COSTA RICA RURAL FINANCIAL MARKETS STUDY

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TABLE OF CONTENTS

LIST OF ACRONYMS

AIR	Agricultural Industrial Reactivation
AITEC	Acción Internacional para la Tecnología
ATM	Automated Teller Machines
AVANCE	PVO AITEC Program. The biggest in the country
BDC	Business Development Center
BCCR	Banco Central de Costa Rica
BNCR	Banco Nacional de Costa Rica
BCR	Banco de Costa Rica
BANCOOP	Co-operative Bank
CACM	Central American Common Market
CATS	Tax Rebate Certificate for Exports of Non-Traditional Products
CNP	Consejo Nacional De Producción
CODESA	National Development Corporation
COFISA	Costa Rican Industry Financing S.A.
COLAC	Confederación Latinoamericana de Cooperativas de Ahorro y Crédito
FEDECREDITO	Federación Nacional de Cooperativas de Ahorro, Crédito y de Servicios Múltiples de Costa Rica
FINCA	PVO for small farmers
FODEA	1987 law rescheduling $77 million in ag loans at negative rates for 16 yrs($70 million from large operations)
FODEIN	Fondo de Desarrollo Industrial
FOPEX	Fondo para Exportaciones
FUCODES	Fundación Costarricense de Desarrollo

FUNDES	Fundación de Desarrollo Económico y Social para la Pequeña Industria
GOCR	Government of Costa Rica
IDB	International Development Bank
IMF	International Monetary Fund
INFOCOOP	Instituto Nacional de Fomento Cooperativo
LC	Letter of Credit
MSF	Michigan Strategic Fund
MUCAP	Mutual Cartago de Ahorro y Préstamo
NGO	Non-Government Organization
PVO	Private Volunteer's Office
RECOPE	GOCR's refining company
SOI	State Owned Industry
UNICOOP	Union Nacional de Cooperativas
UNIBANC	T.A. subsidiary of BANCOOP
UPIAV	Unión Productores Agropecuarios y Asuntos Varios
WO40	AID Program

Exchange Rate: $1.00 = ¢83.25 (at November 30, 1989)

PART I

SURVEY REPORT

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SURVEY REPORT

I. INTRODUCTION

In June 1989, Agricultural Cooperative Development International (ACDI) received a request from Unibanc, the economic development arm of Bancoop, to conduct an economic and financial survey of four rural towns of Costa Rica - Palmares, Ciudad Quesada, Guápiles and San Isidro de El General. These four towns were selected based on a consensus among private bankers that these areas held a great potential for rapid economic growth through increased savings mobilization and financial intermediation. This report was contracted by AID through a buy-in to ACDI's Core Grant.

The primary purpose of the study was to determine the nature, level and concentration of demand for supplementary financial services in rural areas, including additional savings and loan facilities for small scale enterprises.

Based on their findings, the study team has included specific recommendations on the most practical and economic means of serving these markets and an estimation of the costs involved.

It has been shown repeatedly, in numerous developing countries, that a wealth of financial resources - in the form of rural savings - has remained untapped by the formal financial systems of the country. Often these financial systems are characterized by their concentration in urban areas, usually the capital of the country. They typically focus on large, heavily capitalized and fully collateralized businesses, tend to pay very low, if not negative real interest rates on deposits, and have high transaction costs. The net effect of such policies is often to discourage the use of formal institutions for the storage of monetary wealth and idle capital, thereby denying the local economy the most efficient use of its collective resources through investment in productive activities.

Both private Costa Rican bankers and AID staff are convinced that there are significant gaps in financial services in the secondary cities and rural areas of Costa Rica. The existence of these unserved and underserved market segments is due to: 1) a lack of competition caused by GOCR policies which prevent attractive real positive interest rates for short-term deposits, the establishment of checking or sight accounts at private banks, or any increase in lending over 5% in 1989, 2) a lack of awareness or understanding of the potential markets, 3) and a lack of familiarity with the special techniques required to effectively deliver credit to these underserved markets at reasonable cost and risk.

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It is also felt that many small rural enterprises have a much greater capacity for rapid growth than most of the larger firms traditionally served by the banks. This growth would depend on more effective credit delivery systems than currently in place.

Successful small enterprises can generate a significant cash surplus for poor people beyond meeting their basic requirements for adequate food, water, shelter, clothing and medical care. This surplus is the key means by which the "cycle of poverty" can be broken. The resulting savings are the essential ingredient for sustained individual and community economic change. Profits are the foundation for the creation of wealth, and the sum total of "small scale wealth creation" is an important engine for national economic development.

Small-scale enterprises are superior to their medium and large scale counterparts in increasing productivity. They use a higher proportion of locally produced inputs, employ more workers and produce greater output per unit of capital. They are suitable for location in rural areas and market towns, can use technologies appropriate to local factor proportions, can serve specialized local markets efficiently and flexibly, and are characterized by a high degree of backward and forward linkages within the local economy. Because they are often located near the owner's home, the owners can include a higher proportion of women, and husband/wife owned businesses can include more active participation of women in operation and management.

II. OBJECTIVES OF THE STUDY

The key objectives of the Rural Financial Markets Study can be described as follows:

- To determine the level of demand in rural areas for off-farm, small-scale business credit.

- To measure the concentration of that demand.

- To identify the current constraints to serving this market.

- To assess the untapped rural savings potential of the four areas.

- To identify the current constraints to rural savings mobilization.
- To assess the need for other financial services (LCs, specialized savings programs, electronic funds transfers, ATMs, brokeage services, etc.) in rural areas.
- To propose suitable approaches to be tested to mobilize rural savings and satisfy the demand for additional credit and financial services in rural areas.
- To estimate the cost of each approach.

III. BACKGROUND

The current savings/investment equilibrium of the Costa Rican economy is directly affected by the availability of foreign savings and by the need to allocate a substantial share of domestic savings to servicing the external debt. In addition, fluctuations in the terms of trade, particularly the price of coffee, have a direct impact on savings in the short term. Since consumption does not vary much from year to year, the high variability in coffee prices, which affects national income, is transmitted to high variability in national savings.

Foreign savings, which reached over 14 per cent of GDP in 1979-80, financed more than half of gross domestic investment in that period. After the 1981-82 crisis, the economy faced two basic problems in its quest to maintain the level of investment: 1) foreign savings dropped by nearly 50 per cent and 2) although domestic savings increased from 16 per cent of GDP in 1979-80 to 23 per cent of GDP in 1983-84, the higher service of external debt absorbed most of that increase and fixed capital formation declined.

The effects of the 1981-1982 contraction in the domestic financial system were most strongly felt by the private sector, where domestic credit balances declined from 8,544 million colones (in constant 1978 colones) in 1978 to 3,060 million in 1982. With this dramatic reduction in domestic credit, the access of smaller, poorer, riskier producers to formal sources of credit was significantly curtailed. In response to the crisis, the Central Bank liberalized the allocation of credit, allowing public sector banks to set interest rates in response to market forces for the first time. However, due to perceived higher risk and lower return, agricultural and rural business credit declined as a percentage of total credit.

Non-traditional export crops, virtually non-existent before 1984, supplied nearly 9% of agricultural output by 1987. A package of export incentives, coupled with external debt conversion and an aggressive exchange rate policy, were instrumental in bringing about the sharp increase in production during the last four years.

It has to be considered that, at the present time, commercial borrowers receive credit at interest rates up to three times higher than the inflation rate (14% estimated for 1989) because the government has tried to deal with its deficit in part with funds from the local financial market.

IV. METHODOLOGY

The methodology employed for this study consisted of four basic components:

- A review of the available literature at USAID, the World Bank, and local resources.

- A series of interviews with bankers, cooperative managers, business leaders, and NGO representatives both in San José and the rural areas.

- A census based on a representative purposeful sampling of small enterprises in the four target areas.

- A survey of the range of financial services offered by each of the financial institutions in each area.

The basic definitions of rural small, medium and large-scale enterprises used in this study are as follows:

Small-scale Rural Enterprise

"An owner-operated business with less than 20 employees, total investment of less than the equivalent of $20,000, and average monthly sales under $5,000."

Medium-scale Rural Enterprise

"Owner operated businesses with 5 to 20 employees who typically own their premises, maintain business assets equivalent to $20,000 to $250,000, and have average monthly sales of $5,000 to $25,000. They are likely to have a past credit history with a local credit union or state bank branch under specialized lines of credit such as W040. This group would also include professional services, investors of some means who are starting a new business operation and are seeking bank credit, and those small-scale enterprises who have "graduated" from the small scale status."

Large-scale Rural Enterprise

"Businesses, usually but not necessarily managed by one of their owners, with 20 to 100 employees, business premises owned, total assets equivalent to $250,000 to $2,000,000, and average monthly sales of over $25,000. Such businesses can include partnerships and corporations. Normally a past credit history with this or another business activity is common."

During the study the team leaders made visits to existing SSE credit programs like Avance, Finca, Fundes, and Fucodes, to review their SSE portfolios and the mechanics of their credit delivery systems. Data on operating costs were obtained whenever possible. They also conducted interviews with five private banks in San José to obtain their opinions on the potential for initiating rural banking operations, either solely or in partnership with a credit union, and to seek suggestions of financial services which might be introduced in rural areas.

In the four towns under study, the team leaders met with the management of all the local bank branches, credit unions, larger businesses, and those agricultural cooperatives which maintained savings and loan operations (primarily coffee cooperatives). Every financial institution was also surveyed on the range of financial services they currently provide to their customers.

A survey questionnaire and census sheet were designed, based on similar work done in Egypt and Burkina Faso. The questionnaire was designed to determine the following:

1. The general characteristics of the rural SSE sector in Costa Rica, i.e. size in number of employees and monthly sales, sector (formal or informal), premises owned or leased, and years in business.

2. Past credit history.

3. Credit needs, i.e. volume and purpose.

4. Acceptable interest rates and terms.

5. Opinions about local financial institutions, primarily banks and credit unions.

6. Financial, technical, marketing, and legal constraints to rural SSE growth.

7. Savings habits.

8. Methods of handling financial transactions.

9. Any additional financial services which they felt they needed but were not locally available.

The project team then hired and trained eight young college graduates as interviewers, splitting them up into teams of two. An initial two-day seminar was held at the ACDI offices in San José to instruct the four survey teams in the appropriate methods for approaching small businesspeople and asking them sensitive questions about their business operations. The seminar was followed by a series of trial interviews in San Ramón in order to assess and refine the interviewing skills of the teams.

A total of 318 SSEs were interviewed in depth, with an average of 80 in each target city and the neighboring satellite towns within a 40 kilometer radius. Then a general census of all SSEs in both the regional center and the surrounding satellite towns was carried out, noting the type and size of each enterprise.

An effort was made to estimate the total number of each type of SSE in the target areas. Figure 1 shows a statistical breakdown of the sample SSEs interviewed in each area. Even with the thoroughness of the enumeration, many businesses secluded in homes and on farms were missed. The total estimated population of SSEs therefore includes an increase by a factor of .3 to cover this informal business segment. The purpose of the enumeration was to identify the largest concentrations of SSEs in each area in order to make a reasonable estimate of aggregate demand and to facilitate the logistical planning of a new rural SSE credit delivery system.

In addition to the 318 SSE's interviewed, one of the survey teams interviewed an average of 15 participants in the weekly farmers' markets in each town, to get an idea of the mix of products sold and the number, type, and movement of itinerant traders.

Another team interviewed a dozen medium-scale merchants in each area to determine their specific credit needs.

The economic radius of each target town was also measured by identifying the geographical scope of operations of the larger businesses in the towns, the reach of the town's service sector (including co-ops and banks), and the geographical representation of the participants in the local markets.

FIGURE 1. SELECTED SMALL SCALE ENTERPRISES (SSEs) INTERVIEWED IN FOUR RURAL AREAS OF COSTA RICA: BREAKDOWN BY TYPE, 1989.

AREA		SSEs INTERVIEWED					TOTAL INTERVIEWED	ESTIMATED SSE POPULATION *	
		INDUSTRY	COMMERCE	SERVICE	INTERSECTORAL	OTHER		TOTAL NO.	PERCENT INTERVIEWED
SAN RAMON/ PALMARES	NUMBER	33	9	28	25	3	98	746	13.10%
	PERCENT	33.70%	9.20%	28.60%	25.50%	3%	100%		
SAN CARLOS	NUMBER	28	10	37	22	—	97	657	14.80%
	PERCENT	28.80%	10.60%	38%	22.60%	—	100%		
GUAPILES	NUMBER	18	1	19	8	—	46	306	15%
	PERCENT	39.10%	2.10%	41.50%	17.30%	—	100%		
SAN ISIDRO	NUMBER	29	4	31	13	—	77	489	15.80%
	PERCENT	37.70%	5.20%	40.20%	16.90%	—	100%		
ALL AREAS COMBINED	NUMBER	108	24	115	68	3	318	2198	14.50%
	PERCENT	34%	7.50%	36.10%	21.40%	0.90%	100%		

* Includes registered SSEs plus 30%

V. ECONOMIC AND FINANCIAL PROFILES

A. SAN RAMON/PALMARES

1. General Data

The major industry of the San Ramón/Palmares area is, by far, coffee production and processing. 40% of the land surrounding San Ramón and 85% of that around Palmares is planted in coffee. Other important crops in the area include sugar, horticultural crops, and ornamental plants, primarily Indian cane.

The largest business in San Ramón is Coopecafira, the local coffee cooperative with 3,250 members, which processes over 96,000 hundredweight of coffee every year. Coopecafira employs some 200 workers. It is planning an expansion to 150,000 hundredweight of production in 1992 and 200,000 in 1996.

Coopecafira provides its members loans of up to one year for coffee production at a 26% annual rate. All loans are due March 31, the end of the coffee harvest season. The co-op also pays 21% interest on certain sight savings accounts and 24% on term accounts.

Other industries in the San Ramón/Palmares area are the Las Palmas pasta factory, the 14 drawback industries, and the Industria Textiles de Occidente, a textile plant. Two sugar mills employ some 800 workers in total.

The economic radius of San Ramón runs roughly from Alajuela to Naranjo, Zarcero, La Paz in Piedades Norte, Angostura in the Santiago District, and Palmares.

Some San Ramón-based organizations and sectors, such as cooperatives, add Grecia and Sarchí to their radius, defining them as "subregions."

2. Role and Potential of Rural Fairs - San Ramón/Palmares

The rural fairs are like farmers' markets in the U.S.. Hundreds of small farmers park their trucks along the curbs of a town street, with the tailgates of the vehicles facing a central lane. Most products are sold off tailgates or from small kiosks or tables nearby. A number of permanent, storefront SSEs line this street and provide services to the vendors as well as their customers.

The Friday fair in San Ramón is made up primarily of small farmers selling an incredible variety of horticultural products. However, the fair is also attended by about 30 itinerant vendors of homemade products such as: sandals, baskets, pottery, wire mesh products, hammocks, cheese (from Zarcero), toys, one small restaurant, and mobile butcher and seafood shops. About half of these are members of the farmers' families. There is also a Saturday fair in Naranjo.

Sarchí is a major artisan center, specializing in household wood products, tourist souvenirs and painted ceramics. Approximately 1,000 persons are involved in the crafts business. Some of them belong to Coopearsa, which provides working capital loans for their 65 artisan members.

Between 1973 and 1984, coffee production in the area increased 17% while sugarcane was up 216.9%. Poultry production increased 193.7%, from 57,372 birds to 168,504. Corn production dropped by half during the same period.

3. Growth Potential of Area - San Ramón/Palmares

According to conversations held with management leaders of the region, including managers of cooperatives and state banks, the following conclusions were drawn:

- Being close to the Juan Santamaría International Airport, and having excellent road access offers an excell opportunity for drawback development. This will employ mostly women and will slow the movement of laborers to San José and other areas.

- Non-traditionals can play an important role in the region's future. The term non-traditionals refers to agricultural products, but also furniture and wood industries in general, which have achieved important development and could take off. Within the agricultural non-traditional area, the strongest items seem to be flowers and ornamentals.

- Coffee will increase in economic importance, due to expanded plantings, improved practices and higher yields.

4. Small Enterprise Sector - San Ramón/Palmares

The San Ramón area has about 746 small-scale enterprises, of which about 574 are registered. The bulk of these businesses are retail stores, repair shops, or manufacturers of shoes, furniture, metal goods, or processed food. Most of these businesses can be characterized as follows:

- Family owned and operated
- Capital provided by family members, proceeds of family coffee farms, and prestamistas (money lenders).
- Average monthly sales of less than ¢500,000 ($6,006).
- No savings or checking accounts.
- Run out of houses or small storefronts; 96% managed by the business owner.
- 70% use rented locations or facilities.

Palmares has some 40-50 furniture manufacturers, most of whom are small and work out of their homes or an adjacent building. Each manufacturer markets separately, hiring a truck to deliver finished goods to Alajuela, San Ramón, San Carlos, and San José. The competition between producers is fierce and the owners are not currently inclined to pool their output to reduce marketing costs. Two marketing possibilities are a joint showroom in San José or twice-a-year weekend exhibitions in Palmares.

Of the 318 small-scale businesses interviewed in San Ramón and the surrounding towns, 41.9% were recipients of formal credit, 32.7% from one of the state banks and 9.2% from cooperatives. 6.1% obtained credit from prestamistas. Virtually all of the small business owners felt that credit availability was still a serious problem.

The small business sector of the San Ramón area is made up primarily of retail businesses (restaurants, stores, kiosks, beauty salons, fruit and vegetable vendors, etc.), repair shops, and small manufacturing (15.5 %, including bakeries, candy shops, leather craftsmen, cheese making, etc.).

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The major constraints to their growth were seen to be:

1) Availability of credit (54%),

2) Lack of effective marketing channels (for furniture manufacturing primarily) (16%), and

3) Lack of technical knowledge (16%).

SSE owners in the area generally thought very positively of the local cooperatives, felt they were democratic and dynamic, and that they provided valuable services to the community. Their attitude towards the banks was less sanguine, describing them as lacking dynamism and being unnecessarily rigid and bureaucratic. They complained of the amount of paperwork and number of visits required to obtain a loan and the absolute requirement for bankable collateral.

5. Current Financial Services -San Ramón/Palmares

There are several sources of financial services in the San Ramón area. There are a total of ten public sector bank branches: Banco Nacional (4),Banco de Costa Rica (4), Banco Anglo (1) and Banco Popular (1). Two strong coffee cooperatives - Coopepalmares and Coopecafira - provide savings and loans, inputs, and technical assistance for their members. The area is also served by four credit unions - Coopesanramón, Coopeavegra in Palmares, Coopenaranjo, and Coopesarchi. There is also a PVO known as the Associación Pro-Fomento Productivo de San Ramón which is currently financing some 150 small enterprise and agricultural loans with IDB funds.

None of the state banks in the area manifested exceptional dynamism or innovation. Banco Nacional in San Ramón and Banco de Costa Rica in Palmares offer Bolsa (stocks and bonds market) investments and traveler's checks and Banco de Costa Rica in San Ramón handles a few letters of credit. Otherwise most of the business of the state banks centers around lending operations based on targets fixed by the home office in San José and some limited services such as credit cards, payment of utility bills, and money orders. None of the state banks had any specialized savings program such as children's, holiday, higher education or retirement savings.

There are no automatic teller machines (ATM's) in the area.

Of the credit unions, Coopenaranjo is by far the strongest and most dynamic, primarily due to the leadership until recently of Olga Chinchilla, the former general manager, now with FEDECREDITO. Founded in 1968, Coopenaranjo is now the largest credit union in the area with over 8,000 members and more than ¢450 million ($5.4 million) in assets and ¢70 million ($840,000) in member equity.

To mobilize savings, Coopenaranjo pays 17% on passbook accounts and interest rates of 20 - 23% on fixed term deposits. It currently has about ¢ 60 million ($720,000) in passbook savings and another ¢ 130 million ($1.6 million) in certificates of deposit. The co-op has maintained an agressive savings mobilization program. In three years, total passbook savings have increased 122% and long-term savings have increased 52%.

Coopenaranjo makes loans available to its members for a variety of purposes once they have belonged to the credit union for at least six months. The co-op also operates a household goods and clothing store and provides technical assistance to farmers, primarily in non-traditional crops.

Coopenaranjo lends primarily to cover consumer items bought by its members. The co-op will lend up to three times the amount saved by the member. Interest charges depend on the loan amount to savings amount ratio. For a loan of up to 90% of the amount on deposit, the co-op charges 12% per annum. For a loan twice the size of the deposit amount, 24% is charged. For the maximum loan size, the co-op uses market rates.

Coopenaranjo also manages funds for rural housing loans from Banco Popular, BANHVI, INVU and the Canadian-Costa Rica Rural Housing Project. BANCOOP provides a limited line of credit for small industry at about 15%. Coopenaranjo currently manages a portfolio of 80 small industry loans totalling ¢ 50 millions ($600,000) and earning 18% per annum.

Coopenaranjo provides a package of credit and technical assistance to farmers of non-traditional crops. The credit lines come from USAID, BID, PIPA and OIT and the terms and conditions of such loans are determined by the donor agency.

The cooperative also provides credit at 32% to its members for purchases made at the co-op store. This is an attractive income stream since the wholesalers of these goods supply them on credit for 15 to 90 days.

The second largest credit union in the area is Coopeavegra in Palmares, with about 3,000 members. It is the oldest credit union in the country. The third credit union is Coopesanramón, which has about 1,700 members. Both of these credit unions are much more conservative than Coopenaranjo and pay only 12% on sight accounts. However, both have seen steady growth in membership, total assets, and savings over the last three years.

A private voluntary organization, the Asociación Pro-Fomento de Proyectos Productivos de la Sub-región de San Ramón, uses a long-term IDB loan to assist micro-enterprises and small farmers who earn less than $500/year per family member and have no access to financial institutions. The Asociación currently has 83 loans to micro-enterprises at 15% annual interest for up to five years. Current arrears are at about 3%. The 43 agricultural loans made by APPPSSR have not fared as well, experiencing a 26% arrears rate, in spite of the fact that the Asociación provides the assistance of a veterinarian and an agronomist to these clients. The Asociación has also made loans to eight regional cooperatives totalling 45% of their loan portfolio. The arrears rate on these loans is currently 16%, a clear indication that the Asociación's collection efforts are relatively ineffective.

The moneylenders (prestamistas) in San Ramón also appear to be quite active, providing much of the short-term small enterprise credit at rates ranging from 4 to 10% per month, with up-front commissions as high as 5%. As a general rule, the smaller the amount of the loan the higher the interest charged by the prestamista. These lenders do not bother with any kind of project appraisal but lend primarily on their knowledge of the borrower, his or her reputation and history in the community, and his or her past repayment performance. Prestamistas tend to lend to the same clientele over and over.

