



CONCEPT PAPER
FOR
MICROENTERPRISE ASSISTANCE AND STRENGTHENING PROJECT
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ACRONYMS

APPLE	Anti-poverty Lending (Matching Fund Project)
ACCION	ACCION/AITEC
A.I.D.	Agency for International Development
ARIES	Assistance to Resource Institutions for Enterprise Support
ASOMICRO	Asociacion de Corporaciones de Desarrollo de la Microempresa
Autoempleo	Fundacion Autoempleo
BancoSol	Banco Solidario, S.A. (Bolivia)
BNF	Banco Nacional de Fomento
CARE	Cooperative for American Relief Everywhere
CONAUPE	Corporacion Nacional de Apoyo a las Unidades Populares Economicas
CORFEC	Corporacion Femenina Ecuatoriana
CorpoMicro	Corporacion de garantia crediticia para el fomento de la Microempresa
CRS	Catholic Relief Services
DAI	Development Alternatives, International
FADEMI	Fundacion Austral de Microempresas
FED	Fundacion Ecuatoriana de Desarrollo
FEE	Fundacion Eugenio Espejo
FINCA	Foundation for International Community Assistance
FISE	Fondo de Inversion Social de Emergencia
FSN	Foreign Service National
FUNDASUR	Fundacion del Sur
FVR	Fundacion Vicente Rocafuerte
GEMINI	Growth and Equity through Microenterprise Investments and Institutions
GOE	Government of Ecuador
IBRD	International Bank for Reconstruction and Development
IDB	Inter-American Development Bank
INSOTEC	Instituto de Investigaciones Socio-Economicas y Tecnologicas del Ecuador
MAS	Microenterprise Assistance and Strengthening Project
MIS	Management Information System
MSE	Micro and Small-scale Enterprises
NGO	Non-governmental Organization
PACD	Project Assistance Completion Date
PL-480	Public Law 480
PPDA	The Peace, Prosperity and Democracy Act of 1994
PRODEM	Fundacion para la Promocion y Desarrollo de la Microempresa (Bolivia)
PROEXANT	Corporacion de Promociones de Exportaciones Agricolas No Tradicionales
PSC	Personal Services Contractor
PVO	Private and Voluntary Organization
SED	Small Enterprise Development Project (518-0056)
SEGO	Sustainable Economic Growth Office (USAID/Ecuador)
UNICEF	United Nations International Childrens' Emergency Fund
USAID/E	United States Agency for International Development Mission to Ecuador
USAID/W	United States Agency for International Development/Washington
UVC	Unidades de Valor Constante
WOCCU	World Council of Credit Unions

EXECUTIVE SUMMARY:

In Ecuador there are nearly two million microentrepreneurs, poor and marginalized citizens who labor daily to provide to their families the basics of life, viz., food, shelter and clothing. Although they constitute a vital part of the nation's economy, their activities lie mainly outside of the formal sector. These very small businessmen and women offer the potential to make significant contributions to the overall growth of the economy, but their lack of size, lack of collateral and most importantly their lack of access to short-term credit and a secure place to store their financial savings effectively constrain them from a fair chance to participate in the nation's growing economy. As noted in the April 1991 "Ecuador Microenterprise Sector Assessment", **"Lack of access to financial resources, especially in the form of credit for working capital, is the major constraint facing the sector."** (page xi). Reliable studies of microenterprises around the world convincingly show that the poor are excellent credit risks and significant savers. However, private commercial banks and state development banks in Ecuador generally pay only lip service to meeting the needs of microentrepreneurs.

The U.S. Agency for International Development encourages sustainable, broad-based economic growth. As one of the most effective means to attain this objective, the Agency is committed to the development, support and growth of microenterprise programs. The Agency emphasizes microenterprise programs which focus on the development and strengthening of local, sustainable institutions whose financial delivery mechanisms meet the credit and savings needs of rural and urban microentrepreneurs, especially women. In such programs, USAID Missions are enjoined to concentrate on the three most critical elements that are essential to broad-based economic growth: a) finding ways to help microenterprises to expand; b) removing obstacles to the creation of new businesses; and, c) facilitating the transition of microenterprises to the formal sector. No single project need address all three impediments, but Missions should try to leverage others projects, whether such projects are financed by USAID or by other donors, in a coordinated effort to carry out the Agency's strategy.

This Concept Paper is premised on three of the most widely reported "lessons learned" by other Missions, by the GEMINI consortium and from other microenterprise projects. First, the poor are excellent credit risks and given access to credit they can make significant contributions to a country's economic development. Second, there are vast amounts of dormant capital in the hands of the poor because they do not have access to savings facilities. Third, economic democracy is an indispensable handmaiden to political democracy. Full democracy cannot be achieved if major segments of the population are forced to operate outside of the formal economic sector.

The project described in this Concept Paper proposes assistance to two major players in Ecuador's current microenterprise credit programs, and to a new entry in Ecuador in the field of village banking. Both of the current players are committed to transforming themselves into discrete, but equally important financial intermediaries. One will become a bank offering credit and savings facilities to microenterprises; the other will become a financial intermediary, offering credit and savings facilities to microenterprises through a network of non-governmental organizations, highly experienced in microenterprise credit programs. The objective of the project is to improve the lives of the poor by ensuring greater access to credit and savings for microentrepreneurs, especially women, through the strengthening of local sustainable microenterprise institutions. In so doing, the project will demonstrate to Ecuador's private commercial banks that a microenterprise credit and savings program, sometimes referred to as "poverty lending", is a profitable undertaking which should form part of a bank's overall portfolio.

A. Introduction

1. Economic Growth in Ecuador

Ecuador is one of the poorest countries in South America, with an annual per capita income estimated at less than US\$1,000, equivalent to what it was in 1977. An oil boom in the 1970s raised standards of living, provided much-needed infrastructure and laid the foundation for a transition to democracy. But the 1980s brought economic stagnation resulting from excessive debt and falling oil prices. The economic crisis continues today. UNICEF estimates that 50-60% of the population falls below the poverty line, with 42% of the population having a per capita income of \$508.

