheets as of March 21, 1986**

- Millions of Sucres ($1 = 170 Sucres)

| | FINIBER | COFIEC | FINANSUR | FINANC. GUAYAQUIL | FINANSA | ECUFINSA | FINEC | AMERAFIN | FINANDES | FIMASA | FIRESA |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | | | | |
| Cash & Equivalent | 88.0 | 94.7 | 175.8 | 370.3 | 1.041.1 | 537.0 | 32.8 | 29.7 | 49.8 | 99.1 | 79.4 |
| Investments | 0.0 | 188.0 | 0.0 | 33.0 | 0.0 | 4.9 | 113.9 | 219.9 | 0.2 | 0.0 | 0.4 |
| Loans | 4.966.6 | 8.045.5 | 7.405.3 | 6.618.0 | 8.180.5 | 6.413.4 | 3.467.8 | 864.5 | 1.063.1 | 1.361.7 | 1.597.5 |
| Loans Overdue | 166.7 | 1.260.0 | 534.5 | 450.2 | 774.9 | 526.9 | 34.9 | 207.2 | 425.0 | 609.8 | 41.8 |
| Loan/Loss Reserve | (68.5) | (391.6) | (380.0) | (230.0) | (338.0) | (236.0) | (0.0) | (95.5) | (161.6) | (81.2) | (16.0) |
| Receivables Under Acceptances | 194.7 | 224.5 | 318.0 | 650.6 | 117.0 | 103.2 | 8.0 | 32.9 | 44.7 | 13.7 | 10.7 |
| Deferred Expenses | 119.1 | 747.5 | 485.9 | 303.4 | 840.9 | 653.4 | 129.4 | 91.7 | 100.2 | 340.7 | 172.7 |
| Foreclosed Assets | 133.0 | 887.7 | 325.4 | 75.2 | 49.5 | 41.9 | 2.5 | 18.6 | 19.1 | 3.6 | 0.0 |
| Fixed Assets | 64.2 | 229.9 | 74.4 | 97.1 | 201.6 | 49.4 | 0.0 | 7.5 | 32.9 | 38.9 | 39.0 |
| Other Assets | 347.1 | 1.258.0 | 574.2 | 444.8 | 1.097.2 | 252.7 | 143.7 | 16.3 | 240.0 | 99.3 | 34.6 |
| TOTAL | 6.010.9 | 12.544.2 | 9.513.5 | 8.812.6 | 11.964.7 | 8.346.8 | 3.933.0 | 1.392.8 | 1.823.4 | 2.485.6 | 1.960.1 |
| **LIABILITIES** | | | | | | | | | | | |
| Due on Demand | 90.7 | 94.0 | 53.6 | 36.8 | 51.2 | 314.0 | 0.0 | 17.4 | 7.9 | 66.8 | 1.0 |
| Acceptances Outstanding | 194.7 | 224.5 | 318.0 | 650.6 | 117.0 | 103.2 | 8.0 | 32.9 | 44.7 | 13.7 | 10.7 |
| Payables | 11.1 | 341.8 | 888.1 | 168.6 | 50.1 | 597.2 | 33.7 | 10.6 | 70.2 | 115.1 | 4.8 |
| Due to Banks | 4.143.4 | 7.067.7 | 6.705.2 | 5.623.4 | 8.958.8 | 6.015.5 | 3.326.8 | 804.5 | 1.187.4 | 1.798.3 | 1.503.7 |
| Bonds | 648.5 | 2.349.6 | 625.6 | 567.0 | 885.0 | 500.0 | 35.8 | 220.7 | 88.6 | 64.0 | 51.0 |
| Other Liabilities | 465.9 | 1.445.9 | 201.8 | 946.1 | 1.099.7 | 257.8 | 204.4 | 73.9 | 163.3 | 161.9 | 240.9 |
| TOTAL | 5.554.3 | 11.523.5 | 8.792.3 | 7.992.5 | 11.161.8 | 7.787.7 | 3.608.7 | 1.160.0 | 1.562.1 | 2.219.8 | 1.812.1 |
| **SHAREHOLDERS EQUITY** | | | | | | | | | | | |
| Paid in Capital | 327.4 | 800.0 | 614.0 | 625.0 | 666.0 | 464.8 | 300.0 | 176.8 | 240.0 | 240.0 | 129.4 |
| Reserves | 86.7 | 146.4 | 39.7 | 113.2 | 103.6 | 51.5 | 20.0 | 22.9 | 13.3 | 34.1 | 15.9 |
| Surplus | 22.6 | 19.6 | 42.7 | 60.0 | 27.8 | 13.4 | 0.8 | 2.2 | 4.8 | 2.4 | 4.0 |
| Capital Authorized Not Paid In | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 23.2 | 0.0 | 0.0 | 0.0 |
| Profit (Loss) (01 01/03/21 86) | 19.9 | 54.7 | 24.8 | 21.9 | 5.5 | 29.4 | 3.5 | 7.7 | 3.2 | (10.7) | (1.3) |
| TOTAL | 456.6 | 1.020.7 | 721.2 | 820.1 | 802.9 | 559.1 | 324.3 | 232.8 | 261.3 | 265.8 | 148.0 |
| Liabilities and Shareholders Equity | 6.010.9 | 12.544.2 | 9.513.5 | 8.812.6 | 11.964.7 | 8.346.8 | 3.933.0 | 1.392.8 | 1.823.4 | 2.485.6 | 1.960.1 |
| Contra Accounts | 2,268,3 | 3.942.1 | 5.260.7 | 3.697.8 | 3.965.8 | 1.372.5 | 3.651.3 | 888.9 | 559.5 | 936.4 | 1.027.4 |
| GRAND TOTAL | 8,279.2 | 16,486.3 | 14.774.2 | 12.510.4 | 15.930.5 | 9.719.3 | 7.584.3 | 2.281.7 | 2.281.7 | 3,422.0 | 2,987.5 |