The larger prestamistas lend primarily to commercial enterprises in need of rapid, short-term credit, usually for purchasing raw materials or inventory when wholesale prices are low or in preparation for a major selling season, such as Christmas. The smaller ones lend to SSEs in need of short-term working capital and to public sector employees for personal consumption, holiday shopping, weddings, etc. Occasionally the prestamistas lend for agriculture, but only for crops which will be harvested in a matter of months. Often the prestamista will provide a "bridging" loan to cover the farmer's input needs at the time of planting while he is awaiting approval of a bank loan. Once the bank loan is disbursed, the prestamista is repaid.

6. <u>Unmet Demand for Credit and Financial Services - San Ramón/Palmares</u>

Current credit needs expressed by the 98 SSEs interviewed in the San Ramón area are:

Loan Amount Required (In Colones)	Percentage
0 - 100,000	55.1%
100,001 - 300,000	28.6
300,001 - 500,000	7.1
500,001 - 1,000,000	3.1
1,000,000 or more	6.1
	100 %

This represents a current aggregate unmet demand for business credit of ¢ 37 million ($440,000). Given the growth rate of SSEs in the San Ramón area over the last three years, the team projects total demand in excess of ¢ 110,000,000 ($1.3 million) within five years.

SSEs interviewed in the area expressed a willingness to pay 2% - 3% in interest per month to obtain business credit. Most (63.2%) of the SSEs needed the credit for raw materials, 19.4% for production equipment, and 12.3% for purchasing their business premises.

According to the management of Coopepalmares and Coopeindia, there is also considerable pressure for new business development in the Palmares/San Ramón area. Availability of credit and technical assistance for start-ups are seen as substantial obstacles. Many local coffee farms are very small and their owners are looking for other sources of income. There is an abundant supply of well-educated and low cost labor, especially women.

Palmares is especially dynamic, well-organized, and competitive. Over the past two decades it has provided a significant proportion of the managerial and entrepeneurial talent found throughout Costa Rica. The environment is good for new investment in light industry, including drawback activities and food processing. The area is only 45 minutes from San José, allowing easy access to all of the services provided by the capital city.

Only limited demand for new types of financial services was found in the San Ramón/Palmares area. Most business people of any substance travel to the San José at least once a week. Therefore any need for letters of credit, international bank transfers, brokerage services, traveler's checks, etc. is easily met there.

7. Potential for Increased Savings Mobilization - San Ramón/Palmares

There remains considerable potential for mobilizing savings in the region of San Ramón, Palmares, Naranjo and Sarchi. The region is a well-to-do coffee producing area with visible capital going into the financing of new cars and housing renovation. Much more capital could be mobilized by the local financial institutions if they offered more attractive rates of interest, as does Coopenaranjo. Coopenaranjo's higher rates and longer business hours (8 AM to 7 PM daily, with somewhat shorter hours on both Saturdays and Sundays) have allowed it to boost savings an average of 15% per year for the last three years.

As mentioned, Coopenaranjo has been successful with its policy of higher interest rates on savings. But this success is also due to the good image of the cooperative. A high interest rate by itself does not necesarily increase savings. Some Costa Rican cooperatives offering high interest rates have experienced recent severe setbacks due to mismanagement.

Currently the top interest rate on a passbook account in any of the other institutions in the area is 12%. Most small and micro enterprises located in San Ramón and Palmares informed us that they did not maintain a savings account but rather put all surplus funds back into raw materials or other inventory because they were not earning anything above inflation by keeping it in the bank.

There are no special savings programs for retirement, higher education, children or special holidays, with the exception of a Christmas savings program at Coopeavegra in Palmares and a higher education program at the BCR in San Ramón. Given the generally high standard of living in the area, it would appear that there would be an ample market for such programs, if they were properly organized and paid an attractive interest rate that could be periodically adjusted for inflation.

V. ECONOMIC AND FINANCIAL PROFILES

B. SAN CARLOS

1. General Data

San Carlos is a huge region, covering about 10% of Costa Rica within its economic radius. The entire area stretching from the north side of Zarcero to the Nicaraguan frontier and from La Fortuna in the west to Venecia to the east feeds into Ciudad Quesada. The current population of the canton is about 90,000, and is increasing at a rate of about 6% per year - more than double the birth rate - due to migration from other areas of the country such as Guanacaste and Puntarenas. Ciudad Quesada, the administrative center of the canton with about 25,000 in population, is also the financial and agricultural supply center for the whole region.

San Carlos is commonly viewed as the area of Costa Rica with the best potential for development. It is the top producer of milk in the country and is second in beef. 100,000 animals are shipped to San Josè every year for slaughter. There is also a good deal of production of timber, coffee, cacao, macadamia, pineapples, papaya, cassava, rice, beans and vegetables. Coffee production has reached 2,400 hectares and is continuing to increase. Wood production, on the contrary, is beginning to decline due to deforestation. Unless imports can be sought from Nicaragua, the local timber industry will continue to shrink.

From 1973 to 1984, coffee production in San Carlos increased 15%, pineapples 71.5%, beans 162%, and cacao 327%. Potato production, although very limited in area cultivated, also increased significantly, by 330.9%. During the same period, sugarcane production dropped by 32.4%, rice by 55.6%, and corn by 29.4%.

The total number of dairy and beef cattle increased during the 12 year span from 162,561 to 258,105 (58.8%). Poultry also rose significantly, from 82,280 birds to 129,969 (58%).

San Carlos is blessed with a very dynamic business environment and a population which has a strong sense of personal and community development. The city of Ciudad Quesada is clean and well-organized, has a lively central market and shopping district, and boasts a number of new commercial shopping areas.

A key institution in promoting the development of the region is the local Chamber of Commerce and Industry, which is playing a very active role in promoting business, including foreign investment, drawback and the development of export markets for agricultural products. Chamber members routinely make trips to Europe, the Far East and the U.S.A. to make contacts with buyers and determine the exact requirements for penetrating those markets.

The largest businesses are the Dos Pinos Cooperative powdered milk processing plant, the San Gabriel timber mill, Ticofruit (a citrus concentrate exporter), and the Santa Fe, Quebrada Azul, and Arenal sugar refineries.

Thousands of hectares are being converted to citrus by Ticofruit and sold to foreign investors once the trees are in the ground. Then Ticofruit arranges a contract to advise the investors on the proper care of their orchards and to assure that the processing is handled by Ticofruit. The plant has only been in operation for about six months and is running at under 10% of capacity, with only 26 full-time employees at present. They are equipped to process oranges, pineapples, and passion fruit, although their real objective is to focus entirely on oranges. They are targeting 28,000 hectares in oranges for their current capacity, but are ready and willing to expand the existing plant. Financing was partially provided by the Private Investment Corporation at $ 8 million, with ownership held by a big Florida citrus grower in partnership with several Costa Rican businessmen. The equipment is almost all U.S. made, except for a few storage tanks from Brazil.

Some ¢60 million ($720,000) a week flows to San Carlos in the form of Dos Pinos payments for milk collected in the region. About 2,000 head of cattle are transported to San José every week as well, accounting for an additional flow of approximately ¢30 million ($360,000) per week.

Among the medium-sized firms in Ciudad Quesada, there are some twenty-two branches of San José-based companies, most of which receive whatever credit they require through the home office. These businesses include:

Pops	Coca Cola	Gallo más Gallo	Imp. Monge
Cafesa	Matra	Sherwin Williams	Tip-Top
Par II	Cervecería C.R.	Super Canasta Básica	Pali
Jorge Cerdas	Aguilar y Solís	Lachner y Sáenz	Pipasa
Purdy Motors	Hitachi	Super Servicio	Trisan

There are also some 98 independent medium-sized firms in

Ciudad Quesada, about 61 involved in commerce and another 37 in the service industry. Commercial businesses include retail stores, shoe stores, agricultural suppliers, appliance stores, bookstores, supermarkets, pharmacies and jewelry shops. Services include hotels, gas stations, auto repair shops, and discoteques.

2. Growth Potential of Area - San Carlos

Ciudad Quesada has a small but skilled community of leather craftsmen which could be expanded. Saddles and boots from San Carlos, already highly regarded in Costa Rica, could possibly penetrate the U.S. and other foreign markets, given their high quality and very reasonable prices. Work gloves, for which there is already a drawback business in Ciudad Quesada, could be another possibility.

San Carlos also has significant untapped tourism potential, given the proximity of the spectacular Arenal volcano, the enormous nearby Arenal lake - ideal for fishing and water sports - and the number of wild rivers that pass through the area. There has been little development to date for visitors except for the Smithsonian Center near Arenal, which can only accommodate a limited number.

There is real potential for a first class hotel operation on the side of the lake opposite the volcano, which offers the best and safest view of its regular eruptions. Fishing is also excellent on the lake and the surrounding jungle would be good for the kind of nature hikes now popular in the national parks. The hotels in Ciudad Quesada are badly in need of upgrading and competition. Rooms are in short supply and poorly equipped and maintained.

The agricultural growth potential is described in a study made by Peat, Marwick & Mitchell for the Coalición Costarricense de Iniciativas de Desarrollo (CINDE) called "A Constituent Study of the District of San Carlos." Interestingly, the growth potential of the area involves lands which have not been used correctly. One cause is lack of infrastructure (roads). Another is the use of excellent crop land for grazing cattle.

The study concludes the agricultural limits of this district must expand in two ways: a) horizontally: using land for its most productive purpose, and b) vertically: increasing the land productivity and introducing apropriate technology to do so.

Other factors mentioned in the study are human resources, considered plentiful and experienced in agriculture, and capital, considered not adequately developed in the region.

The same study selected three investment projects to promote exports from the San Carlos area. They are:

1) Establishment of a pineapple processing plant.

2) Growing and processing macadamia and cardamom.

3) A ginger processing plant.

These projects were mentioned to show the potential to develop non-traditionals and the importance of adequate financing to do so.

There are indications of some very good opportunities in canning and blast freezing of fruits and vegetables in San Carlos. A total lack of cold storage facilities could become critical if greater investment is made in non-traditional crops like pineapples, asparagus, and mangoes.

The local Chamber of Commerce has most recently worked to enlarge the export market for ornamentals, especially Indian cane and spices, mainly ginger and cardamom.

3. Small Enterprise Sector - San Carlos

There are some 505 registered small enterprises in San Carlos, with 80% of them located in Ciudad Quesada and about 20% in the surrounding towns of Florencia, Fortuna, Agua Zarcas, Pocosol, Pital and Cutris. Informal, unregistered enterprises in the area number about 152.

Of the 97 small-scale businesses interviewed in Ciudad Quesada and the surrounding towns, 55.7% were recipients of formal credit. 15.5% held loans from Coocique and 36.1% from one of the state banks. 6.2% held loans from prestamistas. Virtually all of the business owners felt that credit was still a serious constraint. Either they could not obtain any at all or they could not get as much as they felt they needed.

The small business sector of San Carlos is made up primarily of retail businesses: restaurants, stores, kiosks, beauty salons, fruit and vegetable vendors, etc. (50%), repair shops (28%), and small manufacturing: bakeries, candy shops, leather craftsmen, cheese making, etc. (22%).

The major constraints to their growth were seen to be:

1) Availability of credit (56%),

2) Marketing (16%), and

3) Lack of technical knowledge (12%).

4. Current Financial Services - San Carlos

Ciudad Quesada has a much more dynamic financial sector than the San Ramón/Palmares area. Competition is intense and most institutions are aggressively seeking new ways to attract depositors and creditworthy borrowers. The major players are Coocique, a local credit union with branches throughout the region, San José and Alajuela; Bancc Nacional, Banco de Costa Rica, Coopesancarlos, and a local venture capital firm known as the Corporación de Inversiones.

Coocique is very flexible, sets no minimum or maximum on loans, and is willing to consider any type of loan on its individual merits. By law one has to become a member before taking advantage of any of the services of Coocique, but becoming a member is simple and inexpensive.

Coocique, founded in 1965 with 228 members, now has seven branch offices and over 30,000 members. The branches are located in San José, Alajuela, Fortuna, Pital, Santa Rosa de Pocosol, Guatuso, and San Francisco de la Palmera.

By August 31, 1989, Coocique's total loan portfolio had reached ₡ 668 million ($8.0 million). Member equity had reached ₡197 million ($2.4 million). Fixed term deposits were at ₡287.5 million ($3.4 million) and passbook savings at ₡191 million ($2.3 million). Over the last three years Coocique has maintained average growth rates of 19.6% in new membership and 29.3% in new membership deposits. While total passbook and term savings dropped 17.9% and 11.8% respectively between 1987 and 1988, Coocique weathered the financial crisis well and savings on August 31, 1989 were back up to levels 9% higher in passbook accounts and 4.3% higher in certificates of deposit than in 1987. The total loan portfolio has continued to grow throughout this period at a healthy 28.9%. Total arrears at the end of September 1988 came to 6% of the loan portfolio, with 3.5% under foreclosure proceedings.

Coocique currently pays 17% on passbook savings and 20 - 23% on certificates of deposit running from 6 months to 36 months. Its nearest competitor, Banco de Costa Rica, pays 12% on passbook accounts. The resulting flush of capital has given Coocique the means to expand operations into six branches and to be much more creative and flexible in its lending policies.

Aside from better interest rates, another factor which has helped Coocique capture savings is the image of the manager and the board of directors. They are respected businessmen or professionals in the community.

Of Coocique's entire loan portfolio, 17.7% is in the form of long-term loans of more than five years, 58.2% in medium term loans of 2 - 5 years, and 24.1% in short-term loans of two years or less. The major areas of lending are for housing (30.2%) and personal loans (17.1%). Only 2.3% of the entire portfolio is devoted to small industry, 0.1% to commerce, and 1.1% to agriculture. These figures can be somewhat deceiving because often personal loans are used for business purposes.

Agricultural loans are made at 18 - 24% depending on the activity, with terms running from 1 to 5 years and payments made quarterly. Industrial loans usually carry a 26% interest rate.

Coocique participates in the W040 AID line of credit for small industries, provided through Bancoop for five years. They are currently assisting about 75 small industries in San Carlos and San José. Most are artisans, clothing makers, and repair shops. The average loan amount is about ¢ 1 million ($12,000), the average interest rate is 20%, and average term one year. Coocique will soon be extending credit to milk producers for up to five years under a new Banco Federado line of credit.

Coocique makes very few loans to commercial enterprises. Management does not feel that there is much demand for credit among local merchants. Our findings were to the contrary, that local retail outlets very much need credit, but they need it on short notice. Therefore they resort to the prestamistas whom they pay at least 3 - 4% per month for a three or four month loan, usually for the purchase of additional inventory.

Savings are required for 75 days before one can obtain a loan from Coocique. A member can borrow up to 3.7 times the amount kept in savings for that period. The savings balance must be maintained throughout the duration of the loan. This provides an effective rate of interest to the cooperative of approximately 29.3%, depending on the amortization schedule of the loan.

Coocique has a 24-hour ATM in San Carlos and is connected to its branches by computer and telephone modem. Other services which it offers are Visa/Mastercard, payment of utility bills, and Christmas and youth savings programs. Its savings operations are computerized, which has resulted in a reduction in transaction costs and allows Coocique to calculate interest on a monthly basis. It is planning to introduce international credit cards in November 1989.

Coocique is discussing a long-term (15 years) retirement savings fund with one of the private banks. They still have some technical issues to resolve but hope to have the program started in 1990.

Coocique has had a very positive effect on its competition in San Carlos. The Banco de Costa Rica in Ciudad Quesada is much more dynamic than the Palmares branch, more willing to make loans to small businesses, and more aware of the economic potential of the region. Passbook savings earn 12% at the BCR in Ciudad Quesada as opposed to 10% in Palmares. Central Bank restrictions on raising interest rates on savings is seen as a serious constraint to savings mobilization.

The BCR makes some small business loans, using the W040 AID line of credit, at a 15% annual interest rate. BCR management sees the biggest problems with small business lending being the ability to determine the management capabilities of the entrepreneur and his capacity to repay the loan. They also feel it is difficult to determine the potential market for their products and/or services. They normally require the same guarantees for small industry loans as they do with larger clients. The Ciudad Quesada branch was one of the three studied by Citicorp as part of a restructuring and decentralization plan for Banco De Costa Rica.

The BCR also provides one-year credit to small farmers at 12% under the FOPEX program. According to some of the borrowers, it takes at least four months to process the paperwork. Many farmers are forced to obtain bridge loans from the prestamistas while awaiting the processing of their loan applications. Most such short-term credit goes either to finance inputs for existing farm operations or for beans and corn grown for subsistence.

The BCR maintains six branches in the region, with a total of about 65 employees. 30% of its deposits are in dollars earning about 9%.

Both state banks in San Carlos are extending some overdraft privileges to select commercial clients at a 31% interest rate.

Banco Nacional mainly focuses on loans to sugar growers and agricultural loans at subsidized rates for coffee, milk and beef production. Banco Nacional participates in the W040 line of credit, making loans to small industries at 20%. They only pay 8% on passbook savings, an indication of little interest in savings mobilization.

It is important to point out the opinions of Banco Nacional personnel interviewed by the authors. They believe the Ciudad Quesada area is in a development stage, creating need for more financing. Finding this financing depends upon the effort of each branch's manager. At the same time, there is a little knowledge of small industry, even though they have worked with W040. They consider there is no guarantee problem within the sector, but the present study shows the opposite. Finally, they believe the rural credit unions will disappear because they are very small and should be absorbed by the state banks.

Coopesancarlos is also very active, providing strong technical support for the coffee, cacao and macadamia growers of the area. Current membership is 1,547. They no longer take savings because they could not compete with the rate offered by the two financieras (Ticoamericana and Ibesa) which have since gone out of business. Now Coocique gets most of Coopesancarlos' former savings business.

The Corporación de Inversiones is a venture capital company organized in 1982 by a group of thirty private investors who each put up ¢200,000 ($2,400) in seed capital for local business investments. They have recently reached ¢27 million ($320,000) in equity and leverage another ¢120 million ($1.4 million) by offering 6, 9, and 12 month certificates of deposit at about 2% more than the banks. They also make loans at 3-4% per month to local merchants and well-known individuals in need of fast short-term credit. Their primary areas of activity are finance, real estate, and ornamental plants.

The Corporación is planning a new program of long-term savings for retirement or college education costs, based on weekly contributions of ¢200 - 500 ($2.4-6.0) for 10 to 15 years. The twin objectives of this scheme are to build a reliable long-term capital base for the Corporación and to educate the local population about the need for long-term financial planning and preparation for future educational costs.

The Corporación is looking for new foreign partners, investors with new ideas and expertise, not only capital.

5. Unmet Demand for Credit and Financial Services - San Carlos

Standard Fruit, Del Monte, Turbana, and Banacol are all moving into the area to contract farmers for their pineapple production. Unfortunately, they will only deal with farmers with at least a million plants at this time. There is a possibility that in the near future competition will force these multinationals to extend credit to smaller landowners for upgrading their production in order to feed into company processing operations. Using a medium-size farmer's land as a guarantee, the multinational could serve as the conduit for the medium-term credit required to transform farmland into citrus, pineapple, or other export crop production.

The local Chamber of Commerce pointed out the need for a line of credit for medium-size farmers who cannot qualify for the special 18% lines of credit set aside for small farmers by the state banks. Medium-size farmers have to pay 27% and have difficulty obtaining the medium-to-long term credit (5 - 10 years) needed to finance the increased production of non-traditional crops. Furthermore, such credit does not come with a grace period, although production can rarely begin before the third year. The Chamber also sees a need for financing small agricultural processing operations. They would like to see a special line of credit for agricultural production and processing provided as an incentive to get one or more of the private banks to set up a branch in San Carlos.

The Chamber of Commerce also feels that current collateral requirements are too high, the main reason being that legal costs associated with foreclosure are so high for the banks that they only recoup a small fraction of the value of the collateral in the end.

They also indicated that marketing has been an important problem for farmers in the region because they often plant a new crop without knowing to whom they are going to sell, nor the quality and packaging requirements of the foreign market which they are trying to access.

They emphasized the shortage of short-term credit for the commercial enterprises which are not mere branches of San José firms. Although the local merchants provide the bulk of non-interest bearing checking accounts at the state banks, most of them cannot get a line of credit from the same banks to use for buying bargain inventories in San José. They have no choice but to turn to the prestamistas because they need the money immediately. This struck the authors as somewhat unusual since most of the larger merchants own their stores and normally have good turnover and high cashflow. In most countries they would be considered a very good credit risk.

The authors also determined that there is and will continue to be considerable demand for working capital credit among the small-scale enterprises of the San Carlos region. Current credit needs, as expressed by the 97 SSEs interviewed in the San Carlos area, came to:

Loan Amount Required (In Colones)	Percentage
0 - 100,000	13.4%
100,001 - 300,000	75.2
300,001 - 500,000	7.2
500,001 - 1,000,000	2.1
1,000,000 or more	2.1
	100 %

This represents a current minimum aggregate demand of ¢32.9 million ($390,000). Given the growth rate of SSEs in the San Carlos area over the last three years, this total is likely to exceed ¢100 million ($1.2 million) within three years.

In general, the majority of SSEs expressed a willingness to pay 2.5% - 3.5% in interest per month to obtain business credit. 61.9% said that they would use the cash for raw materials, 31.9% would use it to buy production equipment, and another 3.1% to purchase their business premises.

6. Potential for Increased Savings Mobilization -San Carlos

Coocique's impressive record of increased savings over the last several years is clear testimony to the potential for greater savings in the region. The fact that 20.6% of the small enterprises interviewed by the survey team have just begun their business activities in the last year is a further indication of the rapid growth of the area. The population in San Carlos is increasing at twice the national rate, due to significant migration to the region from Puntarenas and Guanacaste.

V. ECONOMIC AND FINANCIAL PROFILES

C. GUAPILES

1. General Data

Guápiles is the major banana producing area of Costa Rica. Until a new highway was constructed four years ago, the area was very isolated, requiring six hours to reach by road from San José. A rail line runs from Guápiles to Limón, where most of the banana crop is transhipped to foreign markets.

The area has been substantially opened up with the new highway, although the towns of the region still lie primarily along the rail axis. The economic radius of Guápiles is quite limited, running from Braulio Carrillo State Park in the south to the border with Sarapiquí to the west, to Cariari in the north, to Mercedes in the east. 80% of the population of the canton of Pococí live in three towns - Guápiles, Cariari, and Rita, each of which have about 11,000 residents.

There are three cooperatives in Guápiles - Coopediamantes, an experiment station of the Ministry of Agriculture, Coopepococí, an agricultural and industrial cooperative mainly for farmers, and Coopetragua, the Guápiles transport cooperative. There is no credit union in Guápiles or the surrounding area.