President Sixto Duran-Ballen's stabilization program succeeded in reducing inflation from 60% at the end of 1992 to 31% at the end of 1993. Some of the principal measures the GOE took were: reduction or elimination of costly subsidies; a devaluation of 35% and maintenance of a stable exchange rate; implementation of a new budget reform law; and, reduction of the fiscal deficit to less than 1% of GDP. These tight fiscal and monetary policies broke inflationary expectations which had been ground into the economy since 1988 at an annual rate of some 54%. However, these efforts to stabilize the economy had an adverse effect on economic growth and employment. The growth rate of the Gross Domestic Product decreased from 3.5% in 1992 to 1.5% in 1993. Petroleum export growth, which increased by 11%, was not sufficient to offset the decrease by 22% in banana, shrimp, coffee and cacao exports. Non-traditional export products were the only group with growth rates that increased by nearly 20%, to US\$480 million.

President Duran-Ballen's efforts at structural adjustment have been thwarted by the opposition of Congress. Proposed draft legislation for the Modernization Law, which is crucial for a privatization program, was only passed after a contentious eleven month period. As a result, no major state enterprise in the electric, petroleum or telecommunications sectors has been privatized. However, in the interim the GOE was able to divest nearly US\$75.0 million of its investments in several private corporations and reduce the public sector workforce by about 20,000 employees.

2. Microenterprise Environment in Ecuador

The microenterprise environment in Ecuador is conducive to the relatively quick and easy formation of NGOs and other entities interested in working with entrepreneurs in this rapidly growing area. A World Bank internal memorandum estimates that the NGO community in Ecuador is composed of 300-400 mid-level NGOs and several thousand grassroots NGOs, including cooperatives. Approximately 100 primarily are devoted to micro-enterprise development or agricultural development.

The proliferation of NGOs working with microenterprises is both a boon and a bane. The plethora of NGOs is a bane in the sense that they operate in the absence of an overall conceptual framework to assist microenterprises. There is no control point. Therefore, it is not possible at any one time to determine with any degree of precision which NGOs are operating where, with which target groups, and using which methodology. In the absence of a coordinated NGO microenterprise program, the opportunities for redundancy are great and the total demands made on available resources are largely unknown.

The abundance of NGOs is a boon in the sense that there are more opportunities to examine the pros and cons of many NGOs' attempts to deal with resolution of the principal issue confronting NGOs, the donor community and the GOE, viz. access to credit by microenterprises. In addition, the large number of programs in progress offer opportunities to assemble a body of knowledge about the different policy constraints to the development and growth of microenterprises, small businesses, small farmer associations and rural womens' associations in Ecuador. All entities in the microenterprise field could benefit if there were a way to capture and catalog the experiences of ten or twenty of the major microenterprise NGOs. Such information could provide a rich and continuing source of data to the Mission's Policy Dialogue and Implementation project (518-0089).

B. Constraints to Microenterprise Development in Ecuador

As noted on page 12 of the Gemini Technical Report Number 8, dated April 1991 (Ecuador Microenterprise Sector Assessment), "Access to credit - for both fixed assets and working capital - was the major impediment mentioned by all respondents to the survey." The principal reason why this need remains largely unmet is the paucity of viable institutions which possess the financial delivery mechanisms needed to satisfy microenterprise credit and savings requirements. Although some government policies affect economic activity at virtually all levels, micro-enterprises are not generally affected by government policies, nor do they benefit from general policy reform. Microenterprises do benefit from policy reform if the reform is directed to a specific problem faced by specific microenterprises. A recent assessment of microenterprises in Ecuador noted, inter alia, "There appear to be very few general policy issues that affect the MSE sector in Ecuador.....Policy reform needs may be identified through other project interventions and, once identified, could be handled by Fundacion Ecuador." Nevertheless, it is recognized that there are several policy constraints to microenterprise development in Ecuador. Listed below are some of the most important and obvious constraints to successful microenterprise development projects.

1. Policy Dialogue

The proposed project will identify in the Project Paper those constraints which should be eliminated or changed. The Mission's own Policy Dialogue and Implementation project (518-0089) could be an effective instrument for use in working with the GOE in removing microenterprise policy constraints.

2. Legislation

National financial, monetary, labor and trade policies may have severe negative effects on microenterprises and small businesses. The proposed Microenterprise Assistance and Strengthening (MAS) Project will identify key policy constraints to the development of microenterprises and to the transformation of such enterprises to small businesses with access to the services of the formal financial sector.

Key constraints relate to the lack of access to credit and savings facilities for MSEs, the GOE's interest rate policy, control of the rate of inflation, transformation of NGOs to financial institutions, labor laws which increase the cost of labor, and onerous administrative procedures which increase the cost of business and deter microenterprises from expansion.

The proposed project will be closely related to the Mission's Policy Dialogue and Implementation Project (518-0089). As policy constraints to microenterprise development are identified and adequately described and documented, that information will be shared with the Policy Dialogue project manager to enable a coordinated approach to policy reform efforts.

3. Policy

Due to their small size and often perceived unimportance, microenterprises usually escape the country's onerous labor laws. However, if a microenterprise grows and takes on characteristics of a small business, it can become visible and perhaps be subjected to the labor code. Steps should be taken to treat microenterprises differently from small businesses, perhaps by exempting them until they reach an economic or employment "floor", or by establishing increments of compliance for different sizes of microenterprises. Also, current legal requirements regarding bonuses, fringe benefits and severance should be factored in gradually as microenterprises transform themselves to small business and begin to take their place in the formal financial sector.

Current government requirements to legally register as a business are complex and time consuming. Many small and microentrepreneurs cannot meet the basic requirements, which imply literacy and a degree of sophistication in business practices. The vast majority of microenterprises have at best rudimentary business records, and a basic system of bookkeeping is uncommon at this level. USAID/Ecuador and project counterparts should work with the GOE in efforts to simplify procedures and reduce costs for microenterprises to legally register as businesses.