ECUADOR

**Comparative Analysis of Finance Companies Balance Sheets as of March 21, 1986**

**- Millions of Sucres ($1 = 170 Sucres)**

| FINANCIAL RATIOS | FINIBER | COFIEC | FINANSUR | FINANC. GUAYAQUIL | FINANSA | ECUFINSA | FINEC | AMERAFIN | FINANDES | FIMASA | FIRESA |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Past Due Index | 2.20% | 9.36% | 3.96% | 3.95% | 5.95% | 6.26% | 0.49% | 10.72% | 20.32% | 20.88% | 1.57% |
| Loan/Loss Reserve To Past Due Loans | 41.10% | 31.08% | 71.10% | 51.09% | 43.62% | 44.79% | 0.00% | 46.09% | 35.67% | 13.32% | 38.28% |
| Total Debt to Total Assets (incl. contra account) | 17.1:1.0 | 15.2:1.0 | 19.5:1.0 | 14.3:1.0 | 18.9:1.0 | 16.4:1.0 | 22.4:1.0 | 8.8:1.0 | 8.1:1.0 | 11.9:1.0 | 19.2:1.0 |
| Total Debt to Total Assets (excl. contra account) | 12.2:1.0 | 11.3:1.0 | 12.2:1.0 | 9.8:1.0 | 13.9:1.0 | 13.9:1.0 | 11.1:1.0 | 5.0:1.0 | 6.0:1.0 | 8.4:1.0 | 12.3:1.0 |
| Total Loans to Total Assets | 91.76% | 81.72% | 91.50% | 91.26% | 81.85% | 86.59% | 94.44% | 87.37% | 87.81% | 85.38% | 89.62% |
| Return on Capital | 24.32% | 27.36% | 16.16% | 14.04% | 3.32% | 25.32% | 4.68% | 17.44% | 0.08% | 0.00% | 0.00% |
| Total Loans | 7.596.3 | 13.472.1 | 13.518.5 | 11.416.6 | 13.038.2 | 8.416.0 | 7.162.0 | 1.933.5 | 2.092.3 | 2.921.6 | 2.677.4 |
| Total Assets (incl. contra accounts) | 8.279.2 | 16.486.3 | 14.774.2 | 12.510.4 | 15.930.5 | 9.719.3 | 7.584.3 | 2.281.7 | 2.382.9 | 3.422.0 | 2.987.5 |