Over the course of the twelve year period from 1973 to 1984, rice production rose 213%, sugar 79%, coffee 105%, cacao 326%. and bananas 18%. Virtually all of this growth was due to increases in productivity per hectare rather than increased plantings. The number of dairy and beef cattle has also increased precipitously, from 23,037 head to 58,379 (an increase of 153%). During the period the land has been gradually coverted from timber to pasture, with pasture increasing from 33.4% of total land area to 48.6%.

2. Growth Potential of Area - Guápiles

Potential areas for growth in agriculture include: bananas, milk and beef production, and non-traditional crops such as ornamentals, macadamia, palm heart, cassava, papaya, asparagus, and spices (black pepper, ginger, etc.).

Tourism also has good potential. The nearby Braulio Carrillo National Park is due to receive an AID grant of $7 million to upgrade trails, campgrounds, and ranger facilities. The Guápiles area could be a good prospect for the development of modern, comfortable hotels and restaurants for eco-tourism.

There is also an entrepreneur in Guápiles who is contracting small producers to grow cassava for the Puerto Rican market in New York. His own land is insufficient to meet the requirements of his buyers.

Two Colombian banana companies have recently installed an additional 500 hectares of bananas in the Guácimo area, which has had a significant effect on the aggregate income of that town, evidenced by the noticeable increase in new construction and upgrading of civic property.

The new Escuela Agrícola Regional del Trópico Húmedo (E.A.R.T.H.) at Mercedes, financed by AID, will create a considerable number of new job opportunities for local residents and a market for some local produce. The influence of this agricultural polytechnic college on the productivity of the region should be considerable, given the opportunities for agricultural extension work by professors and students alike.

There is a real need for more agricultural cooperatives in the area to supply small farmers with credit, inputs and technical assistance to diversify away from banana production.

3. Small Enterprise Sector - Guápiles

About 244 registered SSEs have been established in the Guápiles-Cariari-Guácimo area, 75% of them since the highway was constructed. There are approximately 62 informal enterprises as well. SSEs are primarily involved in commerce (50%) and the service sector (22%). 11.6% are small industrial operations and the balance (15.4%) are either construction or intersectoral businesses.

Of the 46 small-scale businesses interviewed in Guápiles and the surrounding towns, 13.1% were recipients of formal credit. 2.2% held loans from the transport cooperative and 10.9% from one of the state banks. 4.3% held loans from prestamistas. Virtually all of the business owners felt that credit was still a constraint, either inaccessible, too difficult to obtain, or insufficient for the needs of the enterprise.

The small business sector of Guápiles is made up primarily of retail businesses - restaurants, stores, kiosks, beauty salons, fruit and vegetable vendors, etc. (55%), repair shops (28%), and small manufacturing - bakeries, candy shops, leather craftsmen, cheese making, etc. (17%).

The major constraints to their growth were seen to be:

1) Availability of credit (54%),

2) Lack of effective marketing channels (26%),

3) Lack of technical knowledge (11%).

Other obstacles mentioned included: lack of support from government institutions, constant visits of municipal inspectors, inspectors from the C.C.S.S. (Social Security) and from various government ministries.

4. Current Financial Services - Guápiles

The only banks serving the Guápiles-Cariari-Guácimo area are Banco de Costa Rica, Banco Nacional, and Banco Popular. There are three cooperatives in the area, neither of which is a credit union.

The Banco de Costa Rica is making loans primarily for livestock production, agriculture, housing, and on a very small scale, for small industry, mainly for raw materials and machinery. It currently maintains a portfolio of about fifteen small industry loans on which it charges 17%. Small livestock operations are charged 15%, breeding operations 27%, and fattening operations 29.5%. Medium-sized agricultural operations are typically charged a 27.5% interest rate, while smaller operations can obtain subsidized credit at 15%.

The Banco de Costa Rica maintains very little in savings deposits, which is not surprising considering that the bank only pays 8% on passbook accounts. Its CD rates and minimums are the same as the BCR in Palmares.

The Banco Nacional is more active and aggressive, paying 12% on passbook accounts and 9% on dollar savings. CD's earn 1% more at each level than the Banco de Costa Rica. They also hold the majority of checking accounts for merchants and individuals.

Most of their agricultural loans are for livestock, beans and corn, papaya, and black pepper. They also have small industry and housing portfolios based on W040 and BANHVI lines of credit. They charge 31% on four-year commercial loans and three-year service loans.

Banco Popular pays 12% on sight accounts and rates similar to Banco Nacional on CD's. They lend to commerce at 32% for terms up to seven years, and to small industry at 18%. Small industry working capital loans usually are for two years, investment loans for five.

The prestamistas are quite active in Guàpiles, charging 5 to 10% per month on short-term loans in addition to a 5% commission. This represents an effective rate of interest of 17.6% per month if the loan is for 30 days.

5. Unmet Demand for Credit and Financial Services - Guàpiles

Current credit needs expressed by the 46 SSEs interviewed in the Guapiles area are:

Loan Amount Required (In Colones)	Percentage
0 - 100,000	32.6%
100,001 - 300,000	52.3
300,001 - 500,000	4.3
500,001 - 1,000,000	6.5
1,000,000 or more	4.3
	100 %

This represents a total unmet current demand of ¢ 15 million ($180,000) in SSE credit. However, given the average growth rate of SSEs in the Guápiles area over the last three years of 61.3%, the study team estimates that aggregate demand will exceed ¢50 million ($600,000) within five years.

The SSEs interviewed in the area expressed a willingness to pay 2.5% to 4% in interest per month to obtain business credit. 58.7% said that they would use the additional funds for raw materials, 26.1% for production equipment, and 8.7% for purchasing their business premises.

Smaller farmers in the area also have a difficult time obtaining credit, often because they do not have clear title to their land nor can they easily find the two signatories usually required for a loan.

6. Potential for Increased Savings Mobilization - Guápiles

The potential for increased savings appears to be considerable. Interest rates on passbook accounts are very low and there seems to be little interest on the part of the state banks to increase savings deposits, although the workers of the area are well paid and have disposible income.

Savings interest rates in Guápiles are as follows:

	Banco Popular	BCR	Banco Nacional
Passbook:	12%	8%	12%
1 month	14.75	13.00	16%
2 months	15.80	13.00	16
3 months	20.25	18	19
6 months	21	22.5	22
9 months	21.3	22.5	22
12 months	21.5	22.5	22
18&24	22.1	----	---

V. ECONOMIC AND FINANCIAL PROFILES

D. SAN ISIDRO DE EL GENERAL

1. General Data

The economic base of the San Isidro area is agriculture, primarily coffee and sugar cane. Coffee production is booming, with a 39.6% increase in productivity between 1973 and 1984. Because of the high productivity per hectare of coffee, it tends to have a better average return on investment and assets than most other traditional crops. Pérez Zeledón canton is now number two in Costa Rica in coffee production and boasts over 15,700 coffee farmers. Timber production was significant until recently, when the rapid deforestation of the area forced the sawmills to reduce output. Pineapple production on over 2,000 hectares has been developed in the Buenos Aires area by PINDECO, a division of Del Monte. Tobacco, milk, corn, beans and a few non-traditionals are steadily increasing in production, although their current volumes are relatively small.

The over-reliance on a single export crop - coffee - makes the local economy very vulnerable to fluctuations in world prices. San Isidro must diversify its economic base if it is to maintain greater economic stability from year to year.

Between 1973 and 1984, coffee production increased 39.6%, although total area planted in coffee dropped by 10.6%, and sugar cane production increased by 101.3%. During the same period, banana production fell by 59.3%, and rice by 39.9%. Total area devoted to pineapple production has increased, from 24 to over 2,000 hectares.

The biggest single constraint to the development of the region is the poor road link to San José and the ports. The mountain road is narrow, badly potholed, and increasingly dangerous as a number of spots have been completely washed out. The heavy traffic of large trucks is rapidly exacerbating the problem. And yet there is a chronic shortage of transport for the ever-expanding agricultural output of the area. Local officials estimate that it will cost ¢1 billion ($12 million) to repair all the key roads in the area.

San Isidro has no airport, which hinders its ability to exploit the significant capacity of the area to raise more non-traditional crops for export (ornamentals, berries, asparagus, pineapples, spices, citrus, mangoes, guavas, cassava, etc.).

Except for coffee, milk, and sugar there are no sizable food processing facilities in the area. Fruit processing is being attempted on a small, experimental scale.

San Isidro is a well-organized regional center which provides services for over 100,000 people in the Pérez Zeledón area. It has three active, dynamic, and reasonably well-managed cooperatives - Coopeagri, Coopealianza, and Coopemadereros. The local branches of the Banco de Costa Rica and the Banco Nacional have the most aggressive and innovative general managers the team encountered in any of the four regions under study.

The region has many different climatic zones which would allow it to grow a greater variety of crops. Farms have been divided into smaller and smaller units among family members. The opportunities and the need for introduction of high value export crops are great.

The economic radius of San Isidro de El General covers the whole canton and runs as far south as Buenos Aires. Distribution from San Isidro of certain local products, such as soft drinks and pharmaceuticals, reaches the Panamanian border.

The largest enterprises in San Isidro are Coopeagri, the coffee cooperative, the Coca Cola bottling plant with 75 employees, a number of sawmills and a large drawback operation employing 800 women in their homes. The drawback industry has grown substantially in the last 2-3 years.

There has also been a substantial increase in foreign investment in the last 3-4 years.

Coopeagri is one of the of the most dynamic producers' cooperatives in Costa Rica. It manages six subsidiary enterprises consisting of separate processing facilities for coffee, milk and sugar, a livestock division, a commercial division with stationary and mobile supermarkets and farm input supply operations, and a technical assistance office for members. All of the cooperative's operations are oriented towards the small and medium size producer. There are 3,800 members in coffee production, 100 in milk, and 400 in sugar. The technical assistance division retains a staff of five agricultural engineers (four in coffee and one in sugar cane), one veterinarian, and one specialist in milk production.

The current paid-in capital of Coopeagri is ¢100 million ($1.2 million), based on 5% of the value of products sold through the cooperative. For example, if a farmer sells a hundredweight of coffee through the cooperative for ¢5,000 ($60.0), then he/she must save ¢250 ($3.0). The paid-in capital of Coopeagri's members is now increasing each year at a rate of ¢25-30 million ($300-$360,000).

Coopemadereros was established in 1984 by a group of small sawmill operators. It now has a total of 58 members and boasts sales of ¢80 million ($964,000) per year, 45% from trucking and 55% from the sale of wood products. Each member of the cooperative owns a truck and may also transport grain for the CNP or pineapples for PINDECO. Many of the new refrigerated trucks are financed by prestamistas at 3% per month. Most members of Coopemadereros feel that their future is tied to diversification away from wood, since much of the area has suffered significant deforestation in the last ten years.

2. Growth Potential of the Area - San Isidro

Pérez Zeledón also has great tourism potential. Chirripó is the biggest park in Costa Rica and contains an enormous wealth of animals, plants, mountains, waterfalls, and trees more than 2,000 years old. Unfortunately, the park has virtually no infrastructure and few facilities in the area for camping and up-scale lodging.

Coffee will increase as there is potential for new cropping areas and higher yields from new varieties.

The milk industry is still developing. Coopeagri markets milk products under its own brand.

It was recently announced that the Interamerican Highway will begin rebuilding. This will spur development in the area and will make drawback industries and non-traditional investments more attractive. An example is macadamia, which has untapped potential in the region.

3. Small Enterprise Sector - San Isidro

There are some 376 registered small enterprises in San Isidro, 85% of them located in San Isidro de El General and about 15% in the surrounding towns of Pejibaye, San Cristóbal, Rivas, and General Viejo. Informal, unregistered enterprises in the area number about 113.

Of the 77 small-scale businesses interviewed in the San Isidro area, 19.5% were recipients of formal credit. 2.6% held loans from Coopealianza and 16.9% from one of the state banks. 3.9% held loans from moneylenders. Most of the business owners felt that credit was still a major constraint to their growth.

The small business sector of San Isidro is made up primarily of retail businesses - restaurants, stores, kiosks, beauty salons, fruit and vegetable vendors, etc. (64%), repair shops (20%), and small manufacturing, bakeries, candy shops, leather craftsmen, cheese making, etc. (16%).

The major constraints to their growth were seen to be lack of easy access to credit (67.5%), lack of technical knowledge (14.3%), and lack of effective marketing channels (13%).

Other obstacles cited included: lack of own infrastructure, problem with roads, high municipal taxes and problems caused by the C.C.S.S.

4. Current Financial Services - San Isidro

San Isidro has, by far, the greatest amount of competition in the financial services sector of any of the four rural centers visited by the study team. The dynamism of the local cooperatives, especially Coopeagri and Coopealianza, and the exceptional leadership and experience of the branch managers of Banco de Costa Rica and Banco Nacional have created a healthy environment in which a number of institutions are aggressively vying for customers.

The small industry sector is currently served to a limited extent by the USAID W040 line of credit provided through Banco Nacional, Banco de Costa Rica, and Coopealianza.

Coopeagri provides five types of credit to agricultural producers who are members. These target coffee production, renovation of farms for coffee production, renovation of sugar cane canals, and bridge loans for milk producers. Coffee renovation loans are made at 18% for six years.

Coopeagri has three lines of credit for industrial development funded by Bancoop, Banco Federado, and Banco de Costa Rica. The Bancoop line totals ¢35.5 million ($42o,000) while the Banco de Costa Rica line totals ¢8 million ($90,000).

Coopeagri also has other credit lines such as the one for ¢6 million ($70,000) from the Banco Federado for sugar cane growers who are members of Coopealianza. Funds from USAID-FEDECOOP have provided around ¢53 million ($630,000) to renovate coffee plantations. In housing, they have used more than ¢13 million ($150,000) from the Canadian government.

Banco de Costa Rica also has a credit line of ¢55.9 million ($673,000) for sugar cane growers.

Coopeagri is planning an expansion to six new locations over the next four years - San Rafael Platanares (1990), Distrito Cajón (1991), General Viejo and Rivas (1992), and San Ramón del Sur and San Pedro (1993). Each branch office will have a savings and loan window for member producers. Coopeagri is very interested in participating in any AID program to help small producers or enterprises and would be willing to implement such a program through this network of branches.

The local Banco Nacional branch primarily makes agricultural loans to small producers of coffee, cacao, corn, beans and tobacco at 18% per year. Loans to local merchants are at 31% but lines of credit are limited because of current Central Bank regulations which limit growth in lines of credit to 5% per year. However, overdraft facilities are available to certain customers at 3% per month.

BNCR participates in the W040 line of credit for small industries, charging 18%. The general manager said, however, that it is very difficult to analyze small enterprises, especially the quality of their management and their financial position.

Banco Nacional now has about 3,800 passbook holders receiving 12%. They are planning to install an ATM in San Isidro, once they have resolved some software problems.

Banco de Costa Rica in San Isidro is very aggressive. It currently maintains ¢95 million ($1,140,000) in commercial lines of credit and an additional ¢15 million ($180,000) in overdraft facilities at 3% per month. According to management, almost no letters of credit are issued in San Isidro because very few customers are exporters. BCR has about 80 loans under the W040 AID line of credit for small industry. It also has about 40 loans to medium scale industry at the present time.

Coopealianza is the main credit union in San Isidro, employing 30 full-time staff. It currently has about 6,800 members and adds about 100 per month. Paid-in member capital is ¢48 million ($570,000). About 3,000 savers hold passbook accounts earning 14% per annum while another 1,000 savers invest in short-to-medium term CD's. The six-month CD, earning 22.5% per annum, is by far the most popular. It mainly finances home mortgages and has provided ¢150 million ($1.8 million) in such loans during the last two years. Coopealianza also makes some small loans for agriculture, livestock, and industry, using a ¢20 million ($240,000) Banco Federado line of credit. Coopealianza currently has about 15 small industry loans at 26-27%. The smallest such loan is ¢100,000 ($1,200).

Coopealianza also has branches in San Cristóbal and Pejibaye.

There are no investment companies in Pérez Zeledón like the Corporación de Inversiones in Ciudad Quesada, nor are there any finance companies (financieras). Reportedly there are many moneylenders in the region, typically charging interest rates of 8% or more per month.

Figure 2 presents a summary of the types of financial services available from the various institutions in the San Isidro area.

5. Unmet Demand for Credit and Financial Services - San Isidro

Current credit needs as expressed by the 77 SSEs interviewed in the San Isidro area were;

FIGURE 2. TYPES OF FINANCIAL SERVICES OFFERED BY SIX FINANCIAL INSTITUTIONS IN SAN ISIDRO DE EL GENERAL, COSTA RICA, 1989.

	INSTITUTIONS					
SERVICE	BANCO NACIONAL	BANCO DE COSTA RICA	BANCO ANGLO	COOPE ALIANZA	COOPEAGRI	BANCO POPULAR
1. Credit Card	Yes	No	Yes	No	No	No
2. Paymt of Util Bill	Yes	Yes	Yes	Yes	Yes	No
3. Holiday Saving Prg	Yes	No	Yes	No	No	Yes
4. Children's Sav Prg	Yes	Yes	No	Yes	No	Yes
5. Retirement Sav Prg	No	Yes	No	No	No	No
6. Higher Educ Prg	No	No	No	No	No	No
7.Raffles for New Savers	No	No	Yes	Yes	No	No
8. Commercial lines of Credit	Yes	Yes	Yes	Yes	Yes	Yes
9. Letters of Credit	Yes	Yes	No	No	Yes	No
10. Electronic Transfer	Yes	Yes	No	No	Yes	No
11. ATMs	No	No	No	No	No	Yes
12. Bolsa Investments	No	Yes	Yes	Yes	No	Yes
13. Travelers Checks	Yes	Yes	No	No	No	No
14. Money Orders	Yes	Yes	Yes	No	No	No
15. Credit Checks	Yes	Yes	No	Yes	No	Yes
Total Number of Services Offered	10	10	7	6	4	6

Loan Amount Required (In Colones)	Percentage
0 - 100,000	18.0%
100,001 - 300,000	67.5
300,001 - 500,000	4.0
500,001 - 1,000,000	6.5
1,000,000 or more	4.0
	100 %

This amounts to a current aggregate unmet demand of ¢24 million ($280,000) in SSE credit. Based on the growth rate for SSEs over the past three years of 11.9%, the study team estimates a total aggregate demand in excess of ¢70 million ($840,000) within five years.

They expressed a willingness to pay 2.5% to 3.5% per month in interest to obtain credit. 45.5% said that they would use the money for raw materials, 26% for production equipment, and 13% for purchasing business premises.

According to the local Chamber of Commerce, there is considerable unmet demand for commercial credit. They pointed to a particular problem with loans to upgrade fixtures and interiors of stores.

6. Savings Potential - San Isidro

Banco de Costa Rica in San Isidro has a Children's banking program with its own separate savings window at the local branch. The program pays 12% on passbook accounts compared to 10% on regular passbook accounts and is intended to educate young people about the benefits of deferred gratification and saving for future investment. The program currently has 1,820 savers, after one year of operation.

BCR also has a significant number of dollar savings accounts. Exact figures were not available.

According to several bank managers, many individuals and local businesses do not practice sound money management, leaving very large balances in checking accounts rather than transferring them to certificates of deposit of 1 to 6 months or investing them in the OPAB (overnight deposit) system.

Coopealianza sees the need for a long-term savings program for retirement or college education but feels that the main problem would be a guarantee to savers whose funds are tied up for 10 to 15 years.

Typical interest rates on savings in San Isidro are as follows:

	Coopeagri	Coopealianza	BCR	BNCR
Passbook:	13%	14%	10%	12%
1 month	14	14	13	14
2 months	16	16	15	16
3 months	20	20.5	22.5	22
6 months	22.5%	22.5	22.5	22
9 months	23	22.5	22.5	22
12 months	24	24.0	22.5	22
18 months	24.5%	25	22.5	22
24 months	25	25	22.5	22
36 months	26	----	22.5	22

VI. A Profile of the Rural Small Enterprise Sector in Costa Rica

The team discovered a great deal of similarity among small rural enterprises in all four areas.

Most are owner-operated, with family members making up 60% of the employees of the businesses. 17% of the SSEs employ only the owner.

96% of the entrepreneurs own their businesses but only 30% own the business premises. An exception was San Isidro where 61% of the SSE business premises were owned by the entrepreneur.

Most (82.7%) have fewer than six employees. 10.3% have between six and nine employees and only 7% employ between ten and twenty workers.

Approximately 25% of the businesses are informal, i.e. they are not registered with the municipality and do not pay any Social Security.

Total assets, in the form of cash, inventory, machinery, equipment, vehicles, and real estate rarely exceeds the equivalent of $20,000.

None of the SSEs interviewed revealed sales in excess of ¢500,000 per month ($6,000). The majority (72%) had sales in the range of ¢250,000 to ¢400,000 ($3,000 - $4,800).

In the more established communities of San Ramón and San Isidro, 45% and 51% respectively of the SSEs interviewed have been in business for at least 7 years. In Guápiles, however, 76% have been established in the last three years since the highway was completed. In Ciudad Quesada 50% of the small businesses were established in the last three years, 21.8% have existed for four to six years, and 27.8% for more than 7 years.

On average, 14.2% of the businesses interviewed were established in just the last year, a very rapid rate of new business development for the four areas.

The production/sales cycle of the rural SSEs rarely exceed 30 days, due to the shortage of working capital and the resulting low volume of production. Many small industries sell only to one or two clients because of this limited volume.

Few small enterprises (5%) maintain any formal savings whatsoever. Most of the small business owners interviewed cited low interest rates on passbook accounts and the inconvenience of short banking hours and long lines as disincentives to save. Others felt that the minimum balances required for certificates of deposit were too high in the short terms of one or two months. Some complained of the poor service given by bank personnel.

30% of rural SSEs maintain checking accounts at local bank branches and pay their bills by check. The rest pay all of their bills in cash. Any surplus cash is generally plowed back into the business in the form of raw materials or finished goods inventories.

The only exception to this rule was found in the Ciudad Quesada area, where 31% of the 97 SSEs interviewed kept savings accounts at Coocique, the local credit union. The main reasons cited were the 17% interest rate on passbook savings, the efficiency and service attitude of the Coocique staff, 24 hour access to savings via the ATM, and, above all, the necessity of maintaining a compensatory savings balance to qualify for a loan.

In San Ramón and San Isidro, both major coffee producing areas, it was discovered that many of the small entrepreneurs also owned coffee farms. They pointed out that the land had been divided so many times among offspring that the smaller farming operations no longer required all of their time nor could provide sufficient income to support the needs of their families. Therefore, they launched their small businesses as an additional source of revenue, putting their underemployed family members to work.