4. Credit

a. Inflation:

The Mission should work with the GOE in attempts to establish policies that will reduce not only the level of inflation but also bring about a measure of control, reducing inflation's typically erratic behavior. Also, policy dialogue should focus on reducing subsidized import substitution, and on reducing the fiscal deficit.

b. Interest rates:

The GOE has followed interest rate policies which impose strict interest rate ceilings. Such ceilings benefit large borrowers whose size and experience have made them good credit risks. Small businesses, and especially microentrepreneurs, typically have been excluded from the formal financial system. They lack capital, assets, a credit history, and the cost of administering credit programs for them is viewed as prohibitive. Commercial banks in general consider lending to microenterprises as not only risky, but inherently unprofitable. If banks do loan to microentrepreneurs, they do it more as a social obligation than as a business undertaking. Thus, the major constraint to commercial bank involvement in microenterprise lending is a matter of attitude and bank practice, not national policy.

c. Administrative Procedures: Current requirements relating to registration, licensing and incorporation of microenterprises can be expensive, time-consuming and frustrating, all major deterrents to the development of microenterprises and to their potential entry into the formal sector.

5. PVO Institutional

Most microenterprise lending NGOs in Ecuador have not yet attained a high level of institutional development. They have concentrated their efforts on formation, reaching their clientele, developing working relationships with commercial banks and with CorpoMicro, the credit guarantee facility which facilitates commercial bank lending to NGOs for onlending to microentrepreneurs. NGOs also have concentrated on developing and implementing basic credit tracking and repayment processes. In these activities, the NGOs largely have been successful as attested to by their record in providing access to credit at market rates to tens of thousands of microenterprises, and in maintaining on time repayment rates of about 97%.

C. Government of Ecuador and Non-governmental Organizations' Initiatives

It is estimated that Ecuador has 1.8 million microenterprises which provide employment opportunities to approximately 2.3 million people, approximately 60% of the economically active population. Thus, the microenterprise community constitutes the nation's principal social safety net. Nevertheless, only a few thousand microentrepreneurs have access to credit in the formal sector. Most still must rely on the informal sector where the interest rate rises to twice that of the formal sector. Although millions of small and microentrepreneurs are regular savers, virtually none have access to institutions in the formal sector whose financial savings services include savings accounts. Large sums of capital, therefore, lie dormant.

1. The Government of Ecuador

The Government of Ecuador's microenterprise programs lack leadership, direction and a cohesive strategy. The GOE's principal organization in microenterprise development, CONAUPE, is viewed by many as a highly politically partisan institution and consequently it does not enjoy widespread respect in the donor and NGO communities.

2. The Interamerican Development Bank (IDB)

The IDB's \$20.0 million Global Loan for Microenterprises, initiated in 1991, included a component to strengthen NGOs. However, this goal was not achieved and no significant relationship developed between the NGOs and the IDB's program. It was originally anticipated that more than 23 NGOs would participate in the program and receive support and assistance; however, only 7 NGOs actually did receive support.

Private bank participation in the program did not live up to expectations. Only six banks and financieras made any loans under the program and these totaled only US\$1.1 million, a scant nine percent of the total loaned through January 1994. None of the banks in the program made loans to NGOs for onlending to microenterprises and only a few NGOs were able to negotiate agreements with the banks. Finally, the end borrowers under this program would not be considered microentrepreneurs. BNF loans averaged US\$3,041 per loan, and these were destined principally for small farmers.

Currently, the IDB is considering another microenterprise development project, which will use the private commercial banks as second story banks. It is not clear whether there will be a savings feature in the project, nor is it clear why IDB believes that the commercial banks might be interested in an undertaking they almost uniformly believe to be unprofitable.

3. Ecuador's Commercial Banks and Credit Unions

The country's private banking community shows virtually no interest in a direct relationship with microentrepreneurs. The banking community considers microenterprise lending as too risky, too cumbersome, too time consuming and inevitably unprofitable. Moreover, microenterprise credit programs continue to be seen as a social obligation rather than a legitimate and potentially profitable segment of commercial banking.

Credit unions lend and capture savings from the poorer sections of the community, but their focus is not necessarily on microentrepreneurs. Also, previous experience suggests that inputs of donor funds (other than technical assistance) can develop an unhealthy dependency which is not conducive to the future growth of credit unions. Given this scenario, there is a need to encourage institutions whose primary focus is microentrepreneurs to become financial intermediaries, thereby capturing savings and making them available to microentrepreneurs.

4. The Ecuadorian NGO Community

There are scores of NGOs in Ecuador dedicated to microenterprise development. Most are small and localized. Only a handful have been able to survive as viable institutions which not only provide financial services to microenterprises but also recognize the need for their own evolving institutional development needs. Among the most successful NGOs are the Fundacion Ecuatoriana de Desarrollo (FED), Fundacion Eugenio Espejo (FEE), Fundacion Vicente Rocafuerte (FVR), Instituto de Investigaciones Socio-Economicas y Tecnologicas del Ecuador (INSOTEC), Corporacion Femenina Ecuatoriana (CORFEC) and Fundacion Autoempleo.

Perhaps the most positive development in microenterprise activity in Ecuador is the formation of a corporation (CorpoMicro), composed of eight foundations (NGOs) dedicated to microenterprise development and support. These eight foundations first formed an association, the Asociacion de Corporaciones de Desarrollo de la Microempresia (ASOMICRO), for the purpose of developing innovative financial mechanisms to increase resources available to the microenterprise sector.

In December of 1991, ASOMICRO formed the Credit Guaranty Corporation for the Development of Microenterprise (CorpoMicro). Under the laws which govern the National Guarantee Credit System and in accordance with those of the Superintendency of Banks, CorpoMicro was granted the legal authority to issue guarantees against lines of credit from banks to CorpoMicro's member foundations, which in turn lent the funds to microenterprises. This procedure allows CorpoMicro to leverage funds, thereby increasing the overall amount of credit available for microenterprises. As a legally constituted corporation, CorpoMicro has an equity fund composed of loans and grants from its members, and by a guarantee fund composed of grants and long-term loans from national and international organizations.

Since its inception, CorpoMicro has issued a total of 671 credit guarantees, with a total value of US\$690,000. Approximately 22% of the credits were for services, 55.3% for commercialization and nearly 23% for production. Fifty-six percent of the ultimate borrowers were women.

