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# MICRO-LENDING GUARANTY FUND

## ACCION INTERNATIONAL, INC./AITEC (LATIN AMERICA)

## PRE PROJECT NUMBER 940-0002.44

**Prepared for:**

**Office of Development Planning**
**Bureau for Private Enterprise**
**Agency for International Development**
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## ANNEXES

1. General Economic Environment and Financial Markets Overview: Paraguay
2. Fundación Paraguaya (FP) Organization Chart
3. FP Comparative Income and Expense Statements
4. FP Comparative Balance Sheets
5. Matrix of FP Sub-Borrowers Interviewed (with loans disbursed)
6. Impact on Sample of 20 Sub-Borrowers (Fundación Paraguaya)
7. General Economic Environment and Financial Markets Overview: Mexico
8. Weighted Average Cost of Capital (Mexico)
9. ADMIC Organization Chart
10. ADMIC Comparative Income and Expense Statements
11. ADMIC Comparative Balance Sheets
12. Matrix of ADMIC Sub-Borrowers Interviewed (with loans disbursed)

## ACRONYMS

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|---|---|
| A.I.D. | U.S. Agency for International Development |
| ACCION | ACCION International/AITEC |
| ADMIC | Asesoría Dinámica a Microempresas (Mexico) |
| AmCham | American Chamber of Commerce |
| BANORTE | Banco Mercantil del Norte (Monterrey, Mexico) |
| CAINTRA | Association of Industries (Monterrey, Mexico) |
| CD | Certificate of deposit |
| CPP | Weighted Average Cost of Capital (Mexico) |
| ESP | Economic Solidarity Pact (Mexico) |
| FOGAIN | Guarantee & Development Fund for Small & Medium Industry (Monterrey, Mexico) |
| FOMICRO | Guarantee Fund for the Development of Microenterprise (Nuevo León, Mexico) |
| FP | Fundación Paraguaya (Paraguay) |
| GDP | Gross Domestic Product |
| GNP | Gross National Product |
| IAF | Inter-American Foundation |
| IDB | Inter-American Development Bank |
| LC | Letter of credit |
| NAFINSA | National Finance Corporation (Mexico) |
| NFA | Net Fixed Assets |
| PRE | Bureau for Private Enterprise |
| TAT | Technical Assistance/Training |

## EXECUTIVE SUMMARY
## MICRO-LENDING GUARANTY FUND (LATIN AMERICA)

### Project Purpose

The purpose of this project (PRE Project No. 940-0002.44) is to "increase income and employment generation among urban poor, capitalizing a fund which will guarantee local currency borrowings by local organizations which make small loans to micro-entrepreneurs." The project encourages financial discipline by requiring foundations to charge interest rates that reflect both the full cost of funds and of training and technical assistance (TAT). In addition, the project was designed to involve local commercial banks in serving the credit needs of microenterprises.

A.I.D./PRE established a U.S. $1 million guarantee facility through a loan to ACCION International in September 1985. ACCION also received total grants of $191,000 to cover costs of technical assistance to its affiliates. The A.I.D. loan was deposited in a collateral account in a U.S. bank (Chemical). Using this account as security, Chemical Bank issues standby letters of credit (LCs) in favor of local Latin American banks. With this guarantee, the local banks provide credit from their own resources to local affiliates of ACCION. The affiliates use these resources for on-lending to microenterprises.[1]

A model standby LC (negotiated in each country) is issued in favor of local lending banks. As of November, 1988, LCs for $150,000 and $100,000 respectively had been issued for Asesoría Dinámica a Microempresas, A.C. (ADMIC) and for Fundación Paraguaya (FP), the ACCION affiliates in Mexico and Paraguay. Subsequently, LCs were issued to banks in Chile ($100,000) and in Ecuador ($50,000). A disbursement of $200,000 for Mexico was made in July 1989, bringing total facility utilization to $600,000.

Initially the standby LCs were to guarantee up to 90% of loans by local banks to the affiliates. ACCION was to use its best efforts to reduce the percentage of guarantee coverage, especially after successful repayment of earlier loans. In Mexico the percentage guarantee provided by the PRE facility is potentially only 17.65% because the rediscount line from the Guarantee Fund for SMSEs (FOGAIN) of $1.7 million is guaranteed by the $300,000 of PRE funds.

### Evaluation Purpose and Methodology Used

Data for the Micro-Lending case was collected in December 1988. This evaluation is one of fourteen studies of PRE Revolving Fund investment projects conducted for the PRE Office of Development Planning. The purpose of this effort is to discover lessons learned about the effectiveness of PRE investment project models. These lessons are presented in a separate volume. A standardized data collection guide was used to make data comparable. The process included: (1) review of project documentation and interviews with PRE Investment Officers; (2) site visits to a representative sample of beneficiaries; and (3) interviews and document reviews in participating IFIs.

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[1] An exception to this is Mexico where, due to the use of a rediscount facility the ACCION affiliate is not permitted to lend directly to microenterprises. Instead, the local bank lends its funds to microenterprises with the guarantee of the PRE collateral account.

## Findings and Conclusions

1. In Mexico and Paraguay the institutional impacts of the ACCION Project were more significant than direct impacts on borrowers.

PRE funding was added to existing credit programs, and many borrowers had received loans from the foundations before. These factors made it difficult to determine the specific impacts of PRE funding on borrowers. The most obvious positive impact of the project was on the relationship between ACCION affiliates and commercial banks, because the A.I.D. project provided microenterprise lending institutions with access to funds from private financial markets.

2. The language of the model letter of credit may potentially create difficulties with commercial banks.

In Mexico the LC was accepted without modifications, but only because of a high level of personal contacts between ADMIC and BANORTE. In Paraguay the LC was rejected by nine banks. The affiliate finally found a local bank that accepted a modified LC. The major problems with the LC were due diligence, jurisdiction, collection procedures in the event of default, and the A.I.D. requirement for access to the commercial bank's records. In March 1989 the model LC was simplified by PRE/I. There have been no further problems in the negotiations with local banks.

3. Evidence suggests that it is necessary to waive some standard banking practices in order to reach large numbers of microenterprise borrowers.

Because of a liquidity problem in Mexico, the bank uses the rediscount facility for reimbursement of bank funds lent to ADMIC borrowers. This had "overbureaucratized" the program by requiring borrowers to (a) complete loan forms of three institutions, (b) have two or three visits made to their businesses, and (c) go through three credit approvals. The processing time was approximately three months. During the first half of 1989, the ADMIC/BANORTE relationship was restructured. ADMIC now has almost full authority to approve loans. Bank processing time has been reduced to 17 days.

Fundación Paraguaya's program shows that the guarantee mechanism works best when a microenterprise lending institution borrows directly from a private bank, and then on-lends to microenterprises. FP lends to microentrepreneurs with a credit delivery lag time of 10-15 days. The solidarity group concept also allows the program to reach more borrowers and allows less rigorous credit analysis because of the "cross guarantee". Clearly, independent bank appraisal of loans is a less effective approach if the objective is to reach a large number of borrowers.

In Paraguay as of October 31, 1988, approximately 514 loans had been made from the $90,000 disbursed as of that date, but a much larger amount of loans had been lent as a result of the reflows from these short term loans.[2] In Mexico as of September 31, 1988, 12 loans for a total of $22,270 had been disbursed from the guaranteed funds.

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[2] The exact amount is difficult to calculate due to reflows from other programs being commingled with the PRE guaranteed funds.

4. <u>The sustainability of a microenterprise program requires charging fees and interest rates that are sufficient to cover the program's real costs.</u>

In Mexico, because ADMIC is not the lender, ADMIC receives no interest income, only a 10% one-time processing fee. Prior to the recent restructuring, ADMIC's fee was only 3%. This was inadequate to cover operating and TAT costs. Consequently, ADMIC had to subsidize costs of the PRE program with earnings from other programs. Fundación Paraguaya charges an interest rate that is higher than commercial rates (but lower than money lenders) - 72% per year, add-on, which is a 114% effective rate. This rate allows FP to cover most of its costs and to move towards self-sufficiency.

5. <u>A savings component should be part of microenterprise lending programs.</u>

Some borrowers have suffered the consequences of unforeseen expenses, nonpayment by clients, and other problems. As a result, they have not been able to make their loan payments. If they had an emergency fund of savings, these situations could normally be covered.

<u>Recommendations for Successor Activities</u>

1. If measuring specific borrower impact of A.I.D. guaranteed loan funds is desired, disbursement and reflows of loans made using these funds should be tracked separately and a requirement established for separate accounts. However, this may not be practical (in terms of costs and institutional capacity). If the loans being made with A.I.D. funds are for similar purposes as other loans, then borrower impact could be measured using a random sample of all borrowers. The same baseline data collected at time of application should be compared with data collected at regular intervals.

2. If the letter of credit mechanism is to be used, it should remain simplified and, under some circumstances, a legal representative of A.I.D. should be present to expedite negotiations with the commercial banks.

3. Ideally, the borrower of PRE guaranteed funds from the commercial bank(s) should be the ACCION affiliate rather than the microenterprises. This precludes the need for independent bank appraisal and allows more borrowers to be reached. However, the Mexico program indicates that effective mechanisms can be developed even if funds do not flow directly to the affiliates. The key point is that the affiliate should have primary responsibility for loan processing and analysis.

4. There are two possible approaches to establishing interest rate: a) cost center approach - each source of funding is considered a separate program that must cover its own costs of capital, administration and TAT or b) establishing a weighted cost of capital and charging the same interest rate for all loans. In Mexico the affiliate is prohibited by law from being the actual lender, but does the loan processing. In such a case the bank should be able to cover its cost of capital, but the affiliate should be able to charge fees for the administrative and TAT costs.

5. ACCION affiliates should emphasize to borrowers the importance of savings to cover unforeseen expenses and to facilitate payments on loans. This could be done by offering a savings course or establishing appropriate savings vehicles such as passbook accounts or short-term certificates and by developing and/or joining with local savings institutions such as credit unions.

## MICRO-LENDING GUARANTY FUND

## ACCION INTERNATIONAL, INC./AITEC

# I. AGREEMENTS

### A. INTRODUCTION

The Borrower under this project is ACCION International/AITEC, a U.S. private voluntary organization. Since 1973, ACCION has pioneered credit and training programs for microenterprises in Latin America. ACCION is currently active in over a dozen countries in Latin America and the Caribbean. The organization's affiliates disburse over $1.5 million each month, with loans averaging less than $200. According to ACCION, results of these programs are the following:

- program participants usually increase family income by 30% in the first year;
- an entirely new permanent job can be created with loans of as little as $375; and
- the overall payback rate to ACCION affiliates is over 98%.

When the Bureau for Private Enterprise (PRE) project was designed in 1985, ACCION was judged by the Bureau as the only microenterprise lending institution with a sufficiently solid track record to use the Revolving Fund to access commercial credit for microenterprise lending. PRE did not have sufficient staff to respond to individual requests for assistance from microenterprises, while ACCION has a broad system of affiliates in Latin America. It was felt that, in terms of administrative costs, a Revolving Fund investment of $1 million would be the minimum amount feasible, and that approximately $100,000 to $200,000 would be appropriate for a micro-lending program in any given country. The project agreement clearly spells out that each ACCION affiliate must be financially sound to participate in the program.

The involvement of ACCION and its affiliates in project design took place on two levels. In the U.S., ACCION and Chemical Bank worked out a model standby letter of credit to be issued in favor of local lending banks. With PRE's guidance, ACCION modified this model in each country. ACCION affiliates then negotiated the final details of the standby letter of credit with local commercial banks. As of November 1988, project monies had been disbursed in two countries, Paraguay and Mexico.[1] Both are considered "Advanced Developing Countries", and there is no A.I.D. mission in either country. The A.I.D. Representative in each country was supportive of the project.

Studies have shown that banks are unlikely to change lending policies toward microenterprises as a direct result of a small credit program, although such programs may bring some microentrepreneurs into the commercial banking system. Commercial lending institutions often view microenterprises as non-creditworthy and unprofitable. Microenterprises are considered financially unstable and unable to meet collateral requirements. Lending under the guarantee facility was intended to address this constraint by reducing the perceived risk involved in lending to this sector. An expected result of this change in perception was to make local currency available for lending to microentrepreneurs.

PRE anticipates that lending to microentrepreneurs will continue after the termination of the guarantee facility. To encourage program sustainability, the amount of risk covered by the standby facility is reduced over a period of 5 years. Affiliates are expected to develop a capital base sufficient to continue lending after the program ends. It is also expected that microentrepreneurs who have participated in the program and have good credit records will be able to obtain commercial loans without the assistance of the ACCION affiliate. Clearly, the likelihood of continued lending to this sector will be significantly increased if local banks can charge interest rates that are adequate to cover the perceived risk and higher administrative costs of microenterprise lending.

To implement the PRE program, ACCION hired a former banker to coordinate local affiliates' activities under the guarantee fund.

## B. LOAN AGREEMENT BETWEEN ACCION AND A.I.D.

The loan agreement signed on September 25, 1985 makes the following resources available to ACCION ("the Borrower"): (1) a loan of $1 million to establish a collateral account in a U.S. Depository Bank (Chemical Bank

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[1] Originally four countries were to be included in this program. Recently two more were added: Ecuador and Chile.

of New York), and (2) a grant of $100,000 (increased by $91,000 in September 1988). The purpose of the grant is to assist the preparation of a credit manual, to support administrative costs of operating the guarantee fund, and to provide additional staff for monitoring and technical assistance. ACCION, in turn, agreed to provide "reasonable resources (other than financing) necessary to carry out the project effectively" and to accept liability for the first $100,000 of losses arising from claims against the collateral account under letters of credit to local lending banks. ACCION was to cover this liability by establishing a segregated account of $100,000 with its own resources at the depository bank.

The loan agreement provides for disbursements into the collateral account in increments of $100,000 or multiples thereof. Within 90 days of disbursements, letters of credit guaranteeing subloans are to be issued in an amount equal to loan disbursements.

Chemical Bank pays interest for ACCION's loan directly to A.I.D. The interest rate on the loan is equal to the annual yield that Chemical receives on the collateral account. Loan principal is to be repaid in semi-annual payments within five years of the first disbursement. The first payment is due in September 1991, three years from the execution of the Loan Agreement (9/88). These repayments are reduced if defaults have been paid from the collateral account.

## C. THREE PARTY AGREEMENT AMONG ACCION, CHEMICAL BANK AND A.I.D.

The Three Party Agreement was signed in December 1986. It sets forth the rights and obligations of the three parties with respect to the collateral account. Chemical Bank (the depository bank) was to establish with ACCION the collateral and segregated accounts and to make qualifying investments with A.I.D. funds. A.I.D. was to fund the collateral account with the $1 million loan to ACCION. ACCION was to establish a segregated account with $100,000 of its own resources.[2]

The Three Party Agreement also describes the operation of the collateral account. The depository bank was to issue standby letters of credit against the collateral account in favor of local banks. The standard term of these LCs is one year, and they guarantee up to 90% of loans made by banks to ACCION affiliates in Latin American countries. In turn, the ACCION affiliates would use the funds to make loans to local microenterprises. It was a stated objective that the amount guaranteed by the LCs would be progressively reduced (as LCs expired and new LCs were issued) so that local banks would gradually assume greater risk, and A.I.D. funds in the collateral account would be more highly leveraged.

For payment in cases of default under the original standby LC, the local lending bank must (1) present to the depository bank evidence that a default has taken place and that the local bank has pursued "reasonable collection activities" against the defaulting foundation for 60 days, and (2) request payment in return for assignment of rights. "Reasonable collection activities" were defined as any actions taken by a local bank to collect on a defaulted qualifying subloan, including, but not limited to, undertaking formal legal proceedings against the defaulting foundation. These must be "efforts no less diligent or stringent than those the local lending bank generally employs with respect to its non-guaranteed defaulting loans."

During the first year of project implementation, PRE worked closely with ACCION to fine-tune the Chemical Bank standby letter of credit. The model LC has had to be modified to meet local financial institutions' requirements. Although a letter of credit is used in each country as a means of guaranteeing local currency loans to microentrepreneurs, the

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[2] The ACCION resources for the segregated account come from its Bridge Fund. The Fund is capitalized with investments from individuals, churches and institutions (including A.I.D.), as well as donations. The investments are used to purchase Certificates of Deposit (CDs) in the U.S., and these are used to guarantee between 30% and 100% of loans extended by banks in Latin America to ACCION affiliates. The affiliates, in turn, on-lend to microenterprises. ACCION is thus able to repay investors at the maturity date at a competitive rate of interest (the prevailing CD rate). Investors have suffered no losses since the Fund's inception, while donations are used to capitalize the Fund's Loan Loss Reserve.

letter of credit is negotiated with the participating financial institution in each country to establish procedures required for using the collateral account and the amount of risk to be assumed by the institution.

In Mexico, the letter of credit was readily accepted by a local bank with few modifications. In Paraguay, however, the original letter of credit was rejected by nine financial institutions before a simplified form was accepted by a local commercial bank.

## D. ACTIVITY TO DATE UNDER THE COLLATERAL ACCOUNT

There have been significant delays in project implementation since the loan agreement was signed. The agreement was signed in September 1985, and funds were first disbursed in January 1988. Due to these delays, at the time this evaluation was completed, PRE had received only one status report from ACCION headquarters, dated October 11, 1988. This had been supplemented by frequent telephone conversations between ACCION headquarters and PRE investment officers. The agreement stipulates that reports should be submitted bi-annually.

As of August 31, 1988, $400,000 had been disbursed into the collateral account, all of which had been invested in CDs. Another $860 had been earned on the account; this amount is interest due A.I.D. and is held in the form of demand deposits. As of that date, $200,000 was held as collateral for two standby letters of credit of $100,000 each, issued to banks in Mexico and Paraguay. The remaining $200,000 had been disbursed by A.I.D. to support issuance of LCs in favor of banks in Costa Rica and Peru. An LC had been issued to a local bank in Costa Rica, but it expired and was not renewed. The LC for Peru was never accepted by the Peruvian bank. Part of these funds is currently being used to issue another LC in Paraguay. The remainder may be used in Mexico or in programs currently being developed in Ecuador and Chile.

Certificates of deposit for the $100,000 deposited in the segregated account by ACCION matured between June and September 1988 and were rolled over for an additional 2.5 years.

The following table shows the LCs issued since the beginning of the collateral account, those currently outstanding and cumulative amounts borrowed from local banks by ACCION affiliates:

| Country | Issuance | Acceptance | LCs issued as of 12/31/88 | Borrowed as of 12/31/88 |
|---|---|---|---|---|
| Costa Rica | 6/87-6/88 | Accepted | Expired | ---- |
| Peru | 1/88-1/89 | Rejected | --- | ---- |
| Mexico | 1/88-1/89 | Accepted | $100,000 | $30,000 |
| Paraguay | 11/87-11/88 | Rejected | --- | |
| | 6/88-8/89 | Accepted | $100,000 | $90,000 |
| Ecuador | 12/88-12/89 | Accepted | $50,000 | |
| Chile | 12/88-12/89 | Accepted | $100,000 | |

# II. PARAGUAY

## A. ECONOMIC AND FINANCIAL OVERVIEW

### 1. Economic

Paraguay showed strong economic growth from 1970 until 1981, largely as a result of construction of the Itaipu hydroelectric dam and accompanying high levels of investment from international donors and private commercial banks. Inflation and unemployment remained low and per capita income rose rapidly in real terms.

The period of economic growth ended in 1982 due to completion of heavy construction at Itaipu, falling prices for Paraguay's traditional exports and bad weather that affected agricultural production. These events negatively affected the balance of payments, employment, tax revenues and economic activity in general. The macroeconomic policy response was inadequate, which made a bad situation worse.

The economic downturn reduced growth in GNP and caused high inflation rates, in excess of 30% per year. The result was lower living standards, reduced levels of investment, deterioration in the balance of payments and a substantial increase in external indebtedness. GNP grew at four percent during 1988, but is projected to drop to three percent in 1989.

There are almost one million inhabitants in Asunción and, like many developing country capitals, it has attracted major migratory flows. Recent census information indicates that more than 90,000 microentrepreneurs reside and work there, only 47% of whom were born in the capital.

The economic slowdown following construction of the Itaipu dam and population growth both have contributed to a rapid increase in unemployment and underemployment in recent years. Clearly, the microenterprise sector could play an increasingly important role in the financial sustenance of many Paraguayans, given ever increasing rates of unemployment. A recent study of microenterprises demonstrates the stability of the informal sector and the extent to which people rely on informal sector jobs as a sole source of income. Findings on informal sector credit point out the importance and need for credit programs such as Fundación Paraguaya. Over 33% of respondents stated that they had never received credit; 50% said they had borrowed from money lenders (paying up to 20% interest daily); 14% had received materials on consignment; and only 3% had received credit from a formal institution. The Fundación Paraguaya program not only provides microentrepreneurs with much needed credit, but offers training to improve their businesses.

2. Financial

Paraguay has well developed financial institutions including public and private banks, stock owned savings and loan associations, credit unions and finance companies. An informal credit sector is also active. The banking system functions with a regulated interest rate structure.

Interest rates in Paraguay, when adjusted for inflation, are often negative in real terms. While the Government increased interest rates in 1988, the increases provided only small positive lending spreads. Although financial developments over the past several years have shown rapid increases in domestic credit, there has been a decrease in private sector holdings of financial assets.

Even though growth figures give the impression that there is ample financial liquidity in Paraguay, the private sector entrepreneur faces quite a different reality. Growth figures include public and private sectors, but the overwhelming share of growth is represented by public expenditures to cover deficits. Another factor is money creation, which along with public expenditures, is inflationary. Therefore, business liquidity is shrinking in real terms, and credit available to the private sector is dominated by seasonal credit cycles targeted for export crops.

More detailed information on the economic and financial context is available in Annex 1.

## B. FUNDACION PARAGUAYA ORGANIZATION AND OPERATIONS

Fundación Paraguaya is a private foundation started in 1985 by the current Executive Director, Martín Burt. A $170,000 start-up grant was obtained from AID/FVA, $70,000 of which was turned over to ACCION International for technical assistance when the Fundación became an ACCION affiliate. Fundación Paraguaya is the only organization in Paraguay with the sole purpose of providing training and credit to microentrepreneurs involved in both commerce and production of goods. To date, the Fundación has provided $2.2 million in credit to more than 3,000 borrowers (4,800 loans) comprising more than 800 "solidarity groups" (see discussion below). Since a significant percentage of microentrepreneurs are women, no special targeting of credit was necessary to obtain the Fundación's current average of 60% female credit recipients.

Director Martín Burt has developed an outstanding reputation within the ACCION network for having successfully established a lending program based on the formation of solidarity groups, a concept which could easily be misunderstood within the rigidly controlled political and social environment of Paraguay. Burt has accomplished this by conducting an extensive public relations and public education campaign, and by maintaining constructive relationships with the government and the business community. One of the earliest objectives of the Fundación's public relations staff was to get at least one article printed daily on some aspect of the program in a national newspaper. After three years of operation, about five articles are printed weekly on the program. Maintaining this type of program exposure, or "transparency", has clearly defused suspicion on the part of the government that solidarity groups might become involved in anti-government political activities.

### 1. <u>Organization</u>

The overall management of Fundación Paraguaya's various lending programs is headed by Dr. Carlos Rivarola, Director of Planning and Resources. The Director of Operations, Mr. Gaspar Payá, is responsible for day-to-day management of the Fundación's lending program. This includes solidarity group formation, program orientation, issuance of loans, loan collection, and oversight of the ten business advisors. The

Director of Administration and Finance is responsible for accounts management. These three individuals report directly to the Executive Director. For additional information on the organization of Fundación Paraguaya, see Annex 1.

2. Operations

Credit policies and administrative procedures for loans under the A.I.D. guarantee program are identical to those for loans from the Fundación's other funding sources. Fundación Paraguaya made its first loan under the A.I.D. guarantee program on July 14, 1989, and since the beginning of the program A.I.D. funds have been commingled with funding from other sources. The A.I.D. letter of credit has facilitated obtaining additional commercial credit -- a constant and growing need of the Fundación -- and has encouraged a local commercial bank to assume at least some of the risk (10%) in supporting microentrepreneurs. Managers affirmed that the A.I.D. letter of credit has enabled them to reach many more microentrepreneurs with credit and training, and has reinforced their ability to respond to the huge demand for credit in this sector.

**Formation of Solidarity Groups.** The concept of solidarity groups is central to the successful operation of Fundación Paraguaya. They are formed in the following manner:

Microentrepreneurs often hear about the Fundación from others who have received credit. To become involved in the program, they must attend a series of three meetings. The first meeting gives general information on the Fundación's program, the formation of solidarity groups, and loan terms and conditions. Potential borrowers are told that they must locate three to four other individuals interested in participating in the program. Since each group will be receiving and repaying the loan and no formal guarantee is required, it is emphasized that individuals must carefully consider the reputability of fellow group members. It is also explained that, should a group member be unable to meet his/her loan payment, it is expected that the group will make the payment on behalf of that individual.

Early thinking on the optimal size of solidarity groups was that it was less risky to lend to larger groups than smaller ones, given that there would be more people to back up a group member who was unable to make a loan payment. Experience showed that the reverse was true. There was less cohesion in larger groups and group pressure was also weakened, resulting in more delinquent loans. Now the optimal group size is thought to be three to five persons.

The second meeting is attended by all potential group members. A more in-depth explanation of the program is provided, as well as pros and cons of solidarity groups. Individuals complete personal data forms, and set up appointments for business advisors to visit their businesses.

At the third meeting, legal aspects of the loan program are reviewed. All group members sign an informal contract, which obligates them to loan payment requirements, and outlines responsibilities to other group members. Individuals then complete all applications, sign the promissory note, and a loan file is established.

Until recently, a group coordinator was elected at the third meeting. It was this individual's responsibility to receive and cash the group's check, and to disburse loan money. The group leader concept has now been eliminated, and checks are issued in the name of a randomly selected group member. Since there is only one disbursement per loan, the Fundación's management planned the training schedule around this. Loan recipients are required to take one training course per loan; since all group members must be present to receive their check, checks are issued during the break at the one-day training session.

From the date of the first meeting attended by a potential borrower until issuance of a loan there is a lapse of 10 to 15 days. Since the Fundación's main competition is the money lender (who has the money in his briefcase), a rapid turn-around time is essential to the program.