35.2% of the rural SSEs interviewed were indeed able to obtain formal credit, 76% of which came from the public sector banks and the balance from local credit unions. However, the great majority of these loans were provided to small industries with access to the W040 subsidized line of credit. Virtually all of the 318 businesses interviewed said that lack of credit was the biggest single constraint to their growth. Most commercial and service enterprises were limited to their own resources (48.4%), to loans from moneylenders (5.4%), or from friends or family members (11%). Those who received loans from one of the banks or credit unions using the W040 line of credit said that it normally took 2 to 3 months to get the loan.

Prestamistas routinely charged a 5% up-front commission and 5-10% monthly interest. In addition to selecting clients based on reputation, they require either a house mortgage or two signatories to qualify.

Most SSEs (60%) said they would be happy to pay 3% per month for working capital or capital goods credit. Another 34.3% said they would be willing to pay 2% per month. It is highly probable that these entrepreneurs would be willing to pay a much higher rate if borrower's transactions costs were kept to a minimum. The internal rate of return on a small enterprise working capital loan, given the typical high turnover rate and the availability of family labor, is usually in excess of 100% per year, and is often several times that.

The great majority of SSEs interviewed (85.8%) said they needed from ¢50,000 ($600) to ¢300,000 ($3,600) in credit at the present time. 58% needed credit for raw materials and 28% said they needed it for machinery. Another 9% said they wanted the money in order to buy the premises.

VII. GENERAL CONCLUSIONS

Finding Number 1:

There appears to be sufficient, although modest, demand to permit the establishment of financially viable rural SSE lending programs within existing SOIs, PVOs and local branches of state banks, if they are properly structured and implemented in a cost-effective manner.

The survey shows that there exists the minimum concentration of demand for a SSE lending program which combines the ease, convenience, and speed of the prestamistas with the management systems, information technology, lower interest rates and financial stability of the formal lending institutions.

SSEs have been growing at an average annual rate of more than 29% in the four areas surveyed. On a compounded basis, using the same rates and without any change in credit availability, the total number of SSEs would increase by 1994 to:

Area	Avg Compounded Growth Rate Last 3 Years	SSEs in 1986	SSEs in 1989	SSEs in 1992
San Ramón	16.5%	472	746	1180
Ciudad Quesada	26.3	326	657	1324
Guápiles	61.3	73	306	1284
San Isidro	11.9	349	489	685
	TOTAL	1,220	2,198	4,473

While it is abundantly clear that Ciudad Quesada and Guápiles will not be able to sustain such exceptional annual growth rates indefinitely, the evidence shows that all four areas have strong growth trends which translate into significant increases in aggregate SSE demand over the next three years.
The worst case estimates of current SSE demand for each area therefore are:

Area	Estimated Unsatisfied Demand	Estimated Potential in 3 yrs
San Ramón:	¢ 37,300,000*	¢103,375,000**
Ciudad Quesada	¢ 32,900,000	¢ 91,165,000
Guápiles:	¢ 15,300,000	¢ 42,475,000
San Isidro:	¢ 24,500,000	¢ 67,875,000
TOTAL	¢ 110,000,000 ($1,321,000)	¢304,890,000 ($3,662,000)

* Measured by taking total number of formal and informal SSEs in region, dividing by 2 for those already with loans or disinclined/disqualified to participate, and multiplying by ¢100,000, the average starting working capital loan.

** Same as * except average loan amount is ¢225,000, assuming each original borrower is on third loan with 50% increase on each. The total number of small enterprises is estimated to increase by 20% per year. Of these, half are likely to participate. Therefore, 10% of the original number are estimated to need loans of ¢150,000 ($1,800) and 10% of the compounded first and second year total are estimated to need loans of ¢100,000 ($1,200). This calculation assumes constant 1989 prices.

It should also be noted that most of the new SSEs established in the coming years will not have any formal credit history. Therefore, a higher proportion of the new enterprises than those currently established will need to access a new credit program for financing their future business expansion.

Constraints to More Aggressive Rural Small Enterprise Lending

-Attitudes

Often financial intermediaries have a very negative attitude towards small-scale enterprises, and essentially dismiss them out of hand as too small, too risky, and too high in administrative cost. This is unfortunate because it has been shown conclusively in several countries that the small-scale borrower is often much more reliable than the larger, politically influential borrower.

Most small enterprise owners feel that the local banks are impersonal, far too bureaucratic, very slow in their loan processing, and unlikely to provide a loan unless the client has connections within the bank.

-Lack of Experience with Appropriate Financial Technologies

The banks and credit unions of Costa Rica are unfamiliar with the special financial technologies which are required to address the credit needs of rural small enterprises in a manner which minimizes risk and transaction costs and still provides an attractive return for the intermediary. These technologies are well known and have been highly successful in a number of countries. The principles upon which they are based are essentially the same. Normally, only the institutional framework and the program policies and procedures must be adapted to suit the local socio-cultural, economic and legal contexts.

-Inflexibility of Management

Often the management of bank branches is unwilling to innovate either due to lack of performance-based incentives, lack of sufficient decision making authority, or fear of departing from accepted practice.

-Limited Concentration of Demand In Rural Areas

45% of the population of Costa Rica lives in the greater San José area. Probably 70% of the country's small-scale enterprises are also located there. The number of SSEs in rural areas is limited and, in general, they are geographically dispersed.

In most cases the total demand for SSE credit in a given rural area cannot justify the establishment of new infrastructure or the introduction of a new intermediary. To be viable, a rural SSE program in Costa Rica must be run through an intermediary which already has a large geographical scope of operations, a strong client base, a healthy loan portfolio, and a wide range of financial services.

-Policy Constraints

Without doubt, the savings and loan cooperatives will be limited in their ability to expand geographically by arbitrary limits which they have imposed on themselves by agreement.

The representatives of the principal savings and loan cooperatives held a meeting during the economic crisis caused by the lack of banking liquidity and came to a "gentlemen's agreement" about geographical boundaries of operation. This is now an obstacle to the growth and good health of the savings and loan cooperatives.

This limitation on competition and growth also impedes the introduction of new methods of mobilizing savings and satisfying part of the overall demand for credit.

Furthermore, this geographical limit on operations makes it difficult to achieve the economies of scale necessary to build a profitable loan portfolio for small scale enterprises.

-Accessibility

The rural enterprises covered in the study have reasonably good physical access to financial intermediaries. Every one of the enterprises interviewed had a bank or credit union available within half an hour's distance from their business establishment, and most of them in less time.

In general, the availability of formal credit for small businesses was limited to the W040 credit line and, in the case of San Ramón, some IDB funds. Requirements for even these limited sources of subsidized credit were seen as too onerous by the majority of small industrial enterprises, and commercial and service SSEs are excluded from eligibility.

-Transaction costs

Transaction costs for obtaining credit were seen as the major disincentive to borrowing. The numerous trips and the significant time required to obtain all of the information and documents required by the bank for a loan usually discouraged the small entrepreneur from seeking formal credit. Many of those interviewed had tried, but gave up at some point in the process.

Finding Number 2.

<u>There appears to be considerable potential for increased mobilization of rural savings in Costa Rica.</u>

All four areas have significant amounts of surplus cash, primarily due to the wealth generated from coffee, bananas, and livestock. Coocique and Coopenaranjo are perfect examples of the savings mobilization that is possible if interest rates are raised to realistic levels and customers are given quick, convenient, courteous service.

Current Constraints to Rural Savings Mobilization

-Lack of Borrower Confidence

Lack of confidence in the management or general solvency of local savings institutions was not found to be an issue among the small enterprises in the four areas visited. Most (85%) small businesses interviewed spoke very positively of the local cooperatives and credit unions. Their complaints about the state banks were directed more towards the unavailability of credit, the lengthy procedures to apply for a loan, the poor service attitude, the low interest rates on savings and the high minimums for certificates of deposit. No one questioned the strength of the banks as financial institutions.

However, among individual savers there appears to be some concern about the financial health of certain credit unions, primarily due to the adverse publicity in the national press about the 13 credit unions which are currently insolvent and in danger of being closed. Twice in the last three years there has been a short-term departure of savings from credit unions into the state banks. In most cases, the stronger credit unions were able to retrieve these savings within six months.

-Low Interest Rates

The single biggest factor now limiting rural savings mobilization is the general lack of real positive interest rates on savings. It is important to print out that the lack of savings generation in the system is not from a lack of potential saving funds but rather the lack of saving systems with sufficiently atractive incentives. Most banks and credit unions, with the exception of Coocique and Coopenaranjo, are paying 12% or less on sight accounts, leaving customers with no real return on their savings. To receive a higher return savers either have to deposit a large minimum (¢50,000 - 100,000 or $600 - 1,200) for 1-3 months or tie up their money for at least six months.

Most small rural savers want easy access to their money, security, and a real positive interest rate. As a rule, any institution which offers this will greatly increase their number of savers, and although the average balance may be smaller, will increase the sum total of the institution's assets.

Coocique and Coopenaranjo pay 17% on sight accounts and they rank number one and two in passbook savings of all of the credit unions in the FEDECREDITO system. An interesting trend in both organizations is that the proportion of savings in term deposits has increased dramatically, with the bulk now is in certificates of deposit, as clients' resources have accumulated and they have gained greater confidence in the stability of the institution.

-Policy Constraints to Savings Mobilization

At the moment, the main policy limitation on state banks savings mobilization is the current 5% ceiling on increases in bank lending operations. This constraint, a requirement of the IMF's structural adjustment loan, may be withdrawn following the inauguration of a new government in 1990.

The major institutionalized constraint to savings mobilization appears to be the excessive centralization of decision making authority in the main offices of the state banks. Individual branches allocate credit according to specific targets set by the main office and have little flexibility to respond to local market forces. Since all deposits are placed at the disposal of the head office, there is little incentive to mobilize savings in response to increases in local credit demand. Because of the lack of a cost accounting system which treats each branch as a separate profit center, branch managers are not held responsible for maintaining a healthy balance between deposits and loans. Furthermore, branch managers are not free to set deposit interest rates in relation to the rates of their local competitors, which vary markedly by region.

Even at the national level, the state banks appear to lack a clear, long-term strategy for savings mobilization. The availability of BCCR funds, the lack of competition for checking accounts and deposits of less than 180 days, and the 5% credit ceiling act as strong disincentives to test new initiatives for mobilizing savings in rural areas.

-Transaction Costs

Transaction costs, as well as yields and liquidity, are crucial determinants of the demand for financial assets, especially among low-income savers. This is because of the essential role of working capital management in determining the assets and income levels of these households. If transaction costs of deposits are high, then small savers are deterred from using them and tend to rely on either cash or real goods for working capital. Thus, a successful small saver program will have to make deposits more easily accessible, cut down on paperwork and lines, and otherwise make transactions easier.

Costa Rica is blessed with an infrastructure of roads and communications which is generally much better than most developing countries. In the four areas studied, there exists a sufficient network of bank or credit union branches to make it reasonably easy and economical for savers to access their savings. Most bank branches are located in towns visited at least once a week by the inhabitants of the area, for shopping, business or social reasons.

Finding Number 3.

<u>There is an apparent need in rural areas for the following additional financial services:</u>

-Retirement savings - BANEX, a local private bank, has a pioneer model program.

-Higher education savings.

-Money market funds made available to smaller investors.

-ATMs.

-Checking accounts with minimum balances and lower charges.

-Electronic transfers.

Constraints to Additional Financial Services

-Technical assistance and training for financial intermediaries.

-Cost of ATMs, EFT, and computerized account management systems.

-Education of clients.

Finding Number 4.

There is considerable demand for short-term commercial credit at 25 -30% interest per year among medium and large retail outlets.

The average loan amount required would range between ¢100,000 - ¢150,000 ($1,200 - 1,800).

Constraints to New Short-term Commercial Credit

-Bureaucratic delays. Clients need funds rapidly and go to the prestamistas.

-Perception that there is insufficient need.

-Technical assistance and training for financial intermediaries.

Finding Number 5.

There is considerable demand for medium-term agricultural loans for non-traditionals at 20 to 25% interest per year with grace periods and balloon payments in the years following initial production.

Constraints to New Credit for Non-traditionals

-Undeveloped or unstable markets for some non-traditionals.

-Lack of experience in non-traditional crop lending by financial intermediaries.

-lack of specialized credit programs aimed at exports.

52 P

PART II

RECOMMENDATIONS

INTRODUCTION

This section of the Costa Rica Rural Financial Markets Study embodies the recommendations of the ACDI study team for specific financial and technical assistance interventions which should be considered in order to accelerate broad-based growth in business and employment opportunities in rural areas away from the Central Valley of Costa Rica.

Demographically, over the last thirty years Costa Rica has seen a steady migration of the national labor force away from rural ar as towards the major urban centers of the Central Valley - San Josė, Alajuela, Heredia and Cartago. These four cities will soon form one contiguous megapolis of some 1.5 million people, approximately 60% of the total population of Costa Rica. The problems endemic to such a concentration of the population - traffic congestion, pollution, overburdened public services, housing shortages, and mounting crime - are already diminishing the quality of life for many of the less well off urban dwellers. The situation is most likely to deteriorate further unless more private and donor investment is focused on rapidly expanding the economic base in other areas of the country.

AID can continue to play a significant role in encouraging the rapid development of secondary cities and rural areas away from the Central Valley. Past programs have assisted Costa Rica in establishing a road and telecommunications infrastructure which is the envy of Central America. Massive investment in social services has assured access to quality education and health facilities to the great majority of the population. An effective new program of incentives to public and private financial intermediaries is now required to strengthen the rural economic base by encouraging accelerated investment in private business activities in such areas as San Carlos, San Ramón, Pococí, Pérez Zeledón, Guanacaste, Puntarenas, and Limón. With relatively modest funding AID can put in motion the financial technologies necessary to channel a much greater proportion of the financial resources available in the national banking system to these areas.

VIII. Strategy for Expanding Rural Financial Services

The proposed strategy is intended to accomplish three primary objectives: 1) stimulate an expansion of the local economic base through greatly increased intermediation on the part of credit unions, state banks, and especially, the eighteen private banks located in San Josė, 2) induce greater savings mobilization in rural areas, and 3) create the economic environment for the introduction of a range of banking services not currently available in these areas. Each of these components - increased credit availability, greater savings mobilization, and new banking services - will be addressed in turn.

The suggested approach is low-cost and, at this point, experimental. Yet it is intended to create a financial structure through which greater local savings and current Central Bank lines of credit such as FODEIN and AIR can be directed towards an accelerated program of productive investment in rural areas.

IX. Proposed Rural Credit Programs

The ACDI study team proposes an integrated, three-tiered approach to the development of secondary cities and rural areas. It recommends the introduction of three proven mechanisms of financial intermediation to meet the credit needs of small, medium and larger enterprises established in the cities and towns outside the San José-Alajuela-Heredia-Cartago metropolitan area.

The basic idea is to introduce a package of complementary financial programs in four rural areas which will rapidly expand the economic base of each region, address many of the current gaps in financial services, and allow businesspeople access to the gradually more sophisticated financial and technical assistance they will need as their businesses grow in size and complexity. The four general areas targeted for the testing of the program package are San Ramón/Palmares/Naranjo, San Carlos, Pococí, and Pérez Zeledón.

The proposed credit mobilization component consists of three parts, focused separately on small, medium and larger rural businesses in the target areas. The parts, however, are designed to overlap sufficiently so as to assure the availability of continued assistance as a business grows. The program is intended to accomplish the following:

1. Allow rural small-scale enterprises easy access to credit at market rates for working capital and capital goods requirements.

2. Give new investors and established medium-scale businesses ready access to the technical and financial assistance needed to develop and implement sound business plans for start-ups or expansion of existing operations by providing technical assistance, loan guarantees, and access to bank loans.

3. Provide Costa Rican private banks with the necessary incentives to develop a portfolio of medium-to-large size borrowers in selected rural areas large enough to justify the establishment of permanent, profit-making branches capable of providing a full range of banking services.

The study team has developed two models for rural credit programs, one targeting small rural enterprises and the other larger commercial banking projects. The first model is based on the AVANCE approach and successful projects in Indonesia, Egypt, and the Dominican Republic. The second is patterned after a highly successful portfolio guarantee program in Michigan. These are described in detail in the following pages. For medium-scale rural enterprises, the team recommends initially testing the FUNDES approach in two of the target areas.

A. Small-Scale Enterprise(SSE) Credit Program

1. Background

While the evidence of unmet demand for rural SSE credit in the four areas surveyed during the Rural Financial Markets Study is less than overwhelming, the study team feels that intervention on a low-cost, experimental basis is justified for the following reasons:

1. SSEs have been growing at an average annual rate of more than 29% in the four areas surveyed. On a compounded basis, using the same rates and without adjusting for any change in current credit availability, the total number of SSEs would increase by 1992 to:

Area	Avg Compounded Annual Growth Rate Last 3 Years	SSEs in 1986	SSEs in 1989	SSEs in 1992
San Ramón	16.5%	472	746	1180
San Carlos	26.3%	326	657	1324
Pococí	61.3%	73	306	1284
Pérez Zeledón	11.9%	349	489	685

While it is abundantly clear that San Carlos and Pococí will not be able to sustain such exceptional annual growth rates indefinitely, the evidence shows that all four areas have strong growth trends which translate into significant increases in aggregate SSE demand over the next several years.

2. The very presence of a new, easily accessible rural SSE credit program should be a major stimulus to the establishment of more SSEs in the four areas.

3. The nature of the rural SSE credit program, focusing on high portfolio turnover and rapid growth in individual loan amounts, will permit total loan volume to increase very quickly, once clients have entered the system and successfully completed the credit cycle for the first time.

4. The accelerated development of medium and larger scale businesses resulting from the other credit programs targeting them (See Sections IX.2 and IX.3 below) should help create many new opportunities for small entrepreneurs to enter the market.

2. Program Description

The following section describes the general parameters of the kind of effective credit delivery mechanism which the study team feels is required to 1) meet the current credit needs of rural small-scale enterprises in the target areas, 2) stimulate their rapid expansion; and 3) encourage the initiation of new small business activities.

When we speak of "small-scale" enterprises, in the context of rural Costa Rica, we are referring to:

> "Owner-operated businesses with less than 10 employees who typically lease their premises, own total assets of less than ¢1.5 million ($10,000), and generate average monthly sales of less than ¢300,000 ($3,600). Immediate credit needs generally range from ¢50,000 ($600) to ¢300,000 ($3,600), primarily for working capital and small equipment. These businesses usually, though certainly not always, have no previous credit history with formal institutions."

Program Goal and Purpose

The goal of the proposed rural small-scale enterprise credit program is to improve the productivity and incomes of the Costa Rican rural poor by making capital available for productive activities through a convenient credit delivery mechanism that charges a reasonable interest rate, earns an attractive rate of return for the financial intermediary, and relies primarily on short-term local savings deposits for its lending capital.

The purpose of the program is to prove the technical and financial feasibility of providing formal credit to rural small enterprises in Costa Rica by field testing, on a limited scale, an appropriate rural credit delivery mechanism which combines the speed, ease, convenience and reliability of local moneylenders (prestamistas) with the operating philosophy, management systems, capital base, lower interest rates and profit margin of formal financial intermediaries.

Program Objectives

The specific objectives of the program include:

a. - To field test the validity of several key assumptions on which the proposed credit delivery methodology is based. These assumptions are enumerated on the following pages.

b. - To experiment with an appropriate methodology for the economically viable delivery of credit to rural small-scale enterprises through three types of institutions: a state bank, two credit unions, and a private voluntary organization.

c. - To design, develop, and institutionalize the internal banking policies and procedures necessary to assure efficient and profitable credit delivery to the target group.

d. - To institutionalize a computer-based management information system (MIS) for effective financial control of the program and the statistical analysis of SSE portfolio performance at the local level, based on AVANCE's existing MIS.

e. - To develop and perfect, over the life of the Rural Financial Services project, an effective model for rural SSE credit delivery which can be replicated throughout the existing branch systems of participating intermediaries.

Program Beneficiaries

The primary beneficiaries of such a program will be the 2,000-odd formal and informal small-scale entrepreneurs who will benefit directly from greater and easier access to formal credit facilities. The proposed program will improve the rural entrepreneur's capacity to increase raw material and finished goods inventories, obtain lower prices through volume purchasing, and boost productive capacity through the introduction or repair of capital equipment.

The general population of the trial areas is also expected to benefit from an increase in employment opportunities, greater job security, possibly higher wages and the improved availability, quality and pricing of local consumer products and services.

Technical Approach

The technical approach of the proposed program would consist of five basic steps, as follows:

1. Set up experimental rural small-scale enterprise(SSE) credit departments in Coopenaranjo, Coocique, and the San Isidro branch of Banco de Costa Rica with USAID financial support and technical assistance from an AID contractor experienced in implementing this kind of credit program.

2. Propose the use of existing and new short-term savings deposits for SSE lending capital. If the intermediaries are unwilling to risk their own deposits initially, then USAID should offer a very modest four year USAID line of credit at 17% for this purpose. The amount suggested for this line of credit is ¢25 million ($300,000) per intermediary.

3. Provide the management of the three institutions with the opportunities to participate in a methodology seminar at AVANCE's offices in San José and to visit successful rural SSE programs in the Dominican Republic (ADEMI), Mexico (ADMIC) and possibly Indonesia (BKK and BPD).

4. Assist AVANCE in establishing a small branch office in Guápiles, starting with two full-time credit agents empowered to approve loans without approval from the main office.

   Provide AVANCE with the necessary start-up capital to operate the branch for the first four years on a limited USAID line of credit (¢ 25 million ($300,000) is suggested) at market rates (17%). If and when the approach is proven successful (hopefully within two years), assist AVANCE in creating a Coopeavance in order to allow it to mobilize local savings to first leverage, and eventually replace, the original AID-financed credit fund.

5. In all four cases, utilize the basic methodology described below in Section IX.1.C., modifying it as necessary to the existing internal systems of the various intermediaries and the social, economic, and demographic characteristics of the particular area.

Institutional Participants

Of the four areas surveyed, San Ramón, Ciudad Quesdada, and San Isidro showed indications of an adequate concentration of demand to merit testing out a new credit delivery system for rural SSEs. Guápiles currently appears to be somewhat shy of the requisite level of demand. However, it is situated in an area which has recently experienced very rapid economic growth in general and among SSEs in particular.

In order to optimize the long-term impact of the new methodology, the team suggests that AID fund experiments in all four areas using a variety of financial intermediaries - two of Costa Rica's strongest credit unions, a state bank branch, and one of the more successful private voluntary organizations (PVOs) - to test out the new rural small-scale enterprise credit delivery system.