D. Other Donor Projects and Gaps Not Covered

1. Other Donor Projects

Other bi-lateral and multi-lateral donors are involved in small business development programs, but to date none has met with great success. The International Bank for Reconstruction and Development (IBRD) has not provided funding specifically for MSE programs, although since 1982 the Bank has allocated more than US\$162.0 million for industrial redevelopment. However, the program was geared to medium sized industries and production oriented enterprises. In addition, time consuming loan approval procedures and large loan amounts (US\$10,000 - \$85,000) precluded micro-enterprises and very small scale enterprises from participation in the program.

Currently, the largest multilateral donor is the Interamerican Development Bank. Between 1990-1993, the IDB allocated \$20.0 million in loan funds for small and microenterprise development through the Central Bank. The project was not successful and in view of Banco Nacional de Fomento's (BNF) bad loan record, the soundness of its portfolio is highly questionable. The IDB currently is planning a new project, to be implemented through the GOE's National Finance Corporation, which in turn would onlend to private banks. USAID understands that the sub-loans will be in the several thousand dollar range, as was the case in the previous IDB loan to BNF. At this level, the ultimate borrowers will not be microentrepreneurs. In addition, no provisions have been made to involve Ecuador's NGO community in the project, at least in the provision of credit.

USAID/Ecuador is the largest bi-lateral (government) donor in MSE activities. In accordance with the Agency's economic growth strategy and microenterprise initiative, USAID's design and implementation of the proposed Microenterprise Assistance and Strengthening Project will depend to a significant degree on NGOs and PVOs, several of which have established good track records in the provision of credit, training and technical assistance to microenterprises. USAID will continue to maintain close contact with the IDB and other donors, as appropriate, in order to ensure complementarity of activities in microenterprise development.

2. Gaps Not Covered by Other Donors

The credit and savings needs of Ecuador's nearly two million micro-entrepreneurs and small agricultural producers are so great that the combined efforts of the entire international donor community are able to meet but a small fraction of the sector's requirements. Access to credit and to a safe place to store savings remain the two most important unfulfilled demands of microentrepreneurs and small farmers. Although the general lack of access to credit in rural and urban areas is pronounced, small farmers are the most overlooked group among the poor and marginalized who lack access to credit.

Discussions with the IDB, the country's largest donor to the MSE community, with CorpoMicro, and with many of the country's most successful NGOs involved in microenterprise credit programs conclusively illustrate that even with increases of several times the current level of donor loans and grants, the magnitude of credit needs among MSEs overwhelms the capacity of the donors. Thus, there are large gaps - geographic, sectorial and sub-sectorial, and lending levels - that are not covered by the donors.

Therefore, any well-designed microenterprise credit and savings program, whether destined principally for urban or rural areas, whether principally for working capital requirements, production, services, commercialization or any combination, will help to fill the many gaps in the fabric of Ecuador's MSE credit and savings requirements.

Village banking is one of the most recent and innovative approaches designed to reach rural communities. In addition, village banking programs are designed specifically to benefit women. In Ecuador only CRS and Project Hope are currently involved in a village banking project. Both are recent entries into the field. Therefore, village banking should be considered as a major gap in microenterprise lending programs in Ecuador. However, this problem will soon be addressed by the Foundation for International Community Assistance (FINCA), the most experienced PVO in village banking.

FINCA, a pioneer in village banking, has developed successful methodologies for national village level banking programs in Latin American and the Caribbean. In the past three years FINCA programs increased from only 6,000 borrowers to more than 52,000 (92% of whom are women). Specifically, the goal of FINCA International and its affiliates is to benefit between 150,000 and 220,000 poor women by the year 1999. FINCA reaches its beneficiaries through the program's 1,966 village banks, whose combined portfolio is valued at US\$7.4 million. Village bank management committees, which are trained by FINCA, currently process approximately 2.2 million loan payments annually. Delinquencies are only 2.3%.

FINCA has applied to USAID/Washington for a matching grant to carry out village banking programs in Ecuador, the Dominican Republic and Uganda. Since no other institution in the country has programs devoted almost exclusively toward improving the economic status of poor rural women, the Mission has a strong interest in FINCA's success in this important sub-set of microenterprise credit programs.

FINCA's proposed five year Ecuador program will cover Quito, Latacunga, Ambato, Otavalo, Machachi and major portions of the provinces of Pichincha, Cotopaxi and Esmeraldas. FINCA's goal is to establish and operate 554 village banks, with a total number of 16,620 members, managing a loan portfolio of \$US1,765,490, and mobilize savings of US\$761,657 over the life-of-project.

By the end of the project, FINCA/Ecuador anticipates to be able to generate sufficient net revenue from its portfolio to cover 100% of program operating costs and to be able to borrow funds at commercial rates to finance program expansion. The Mission strongly supports FINCA's application to USAID/Washington for a matching grant for a village banking program in Ecuador. The program will contribute significantly to the Mission's goal of broadening the economic base through increasing opportunities to participate in broad-based economic growth. In order to complement this critical undertaking, the Mission plans to award a US\$900,000 Cooperative Agreement to FINCA for village banking activities.

E. USAID/Ecuador Prior Project Activity and Results

USAID/Ecuador's most recent microenterprise activity, the Small Enterprise Development project, (518-0056) was completed in April 1991. The US\$4.3 million grant project was implemented through CARE and INSOTEC, a local NGO. The purpose of the project was to expand and improve the supply of technical assistance, credit and services to the small scale enterprise

sector. The project was expected to generate 1,300 new jobs and s/. 570 million in value added (in constant 1984 terms) over the life of the project.

Both a mid-term project evaluation and a post-PACD Mission assessment of the project concluded that virtually every project component had encountered serious difficulties. Project design was highly complex and changed several times; the eleven implementing agencies were unclear as to their roles; the credit component was treated as a social undertaking rather than an economic one; loans were subsidized rather than provided at market, near market or above market rates; working capital loans were made for very long periods; technical assistance was inefficient and perhaps unnecessary. The project was an example of good intentions gone awry - a case of a complex, integrated project with too many goals, services, clients and conflicting objectives.