**Business Advisors.** The ten business advisors are essential to the successful operation of the program, providing the critical link between the microentrepreneur and the Fundación. Each of nine advisors is responsible for a geographic zone in the Asunción area, and conducts all promotion and follow-up with microentrepreneurs in that area. One advisor acts as a resident advisor, and is always available to provide assistance to group members at the main office. Advisors are provided motorcycles, which enable them to easily reach even the most inaccessible areas. The operations manager is now purchasing walkie-talkies to facilitate communication with them, since the advisors spend the bulk of their time in the field.

The business advisors' professional backgrounds are varied, with only half of them having previous business experience. Fundación management considers that an innate "viveza", or astuteness, is the personal characteristic most necessary to effectively deal with microentrepreneurs. A two month course forms part of the training, which includes aspects of accounting, business management, psychology and human relations, although there is an expressed interest among managers to develop a more formal training program.

The advisors make their initial contact with potential borrowers following the second group meeting, when a site visit is made to both the business and home. This involves (a) an informal credit analysis, which includes a review of the microentrepreneur's assets and liabilities, ability to repay the loan, monthly sales, and family expenses, (b) a general assessment of the applicant's moral character, and (c) verification of whether the applicant has ever received credit from a financial institution (this, theoretically, would eliminate the possibility of receiving credit from the Fundación). Advisors also ask whether credit was ever obtained from a money lender, or goods on consignment from a supplier. If the microentrepreneur has demonstrated the ability to repay such a loan, this weighs in his/her favor.

Since the vast majority of microentrepreneurs maintain no formal business records, baseline data for loan appraisal is often "created" by making approximations during the site visit. A data sheet is completed by the advisor, and becomes part of the applicant's loan file. The decision to extend or withhold credit is made largely by the business advisors, although the final credit approval is made by the Director of Operations. Simultaneously, the solidarity group members are assessing one another's creditworthiness, knowing that the group must assume the responsibility of making any loan payment that another group member cannot make.

Once the credit is granted, the advisor visits all group members every other month, and makes a report for each borrower's file. Notations are made on observable improvements in sales and overall business management, as well as on problems. Each such report is signed by the microentrepreneur.

Every week a delinquent loan list is issued. If a borrower skips a payment, the business advisor visits the microentrepreneur the next day to assess the problem. Borrowers are "graded" on a scale of one to five, according to the efficiency with which their loans are repaid. When one group member in particular is slow in repaying, he/she will often receive a reduced amount for the second credit. If delinquency continues, he/she is asked to leave the group once the term of the loan has passed, and the individual is replaced by a new member. If a number of group members are having difficulty paying, the group's file is frozen.

Fundación Paraguaya only considers a loan delinquent if the term of the loan has expired and there is an outstanding balance. If the loan term has not expired, the loan is only considered "atrasado", or late, as opposed to delinquent. According to the director for operations, the delinquency rate for loans made under the A.I.D. guarantee facility (all loans issued since July 13, 1988) is 3%, whereas the delinquency rate for the institution as a whole is 9%. Since last year, the Fundación maintains a loan loss reserve of $2,000 - $4,000 to cover those loans that have been declared uncollectible.

However, the above definition of delinquency and default is inadequate. A recent report [3] points out that because loans are currently given for such a short period of time, this definition has not yet caused major problems. However, as the program extends longer term loans, this could become a major issue. Actually, the correct method for calculating delinquency is to consider as delinquent the entire outstanding balance of loans that have payments more than a certain period (e.g., 60 days) past due. However, since no loans are currently granted for more than eight weeks, the above delinquency rates are probably reasonably accurate.

Since its inception, changes have been made in three operational aspects of the program:

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[3] Magill, John H. and Arelis Gomez Alfonso, "Micro-Enterprise Field Evaluation: Fundación Paraguaya de Cooperación y Desarrollo", Development Alternatives, Washington, D.C., November 1988, p. 32.

(a) **Check issuance.** At the outset, the Fundación was having difficulty getting borrowers to comply with the "one training course per credit" requirement. This necessitated changing course offerings to coordinate with check issuance days. Also, until mid-1988, national banking laws did not permit the issuance of machine-written checks -- all checks, whether in business or government, had to be hand-written. The Fundación is now automating this procedure.

(b) **Group size.** As mentioned above, solidarity groups were initially larger, until it was discovered that groups of three to five members were most effective.

(c) **Potential size of second loan.** Early borrowers were automatically offered a 50% increase over their first loan amount if they requested an increase, and had efficiently paid the first loan back. Now these groups may request an increase of 100% of the first loan.

The interest rate and fees charged by Fundación Paraguaya are set by the Board of Directors. One of the organization's primary objectives is financial self-sufficiency. As mentioned previously, it has made great progress toward reaching this goal in a short three-year period. Borrowers pay 2% interest, a 2% commission (for selection and administration), and a 2% training fee monthly (total of 6% per month or 72% per year). In addition, Law 1003 exacts a 1.75% one-time tax on promissory notes and Law 1035, a one-time 4% tax on commissions. This translates into a 114% per annum effective interest rate when calculated over twelve months, since borrowers pay interest and fees on the total loan amount for the life of the loan.[4] This interest rate falls between regular commercial interest rates, which are 28%, and the rates charged by money lenders, which could be as high as 20% per day.

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[4] This method is called "add-on" interest and is calculated as follows: loan amount x annual interest rate x term (years) of loan = monthly interest payment. The principal divided by the number of months is the monthly principal payment. Since the principal outstanding balance declines over the loan term, but the monthly interest payment does not, the effective interest rate is much higher than the nominal rate.

The Fundación charges such a substantial interest rate in order to cover its own financial and administrative costs, which are high. It receives no preferential interest rate from Banco Union, and must support a staff of 34 employees. Management hopes that the costliness of the credit will have a positive impact by encouraging borrowers to "graduate" more quickly from the program. The only point that is unclear in this argument is <u>to where</u> the microentrepreneurs will graduate, since there are no commercial credit programs in the country which specifically address the needs of this sector of the economy.

There is no collateral requirement for Fundación Paraguaya loans. Since the objective of the program is to provide credit to people who have no collateral, the good faith and mutual "backing" of group members serves as the only guarantee.

In the view of the operations manager, the largest impediment to increasing the success of the program is its very high operational costs. This has required the Fundación to charge very high interest rates in an effort to become financially self-sufficient. Annex 2 indicates that self-generated income covered 53% of the Fundación's expenses in 1987; it covered 84% through October 1988. Although the interest rate charged to microentrepreneurs is between commercial interest rates and those charged by money lenders, Fundación management is not satisfied with this and feels that it could reach many more people if rates were lower. High interest rates, however, is the only means through which it can cover administrative costs. Microentrepreneurs will continue to borrow at the rate charged by the Fundación because they have no credit options other than usurers. Management continues, nonetheless, to investigate ways of offering preferential interest rates.

The operations manager also had a number of suggestions as to how the Paraguayan government could show support for microentrepreneurs. In fact, the Fundación received a $30,000 grant from the U.S. Chamber of Commerce to draft a "Law Governing Microentrepreneurs." It is trying to gain support for the law in the Ministry of Industry and Commerce. The law contains the following provisions:

- the government should decree that 1% of all commercial bank portfolios go to microenterprise lending;

- a special simplified registration process should be developed for microenterprises involving payment of a one-time-only tax. These tax proceeds would be applied to special training programs for microentrepreneurs;
- a portion of the 1.75% tax currently charged on every credit transaction should be utilized to support microenterprises; and
- the current development banking regulation which states that development funds can only be lent against "real" guarantees should be loosened.

Discussion of Letter of Credit

At the end of 1986 Fundación Paraguaya tried unsuccessfully to negotiate the original form of the Chemical Bank letter of credit (LC) which had been prepared with the assistance of PRE. Nine financial institutions (two of which were government banks) rejected the original LC for being too cumbersome. The banks wanted a simple, "clean" LC -- i.e., in the event of a borrower default, collection from the guarantee would be automatic. The Fundación went through several revisions with Lloyds Bank over an 18-month period, only to have Lloyds ultimately decide that it did not want further involvement with the program. Finally, the edited version of the LC was accepted in 1988 by another local commercial bank, Banco Unión. At this point in time, Banco Unión had decided to utilize its involvement with the highly publicized Fundación Paraguaya as a marketing scheme, labeling itself "the bank of the microentrepreneurs." While these negotiations were taking place, the Fundación ran out of loan funds, so ACCION had Chemical Bank issue a "clean" (simple) LC for $65,000 backed by its Bridge Fund. This was re-issued three times (every 6 months) until the PRE LC was finally accepted.

The objections which Lloyds had to the original PRE LC revolved around actions that the bank was required to take before the LC guarantee could be accessed and Lloyds was reimbursed for defaulted loans. The main objections were as follows:

1) **Legal action.** The bank would have been required to exhaust all legal procedures, including getting an auction order (right to send bailiff and possess the Fundación's assets) and an embargo on assets (to prevent the Fundación from selling its assets). Lloyds did not want to

have to sue or take the Fundación to court. This would be a bad public relations move, since the Fundación enjoys substantial government and popular support, and such action would cast Lloyds as a large international bank going against tiny businesses. Lloyds said that a requirement for <u>extra</u>-judicial efforts would have been acceptable.

2) **Demand for payment.** This had to be filed not more than 30 days after the default took place. Lloyds felt that this would not be adequate time for its lawyer to obtain all the required documentation.

3) **Due diligence.** The burden was on the bank to prove that due diligence had in fact been exercised in attempting to collect the defaulted amount. Lloyds doubted that its concept of due diligence would coincide with the court findings. For example, if Lloyds chose a lawyer who ultimately lost the case, would this still be considered "due diligence"? Lloyds was not "master of its own destiny", but rather at the disposition of the courts as to whether it would be paid.

4) **Jurisdiction.** The LC required that default cases be submitted to a New York court and that New York law be applied by the court in rendering a decision. Lloyds was uncomfortable submitting the case to that jurisdiction.

5) **Access to records.** The LC required that the bank make any of its records available for inspection at A.I.D.'s request. Lloyds' position was that it had the right to decide which records, if any, would be provided for inspection by an outside agency.

6) **Release of letter of credit.** One of the requirements was that the bank submit the original LC (legal document) to Chemical Bank before receiving payment. Lloyds was unwilling to do this because of the many other hurdles it had to pass before receiving payment. Once it submitted the LC, there would be no legal proof of the guarantee. In the case of the ACCION-backed LC, it was willing to submit the original LC. The distinction was that Lloyds knew it would receive payment since the procedures of this LC were so simple (i.e., with submission of a certification of borrower default and the LC, payment would be automatic).

Lloyds felt that a representative from A.I.D./Washington or the U.S. Embassy should have negotiated the LC and explained its purpose. It was suggested that the A.I.D. Regional Legal Advisor based in Quito could have fulfilled this role if a PRE attorney was not available for such a trip.

3. <u>Sources of Funding and Financial Soundness</u>

Fundación Paraguaya has obtained funding from a variety of sources since its inception. Some examples are as follows:

- Since 1985 A.I.D. has contributed a total of $369,851, including in-kind contributions of $19,851 in addition to PRE guaranteed funds. The remaining $350,000 consisted of $121,900 for technical assistance and $228,100 for budget support.
- $25,000 loan from Banco Unión in 1986 for the revolving fund [5], obtained by using personal guarantees of the Fundación's Board of Directors.
- $65.000 LC from ACCION, through Lloyds Bank, in 1986 for the revolving fund (required due to delays in receipt of loan from the Inter-American Development Bank at the initiation of the program).
- $10,000 from Peace Corps in 1986, for similar purposes as above.
- $50,000 from the Inter-American Foundation in 1986. The Fundación's only requirement is to submit bi-annual reports.
- $25,000 in local donations (includes $16,500) for the revolving fund.
- $182,000 in local bank loans (includes $90,000 guaranteed by PRE for the revolving fund).
- $500,000 from IDB to fund fixed asset purchases by microenterprises. The first disbursement of $25,000 was in August 1988. Disbursements will be made every three months, although the Fundación may advance the disbursements if required. Only 35% interest may be charged annually on the total amount of each loan. Even the destination of the interest earned by the Fundación is fixed by IDB -- 50% must go into a reserve fund for the entire three-year loan period, and 50% may be used to cover internal costs.

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5 "Revolving fund" is a general term used to refer to the loan capital of Fundación Paraguaya. Funds are relent (revolved) as soon as possible after repayments are received.

Thus, Fundación Paraguaya has received external funding to cover both operating costs and lending to microentrepreneurs. In spite of the current dependence on borrowed funds, the Fundación is not highly leveraged and had a debt to equity ratio of only 1.4:1 as of October 1988. However, only 14.8% of its net worth is from local sources. Another 52.5% is donated capital for the revolving fund. Comparative balance sheets are presented as Annex 3.

As of October 1988, the Fundación had achieved 84% operating self-sufficiency, as can be seen in Annex 2. If the costs of new special projects are included in costs, the rate is only 50%. However, the costs of all of these special projects are supported by external donations.

One possible cause for concern is that for the period December 1987 to October 1988 interest income was only 14% of the average total outstanding loan balance and 15% for the period December 1986 to December 1987. At the 2% per month charged borrowers it should have been 20% and 24% respectively. This indicates a possible arrearage problem.[6] On the other hand, the income from supervision and training was 50% and 61% (it should have been 40% and 48%). Therefore, the total of the three income items for these two periods (64% and 76%) exceeds that expected (60% and 72%).

4. Relationship with ACCION

Since the establishment of Fundación Paraguaya in 1985, ACCION has provided technical assistance at various points in project development and expansion. However, more recently such assistance has been limited by funding constraints. There is a sharing of information among affiliates in the ACCION network which provides a cross-fertilization of ideas and experiences. Yearly conferences of personnel from these programs are held in the region. A monthly statistical report is sent to each affiliate which compares all programs in various areas.

The Executive Director of Fundación Paraguaya is also an ACCION advisor in that he is an employee of ACCION (as well as of the Fundación).

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[6] As discussed on p. 12, the delinquency rate was 3% for the PRE loans and 9% for the institution as a whole.

ACCION pays half of his salary in local currency. In exchange, the Director does consulting and travelling for ACCION.

## C. LOAN DISBURSEMENT AND IMPACT ON SUB-BORROWERS

Commercial bank funds guaranteed by the PRE letter of credit finally became available on July 14, 1988. By October 1988, approximately $90,000 had been disbursed to the Fundación Paraguaya from these funds. Of that amount, $70,000 had been disbursed directly from Banco Unión and another $20,000 from Lloyds Bank with a guarantee from Banco Unión. Approximately 514 loans had been made from these funds. All of these were four months or less in term. At the end of October 1988, the outstanding loan portfolio for these funds was estimated at $75,000 representing 45% of the total portfolio on that date. By December 1988, a cumulative total of $373,000 had been lent in 2,124 loans since the initiation of the program, but this figure includes an undetermined amount of reflows from the LC guaranteed funds and other borrowed and donated funds.[7] This compares to 4,800 loans made since the Fundación began up until December 1988, at an approximate total of $2.7 million (a precise figure canot be calculated due to exchange rate variations).

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[7] An approximation of the outstanding loans and the funding sources as of 10/31/88 is as follows:

| Assets | | Liabilities | |
|---|---|---|---|
| | | Loans: | |
| Undisbursed funds on deposit in banks (15-18%) | $22,978 | Citibank | $15,000 |
| Loans to micro-producers | 69,370 | Banco Unión | 70,000 |
| Loans to micro-retailers | 49,480 | Lloyds | 20,000 |
| | ------- | Sub-total | 105,000 |
| Total | 141,828 | Donated capital: | |
| | | Local donations | 15,500 |
| | | Peace Corps | 22,395 |
| | | Sub-total | 37,895 |
| | | Total | 142,895 |

The Citibank loan was guaranteed by the Fundación's directors. The number of loans made with the $90,000 (Banco Unión and Lloyds funds guaranteed by PRE) was estimated as follows: $373,000/2,124 = $175; $90,000/$175 = 514. The amount outstanding as of 10/31/88 was estimated as: 69,370 + 49,480 = 118,850/141,828 = .838 x 90,000 = 75,419.

The average loan size was $175. Since many of the borrowers receiving loans from this source have been previous clients of the Fundación, it is difficult to measure the impact on their businesses that can be specifically attributed to the A.I.D. guarantee program. However, had it not been for the LC, these funds would not have been available from local commercial sources except to the extent that ACCION itself was able to provide LCs to guarantee these loans.

In order to gain insights about the operations and impact of the microenterprise lending project in Paraguay, visits were made to a stratified random sample of borrowers. This sample was selected from all those who had received a loan (either first time or repeat) after July 7, 1988, when the PRE funds first became available. The sample of 24 borrowers represents all of the major types of businesses that have received loans under the program since July 1988. These included shoemakers, carpenters, garment makers, food preparers and vendors, and retailers.

Sub-borrower interviews followed a standard data collection guide which team members used to record responses and ensure consistency in the data obtained. These sub-borrower visits are summarized in the borrower profiles presented in Section II.D. below. Statistical data on this sample is presented in Annex 4.

In order to estimate the economic impact of the PRE facility on the sample of sub-borrowers, it was assumed that the impact of the PRE guaranteed loan was the same as the impact from non-guaranteed loans. This appeared to be an appropriate assumption inasmuch as the PRE funds were lent from a common pool of funds using lending procedures identical to those previously used by the Fundación. Baseline data was taken from the time when the sub-borrower first entered the Fundación program rather than the time that they received the PRE loan.[8] This baseline data was then compared to the condition of the business when the sub-borrower visits were made in December of 1988. By design, each borrower visited had received at least one loan after July 7, which means there is a high

[8] The reason was that 87.6% of the borrowers after July 7 had previously received a loan (or loans) from Fundación Paraguaya. Baseline data is recorded only at the time of the first loan, not at the time of all succeeding loans.

capital. The average loan size of the borrowers visited was $243 All of the 24 businesses visited had used the loans for productive purposes, in most cases to purchase raw materials or goods for retail sale. In addition, all of the businesses were viable, well-managed, had been in existence for more than one year and were repeat borrowers. The borrowers visited were all microenterprises by the standard definition of the Fundación. [9]

For the businesses visited, average gross monthly sales were $3,152. The largest business had gross sales of $37,440; the smallest had sales of $100. The average increase in sales was 107% since beginning with the Fundación.

The average sub-borrower had $2,179 in net fixed assets (NFA) as of December 1988. The smallest sub-borrower had $50 in NFA; the largest sub-borrower had $10,000 in NFA. The average increase in net fixed assets was 66% since beginning with the Fundación.

The average number of full-time employees was three, and 30% had no employees. A total of 60 persons (52% of whom were women) were employed by these borrowers. The average increase in employees was 32%.[10]

A common practice of the Fundación is to return to first-time borrowers six months after the original application to see what changes there have been in certain variables. Recently (January 1989), 20 borrowers were sampled who had received their first loans in July 1988, right after the LC guaranteed funds became available. Therefore, it is very likely that most of these borrowers received their loans from this source. The results of this survey are presented in Table 11. [11] Current average gross sales were $721, and had increased an average of 29%; net profits had increased 26%. Fixed assets increased only 12% due to the fact these loans were for working capital only. There was an average increase in employees of 30%. The fact that these were all first time

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[9] The Fundación defines microenterprises as those businesses that do not have access to formal bank credit.

[10] This is the cumulative result of <u>all</u> loans made to date and not just of the latest loan. However, this average is based on only half of the borrowers interviewed. The rest had no employees or were a start-up business (no employees) at the time of the first loan.

[11] For the purposes here US$1 = G 1,000.

average gross sales were $721, and had increased an average of 29%; net profits had increased 26%. Fixed assets increased only 12% due to the fact these loans were for working capital only. There was an average increase in employees of 30%. The fact that these were all first time borrowers may explain why the absolute average amounts are smaller than those of the sample taken during the evaluation visit. The sample of enterprises interviewed were all repeat borrowers (selected randomly without knowing if they were repeat or not) and so had more time to grow.

## D. INSTITUTIONAL IMPACT OF THE PROJECT

The use of the letter of credit has had a significant impact on the Fundación Paraguaya. In general, it has forced FP to strengthen its public relations and education towards the formal private sector. Prior to the PRE project, the Fundación relied on the signatures of Board members to guarantee loans. The A.I.D. LC has now encouraged the Fundación to establish a more "commercial" banking relationship with Banco Unión. In a similar vein, the Executive Director says, "the beneficiaries may be not only the microenterprises, but also the business class of Asunción. Their attitudes toward the informal sector are changing. The Fundación has entered into constructive engagement with them (the business class)." He has abandoned the "do-gooder, bleeding-heart liberal" image and dealt with the private sector on its own terms. This approach induced the Director to join the Chamber of Commerce, run for and become elected its president, and generally seek to enhance the Fundación's reputation among local businessmen.

At the same time the Fundación continues to serve a unique need; providing credit, training and technical assistance to microenterprises. These are services not provided by any other private sector institution. The important fact here is that FP is also trying to cover its own costs and operate in a business-like fashion.

The letter of credit and commercial borrowing have forced the Fundación to increase interest rates to borrowers so as to cover both capital and operational costs. This has allowed the Fundación to borrow from the banks at a commercial rate and be treated like any other good customer. If it had asked for lower, subsidized rates, it would receive lower priority treatment from the banks. The letter of credit has facilitated the Fundación being treated as one large borrower, as opposed to a group of many small borrowers. Since the bank assumes 10% of the risk, it charges the Fundación the highest rate allowed by the Central Bank - 28% add-on.[12] Currently, more than 50% of the loan portfolio is financed by commercial bank loans. This has given the Fundación almost unlimited access to local financing and, as a result, the prospect of eventually lowering further the need for external financing. It has also encouraged it to become increasingly self-sufficient both in terms of covering expenses and covering capital needs.

One of the findings is that the bank has been tougher with the Fundación because the letter of credit is less attractive than a 100% guarantee. Moreover, even though the LC has given the Fundación access to local financing, this financing may not always be available due to shortages of liquidity at particular banks resulting from the high legal reserve requirements of the Central Bank.

A lesson learned here was that if commercial banks are to be encouraged to lend their own funds to foundations for microenterprise on-lending, there must be some incentive to compensate banks for the perceived risk assumed with such lending. ACCION's experience appears to suggest that LCs issued for microenterprise lending should be considered as special cases and streamlined to facilitate acceptance by commercial banks.

The Director said that the Fundación would definitely use the LC mechanism again despite the initial difficulties in negotiating it as described in Section C. Since it does not have a very large capital base, the Fundación is always desperate for new funds. Although the initial negotiations were burdensome, the procedure now simply entails calling and requesting the bank to disburse the amount needed to the Fundación's account, up to the limit of the LC.

The Fundación is constantly trying to diversify and increase its sources of funding because of the overwhelming demand for its services. As indicated above, there are approximately 90,000 microenterprises in Asunción alone. A dilemma for FP is whether to continue making loans primarily to prior borrowers or shift the focus to new borrowers. The

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12 See definition of "add-on" interest on p.13.

former addresses the need for risk management (i.e., former borrowers with good repayment records are less risky than new borrowers), while the latter addresses the great demand for services.

## E. BORROWER PROFILES - PARAGUAY

The following pages provide brief descriptions of twenty of the twenty-four borrowers visited. They are intended to capture something of the flavor of the individuals involved and their unique business situations. Statistical information on these enterprises is presented in Annex 4.

Group #006, "Los Gómez"
Miss Rosa Concepción Gómez
Furniture Maker
Robert L. Petit area (Asunción)
Most recent loan = $200

This company makes closets, beds and other types of furniture. It handles the entire production process from raw lumber to finishing.

Miss Gómez with one of the cabinets made by "Los Gómez"

Los Gómez is a family business owned by Miss Gómez and her two brothers. Her older brother started the business in 1958 when he was working on contract to a "patrón" who purchased all his production. He began with one machine (saw) and worked "al aire libre" (no roof). He gradually added other machines such as a router and sander. He taught the business to his brother and sister and they formed a partnership. Miss Gomez is specifically responsible for administration and sales, but she also helps with some of the assembly aspects of production. She is currently studying business administration and will receive her degree in two years.

The relationship with Fundación Paraguaya began in 1986 as one of the first groups. Miss Gómez' brothers have received 15 loans totalling $3,765. Miss Gómez has taken out 9 loans totalling $900. Previously, they only used their own capital and required a 50% advance from their clients. Los Gómez did not even attempt to obtain a loan from a commercial bank because a property title (which they lacked at the time) and many "trámites", or transactions, were required. The first loan from Fundación Paraguaya was for a roof "to protect our machinery from the rain." Other loans have been for machinery maintenance and for materials other than wood (which they buy with their own resources). According to the Gómez', they have a good relationship with Fundación Paraguaya. For example, the business has been able to adjust its loan payments to monthly instead of weekly installments. One of the benefits of the training course has been that the business partners are able to determine the true price of their products, and have developed a rudimentary accounting system that allows the concern to keep track of monthly sales and to prepare a balance sheet every three months. Since Los Gómez began its relationship with Fundación Paraguaya its fixed assets (excluding land) have grown from $2,000 to $2,400 and monthly sales from $1,230 to $2,600.

There is a significant amount of price competition from the 30 other furniture makers in the barrio alone. The concern is not looking for new clients since its production level tends to equal the demand. The main clients are furniture stores (90%), with the rest sold to individuals. The business is not growing (nor does it appear that the owners want it to grow). Profit is used to cover living expenses and to maintain the current level of production. One problem is that only 70% of the clients pay on time. As a result, loan payments to Fundación Paraguaya are occasionally difficult to make.

Plans for the future include opening a new store so that the business can sell directly to customers. A book store is also being discussed as a possibility.

Group # 112, "San Martín"
Mr. Lorenzo Vera L.
Shoe Repair
Tembetary area (Asunción)
Most recent loan = $300

Mr. Vera repairs shoes. Although he does not make shoes from scratch, he does reconstruct them. He changes soles and heels and does cleaning and polishing.