For a rural small scale enterprise credit program to work through existing financial institutions, a high level of commitment, dynamism, and creativity is required from key and respected managers both at the headquarters office and at the local branch level. The organizations visited by the team leaders which clearly manifested this type of leadership were AVANCE in San José, Coopenaranjo in the San Ramón area, Coocique in San Carlos, and, in San Isidro, the Banco de Costa Rica. Such leadership was not readily apparent among the three public sector financial institutions in Guápiles, although the Banco Nacional was by far the largest and most active of the three. Furthermore, Guápiles has only three cooperatives, none of which are credit unions.

Ciudad Quesada and San Isidro both have financial intermediaries which are capable of testing out new approaches to rural credit delivery. Coocique in Ciudad Quesada and the local branch of the Banco de Costa Rica in San Isidro are both blessed with experienced and innovative managers who have expressed a strong interest in participating in the proposed new SSE credit program. Both institutions have a reputation for introducing new financial services to their clients, encouraging a service attitude among their staff members, and taking an aggressive approach to developing a growing and diversified loan portfolio.

These two geographical areas offer an excellent opportunity to test new approaches to small enterprise lending through two very different types of financial intermediaries.

Coocique in Ciudad Quesada offers the advantages of:

An excellent reputation in the community

Dynamic Leadership

A well-trained staff

A large branch network

The desire to broaden its portfolio mix

Solid financial underpinnings

A sufficient concentration of demand

A large volume of small savers and borrowers

Computerized accounting and portfolio management systems

The benefits from working with the Banco de Costa Rica in San Isidro are:

Dynamic, innovative management at local branch

A well-trained, service-oriented staff

Willingness of corporate management to participate

Willingness to establish separate accounting system for SSE program

A national network of branches

Increased computerization

A highly competitive environment for financial services

Many of the rural branches of state banks need new business. Their current loan volume is often too low to fully cover their running costs and effectively employ their staff. They often find themselves competing with each other for the same limited number of larger, well-heeled clients and ignoring the viable, profit-making small and medium scale enterprises because of the strict lending formulas and interest rates set by their main offices, which generally stipulate tougher requirements for SSEs than for large, heavily capitalized businesses.

In the San Ramón area, Coopenaranjo is by far the strongest and best-managed credit union. It has many of the same qualities as Coocique (with the exception of Coocique's branch system) a healthy balance sheet, and a track record of aggressive savings mobilization and steady portfolio growth.

It is recommended, therefore, that experimental SSE credit departments be set up with USAID financial support in Coocique in San Carlos, Coopenaranjo in Naranjo, and the Banco de Costa Rica in San Isidro. Small initial operations should be launched using current and newly mobilized short-term savings deposits for lending capital. If intermediaries are initally unwilling to use deposits, then AID should consider using a matching mechanism or a short-term line of credit at 17% for this purpose.

None of these institutions have had any experience with administering the kind of rural SSE credit program proposed herein, which is based on similar, highly successful programs in Indonesia, Bangladesh, the Philippines, and the Dominican Republic. Therefore, AID-financed technical assistance from a company experienced in implementing this kind of program will be required on a part-time basis for three years.

In Guápiles the team proposes having AVANCE open a small branch office, with a minimal staff and ¢25 million ($300,000) in loan funds.

AVANCE, established just three years ago with technical assistance from Accion, Inc. to serve the credit needs of urban microentrepreneurs in the poorer barrios of San José, is easily the most successful of the 30-odd PVOs which manage small-enterprise credit programs in Costa Rica. AVANCE currently manages a portfolio of ¢55 million ($66,000) in loans and is targeted to break even early in 1990. It is the only PVO credit program which can claim to be self-sufficient, i.e. able to covering all of recurrent operating costs, including cost of funds and provisions for bad debts, out of the return on their loan portfolio. Thus far AVANCE has assisted more than 1,400 small businesses in San José.

Under the proposed program, AVANCE would be provided with investment, working, and loan capital to open an agency branch in Guápiles to deliver credit to small entrepreneurs based on their successful past experience in San José. In order to keep operating costs to a minimum, the Guápiles agency would rely on the main office an hour away for support services such as legal and management accounting departments. Initial staff would be limited to two credit agents, a cashier and a guard.

If the initial experience in Guápiles is positive, AVANCE should become a credit union after two years in order to begin mobilizing local savings. It should be required to repay its AID loan after six years with 17% annual interest, allowing four year in which to replace the loan with deposits. Once established as a credit union, AVANCE could begin to lower its collateral requirements and require membership, annual dues and compensatory savings balances from borrowers partially in place of its usual liens on fixed assets and inventory.

3. Credit Delivery Methodology

In order to address the problems of lack of accessibility, mutual misconceptions between banks and SSEs, cumbersome loan application procedures, high per-loan administrative costs and perceived higher risk, the selected local institutions, with the technical assistance of the AID contracting firm, should field test a rural credit delivery mechanism, the key elements of which would be to:

- Charge interest rates high enough to cover operating expenses - including cost of funds and provisions for bad debts - and return a real profit for reinvestment and expansion of services;

- Rely on character references from a group of community leaders (similar to the juntas rurales) for loan eligibility, rather than on availability of collateral or lengthy analysis of a proposed enterprise's feasibility. After the first year of operations, half of the membership of the juntas should be elected by those borrowers with a 100% on-time repayment rate over the course of at least two loans;

- Reduce risk by initially making small short-term loans to a new borrower at a level s/he is used to managed efficiently, and then gradually raise the client's credit ceiling as his or her repayment record and marketing capacity warrants;

- Actively involve prospective clients in the preparation of a simple business plan for the proposed use of and repayment of their loans;

- Lend initially only to clients with businesses established for at least a year;

- Use the opportunity for larger repeat loans as the borrower's primary incentive for full and timely repayment;

- Blend local autonomy with overall program quality control, by stressing a highly decentralized organizational structure with local offices as the focus of operations, together with central program technical supervision by the AID contractor and the counterpart BCCR project office in San José;

- Minimize investment and operating costs by managing the state bank and credit union experiments out of existing branch offices. The PVO experiment in Guápiles will require the rental of a small office. All four institutions should use motorcycles for credit staff follow-up with clients. And, in all experiments, program staff compensation should be at least partially pegged to profitability by means of an incentive system of bonuses based on net profits derived from the rural SSE program.

The principal characteristics of the proposed rural small-scale enterprise credit delivery system can be described as follows:

Demand-driven	-	Effective interest rates should be set in response to market forces.
Accessible	-	Special windows in each financial institution for SSE program transactions. In the case of the PVO program, services may eventually be made available through kiosk banks in towns such as Cariari, Rita and Guácimo, once or twice a week if the concentration of business warrants it.
Fast, easy and convenient	-	A minimum of documentation for credit application/approval. No lengthy business appraisal process. First loan approval process should not exceed two weeks. Repeat loans, one week. Capital goods loans should be made available after successful completion of second working capital loan.

Profitable	-	Operating revenues should cover all recurrent operating costs, including cost of funds, adjustment for inflation, and provisions for bad debt -and return a modest real profit for reinvestment and expansion of services.
Decentralized	-	Decisionmaking authority for loan approval should be at the lowest feasible administrative level, the SSE program loan officer.
Flexible	-	No preference given to particular type of enterprise or sector. Loan purpose to depend on the needs of the individual enterprise and the local market.
Fungible	-	All loans should be made in cash. Capital goods loans should require a proforma invoice for the equipment needed.
Low Cost	-	Employee compensation pegged to profitability, minimal investment in fixed assets, use of motorcycles for staff transport and follow-up, program managed from existing premises whenever possible.

SSE Credit Program Hypotheses

The proposed methodology is intended to test out the following key hypotheses concerning the provision of credit to rural SSEs in Costa Rica:

1. - The rural small-scale entrepreneur in Costa Rica is much less concerned with interest rates than he/she is with the easy accessibility, speed and reliability of the credit delivery system and the level of transaction costs, i.e. time, transportation, convenience of banking hours, opportunity costs and the complexity of loan application procedures.

2. - Most rural SSEs have a very high rate of return on investment. Short-term working capital and bridging loans currently made by moneylenders command very high annual interest rates (36-200%) and are almost universally repaid.

3. - The most pressing credit need for rural SSEs is for working capital to increase retail inventory or raw material stocks, purchase tools or spare parts, or repair existing equipment.

4. - The rural small businessperson in Costa Rica does not require a lot of expensive technical assistance to manage his/her money and business activity, given the levels of investment and sophistication involved.

5. - The target group of clients are existing businesspeople with well-known activities. Therefore, the credit delivery system will not require lengthy individual sub-project appraisal.

6. - A group of community leaders can be relied upon to give fair and honest character references for borrowers and to help follow up on seriously delinquent clients.

7. - The future prospect of qualifying for larger loans of longer maturities, capital goods loans, and/or lines of credit represents the greatest practical repayment incentive for borrowers.

8. - The proposed credit program can be financially viable if permitted to charge effective rates of interest that are competitive with informal sources of rural credit available on the local market.

9. - Clients will agree to maintaining compensatory savings balances of 10 - 20% in order to qualify for loans.

SSE Loan Terms and Conditions

Target Group

Based upon the field survey of 318 small enterprises carried out by ACDI/Costa Rica in August and September 1989 and interviews with rural branches of state banks, productive cooperatives, credit unions, and private voluntary organizations, it is evident that there remains a considerable demand for credit among rural SSEs which is not currently met by the W040 line of credit for small industry or the many small PVO credit programs existing in various areas of the country. The target group for these experimental credit programs is that group of enterprises which are:

> "Owner-operated businesses with less than 10 employees who typically lease their premises, own total assets of less than ¢1.5 million ($18,000), and generate average monthly sales of less than ¢300,000 ($3,600)."

The target group in the four areas covered by the ACDI survey have certain characteristics which make them generally less risky than the typical AVANCE client in San Josė. First of all, most of the businesses are formally registered with the municipality and are managed by well-established residents who are known to the leaders of the community. Typically, the total value of their business and personal assets is much higher than that of their San Josė counterparts. And they live in a much more socially stable and safer environment than the barrios of the capital city.

The Financial Services Outreach Project office in the BCCR and the participating institutions should closely monitor the portfolio mix of the rural SSE credit program to assure that its financial intermediation continues to be broadbased and suitable to the needs of the local economy. A situation in which the bulk of the loans go to a single group, e.g. small traders, should be avoided. If there is any particular emphasis in the selection of clients, it should be on productive enterprises which add significant value.

It is anticipated that borrowers participating in the experimental rural SSE credit program will eventually "graduate" to other lending facilities either provided by the same participating institutions or through FUNDES (See Medium-Scale Enterprise Credit Program below), once the SSEs have established a solid credit rating and have shown their capacity for steady growth. These lending facilities should be designed to provide the "seasoned" SSE borrowers with investment capital for business expansion, mechanization, increasing productive capacity, upgrading business premises, etc. Given the increased business volume of the enterprise and the larger size of the loan, access to these lending facilities would normally require a more in-depth analysis of the financial health of the enterprise and its future market potential.

Loan Purpose

Initial loans under the experimental program are intended to meet the current short-term working capital needs of existing small-scale rural enterprises, regardless of sector - whether trading, manufacturing, food processing, transport, construction, or services. It is anticipated that most loans will be used for increasing trading and raw material inventories, purchasing spare parts, and repairing broken equipment. Larger loans of longer maturities and initial grace periods on principal should be made available for investment in capital equipment for borrowers who have completed at least two loans and have maintained a high credit rating throughout. Automatic lines of credit or overdraft privileges for small commercial enterprises should also be considered once the enterprise has established a sufficiently high credit rating.

Loan Eligibility Criteria

In order to minimize transaction costs, the participating institutions should base their creditworthiness analysis of rural SSE borrowers on a simplified assessment of the proposed activity's viability, the owner's character and management ability, and market conditions, rather than on bankable collateral or significant capital assets. For initial loans, the debt/equity ratio should not exceed 1:2.

Essential loan criteria will include:

1. - That the borrower be a resident of the local area. The intermediary will wish to avoid making loans to transient types.

2. - That the business assisted be an ongoing enterprise which has already consistently turned a profit for its owners. A minimum of one year of successful operation should be stipulated by the lending institution.

3. - That the borrower obtain a recommendation from the junta rural, made up of leading members of the local community recognized by the lending institution for their high level of integrity and sound judgement.

4. - That the borrower be willing to accept a "pledge of goods" or a lien on tools or equipment as a guarantee against default on his or her loan.

5. - That the borrower accept legal responsibility for making the necessary repayments of the loan according to the agreed-upon schedule.

Loan Size Limitations

Given the characteristics of the target group and the need to develop individual credit records for the rural poor at low risk to the lending institutions, the minimum loan amount should be ¢50,000 ($600). The maximum amount for first loans should be ¢500,000 ($6,000), to be adjusted annually for inflation. There should be no fixed upper limit, however, for experienced borrowers with an excellent credit rating over several loans. The lower cost of conventional loans should eventually entice larger, more experienced borrowers to eventually graduate out of the rural SSE credit program. And their proven credit history established under the program should greatly facilitate access to such more conventional credit sources or to those provided under the Medium-Scale Enterprise Credit Program.

Interest Rates on SSE Loans

Interest charges on loans should be set according to what the market will bear, while always keeping in mind the developmental objectives of the program. Of the 318 small enterprises interviewed during the ACDI survey, 64% indicated that they would be willing to pay 3% per month for short-term working capital loans of up to one year. This is a rate similar to that which AVANCE is now successfully charging to micro-enterprises in the poorer neighborhoods of San Josè.

However, given that this rate is far lower than the rates of local moneylenders in the secondary cities and that the typical rate of return on working capital for a small enterprise is in excess of 100%, the intermediaries should initially test the market by requiring effective rates of around 5% per month on initial working capital loans. The int rmediary will then have the option of gradually reducing interest rates based on practical experience, increases in portfolio volume, and administrative cost cutting.

Loan Terms

Maturities and repayment schedules should depend on the production/sales cycle of the individual business. Of the 318 SSEs interviewed in the ACDI study, 95% of them had a current production/sales cycle of less than 30 days, a clear indication of a shortage of working capital.

While increased working capital will certainly extend the production/sales cycle for most businesses by allowing them to build larger inventories and sell in greater quantities, the increase in the cycle resulting from the initial loan under the program will normally not exceed 100%. Hence, most new borrowers should be able to make good use of initial working capital loans of 3 - 4 months. Therefore, at the beginning of the program when clients have yet to establish a credit rating, the loan term should be limited to no more than three complete production/sales cycles. Based on experience, need, and borrower repayment performance, the participating institution can later increase loan maturities or consider the establishment of revolving lines of credit.

Once a client has established a solid track record by successfully paying off two working capital loans, on-time and in full, he/she should become eligible to obtain a capital goods loan for tools or production equipment in addition to his/her regular working capital loan. Capital goods loans will normally require terms of one to two years to repay. Short grace periods of one to three months on principal should also be considered so that the client's cash flow can be boosted from the higher "mechanized" production prior to having to service significantly higher debt.

Amortization

In keeping with the demand-driven nature of the rural SSE credit program, amortization schedules should be kept very flexible at first, tailored to meet the specific needs of a wide range of enterprises. Businesses with high turnover, such as retail traders, should be able to borrow very short-term (2 to 4 months) and make equal principal and interest payments on their first loan. Small manufacturing operations often can pay only the interest on a loan until they have produced a sufficient volume of finished goods inventory to effectively sell at high margin. A good example of such a business is a small furniture manufacturer, who must produce enough to merit hiring a large truck to transport his finished goods to market. Other businesses depend on fairs, regional exhibitions, or the Christmas season for the bulk of their sales. Once the intermediary has gained sufficient practical experience, the number of possible loan packages can be narrowed to those most commonly preferred by clients.

Fees

It is suggested that first-time borrowers pay a one-time initiation fee of 1% of the loan amount as earnest money and to help offset the cost of the additional paperwork required for new clients. The financial analysis in Annex A indicates that with an effective monthly interest rate of 3.0% or more, no other special fees should be required to make the operation financially viable.

However, each intermediary should decide whether any additional management and guarantee fees can and should be charged to the borrower to cover the increased administrative costs associated with maintaining a large portfolio of small loans or to increase loan loss provisions in anticipation of a higher-than-usual default rate. The precautionary use of such fees could later be discontinued if the experience of the intermediary over time shows them to be unnecessary. In the end, of course, the market will determine the total cost that the intermediary will be able to pass on to the customer.

Collateral Requirements

Borrowers should not be obliged to produce bankable collateral in order to obtain a loan. However, character references from the respected members of the community represented in the <u>junta rural</u> should be required. A pledge of goods for raw material inventories or a lien on tools and equipment will generally serve better than formal collateral, given the lengthy legal process and costs associated with foreclosing on and liquidating real estate in Costa Rica. Compensatory savings balances required under the program will also serve as a partial guarantee of repayment.

The principal means of ensuring prompt repayment of loans should be by first establishing the trustworthiness of the borrower and then starting with small loans of short maturity and gradually increasing both loan amount and terms with each successive loan, depending on the on-time repayment performance of the borrower. Future access to more substantial credit would then depend on an individual's satisfactory repayment record on prior loans.

Savings Incentive Program

In the San Ramón area, Ciudad Quesada, and San Isidro the experimental SSE credit program should make an effort to mobilize savings by familiarizing SSE clients with the mechanics of a passbook savings program and by providing them with a convenient and secure savings facility which offers them a return on their short-term savings high enough to be an incentive to save rather than spend surplus funds on additional inventory or consummables.

Potential borrowers should be required to open a passbook savings account at least two weeks prior to the submission of their initial loan application. The upper limit on the initial loan amount should be equivalent to five times the amount deposited in the savings account. The client should not be able to withdraw his/her savings balance prior to full repayment of the loan. Such savings should be allowed to earn about 5% above the official inflation rate.

Besides serving as a kind of compensatory balance and helping maintain the credit fund's cash flow, the savings incentive program is intended to encourage voluntary savings in rural areas and to educate the general population about the economic benefits of saving short-term. Once savers are comfortable with the procedures for formal savings and are confident of the rural SSE credit program, competitive returns on deposits and the convenience of easy access to personal savings close to home should stimulate increased voluntary savings and an additional source of credit funds.

Client and SSE Loan Officer Performance Rating

Individual clients and SSE program loan officers should be rated according to specific performance criteria. These ratings will serve as a valuable tool for management decision-making on increasing credit ceilings for clients with established track records and will provide benchmarks for remedial action when a loan portfolio is deteriorating in quality.

For individual client loans the rating system should be on an A to D scale; with A representing consistently high performance and D describing a loan in risk of default. A special rating of A+ should be applied to clients who have the sterling credentials of a perfect on-time repayment record over the course of three loans or more.

The key criteria for the rating of individual clients should be:

1.- Number of loans received and paid in full
2.- On-time repayment rate
3.- Increase in total business equity
4.- Debt/equity ratio
5.- Quality of collateral, if any

The participating institutions should classify individual loans on the basis of a weighted average of these five factors. The first two factors should receive double the weight of the other three.

Loan officers should be rated on the basis of the average on-time repayment rate of their portfolio, the number of new clients developed each quarter, and the increase in the total value of their individual portfolio. The first factor should receive double the weight of the other two.

4. Financial Analysis

The financial analysis for the proposed Rural Small-Scale Enterprise Credit program is presented in Annex A to this report.

B. Medium-Scale Enterprise Credit Program (Including Start-ups)

This component of the program is designed to assist those enterprises which can best be decribed as:

> "Owner operated businesses with 5 to 20 employees who typically own their premises, maintain business assets equivalent to ¢1.5 million ($18,000) to ¢25 million ($300,000), and have average monthly sales of ¢500,000 ($6,000) to ¢2 million ($24,000). They are likely to have a past credit history with a local credit union or state bank branch under specialized lines of credit like W040. This group would also include professional services, investors who are starting a new business operation and seeking bank credit, and those small-scale enterprises who have 'graduated' from the rural SSE program."

Businesses or investors in this group are likely to require technical assistance in developing a detailed business plan, conducting the necessary feasibility analysis, and obtaining a private bank loan. To qualify for bank financing they are also likely to need a guarantee on their first such loan.

Therefore, ACDI proposes that AID provide financing for the establishment of trial operations of FUNDES in San Ramón/Palmares and Ciudad Quesada. At first, FUNDES representatives would work part-time two or three days a week out of their San José office in conjunction with private bank loan officers (See Large-Scale Rural Business Credit component below) working on the same part-time basis. If a sufficient volume of business warrants a full-time commitment in the region, FUNDES could then set up a permanent regional office.

The idea is to create a medium-sized loan portfolio - based on FUNDES' loan brokering, technical assistance and guarantee functions - which is sufficiently concentrated to help support the establishment of one or more private bank branches in the area.

FUNDES could also guarantee loans for commercial lines of credit to mid-size merchants until they have established a sufficient track record to merit direct access to overdraft privileges from private or state banks.

AID should be prepared to increase FUNDES' guarantee fund capital, if necessary to serve a larger portfolio of clients outside the San José metropolitan area. FUNDES will also require financial support for the increased technical assistance costs associated with this trial program.

Consideration should also be given to setting up a Costa Rican version of the International Executive Service Corps(IESC) to help troubleshoot management, production, and marketing problems on a voluntary basis. Apparently, Costa Rica has an abundant supply of retired management and technical talent. Such a program could be established at FUNDES by means of a computerized consultant roster. Volunteers could then work on assignments drawn up by FUNDES field personnel and based on specific requests from local businesspeople. The IESC has been very successful in its worldwide program for over thirty years. Furthermore, a number of former leaders in Costa Rica assured the study team that a sizeable pool of retired business talent does exist in-country.

C. Large Rural Business Credit Program (Including Start-ups)

This program is designed to greatly broaden and strengthen the economic base of selected rural areas by providing the financial means to launch new business activities on a scale large enough to have a major impact on employment, income generation, and the development of smaller "feeder" businesses in the rural areas.

The main focus of the program should be on establishing new enterprises or assisting the expansion of existing companies into new lines of business, with priority going to activities related to agriculture and agro-processing. The general definition of this size of business would be as follows:

"Businesses, usually but not necessarily managed by one of their owners, with 20 or more employees, their business premises owned rather than leased, total assets of more than ¢25 million ($300,000), and average monthly sales of more than ¢2 million ($24,000). Such businesses can include partnerships, cooperatives, and corporations. Considerable past credit experience in this or another business activity would be expected."

A major disincentive for private banks to move into rural areas is the high personnel costs associated with developing new business in those areas and closely monitoring the use of the bank's investment loan capital. The general consensus among private Costa Rican bankers is that the potential does exist in certain rural areas to develop the business volume necessary to sustain profitable branch operations. However, as long as lower cost opportunities exist closer to the home office, private banks will naturally avoid having their margins reduced by incurring the higher business development and management costs involved in financing projects in these areas.