Notwithstanding these difficulties, the Mission's experience in the design and implementation of the SED project resulted in the accumulation of a considerable amount of valuable information about the numerous entities in Ecuador who participate in small and microenterprise activities. Most important, the Mission gained valuable experience working in one of the most challenging and difficult areas, thereby preparing itself for subsequent involvement in the Agency's Microenterprise Initiative. The "lessons learned" from the mid-term evaluation and from the Mission's own post PACD assessment will prove invaluable in the design and implementation of the proposed "Microenterprise Assistance and Strengthening" project.

F. Relationship to Action Plan Strategic Objective, GOE plans and priorities and other donors

The proposed Microenterprise Assistance and Strengthening Project is directly related to the Mission's Strategic Objective Number 1, "To increase sustainable economic growth for a broad base of the population." The second Program Outcome under this objective is "expanded opportunities and participation by low-income groups in a growing market economy." The proposed project will help attain this Program Outcome by assisting micro-entrepreneurs to gain greater access to credit, savings services, and targeted training and technical assistance, thus increasing the economic base of the country and providing opportunities for microentrepreneurs to participate actively in the democratic process.

Through the active participation of grassroots organizations and the beneficiaries, efforts will be made to identify policy and legal constraints to involvement of microenterprises in credit and savings programs, and to full engagement in the country's production, marketing and export sectors. Although experiences from around the world over the past twenty years confirm that microenterprise credit programs have a significant impact on women, the proposed project design will be devised in such a way that approximately 60% of the beneficiaries will be women.

The GOE is not actively pursuing significant programs aimed at the microenterprise sector. The GOE has participated to greater or lesser degrees with both multi-lateral and bi-lateral donors and with international and local PVOs and NGOs in their efforts to work with small and microenterprises. However, there are no readily apparent indicators that the government plans to devote in any meaningful way human and financial resources directly to developing the microenterprise community. In general, neither state development banks nor private commercial banks have shown intentions of creating internal facilities specifically to deal with the credit, savings, and other service needs of microentrepreneurs.

Among the multi-lateral and government bi-lateral donors, only the Inter-American Development Bank (IDB) and USAID have launched projects intended to assist microentrepreneurs. Neither institution has met with much success in their projects. The IDB is revamping its program and USAID/Ecuador, building on the lessons learned under its recently completed Small Enterprise Development (SED) project, will use lessons learned from the implementation of that project in this Concept Paper and in the Project Paper.

G. USAID Strategy and Policy Directives

In March 1994, the Agency for International Development issued "Strategies for Sustainable Development", official Agency statements on strategies to be pursued in each of USAID's areas of concentration. Encouraging broad-based sustainable economic growth is one of the Agency's principal strategic objectives. The Agency's fundamental goal is to help individuals improve the quality of their lives and share equitably in the benefits of broad-based, sustainable economic growth. In the area of expanding access and opportunity, USAID's programs are to emphasize microenterprise and small business development programs.

There is broad agreement within the donor community and countries in the developing world on the basic requirements to alleviate poverty and stimulate economic growth. Chief among these are sound economic policies, well-managed public and private institutions, access to food, education, and housing, and broad participation in the democratic process. USAID's fundamental objective within the economic growth strategy is to help ensure that individual citizens improve their quality of life through the benefits derived from sustainable economic growth.

The poor and marginalized citizens throughout the developing world struggle to acquire the basics of life. Too often, the struggle is an endless one which offers few possibilities to break the cycle. One of the proven strategies to assist the poor to rise above the subsistence level is through microenterprise development. Agency strategy calls for Missions to emphasize microenterprise programs which focus on three principal ingredients of broad-based economic growth, viz., a) the removal of obstacles which impede the creation of new businesses; b) the expansion of existing businesses and c) support for small and microenterprises to make the transition to the formal sector.

To achieve this strategy, the Agency will support programs which address regulatory and policy constraints, increase access to credit, technology and markets, encourage savings, and promote the development of sustainable financial institutions which offer services to small and microenterprises. In addition, Agency policy calls for support for the creation of specialized banks and other self-sustaining financial institutions dedicated to the provision for credit, savings and other financial services to small savers and microentrepreneurs.

H. USAID Microenterprise Development Goals:

The Administrator's March 19, 1994 statement on the Agency's microenterprise initiative is a comprehensive description of the need to integrate microenterprise development projects into Missions' overall development strategy. Specifically, the Administrator noted, "The Agency affirms that support for microentrepreneurs will be one of the main aspects of its approach to economic growth that stresses increasing the economic

participation of the poor and people in transition economies." In support of the Administrator's statement, Agency funding for micro-enterprise programs will increase from US\$80.0 million in FY93 to \$140.0 million in FY95.

The Microenterprise Initiative lists three main goals. The first involves support for microenterprise programs implemented by local entities which offer credit, savings, and training. Among such entities are credit unions, savings and loan associations, public and private banks, and both governmental and non-governmental organizations. The Agency intends to support activities which remove national and local level constraints to small and microenterprise development.

The second goal of the initiative is to ensure that microenterprise programs increase the skill and productivity base of the economy. As microenterprises gain access to credit, savings, technology, and markets they may grow, creating employment opportunities and generating demands for additional services throughout the economy.

The third goal is to promote the creation and development of local organizations which become advocates for economic democracy at the local level. Microentrepreneurs who gain access to such financial services as savings and credit facilities stand to become empowered citizens. Empowerment may occur first economically as individuals and small groups benefit from successful credit programs. Even greater empowerment may transpire later, through formation of community associations of various types. Such groups may become politically powerful advocates for small and microentrepreneurs on a local, regional and national level.

Underlying the Agency's overall economic growth strategy and its microenterprise initiative is the absolute objective of financial viability. Sustainable economic growth aims for the creation and development of the institutional capacity to provide the full range of financial, technical, and other services without external subsidies.

I. USAID/Ecuador Project Goal and Purpose Statements

1. Goal Statement

The goal of the Microenterprise Assistance and Strengthening project is to increase sustainable economic growth for a broad base of the population.

2. Purpose Statement

The purpose of the project is to develop and strengthen the credit and savings delivery mechanisms of key Ecuadorian microenterprise development organizations, thereby ensuring increasingly greater access to such mechanisms by project beneficiaries.