Mr. Vera opened this second business in September 1988. In 1984 he started a food and dry goods kiosk that his wife now runs. Before this he had worked as the employee of a metal shop for five years. He opened the kiosk because he was tired of being an employee and he thought he could earn more on his own. He worked with his cousin for a month in shoe repair to learn the trade. He used his earnings from the kiosk for the initial investment in the shoe repair business. He chose a service industry because it gives him more freedom. It is also more relaxed. He sits under a large jacarandá tree outside his house listening to music and hammering nails in shoes. On the other hand, the kiosk required that he be present all the time. Now when it is slow with the repair shop, he can go help his wife with the kiosk. She also helps him by "painting" shoes if time permits. Mr. Vera was illiterate, but he is now taking primary education courses.

Mr. Vera received his first loan of $75 from Fundación Paraguaya in 1986. He has since received a total of 14 loans totalling $2,665. Training provided by Fundación Paraguaya has helped him to administer his business, control cash flow and determine his profits. He uses the loans from Fundación Paraguaya for the purchase of materials and his own funds to buy equipment and machinery; he recently bought a buffing machine. Vera's fixed assets have increased from $15 to $150. His daily income has increased from $2 to $15-20.

There is little competition for Mr. Vera in his immediate area. Since all of his customers are neighbors, this is the only area with which he is concerned. His only advertising is a sign in front of his house.

Mr. Vera would like to expand his repair shop as he believes that the demand exists. Both businesses are doing well and he has been able to buy a motorcycle, although his ultimate goal is to buy a house.

Group # 133, "Sensación"
Mr. Ramón Quintana
Retailer - kiosk
Trinidad area (Asunción)
Most recent loan = $50

Mr. Quintana operates a kiosk that sells dry goods. He also sells breaded cutlets, hard boiled eggs and meat pies that he prepares at home.

Mr. Quintana formed his business in 1978. Previously he had been a musician and played in a musical group. However, he became tired of the music business and wanted a change. He learned retailing through trial and error.

Mr. Quintana in his kiosk

Fundación Paraguaya granted his first loan of $75 in 1986, the first credit he had ever received. He had tried going to the bank, but "they told me I had to be large." Since then he has obtained 13 more loans averaging $73 for a total of $1,022. He usually makes weekly repayments and uses the loans to buy the goods to sell. He has attended all the courses offered by the Fundación Paraguaya and he feels that they have helped him greatly in buying and selling. In 1986 his monthly sales were $872; they are now $1,430. His fixed assets have increased from $436 to $700. He also has other businesses buying charcoal and making beef grease for sale to bakeries.

Since other kiosks are relatively far away, Mr. Quintana does not feel that he has much competition. His customers are mostly office and factory workers and students. His only advertising is the sign over his kiosk.

Mr. Quintana feels that he is doing well and he may buy another kiosk soon.

Group #170
Ms. Arminda de Carmona
Retailer - Kiosk
Most recent loan = $300

Ms. Carmona was a member of one of the first solidarity groups at Fundación Paraguaya to receive a loan; she expressed pride in having been involved since the beginning. The owner of the house she rents had pointed out the Fundación's advertisement in the paper. Ms. Carmona showed up at the first meeting with her daughter who is a seamstress, and a friend, who owns a luncheonette, prepared to form their own group. She knew from the beginning that she could count on them, and she was pleased to report that their group has always been on time with loan payments.

Ms. Carmona has run her kiosk for eight years. Previously, she travelled to Brazil and Argentina to purchase goods for other people's businesses. Her husband, who works in mining, was assigned to the distant Chaco region, and Ms. Carmona suddenly needed to find a business that she could operate out of her home in order to supplement their income. Locating the kiosk beside their home also facilitated her children's involvement in the business, since they can work during their free time between school and studies.

Ms. Carmona had never received credit prior to becoming involved in Fundación Paraguaya and said that, to her knowledge, no other credit programs exist for microenterprises in Asunción. Prior to his transfer, her husband had always helped her out financially. Since receiving the first loan from the Fundación, Ms. Carmona is selling more than double what she used to sell because of improved stock. Every two months, their group automatically takes out another loan. Neither she nor the other group members have ever had trouble paying back the credit, although Carmona said that "lengthening the term of the loan would make payback much easier."

With respect to her business' future, Ms. Carmona is most concerned about two new kiosks which have opened near her. Although she is always thinking of expansion, her thoughts have now turned to survival. "Now I've got to look for a way to offer better, cheaper service to keep my clients and keep any new ones from going to the competition."

Group #284, "Tayi"
Mrs. Olila Mercedes Rojas de Espínola
Mr. Antonio Virgilio Espínola
Food preparation
Vista Alegre area (Asunción)
Most recent loan = $600

This is a family business that prepares a variety of foods -- e.g., meat pies, sandwiches of breaded cutlets "milanesas", and "viandas" -- as well as portable multi-course meals for families and persons who cannot or do not want to cook. Although all of the food is prepared by hand, the family owns several large pieces of equipment such as an industrial stove to prepare the large volume of production.

Mrs. Espínola worked in her parents' restaurant where her mother showed her how to make "empanadas" (meat pies); she learned home economics in high school. The Espínolas got married in 1960 and formed their own "empanada" business three years later. Their main customers were students from the high school that Mrs. Espínola attended. At the beginning the Espinolas had to do everything themselves: they got up at 1 A.M. to make enough "empanadas" for the day. By 1967 they had 27 employees, but sold everything and went to Argentina to open a restaurant thinking it would be more lucrative. However, the business was not successful and they returned to Paraguay in 1976 to open a small restaurant in the interior of the country with no machines. This wasn't successful either; they returned to Asunción the same year and established the current business. The average monthly sales have grown from approximately $2,600 in 1986 to a current estimated $37,400 based on the level of production. They produce daily some 900 empanadas, 60 "viandas" (1,400 when school is in session, 10 months per year) and 400 "milanesas". Their fixed assets have increased from $2,800 to $7,800.

"Milanesa" sandwiches

The Espínolas now have 16 employees aged 5 to 38, all males. Most of the employees are primary and secondary school students originally from the interior. The Espínolas provide the boys with room, board, a small salary and an opportunity to go to school in Asunción and learn Spanish (most speak only Guaraní). They probably would not get an education otherwise as most are helping their parents on their farms. The boys go to school for half a day and work and study the other half. There are two shifts.

The first loan from Fundación Paraguaya was in 1987 for $120 to each of the three members of the group. Later that year the older daughter, Olga Espínola, joined the group. She is a teacher of philosophy and has a small greeting card business which she runs in her spare time. The Espínolas have received a total of 7 loans for approximately $2,660. These loans have been used to buy materials such as flour, oil, meat, etc. These loans have been critical to the Espínolas' success because they provide security; they know that they will get another loan as soon as the current one is paid off. It helps cover their periods of illiquidity, which occur often when customers do not pay on time. They began with weekly payments, but later began to request bi-weekly payments due to the cash flow problem. In order to keep customers and be competitive, they had to offer credit.

By and large, the Espínolas say they have had a good experience with Fundación Paraguaya. If they cannot make a payment they advise FP and an adjustment is made. They are in agreement with the interest rate and have been able to get a loan without a conventional guarantee.

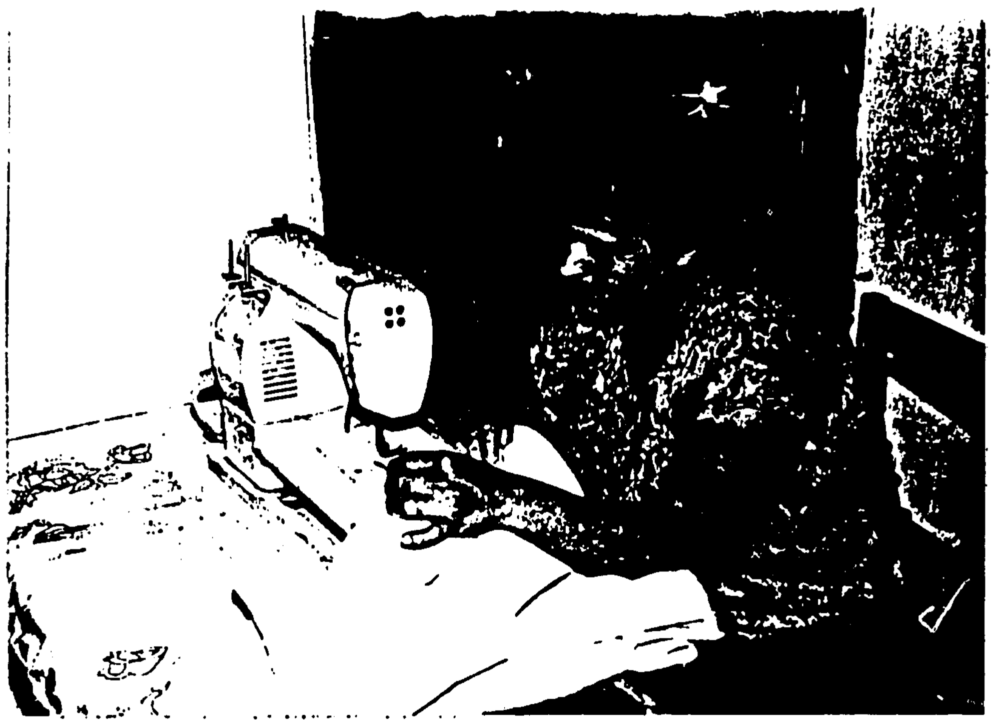
The Espínolas have not tried to obtain a loan from commercial banks because the processing period is long and complicated. Moreover, a mortgage guarantee is necessary and, since they rent their house, this was impossible. They once borrowed for three months from a money lender who charged them 20% per month and required daily payments.

The Espínolas business faces considerable competition from other small scale food preparers. Many competitors were flood victims and receive free flour (probably from Food for Peace). They sell empanadas for 2-3 days, and then stop until they need money again. Because of their lower costs they can sell empanadas much more cheaply than the Espínolas. These are called the "hormigas" (ants) because they are a "competencia disleal" (unfair competition). Their clients are students from the schools with which they have contracts, street vendors and families.

Currently, the Espínolas' sales cover their costs, but have been insufficient to permit reinvestment in the business. They say that if they had a pick-up truck they could buy raw materials in the interior and could also deliver to customers. They currently use delivery people who are not always reliable.

Group #287, "Lila"
Mrs. Marina Bernal de Ovando
Seamstress
Villa Elisa
Most recent loan = $300

Mrs. Ovando designs and produces women's clothes. Five to ten percent are produced by special order, and the remainder are mass produced. She conducts the entire process herself in her home using two sewing machines. She also sells thread and buttons as well as plates, glasses and utensils. Two of her children help her part-time.



Mrs. Ovando making clothes at one of her two sewing machines

Mrs. Ovando formed the business in 1986. Before that she sewed in another shop. However, it was far away and she really wanted to work at her own home. Although she only has a third grade education, she began a three year course in clothes-making. At the beginning she was afraid that customers would not pay, but she now has an established, trusted set of clients. Her husband gave her $220 and she put up $75 to buy materials. Her monthly sales have actually decreased from $201 to $100 since 1987, but her fixed assets have increased from $176 to $300. Part of this decrease could be attributed to devaluation.

Mrs. Ovando received her first loan of $120 from Fundación Paraguaya in 1987. The solidarity group consisted of four members, but the coordinator was often late with her payments and the others had to pay for her. This had a negative effect on the group's credit rating and subsequent loans were smaller. The group now consists of only three members. So far Mrs. Ovando says she has had a good experience with Fundación Paraguaya. She has received seven loans from FP for a total of approximately $1,100. She describes the courses as especially valuable. For example, the accounting proved to her the value of keeping books. In fact, she thinks the training <u>should</u> be obligatory because some people don't see the value of it or think that they don't need it. She chose Fundación Paraguaya because it was easy to get a loan there; she could not get one from a bank because of infeasible mortgage requirements.

Mrs. Ovando says her competition can offer lower prices, but not better quality than the garments she produces. Most of her clients are low-income individuals; they are generally more interested in low prices and less concerned with quality. She travels with her goods to other areas and sells in local markets as well as going door to door.

In general, Mrs. Ovando feels that her business is doing well. Most importantly, it has helped to cover expenses for her six children.

Group #287, "Lila"
Mrs. Selva de Rodríguez
Seamstress
Villa Elisa
Most recent loan = $200

Mrs. Rodríguez designs, produces and sells clothing for women and children. She makes all of the clothes on one machine in her home and either sells them in a rented stall in the local market, or on the street as an "ambulante" (walking street vendor).

Mrs. Rodríguez learned her craft from her mother, coursework, and by working for other seamstresses. She established her business in 1976 because she could earn more on her own and her time was more flexible. Her monthly sales have actually decreased from $490 in 1987 to $143 in 1988, attributable in part to devaluation and changing assessments of fixed assets. In addition, she no longer is able to afford the cost of an employee. Her fixed assets have increased from $176 to $300.

Mrs. Rodríguez's first loan from Fundación Paraguaya was for $120 in 1987. She has received six loans for a total of approximately $790. These loans have provided her with the opportunity to buy more raw materials. Previously she had borrowed at 15% per month from money lenders who required daily payments. The FP loans allowed her less frequent repayments: she can now work for a few days producing clothes and then go to the market to sell. She also borrowed once from a finance company at 8% per month. She recently had difficulty paying the Fundación Paraguaya loan and missed three payments because she got sick and could not work.

The courses at FP have helped Mrs. Rodríguez to improve the administration of her business. For example, she realized that she needed to charge more for her clothing in order to cover costs. Through closer attention to record keeping she now knows if she has any real profit. Previously, she would merely buy additional material if there was any cash available. She has begun to control her purchases better.

Group #292, "Nanawa"
Mrs. Justa Segovia
Food preparation
Obrero area (Asunción)
Most recent loan = $50

This business involves the preparation of "empanadas" (meat pies) and "mazamora". Empanadas are prepared by inserting cooked ground beef into a pocket of dough. This is then deep fried. "Mazamora" is made by boiling sweet corn until the kernels double in size. A type of broth is formed which is eaten with sugar as a dessert.

Mrs. Segovia began her own business in 1971 with the preparation of breaded cutlets. However, this proved to be too expensive and complicated and the level of sales was low. As a result, she switched to making mazamora which is easier and cheaper. She began preparing empanadas only recently. Mrs. Segovia learned how to prepare food from her mother and "from just being a housewife". One of her motivations for forming the business was to supplement family income, since her husband's income was not enough to cover all the expenses (they have five children). Her husband has his own business as well: a barbershop. She has a primary education only because there was no time for high school; "My mother needed my help," she said.

Previously her husband had been in the solidarity group for two years. He borrowed for both his business' needs and hers. In June 1988 one member of the group dropped out, so the group was restructured and Mrs. Segovia joined as a member. Since then she has had three loans for $50 each from Fundación Paraguaya, each of which she used for the purchase of materials. She never had a loan before and had always used her own capital for her business. The loans have helped her buy more raw material and, as a result, obtain a better unit price. Although her sales of empanadas have doubled since June 1988, she has had to lower the price in order to stay competitive. The net effect is that her monthly sales have decreased from $217 to $158. As in many microenterprises, this is probably due to a combination of devaluation and changing definitions of fixed assets. However, she "always has money left over after paying for the materials" and so has no trouble making her loan payments.

Mrs. Segovia says that there is a lot of competition in the sale of empanadas, though not in mazamora. She has recently opened another business, a retail store, which she uses for the sale of some of her empanadas. Most of her sales are made through visits to small workshops and directly to homes in her area.

Group #350
Mr. Rufino García
Shoemaker
Most recent loan = $200

Rufino García is a quiet, methodical man who has been a shoemaker for over twenty years. He had always worked for other business owners until four years ago, when he decided to go into independent shoe production. Friends and contacts began asking him to make shoes on the side, so he decided to couple this demand with a life-long interest in having his own business. García moved slowly into self-employment by filling personal orders on the side while maintaining his full-time job. He accomplished this by obtaining his boss's approval and utilizing the company's tools after hours.

Two years ago, García located a small shop that would lease working space, so he and his wife decided to start their own business. García affectionately describes her as being "agressive and good with people", which he considers ideal characteristics for sales. He prefers to stick to raw materials acquisition and production.

About two years ago, García's cousin, a seamstress, asked him to become part of a solidarity group after she had attended the first meeting at Fundación Paraguaya. Since the third group member was a neighbor and friend of his cousin, García had faith in the others and knew the payments were sufficiently low that pay-back would not be a problem.

García estimates that his sales have doubled since receiving his first Fundación Paraguaya loan. Sales are extremely seasonal in the shoe business, with peaks occurring at the beginning of the hot and cool seasons. García had never applied for or received credit prior to joining Fundación Paraguaya. He has maintained an excellent pay-back record during two years of participation in the program. The Fundación staff tells him that he could obtain commercial credit _if_ a credit program for microentrepreneurs existed in a commercial bank.

García's first loan two years ago was for $50; today he borrows $200 every four months and makes bi-weekly payments. The loans are used to purchase leather and other raw materials. García is now looking into getting an IDB loan to purchase his own machinery to augment his production and sales considerably. He currently rents working space and tools from a man who has no finishing machines, and this requires him to do the laborious work by hand. García considers insufficient capital for purchasing machinery and hiring an assistant to be the biggest impediment to making his business grow.

García speaks well of the course offerings at the Fundación, and found those on administration, accounting and marketing to be very relevant and "worth repeating". He also actively participates in a "trade group" comprised only of shoemakers.

Group #416
Ms. María Alicia de Cárdenas
Seamstress
Most recent loan = $200

María Alicia does dress design and sewing in the idyllic setting of her back yard -- under a grape trellis surrounded by a dozen varieties of fruit trees and other plants. For over twenty years she has been involved in the same line of business and has always worked out of her own home. Her clientele has expanded over the years strictly by word-of-mouth, and it has never occurred to her to do any kind of advertising. María Alicia knows that the vast majority of her clients live within a few blocks of her and feels that quality work should speak for itself. The only difficulty confronting this line of business is competition. There are up to 20 seamstresses per neighborhood and 5 per square block. Business is also very seasonal; it becomes extremely busy before holidays and then dwindles during the rest of the year.

María Alicia first learned about the Fundación Paraguaya program from a newspaper article and subsequently was approached by a girlfriend who had attended the first solidarity group meeting. "Solidarity groups aren't always made up of people who know one another," she explained. "I went and visited the businesses of the other two women who my friend had selected for the group, and just from observing how they ran their businesses, I could tell whether they were serious and reliable or not". María Alicia commented that the input from the business advisors and the classes offered at the Fundación were very helpful and taught her how to manage her money better.

Since joining the program, María Alicia has taken out six loans, which are used to purchase fabrics and notions. The first loan was for \$50; now she receives \$200 every four months, which must be repaid bi-weekly. She is proud of the fact that her group has always paid on time, but admits that the last payment was extremely difficult because her business has been bad. "When you have no capital, it's very hard to get ahead. Getting the loans from Fundación Paraguaya, even if it's hard sometimes to make the payments, really makes my work a lot easier. Then I can buy materials up front and my customers don't have to pay all at once. I always hope that this will keep my customers coming back and will attract new ones."

Group #429
Ms. Asunción Samudio
Kiosk Owner
Most recent loan = \$200

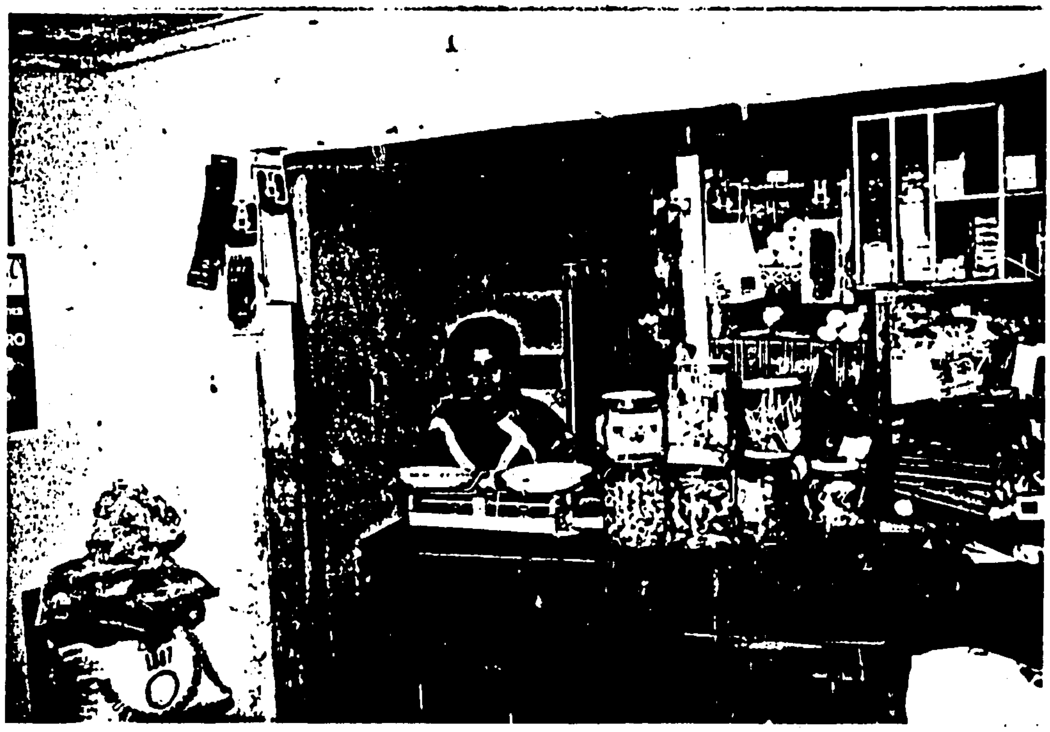
At the end of a dusty gravel road, Asunción Samudio manages a neighborhood kiosk that she has owned for two years. Previously, she independently ran a small soda distributing business, but felt that opening a kiosk would provide work for her children. Asunción's husband was unable to return to his job following an occupational injury, so the Fundación loan has enabled him and their two children to work at the kiosk.

Asunción heard about the Fundación Paraguaya program from a girlfriend of thirty years, who had asked her to join a solidarity group. She had faith in the other two group members, who were also friends, and knew they would be conscientious in making loan payments. After attending the first two meetings, Asunción was convinced of the value of the program. To date, their group has had no trouble repaying the loans.

Asunción found the training courses at the Fundación very helpful because she knew that she had the capacity to sell more, but didn't know how. In her own words, "the courses on buying and selling and competition opened my eyes, and taught me how to develop my business. I now take my daughter along to hear the classes."

The first loan for $50 came at a very critical time because the Samudio family was in a bad financial situation and needed the money to purchase stock for the kiosk. Prior to this, Asunción had always developed the business with the family's money and had never asked for a loan anywhere. "I was afraid to ask for credit," she explained. "I knew that they would ask me to fill out a lot of forms and put up a guarantee." Since the first loan, Asunción has received four more, the amounts of which have slowly increased to $200.

Asunción's sales have increased by 50% since her first loan, and she directly attributes this to having received the credit from Fundación Paraguaya. "The only problem my business really faces is lack of capital," she explained. "Often people come looking for things that I don't carry because I don't have enough money to buy everything." Another consideration is a lack of storage and display space. Asunción's goal is to expand her kiosk but, unfortunately, credit from Fundación Paraguaya cannot be used to cover construction costs. In spite of this, she is proud of her business and feels that she is doing very well, especially considering the newness of the venture.



Borrower #438
Juan Carlos Ortíz
Milk Distributor
Loan: $200

Juan Carlos Ortíz is a stern-looking yet soft-spoken man who began his milk distribution business seven years ago. Prior to that, he had gained business experience by working for his cousin selling eggs and milk from a truck. After two years of seeing the perishability and loss involved in the egg business, Ortíz decided to start his own business, but restrict it to milk distribution. The milk is purchased sterilized and cold -- "almost directly from the cow". A truck delivers the milk to Ortíz's home, where it is placed in 50 liter containers.

Ortíz started out by selling milk to kiosks and luncheonettes. He developed his clientele by systematically covering different zones of the city and calling on every potential customer. About three years ago, when he saw that a much higher profit margin could be made through bypassing the store owners, Ortíz began selling directly to homes. At that point, he was purchasing a liter at G 120; the milk was resold to a kiosk at G 130, when the average "at your door" price was G 150. Ortíz then employed the same sales technique, and canvassed entire neighborhoods in search of customers. Many new customers were obtained via word-of-mouth, since Ortíz' milk delivery service was not only more convenient, but offered cheaper and fresher milk than the stores (the store price at that time was G 180/liter).

Ortíz had started the business with his own money, and received his first loan of $50 from Fundación Paraguaya in 1987. His wife, who has a custom curtain business, had heard about the program on television and encouraged a friend of many years to form a solidarity group with them. Ortíz and his wife have known the individual for many years, and had a lot of faith that he would repay the loan.

Since 1987, Ortíz has received a loan every four months, and makes bi-weekly loan payments. The most recent loan was for $200. Every day he is required to pay cash for the milk purchased, whereas the customers pay only once a month. This requires Ortiz to settle accounts with his customers every day, in addition to doing the milk distribution. The Fundación Paraguaya loans help him with cash flow problems and facilitated his purchase of a new mini-truck for milk runs, which has also contributed to greater sales.

Ortíz feels that he could qualify for commercial bank credit, although he would have to ask a family member to put up the guarantee. Since commercial banks do not have credit programs expressly for microentrepreneurs, the loan amounts are too large for micros to manage, with $1500 being the minimum loan amount.

At the time of the interview, Ortíz described his business as being in a solid growth stage and having no impediments to continued growth. Since distributors seem to take entire neighborhoods, Ortíz sees his company as having no competition.

Group #441, Pérez Family
Mr. Paulino Pérez Ramírez
Mrs. Esther Morena de Pérez
Shoemaker
Fernando de la Mora (San Pedro)
Most recent loan = $150

Mr. Pérez and his wife make shoes that they design themselves. They have two machines, one of which is multi-purpose. They have one full-time salaried employee, a 14 year old student who attends high school classes at night. In addition, their two children also help with the process.

The Pérezes were married in 1963 and shortly thereafter began their business. Mr. Pérez has a primary education and had been working as an apprentice for two years. They began with a table and performed every task by hand. Two years ago Mr. Pérez bought a machine that does polishing and other preparations. He bought this and, more recently, a second machine with their own capital. All of the large leather pieces are cut by hand. He has learned the business solely by experience.