Furthermore, most private banks consider more distant borrowers involved in new business operations - especially non-traditional crop development - which are reliant on less certain infrastructure and markets, as being much riskier than the short-term commercial lending they currently emphasize in San José.

The Large-Scale Rural Business Credit Program seeks to address these constraints by calling for the establishment of two complementary sub-programs: a four year Rural Business Development Program and a permanent Rural Credit Guarantee Program housed in the Costa Rican Bankers Association or an appropriate similar body.

1. The Rural Business Development Program

The Rural Business Development Program would reimburse participating private banks for the costs associated with developing a concentrated portfolio of borrowers in selected rural areas. Reimbursable costs would be restricted to actual traveling and living expenses incurred by a limited number of private bank loan officers while developing and monitoring new business away from the metropolitan area.

An initial monthly maximum amount per bank would be established and each bank would have to present a plan and budget to AID targeting a specific area or areas for new business development. The program should be arranged so that costs are reimbursed on a declining scale over the four year project period, i.e. 100% the first year, 85% the second, 60% the third, and 30% the fourth. By the fifth year the banks should have sufficient business in the area to either set up a permanent branch or at least cover the cost of future business development out of the spread on their existing loan portfolio in the area.

2. Rural Credit Guarantee Program

The Rural Credit Guarantee Program calls for the establishment of a modest guarantee fund in the Costa Rican Bankers Association or some other appropriate body (which would act as Rural Credit Guarantee Fund (RCGF) Manager) to reimburse participating banks for net defaults on new loans made for investment in specific rural areas selected by AID and the Central Bank. The composition of the target areas would be reviewed annually by the Fund Manager, the participating banks, the Central Bank and AID.

The idea behind the guarantee fund is to provide a powerful incentive for the private banks to utilize special Central Bank project lending funds like FODEIN and AIR in rural areas where risks and management costs are somewhat higher, rather than concentrating their loan portfolio on commercial and industrial projects close to San José.

The purpose of the fund would be to dramatically increase the total amount of financial flows going to rural areas, to increase opportunities for employment and the creation of smaller feeder operations, and to help develop a sufficient client base to justify the establishment of rural branches by the private banks.

Preference, if any, for loans guaranteed under the program should generally go to agro-processing and export crop activities which create opportunities for smaller producers to contract with the borrowing processor/exporter, supplying raw product of consistently high quality in exchange for a fair market price, technical assistance, quality control and access to bank credit. Loans to commercial, industrial and service enterprises, of course, would not be excluded. However, the program would hopefully focus on those projects which would have the greatest economic "multiplier" effect in the local region.

Drawback activities would be another possibility for loans under the program. Drawback has met with reasonable success in recent years in Ciudad Quesada and San Isidro, creating 400 jobs in Ciudad Quesada and 800 in San Isidro, primarily for underemployed spouses.

The proposed Rural Credit Guarantee Program is modeled on a highly successful Michigan state government program, known as the Michigan Strategic Fund (MSF) Capital Access Program, launched in late 1986 to provide banks with a flexible and non-bureaucratic tool for making business loans which are perceived to be somewhat riskier than conventional bank loans, in a manner consistent with standard safety and soundness regulations.

Forty-five banks in Michigan are currently using the Capital Access Program. Another forty-one have recently signed up. After two and a half years of operation, the program has a portfolio of approximately 450 guaranteed loans with a total volume of around $27 million. At the present time, each dollar of the guarantee fund is leveraging about $18.75 in new business financing from private sources. Until mid-1989, the program was administered by a single individual in the MSF. All recurrent administrative costs are now more than adequately covered by the portion (50%) of the interest earned on the fund which reverts back to the MSF. In the past six months, several other states and the federal government have recently expressed an interest in establishing similar programs.

According to the banks currently participating in the Capital Access program, its primary use it is to meet shortfalls in collateral requirements. The program has been used to assist a wide range of business types and sizes, thus achieving the goal of broadening the base of each bank's portfolio. Moreover, approximately 20% of the loans guaranteed under the program have been for new business start-ups. The current average loan size is about $60,000 and the largest loan guaranteed to date has been $975,000.

The proposed Rural Credit Guarantee Program is intended to assist Costa Rican private banks in rapidly expanding their customer base away from the San José area in order to eventually create a rural loan portfolio large enough to justify the establishment of permanent branches and the introduction of other financial services. The program should also have a significant positive impact on the creation of job opportunities in rural areas and should improve the effectiveness of Costa Rica's economy by supporting the development of businesses in which Costa Rica has a strong comparative advantage but limited experience to date.

The proposed Rural Credit Guarantee Program is based on a portfolio insurance concept, which is fundamentally different from the more common type of loan insurance or guarantee program found in developing countries which normally guarantees a specific percentage of a loan on a loan-by-loan basis.

The program is intended to use a relatively small amount of AID funds to generate a large amount of private bank lending. It is anticipated that within five years the ratio of private to AID resources made possible by the program will be on the order of 25 to 1. This would of course depend on the availability of sufficient on-lending facilities from the Central Bank, such as FODEIN and AIR.

The key feature of the proposed program is its efficient, non-bureaucratic administration. With the exception of selecting the geographical location of the business to be financed, each participating bank would have sole responsibility for deciding who should qualify under the program and what the terms and conditions of the loan should be.

From the borrower's point of view, the most attractive feature of the program is that it provides access to financing that might not otherwise be available from a Costa Rican bank. Access to such financing is often a critical factor in deciding whether a new business venture can or should be attempted.

Ownership and Maintenance of the Reserve Fund

A central concept of the guarantee program is that although the Fund Manager owns the funds in each bank's earmarked reserve, these funds can be used solely to cover losses on loans made by the bank under the program. Legally, the Fund Manager would pledge all funds in the reserve to be available to pay claims on loans guaranteed under the program.

For the administrative convenience of both the Fund Manager and the bank, and to provide an extra benefit to the participating bank, the implementation plan should call for the Fund Manager to open an account at each participating bank, and deposit the monies for the bank's earmarked reserve directly in the bank. It is suggested that for each participating bank, an OPAB deposit account in the Fund Manager's name be established at the bank's published rate of interest. In this way each bank can still benefit from the use of the capital of its own reserve fund, half of which is supplied by AID, and can more easily keep track of its fund balance. At the same time, the reserve would earn the highest possible rate of interest without being locked into fixed term deposits.

Of the interest earned on the funds in each bank's earmarked reserve, 80% should be dedicated to growth and replacement of fund capital. The other 20% should be transferred to the Fund Manager to cover the day-to-day administrative costs of managing the fund.

However, it should be made clear in the original agreement between the Fund Manager and the bank that although the above procedure is consistent with the full intent of the program, and there are no plans to do otherwise, the Fund Manager is not <u>legally</u> bound to maintain the funds in a deposit account at the bank. In this way, the Fund Manager will always retain the right to close that deposit account and transfer the monies in the reserve elsewhere, should the bank not adhere to the terms of the original agreement.

This right on the part of the Fund Manager, however, would not change the legal status of the reserve, i.e. to be used solely to cover losses from loans that the bank guarantees under the program. Moreover, in the event that the Fund Manager does <u>not</u> deposit the funds in an account at the bank itself, the resolution establishing the Rural Credit Guarantee program should specify where the funds may be invested.

Although the Fund Manager will technically own the funds in the reserve, it is intended and expected that banks will develop a proprietary interest in the reserve. The reserve earmarked for a participating bank takes on the nature of an off balance sheet asset of the bank, which enables it to be more aggressive in its rural lending activities. The bank has full control over the amounts of payments going into the reserve and the reserve is reduced only when a bank suffers a loss on a loan made under the program. The program rewards good performance. If losses are limited, the reserve fund continues to grow, and the bank is able to broaden its portfolio of guaranteed loans even further. At the same time interest earnings on the reserve would continue to increase.

However, if at some point in the future the bank were to completely drop out of the program, the Fund Manager would ultimately be able to withdraw the funds from the reserve, once all the loans guaranteed under the program had been paid off.

A key provision in protecting the structural integrity of the program is that the participating bank can only gain access to the funds in their earmarked reserve to cover losses on loans guaranteed under the program. If a bank were able to ultimately withdraw funds from the reserve after dropping out of the program, this might encourage the bank to place conventionally bankable loans under the program, because the bank might reason that it will ultimately get the money back in any case. However, if the only way the bank can gain access to the funds in the reserve is to cover losses from its guaranteed loans, then the only way the bank can ultimately get access to the funds is to use it for its intended purpose - as a flexible tool to enable it to expand its market into rural areas by taking more risk than it could otherwise take.

The proposed program should contain a formula for addressing the situation in which a bank completely drops out of the program. If for a consecutive period, to be determined by AID and the Central Bank, the amount in the reserve fund continuously exceeds the outstanding balance of all of the bank's loans guaranteed under the program, the Fund Manager should be authorized to withdraw any such excess to bring the reserve down to an amount equal to 100% of the outstanding balance. As a practical matter, such an action would only take place if a bank stopped using the program altogether. If the bank again began making guaranteed loans during the specified period, the total outstanding balance would generally quickly exceed the reserve. The above formula provides the Fund Manager with the ability to withdraw funds from the reserves earmarked for individual banks that are no longer actively participating in the program, but to do so in a manner that in no way jeopardizes the guarantees that the reserve provides for any loans still outstanding.

Funding

It is suggested that AID initially allocate $5 million to the Rural Credit Guarantee Fund, to be used solely as matching funds for guarantees on rural loans. This amount should support an estimated $125 million in lending by participating banks.

Program Management

A computerized office, staffed by a single mid-level manager and a secretary, would be set up at the Fund Manager's headquarters to track each participating bank's activity under the program, enroll new participants, and process claims. The administrative costs of managing the program office would need to be subsidized initially. However, in time these costs could be covered out of the interest earned on each of the reserve accounts. It is estimated that 20% of the interest earned should be sufficient to cover these costs.

AID and Central Bank Commitment to the Program

In its Convention establishing the program and making the initial funding allocation, AID and the Central Bank should include a strong statement of their long-term intentions regarding the program. This resolution should specify: 1)that the program will be operated on a market driven basis, without limiting the aggregate amount of loans that can be made under the program, 2)that the resources of the Rural Credit Guarantee Fund should be more than enough to cover any forseeable loan volume under the program for a number of years into the future, and 3)that the commitment of $5 million is only an initial allocation, and that AID and the Central Bank will consider providing additional allocations at future times as needed to meet market demand. Thus a bank should be able to participate in the program with confidence that it will have an opportunity to build up a substantial portfolio of loans under the program, without fear that the program will run out of money.

The Mechanics of the Program: How It Would Work

The Signing Up Process

If a private Costa Rican bank chooses to participate in the program, it would sign a Letter of Agreement with the Fund Manager stipulating that it agrees to adhere to its terms and provisions.

A master form of the Letter of Agreement, to be entered into by the Fund Manager and each bank wishing to participate in the program, should be drawn up and agreed to by AID, the Central Bank, and the Fund Manager. Signing the Agreement would not compel a bank to make any loans under the program, but would spell out the official parameters that would apply if a bank does begin to make such loans, and the specific obligations of the Fund Manager and the bank under the program.

In its resolution approving the Agreement format and authorizing the Fund management staff to enter into such Agreements, the Board of Directors of the Fund Manager should state that "it is the policy of the Board that such Agreements should be entered into with any private banking institution, having its principal office located in Costa Rica, that wishes to enter into such Agreement and that has sufficient experience and capacity to participate in the program, and that such private banking institution should be deemed to have such experience and capacity in the absence of any credible evidence to the contrary."

The process for a bank to sign up to participate should be kept simple and routine. A half-page application form should provide information on the status of a banking institution's year-end commercial and industrial loans outstanding for each of the last three years. Absent any strong evidence that a private Costa Rican banking institution lacks the experience and/or capacity to participate in the program, the staff of the Fund Manager could sign up lenders that wish to participate simply by entering into the Agreement with them.

The Rural Credit Guarantee Program is intended to be structured in such a way as to give banks the maximum possible freedom to make intelligent private sector lending decisions. Structural incentives are built in to promote the goals of the program. However, AID and the Central Bank will still be relying on the participating banks to act responsibly. The program can be kept administratively simple and effective if the participating banks seek to follow the spirit and intent of the program rather than merely adhere to the specific legal terms of the Letter of Agreement.

In order to safeguard the nonbureaucratic nature of the program and to avoid any abuse in its implementation, the Fund Manager should retain, in its legal agreement with each participating bank, the absolute right to prevent a bank at any time from making new loans under the program. Loans already made under the program would still be covered until paid in full, but future participation could be brought to a halt. Since it should be AID and the Central Bank's objective to have as many private banks as possible use the program successfully, the intention would be to enforce this provision against a particular bank only if the bank had exhibited a clear pattern of abuse of the program. It would be hoped that this authority would never have to be used.

Once the Agreement is signed, a special reserve fund would then be set up to cover future losses from a portfolio of rural loans that the bank would make under the program. The special reserve would technically be owned and controlled by the Fund

Manager, but it would be earmarked in the individual bank's name. Each bank could withdraw funds from its earmarked reserve, but only for the purpose of covering losses on loans made under the program.

Each time the bank makes a loan under the program, the borrower would make a premium payment above and beyond the usual interest and fees. The bank would then match the borrower's payment, and then the Fund Manager would match the combined total of the two, drawing from the guarantee funds provided by AID. The bank would, of course, always have the option of passing on its portion of the contribution to the borrower, either in the form of a higher interest rate, additional fees, or some combination thereof. The guarantee fees could also be financed as part of the loan.

The actual size of payments made into the reserve at the time of making any loan would be determined by the bank, within certain parameters negotiated between AID, the Central Bank, and the Fund Manager. For example, a borrower might be asked to pay a minimum amount equal to 1% of the loan amount. The bank would match that with another 1%, and then the Fund Manager would contribute 2%, for a total of 4%. At the maximum level, the borrower might be required to contribute 3%, the bank another 3%, and the Fund Manager 6%, for a total of 12%. The actual parameters for the Costa Rican program will have to depend on what the market will bear and what the banking industry feels are the additional loan loss requirements needed for this kind of higher risk rural lending.

Using this scenario, for any loan made under the program, an amount equal to anywhere from 4% to 12% of the loan amount would be paid into the bank's earmarked reserve. Thus, after a bank has developed a sizeable portfolio of loans under the program, it might have a reserve equal to, say, 10% of the total amount of that portfolio. The bank could then tolerate a loss rate of up to 10% on its entire rural loan portfolio and still be <u>completely</u> covered against loss. The <u>full amount</u> in the bank's total reserve would be available as needed to cover any loss from any of the loans guaranteed under the program. And if the loans are paid off without loss, then the guarantee funds associated with those loans would accumulate in the reserve, allowing the bank to increase over time the total volume of rural loans which could be covered by the program.

The earmarked reserve would enable each participating bank to be more aggressive in making loans and expanding its market into the secondary cities and rural areas of Costa Rica. However, if a bank's loss rate were to exceed the coverage provided by the reserve, the bank would still be at risk for that excess loss. Thus, there would always be a clear incentive for the bank to be conscientious in its loan appraisal process.

Nevertheless, since the reserve would allow a bank to sustain a substantially higher loan loss rate than before, the program would enable a bank to make loans to companies which might have fallen short of qualifying under conventional terms. For example, such loans might be made to companies with solid management, good market potential, and a satisfactory debt/equity ratio, but who lack sufficient collateral or credit history.

Initial Incentives for Banks to Participate

In the early stages of its participation in the program, before a substantial reserve has been built up, most banks will understandably have a tendency to be rather cautious, as the early experience in Michigan has shown. As its reserve begins to build up, and as the bank gains more experience under the program, the bank will most likely evolve to a more aggressive posture, gradually expanding its lending to smaller and more risky borrowers.

However, if a bank is so unfortunate as to encounter difficulties with one of its early guaranteed loans, it will still be likely that some time will pass before the loan actually defaults. By that time the bank will hopefully have a large enough portfolio of loans to have built up an adequate reserve. Nevertheless, there is always some extra risk attached to these early loans made before a substantial reserve has been built up.

The Michigan Capital Access program includes two special features to address this extra risk during the early stages of the program. The first provides that the Fund Manager will contribute a greater portion to the reserve for the first $2 million of loans guaranteed under the program by any one bank. Rather than simply matching 100% of the combined total of the borrower and the bank, the Fund Manager would instead contribute an amount equal to 150% of the combined total. Thus, in the minimum fee case, the borrower would contribute 1%, the bank 1%, and the Fund Manager 3%, for a total of 5%. In the maximum fee case, the borrower could contribute 3%, the bank 3%, and the Fund Manager 9%, for a total of 15%. This first special feature is designed to help build a bank's reserve more rapidly, and to give the bank an extra incentive to initiate the program.

The second special feature applies to the first $5 million in loans that a bank insures under the program. Suppose a bank takes a loss on an early loan which exceeds the total amount of the reserve. This feature allows the bank to withdraw the total amount of the reserve to cover the loss as much as possible. And then, as it continues to make loans under the program and builds up its reserve, the bank could withdraw the balance of the earlier loss from the reserve at a later date. The only limitation would be that the bank could not deplete more than 75% of the total reserve at any one time.

In this manner, the bank would have the benefit of the portfolio insurance effect, even in the very early stages of its participation in the program. If, in the long run, its losses under the program are kept to a reasonable level, it will be fully protected against loss, and it will not unnecessarily suffer from any unfortunate early losses.

Administrative Ease and Flexibility: Keys To The Program

Because the participating bank would still share the risk on the loan, there will be no need for a separate loan review process to be carried out by the Fund Manager, as is often required in other credit guarantee programs. The reserve would be there for the bank to protect and use as an additional provision for bad debt. The bank would be required to file a simple one-page loan guarantee form with the Fund Manager within 10 days after the loan is made. The enrollment process for loans under the program would essentially be automatic. There would be no delay in qualifying the loan, and a minimum of paperwork to process.

Each participating bank would be totally free to determine how it wants to use the program, as long as the loans are made in one of the geographical areas specified by AID and the Central Bank, and meet the terms and conditions set down in the Letter of Agreement (See Eligible Loans and Borrowers below). The bank would still be able to set its own criteria for determining whether to make the loan, what types of loans to make, and what interest rate and fees to charge, and what maturity, collateral requirements (if any), and other conditions to place on the loan. In this way the market would continue to determine the allocation of resources, and intelligent private sector decision making would be unhindered.

The program would also give the participating banks the option of covering an amount which is less than the full amount of the loan. This would provide further flexibility, since a bank might feel that only a portion of the loan is actually at risk and therefore only that portion need be guaranteed. Borrower and bank contributions to the reserve could then be lowered, and the cost of qualifying for the loan could be kept to a minimum. In such a scenario, the bank might determine that it can easily recover $50,000 out of a $150,000 loan. Therefore, it would only enroll $100,000 of the loan for inclusion under the program. The funds in the reserve could then be used to cover only the first $100,000 in principal lost on the loan, plus any accrued interest and documented out of pocket expenses.

Another key element of the program's built-in flexibility is that it would allow the bank to restructure or refinance the loan as it sees fit, without having to obtain approval from the Fund Manager. The bank could extend the term of the loan, change the amortization schedule, or add funds as it wishes. Only if the total amount of the refinanced loan exceeded the amount previously enrolled under the program would any additional borrower and bank payments have to be made into the reserve, and only if the bank wished to cover the additional amount.

A similar approach could be used for lines of credit. In enrolling a line of credit in the program, the amount of the loan to be covered by the guarantee would be the maximum amount that could be drawn down against the line of credit. Banks could then use their normal procedures, including informal arrangements as applicable, in establishing and permitting access to a line of credit. The line of credit could then be renewed each year, staying covered under the program, without new premium payments being required, unless the bank increased the total amount to be covered under the program.

The collection and claims process should also designed to work in an easy, uncomplicated way. The bank would simply follow its normal internal procedures for determining when and how much to charge off on a loan. At the same time a bank charges off all or part of a guaranteed loan, the bank would file a simple claim form with the Fund Manager, and payment would be made immediately. Unless a clear pattern of abuse was evident, the Fund Manager would not challenge the bank's decision to charge off the loan.

Because of the borrower and bank payments into the reserve, a loan made under the Rural Credit Guarantee Program will most likely be somewhat more expensive than a conventional bank loan. The premium payments for the guarantee would normally be one-time, up-front payments. However, the additional costs of the

Business Purpose

The proceeds of the loan should be used for an endeavor related to an agricultural, industrial, commercial or service enterprise, or any combination thereof, within the underserved rural areas of Costa Rica as specified by AID and the Central Bank. Generally, therefore, the program would be geared to businesses established in those areas. In the case of a loan to a Central Valley-based company with other business activities, the determining factor would be whether the primary economic impact of the endeavor financed by the proceeds of the loan would be within the geographical target area.

Exclusion of Retail

AID and the Central Bank should specify that the Rural Credit Guarantee program is not intended to assist the financing of a project involved in the sale of goods at retail. Hence, a purely retail business would not be financed under the program. It is important to emphasize, however, that a business providing services to consumers (as opposed to selling goods) would be eligible for a guaranteed loan. To illustrate, although a clothing store would be ineligible because it involves the sale of goods at retail, a dry cleaning shop would be eligible as a service business. Also eligible would be manufacturing, wholesale trade, construction, mining, agriculture, forestry, fishing, tourism, etc.

In general, the prohibition against providing financial assistance to retail operations should be interpreted literally and narrowly. For example, a loan to a developer to remodel a shopping arcade would not be considered a loan for a retail business, since the borrower is actually engaging in a construction activity rather than a retail business.

If a borrower is engaged in selling goods at retail as well as other eligible activities (e.g. service or manufacturing), the bank should be able to make a loan to the company under the program as long as the financing is not used for the retail end of the operation. An example would be a shoe manufacturing business which also operates a retail outlet. The loan could be used to purchase new equipment to expand the manufacturing side of the business but not, for example, improving the fixtures in the retail store.

guarantee could be financed. The longer the term of the financing, the smaller would be the increase in the borrower's effective interest rate. Still, the transaction will be a bit more expensive than a conventional loan. Therefore, borrowers who can obtain conventional bank financing to meet their needs would possibly do so. The competition among private banks would normally direct such borrowers towards conventional loan programs, saving the guarantee program for riskier clients. From the perspective of rural borrowers, the raison d'etre of the Rural Credit Guarantee Program is that it would provide access to financing for those companies which might otherwise not be able to obtain bank financing to meet their needs. Moreover, financial assistance under the program is still likely to be much less expensive for a company than alternative non-bank sources of financing, such as the "financieras."

Prospective borrowers using the guarantee program should remember that the loan is a private transaction between the bank and the borrower. While the program may assist a bank in being able to take more risk than normal, it is still the bank that is bearing the bulk of the risk of the loan, and is therefore responsible for the decision making.