# SPECIAL CERTIFICATES
(millions Sucres)

## 1. Commercial Banks

| 1985 | Total | Days 90-119 | 120-149 | 150-179 | 180-269 | 270-359 | 360-up |
|---|---|---|---|---|---|---|---|
| Apr | 7,924 | 3,727 | 469 | 70 | 2,545 | 286 | 825 |
| May | 12,193 | 6,106 | 680 | 133 | 3,848 | 299 | 1,066 |
| Jun | 17,670 | 6,984 | 1,017 | 542 | 7,330 | 353 | 1,442 |
| Jul | 21,879 | 8,528 | 1,177 | 841 | 8,559 | 587 | 2,184 |
| Aug | 26,981 | 10,222 | 1,559 | 1,191 | 10,231 | 643 | 3,132 |
| Sep | 29,285 | 10,428 | 1,668 | 1,203 | 11,486 | 650 | 3,848 |
| Oct | 30,834 | 10,252 | 2,049 | 1,455 | 11,676 | 611 | 4,739 |
| Nov | 32,208 | 10,408 | 2,296 | 1,410 | 12,175 | 672 | 5,244 |
| Dec | 33,756 | 10,486 | 2,355 | 1,076 | 13,081 | 582 | 6,174 |
| 1986 | | | | | | | |
| Jan | 36,474 | 11,333 | 2,566 | 1,024 | 13,636 | 683 | 7,230 |
| Feb | 37,555 | 11,088 | 2,438 | 1,281 | 13,888 | 639 | 8,218 |
| Mar | 38,559 | 11,028 | 2,496 | 1,254 | 13,959 | 863 | 8,957 |
| Apr | 40,858 | 12,324 | 2,340 | 1,236 | 14,710 | 884 | 9,362 |
| Annual Yield | | | | | | | |
| April 1986 | | 25.30 | 25.70 | 26.10 | 26.70 | 27.10 | 27.70 |

## 2. Financieras

| 1985 | Total | Days 90-269 | 270-359 | 360-up |
|---|---|---|---|---|
| Oct | 134 | 124 | - | 10 |
| Nov | 194 | 177 | - | 17 |
| Dec | 287 | 260 | - | 27 |
| 1986 | | | | |
| Jan | 316 | 283 | - | 33 |
| Feb | 372 | 338 | - | 34 |
| Mar | 434 | 398 | 2 | 34 |
| Apr | 641 | 478 | 126 | 38 |
| Annual Yield | | | | |
| April 1986 | | 25.30 | 26.70 | 27.30 |

U.S. $1,400,000

Analysis Utilization L/C Confirmation Facility
Tripartite Agreement of AID/PRE-First Pennsylvania Bank-FINIBER

1. STATUS

| | | |
|---|---|---|
| Signing of Agreement | : | September 27, 1984 |
| Disbursement Date | : | November 28, 1985 |
| Amount Utilized in May 23, 1986 | : | U.S. $1,368,844.89 |
| Maximum Amount Allowed | : | U.S. $ 250,000.00 |

2. UTILIZATION BREAKDOWN

a) Average Amount L/C confirmed: U.S. $ 57,000.00
b) Minimum Amount : U.S. $ 10,000.00
c) Maximum Amount : U.S. $250,000.00
d) Number Letters of Credit : 24

e) End User :

| End User | Amount (000) | % |
|---|---|---|
| Agriculture | 257 | 18.76 |
| Agroindustries | 96 | 7.01 |
| Textile Industries | 155 | 11.31 |
| Chemical Industries | 96 | 7.01 |
| Shoe Manufacturing | 8 | 0.58 |
| Metal Mechanical | 328 | 23.94 |
| Electric Products | 149 | 10.88 |
| Food Products | 23 | 1.68 |
| Services | 258 | 18.83 |
| Total | 1,370 | 100.00 |

f) Geographical Distribution:

| | | |
|---|---|---|
| Azuay | 195 | 14.23 |
| Cotopaxi | 195 | 14.23 |
| Pichincha | 541 | 39.49 |
| Guayas | 439 | 32.05 |
| Total | 1,370 | 100.00 |

PD-ABK-423

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D.C. 20523

MEMORANDUM FOR AA/PRE, NEAL PEDEN

JUL 9 1986

A-DAA/PRE, ROBERT BECKMAN
AA/PRE, DOUGLAS TRUSSELL
AA/PRE, AILEEN KISHABA
PRE/PD, RUSSELL ANDERSON
PRE/PR, CAROLYN WEISKIRCH
PRE/I, COMPTON CHASE-LANSDALE
PRE/I, HOWARD ALLER
GC/PRE, MICHAEL KITAY
GC/PRE, ROBERT SONENTHAL
PPC/PDPR/IP, NEAL ZANK
USAID/Quito, FRANK ALMAGUER
LAC/SA, KENNETH JOHNSON
LAC/DR, ROBERT OTTO

FROM : PRE/I, Sean P. Walsh

SUBJECT: Investment Opportunity Proposal Review of Finiber/Finanquil Deposit Guarantee for PRE Revolving Fund

An IOP Review for a US$3.0 MM loan from PRE's Revolving Fund to the subject Financieras is scheduled for Friday, July 11, 1986, in Room 6212, New State from 10:30 to 11:30 a.m. Attached ~~is~~ the IOP document.

Attachment:
Investment Opportunity Proposal: Financiera Ibero-Americana S.A. -- Finiber and Financiera de Guayaquil S.A. -- Finanquil

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