The Pérezes got the first loan from Fundación Paraguaya in 1987. They have received five loans totaling $650. Recently, they had some difficulty making their loan payments for the first time, due to cash flow problems. Clients fail to pay for shoes on a timely basis. In addition, heavy demand at the end of the year requires more raw materials than usual. If they had made the payment due on December 5th, they would not have been able to buy materials and could not have continued working. Mr. Pérez says that they should be able to make the next payments.

Mr. Pérez considers the FP interest rate to be too high. In fact, his opinion is that they are "just one more usurer". There has been much pressure from FP to make the loan payments. He says that the only course offered to him by FP was one on the importance of prompt payment, which he interprets as another form of pressure. He is considering not using FP anymore and selling some personal items in order to buy raw materials. He acknowledged that the FP loans have helped his business to grow. He could also probably get a bank loan using a mortgage guarantee on their house. Since receiving the first loan, monthly sales have decreased from $2,261 to $1,440 and fixed assets have decreased from $2,161 to $1,000, due in part to devaluation.

There are approximately 50 other shoemakers in the area. The Pérezes sell only to retailers and department stores based on specific orders. Mr. Perez does his selling by going to individual stores with samples.

Group #455
Catalina and Cándido Miranda
Bakery
Most recent loan = $500

On the day of our visit, Catalina and Cándido Miranda were busy preparing a batch of the traditional Paraguayan Christmas breads, which contain nuts, raisins and a variety of fruits. This cheerful couple spoke of the substantial economic progress they had made during their twenty years of marriage. "When we were married, all we had was one chair," Catalina explained. Cándido worked in a bakery for a number of years, then decided to start his own bakery on the side. At that time, Catalina baked in their home, and Cándido went out in search of customers.

The Mirandas are proud to say that they started the business with their own money, and a contribution of some old equipment from Cándido's kindly boss. In 1974, they got a loan from Banco de Londres to buy two industrial ovens and to complete the necessary electrical work. This was possible because, at that time, a relative of Cándido's (who was a person of means) cosigned for them. Subsequently, the relative left the country, so this was the only commercial credit they received.

About eighteen months ago, the Mirandas received a visit from two Fundación business advisors, who told them about the credit program for microentrepreneurs. Catalina and Cándido persuaded a friend who sells baking equipment to form a solidarity group with them. The group was favorably impressed with the ease with which they obtained credit at the Fundación. "Every place else the credit transaction is so complicated and slow, that is if you can even find a bank that offers credit to small businesses. At the Fundación, if you pay well, they open a credit window to you that is automatic."

The first loan was for $150 per person; now the group members each receive $250. The credit has helped the Mirandas economically, since it enables them to purchase flour and other ingredients in bulk. Now that there is more stock on hand, they have made additional business calls to kiosks and stores, and have doubled their sales over the past 18 months. Cándido commented, "we have many more possibilities now that we have continuous working capital for materials."

The Mirandas consider competition to be their biggest problem, and must always keep up-to-date on what their competitors are charging. Cándido muses that "maintaining and improving the quality of our products is the key to beating them."

Group #457
Mrs. Hercilda Cáceres de Quesnel
Seamstress
Asunción
Most recent loan = $600

This business makes a variety of clothing, primarily women's clothes and men's shirts. Mrs. Cáceres and her four employees, all women, use two family-sized and one industrial-size sewing machine. Each person makes the whole garment.

Mrs. Cáceres started her business in 1984 in her home with two sewing machines and one employee. Previously, she had worked under contract for a "patrón" and was paid by the piece. She also had about 20 years experience as a dressmaker. Although she only has a general primary education, she took a three-year course in clothes making. She formed her business because she felt she could earn more on her own.

Mrs. Cáceres spent the first 2-3 months of operation looking for clients in her neighborhood. After that she had more than enough demand for her level of production and has not done much marketing since. Her place of business is a front room of her house which serves as both a production area and a store to display her clothes. Her husband is a furniture maker and has his workshop behind their house.

Her relationship with Fundación Paraguaya began in 1987. Mrs. Cáceres learned about FP from friends who were clients. She uses the loans to purchase materials. Her monthly sales have gone from $500 in 1987 to $1,000 in 1988, and fixed assets have risen from $1,500 to $2,000. She says she chose FP because the application procedure was simple, the interest rate is very low in comparison to a bank or a finance company, and the guarantee required is feasible. She could not get credit from a bank without a mortgage guarantee and was unwilling to mortgage her house for such small sums ($150 to $600). She feels good about her relationship with Fundación Paraguaya; "If one makes the payments, there is no problem getting a loan." She would prefer a longer term for the loans, however, so that she could make monthly rather than weekly payments. She likes the FP courses and thinks that they should be obligatory because many people do not realize their value until they attend.

There is considerable competition in her area. Most of the other clothing businesses are of the same size. However, the competition has decreased somewhat due a lack of sales caused by devaluation of the guaraní. Most of her customers are individuals who pay cash. She is also looking for commercial customers. Approximately 60% of her sales are specific orders; the other 40% she sells from her store.

In spite of a slight drop in sales recently, Mrs. Cáceres feels she is doing well. She has no other debts. She will soon look for additional clients and later will possibly open another store. She would like to buy another sewing machine and then hire additional employees.

Group #481, "Sary"
Mrs. Angela Villagra de Cera
Seamstress/ Tailor
Ciudad Nueva (Asunción)
Most recent loan = $600

Mrs. Cera and her husband make various types of clothing, basing their designs on what they see in fashion magazines. To assist them with production they have four employees that work on three industrial sewing machines and one recently purchased finishing machine. They sub-contract out the making of buttonholes.

The Ceras are from Mexico where they were working as professionals -- he as a business administrator (has an MBA) and she as a speech therapist. Before moving to Paraguay permanently, Mr. Cera visited to make sure there were adequate suppliers and to determine if there was a market for clothing. They moved to Paraguay in 1986 and established their business the same year with $5,000 of working capital, $3,000 worth of machinery and 10 employees. One of the initial problems was that they extended 90 day credit to customers. Also, there were many bad checks, especially from buyers in Puente Stroessner. Consequently, they had to reduce the number of employees and change their client base to Asunción. Currently, they are both still working half-time as professionals.

They received the first loan from Fundación Paraguaya in 1987 and have a total of five loans (all for material purchase) for an approximate amount of $2,300. They could not get a loan from a finance company because it required a mortgage on their house. The banks would not even consider them for credit previously since they had no references. However, Fundación Paraguaya provides them with references enabling them to open a line of credit of $400 at the Banco de Trabajadores (2.5% interest per month). They have also gotten a loan for $300 from the Unión Industrial Paraguaya under a program for small and micro businesses. Since getting the first loan from FP their monthly sales have increased from $3,000 to $4,700 and fixed assets from $4,200 to $7,500.

The Ceras say that they have a good relationship with Fundación Paraguaya. They particularly appreciate the fieldworkers who are always available to provide assistance. Mrs. Cera has been giving accounting, human relations and administration courses at FP. The Ceras are involved in the formation of an association of about 300 small clothes makers that are clients of FP. Such an association would be able to buy materials wholesale, possibly enjoy tax free importation status, and could sell under a group brand name direct to the public and to large retail stores.

The Ceras say that competition comes from both imports (cheaper Brazilian clothing) and local producers, particularly "Koreans who work in their homes, many of whom are illegal and not registered". Their sales are to individuals (30%) and to retail stores (70%). The Ceras visit stores personally to sell their products. Previously they sold more to stores (90%), but many have closed due to lack of demand. This caused a certain drop in the Ceras' sales and some difficulty in making the loan payments.

In terms of the future, they would like to open a store in the front of their house. However, they are currently very frustrated because a high-rise building is being constructed next door and material is constantly falling on their house. They hope to open the store when the construction is finished.

Group #553, "Cantua"
Mrs. Victorina Rissi
Retailer of handicrafts
Mercado 4, Stroessner area (Asunción)
Most recent loan = $100

This store, known as "María La Milagrosa", sells various types of handicrafts: mostly baskets, ceramic pieces, and wood carvings. Craftsmen come to the store or Mrs. Rissi visits towns in the interior to obtain merchandise. She has a permanent store in the largest market in Asunción. Her two teenage children help her part-time.

Mrs. Rissi in her handicraft store in
Mercado 4 with her son and daughter

Mrs. Rissi started her business in 1986. Prior to that she did not work outside the home. The store originally belonged to her mother-in-law who became ill; Mr. Rissi then bought the store from his mother. Since he did not have time to run it (he works in the Chaco), Mrs. Rissi felt "obligated" to take it over. With only a primary education, Mrs. Rissi learned the business by trial and error.

Mrs. Rissi received her first loan from Fundación Paraguaya in June 1988. She received a total of four loans for approximately $350, all for the purchase of merchandise. Since getting her first loan, monthly sales have increased from $814 to $2,600 and fixed assets from $100 to $800. She could have gotten a bank loan, but did not want to mortgage her land. Also, she finds that the FP processing is quicker and simpler and does not require a guarantor. She has not been able to attend FP classes because they are at times when she must be in the store. Her solidarity group consists of herself and two other retailers. All are related by family ties, and she feels that the group functions well and harmoniously. Mrs. Rissi is the coordinator and thus makes the loan payments each Monday to Fundación Paraguaya. There was only one instance where a member missed a payment, but it was rectified within one week.

Most of her competition comes from specialty craft stores, but she believes that there are few other mixed craft stores. Her largest selling item is baskets while sales of ceramic items seem to be slacking off. Most of her customers are individuals, including a large number of Bolivian and Argentine tourists. There have been a few fairs where she takes orders for larger amounts of merchandise. She also gives her card to customers and uses word of mouth advertising. Most sales occur on the weekend.

Mrs. Rissi says she wants her business to grow slowly because she is very cautious. She has not considered opening another store.

Group #613, "Dania"
Mrs. Dania Pincheira Pascal de Cerda
Mr. Hugo Cerda Montoya
Restaurant
San Lorenzo (center of Asunción)
Most recent loan = $200

This is a family business which consists of a restaurant and an adjoining store where the Cerda family sells their own ice cream, sandwiches and packaged food. Before opening the restaurant, Mrs. Cerda was a journalist and also sold imported products. She still spends 70% of her time in her market stall. She and her husband opened the restaurant in 1986 with a partner, but after one year they bought out the partner and also acquired the store he owned next to the restaurant. From the beginning the Cerdas had problems with their six employees. They could not afford to hire experienced employees, so the people they hired required a considerable amount of supervision. In the beginning they worked 13 hours a day and only slept for about four hours. They have learned that their rented locale is too large, and that they could have the same business in a smaller location for less rent. They are now liquidating the restaurant to move to such a location.

Mrs. Cerda's first contact with Fundación Paraguaya was in 1987 when she joined a solidarity group with four other retailers. But after two months she left the group because the others were too far away and because she was afraid she would not be able to increase her payment if one member did not pay her share. She says that she did not like the group approach because it is difficult to find responsible people. She received three loans for $240 while in this group. She then formed a group with her husband and has since received three more loans for $1,100. The last loan was for the purchase of a freezer. The others were for food for the restaurant and store. She feels the courses at FP have been positive. On the other hand, she feels that the loan terms are too short, payment periods too frequent (every two weeks) and the interest rate too high. After successfully repaying several loans she now has access to credit from a finance company based only on her signature. In ten minutes she can get a loan for as long as 24 months. The main reason she continues getting loans through FP is the training and technical assistance. She says she has benefitted from the accounting and administration courses, but mostly from the follow-up visits of the fieldworker. Since beginning with FP, sales from the restaurant and adjoining store have decreased from $1,884 to $1,650, due in part to devaluation. However, her fixed assets have increased from $2,261 to $4,000.

The Cerdas' main competitors are street food vendors, who can undercut them in price because of low overhead. Also there are five other restaurants nearby. This competition is increasing by about 10% per month. The main customers are office workers who are very demanding and "want to eat like the rich, but pay like the poor." Mrs. Cerda does not feel that the business is doing too well. She admits that she needs to spend more time there, but this would detract from the time spent at her market stall.

Group #671, "Amoníaco [13]
Mr. Catalacio Roja Baez
Carpentry
Ñemby (Mbocayaty)
Most recent loan = $50

Mr. Roja makes various types of furniture to specific order although he will occasionally make a sample and sell it. He buys rough cut lumber and constructs the furniture from scratch to finishing. He has machines that make certain pieces such as mounts, frames, etc.

Mr. Roja formed his first carpentry business in 1979. He established the current business in 1986 with a partner who had been in business for 15 years. From 1973-79, he worked as an employee for another carpenter who made furniture for sale in Puente Stroessner. He also learned the trade through a series of carpentry courses. Mr. Roja got into the current business because his friend's father became ill and asked Mr. Roja to become his partner. He later formed his own business because "customers came into the shop and spoke only with the owner; they ignored me." His pride and the knowledge that he could do well on his own were his main incentives.

Mr. Roja got his first loan from Fundación Paraguaya in August 1988. He has had only two loans for $50 each, both for the purchase of lumber. There are two other persons in his solidarity group: his wife and Tomás Saavedra. The day of the interview Mr. Roja had taken over the operation of Mr. Saavedra's shop as a favor to him since Mr. Saavedra was out of town buying materials and demand was especially heavy before Christmas.

Initially Mr. Roja heard of Fundación Paraguaya from a señora whose husband had gotten drunk and gambled away all of their money. As a result, the other members of the group had to make the payment for her. Thus Mr. Roja was skeptical of the group approach. When he found that the other member of his group would also be a carpenter, he felt reassured.

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[13]A fieldworker trained as a chemical engineer named this group after the molecule, $NH_3$.

He feels this is less risky than having members in different businesses because if one member gets in trouble, the other members know how to help him out. He feels that FP helps families to continue to invest in their businesses. The loans allow families to cover their own expenses from the business profits and at the same time be able to purchase additional materials. The one time he tried to get a bank loan, the bank required collateral to cover four times the amount of the loan. His monthly sales have decreased since August 1988 from $543 to $390 and fixed assets from $945 to $870, again due in part to devaluation.

Mr. Roja says that carpenters do not compete for existing clients, but complement each other since each has his own clientele. In fact, they often help each other with special jobs or when demand is heavy. However, there is competition for new clients. Carpenters do not cut prices, but rather compete in the quality of their work. Mr. Roja sells 90% of his wares to individuals on special order. His only advertising is word of mouth.

Group #681, "Hacia La Meta" (toward the goal)
Mr. Diego Guzmán
Photographer
Fernando de la Mora (San Pedro)
Most recent loan = $75

Mr. Guzmán accepts contracts to take pictures for weddings, graduations and other social events. In addition, he does identification card pictures for schools and is under contract to a magazine to take pictures every time there is an accident at the "Curva de la Muerte", a dangerous curve in the road near his house. He does not develop pictures, but sends them to a processing lab for developing. He has no full-time employees although his brother helps him part-time when necessary. Other photographers also help him when he has a heavy work load.

Mr. Guzmán established his business in 1987 after working for another photographer for three years. Before that, he worked in a leatherwork shop. When Mr. Guzmán was 12 years old, his brother had a camera. Mr. Guzmán used to take pictures that usually turned out well. A woman recommended that he work as an apprentice to a photographer. Although he learned a lot in this job, he was treated very poorly. This poor treatment was an incentive for him to learn more so that he could start his own business. Mr. Guzmán began with $60, a camera and a flash. A friend who has a hamburger stand offered him an adjoining shelter where he put up his first sign. He later moved to his current one room office. Luckily, people in the area knew him, and eventually learned that he was in business. His first jobs were in schools and at parties. His clientele grew by word of mouth.

Mr. Guzmán's first loan from Fundación Paraguaya was for $50 in September 1988. He has since received another loan for $75. Both of these loans had a two month term, they were used to purchase film and batteries. He borrowed from a money lender who charged 5% per month to buy his camera. The training courses at FP have taught him to seek out more clients. He says that having to pay his loan promptly has taught him how to administer his money better. Since not all clients pay on time, he has learned to ask for an advance from 30% of his clients. The other 70% can pay later, but he has found that 20% of these clients don't pay on time. He concludes that he must get to know his clients better. His monthly sales since September 1988 have increased from $1,412 to $1,950, but assets have decreased from $174 to $160, due in part to devaluation and changing definitions of fixed assets.

Mr. Guzmán says that he has a lot of competition, but that he has many clients because his many friends recommend him. His clients are mostly individuals as indicated above.

He feels he is doing well and that his clientele is expanding. He plans to buy better equipment eventually, and a motorcycle. He may even set up a darkroom.

# III. MEXICO

## A. ECONOMIC AND FINANCIAL OVERVIEW

### 1. Economic

Mexico's economy is becoming open and competitive, with a dominant manufacturing and commercial sector and a relatively small agricultural sector. Because of its increasing openness and former dependence on the international market for export of oil and, more recently, the import of industrial goods, Mexico's economy is strongly influenced by external economic conditions.

After high inflation during the 1970s and early 1980s, Mexico suffered a general macro-economic crisis in 1982. The government responded with a stabilization and structural reform program which began in 1986, following the collapse of international oil prices.

In spite of Mexico's efforts at adjustment, inflation has remained high (peaking at 159% in 1987), but has been reduced to an estimated 50% in 1988 as a result of the Economic Solidarity Pact (ESP). The Pact consists of a combination of tight fiscal and monetary policies along with controls on wages, prices and the exchange rate, as well as an opening of the economy. In addition to reducing the rate of inflation, the ESP has reduced government expenditures, although the deficit still remains high. Nominal interest rates have also been reduced though effective rates remain high.

The recent slowing of economic growth and the ongoing high inflation rate have had a negative impact on microenterprises. Sales have been limited by the drop in internal demand, while the costs of production remain relatively high. Both of these factors have tended to reduce profits.

Unemployment and underemployment have become serious problems. Although the population grew at an average annual rate of only 2.3% from 1983 to 1986, the labor force expanded at an average annual rate of 3.7%. On the other hand, employment in the formal sector decreased an average of .7% annually. This has caused high unemployment rates and has led to an increase in the number of workers seeking employment in the informal sector and to increased emigration and unemployment. As in many countries, those forced to enter the informal sector often form microenterprises or work for other microentrepreneurs.

Monterrey, where the ACCION project is centered, is in the state of Nuevo León. The city of Monterrey and the state of Nuevo León occupy important positions in the industrial economy of Mexico. The Chamber of Industries (CAINTRA) estimates that there are 8,500 industries in Nuevo León, of which 90% are micro (1 to 5 employees) or small (6 to 49 employees). Of these, approximately 75% are formal (i.e. registered) and 25% are informal. The majority of these enterprises are micro-retailers and micro-service businesses. The majority (90%) of the micro-producers are men.

Unemployment has been increasing in Monterrey, though not as severely as in Mexico as a whole. The economic crisis of 1982 was felt strongly there with the closing of entire divisions of companies. Many of those laid off formed small or micro-businesses.

An assessment of the informal sector in Monterrey in 1980 refuted the frequently held belief that microentrepreneurs' businesses are unstable and transitory, but it confirmed that access to credit is a major problem. One hundred percent of respondents needed credit to expand their businesses, 50% had difficulty obtaining bank credit, and only 28% had actually obtained formal credit.

2. Financial

In 1982, privately owned commercial and investment banks of Mexico were nationalized and consolidated, resulting in capital losses of approximately U.S. $1 billion. Nationalized banks are two thirds owned by the federal government.

In Monterrey, there are 19 banks -- three regional banks, fifteen national and multi-regional banks, and one international bank. There are also three government development banks and the National Finance Corporation (NAFINSA), which provides funding to five national development rediscount facilities. One of these funds is the Guarantee and Development Fund for Small and Medium Industry (FOGAIN). This fund acts as a secondary market which buys loans made by commercial banks to medium, small and micro-producers.

The Bank of Mexico (Central Bank) sets maximum rates only for deposits, leaving free market forces to determine rates on loans. There has been a dramatic decrease in the weighted cost of capital (CPP) since the beginning of 1988. The Bank of Mexico regulates the disposition of 57% of the resources captured from the public by commercial banks.

A recent decrease in the real value of deposits in financial institutions in the state of Nuevo León plus the high legal reserve has caused a severe liquidity crunch with a resulting drop in the value of outstanding loans. Due to the shortage of liquidity and high operating costs, current interest rates for most borrowers are high (e.g., 70-84%) and loan terms are a maximum of 180 days.

The lack of liquidity and the perceived high risk has negatively affected term loans to small- and micro-borrowers. One banker indicated that his bank required a 2:1 guarantee coverage. Banks only lend short term and then are reimbursed through FOGAIN. However, this reimbursement can often take several months.

FOMICRO, the Guarantee Fund for the Development of Microenterprise in Nuevo León, is run by the state government and in a sense is competitor to Asesoría Dinámica a Microempresas (ADMIC), the ACCION affiliate. The fund currently has agreements with five commercial banks in Nuevo León where lines of credit, backed by a guarantee fund, have been established.

FOMICRO credit is for manufacturers only and may be used to purchase both fixed assets and raw materials. The maximum loan size has increased the current $6,700. The minimum loan is $1,300 and the average loan approximately $4,400. The interest rate charged is exactly that charged by ADMIC, or 90% of the CPP. To date, the program has placed almost 800 loans totalling over $1.1 million. Although FOMICRO claims to have a very low loan delinquency rate of 2%, other sources in the financial sector on the FOMICRO that FOMICRO had an exorbitant default rate, offered no structured training, was only in the business of "placing" loans, and did nothing to recover defaulted loans.

More detailed information on the economic and financial contexts is available in Annex 7.

## B. ADMIC/BANORTE ORGANIZATION AND OPERATIONS

### 1. ADMIC

ADMIC, which stands for "Dynamic Assistance to Microenterprises", is a private service institution established in 1980. It was founded by a group of Monterrey businessmen who saw the establishment of ADMIC as a way to contribute to the economic development of the country through the creation and strengthening of microenterprises. ADMIC offers microentrepreneurs an integrated program of technical assistance, credit and training, with training being a major focus of the program.

#### a. Organization

ADMIC's early lending to microenterprises was financed by a loan from the Inter-American Development Bank and a grant from the Inter-American Foundation; today these are referred to as "traditional funds". Since January 1988, ADMIC has been in the first stage of integrating the A.I.D. guarantee program into its regular lending practices. Program administration is centralized at ADMIC's headquarters in Monterrey, and is the responsibility of the executive director, the operations manager, the administrative manager and the credit analyst.

In the second stage of the PRE project (beginning January 1989), program administration will be decentralized to ADMIC's operations manager and three branch office managers in the Monterrey area. Completion and processing of loan applications is currently done at headquarters. After January, the three branch managers will assist microentrepreneurs in completing required documentation. Documents will then be analyzed by the credit analyst and approved at headquarters. For additional information on the organization of ADMIC, please see Annex 7.

#### b. Operations

Due to the liquidity situation in the country, BANORTE must utilize the rediscount mechanism of FOGAIN (the Guarantee and Development Fund for Small and Medium Scale Industry of the National Development Bank) to obtain funds to lend under the A.I.D. program. Since FOGAIN requires that lending transactions be conducted through a commercial bank, ADMIC must utilize the services of Banco Mercantil del Norte (BANORTE) to disburse loans. BANORTE does provide short term "bridge" financing to microentrepreneurs from its own resources to cover the lengthy time period required by FOGAIN to process loan applications.

The procedure, including the rediscount mechanism, works as follows: once a microentrepreneur's loan is approved by both ADMIC and BANORTE, the bank issues a check to the microentrepreneur for a short-term "bridge loan" to cover the period between the bank's submission of the loan documentation to FOGAIN and receipt of the funds. Once FOGAIN approves the loan, it disburses funds into BANORTE's account in the Central Bank.

Once the bank receives the FOGAIN disbursement, the borrower begins to pay to BANORTE the subsidized interest rates (90% of the CPP) offered by the FOGAIN program, and is reimbursed the difference between this rate and the commercial rate paid during the term of the bridge loan. BANORTE, in turn, pays FOGAIN a rate equivalent to 87% of the CPP for the use of these funds. The 3% difference is used to cover the bank's administrative costs. BANORTE is considered the borrower of the FOGAIN funds, and loan repayments are drawn down from its legal reserve in the Central Bank.

It is important to note that since the source of local resources lent under the A.I.D. guarantee program is ultimately FOGAIN, microentrepreneurs are bound to comply with FOGAIN loan requirements in addition to those of ADMIC and A.I.D. FOGAIN borrower requirements state the following:

- lending is to be limited to industry (transformation of raw materials into finished products);
- the term "microenterprise" is defined as a business having up to 15 paid employees, and up to $88,000 in annual sales; and
- in order to be considered industry, a business must receive at least 60% of total income from sale of its own products.

ADMIC has no discretion in setting interest rates for the A.I.D. guarantee program. Because loans issued by BANORTE are discounted through FOGAIN, no additional points may be charged by the bank.[12] ADMIC does charge microentrepreneurs a one-time 3% loan processing fee, but in turn

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[12] The CPP = (average commercial cost of capital for all banks) which for October, 1988 equalled 39.9% p.a. The prevailing commercial interest rate was CPP + 15%, or 54.9% p.a. The prime rate was CPP + 8% (47.9%).

must pay a $55 contract ratification fee, an $11 business registration fee, plus other indirect costs like computer processing and staff time. The end result is that ADMIC subsidizes the cost of administering the A.I.D. program with income generated by other programs.

ADMIC's credit policies for lending under the guarantee program are different from those that apply to traditional IDB/IAF loans. The interest rate charged for IDB/IAF loans is the CPP + 10% (or 49.9% per year), while the interest rate on loans made under the A.I.D. guarantee program is 90% of the CPP (or 35.95% per year). The collateral requirement of one-to-one is the same for both programs. Another distinction of the A.I.D. program is that because of the rediscount through FOGAIN, borrowers must be producers, since that is one of the requirements for FOGAIN borrowers. Loans under the A.I.D. program are larger and loan terms are longer than those made with IDB/IAF funds. ADMIC has set minimum and maximum loan amounts which differ substantially from the parameters set by FOGAIN. ADMIC's maximum loan amount for IDB/IAF loans is $2,200 and the minimum is $880. The maximum for regular FOGAIN loans is $19,800; the minimum lent by BANORTE with FOGAIN funds is $2,200 (ADMIC and BANORTE's changes in the parameters on FOGAIN loan size were made to accommodate the program to micro lending). For additional comparative information, please see the chart on page 87.