3. Project Strategy Statement

The project will provide appropriate financial and technical assistance to support and strengthen local, sustainable microenterprise institutions who deal with Ecuador's nearly two million microentrepreneurs, and to support a major village banking program. Emphasis will be placed on ensuring access to credit and savings for microenterprises where such access traditionally has been absent or highly limited. Poor rural and urban entrepreneurs, small farmers, village associations and womens' associations are among the target groups. Up to 60% of the beneficiaries will be women.

The strategy calls for focusing project activities in rural areas where agriculture is the predominant economic activity and in small cities and towns where microentrepreneurs' principal needs are access to credit for working capital and to a secure financial savings mechanism. The strategy aspires to demonstrate to the nation's commercial banks that microenterprise savings and credit programs directed to the rural and urban poor are profitable undertakings in which commercial banks should play a major role.

The strategy embraces the philosophy that the poor throughout the developing world are major savers and that their need for a safe place to store their savings is at least as great as their need for access to short-term credit. Therefore, the project's strategy is to offer non-subsidized credit and savings services to the rural and urban poor, through viable and sustainable local microenterprise development institutions. In essence, microenterprise savings will largely finance microenterprise credit. This strategy is consistent with a recommendation in GEMINI Technical Report No. 8, "Ecuador Micro-enterprise Sector Assessment" (April 1991) which states "Any long-term strategy for the micro- and small-scale enterprise sector must have as its major objective the development of sustainable access to useful financial resources." (page 23).

The Project will use the soon to be expanded services of a transformed (see "Transformation of CorpoMicro" and "Transformation of FED" sections, pages 13-17) CorpoMicro and FED, and several NGOs working in microenterprise programs. Currently, CorpoMicro operates as a credit guarantee facility through commercial banks for microenterprise lending. The local NGOs expected to participate in the project are founding members of CorpoMicro. Some of them have attained financial self-sufficiency, have established a moderate record of institutional development, have incorporated some modern managerial practices, and have close and productive linkages with the microenterprise community. The NGOs will benefit from further institutional development through training in operating microenterprise financial service programs and sub-sector analysis. Several of these NGOs are sufficiently advanced that in the future they may evolve into full-service financial intermediaries for the microenterprise community. FED is by far the leading contender for such a transformation.

Institutional viability is a sine qua non to the success of a microenterprise credit program. Viable institutions are trusted by their clientele and valued for the critical services they provide, of which access to credit, appropriate terms, and a simple, fast application and approval process are of singular importance. Such institutions realize that their prosperity depends on offering a range of financial and non-financial services to their clients, without cumbersome procedures to evaluate the clients' use of funds. The institutions realize that the clients themselves know better than any other person for what purpose the funds are best utilized.

The Project will take an "enterprise expansion" approach. This approach seeks to offer services, principally short-term credit and minimal technical assistance, to microentrepreneurs in order for them to increase their sales and income and produce new jobs. The "enterprise expansion" approach is particularly advantageous in situations where there are large numbers of microentrepreneurs who already possess basic business skills, appropriate to their level of activity. These programs are directed principally toward commercial and retail activities, where the majority of beneficiaries tend to be women. Enterprise expansion projects typically reflect participation by female entrepreneurs at levels above 40%. The proposed project aims for 60%.

Experience shows that the most successful programs provide simple and quick loan applications and disbursement of loan funds, offer repayment terms appropriate to the cash flow of the enterprises served and offer prompt follow-up loans to clients who repay their initial loans on time. Technical assistance may be included, but only when it is targeted to specific and clearly identified needs of the microenterprises.

This approach to microenterprise lending seeks to ensure a significant increase in the number of microenterprises who ultimately will be able to participate in the formal economy and will, therefore, improve the quality of life for thousands of poor and marginalized citizens, especially women, by increasing their incomes and access to the basics of life.

As an additional mechanism, the Mission will include in its Cooperative Agreement with FINCA, expected to be executed in the third year of the project, a provision to enable FINCA project implementors to identify constraints in providing credit and savings services to associations of poor, rural women. This data also will be channeled to the Policy Dialogue and Implementation project manager. Overall, it is the Mission's intention to make full utilization of information regarding any impediments to the participation of the urban and rural poor in the benefits of broad-based, sustainable economic growth.

J. Project Organization and Management

The project design takes into consideration the many lessons learned by USAID, ACCION, GEMINI, CRS, and other entities which have long experience in microenterprise lending projects around the world. The project design attempts to put to appropriate use these "lessons learned", thereby avoiding the pitfalls which have scuttled many other microenterprise projects and incorporating, as appropriate, those positive design features which have contributed to project success.

Chief among the lessons learned are: a) avoid overly complex and complicated project design; b) have a clear statement of project goals and objectives which are limited and attainable; c) limit the entities involved in project implementation to those entities which are absolutely essential to attainment of project goals and d) utilize private sector entities.

The Microenterprise Assistance and Strengthening Project will involve the direct participation of three principal entities, viz. CorpoMicro, not as a credit guarantee facility, but in its forthcoming role as a financial intermediary for NGOs involved in microenterprise credit programs; FED, which is moving toward becoming a microenterprise bank; and FINCA, which will soon undertake a major new village banking program under the auspices of a USAID/W matching grant. Since this is FINCA's first experience in Ecuador, it is prudent to allow FINCA to gain two years of experience in establishing its program. In the third year of the MAS project, assuming that FINCA's first two years of program experience generally have been successful, the Mission plans on signing a US\$900,000 Cooperative Agreement with FINCA.

The MAS project will be managed by two project-funded FSNs from the Mission's Sustainable Economic Growth Office (SEGO). Working closely with FED, CorpoMicro and FINCA, the FSN project managers will provide overall guidance and direction and help to identify key legal, policy and technical constraints which impede microenterprise development. Once constraints have been identified, the project managers will ensure that they are brought to

the attention of the project manager of USAID/Ecuador's Policy Dialogue and Implementation project in order that the issues and constraints may be dealt within the framework of policy dialogue. The FSN project managers also will work closely with CorpoMicro, FED and the NGOs to identify the most appropriate technical assistance and training for the continued institutional development of each of these entities.