Eligible Loans and Borrowers

Eligibility should be as broadbased as possible so as to maximize the impact on Costa Rica's rural economy and to avoid second guessing private market decisions. The borrower could be a corporation, partnership, joint venture, sole proprietorship, cooperative or other entity, whether for profit or nonprofit, which is authorized to conduct business in Costa Rica.

Once again the idea is to keep the program flexible so that each bank can use it in the manner which best suits its needs and those of its customers. Keeping the program broadbased will also assist banks in quickly building up a large rural business portfolio to take maximum advantage of the portfolio insurance effect, making the program more attractive and effective, and helping to create the customer base needed to make the opening of rural branches profitable for private banks. Moreover, the high degree of leveraging of AID resources and the general absence of minimum and maximum loan size limitations will give the banks the flexibility to serve an expanding segment of the market.

There are, however, a few restrictions which should be mandated by statute to protect the basic integrity and purpose of the program. These restrictions are described below.

Furthermore, if a participating bank provides a loan to a company, a part of which is to be used for retail operations and part for non-retail, only that portion of the loan to be used for the non-retail operation could be covered under the program.

Exclusion of Housing

The Rural Credit Guarantee Fund should not be used for the construction or purchase of residential housing. However, loans to motels, hotels, or other temporary lodging for tourism or business travelers or for their construction would be eligible.

Exclusion of Passive Real Estate Ownership

Loans under the Rural Credit Guarantee program should not be used to finance passive real estate ownership, i.e. the purchase of land or buildings simply as an investment, without developing the real estate for a business operation.

It should be made clear that the program <u>can</u> be utilized for real estate financing if the land or buildings are intended to be used in the business operations of a company or if they are purchased by a developer with the intention of constructing or renovating a building. However, in the case of such a loan to a developer, the loan under the program should be scheduled to cover the period through the construction or renovation phase.

Exclusion of Refinancing of Existing Debt

Obviously, a bank should not be allowed to take an existing rural loan and simply refinance it under the guarantee program. However, if a bank refinances an existing loan and adds new money by increasing the outstanding balance, it should be possible to cover the amount of the new money under the program. If an existing loan, not under the program, has an outstanding balance of $100,000, and the loan is refinanced with a new balance of $150,000, the refinanced loan could then be included in the guarantee program, but the amount guaranteed could not exceed $50,000.

Avoiding Conflicts of Interest

AID and the Central Bank should naturally specify that participating banks are not allowed to use the program for loans to an executive officer, director or principal shareholder of the bank, any member of their immediate families or to a company controlled by any of these people.

Loan Size

There should be no fixed borrower size requirements or minimum or maximum loan sizes. The structure of the program should tend to channel financial assistance to medium to large-sized, locally-owned companies, rather than to the larger Costa Rican firms who normally have little trouble obtaining conventional credit in San José. As each bank's loss reserve and portfolio of guaranteed loans grows, it is anticipated that smaller and smaller companies will become eligible, thus making it easier for businesses to advance from participation in the medium-scale component of the proposed rural credit program to the larger-scale component.

A maximum should be set, however, on the amount paid by the Fund Manager into a bank's earmarked reserve in connection with any single borrower during any three year period, unless the Fund Manager has approved, in writing, a greater payment. It is suggested that this limit be set at the equivalent of $75,000. With the Fund Manager making payments of between 2% and 6% of the loan amount, a $75,000 maximum contribution would support a loan of anywhere from $1.25 million to $3.75 million. Given the likely size of loans needed in rural Costa Rica, it is doubtful that this maximum will have to be exceeded. Providing for advance authorization to exceed the $75,000 limit will assist the Fund Manager in monitoring the sufficiency of its own allocated funds.

Collection and Claims

The process for collecting on claims made by a bank participating in the guarantee program is intended to be as easy and nonbureaucratic as that for enrolling loans. The Fund Manager should simply rely on the banks to exercise the same care and due diligence as they do in their regular collection activities. If a guaranteed loan gets into trouble, the bank is free to determine when and how much to charge off on the loan using the bank's normal method for making such determinations on a conventional business loan. The bank would file a claim with the Fund Manager at the time it charges off all or part of a guaranteed loan. The bank would be allowed to include in the claim the full amount of principal charged off, plus accrued interest, plus out of pocket expenses. If the amount of the loan covered under the program is less than the amount of principal charged off, then the amount of principal and accrued interest included in the claim should not exceed the principal amount covered under the program, plus the accrued interest attributable to such covered principal amount.

The claim form submitted by the bank to the Fund Manager need not be longer than a single page. Processing and payment should take no more than five work days. The Fund Manager should not second-guess the validity of a bank's claims. The success of the program depends on avoiding any delay in meeting the bank's request for reimbursement of losses quickly and routinely. Timely claims processing has been a major factor in the success or failure of other credit guarantee schemes throughout the developing world.

Certain precautions are built into the program to avoid abuse by the participating banks and to give the Fund Manager the ability to take remedial action. The program should be structured so that whenever a bank makes a loan under the program, the bank automatically makes a small number of representations and warranties to the Fund Manager that the loan is in compliance with program requirements. These assurances should be stated on the reverse side of the filing form for each guaranteed loan. If the bank later suffers a loss on the loan and correctly files the claim form, the only grounds for denial of the claim would be if the representations and warranties made by the bank at the original time of the enrollment of the loan were known by the bank to be false at that time.

The claims process should permit a bank to recover its loss at the time it recognizes the loss, before having to exercise its collateral rights or other legal remedies in connection with the loan. However, the bank should still be expected to continue to exercise its collateral or other rights in the same manner it would for a conventional bank loan. If the bank eventually recovers part of its loss through its normal foreclosure process, resulting ultimately in a loss of less than the amount for reimbursed from the earmarked reserve, the bank should be obliged to put the relevant amount of the recovery, less documented out of pocket expenses, back into its earmarked reserve. This would be similar to the process that a bank would normally follow in returning recoveries on conventional loans to its internal loan loss reserve.

The guarantee program should allow the bank to be fully responsible for collection activities. Normally, the Fund Manager would simply process and pay the claims. However, as a safeguard against what one would hope would be an extremely unusual situation where a bank fails to practice reasonable care and diligence in its collection activities, the Fund Manager should reserve for itself - in limited circumstances and as a last resort - the right to be subrogated to the collection rights of the bank. Such a subrogation would apply to any collateral, security or other right of recovery, in connection with a guaranteed loan, which has not been exercised by the bank. This provision would take effect only after the bank has filed a claim and has had its loss fully recovered. It is hoped that the Fund Manager would never have to exercise this right, but it still would be prudent for such a right to be established as a precaution.

X. Increased Rural Savings Mobilization

Greater domestic savings are necessary to foster investment and future development of the rural areas of Costa Rica. Any effort to increase savings, however, has to be part of a coherent and consistent set of macroeconomic policies that will provide a framework for sustained economic growth.

As part of its policy dialogue with the GOCR, AID must continue to press for a clearcut commitment to eventually bring inflation down and keep it down, ideally below 5%. To achieve this the government must be committed to balance its budget and bring growth in the money supply more in line with the average annual growth in GDP.

Without such a commitment on the part of the political leadership, it will be next to impossible to engender the confidence needed to encourage individuals and businesses to procure long-term savings instruments. And, as long as the preferred savings vehicle is the six-month certificate of deposit, lending in Costa Rica will understandably remain short-term and commercially oriented.

There are a number of basic requirements which any rural savings program must provide, if it is to be successful. These include:

1. Attractive real positive interest rates. Most borrowers want a return on their savings of at least 3-5% above the inflation rate. Otherwise, the tendency is to spend the surplus on consumer durables or other illiquid assets, such as business inventory.

2. Savers must have confidence in the management and financial solvency of the depository institution.

3. Reciprocity. Potential borrowers should be required to save at the same institution where they obtain credit. This helps to establish a stable client base and a predictable average level of deposits.

4. Low transactions costs. Intermediaries should establish quick and easy deposit and withdrawal procedures not requiring a lot of time and inconvenience for the saver. Banking hours should be scheduled to suit the free time of savers. An adequate branching network and the use of modern, computerized technology also greatly reduce the time a saver must devote to savings transactions.

5. A service attitude on the part of staff. Savers, big and small, want to feel the respect they deserve for providing the institution with the bulk of its capital. Quick, courteous, efficient service is a non-tangible asset highly valued by customers. It is also an indication of dynamic, competent management and it increases client confidence in the institution. Unfortunately, this point is rarely stressed in Costa Rica unless the business environment is very competitive.

6. An absence of regulatory constraints. A competitive market for financial services is critical for offering savers the highest possible return on their investment and the lowest transactions costs. Artificial limitations on a saver's choice of depository institutions reduces efficiencies, dampens interest rates, and encourages poor service and higher transactions costs.

In order to enhance rural savings in Costa Rica, the study team recommends that AID organize training seminars, with the assistance of INCAE, Coocique, and Coopenaranjo, for state bank headquarters and branch managers and the leadership of smaller credit unions in order to promote the following innovations:

1. <u>Greater local automony and responsibility</u> for individual state bank branch managers. Allow managers the freedom to set interest rates on savings in response to local market forces rather than directives from the main office where the understanding of the local business environment is likely to be limited.

   Assist the state banks with the introduction of a cost accounting system which treats each branch as a profit center and holds local management responsible for the health of the branch's loan portfolio and its corresponding level of deposits.

   If they are ever to become financially viable, the state banks will have to treat their branches as individual profit centers and hold their local branch managers responsible for their financial health. With responsibility must go authority, so the state banks must be willing to decentralize decision-making to the local level, allowing branch managers to set interest rates on both savings and loans and to innovate in response to the local market and the actions of competing institutions.

   To be truly effective, state bank branches should be ranked according to performance. Branches which are perennial losers should be examined. If remedial action cannot turn the operation around, the branch should be shut down and the staff transferred elsewhere. The state banks should institute a system of financial and status incentives to reward managers and employees who improve the performance of individual branches. Individual loan officers should be paid bonuses based on the total on-time repayment rate as well as the growth in earnings on their loan portfolio.

2. <u>Higher interest rates on passbook savings accounts at rural bank branches and credit unions</u> to encourage the transfer of more assets from inventories and consumer goods to formal savings instruments where they can be invested in more profitable enterprises.

3. <u>Long-term retirement and higher education savings</u>, funds with a guarantee of 5% above the official inflation rate. Such instruments appear to be one of the only means currently available to generate medium-to-long term domestic savings which can in turn be lent for similar periods. Given the current volatile economic environment vis-a-vis inflation in Costa Rica, a guarantee of an assured margin of real return on investment over time would greatly enhance the attractiveness of this form of savings instrument.

4. <u>Short-term money market funds</u> invested in the securities market through rural credit unions which have computerized account management systems and access to electronic funds transfer technology either on their own or through a local branch of one of the state banks. This would allow local companies an alternative to placing large sums of money in non-interest bearing demand deposit accounts.

5. <u>Children's savings programs</u> similar to those of Banco de Costa Rica and Coocique should be encouraged in those institutions which do not yet have them. Such programs are critical to the development of a savings mentality among the next generation and are a key vehicle for developing future borrowers of the institution. Interest rates for such programs should also be pegged to inflation to assure a real return to young savers.

6. <u>Reduced transactions costs through</u>:

   A. Computer technology to facilitate processing of accounts and interest calculations.

   B. Automated teller machines(ATM's) where justified by volume to assure 24 hour access to funds. The ATM is a great innovation to reduce bank and customer transaction costs. Customers have access to the ATM 24 hours a day, which usually allows them to avoid long lines inside the bank. It also allows customers the security of limiting the amount of cash they carry, retaining the surplus in the institution where it can continue to earn revenue for the bank and interest for the customer. ATMs cost about ¢3 million ($36,000) each. They are not cheap. But in major centers where financial institutions have a large customer base, they make good economic sense.

   C. Special windows within branches for passbook savers and specialized savings programs such as children, higher education, or retirement savings.

   D. Longer banking hours and weekend business hours.

XI. Increasing Other Financial Services

Increasing the availability of financial services other than savings and lending programs will depend greatly on increasing the level of demand for such services in the secondary cities and rural towns of Costa Rica and on establishing permanent operations of the private banks in these areas. The Rural Business Development Program and the Rural Credit Guarantee program would go a long way towards addressing these two issues.

If AID agrees to offset some of the rural business development costs of the private banks to encourage them to develop a larger borrower base in these areas, it is certain that the banks will use the same opportunity to test the market with some of their other products. The depth of demand for these other services in rural areas is still in question. The anticipated expansion in the economic base resulting from the proposed lending programs will help augment the market for other banking services.

AID should encourage the private banks to utilize the funding from the Rural Business Development Program to continue to pursue the discussions of joint venture activities with established credit unions in the secondary cities of Costa Rica. One or two banks have already established such links on a very limited basis. Offsetting the up-front marketing costs should allow more banks to pursue such possibilities much more aggressively.

XII. Other Recommendations

1. A national credit rating system for borrowers needs to be established in Costa Rica, preferrably as a private sector business operating on a fee-for-service basis. Such systems already exist to some degree in individual public and private sector banks, but apparently there is no ready vehicle for crosschecking the creditworthiness of borrowers and their current financial status with other institutions. It is still quite possible for a borrower to obtain a loan for the same purpose from two different institutions. An easy way to initiate such a system would be to begin with the borrowers participating in the Rural Credit Guarantee program. Once the participating banks saw the value of a central exchange of credit information on their clients, they could be more easily encouraged to register all of their borrowers in the system.

2. The same kind of rating system should eventually be established to banks and SOIs, so that borrowers and savers are assured of the financial health of the institution with whom they are doing business. This accrediting function could be carried out by the Auditoria. The Central Bank could then limit credit ceilings based on this performance indicator.

3. All financial institutions should be compelled to contract for an independent external audit every year and to make the results of the audit public.

4. The financial functions of co-operatives should be separated from other services. Agricultural cooperatives should not be allowed to use member savings for working capital, but should learn to generate sufficient internal reserves.

5. There should be action to help resolve the structural access problem presented by the BCCR regulation which prohibits discount loans to any Costa Rican bank in amounts in excess of 50% of the banks "net realizable assets." This currently brings FODEIN lending (long-term project funds) into direct competition with FOPEX (short-term financing for exporters) loans which are less risky and more profitable for the banks.

6. With increased computerization in Costa Rica, it should be feasible to set up local business development centers (BDCs) in the secondary cities, tied into a central information clearinghouse by modem. Likely participants would be local Chambers of Commerce or FUNDES. BDCs would assist investors, on a fee basis, in setting up new businesses, obtaining licenses, and identifying locally available technical assistance, local and export markets, intermediate buyers of finished product, and sources of financing.

7. The state banks should be encouraged to increase availability of overdraft facilities for major retailers and other commercial businesses who own their premises and have a high turnover of inventory.

XIII. Cost Projections for Proposed Programs

The implementation of the four experimental credit programs recommended by the study team will require AID financial assistance totalling $7,141,128 over the four year life of the Financial Services Outreach Project, in addition to the project technical assistance costs already budgeted by AID/Costa Rica in the Project Identification Document. The bulk of this sum would be in the form of guarantee funds, $5,000,000 for the Rural Credit Guarantee fund and $500,000 to increase the existing FUNDES guarantee fund. Another $300,000 of this total would be in the form of a six-year loan to AVANCE to be used as credit funds for its experimental operation in Guàpiles.

It is assumed in these calculations that the AID contractor hired to implement other aspects of the Financial Services Outreach Project would be able to manage, monitor, and evaluate these experimental programs as well, as part of their overall technical assistance functions.

The funding to be allocated for the four credit programs described earlier in the report, i.e. those specifically targeting small, medium and larger rural enterprises in Costa Rica, can be broken down as follows:

Small-scale Enterprise Component:	U.S.$446,600	
Observational Travel:		$24,400
In-country Training:		$14,200
Starp-up Investment & Working Capital Requirements:		$408,000
Medium-scale Enterprise Component:	$731,040	
Initial Business Development:		$21,340
Start-up Operating Costs:		209,700
Increase in FUNDES Guarantee Fund:		500,000
Large-scale Enterprise Component:	$5,963,488	
Business Development Program:		835,000
Rural Credit Guarantee Program:		5,128,488

Basis for Cost Estimates

The above figures are based on the following general cost estimates for the resources required to implement each component of the rural credit program.

Rural Small-scale Enterprise Credit Component

The development costs of initiating the proposed SSE credit component will be limited to those associated with observational travel and in-country training for key SSE credit program mamangement personnel from Coopenaranjo, Coocique and Banco de Costa Rica, start-up investment and working capital for all four institutions participating in the experimental program (those mentioned above plus AVANCE), and a credit fund for AVANCE. The other three institutions should be able to mobilize sufficient short-term deposits for the lending capital of their SSE programs.

The program costs which AID should support for the three existing institutions -Coopenaranjo, Coocique, and Banco de Costa Rica/San Isidro- would come to:

-Observational Travel (2 Staff x 3 Institutions)	U.S. $24,400		
6 RT Airfares to Mexico and Dominican Republic: 6x1,000		=	$6,000
Per Diem: 6 x 14 days x $100/day		=	8,400
Local Transportation:		=	2,000
Preparatory Costs for ADMIC and ADEMI:		=	8,000
-In-country Training	$14,200		
Training Workshops at AVANCE: (3 staff from each insitution) Total of 20 days of Training			
Training Fees:		=	5,000
Training Materials:		=	2,000
Per Diem: 6 x 30 days x $40/day		=	7,200
Subtotal: Training Costs			$14,200

-Start-up Investment and Working Capital Requirements: (See Financial Analysis: Annex A)				$408,000

<u>Coopenaranjo, Coocique, Banco de Costa Rica:</u>

Investment Capital: (Motorcycles, equipment, furniture)	3 x $18,000	=	54,000
Initial Working Capital:	3 x 12,000	=	36,000

<u>AVANCE Experiment</u>:

Investment Capital:	6,000
Initial Working Capital:	12,000
Credit Fund: (Repaid after 6 years)	300,000
	$318,000

<u>Rural Medium-scale Enterprise Credit Component</u>

The start-up costs of the medium-scale credit component will initially be limited to the additional travel costs associated with plancing two FUNDES credit analysts in two of the target areas on a temporary basis (three days a week) for six months. Based upon the success of this initial work, AID should be prepared to support the costs of establishing permanent FUNDES field offices in two locations, including the financing of their initial working capital needs and an increase in the size of their credit guarantee fund to cover a larger portfolio of borrowers from rural areas.

It can be estimated that each field office would eventually require two full-time credit analysts, a business management trainer, a secretary, and a messenger. Each office would also need a desktop computer, a photocopier, two telephone lines, and two motorcycles.

-Initial Travel and Lodging Costs for Business Development: (2 credit analysts) $21,340

Personnel Costs:	2 x $420/mo x 6 mo	=	5,040
Motorcycles:	2 x $1,250	=	2,500
O & M Costs:	2 x $200/mo x 6 mo	=	2,400
Per Diem:	2 x 80 days x $40/d	=	6,400
Misc. Admin Costs:		=	5,000

-Start-up Investment and Working Capital Costs for Two Offices: $209,700

Investment

Furniture.	2 x $4,000	=	8,000
Office Equipment:	2 x $12,000	=	24,000
Additional Motorcycles:	2 x $1,250	=	2,500
			$34,500

Working Capital

Personnel Costs:

4 Credit Analysts	4 x $700/m x 24 m	=	67,200
2 Trainers	2 x $600/m x 24 m	=	28,800
2 Secretaries	2 x $400/m x 24 m	=	19,200
2 Messengers/ Office Boys	2 x $250/m x 24 m	=	12,000
Rent:	2 x $300/m x 24 m	=	14,400
O & M:	4 x $200/m x 24 m	=	19,200
General Admin:	2 x $300/m x 24 m	=	14,400
			$175,200

Subtotal: Start-up Investment and Working Capital Costs $209,700

-Increase in Guarantee fund: U.S. $500,000

-Total Costs: Medium-scale Component $709,700

Rural Large-scale Enterprise Credit Component

A. Rural Business Development Program

AID should be prepared to offset the rural business development costs of five private commercial banks for four years, up to a total outlay of $5,000 per month per bank in Year One. In each of the three subsequent years, AID should be willing to cover 85%, 60%, and 30% of these development costs, assuming that each participating bank will continue to invest $5,000/month in this activity.

Total cost for the Rural Business Development Program during the course of project life would come to approximately $820,000 based on the following projections:

Year 1:	5 Banks x $5,000/month x 12 months =	$300,000
Year 2:	5 Banks x $4,250/month x 12 months =	255,000
Year 3:	5 Banks x $3,000/month x 12 months =	180,000
Year 4:	5 Banks x $1,500/month x 12 months =	90,000
	Total Cost of Rural Business Development Program:	$825,000

B. Rural Credit Guarantee Program

Based on the experience of the Michigan Strategic Fund Capital Access Program, the proposed Rural Credit Guarantee Program should not be expensive to set up and administer. The Fund itself will require a permanent grant from AID of $5 million. Three two week visits to Costa Rica by the manager of the Capital Access Program should be funded to assist in the guarantee program. AID should consider subsidizing the initial start-up costs and the operating costs of the program for Years One and Two, so as to allow enough time for the portfolio of guaranteed loans to reach a size large enough to generate sufficient interest to carry the running costs of the program.

1. Proposed Guarantee Fund: U.S. $5,000,000

2. Technical Assistance from MSF: $16,488

Fees:	30 days x $270/d	=	$8,100
Airfares:	3 RT airfares @ $1,200/trip	=	3,600
Per Diem:	42 days x $114/day	=	4,788

3. Start-up Costs (Year One only): $26,000

2 PCs and software:	=	$16,000
Promotional Costs (Advertising, Seminars, etc.):	=	10,000

4. Operating Costs: (Two years) $86,000

Program Manager:	2 yrs x $25,000	=	$50,000
Secretary:	2 yrs x $6,000	=	12,000
Office Expenses:	2 yrs x $12,000	=	$24,000

Total Cost of Rural Credit Guarantee Program: $5,128,488

Total Cost of Large-scale Rural Credit Program: $5,953,488

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ANNEXES

ANNEX A

Proposed Small-scale Enterprise Credit Program

Financial Analysis

During the research phase of the Costa Rica Rural Financial Markets Study, the study team surveyed 318 small rural businesses on their credit needs and also obtained detailed revenue and cost data from AVANCE pertaining to the establishment and operations of a trial rural small-scale enterprise credit program run out of an existing financial institution. From this information, the team was able to conduct an analysis of the financial feasibility of the program based on the following assumptions:

1. Initial capitalization required to obtain office furniture, office equipment and motorcycles for the credit agents and to offset working capital needs in the first several months of operation, would be ¢1,450,000 ($17,400).