ADMIC's credit analyst pre-screens prospective borrowers for the A.I.D. guarantee program using the following guidelines:

- annual sales must be less than $88,000;
- less than 15 paid individuals can be employed;
- prior positive credit experience with ADMIC (at least one fully paid loan) is required;
- applicant must be a producer;
- microentrepreneur should be an active participant in ADMIC activities;
- the amount of the loan requested must be within the limits established for loans under the A.I.D. guarantee facility;
- the purpose of the loan can only be for working capital or the purchase and repair of fixed assets (excluding real estate).

The source of baseline data for loan appraisal is a completed BANORTE and FOGAIN application form. Once the potential borrower has been prequalified, he/she meets with the credit analyst, is informed of how the program operates, and receives assistance in completing the required forms. The credit analyst visits the borrower's business to complete the application.

Credit analysis and approval consists of a number of steps. A pro forma production analysis is done for the next year, which gives a projection of production and sales. Although a formal market analysis is not done, current sales figures are reviewed to assure that sales projections are realistic. Loan applications are reviewed and approved by four staff members: the credit analyst, the administrative manager, the operations manager, and the executive director. Once ADMIC has approved a microentrepreneur's loan application, the credit analyst forwards the application to BANORTE. BANORTE may take up to two months between receipt of application and disbursement of funds. [13]

ADMIC headquarters retains a file on each borrower which contains background information on the microentrepreneur's business and financial standing. Once the credit is formalized through BANORTE, the branch bank keeps all payment records.

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[13] It is important to note here that during the first half of 1989 the ADMIC/BANORTE relationship was restructured. ADMIC has almost full authority to approve loans. BANORTE no longer visits individual borrowers nor does an independent credit analysis. BANORTE merely ascertains that the application fits within the general guidelines of FOGAIN. As a result, processing time at BANORTE has been reduced to 17 days. This reflects the confidence that BANORTE now has in ADMIC because they would never have made loans with their own funds based simply on the PRE guarantee. Also, ADMIC is now permitted to charge a 10% (instead of 3%) up front processing fee which will allow it to cover more (but still not all) of the program costs.

Another positive development since the evaluation is that FOGAIN has made available up to $1.7 million for lending to microenterprises. This is to be guaranteed by only the $300,000 that is now currently available in the collateral account for ADMIC borrowers. The arrangement is structured so that the maximum coverage of individual loans by the collateral account is 90%. However, as the total outstanding loan amount increase this coverage is reduced to a minimum of 17.6% (300,000/1,700,000).

c. Sources of Funding and Financial Soundness

In addition to the A.I.D. guarantee program, ADMIC has two sources of funding for microentrepreneurs. In 1982, it received a peso-denominated loan of US$ 500,000 from the Inter-American Development Bank (IDB). Loans under this program can finance working capital or machinery and equipment. Subsequently, it received a grant for US $150,000 from the Inter-American Foundation (IAF), which was added to the IDB loan program. This original $650,000 "traditional loan" fund is worth only $300,000 at today's exchange rates. The IDB loan has a 40 year term, and includes a 10 year grace period (ADMIC is now paying the interest, which is 1% of the outstanding balance).

The IDB/IAF program stipulated that for the first five years interest rates would be fixed below the official commercial interest rate. For example, the commercial interest rate in 1987 was 120%, while loans under the IDB program were being issued at a 75% interest rate. Now that five years have passed, ADMIC has flexibility in the interest rates it charges under the IDB program, and has only to submit an annual audit report. ADMIC now charges the CPP + 10%, which is equivalent to 52-55% interest per annum. Borrowers are also required to pay a 3% credit processing fee, an $80 yearly technical assistance fee, and $15 for two ADMIC training courses. This makes the cost of the IDB lending program equal to regular commercial lending programs. ADMIC recently received another $500,000 loan from IDB, although the terms have not been finalized.

The IDB loan and the IAF donation were disbursed into an account at BANORTE. In the case of the A.I.D. guarantee, the source of funding is initially BANORTE, which makes bridge loans with its own resources. BANORTE is ultimately reimbursed by FOGAIN to replenish these funds.

Approximately two years ago, ADMIC began discussions with A.I.D. about the Revolving Fund, but hesitated to get involved in the program because they had heard that the Paraguay affiliate was having problems starting its program. In 1987, ADMIC reinitiated discussions with PRE in order to diversify its funding sources, and a $100,000 letter of credit was issued in favor of BANORTE.

Since the A.I.D. program funds are not being lent to ADMIC, but directly to microenterprises, there is no capital cost to ADMIC. However, ADMIC estimates its administrative costs to be 8% to 10% of loan value. In addition, it must pay a $55 contract ratification fee, an $11 business registration fee, plus other indirect costs like computer processing and staff time. Yet the only income it receives to cover these costs are charges to the borrowers of a 3% one time charge for processing, an $80 yearly fee for technical assistance, and $15 for two required training courses. The end result, as mentioned above, is that ADMIC is subsidizing the cost of administering this program with income generated by other programs.[14] ADMIC will shortly be calculating its costs of operating the guarantee program to determine the level of program self-sufficiency.

Regarding the institution as a whole, ADMIC was 63.2% self-sufficient at the end of 1987. However, there is no indication of any expense for bad debts even though the balance sheet shows a deduction for bad debts. Therefore, the percentage of self-sufficiency may actually be less. The financial statements for the last four years are presented in Annexes 10 and 11. The "Loans to MEs" on the asset side are those made with IDB or IAF funds from ADMIC's account in BANORTE. The interest from these loans goes to ADMIC, although the disbursements and repayments are done through BANORTE. The "Prepaid interest" is from borrowers who have paid interest before it is due. The "Deferred donations" (liabilities) is the balance of IDB funds not yet lent, but which must be disbursed.

If there is any "profit" it is capitalized ("Retained earnings") and is used for additional loans to microentrepreneurs. Due to accumulated retained earnings ADMIC has a broad capital base (2.41 times liabilities in 1986, increasing to 10.1 times in 1987). This was largely due to an 50% real increase in budget support contributions which was converted to capital as retained earnings at year end.

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[14] As noted above, ADMIC has no discretion in the setting of interest rates under the guarantee facility. ADMIC is not the lending institution in this program and acts only as an "overseer". Due to the fact that loans issued by BANORTE are discounted through FOGAIN, only those interest rates (and no additional points) may be charged by the bank. BANORTE is the recipient of the difference between 90% of the CPP charged to the borrower, and 87% of the CPP paid to FOGAIN by BANORTE for use of the funds. It is unknown if this spread is sufficient for BANORTE to cover its administrative costs.

Delinquency for the loans under the PRE program is calculated as 7%. However, this calculates only the payments missed (even one day past due) as a percentage of the loan balance outstanding. It would be better to age accounts and include the total balance due as delinquent for loans with payments more than a certain number of days (e.g., 60) past due. However, since this is not done, there is no way to know if delinquency is really higher than 7% or not.

#### d. Relationship with ACCION

ACCION (but not ADMIC) was involved in the design of the project with PRE. Even in the early stages of implementation, ADMIC was only minimally involved. The letter of credit developed by PRE and ACCION was transmitted to ADMIC and was immediately accepted by the commercial bank. This was due to the lengthy relationship that the two institutions had developed through the IDB lending program and a connection at the board level.

ACCION has provided technical assistance at various points in project development and expansion since the establishment of the first ADMIC office in 1980. Personnel from ACCION programs in Colombia, Paraguay, Peru, Dominican Republic and Costa Rica have visited ADMIC on various occasions to help solve specific problems and avoid "reinventing the wheel". ADMIC signed a formal contract for technical assistance from ACCION in October 1988.

One important source of information to ADMIC is the ACCION network which provides a cross-fertilization of ideas and experiences among the various ACCION affiliates. Yearly conferences of personnel from these programs are held in the region. A monthly statistical report is sent to each affiliate which compares all programs in various areas.

The Executive Director of ADMIC is also an ACCION advisor in that he is paid half of his salary in local currency by ACCION.

### 2. Banco Mercantil del Norte (BANORTE)

#### a. Organization

BANORTE is divided into two divisions under the General Manager of the bank: Commercial Banking and Specialized Banking. The Development Banking Department falls under Specialized Banking and administers the various development funds sponsored by the Central Bank of Mexico and the National Development Bank. Of the ten national development funds, BANORTE uses seven: FOGAIN (for small and medium scale industry); FIDEC (for commercial development); FONEI (for large industry); PROFIRI (for metal mining); Fondos Minerales (for non-metallic minerals); FIRA (for agricultural development and livestock); and FOMEX (for export promotion).

The Director of Development Banking has overall management responsibility for lending under the A.I.D. guarantee program. The manager of the FOGAIN Fund, a credit analyst and three extension workers are responsible for loan application analysis.

In addition to the A.I.D. guarantee program, BANORTE lends to microentrepreneurs through the state government's FOMICRO guarantee program (Guarantee Fund for the Development of Microenterprise). Both ADMIC and FOMICRO act as intermediaries between the microentrepreneur and BANORTE (although the FOMICRO guarantee fund is also accessed by other commercial banks), with the major distinction being that FOMICRO is a program established by the state of Nuevo León.

b. Operations

BANORTE was formed in 1986 by the merger of Banco Mercantil de Monterrey and Banco Regional del Norte. In terms of size, it falls exactly in the middle range of commercial banks in the Monterrey area. Total assets are over $400 million, and total equity over $33 million. Since its founding, BANORTE has performed with above average profitability. Its current return on assets is 3% (the average for the Mexican banking system is 1.4%), and its return on equity 37.7% (the national average is 34.8%). ADMIC has had a banking relationship with BANORTE since its formation in 1986, when the bank began managing its account for the IDB/IAF lending program.

The management of Banco Mercantil del Norte considers its involvement in the ADMIC program as pro bono, based on its view that dealing with microentrepreneurs will never represent any volume business for the bank. A number of interviewees did comment that BANORTE required borrowers to have a personal checking account with them to qualify for credit under ADMIC's program, but none thought that the deposits generated in this way were of material consequence to the bank.

BANORTE's operational responsibilities with respect to the A.I.D. guarantee program are as follows. Once ADMIC's credit analyst brings in completed documentation, the credit analyst at BANORTE reviews the file to assure completeness and does a financial analysis to determine whether the loan can be rediscounted. Documentation is then sent to the BANORTE branch office where the microentrepreneur will send monthly loan payments. This office is responsible for final approval. From this point, the branch manager has control over the priority given to loan processing. Not infrequently, branch managers consider these loans low priorities, since "the same level of effort is required to process tiny loans as loans of any other size." Subsequently, the FOGAIN documentation which was also submitted by the microentrepreneur is reviewed and submitted for approval.

The only contact between BANORTE and the microentrepreneur is at the branch office. The branch manager makes a site visit to the business prior to loan approval. After this the microentrepreneur makes all loan payments directly to the branch office.

The 40 BANORTE branches in the greater Monterrey area are divided into ten zones. There is one credit committee per zone, and this committee meets monthly to review pending loan applications. The credit committee is comprised of the Deputy Director of Branch Banking and the managers of each branch. Even if a loan has been approved at the main office, the loan committee in each zone has the authority to reject the loan based upon the "moral character" of the prospective borrower. This assessment occurs during the site visit. In the words of the FOGAIN Fund Manager, three criteria are considered in approving a loan: (1) convenience -- "How much business will this individual ultimately represent for the bank (through checking accounts, future loans, and other business); (2) security -- "Are his/her guarantees sufficient?"; and (3) liquidity -- "Is this project self-sustaining?"

There is considerable lag time between the receipt of a completed set of loan application forms from ADMIC and loan disbursement. Processing an average loan takes three months (although reports from a number of loan recipients indicated that it had taken up to five). As noted above, since rediscounting the loans through FOGAIN could take up to two months, bridge loans are offered by BANORTE to expedite the process.

BANORTE's financial policies are established by the Directorate of the bank. This body is comprised of the General Manager and two assistant managers, one responsible for all branch banking activity, the other responsible for international and development banking.

The limits on interest rates charged by commercial banks are established by the government, although banks do have certain flexibility. This allows banks to charge preferential interest rates to good customers. For example, BANORTE offers the CPP + 5% to excellent customers, the CPP + 10% to above average customers, and the CPP + 15% for all others.

Over the past two years, BANORTE has significantly increased the amount of money it lends through FOGAIN rediscounts. In 1986 BANORTE loans rediscounted through FOGAIN totalled PP 1,500 MM; in 1987 the amount was over PP 8,000 MM. This increase in demand for FOGAIN loans can be attributed to a huge promotion by BANORTE of the various national development funds available to borrowers.

The maximum size of regular (i.e., non-microenterprise) loans discounted through FOGAIN is $440,000 for loans used to purchase raw materials, and $264,000 for loans utilized to restructure liabilities. The minimum size of regular loans is $2,200 (this is the maximum size of loans granted by ADMIC). The range of regular loans discounted by BANORTE through FOGAIN is between $44,000 and $175,000. Minimum maturity for FOGAIN loans is two years; maximum is twelve years. Grace periods range from six months to two years. The usual contracting charge, which includes fees for drafting the loan contract and registration of the business, is 5% of the total loan amount. All loans are paid monthly. Late payment charges are the same for all FOGAIN loans: 1.5 X CPP/360 x number of days late.

The Ley Reglamentaria del Servicio Publico de Banca y Credito governs foreclosure and liquidation of collateral in Mexico. Banks are not required to complete a fixed waiting period to foreclose on a borrower, and may do so from the first day that a payment becomes overdue. Banking regulations are written strongly in favor of financial institutions, to the extent that a bank may officially sue a borrower and request full repayment of a loan for reasons as vague as "moral grounds", even if the loan is not delinquent.

With respect to loss mitigation from defaulted ADMIC loans, BANORTE receives an "aval" (guarantee) signed by ADMIC's director. ADMIC undertakes to repay BANORTE in the event of a sub-borrower default. In BANORTE's view, the A.I.D. guarantee fund serves little purpose. Making a claim against the letter of credit at Chemical Bank (in New York) would be extremely time consuming and costly, and would require numerous overseas telephone calls and FAX transmissions. The established procedure is as follows: BANORTE will allow one month to pass, then the branch manager will contact the borrower and request payment. If no results are obtained, the branch manager will contact ADMIC, with the understanding that ADMIC will pressure the borrower for payment. Should this be unsuccessful, the bank indicated that it intends to obtain payment from ADMIC. Since there have been no defaults to date, the system has not been tested.

The letter of credit requires the commercial bank to first take judicial action against a borrower, and to be able to show Chemical Bank that all other requirements have been completed. The Manager of Development Banking at BANORTE commented that the value of the guarantees put up by microentrepreneurs is often questionable, so BANORTE does not anticipate taking any legal action against microenterprises to collect on delinquent loans. ADMIC is considered to be a well-administered organization that knows its clients, so there is no concern on the part of BANORTE about the level of risk it is assuming in lending to microentrepreneurs.

With regular (non-ADMIC) FOGAIN loans, the branch manager visits a borrower once a loan has been delinquent for 30 days. The payback record for regular FOGAIN loans is excellent -- only 1% are delinquent.

The slow turn around time with BANORTE has impeded ADMIC from reaching more borrowers. Lending to microentrepreneurs is not attractive to the commercial bank since the microenterprises will never represent large volumes of business. One bank officer said: "This program is insignificant for the bank, both in terms of the total amount of money involved and the value of each individual loan." ADMIC's four regional managers were of the opinion that the relationship with the bank "was not functioning well." This contrasts with the fact that when ADMIC uses traditional (IDB) funds for lending, BANORTE has no involvement in the approval process. In this case, ADMIC receives a direct loan from the IDB, which it deposits in BANORTE. ADMIC then disburses its own checks to the microentrepreneurs.

Lending under the A.I.D. guarantee program is not perceived as profitable by the bank. The amount of money lent is very small, as is the interest (90% of the CPP) charged. Because of the relative newness of the A.I.D. program, BANORTE did not have detailed information on costs associated with administration of the ADMIC program.

Another impediment to the successful operation of the program is that private banks are not currently able to use their own funds for longer term lending. There is a serious liquidity problem in Mexico because of government restrictions. Mobilizing deposits is another problem. According to one official, "No one in Mexico deposits money for six months to a year. Thirty days is the maximum, given the high inflation, low interest rates, and exchange parity." This is why BANORTE could not be involved in the A.I.D. guarantee program without rediscounting the loans through FOGAIN.

## C. LOAN DISBURSEMENT AND IMPACT ON SUB-BORROWERS

At the end of September 1988, twelve loans for an approximate amount of $22,270 had been disbursed. Applications for another twelve loans totalling $23,142 had been submitted to BANORTE for processing. The first two loan applications were submitted to BANORTE in March 1988, which disbursed the short term bridge loans in April 1988. However, it took until September 1988 (five months) for FOGAIN to reimburse BANORTE for these loans and for the only other two loans reimbursed as of the end of September.

The actual direct impact on the borrowers who have had loans disbursed is difficult to measure since any changes may not be wholly attributable to getting the loan, particularly since many borrowers have had previous loans through ADMIC. It is also difficult to draw any conclusions with such a relatively small number of borrowers.[15] However, it is useful to compare sales, asset size and number of employees before the loan and at present. This data is presented in Table 12. The average increase in monthly sales was 95%. The average increase in fixed assets was less, 28%, since loans have been for working capital to allow

[15] The team visited all of the sub-borrowers who had received loan disbursements, except one.

microenterprises to purchase more raw materials rather than for fixed assets purchase. The increase in number of employees averaged 44%, although in 4 cases there was no increase.[16] A total of 31% of the employees are women. All but one of the owners was male, although two were in partnership with their wives.

## D. INSTITUTIONAL IMPACT OF PROJECT

Despite all of its implementation problems and limited use to date, the PRE letter of credit facility has made a number of impacts both on ADMIC and BANORTE. Before the LC was available, the bank did not make loans to microenterprises with its own funds. It previously disbursed loans to microenterprises only from IDB and IAF funds in ADMIC's account. Thus, the LC potentially means that ADMIC can now provide credit to more microenterprises by leveraging domestic commercial funds. By the end of 1988, applications were in process or were approved for 116 loans (48 of which were made in December 1988) that would not have been made otherwise. An indirect result of the A.I.D. LC is that ADMIC has just negotiated a direct line of credit with FOGAIN for $66,000 which will be available through BANORTE. It is estimated that this will result in 1,287 loans (average loan = $515). After processing by ADMIC, BANORTE will only need to check that documentation is complete and the borrower has no other loans outstanding before disbursement can be requested from FOGAIN. This will greatly reduce the time for processing since BANORTE will not be assuming any of the risk. These loans will be guaranteed 90% by the LC, but the additional 10% risk will be assumed by FOGAIN rather than by BANORTE.

Since the current LC of $100,000 expires in January 1989, ADMIC will be requesting a renewal for one year and an increase in the coverage to $300,000. With this increase ADMIC plans to expand the use of LC guaranteed loans to include other areas of the country. Another positive development is that BANORTE is going to establish a guarantee fund from its own resources to cover loans to microenterprises. Also, BANORTE has agreed to publicize the ADMIC program at its own expense, thereby allowing

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[16] However, the absolute numbers of employees added was very small. The maximum number added was five employees.

the ADMIC fieldworkers, who now spend 60% of their time promoting the program, to devote all of their time to technical assistance and follow-up. These developments are all a result of the "demonstration effect" of working with ADMIC.

The project has had negative impacts on ADMIC as well. Since the loans are made from BANORTE's funds, the interest income goes to BANORTE. Thus ADMIC is forced to subsidize much of the project's administrative costs from its own funds.[17] Another negative impact is that use of the LC has required an additional burden of paperwork for recordkeeping purposes. ADMIC has set up a separate accounting system to keep records on LC loans, but the establishment of this system required the contracting of an outside computer programmer.

## E. BORROWER PROFILES

The following pages provide brief descriptions of nine of the thirteen borrowers visited in Monterrey, Mexico. They are intended to capture something of the flavor of the individuals involved and their unique business situations. Statistical information on these borrowers is presented in Annex 12.

Borrower #1
Mr. and Mrs. Aaron Aguilar Gonzalez
Ceramic Producer
Guadalupe
Loan: $1,747

Mr. Aguilar and his wife are equal partners who produce ceramic figurines. Model figures are bought in hobby stores in the U.S. and molds are made from each. Clay is poured into the mold and when ready the figures are put through a kiln on a long conveyor. The figures are then hand painted and fired again.

The Aguilars began their business in 1980 with an investment of $870. Currently, they estimate that the total asset value of the business, including land, building and inventory, is $63,320. The only assets they

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[17] This is not true of the IDB funds. These funds "belong" to ADMIC who also assumes the risk for their recovery. BANORTE merely disburses the funds at ADMIC's request. Therefore, the interest income is for ADMIC.

had when they began were a simple roof, some equipment, and raw materials (clay). They began by working 12-14 hours per day. Mr. Aguilar only attended primary school, and learned his trade by working as an apprentice. He saw his years as an apprentice as an opportunity and a means to an end rather than as an oppressive situation. He also took some courses on sales and business formation before he and his wife opened their own business. The Aguilars now have 13 full-time employees which they see as an opportunity to help others develop professionally. The Aguilars' expressed their positive attitude toward their business in saying, "To have a business in Mexico is not easy. To work honestly, risking what you have is difficult. Many times we have wanted to give up, but we always have had the courage to go on because it is difficult (if not impossible) to go back to being an employee."

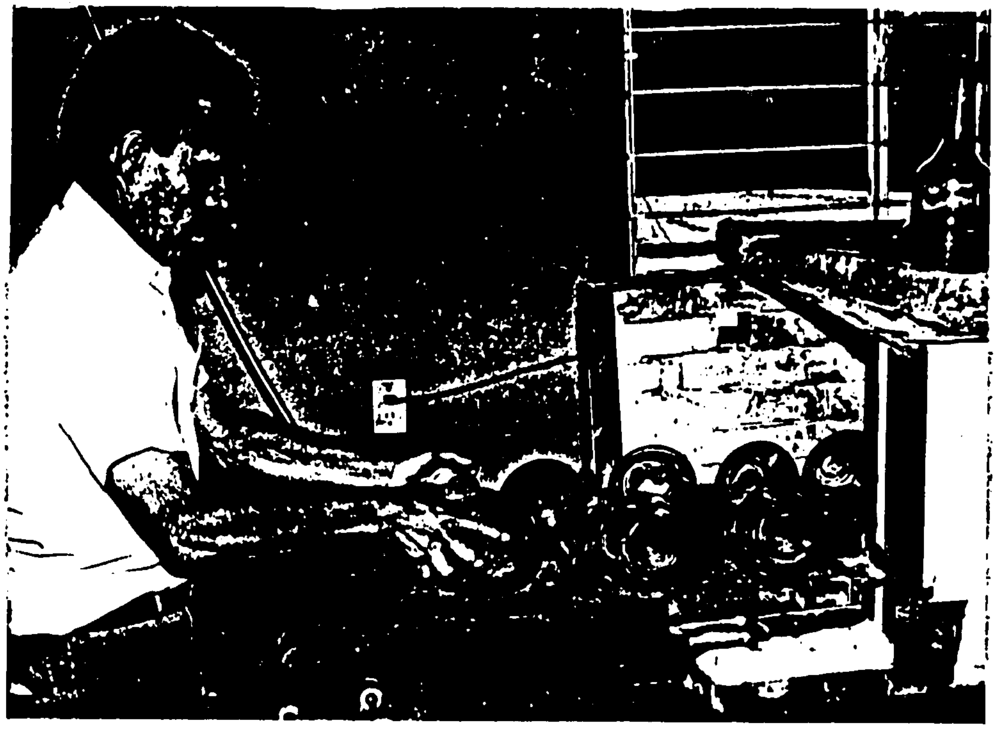
The Aguilars have been using ADMIC's services since 1981, when they got their first loan for the purpose of building a wall below the original roof. They have received six loans since then -- three for capital investments and three for raw material purchases. In fact, Mr. Aguilar says "ADMIC is our strong right arm"; they always consult with ADMIC before making an important business decision. They could now get a loan from a bank, but would prefer to use ADMIC because bank processing is much slower. The loan from the guaranty fund was for raw material purchases, but they could use an amount two or three times larger so that production could be raised to meet potential demand. One benefit of the association with ADMIC was the recent exposition for micro-enterprises held in Monterrey. The Aguilars received $6,550 in orders from one store and monthly orders of $440 from another as a result of having their products displayed there.

Taking figurines out of molds

Although the Aguilars have about six competitors, their business has survived, whereas other producers their size have failed. They sell wholesale to fifteen chain and smaller retail stores, plus another eight to ten stores in other towns within the state. They do not advertise; most of their business comes from the references of satisfied customers. They are planning to modify their production system to obtain better quality figurines and to expand the product line.

Borrower #2
Mr. Adolfo Sánchez Hinojosa
Decorative Glassware Producer
Guadalupe
Loan: $1,747

Mr. Sánchez produces decorated glassware to order. He either designs the decoration himself with a general idea from the customer, or the customer gives him an exact design to be copied. Through an ingenious photographic process that Mr. Sánchez developed, he copies the design onto a silk screen. The design is then applied to the glassware in single or multi-colors. The glassware is then passed on a conveyor belt through a long oven to bake the paint onto the glass.



Mr. Sánchez loads glassware on a conveyor that passes through a high temperature oven. This bakes the designs onto the glass.

Mr. Sánchez wanted to start his own business ever since he was in college (he has a bachelor's degree in chemical engineering). He first thought of making ceramic pieces, but after becoming familiar with glassware, he decided to focus his attention on its production. He began with a single oven and a total investment of 200,000 pesos ($8,700) of his own resources in 1980. He now estimates that he has 20 million pesos invested in the business, but this is worth nearly the same amount in dollars ($8,734) due to severe devaluations in the 1980s.

ADMIC has helped Mr. Sánchez since 1983 when a fieldworker visited and introduced the program; he received his first loan for $600 to buy raw materials and glassware. He has had a total of five other loans since then. He is pleased with the current loan from the guarantee fund since he could get a larger amount than previously (maximum was 1 million pesos). This allows him to buy more raw material at a lower unit price. Mr. Sanchez tried going to one of the commercial banks for a loan, but they wanted to discount all of the interest up front. He also feels that the training at ADMIC has helped him grow, although he does wish that they had technical assistance in his specific area of production.