1. The History of CorpoMicro:

CorpoMicro, an Ecuadorian non-profit financial institution, was founded in 1991 by eight Ecuadorian NGOs dedicated to carrying out micro-enterprise programs. CorpoMicro was incorporated under the nation's banking laws and its principal activity is to issue guarantees for its member NGOs micro-enterprise credit programs. CorpoMicro places loan guarantees with commercial banks and, in accordance with law, is able to issue guarantees for up to eleven times its equity.

For each dollar guaranteed by CorpoMicro, participating commercial banks typically make available two dollars in loan funds to the NGOs for onlending to microenterprises. The average loan amount guaranteed is US\$1,030 and the average term is eight months. For calendar year 1994, CorpoMicro forecasts issuing guarantees totaling US\$1.5 million.

Since its founding in 1991, CorpoMicro has developed excellent professional relationships with several private commercial banks and with a number of successful financieras. Although in general the commercial banks continue to show great reluctance in dealing directly with microenterprises. CorpoMicro's guarantees to the banks have resulted in a substantial amount of lending to CorpoMicro's member NGOs for microenterprise projects.

Under its current charter, CorpoMicro can neither lend funds nor offer savings facilities. This is a major constraint to its advancement as a microenterprise development institution. The NGOs themselves can lend to microenterprises, but cannot mobilize savings. ASOMICRO's experience in microenterprise development programs substantiate the world-wide findings of such highly respected groups as GEMINI, ACCION, FINCA and others which first exposed the myth of rural undersaving. Throughout the developing world, it has been found the poor are significant savers and consider having a safe place to deposit their savings to be as important as having access to credit. Also, rural savings is the best source for financing microenterprise credit needs.

ASOMICRO and CorpoMicro have decided to transform CorpoMicro into a new entity, more suited to meeting the credit and savings needs of micro-entrepreneurs.

2. The Transformation Of CorpoMicro:

Thus, CorpoMicro recently announced its intention to transform itself from a credit guaranty facility to a financial intermediary, offering additional financial services to microenterprises through NGOs and directly to small business. This new development represents a major change in the microenterprise and small business community in Ecuador and it has immediate and profound implications for the design of the Microenterprise Assistance and Strengthening Project. It means that for the first time, microentrepreneurs and the NGO members of ASOMICRO (and other NGOs, as appropriate), will be able to deal with a financial intermediary dedicated to

the development of NGOs in microenterprise programs and to the microenterprise community itself. Not only will access to credit be available through the NGOs, but rural and urban microenterprises will be offered a secure financial savings feature.

In order to become a financial intermediary, CorpoMicro's founders/shareholders, who already have formally approved the proposed change, must increase its equity to US\$3.0 million, 50% of which must be subscribed before operations begin. The remaining amount required must be paid in within one year.

CorpoMicro is looking to its shareholders/founders to provide 51% of the total required. In addition, CorpoMicro has prepared a proposal which describes its aims, timetable and financing requirements. Copies of the proposal have been provided to USAID/Ecuador, the IDB, PROFUND (composed of FUNDES, Calmeadow, and the Multilateral Investment Fund), the Washington Development Corporation and Fundacion Ecuador. Each entity represents a potential source of financing for CorpoMicro to reach its required capital.

The General Manager of CorpoMicro plans to travel to Washington in July in efforts to acquire firm commitments from those organizations previously mentioned whose headquarters are in Washington. Also, Fundacion Ecuador has encouraged CorpoMicro to convene a workshop in Quito within the next two months. The workshop would bring together multi-lateral and bi-lateral donors, Fundacion Ecuador, selected representatives of the private sector and NGOs involved in microenterprise programs. The purpose of the workshop is to bring together all the major players, actual and potential, interested and active in microenterprise activities in Ecuador; discuss the status of the proposed transformation of CorpoMicro, the current levels of financial commitments; and agree on subsequent steps required.

CorpoMicro hopes that by the end of calendar year 1994, it will complete all necessary administrative requirements and provide evidence to the Superintendencia de Bancos that it has on hand 50% of the required US\$3.0 million. Current law allows CorpoMicro to acquire the remaining 50% within one year, but in the meantime - assuming that all administrative requirements are satisfied - CorpoMicro could be granted authority to open its doors as a financial intermediary by the second quarter of calendar year 1995.

The goal of the new institution is to offer an extensive range of services to micro and small businesses in Ecuador. Specifically, CorpoMicro's proposal envisions the following services:

- Assist in the mobilization of savings and investments
- Finance micro and small business activities
- Supply the sector with a variety of financial services that the institution will identify directly or through its foundations
- Promote a private sector initiative through financial services to small companies and to the microenterprise sector.

The new institution will not issue credit guarantees to commercial banks for lending to NGOs and on to micro-entrepreneurs. Instead, the new company will lend directly to its member NGOs (ASOMICRO) which in turn will onlend to microenterprises. In addition, the new institution intends to lend directly to larger small businesses, issuing loans in the US\$5,000 range. The Mission will take appropriate measures in the negotiation stage and in the Project Paper to ensure that the new CorpoMicro devotes one half of its loan portfolio exclusively for microenterprises.

Finally, and of major significance, the new institution will be able to capture savings from microentrepreneurs. The ability to capture savings can have a dramatic and profound effect on microenterprise programs. As noted in "The New World of Microenterprise Finance", ".....savings mobilization brings far-reaching changes. Once an institution captures savings, it becomes a financial intermediary. Savings are equally important for enterprise growth, for it is from savings that most investments in enterprises comes.....more people want a good place to save than want loans. Thus, savings services can reach deeper into the community."

The new institution's commercial strategy will be to transform the former credit guaranty corporation (CorpoMicro) into a financial company to provide financial services to NGOs involved in microenterprise lending. The NGOs also will be shareholders of the company. The NGOs themselves will be considered clients and their programs will be screened by the new company's staff to ensure program soundness and viability. In addition to lending to NGOs for microenterprise purposes, the new company intends to open a "small business window" for direct lending to small businesses. Although not permitted to operate checking or demand savings accounts, the new company will capture savings by placing small savers' deposits in its own account in a commercial bank and issuing passbooks to the depositors.