2. Initial investment costs would come to ¢450,000 ($5,400) for two motorcycles and office requirements for two credit agents and a cashier. These costs would be increased in Months 13, 17 and 20 as additional credit agents are brought on board.

3. The maximum number of loans to be managed by a single credit agent is estimated to be 100.

4. For the sake of simplicity, all loans in the analysis are assumed to be working capital loans, the average loan term is estimated to be four months.

5. The number of new loans (new loans less dropouts) per month that a single office can be expected to process should climb over time as the staff gains more experience and as small businesspeople in the area become more familiar with the program and how it works. It is estimated that the office will only process an average of 10 loans the first two months and gradually increase over time until production levels off at about 30 per month in Month 17. At this rate, and with the addition of more credit agents as needed, the total number of loans in the portfolio by the end of Year Two is estimated at 500.

6. The average loan amount is expected to begin at ¢100,000 ($1,200) and increase at approximately 5% per month after the first few months, due to the high turnover of working capital loans and the regular 50% increases in loan amount on subsequent loans.

7. For illustrative purposes, cost of funds is estimated at 17%, the interest rate on passbook savings accounts at Coocique and Coopenaranjo. It should be noted that if interest is paid on a minimum quarterly balance basis, cost of funds will be somewhat lower.

8. Fixed and variable operating costs have been increased by 10% year to year to adjust for inflation.

9. Depreciation of vehicles and office furniture and equipment has been calculated over a 36 month period.

10. The settlement of bad debts has been calculated as occuring on loans which are more than two months overdue. Therefore, this expense has been calculated by multiplying the estimated default rate times the total amount of loans outstanding six months previously.

11. Staff incentives were calculated at 2% of net annual profits, paid as a bonus once a year.

12. Taxes were not included in the calculation of net profit because the local tax rates on credit unions, if any, were not known at the time of the analysis.

In conducting the analysis, the study team prepared a series of spreadsheet models which link projections in SSE credit portfolio growth over time to proforma income statements and balance sheets and a cash flow analysis. The entire computerized model can be manipulated simply by altering the assumptions listed in the upper left hand corner of the spreadsheet.

Since the portfolio growth projections are viewed as being conservative in all cases and the cost data is based on AVANCE's actual experience, the main variables in the assesment of best, worst and expected case scenarios are the effective interest rate that the institution will be able to charge for SSE working capital loans, and the estimated default rate.

<u>Expected Case Scenario</u>

In the expected case, an effective interest rate of 3.33% per month was utilized and the default rate was estimated at 3%. Both of these rates are based on AVANCE experience. Due to the size and greater stability of rural SSEs as opposed to AVANCE's typical urban client, the default rate might well turn out to be substantially lower.

Based on these estimations, the SSE program would be expected to cover all of its current operating costs, including depreciation and cost of funds, by Month 8, when total portfolio volume reaches just over ¢8 million ($96,000). Program cash flow drops as low as ¢252,118 ($3,000) in Month 7 which suggests that a modest but prudent increase in start-up capital might be warranted. The program would fail to turn a profit in its first year, but second year profits are estimated at a healthy ¢2,099,596 ($25,200). Recovery of the paid-in capital of ¢1,450,000 ($17,400) would require 16 months, but accumulated retained earnings by the end of Year Two should reach ¢1,472,123 ($17,700).

Because of the extremely low investment cost due to the prior existence of the intermediary's infrastructure and management systems and the subsidized technical assistance and training costs, return on investment after two years would be very high-averaging 50.7% per year. A more realistic indicator of the profitability of the SSe program would be return on assets, which at the end of Year Two comes to 1.35%. This is about half the current margin of private banks in Costa Rica on large commercial and industrial loans.

Best Case Scenario

For the Best Case Scenario, the team projected an effective interest rate of 5% per month, similar to what the local moneylenders are currently charging for short-term credit, and left the estimated default rate at 3% of the outstanding portfolio. All other variables remain unchanged.

With this higher level of earnings, the program would break even in Month 6 and return a profit of ¢1,130,269 ($13,600) in Year One. Net profit in Year Two would reach an impressive ¢15,126,308 ($181,700). Cash Flow would not be threatened, dropping to ¢440,417 ($5,300) in Month 5 and then increasing rapidly. Original paid-in capital would be replenished by Month 11. Return on assets would reach 11.7%, a very profitable return on a banking operation.

Testing for sensitivity, it was noted that at a 5% effective interest rate, the program could sustain a default rate of 5% of the total portfolio without risking decapitalization.

Worst Case Scenario

If the effective interest rate on SSE loans drops to 3% per month or lower, the default rate remains at 3%, and all other variables remain constant, the program will decapitalize within two years. The same holds true if the default rate reaches 4% and the effective interest rate remains at 3.33% per month. To sustain a 4% default rate will require an effective interest rate of at least 4% per month.

CONCLUSIONS

Given the past experience at AVANCE, the typical kinds of interest rates currently charged by moneylenders for short-term working capital credit, and the typical rate of return on working reasonably safe to assume that a new rural SSE credit program would be able to charge an interest rate from 3.33% to 4% per month with little difficulty.

The experience of AVANCE in Costa Rica indicates that maintaining a write-off rate of 3% or less for rural SSes is realistic, especially if the program is properly supervised and implemented and regular follow-up with clients is an integral part of the program.

Until the program is actually tested in the field, it will be impossible to know for sure exactly what kind of a return it will provide, if any. However, considering the low investment cost for AID and the potential in terms of economic growth away from the Central Valley of Costa Rica, the program should be tried on an experimental basis, and carefully monitored to determine if it does indeed live up to its projected potential.

FINANCIAL ANALYSIS

COSTA RICA RURAL SMALL-SCALE ENTERPRISE CREDIT PROGRAM
FINANCIAL ANALYSIS
EXPECTED CASE SCENARIO

All figures are in Costa Rican Colones

PROFORMA BALANCE SHEET	Pre-Project	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12
ASSETS:													
Fixed:													
Office Furn/Eqpt less Depreciation	0	250.000	243.056	236.111	229.167	222.222	215.278	208.333	201.389	194.444	187.500	180.556	173.611
Vehicles less Depreciation	0	200.000	194.444	188.889	183.333	177.778	172.222	166.667	161.111	155.556	150.000	144.444	138.889
Total Fixed Assets:	0	450.000	437.500	425.000	412.500	400.000	387.500	375.000	362.500	350.000	337.500	325.000	312.500
Current:													
Outstanding Loan Portfolio	0	0	0	1.000.000	2.000.000	3.500.000	5.000.000	6.325.000	8.320.000	11.576.250	14.586.075	17.367.942	21.441.530
Cash on Hand	1.450.000	944.500	.575.500	537.533	417.900	331.357	274.533	252.118	267.874	311.367	382.447	471.329	582.563
Accumulated Depreciation Account	0	0	12.500	25.000	37.500	50.000	62.500	75.000	87.500	100.000	112.500	125.000	137.500
Provisions for Bad Debt	0	0	0	20.000	40.000	70.000	100.000	136.500	176.400	231.525	261.722	297.359	323.331
Total Current Assets:	1.450.000	944.500	588.000	1.582.633	2.495.400	3.951.367	5.437.033	7.288.618	9.351.774	12.219.142	15.342.743	18.261.621	22.485.429
TOTAL ASSETS:	1.450.000	1.294.500	1.126.500	2.007.533	2.907.900	4.351.367	5.824.533	7.663.618	9.714.274	12.569.142	15.680.243	18.986.521	22.798.329
LIABILITIES AND EQUITY:													
Current Liabilities:													
Bad Debt Write-offs	0	0	0	20.000	40.000	70.000	100.000	136.500	176.400	231.525	261.722	297.359	323.331
Total Current Liabilities:	0	0	0	20.000	40.000	70.000	100.000	136.500	176.400	231.525	261.722	297.359	323.331
Long-Term Liabilities:													
Funds from Depositors	0	0	0	1.000.000	2.000.000	3.500.000	5.000.000	6.825.000	8.820.000	11.576.250	14.586.975	17.367.942	21.441.530
Total Long-Term Liabilities:	0	0	0	1.000.000	2.000.000	3.500.000	5.000.000	6.825.000	8.820.000	11.576.250	14.586.975	17.367.942	21.441.530
Total Liabilities:	0	0	0	1.020.000	2.040.000	3.570.000	5.100.000	6.961.500	8.996.400	11.807.775	14.847.797	18.165.301	21.765.361
EQUITY:													
RSSE Program Paid-In Capital	1.450.000	1.450.000	1.294.500	1.126.500	987.633	867.900	781.367	724.533	702.118	717.874	761.367	832.447	921.329
RSSE Program Accumulated Equity Growth	0	0	0	0	0	0	0	0	0	0	0	0	0
Monthly Retained Earnings or (Loss)	0	(155.500)	(168.000)	(138.367)	(119.733)	(86.333)	(57.333)	(22.415)	15.756	43.492	71.080	88.873	112.240
Total Equity:	1.450.000	1.294.500	1.126.500	987.633	867.900	781.367	724.533	702.118	717.874	761.367	832.447	921.329	1.033.568
TOTAL LIABILITIES AND EQUITY:	1.450.000	1.294.500	1.126.500	2.007.533	2.907.900	4.351.367	5.824.533	7.663.618	9.714.274	12.569.142	15.680.243	18.986.521	22.798.329

Month 13	Month 14	Month 15	Month 16	Month 17	Month 18	Month 19	Month 20	Month 21	Month 22	Month 23	Month 24	Year One Totals	Year Two Totals
3	3	3	3	4	4	4	5	5	5	5	5		
25	25	25	25	30	30	30	30	30	30	30	30	150	340
185	210	235	260	290	320	350	380	410	440	470	500	160	500
140.710	147.746	155.133	162.889	171.034	179.586	188.565	197.993	207.893	218.287	229.202	240.662	134.010	240.662
26,831.358	31.026.564	36.456.213	42.351.260	49.599.841	57.467.402	65.997.720	75.237,401	85.235.055	96.946.402	107.724.861	120.330.952	21.441.530	120.330.962
Month 13	Month 14	Month 15	Month 16	Month 17	Month 18	Month 19	Month 20	Month 21	Month 22	Month 23	Month 24	Year One Totals	Year Two Totals
866.844	1,033.185	1.212.992	1.410.297	1.651.675	1,913.665	2.197.724	2.505.405	2.835.361	3.198.348	3.587.238	4.007.821	3.084.139	26.423.754
25.000	25.000	25.000	25.000	30.000	30.000	30.000	30.000	30.000	30.000	30.000	30.000	150.000	340.000
891.844	1,058.185	1.237.992	1.435.297	1.681.675	1.943.665	2.227.724	2.535.405	2.865.361	3.228.348	3.617.238	4.037.821	3.234.139	26.763.754
16.500	16.500	16.500	16.500	16.500	16.500	16.500	16.500	16.500	16.500	16.500	16.500	180.000	198.000
110.000	110.000	110.000	110.000	135.000	135.000	135.000	150.000	150.000	150.000	150.000	160.000	880.000	1.645.000
55.000	55.000	55.000	55.000	67.500	67.500	67.500	80.000	80.000	80.000	80.000	80.000	450.000	822.500
5.500	5.600	5.600	5.600	8.000	8.000	8.000	11.000	11.000	11.000	11.000	11.000	48.000	107.000
368.778	439.543	516.463	599.976	702.664	814.122	934.958	1.065.963	1.207.511	1.356.658	1.526.102	1.704.589	1.312.071	11.241.337
556.878	627.543	704.563	785.976	930.454	1.041.922	1.162.768	1.333.363	1.475.011	1.628.158	1.793.602	1.972.189	2.890.071	14.014.837
0	0	0	0	0	0	0	0	0	0	0	37.771	0	37.771
4.400	4.840	5.324	5.856	6.442	7.086	7.795	8.574	9.432	10.375	11.412	12.554	45.009	94.091
26.400	26.400	26.400	26.400	35.200	35.200	35.200	44.000	44.000	44.000	44.000	44.000	192.000	431.200
6.600	6.600	6.600	6.600	8.800	8.800	8.800	11.000	11.000	11.000	11.000	11.000	48.000	107.800
8.333	8.333	8.333	8.333	9.722	9.722	9.722	11.111	10.918	10.725	10.532	10.340	76.389	116.127
8.611	8.611	8.611	8.611	11.667	11.512	11.358	14.722	14.568	14.414	14.259	14.105	51.111	141.049
204.750	264.600	347.290	437.582	535.838	643.246	780.941	938.797	1.093.686	1.270.538	1.407.995	1.724.022	345.000	9.721.483
259.094	319.384	402.556	493.303	607.869	725.557	852.816	1.020.205	1.183.504	1.361.052	1.579.199	1.853.791	770.500	10.649.521
815.972	947.027	1.107.119	1.281.459	1.538.334	1.757.480	2.016.584	2,353.568	2,658.615	2.989.210	3,372.002	3.825,980	3.560.571	24.564.158
75.872	111.157	131,873	153.838	143.341	186,176	211.141	181.838	205.746	239.130	244.436	211.841	(416.432)	2.099.596

COSTA RICA RURAL SMALL-SCALE ENTERPRISE CREDIT PROGRAM
FINANCIAL ANALYSIS
EXPECTED CASE SCENARIO

CASH FLOW ANALYSIS

All figures are in Costa Rican Colones

CASH FLOW ANALYSIS	Pre-Project	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12
CASH IN:	1.450.000	1.450.000	844.500	676.500	537.633	417.900	331.867	274.533	252.118	257.874	311.357	382.447	471.320
Interest Earnings on Loans	0	0	0	33.300	66.600	116.550	166.590	227.273	293.706	385.485	485.715	595.002	714.003
Initial Commitment Fees	0	0	0	10.000	10.000	15.000	15.000	15.000	15.000	20.000	20.000	20.000	20.000
Start-up & Investment Costs	0	450.000	0	0	0	0	0	0	0	0	0	0	0
Fixed Costs	0	131.500	131.500	145.667	159.833	181.083	202.333	228.188	256.450	295.497	338.135	384.629	425.255
Variable Costs less Depreciation	0	24.000	36.500	36.500	36.500	36.500	36.500	36.500	36.500	66.500	96.500	141.500	186.500
CASH OUT:	1.450.000	844.500	676.500	537.633	417.900	331.867	274.533	252.118	257.874	311.357	382.447	471.320	583.568

Month 13	Month 14	Month 15	Month 16	Month 17	Month 18	Month 19	Month 20	Month 21	Month 22	Month 23	Month 24	Year One Totals	Year Two Totals
215.278	206.944	198.611	190.278	230.556	220.833	211.111	250.000	239.982	228.356	217.824	207.485	172.611	207.485
240.278	231.567	222.956	214.444	312.778	301.265	289.907	385.185	370.517	356.204	341.944	327.840	138.989	327.840
455.556	438.511	421.567	404.722	543.333	522.099	501.019	635.185	609.500	584.560	559.769	535.324	312.500	535.324
26.331.358	31.026.554	36.456.213	42.351.260	49.599.341	57.467.402	65.997.720	75.237.401	85.236.055	96.046.482	107.724.861	120.330.352	21.441.530	120.330.352
499.440	519.597	742.479	896.308	879.549	1.065.025	1.275.966	1.298.304	1.508.549	1.747.687	1.992.123	2.283.154	583.560	2.283.154
154.444	171.389	198.333	205.278	225.557	247.981	258.981	284.815	329.301	345.440	370.231	394.576	127.500	394.576
379.527	415.781	464.524	499.730	554.415	613.318	576.708	722.387	773.924	827.243	883.959	918.524	323.831	918.524
27.055.379	32.224.332	37.851.541	43.952.504	51.260.572	59.394.439	68.229.375	77.554.325	87.538.230	98.356.352	110.371.175	123.847.425	22.406.429	123.847.426
27.511.425	32.662.943	38.273.208	44.357.306	51.803.395	59.916.538	68.721.394	78.190.812	88.448.529	99.551.412	111.530.943	124.382.750	22.798.329	124.382.759
379.527	415.781	464.524	499.739	554.415	613.319	676.708	723.997	773.924	827.243	883.359	918.524	323.831	918.524
379.527	415.701	464.524	499.725	554.415	613.318	576.708	723.857	773.924	827.243	883.959	918.524	323.831	918.524
26.331.358	31.926.554	36.456.213	42.351.260	49.599.341	57.467.402	65.997.720	75.237.401	85.236.855	96.946.482	107.724.851	120.330.352	21.441.539	120.330.952
26.331.352	31.026.564	36.456.213	42.351.250	49.599.341	57.467.402	65.397.729	75.227.401	85.236.855	96.946.402	107.724.861	120.330.352	21.441.530	120.320.952
25.401.985	31.442.346	36.329.737	42.350.998	50.154.255	58.380.712	66.574.428	75.961.290	86.909.380	96.873.725	108.508.529	121.249.586	21.765.361	121.249.586
1.032.568	1.109.440	1.229.597	1.352.470	1.450.900	1.450.900	1.450.900	1.450.900	1.450.900	1.450.000	1.459.900	1.459.900	921.329	1.450.900
0	0	0	0	56.303	199.649	385.325	596.966	778.904	980.549	1.227.687	1.472.123	9	1.472.123
75.372	111.157	131.873	153.330	143.341	186.176	211.141	181.530	209.746	239.130	244.436	211.041	112.240	211.941
1.109.440	1.229.597	1.352.478	1.506.360	1.649.549	1.835.925	2.046.966	2.225.804	2.430.545	2.677.587	2.922.123	3.133.154	1.933.560	3.133.164
27.511.425	32.662.943	38.273.208	44.357.306	51.803.905	59.915.538	68.721.394	78.190.812	88.448.529	99.551.412	111.530.943	124.382.750	22.798.929	124.382.750

OPERATING STATEMENTS

All figures are in Costa Rican Colones

Assumptions:
1) Effective Interest Rate on SSE Loans = .0333
2) Estimated Net Default Rate = .03 of loans 6 months old
3) Estimated Bad Debt Provisions Rate = .02 of outstanding portfolio
4) Avg Monthly Rate of Increase in Avg Loan Amt = .05
5) Annual Cost of Funds = .17
6) Annual Inflation Factor = .12
7) Average Loan Term = 4.00 months
8) Annual Staff Bonus - % of annual net profit = .02

PORTFOLIO GROWTH PROJECTIONS	Pre-Project	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12
NUMBER OF CREDIT AGENTS:	0	2	2	2	2	2	2	2	2	2	2	2	2
NET MONTHLY INCREASE IN NO. OF LOANS:	0	0	0	10	10	15	15	15	15	20	20	20	20
CUMULATIVE NUMBER OF LOANS:	0	0	0	10	20	35	50	65	80	100	120	140	160
AVERAGE LOAN AMOUNT:	0	0	0	100.000	100.000	100.000	100.000	105.000	110.250	115.763	121.551	127.628	134.010
TOTAL AMOUNT OF LOANS OUTSTANDING:	0	0	0	1.000.000	2.000.000	3.500.000	5.000.000	6.825.000	8.820.000	11.576.250	14.586.375	17.867,242	21.441.530

PROFORMA INCOME STATEMENT	Pre-Project	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12
INCOME:													
Interest on Outstanding Loans	0	0	0	33.300	66.600	116.550	166.500	227.273	293.706	385.489	485.716	595.202	714.003
Initial Commitment Fees	0	0	0	10.000	10.000	15.000	15.000	15.000	15.000	20.000	20.000	20.000	20.000
Total Income:	0	0	0	43.300	76.600	131.550	181.500	242.273	308.706	405.489	505.716	615.202	734.003
EXPENSES:													
Fixed:													
Rent	0	15.000	15.000	15.000	15.000	15.000	15.000	15.000	15.000	15.000	15.000	15.000	15.000
Salaries	0	75.000	75.000	75.000	75.000	75.000	75.000	75.000	75.000	75.000	75.000	75.000	75.000
Benefits	0	37.500	37.500	37.500	37.500	37.500	37.500	37.500	37.500	37.500	37.500	37.500	37.500
Insurance	0	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000
Interest Expense	0	0	0	14.167	28.333	49.583	70.833	96.688	124.950	163.997	206.636	253.129	303.755
Total Fixed Expenses:	0	131.500	131.500	145.667	159.833	181.083	202.333	228.188	256.450	295.497	338.136	384.629	435.255
Variable:													
Bonuses	0	0	0	0	0	0	0	0	0	0	0	0	0
Utilities	0	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000
Vehicle Expenses	0	16.000	16.000	16.000	16.000	16.000	16.000	16.000	16.000	16.000	16.000	16.000	16.000
General Administration	0	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000
Depreciation - Office Furn/Equipment	0	0	6.944	6.944	6.944	6.944	6.944	6.944	6.944	6.944	6.944	6.944	6.944
Depreciation - Vehicles	0	0	5.556	5.556	5.556	5.556	5.556	5.556	5.556	5.556	5.556	5.556	5.556
Settlement of Bad Debts	0	0	0	0	0	0	0	0	0	30.000	60.000	105.000	150.000
Total Variable Expenses:	0	24.000	36.500	36.500	36.500	36.500	36.500	36.500	36.500	66.500	96.500	141.500	186.500
TOTAL EXPENSES:	0	155.500	168.000	182.167	196.333	217.583	238.833	264.688	292.950	361.997	434.636	526.129	621.755
Net Income	0	(155.500)	(168.000)	(138.867)	(119.733)	(86.033)	(57.333)	(22.415)	15.756	43.492	71.080	89.073	112.248

115

Month 13	Month 14	Month 15	Month 16	Month 17	Month 18	Month 19	Month 20	Month 21	Month 22	Month 23	Month 24	Year One Totals	Year Two Totals
583.568	499.440	610.597	742.470	896.300	879.649	1.065.825	1,276.966	1.290.804	1.500.549	1.747.687	1.992.123	1.450.000	583.568
866.944	1.033.185	1.213.992	1.410.297	1.651.675	1.913.665	2.197.724	2.505.405	2,830.361	3.198.340	3.587.238	4.007.021	3.004.139	26.423.754
25.000	25.000	25.000	25.000	30.000	30.000	30.000	30.000	30.000	30.000	30.000	30.000	160.000	340.900
160.000	0	0	0	160.000	0	0	160.000	0	0	0	0	450.000	480.900
556.070	627.643	704.563	788.976	930.464	1.041.922	1.162.760	1.333.363	1.475.011	1.620.150	1.793.562	1.972.189	2.990.971	14.014.637
259.094	319.304	402.556	493.303	607.069	715.567	853.815	1.020.295	1.183.604	1.361.052	1.579.199	1.853.791	770.500	10.649.521
499.440	610.597	742.479	896.300	879.649	1.065.025	1.276.966	1.298.304	1.500.549	1.747.687	1.992.123	2.283.164	583.568	2.283.164

116