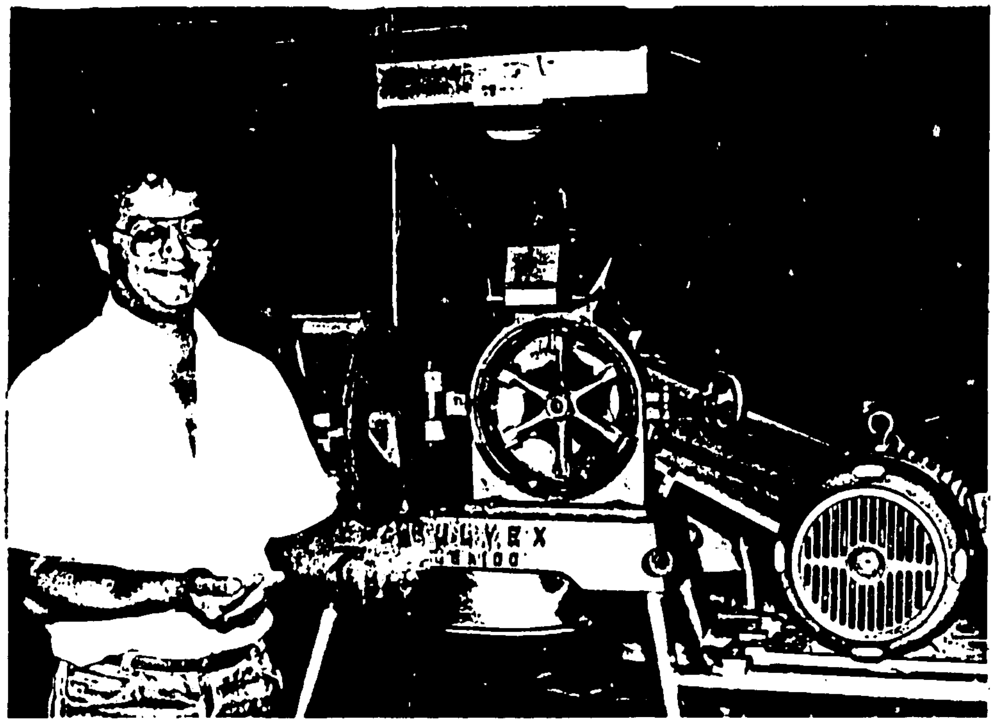
Although Mr. Sánchez has four competitors, he has developed a market niche in that he is the only one that does publicity decoration on glassware. He uses the yellow pages, commissioned salesmen and personal visits to promote his products.

Mr. Sánchez is optimistic about the future. His plans include the purchase of a computer for control of inventory and orders, possible exporting and opening a retail store to display his products.

Borrower #3
Mr. Rafael Balandrano Sandivar
Quimica y Materiales Industriales
Aluminum dust producer
Monterrey
Loan $1,747

This company's main product is aluminum "dust" made from metal shavings. The product is used in the manufacture of stainless steel. In addition, they produce sawdust, graphite and charcoal.

Before starting his own business, Mr. Balandrano was in charge of quality control for a copper production plant. When that contract ended, he searched for a way to form his own business. He is an industrial engineer and his current partner is an architect; he has known his partner since college. Mr. Balandrano began his charcoal production business in 1984. In 1985, he and his partner each invested $485 and began the aluminum dust business.



Mr. Balandrano holds metal shavings -
the raw material to make "aluminum dust"

Mr. Balandrano's loan from the guarantee fund was used entirely for the purchase of raw materials. The processing of his application took two months in ADMIC -- probably because he was one of the first borrowers with this new source of funds -- but only one month in BANORTE. ADMIC did not require as many guarantees as FOMICRO or the commercial banks. He applied for a loan from BANORTE in February 1988. They required a mortgage guarantee which he could not provide. Since receipt of the loan from ADMIC Mr. Balandrano's monthly sales have increased from $1,490 to $3,270; his fixed assets have remained the same.

One of the attractive features of this loan was the availability of a larger amount than ADMIC usually provides. Since his company is currently operating at only 50% of production capacity, a larger loan (as much as $6,100) is needed to meet the current demand of fifteen tons more per month

Mr. Balandrano's competition is from factories in the Federal District and Chihuahua. His main customers are two factories, one in Monterrey and the other in Coahuila. In order to be competitive he must offer lower prices and give at least 15 days credit. His competitors require 50% payment in advance and 50% on delivery. His marketing is done by direct contacts with factories.

Borrower #5
Mr. Raúl Estrada Rubio
Motor repair
San Nicolás
Loan $1,747

This company rebuilds automotive alternators, starters and industrial motors. Mr. Estrada also accepts some motors for repair, but it is not a major activity. He will give a better price on individual repairs to regular clients who buy a large number of rebuilt motors. Although there is some line manufacturing, all of it is done by hand. There is only one lathe which is used to make round pieces true. In general, the company's production processes utilize old technology. The raw materials are wire, varnish and insulation paper. Mr. Estrada's partner is his wife and he has seven employees.

Mr. Estrada prepares electrical armature for motors.

Before beginning his current business in December 1982, Mr. Estrada sold lubricants and bearings for his wife's brothers. They did not want to teach him how to make these products, but he watched the production process carefully and finally learned it. Mr. Estrada had a truck which he sold to buy materials and equipment; soon he was producing items that were of better quality than those made by his brothers-in-law. In 1982 Mr. Estrada began the current business with an investment of $1,750. He now estimates that his total investment to date is $24,000.

Mr. Estrada is one of ADMIC's clients of longest standing. He got his first loan of $720 for materials in 1984, and he has received a total of seven loans for approximately $5,735. Mr. Estrada also borrows from money lenders occasionally, for which he pays 84% interest per annum. He borrowed from an individual to buy his shop; he pays 7% interest on this loan each month and is paying off the principal as he can. His only loan from the guarantee fund so far is the current one for $1,747 that he received in April 1988. The loan has a term of one year and is for the purchase of materials. Since then Mr. Estrada's average monthly sales have increased from $2,620 to $4,370 and his fixed assets have increased from $17,320 to $23,140. He says that the main advantage of the guarantee fund is that he can get a larger loan from ADMIC than he could previously. This has allowed him to buy materials in larger quantities and thereby get a better price. Mr. Estrada thinks ADMIC should be more selective and help fewer people, giving larger loans to each. He would also like to have ADMIC give information on the technology in his specific area of production (e.g., what new machines could improve the quality and quantity of his production?)

Mr. Estrada has five competitors in Monterrey -- four smaller and one larger than his company. Sixty percent of Mr. Estrada's clients are in Monterrey and are truck repair shops and electrical supply stores. The rest of his clients are auto repair shops in the border area. He markets by making personal visits to these shops and also by recommendations from current clients. One of his biggest problems is the lack of trained personnel. He says he cannot afford to train his current employees or to hire more skilled workers.

Mr. Estrada's sales are increasing and he is reinvesting in his business because he feels confident about the future. His short term plans are to pay off the $2,300 debt for the shop. His long term plans are to expand the business, hire more employees and set up a production line to increase output. He also wants to finish his formal vocational training. He is currently teaching electrical classes pro bono in a technical school; he wants to give more specialized classes such as electrical armature.

Mr. Estrada feels that the rewards of a business are not only the income, but also the acquisition of knowledge. He feels a certain satisfaction in being able to give work to people and to help them learn a trade. He says that many mothers have asked him to teach their sons a trade so that they will not be "hanging around the street corner being bums". He adds, "many people earn more than I do, they work eight hours and go home, but they don't have a specific objective in life; they don't have a focus."

Borrower #6
César Villareal
Artwork and Custom Framing
Loan: $2,100

César Villareal is a cosmopolitan gentleman who has always had a love for antiques and works of art. After receiving an MBA, he purchased a rug and drapery business with a friend, but the business failed after one year. César feels that he has a natural ability for business, and attributed its failure to a bad working relationship with his partner and poor business financing from the outset. After that, he worked successfully as a business advisor for a number of years, and two years ago decided to open his own frame shop/art store.

"DaVinci" carries a full assortment of frames and a fine selection of original art and art reproductions. "We pay great attention to details such as frame joints, and use only the highest quality woods," César explained. He serves a very select and discriminating clientele; if a piece is not absolutely perfect, it must be redone. César has two other competitors in Monterrey who do the same high-end work, and each of them has been in business for more than ten years. This requires him to pay even greater attention to detail, and to use a personal approach with customers.

César received a personal loan from a friend to set up his shop. He remarked that he had a negative experience with bank credit before, and didn't think of going to a commercial institution. When the business was in its planning stages, César saw an announcement about ADMIC in the newspaper. Since then, he has received two loans, which is the only credit he has received. One loan was used to purchase framing equipment, the other was used for raw materials.

César displays his quality work

César felt that the treatment and support given to microentrepreneurs by ADMIC was excellent. "You don't get bounced around to different people, like in a bank. They take you directly to the credit analyst, who handles your request." The only objection he expressed was that all loan applicants are required to take the courses offered at ADMIC, which he viewed as rather "elementary", given the fact that he holds an MBA. But he considered this a small "price" to pay, since no credit is available anywhere else. "If it weren't for this program, I couldn't borrow ten pesos from a bank. Even if I could, the interest would be worlds higher," he remarked.

One of the major problems his business faces is the overall poor economic situation in Mexico. This signifies that people have less money for the luxury items that "DaVinci" sells. "Also, it's difficult to find workers who have the same quality standards as I do, and who really want to work. I guess that's the most difficult thing of all," César explained.

Borrower #9
Irene Serrato
Seamstress
Loan: $2,100

Irene Serrato is a dynamic and charming woman whose life has centered around the fashion industry. Over twenty years ago, she started to make clothing for friends part-time out of her home. Following a divorce, her sewing skills suddenly became her livelihood. Although Irene was already adept at assembling garments, she knew that she "wanted more", and decided to study tailoring. Being able to construct more complex garments moved her small fashion business into another realm. Five years later, a German company offered her a position marketing a "quick design and sewing" instruction method. Although she was highly successful, the position required her to travel around the country, which was difficult because of her two sons.

Irene then went back to dressmaking, but still felt that she wasn't utilizing her creative talents. She spent all of the money she had saved to take a fashion design course at the Monterrey Polytechnic Institute. This opened new doors for Irene, and she began designing uniforms for the many large companies that are based in the city. Eventually, a uniform manufacturing company offered her a position, which she left in 1973 to regain the independence of having her own business.

Since 1973, Irene has worked out of her home designing and constructing both uniforms and garments for specialty boutiques in Monterrey. She has one full-time seamstress, and, depending upon the volume of work, may bring in up to three part-time workers. Irene reports that her business is experiencing a big growth period.

About seven years ago, Irene got her first credit directly from BANORTE to purchase two industrial sewing machines. She explained that since then, the economic situation has worsened considerably in Mexico, such that today these same loans are not available to small businesses. Irene became involved in the ADMIC program in 1986 at the suggestion of a friend. The ADMIC loans help her to increase profits, since she can purchase fabrics in volume and thereby significantly lower costs. She estimates that sales have increased by 50% since receiving her first ADMIC loan. Irene feels that the ADMIC program has helped her to "keep reaching (her) goals."

Irene Serrato and her seamstress hard at work.

Borrower #10
Mr. Andrés Ortíz Tirado
Rotaflex
Monterrey
Loan $2,183

Rotaflex manufactures various sizes and styles of industrial dollies. It makes some of the parts itself, and purchases others on contract. The proprietor, Mr. Ortíz, feels that he is more of a craftsman than a manufacturer since there is a low level of production and the work is very labor intensive. He manages four employees and is in partnership with his wife, father, and two others. He owns 15% of the business.

Mr. Ortíz possesses a degree in business administration and started the business in December 1985 because he was tired of being an employee and taking orders from those above him. He felt that he was creative and had a distinct way of looking at things. He saw a market for his product because of the growth in the office equipment business.

Since getting the loan from ADMIC, the business' monthly sales have increased from $240 to $868 and fixed assets have increased from $5,240 to $9,170. Mr. Ortíz could have obtained a bank loan as an individual due to the long standing relationship he has had with his commercial bank. However, in lending to Rotaflex as a company, the banks required a two to one guarantee.

Mr. Ortíz felt he needed little of the training offered by ADMIC, but he is taking computer courses elsewhere. He provides training for his employees, but he would like ADMIC to provide such training.

He has no competition in Monterrey, where he has 20-25 customers, but he does compete in other cities such as Chihuahua, Saltillo and Torreón (eight to ten companies outside Monterrey). All of his competitors are larger and are based in Mexico City or Guadalajara. His clients are large factories such as canneries, office furniture producers, plywood makers, etc.

Mr. Ortíz feels that the business is growing and he is adding computer capability. Although he is at 70% production capacity, he needs to find new clients in a different line of products so that the company can diversify. He has an engineer designing new products now. He is also conducting a study of the entire market to assess the best products, his competition, potential clients, and possible investments.

The biggest problems confronted by the business are employee training and the lack of resources for investment in equipment and the administrative structure of the company. In general, Mr. Ortíz feels the company is doing well. Three years after becoming independent he says, "it was the best decision of my life and I feel very satisfied." He thinks Mexico is a country full of opportunities as in few other countries. He also feels that the people of northern Mexico are more ambitious and responsible than those in the center and the south.

Borrower #16
Mr. Antonio Somarriba Aubert
Tortilla Factory
San Pedro Garza García
Loan: $873

Mr. Somarriba runs a partially mechanized factory that produces an average of 375 kilos of tortillas per month. The "masadora" (mixer) can produce 25 kilos of tortilla "masa" every three minutes. Another machine produces the flat tortillas which then go on to a conveyor belt to pass through the oven three times. The ideal cooking temperature is 380°C, but the oven must occasionally be shut off because it tends to overheat. After cooking, the tortillas are packed and weighed. Half are sold over the counter and half are delivered in Mr. Somarriba's pickup truck to stores.

Mr. Somarriba was born in Nicaragua, but moved to Mexico many years ago. He met his wife and became a citizen of Mexico ten years ago. He has a degree in business administration. Before starting his business Mr. Somarriba worked in a motor repair shop. His father-in-law offered him the ownership of a "tortillería" in Saltillo and it was there that he began his business in 1971. He started with one machine, but did so well due to the high quality of his tortillas that after six months he bought a second factory; six months later he bought a third. However, he found that each demanded his full time presence so he sold all but the last. He originally used corn flour, but now uses a pre-mix ("maseca"), which is cheaper (due to its subsidized price) and of better quality. Since tortillas are a staple food, the government controls the price. The price remained constant throughout 1988 even though production costs increased. Currently Mr. Somarriba is working only at 70% of production capacity due to a combination of low sales, the economic situation and the hot season. He says people have less appetite for tortillas in hot weather.

Putting "maseca" for tortillas into the "masadora"

The first loan he received from ADMIC was in 1986 for the repair of his truck. He preferred to borrow from ADMIC because banks will only lend for one month and the interest rates are much higher (67-73%) even though the banks don't require a guarantee "because they know me". He uses the bank for his short term needs such as utility bills, etc. With his recent loan from the guaranteed funds, the BANORTE branch office told him that he had to open a checking account with them in order to receive a loan. This loan was to purchase "maseca". The processing in ADMIC took only 15-20 days, but in BANORTE it took three months, most of which was spent at the main office. He also has another loan of $1,300 from FOMICRO which allowed him to buy 15 months worth of "maseca".

Sales have increased by 32% since receipt of the loan, but fixed assets have remained the same. Competition is from four other "tortillerías", three of which are larger. However, he feels that he is doing better than the competition because he can produce more, better quality tortillas using his new mechanized system. The old process took eight hours, whereas the current system is nearly immediate due to a constant flow of tortillas. He has never done any advertising because word of mouth is sufficient and "the quality sells itself". One problem he does have is with his employees: two of the four are responsible, but the other two lack training and "cannot be left alone". Mr. Somarriba is satisfied with his current situation. Even if demand increases, he will not expand operations because the business already requires all of his time.

Borrower #20
José Luis Ramos
Shoe Manufacturing
Loan: $2,100

José Luis Ramos has been in the footwear business, either as a shoemaker or a business owner, for over 25 years. He started by working out of his home filling shoe orders, and slowly accumulated tools and materials. Eventually, a large shoe manufacturer became interested in his work and provided Ramos with all of the necessary tools and between seven and eighteen workers to supervise, according to how busy they were. From 1968 to 1972, he manufactured his own shoes and sold them from a shop on the premises.

Since 1973, Ramos has sold the shoes that he manufactures both at his own store, and under a different label to a store chain. His goal is to see his store in a good commercial location downtown.

Placing finishing touches onto shoes.

Ramos learned about ADMIC through the Chamber of Shoe Manufacturers in Monterrey. An ADMIC promoter came to a meeting and explained the courses, credit and technical assistance offered by the program. In the early 1980's, Ramos had received a small commercial bank loan, but has largely built his business from personal savings and reinvestment of profits. Since 1986, he has been receiving credit from ADMIC, and has always used it to purchase raw materials. Ramos feels that the ADMIC loans are too small, but doesn't think that he could get a loan from a commercial bank, given the low liquidity in the financial sector and his scant formal credit history.

In Ramos' view, the biggest problem that his business faces is competition, because there are so many manufacturers. "My salesmen must work harder and harder to convince clients to buy our product," he laments. "This is because our shoes are higher quality and, consequently, more expensive."

## IV. A COMPARISON OF THE ADMIC AND FUNDACION PARAGUAYA PROGRAMS

The following chart offers a comparison of the major aspects of the ADMIC and Fundación Paraguaya programs:

| | Mexico | Paraguay |
|---|---|---|
| ACCION affiliate | ADMIC (Asesoría Dinámica a Microempresas) | FP (Fundación Paraguaya de Cooperación y Desarrollo) |
| Borrowers | Micro-producers | Micro-producers and micro-retailers |
| | Existing businesses only | Existing businesses only |
| Lending mechanism | To individual MEs from commercial bank | To solidarity groups of MEs from the affiliate (commercial bank makes loan to affiliate) |
| Collateral | Fixed assets or cosigner | Cross guarantee of solidarity group |
| Loan size: | | |
| Maximum | $2200 | $100 (first time)<br>$800 (repeaters) |
| Minimum | $880 | $50 |
| Interest rate (per year) | 90% of ave. bank cost of capital (currently 35.9%) | 72% add-on (effective rate = 114%) |
| Loan term | 6-18 months | 2-4 months |
| Frequency of repayments | Monthly | Weekly, biweekly, monthly |
| Delinquency rate | 7% (payments)[18] | 9% (post maturity)[19] |
| Ave. application processing time (submssn to disb) | 2-6 weeks | 10-15 days |

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[18] See p.63 for a discussion as to how delinquency is calculated by ADMIC.

[19] See p.11 for a discussion as to how delinquency is calculated by Fundación Paraguaya.

| | Mexico | Paraguay |
|---|---|---|
| Definition of ME | 8 employees or less | Self-employed with no access to formal credit |
| Source of funds | a) Bridge loan with commercial bank funds<br>b) GOM rediscount facility | Commercial bank funds |
| Total amount lent to borrowers | $47,000 | $90,000 |
| Number of borrowers | 24 | 2,124 [20] |

In studying these two guarantee programs which support microenterprise lending, a number of interesting contrasts became apparent. Each program has its merits, although it was clear that the Fundación Paraguaya program delivered credit to this sector in a more expeditious and effective manner. This can be attributed, in large part, to the credit delivery mechanism established between the ACCION affiliate and the commercial bank in each country. In Paraguay, Fundación Paraguaya is the direct recipient of loan monies from Banco Unión, which are borrowed at commercial interest rates. Through its own in-house credit approval and delivery system, the Fundación issues loans to microentrepreneurs. Since loans made under the A.I.D. guarantee facility had to be rediscounted through a national fund in Mexico, ADMIC was prohibited from doing direct lending. This necessitated the involvement of BANORTE in the program. Therefore, loan approval is done not only at ADMIC, but on two different levels at BANORTE. BANORTE, not ADMIC, ultimately disburses the loan directly to the microentrepreneur. The result of this arrangement is that Fundación Paraguaya is treated by the bank just like any other large, good customer. BANORTE, conversely, views its involvement with ADMIC as a "social contribution", and considers the processing of such small loans burdensome and low priority.

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[20] Some borrowers have received loans from reflows from other funding sources, but since separate accounts are not maintained, it is impossible to identify which are reflows from the A.I.D. guarantee program. This is the total number of borrowers (new and repeat) since July 14, 1988, when the LC funds became available. The number of new borrowers since that date is 262. They received a total of $24,000.

Similarly, solidarity group lending (as seen in Paraguay), as opposed to issuing individual loans to microentrepreneurs (as seen in Mexico), appears to be the more advisable approach in providing credit to the informal sector. Considerable administrative time is expended in the Mexico program in assuring that each microentrepreneur's guarantee is sufficient for the loan. Since this is not a factor in lending to solidarity groups because of the cross-guarantee among group members, a great deal of administrative procedure is avoided.[21] This, combined with the fact that three to five microentrepreneurs' loans are approved with the initiation of each group into the program, allows significantly more borrowers to be reached.[22]

Another interesting finding was that the amount of interest charged to microentrepreneurs in programs such as ADMIC and Fundación Paraguaya has no impact on the demand for these loans. This is particularly evident in the case of Fundación Paraguaya, whose 114% effective interest rate in no way deters microentrepreneurs from participating in the program. They willingly pay this high rate (which is charged by the Fundación in its efforts to become more financially self-sufficient) since no other credit programs exist for the informal sector. The rate charged falls between commercial interest rates and usury rates. If a similarly high interest rate could be charged in Mexico, it would contribute to ADMIC improving its financial standing. Unfortunately, its current banking arrangement prohibits this, since the loans issued by BANORTE are rediscounted through the Central Bank.

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21 However, at FP a financial analysis is done of each applicant before the first loan is made. This includes an analysis of the applicant's financial situation and his/her capacity to repay the loan. If the group repays the first loan satisfactorily, they are automatically eligible for a subsequent loan. This avoids the need for a continual reassessment of each borrower. FP carefully tracks the repayment record of each loan and assigns a rating. If the rating falls below a certain level, no future loans can be made until the rating is improved.

22 However, at Fundación Paraguaya a financial analysis is done of each applicant before the first loan is made. This includes an analysis of the financial situation (assets vs. liabilities and equity) and of income and expenses. The latter analyzes the borrower's capacity to repay the loan. If the group repays the first loan satisfactorily, they are automatically eligible for a subsequent loan. This avoids the need for a continual reassessment of each borrower. FP carefully tracks the repayment record and a fieldworker immediately follows-up if any payment is missed.

# GENERAL ECONOMIC ENVIRONMENT AND FINANCIAL MARKETS OVERVIEW: PARAGUAY

## I. ECONOMIC

### A. Macro-Economic Environment

Paraguay showed strong economic growth from 1970 until 1981. During this period, the GNP grew at an average rate of 8.1 percent, the highest growth rate recorded in Latin America. This sustained growth was fueled by high commodity prices, high internal production levels and significant capital formation. Such growth factors were primarily the result of construction of the Itaipu hydroelectric dam and the accompanying high levels of investment from international donors and private commercial banks. Inflation and unemployment remained low and per capita income rose rapidly in real terms. This led to Paraguay's classification (in retrospect, prematurely) as an "Advanced Developing Country," and the U.S. government's decision to phase out regular bilateral development assistance.

The period of economic growth ended in 1982. A distinct new period began brought about by the completion of heavy construction at Itaipu, falling world prices for Paraguay's traditional exports, and bad weather conditions that affected agricultural production. These events negatively affected the balance of payments, employment, tax revenues and economic activity in general. The macroeconomic policy response was hesitant and inadequate, which made a bad situation even worse. Examples include creation of a multiple exchange rate system in the early 1980s. This system caused severe distortions, large fiscal deficits and excessive monetary expansion.

The economic downturn reduced growth in GNP and caused abnormally high inflation rates (in excess of 30% per year). The result was lower living standards, reduced levels of investment, deterioration in the balance of payments and a substantial increase in external indebtedness. Real capital formation as a percentage of GNP dropped from 35% in 1982 to less than 20% in 1986. Low savings rates, as well as the scarcity of international private capital, have limited private sector growth. The economy has come to rely increasingly on public sector projects financed by multilateral donors.

With a population growth rate of 3% per year, GNP per capita in 1986 was 14% lower than in 1981. Declining capital inflows and limited domestic savings have contributed to an even further drop in investments. Gross domestic investment declined by an average of almost 7% per year during 1981-1986 and real capital formation as a percent of GDP declined from 35% to 20%. While this share of investment is still large, the bulk of it is in capital intensive and inefficient projects, such as steel and cement, which do not lead to productive growth.

The GNP grew at a rate of 4% during 1988, but is projected to drop by 3% in 1989 because of a weak manufacturing output.[1] Manufacturing grew by 4% during 1988, but it is forecast to drop to 2.5% in 1989, based on fierce competition from Argentina and Brazil. Due to the fiscal deficit, devaluation and petroleum import exchange rate, inflation during 1989 is forecast to rise to a 35-40% range from 32% in 1988.

## B. Economic Factors Related to Microenterprises in Asunción, Paraquay

There are almost one million inhabitants in Asunción and, like all Third World capitals, it has attracted major migratory flows. Recent census information collected by the national government indicates that more than 90,000 microentrepreneurs reside and work there, only 47% of whom were born in the capital.

The economic slowdown following the construction of the Itaipu dam and growth in the labor force have contributed to a rapid increase in unemployment in recent years. A U.S. Embassy study shows that unemployment in Paraguay has grown from 4% in 1981 to 12% in 1987. During this same period, underemployment increased from 16% to 23%. Clearly, the microenterprise sector could play an increasingly important role in the financial sustenance of many Paraguayans, given the ever increasing rates of unemployment and underemployment.

In September 1988, a report was published entitled "A Study of the Informal Sector in Paraguay," which served to dispel some of the myths that surround microentrepreneurs. The study focussed on the Mercado Cuatro, or Market No. 4, which is the largest open-air market in Asuncion. A survey was conducted in which a sample group of 327 microentrepreneurs was selected from among 1,916 vendors who had gotten credit from Fundación Paraguaya, the ACCION affiliate who received the A.I.D. guaranteed letter of credit.

As far as strata of economic activity are concerned, respondents were comprised of 35% clothing vendors, 27% produce vendors, 12% food preparers/vendors, 10% medicinal herb vendors and 16% other (crafts, cosmetics, hardware, etc.).

The most commonly held misconception about microentrepreneurs is that their businesses lack continuity and stability. The findings clearly refute this since 11% of the study's sample businesses had been involved in the same economic activity for more than 20 years; 28% for 10 to 19 years; 26% for 5 to 9 years; 23% for 2 to 4 years; and only 11% for less than 1 year. Only about 5% of the microentrepreneurs surveyed had another job, which is again indicative of the stability of the informal sector and

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[1] Business International, January 16, 1988.

the extent to which people rely on these jobs as their sole source of income.

The importance and need for credit programs such as Fundación Paraguaya is underlined by the survey's findings on microentrepreneurs' credit history. Over 33% of respondents stated that they had never received credit; 50% said they had borrowed from money lenders (who may charge up to 20% interest daily); 14% had received materials on consignment; and only 3% had received credit from a formal institution. The Fundación Paraguaya program not only provides microentrepreneurs with much-needed credit, but offers training which is essential to the improvement of their businesses.

## II. FINANCIAL

### A. Institutional Framework

The financial and banking system in Paraguay is comprised of:

- 22 private commercial banks;
- 2 Government commercial banks; and
- 28 finance companies (regulated by the Central Bank).
- 10 savings and loan associations
- 58 credit unions

Paraguayan banking institutions form a well developed market, and are comprised of a wide range of public and private banking institutions, stock owned savings and loan associations, credit unions and finance companies. An informal credit sector is also quite active. While some foreign banks have operations in Paraguay, Chase Manhattan Bank of Boston and Bank of America have withdrawn in recent years.

The banking system functions through a regulated interest rate structure. The current maximums are noted in the following section.

In addition to interest rate caps, the law requires strict compliance with reserve deposits. Forty-two percent of all checking and interest earning demand deposits and 30% of time deposits must be placed in a non-interest bearing account with the Central Bank. Banks are required to use 50% of the remaining resources for loans which fall under development targets, while the use of the other half is determined at the banks' discretion. The Central Bank does, however, permit rediscounting the portfolio of development loans at 10%. Other legal requirements which particularly affect the private sector are restrictive banking laws, such as one that limits loan amounts to 20% of a company's net worth. Banking laws such as interest caps and reserve requirements place heavy burdens on bank performance.

## B. Interest Rate Structure, Cost of Money and Liquidity

Interest rates in Paraguay, when adjusted for inflation, have yielded negative real rates. While the Government increased these interest rates during 1988, the increases provided for only marginally positive spreads. The spreads range from 4% to 20%. The current interest rates in effect are as follows:

| | | |
|---|---|---|
| Loans: | | |
| Commercial banks | 28% | (commercial loans) |
| | 22% | (development loans) |
| Finance companies | 35% | |
| Deposits: | | |
| 31-60 days | 15% | |
| 61-90 | 16% | |
| 91-180 | 17% | |
| more than 180 days | 18% | |

Inflation is forecast to reach 35-40% in 1989[2], which would plunge the system back into negative real rates. Although financial developments over the past several years have shown rapid increases in domestic credit, there has been a decrease in private sector real holdings of financial assets.

The World Bank estimated total credit growth as the following:

| 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|
| 18.3% | 18.4% | 19.8% | 27.1% |

Economic expansion during 1987, largely fueled by agricultural exports, increased the systems' nominal liquidity. Loans, while expanding by 27.1% in nominal terms, actually represented an adjusted real decline of 6.3%. Commercial bank deposits increased by 26.6% in nominal terms and 6.7% in real terms, and real savings increased at 6.7%.

2 Business International, January 16, 1989, p. 13.

Very little data exists for the system during 1988, since reviews for this period had not yet been published at the time this report was prepared. Business International forecasts an increase in the money supply for 1989 (a 50% over 1988), and the availability of ample credit at rates exceeding the government caps.

This data may give the impression that there is ample financial liquidity in Paraguay. Actually, the private sector entrepreneur faces quite a different credit reality. Growth figures include both public and private sectors. The overwhelming share of the growth is represented by public expenditures to cover deficits. Another factor accounting for these figures is money creation, which enters the system as a financial asset that is utilized for buying and selling currencies. Both of these factors are inflationary vehicles.

The entrepreneur's liquidity is shrinking in real terms. Credit available to the private sector is dominated by the agricultural sector, primarily for seasonal credit targeted for export crops. Even the National Development Bank of Paraguay has no long term credit for the private sector; even short-term credit is very tight.[3]

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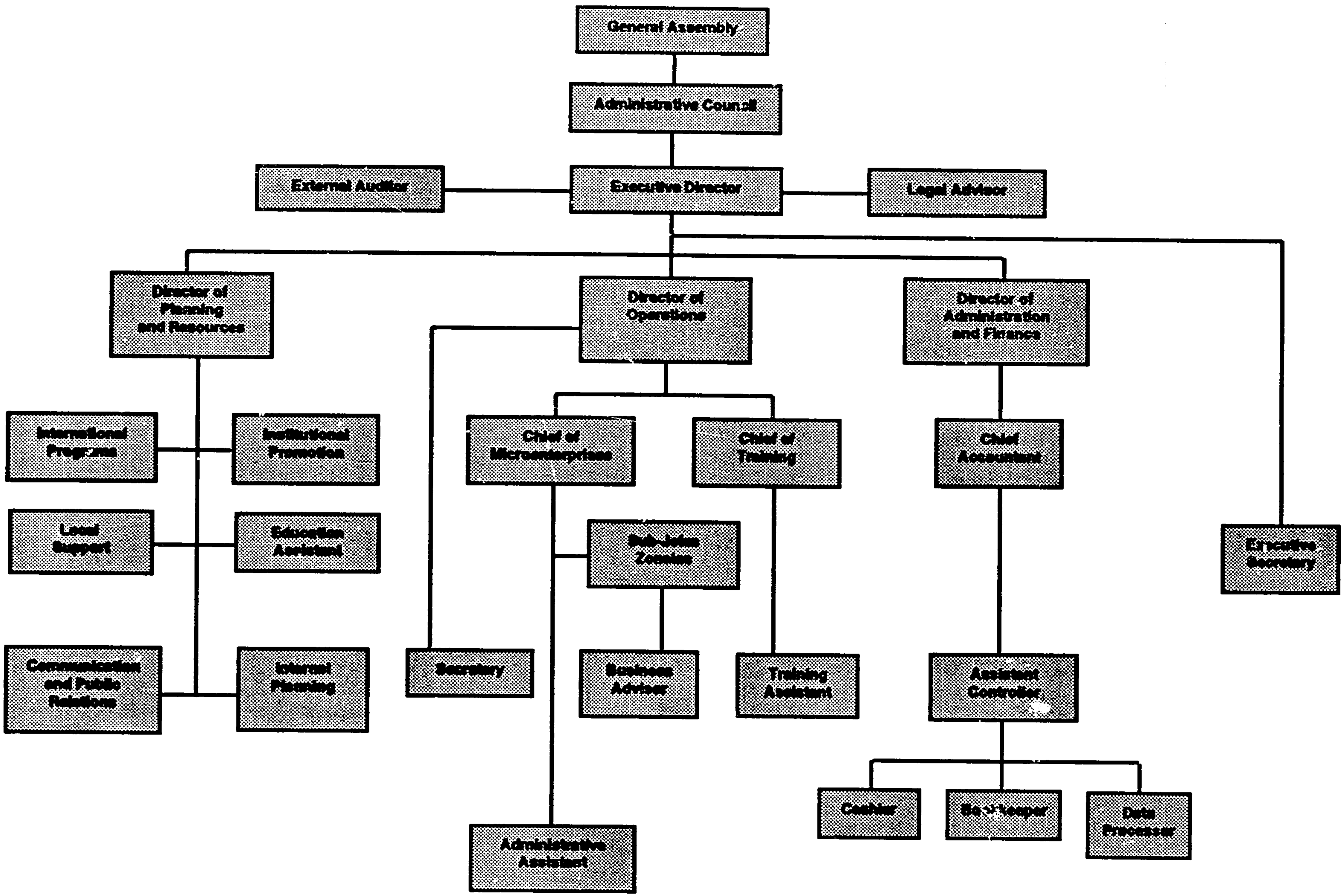
[3] Financial literature on Paraguay is very scarce. This section (II.B.2) of the report depended very heavily on the following sources:

1) Business International, "Business Latin America," January 16, 1989, pp. 12-13.

2) U.S. Department of Commerce, "Foreign Trends and Their Implications for the U.S. and Paraguay," November, 1988.

3) World Bank, "Paraguay Country Economic Memorandum," January 11, 1988, pp. 18-19.

# Fundación Paraguaya Organization Chart




ANNEX 2

ANNEX 3: Fundacion Paraguaya Comparative Statement of Income and Expenses
(Guaranies)

| | 1985 | 1986 | 1987 | 1988 (thru 10/88) | 1988 (thru 10/88)* |
|---|---|---|---|---|---|
| Self-Generated Income: | | | | | |
| Interest on Loans | 2,133 | 1,931,671 | 11,823,812 | 19,094,718 | 19,094,718 |
| Charges for Supervision | 2,133 | 1,994,820 | 23,294,901 | 34,414,166 | 34,414,166 |
| Charges for Training | 4,266 | 3,824,732 | 23,466,084 | 34,212,557 | 34,212,557 |
| Other Income | 0 | 0 | 2,823,062 | 3,175,193 | 3,175,193 |
| Total | 8,532 | 7,751,223 | 61,407,859 | 90,896,634 | 90,896,634 |
| Expenses: | | | | | |
| Personnel Costs | 4,385,425 | 32,363,606 | 67,415,664 | 57,470,874 | 57,470,874 |
| Interest and Fees on Loans | 0 | 1,292,079 | 4,766,632 | 21,054,489 | 21,054,489 |
| General Administration | 2,826,312 | 20,574,077 | 40,089,361 | 29,748,226 | 29,748,226 |
| Write-off for Bad Debts | 0 | 0 | 4,364,291 | 0 | 0 |
| Special Projects | | | | | 73,710,660 |
| Total | 7,211,737 | 54,229,762 | 116,635,948 | 108,273,589 | 181,984,249 |
| Gross Margin | (7,203,205) | (46,478,539) | (55,228,089) | (17,376,955) | (91,087,615) |
| Self-Sufficiency | 0.1% | 14.3% | 52.6% | 84.0% | 49.9% |
| Budget Support Donations | 14,023,000 | 104,150,899 | 79,567,356 | 19,413,142 | 19,413,142 |
| Donations for Special Projects | | | | | 83,080,796 |
| Net Margin (added to net worth) | 6,819,795 | 57,672,360 | 24,339,267 | 2,036,187 | 11,406,323 |

* Includes Special Projects Costs and donations to cover them.

ANNEX 4: Fundacion Paraguaya Comparative Balance Sheets
(Guaranies)

| | 1986 | 1987 | 1988 (thru 10/88) |
|---|---|---|---|
| **ASSETS** | | | |
| Cash on Hand | 1,030,151 | 6,702,371 | 1,928,838 |
| Cash in Designated Accounts | 22,802,166 | 27,193,077 | 54,694,757 (1) |
| Loans to Micro-retailers | 12,236,637 | 53,882,261 | 75,245,277 (2) |
| Loans to Micro-producers | 39,574,265 | 50,318,441 | 91,763,610 (3) |
| Receivables | 586,534 | 2,097,132 | 0 |
| Prepaid Items | 181,859 | 835,859 | 6,719,785 |
| Other | 0 | 0 | 1,237,664 |
| Less: Provision for Bad Debts | 0 | (4,364,291) | (4,082,100) |
| Total Current Assets | 76,411,612 | 136,664,850 | 227,507,831 |
| Net Fixed Assets | 13,802,404 | 18,819,322 | 25,990,935 |
| TOTAL ASSETS | 90,214,016 | 155,484,172 | 253,498,766 |
| **LIABILITIES** | | | |
| ST Loans | 15,000,000 | 50,000,000 | 95,000,000 |
| Payables | 0 | 1,592,781 | 18,706,124 |
| Provision for Payments | 1,685,772 | 3,539,741 | |
| Other | 321,969 | 2,806,108 | |
| Total Current Liabilities | 17,007,741 | 57,938,630 | 113,706,124 |
| LT Loans | 0 | 0 | 35,201,034 |
| TOTAL LIABILITIES | 17,007,741 | 57,938,630 | 148,907,158 |
| NET WORTH | 73,206,275 | 97,545,542 | 104,591,608 |
| TOTAL LIABILITIES AND NET WORTH | 90,214,016 | 155,484,172 | 253,498,766 |

Notes:

(1) Earns 15-18% per year
(2) Includes G49,480 in loans made since 7/88 (the date PRE funds became available), the majority of which were probably made with PRE guaranteed funds and repayments of loans from these funds.
(3) Includes G69,370 in loans made since 7/88

ANNEX 5: Matrix of Fundacion Paraguaya Sub-Borrowers Interviewed (with loans disbursed)

| Brwr/ Group No. | Borrower Name | Type of Business | Gender of Owner | Loan Amt (fr guar funds) | Purpose | New/ Re-peat | Ave Mnthly Sales ($)(*) Before Fn Par | At Present | % change | Fixed Assets ($)(*) Before Fn Par | At Present | % change | Full Time Employees(*) Before Fn Par | At Present | % change | Fl Tm Employ Men | Women |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 6 | Rosa Concepcion Gomez | Carpentry | F | 200 | machin mn | R | 1,231 | 2,600 | 111% | 1,068 | 2,400 | 125% | 0 | 2 | | 2 | 0 |
| 112 | Lorenzo Vera | Shoe repair | M | 300 | RM | R | 392 | 1,040 | 165% | 291 | 1,000 | 244% | 0 | 0 | | 0 | 0 |
| 133 | Ramon Quintana | Retailer-kiosk | M | 50 | mrchdse | R | 872 | 1,430 | 64% | 436 | 700 | 61% | 0 | 1 | | 1 | 0 |
| 170 | Arminda de Carmona | Retailer-kiosk | F | 300 | mrchdse | R | 1,744 | 6,000 | 244% | 581 | 400 | -31% | 1 | 2 | 100.0% | 0 | 2 |
| 276 | Serafin Saldivar | Tailor | M | 200 | RM | R | 302 | 448 | 49% | 314 | 250 | -20% | 2 | 2 | 0.0% | 1 | 1 |
| 284 | Virgilio Espinola | Food preparat. | M | 600 | RM | R | 2,638 | 37,440 | 1319% | 2,814 | 7,800 | 177% | 16 | 16 | 0.0% | 16 | 0 |
| 287 | Marina de Ovando | Seamstress | F | 200 | RM | R | 201 | 100 | -50% | 176 | 300 | 71% | 0 | 0 | | 0 | 0 |
| 288 | Selva de Rodriguez | Seamstress | F | 200 | RM | R | 490 | 143 | -71% | 107 | 70 | -34% | 1 | 0 | -100.0% | 0 | 0 |
| 292 | Justa Segovia | Food preparat. | F | 50 | RM | R | 217 | 158 | -27% | 0 | 50 | | 0 | 0 | | 0 | 0 |
| 350 | Rufino Garcia | Shoemaker | M | 200 | RM | R | 113 | 240 | 112% | 182 | 145 | -20% | 2 | 2 | 0.0% | 1 | 1 |
| 416 | Maria de Cardenas | Seamstress | F | 200 | RM | R | 163 | 200 | 22% | 144 | 115 | -20% | 1 | 1 | 0.0% | 0 | 1 |
| 429 | Asuncion Samudio | Retailer-kiosk | F | 200 | mrchdse | R | 98 | 150 | 54% | 195 | 180 | -8% | 2 | 4 | 100.0% | 1 | 3 |
| 432 | Rosa Vera | Hairdresser | F | 200 | supplies | R | 377 | 430 | 14% | 535 | 426 | -20% | 1 | 2 | 100.0% | 0 | 2 |
| 438 | Juan Carlos Ortiz | Whlslr- mlk dist | M | 200 | milk | R | 206 | 400 | 94% | 2,172 | 6,000 | 176% | 1 | 2 | 100.0% | 1 | 1 |
| 441 | Esther Morena de Perez | Shoemaker | M | 150 | RM | R | 2,261 | 1,440 | -36% | 2,161 | 1,000 | -54% | 0 | 0 | | 0 | 0 |
| 455 | Cadido Miranda | Bakery | F | 750 | RM | R | 3,015 | 6,000 | 99% | 5,905 | 10,000 | 69% | 3 | 5 | 66.7% | 2 | 3 |
| 457 | Hercilda de Quesnel | Seamstress | F | 300 | RM | R | 503 | 1,000 | 99% | 1,508 | 2,000 | 33% | 0 | 4 | | 0 | 4 |
| 481 | Angela de Cera | Seamstress | F | 300 | RM | R | 3,015 | 4,680 | 55% | 4,183 | 7,500 | 79% | 4 | 4 | 0.0% | 0 | 4 |
| 553 | Victorina Rizzi | Retailer-handcrf | F | 100 | mrchdse | R | 814 | 2,600 | 219% | 98 | 800 | 719% | 0 | 0 | | 0 | 0 |
| 613 | Danis Pincheira | Restaurant | M | 200 | food | R | 1,884 | 1,650 | -12% | 2,261 | 4,000 | 77% | 0 | 5 | | 2 | 3 |
| 619 | Cristino Palacios | Restaurant | M | 700 | food | R | 3,909 | 5,000 | 28% | 6,580 | 6,060 | -8% | 4 | 6 | 50.0% | 1 | 5 |
| 620 | Maria Bezama | Retailer-market | F | 100 | mrchdse | R | 151 | 150 | 0% | 94 | 75 | -20% | 1 | 1 | 0.0% | 0 | 1 |
| 671 | Catalicio Roja | Carpentry | M | 50 | RM | R | 543 | 390 | -28% | 945 | 870 | -8% | 0 | 1 | | 1 | 0 |
| 681 | Diego Guzman | Photography | M | 75 | supplies | R | 1,412 | 1,950 | 38% | 174 | 160 | -8% | 0 | 0 | | 0 | 0 |
| | | TOTALS | | 5,825 | | | 26,552 | 75,639 | | 32,923 | 52,301 | | 39 | 60 | | 29 | 31 |
| | | AVERAGES | | 243 | | | 1,106 | 3,152 | 107% | 1,372 | 2,179 | 66% | 2 | 3 | 32% | 1.21 | 1.29 |

Note:

* "Before" figures are from applications taken at the time of the first loan from FP;
"after" figures are from the interviews with borrowers conucted by the evaluation team.

ANNEX 6: Impact on Sample of 20 Borrowers: Fundacion Paraguaya
(Guaranies)

| Original (7/88) | Total Sample: Women (9) | Total Sample: Men (11) | Total Sample: Total (20) | Total Sample: Average | Micro-Producers: Women (4) | Micro-Producers: Men (8) | Micro-Producers: Total (12) | Micro-Producers: Average | Micro-Retailers: Women (5) | Micro-Retailers: Men (3) | Micro-Retailers: Total (8) | Micro-Retailers: Average |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross Sales | 5,030,000 | 6,129,000 | 11,159,000 | 557,950 | 2,480,000 | 4,225,000 | 6,705,000 | 558,750 | 2,550,000 | 1,904,000 | 4,454,000 | 556,750 |
| Net Profit | 1,013,760 | 1,697,530 | 2,711,290 | 135,565 | 560,760 | 1,364,950 | 1,925,710 | 160,476 | 453,000 | 331,580 | 784,580 | 98,073 |
| Fixed Assets | 2,374,500 | 5,557,000 | 7,931,500 | 396,575 | 1,148,000 | 4,810,000 | 5,958,000 | 496,500 | 1,226,500 | 747,000 | 1,973,500 | 246,688 |
| Employees | 9 | 11 | 20 | 1.0 | 8 | 11 | 19 | 1.6 | 1 | 0 | 1 | 0.1 |
| **Six Months Later (1/89)** | | | | | | | | | | | | |
| Gross Sales | 5,756,100 | 8,660,000 | 14,416,100 | 720,805 | 2,928,000 | 5,840,000 | 8,768,000 | 730,667 | 2,828,100 | 2,820,000 | 5,648,100 | 706,013 |
| Net Profit | 1,388,760 | 2,028,490 | 3,417,250 | 170,863 | 782,000 | 1,588,000 | 2,370,000 | 197,500 | 606,760 | 440,490 | 1,047,250 | 130,906 |
| Fixed Assets | 2,469,500 | 6,420,000 | 8,889,500 | 444,475 | 1,240,000 | 5,390,000 | 6,630,000 | 552,500 | 1,229,500 | 1,030,000 | 2,259,500 | 282,438 |
| Employees | 5 | 21 | 26 | 1.3 | 4 | 21 | 25 | 2.1 | 1 | 0 | 1 | 0.1 |
| **Difference** | | | | | | | | | | | | |
| Gross Sales | 726,100 | 2,531,000 | 3,257,100 | 162,855 | 448,000 | 1,615,000 | 2,063,000 | 171,917 | 278,100 | 916,000 | 1,194,100 | 149,263 |
| Net Profit | 375,000 | 330,960 | 705,960 | 35,298 | 221,240 | 223,050 | 444,290 | 37,024 | 153,760 | 108,910 | 262,670 | 32,834 |
| Fixed Assets | 95,000 | 863,000 | 958,000 | 47,900 | 92,000 | 580,000 | 672,000 | 56,000 | 3,000 | 283,000 | 286,000 | 35,750 |
| Employees | (4) | 10 | 6 | 0.3 | (4) | 10 | 6 | 0.5 | 0 | 0 | 0 | 0.0 |
| **Percent Change** | | | | | | | | | | | | |
| Gross Sales | 14% | 41% | | 29% | 18% | 38% | | 31% | 11% | 48% | | 27% |
| Net Profit | 37% | 19% | | 26% | 39% | 16% | | 23% | 34% | 33% | | 33% |
| Fixed Assets | 4% | 16% | | 12% | 8% | 12% | | 11% | 0% | 38% | | 14% |
| Employees | -44% | 91% | | 30% | -50% | 91% | | 32% | 0% | 0% | | 0% |

Source:
Fundacion Paraguaya

# GENERAL ECONOMIC ENVIRONMENT AND FINANCIAL MARKETS OVERVIEW: MEXICO

## I. ECONOMIC ENVIRONMENT

### A. Macro-Economic Environment

Mexico's economy is becoming open and competitive, with a dominant manufacturing and commercial sector and a relatively small agricultural sector. Because of its increasing openness and former dependence on the international market for export of oil and (more recently) the import of industrial inputs, Mexico's economy is strongly influenced by external economic conditions.

After high inflation during the 1970s and early 1980s, Mexico suffered a general macro-economic crisis in 1982. The government responded with a stabilization and structural reform program which began in 1986, following the collapse of international oil prices.[1] Other external conditions unfavorable to adjustment were high international interest rates plus an abrupt halt in the increases in voluntary lending to Mexico that had characterized the preceding decade. Net capital inflows declined precipitously from $23 billion in 1981 to $.4 billion in 1986, all of which aggravated the internal financial crisis.[2]

In spite of Mexico's efforts at adjustment, inflation has remained high (peaking at 159% in 1987), but has been reduced to an estimated 50% in 1988 as a result of the Economic Solidarity Pact (ESP). This program was initiated at the end of 1987 in an effort to slow inflation, reduce the public deficit and domestic interest rates, and stabilize exchange rates. The Pact consists of a combination of tight fiscal and monetary policies along with controls on wages, prices and the exchange rate, as well as an opening of the economy. In addition to reducing the rate of inflation, the ESP has reduced government expenditures although the deficit still remains high. Nominal interest rates have also been reduced though effective rates remain high. Wage increases have been moderate and non-petroleum exports have continued to grow. In 1986, public and private external debt service payments were 54.5% of export earnings. [3] The country's external debt has fallen by $4 billion in the first half of

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[1] Oil, which had been Mexico's leading export in the 1970s, has declined in price by nearly two-thirds since 1981, resulting in a decline of 44% in the country's terms of trade through 1986.

[2] Department of State, American Embassy Mexico, "Economic Trends Report", November 1988, p. 4.

[3] World Bank, op. cit., p. 16.

1988, but external interest payments were 40% of export earnings in 1987 and are expected to be 43% for 1988.[4]

The country's trade surplus fell from $4.76 billion in the first half of 1987 to $2.4 billion in the first half of 1988. This was due to a sharp increase in imports, a slowing of non-oil export growth and the continued decline in international oil prices which depressed crude oil export earnings.[5]

Overall industrial growth slowed during 1988, with the annual rate of expansion falling from 5.2% to 0.9% during the first and second quarters of the year. This reflects the fact that internal demand has been falling as the government's anti-inflation program has taken hold. Real GDP growth was minimal (0.5%).

The recent slowing of economic growth and the ongoing high inflation rate have had a negative impact on microenterprises. Sales have been limited by the drop in internal demand, while the costs of production remain relatively high. Both of these factors have tended to reduce net profits.

Unemployment and underemployment have become serious problems, with only about 200,000 new jobs per year being created compared with 700,000 to 1 million yearly entrants into the labor force. The unemployment rate currently stands at approximately 18% of the workforce.[6]

Since the unemployment rate has particular relevance to microenterprises, a more detailed discussion is merited on this subject. Although the population grew at an average annual rate of only 2.3% from 1983 to 1986, the labor force expanded at an average annual rate of 3.7%. On the other hand, employment in the formal sector decreased an average of 0.7% annually. This has caused high unemployment rates and has led to an increase in the number of workers seeking employment in the informal sector and to increased emigration and unemployment. As in many countries, those forced to enter the informal sector often form microenterprises themselves or work for other microentrepreneurs.[7]

Some key economic indicators are shown in the following table:

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[4] Amembassy Mexico, op. cit., p. 4.

[5] Amembassy Mexico, op. cit., p. 14.

[6] Amembassy Mexico, op. cit., p. 6.

[7] World Bank, "Mexico After the Oil Boom: Refashioning a Development Strategy", 1987, p. 39.

## TABLE 1

## KEY ECONOMIC INDICATORS

| Indicator | 1986 | 1987 | 1988 (proj) |
|---|---|---|---|
| Population (millions, yr. end) | 80.5 | 82.0 | 83.5 |
| GDP (curr. US$, billions) | 127.2 | 143.1 | 175.0 |
| GDP per capita (US$) | 1,580 | 1,745 | 2,096 |
| Real GDP growth (change per year) | -3.8 | 1.4 | .5 |
| Consumer Price Index (% change p.a) | 105.7 | 159.2 | 48-50 |
| Labor Force (year end, millions) | 24.7 | 25.4 | 26.1 |
| Unemployment (% of workforce) | 19.4 | 18.0 | 18.0 |
| Gross Domestic Investment (% of GDP) | 15.5 | 15.3 | 15.7 |
| Exports (US$ billions) | 16.0 | 20.6 | 20.9 |
| Imports (US$ billions) | 11.4 | 12.2 | 18.7 |
| Trade Balance (US$ billions) | 4.6 | 8.4 | 2.2 |
| Foreign Direct Investment (US$ billions) | 1.5 | 3.3 | 2.0 |
| Foreign Debt (US$ billions) | 101.2 | 107.4 | 105.0 |
| Average Exchange Rate (pesos per US$): | | | |
| Controlled | 611.35 | 1,366.73 | 2,250 |
| Free | 637.88 | 1,405.81 | 2,290 |

Source: American Embassy, Mexico, op. cit., p. 3.

The most important sectors in Mexico are manufacturing and commerce, which accounted for 24.6% and 23.8% of the GDP in 1985, respectively.[8]

Monterrey, where the ACCION project is centered, is in the state of Nuevo León. The city of Monterrey and the state of Nuevo León occupy important positions in the industrial and commercial economy of Mexico. Of the 500 largest Mexican corporations, 47 (9%) are located in Monterrey; 28 (10%) of the most important export firms and 29 (8%) of the most important import firms are located in the state of Nuevo León.[9] Nuevo León holds 12% of all the industries in Mexico. The Chamber of Industries (CAINTRA) estimates that there are 8,500 industries in Nuevo León, of which 90% are micro (1 to 5 employees) or small (6 to 49 employees). Of these, approximately 75% are formal (i.e. registered) and 25% are informal. The majority of these enterprises are micro-retailers and micro-service businesses. Most of the micro-producers are concentrated in the areas of carpentry, furniture manufacturing, food preparation, and metal working. The majority (90%) of the micro-producers are men.[10]

The population of metropolitan Monterrey is 3.25 million, which represents 4% of the national population. In 1980, the state of Nuevo León contributed 6% to the national GDP and is estimated to make a comparable contribution in 1988.[11] In 1986, Nuevo León accounted for 11% of the Industrial GDP, making it Mexico's second largest industrial center[12], despite an average idle production capacity of 37% in Monterrey. The following is a comparison of the annual average unemployment rates for Monterrey and Mexico nationwide.

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8 World Bank, op. cit., p. 127.

9 El Norte articles

10 Jorge L. Mancilla, Manager of Economic Studies, CAINTRA, Interview, 10/27/88.

11 World Bank, op. cit., p. 115 and Mancilla, op. cit.

12 AmCham, p.6.

TABLE 2

COMPARISON OF UNEMPLOYMENT RATES

| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|
| Mexico | 3.4 | 7.0 | 11.7 | 12.6 | 14.7 | 19.4 |
| Monterrey | 4.9 | 5.8 | 13.0 | 9.65 | 6.1 | 8.9[13] |

Source: World Bank, "Mexico After the Oil Boom: Refashioning a Development Strategy", 1987, p. 39.

If these statistics are correct, the recession of 1985-1986 was not as severe in Monterrey as in the nation as a whole. CAINTRA indicates, however, that in the first half of 1988 there was an overall reduction in the number of personnel employed in the state. Of the companies operating there, 24% reduced their number of employees and another 60% did not hire any new employees due to sharp drops in sales and production. If the labor force was increasing as in the rest of Mexico, the combination of these factors would mean an increase in the unemployment rate for Monterrey for 1988. CAINTRA estimated that this reduction in employment would continue for the rest of 1988.

One aspect of the ESP is the closure or privatization of inefficient or failing state owned enterprises. A significant manifestation of this in Monterrey was the closure of the government foundry with the consequent layoff of approximately 3,000 workers in 1987.

## B. Economic Factors Related to Microenterprise in Monterrey, Mexico

The 1980 national census in Mexico estimated the number of microentrepreneurs to be more than 30,000. This number has, in all likelihood, increased significantly in recent years, if one considers the dynamics of job generation and population growth. Formal employment growth has dropped from an average of 4% annually during the 1970s to only 1.7% in the 1980s. Growth in the national labor force, by contrast, has been an average of 3.7% per year in this decade, with Monterrey's population and labor force growing considerably faster than the national average. These phenomena have resulted in a sizeable increase in the number of individuals seeking informal employment.

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[13] AmCham, p. 3. This is open unemployment. Another 32.9% were underemployed or self-employed.

The economic crisis of 1982 was felt severely in Monterrey with the closing of entire divisions of companies. Many of those laid off formed small or micro-businesses. CAINTRA indicated that this process of micro-business formation continues at present.[14]

An assessment of the informal sector in Monterrey was completed by ADMIC in 1980. The findings refuted the frequently held belief that microentrepreneurs' businesses are unstable and transitory. Thirty-four percent of respondents had their businesses for 1 month to 3 years; 30% for 3 to 6 years; 11% for 6 to 9 years; 9% for 9 to 12 years; 4% for 12 to 15 years; and 12% for more than 15 years.

Worldwide studies show that most microenterprises fail to reach their productive capacity due to a lack of capital or management expertise. In the Monterrey survey, access to credit was one of the most frequently mentioned "major problems that affect microenterprises." One hundred percent of the respondents felt that they would need credit to expand their businesses. Fifty percent claimed to have had difficulty in gaining access to bank credit, and only 28% had actually obtained formal credit.

## II. FINANCIAL MARKETS OVERVIEW (BANKING AND FINANCE)

### A. Institutional Framework

In 1982, privately owned commercial and investment banks of Mexico were nationalized, resulting in capital losses of approximately US $1 billion. Part of the nationalization process included consolidation, meaning that the number of banks was reduced from nearly 200 to 60, and subsequently to 20. The objective of consolidation was to increase efficiency, reduce operating costs, diversify services and eliminate smaller banks. The nationalized banks were designated as "national credit societies". The federal government holds 66% of the shares; the other 34% may be held by other public sector entities (municipal governments, parastatals) or employees of the societies. After the 1985 consolidation, the banks were designated as either regional, multi-regional or national.[15] The regional banks were to encourage decentralized economic activity by concentrating resources in the regions where they operate. All banks are regulated and supervised by the Finance Ministry, the

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[14] Mancilla. op. cit.

[15] These distinctions are geographic - regional banks are located only in the state of Nuevo León; multi-regional banks have branches in several state; national banks have branches throughout the country.

Central Bank of Mexico and the National Banking and Insurance Commission.[16]

In Monterrey, there are 19 banks -- three regional banks, 15 national and multi-regional banks, and one international bank. There are also three government development banks and the National Finance Corporation (NAFINSA), which provides funding to five national development rediscount facilities. One of these funds is the Guarantee and Development Fund for Small and Medium Industry (FOGAIN). This fund acts as a secondary market which buys loans made by commercial banks to medium, small and micro-producers.[17]

## B. Interest Rate Structure, Cost of Money and Liquidity

The Bank of Mexico (Central Bank) sets maximum rates only for deposits, leaving free market forces to determine the rates on loans. The Bank of Mexico publishes the average weighted cost of capital (CPP) for all types of deposits as calculated by data from commercial banks. In addition to the cost of funds, banks add a spread to cover administrative costs. The trend in the CPP for the last three years is presented in Annex 6. As can be seen, there has been a dramatic decrease since the beginning of 1988.

The Bank of Mexico regulates the disposition of 57% of the resources captured from the public by commercial banks. This is broken down as follows:

10% in cash on deposit in Bank of Mexico (pays CPP - 2%)
31% in loans to Government of Mexico
10% in loans to government development banks
6% in loans for housing

The remaining 43% can be lent for any purpose.[18]

There was a decrease of 41% in the real value of deposits in financial institutions in the state of Nuevo León from December 1987 to June 1988. This, plus the high legal reserve, caused a severe liquidity crunch. In the same period there was a 29% drop in the value of outstanding loans.[19]

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16 Amembassy Mexico, Econ Trends Cable, 8/86, pp. 1-2.

17 J. Francisco Vara Mora, General Manager, Bank of Mexico, Monterrey Regional Office, Interview, 11/3/88.

18 Assoc Bcos.

19 Bank of Mexico, Reg Office.

The equivalent of the prime rate for loans is CPP + 5%, or 45% currently. Due to the present shortage of liquidity and high operating costs, current interest rates for most borrowers are high and loan terms are a maximum of 180 days. A loan officer at a bank in Monterrey indicated that consumer loans of less than 30 days with no contract carry an interest rate of 70% per annum; those contracted up to 180 days are 84% per year. If the borrower makes a down payment, rates are correspondingly lower.[20]

The lack of liquidity and the perceived high risk has negatively affected longer term loans to small and micro-borrowers. One banker indicated that his bank required a two to one guarantee coverage. Banks only lend short term and then are reimbursed through FOGAIN. However, this reimbursement can often take several months.

## C. Other Programs for Microenterprises - FOMICRO

FOMICRO, the Guarantee Fund for the Development of Microenterprise in Nuevo León, was started by the state government in 1985. ADMIC management maintains that FOMICRO was conceived when the successes of the ADMIC program became apparent. The fund currently has agreements with five commercial banks in Nuevo León where lines of credit, backed by a guarantee fund, have been established. During that year, ADMIC had received approval of its second loan from the Inter-American Development Bank for $1 million, but had to obtain a statement of "no objection" from the Mexican Government. The Ministry of Finance refused to grant it on the grounds that the IDB funds should be used for a national government program. The ministry subsequently applied to the IDB for a similar loan on behalf of FOMICRO, but was rejected because FOMICRO's administrative procedures were considered too bureaucratic. ADMIC subsequently obtained a "no objection" from the ministry, and has recently received its first $500,000 from IDB. In a sense FOMICRO is a competing program so ADMIC does not use any funds from FOMICRO.

There is a team of five business advisors at FOMICRO who consult with microentrepreneurs and assist them in completing loan documentation. After visits by the business advisors, an extension agent conducts a site visit to each business. Microentrepreneurs who have well-run businesses and a market niche for their products must put up 100% collateral; others must put up 200%.

FOMICRO credit is for manufacturers only and may be used to purchase both fixed assets and raw materials. The maximum loan size increased from $700 in 1986 to $2200 in 1987, and then to the current maximum of $6700. The minimum loan is $1300 and the average loan approximately $4400. The interest rate charged is exactly that charged by ADMIC, or 90% of the CPP.

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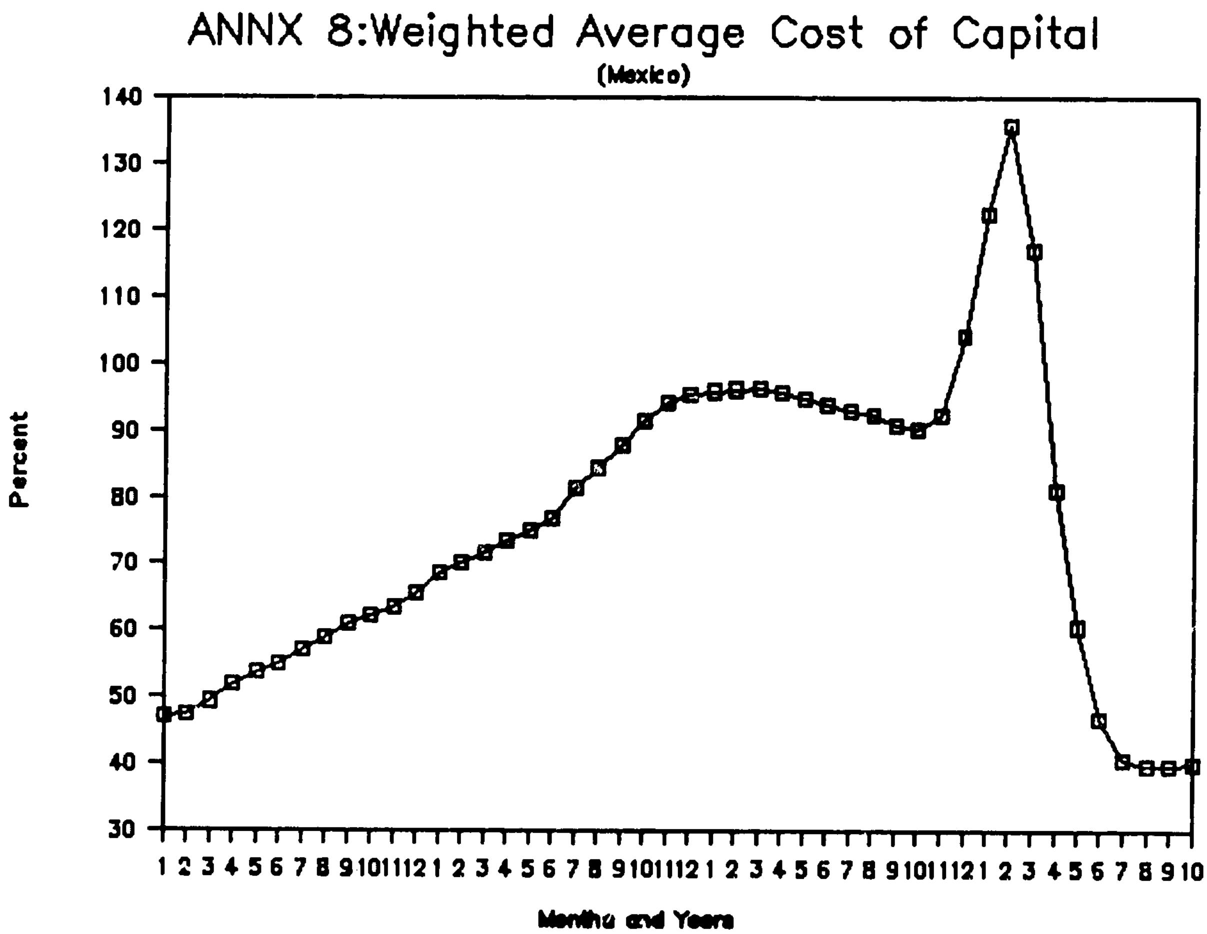
[20] Banpais

To date, the program has placed almost 800 loans totalling over $1.1 million.

According to FOMICRO's general manager, the program has had a very low loan delinquency rate of 2%. The loan agreement between the commercial bank and FOMICRO stipulates that in the event of a default, the bank must attempt to collect for three months, then it may go to FOMICRO for payment. Comments from other sources in the financial sector on the FOMICRO program and its successes were significantly different than those made by the program's general manager, and reported that FOMICRO had an exorbitant default rate, offered no structured training, was only in the business of "placing" loans, and did nothing to recover defaulted loans.




**Weighted Average Cost of Capital (Mexico)**

| Month | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|
| January | 47.17 | 68.55 | 95.89 | 122.54 |
| February | 47.33 | 70.30 | 96.20 | 135.88 |
| March | 49.36 | 71.79 | 96.25 | 117.16 |
| April | 51.93 | 73.48 | 95.79 | 81.03 |
| May | 53.76 | 75.02 | 94.79 | 60.59 |
| June | 54.92 | 76.97 | 93.76 | 46.76 |
| July | 57.00 | 81.36 | 92.91 | 40.72 |
| August | 59.06 | 84.40 | 92.50 | 39.90 |
| September | 60.98 | 87.72 | 91.02 | 39.90 |
| October | 62.29 | 91.48 | 90.30 | 40.00 |
| November | 63.39 | 94.19 | 92.37 | |
| December | 65.66 | 95.33 | 104.29 | |

Source:
Bank of Mexico (Central Bank)

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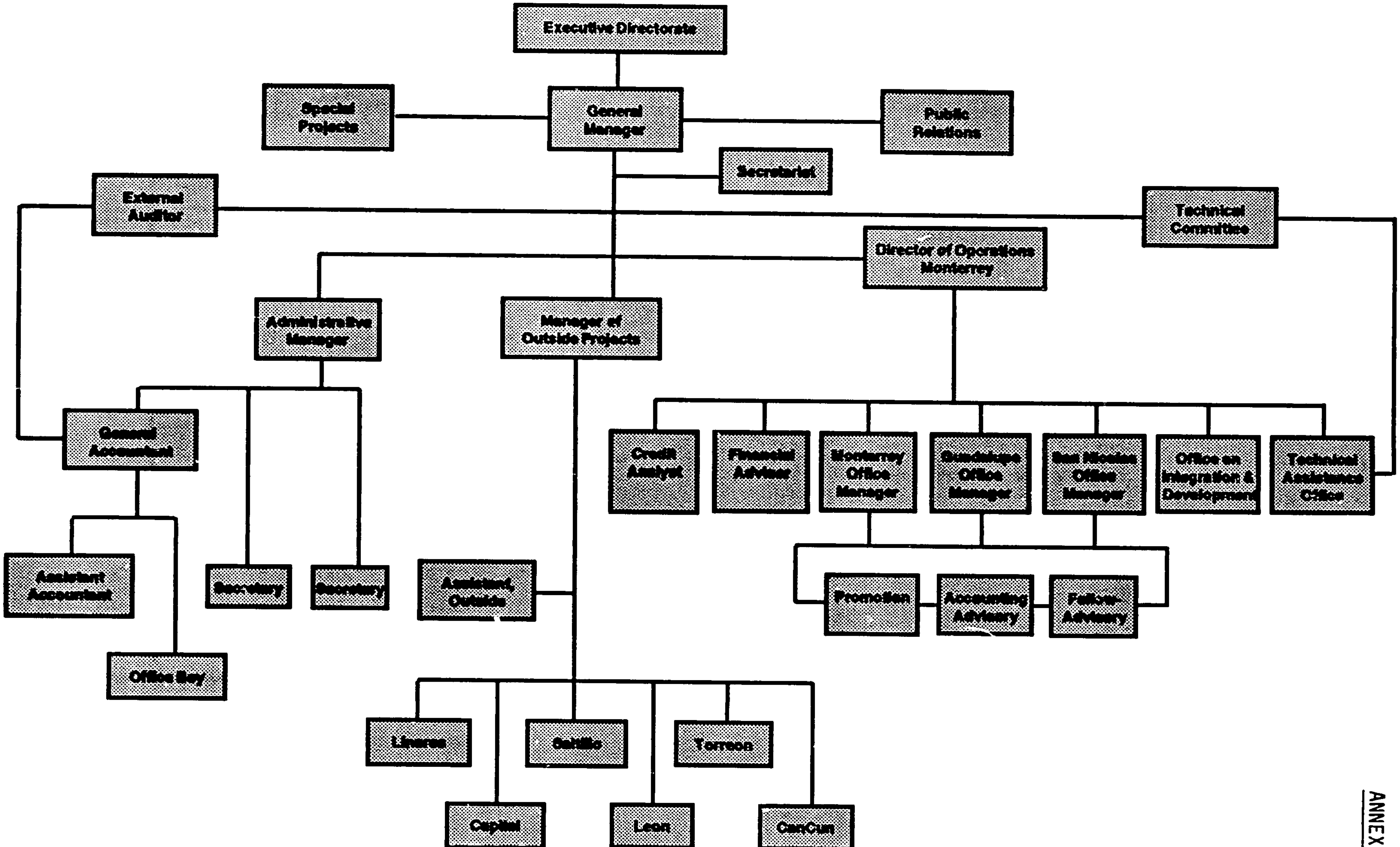
## ASESORIA DINAMICA A MICROEMPRESAS, A.C.

## ORGANIZATION CHART




ANNEX 9

015-V11

ADMIC Comparative Income and Expense Statements

| | 1985 (US $) | 1986 (US $) | 1987 (US $) |
|---|---|---|---|
| **INCOME** | | | |
| Interest from Loans* | 97,805 | 168,217 | 184,478 |
| Other Income | 0 | 0 | 40,621 |
| Total | 97,805 | 168,217 | 225,099 |
| **EXPENSES** | | | |
| General Expenses | 239,494 | 276,826 | 354,909 |
| Financial Expenses | 541 | 2,278 | 1,105 |
| Total | 240,035 | 279,104 | 356,014 |
| Gross Margin | (142,230) | (110,887) | (130,915) |
| Self-Sufficiency | 40.7% | 60.3% | 63.2% |
| Donations | 347,286 | 368,958 | 552,389 |
| Increase to Net Worth | 205,056 | 258,071 | 421,474 |

* Interest from loans made with IDB loan funds and donated capital.

## ADMIC COMPARATIVE BALANCE SHEETS

| | 1985 (US $) | 1986 (US $) | 1987 (US $) |
|---|---|---|---|
| **ASSETS** | | | |
| Cash | $75,765 | $79,756 | $141,751 |
| Investments | 162,433 | 133,649 | 259,783 |
| Loans to MEs | 223,716 | 308,030 | 254,841 |
| Reserve for Bad Debts | (4,473) | (6,200) | (12,743) |
| Prepaid Interest | (17,580) | (27,381) | (32,039) |
| Other A/R | 22,208 | 5,995 | 8,341 |
| Short Term Assets | 462,069 | 493,849 | 619,934 |
| Furniture & Equipment | 46,932 | 0 | 0 |
| Vehicles & Buildings | 4,151 | 51,242 | 36,849 |
| Accumulated Depreciation | (1,386) | (3,245) | (5,106) |
| Land | 0 | 0 | 996 |
| Fixed Assets | 49,697 | 47,997 | 32,739 |
| Deferred Assets | 2,452 | 2,602 | 2,470 |
| Total Assets | $514,218 | $544,448 | $655,143 |
| **LIABILITIES** | | | |
| Short Term Loans | 3,764 | 2,410 | 0 |
| Payables | 4,876 | 9,886 | 8,809 |
| Taxes Payable | 3,580 | 8,194 | 5,444 |
| Short Term Liabilities | 12,220 | 20,490 | 14,253 |
| Long Term Loans (IDB) | 203,268 | 98,881 | 44,867 |
| Total Liabilities | 215,488 | 119,371 | 59,120 |
| Deferred Donations | 38,453 | 40,392 | 0 |
| Retained Earnings | 260,277 | 384,685 | 596,023 |
| Net Worth | 298,730 | 425,077 | 596,023 |
| Liabilities & Net Worth | $514,218 | $544,448 | $655,143 |



\\12'

## ANNEX 12: Matrix of ADMIC Sub-Borrowers Interviewed (with loans disbursed)

| Brw No. | Borrower Name | Type of Business | Gender of Owner | Loan Amt($) (fr guar funds) | Loan Term (months) | Pur-pose | New/ Re-peat | Ave Mnthly Sales ($)(*) Before Loan | At Present | % change | Fixed Assets ($)(*) Before Loan | At Present | % change | Fl Tim Employees(*) Befr Loan | At Prnt | % change | Fl Tm Employ Men | Women |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Aeron Aguilar Gonzalez | Ceramics | M | 1,747 | 24 | RM | R | 1,747 | 5,900 | 238% | 30,570 | 39,300 | 29% | 8 | 13 | 63% | 5 | 8 |
| 2 | Adolfo Sanchez Hinojosa | Painted glass | M | 1,747 | 24 | RM | R | 1,310 | 1,820 | 39% | 870 | 2,620 | 201% | 3 | 3 | 0% | 2 | 1 |
| 3 | Quimica y Materiales | Aluminum dust | M | 1,747 | 12 | RM | R | 1,490 | 3,270 | 119% | 16,160 | 16,160 | 0% | 2 | 2 | 0% | 2 | 1 |
| 4 | Jose Luis Ballesteros | Wood products | M | 1,747 | 24 | RM | R | 363 | 700 | 93% | 6,400 | 6,400 | 0% | 2 | 2 | 0% | 2 | 0 |
| 5 | Raul Estrada Rubio | Motor repair | M | 1,747 | 13 | RM | R | 2,620 | 4,370 | 67% | 17,320 | 23,140 | 34% | 2 | 4 | 100% | 3 | 1 |
| 6 | Cesar Villareal | Wood frames | M | 2,183 | 36 | RM | R | 500 | 1,310 | 162% | 13,000 | 13,000 | 0% | 7 | 7 | 0% | 7 | 0 |
| 7 | Creaciones Mon-Rel, S.A. | Leather prducts | M | 2,183 | 24 | RM | R | 2,300 | 4,000 | 74% | 57,000 | 57,000 | 0% | 4 | 5 | 25% | 4 | 1 |
| 8 | Leandro Salazar Duran | Marble products | M | 1,747 | 16 | RM | R | | | | | | | | | | | |
| 9 | Irene Serrato | Seamstress | F | 2,183 | 24 | RM | R | 473 | 727 | 54% | 14,000 | 14,000 | 0% | 1 | 2 | 100% | 2 | 0 |
| 10 | Andres Ortiz Tirado | Dollies | M | 2,183 | 24 | M | R | 240 | 868 | 262% | 5,240 | 9,170 | 75% | 1 | 2 | 100% | 0 | 2 |
| 16 | Antonio Somerriba Aubert | Tortillas | M | 873 | 16 | RM | R | 3,970 | 5,240 | 32% | 20,070 | 20,070 | 0% | 4 | 6 | 50% | 6 | 0 |
| 18 | Rodolfo Berthely Lopez | Computer access | M | 2,183 | 24 | RM | R | 775 | 775 | 0% | 40,000 | 40,000 | 0% | 4 | 4 | 0% | 2 | 2 |
| 20 | Calzado Jolur, S.A. | Shoemaker | M | 2,183 | 6 | RM | R | 3,012 | 3,012 | 0% | 12,000 | 12,000 | 0% | 4 | 6 | 50% | 5 | 1 |
| | | | | | | | | | | | | | | 10 | 14 | 40% | 13 | 1 |
| | | TOTALS | | 24,453 | | | | 15,788 | 28,980 | | 220,630 | 240,860 | | 40 | 54 | | 38 | 16 |
| | | AVERAGES | | 1,881 | 21 | | | 1,567 | 2,666 | 104% | 19,386 | 21,072 | 31% | 4 | 6 | 44% | 4 | 1 |

Source:

(*)"Before" data from ADMIC files of borrower applications
"After" data from interviews conducted by the evaluation team

Note: It was not possible to visit borrower number 8, so the other totals (and averages) are based on only 12 borrowers.