In order to complete the transformation process, CorpoMicro must present an application, evidence of the required capitalization, detailed data on its "promotores", and proposed statutes to the Superintendency of Banks. CorpoMicro expects all steps to be completed and to be operating as a financial institution by mid-1995. CorpoMicro currently has offices in Quito and plans to open others in Guayaquil and Cuenca and in other population centers. In order to broaden its geographic coverage in a short period of time and in an inexpensive manner, the new CorpoMicro may consider placing a representative in each office of the members of CorpoMicro. A similar procedure was used by BancoSol and PRODEM in Bolivia. Such a move would result in a CorpoMicro presence in 20 cities throughout the country.

3. Traditional NGO Activities: (ASOMICRO)

ASOMICRO was founded in 1990 by five NGOs specialized in microenterprise development. The principal purposes of ASOMICRO were to offer institutional development programs to its members and to generate financial resources to provide for the growth of microenterprise credit facilities. ASOMICRO's current membership includes the following NGOs: Fundacion Femenina Ecuatoriana (CORFEC), Fundacion Ecuatoriana de Desarrollo (FED), Fundacion Austral de Microempresas (FADEMI), Fundacion Eugenio Espejo (FEE), Fundacion del Sur (FUNDASUR), Fundacion Autoempleo (AUTOEMPLEO), Insotec (INSOTEC), and Fundacion Vicente Rocafuerte (FVR). (See pages 25 and 26 for further information).

The NGOs who have worked with CorpoMicro (as a credit guaranty institution) onlend the loan proceeds from the commercial banks to microenterprises, charging interest rates somewhat higher than market rates. The NGOs have continued to refine their lending procedures by using modern risk-reduction screening techniques, maintaining close control over delinquencies, and seeking to simplify application and approval procedures. Also, the NGOs gained experience in working directly with commercial banks and some attempts were made to negotiate more advantageous interest rates and terms. This experience was useful, especially since one of the NGOs plans to become a bank. When CorpoMicro becomes a financial intermediary, NGOs may borrow funds directly from it and bypass the commercial banking system.

4. The Transformation Of FED:

The Fundacion Ecuatoriana de Desarrollo (FED), created in 1968, is the oldest local non-profit institution in Ecuador. During the past few years it has devoted itself almost exclusively to microenterprise credit programs. With approximately 120 employees and 18 offices throughout the country, FED is by far the largest NGO microenterprise entity in Ecuador. Recent data show that to date FED has disbursed 17,217 loans. Its active portfolio is valued at US\$3,256,100 and its loan payment delinquency rate is 2.7%.

A recent external analysis of microenterprise development in Ecuador concluded that FED is the leading NGO in Ecuador and has become one of the leading microenterprise credit programs in Latin America. The analysis states, "FED is proceeding to become a full financial intermediary, and could become the next BancoSol success story (NGO becomes a bank). AID/Bolivia...was instrumental to BancoSol's success, and a similar opportunity may be developing for AID/Ecuador with FED."

FED, indeed, plans to transform itself from an NGO to a full financial institution, similar to BancoSol in Bolivia. Like CorpoMicro, FED recognizes that while the needs to meet credit and savings demands of Ecuador's rural and urban microenterprises continue to grow, the interest of the nation's commercial banks in microenterprise credit and savings programs is lukewarm at best and unlikely to change. Thus, FED believes that it must take steps to transform itself into an institution which offers credit and savings services directly to microenterprises. Its maturity as an institution, long involvement in microenterprise lending programs, and broad geographic coverage are important and positive harbingers of a new and successful microenterprise bank.

As does CorpoMicro, FED already has plans to raise the necessary funds from local sources, microentrepreneurs, and its own revenues. Also, FED will look to international donors. In accordance with requirements stipulated in the "Ley General de Instituciones del Sistema Financiero", the minimum capital required to become a bank is 1,000,000 UVCs (Unidades de Valor Constante), which is equal to approximately US\$6.0 million.

FED's financing plan calls for capital subscriptions as follows: FED will contribute 40%; international organizations will provide 30%; the remaining 30% will come from local businesses (15%) and microentrepreneurs (15%). As of December 1993, FED's equity had reached US\$1.0 million. By the middle of calendar year 1995, it should increase to US\$1.75 million through capitalization of earnings. It will need a further US\$1.25 million from donors and investors before it can initiate operations as a bank, with a commitment for an additional US\$3.0 within one year.

FED notes that it is the only Ecuadorian NGO which is formally affiliated with ACCION/AITEC, the leading institution devoted to microenterprise banking. An ACCION/AITEC official visited FED in July to cooperate in the preparation of FED's business plan. The business plan and a feasibility study, a formal request to the Superintendencia de Bancos, and detailed information on FED's proposed five "socios" (both natural and legal persons may be "socios") will be submitted to the Superintendencia by the end of calendar year 1994. FED expects to provide evidence by the second quarter 1995 that it has reached 50% of the minimum capital required. This percentage, and satisfaction of all administrative requirements, is all that is required by the Superintendencia for FED to begin functioning as a bank. FED's goal is to open its doors by mid-1995.

ACCION intends to take a US\$250,000 equity position in FED. The Mission may have the option of providing grant funds to ACCION for equity investment in FED. This could simplify project management and would strengthen the relationship between FED and ACCION. A legal opinion on this possible option is pending in USAID/W. The formal relationship with ACCION/AITEC also means that FED will receive the technical assistance and training necessary to become a bank and to function in that capacity. Therefore, it will not be necessary to earmark project funds specifically for these purposes. However, the Mission should begin to collaborate closely with ACCION in order to define the role that each will play in its relationship with FED.

K. Project Components

The Microenterprise Assistance and Strengthening will be divided into the following main components:

- A Cooperative Agreement with FED or a grant to ACCION for investment in FED.
- A Cooperative Agreement with CorpoMicro.
- A Cooperative Agreement with FINCA.
- Life-of-Project funding for FSN project management.

In addition, the Mission will seek independent support from PL-480 for agricultural projects that provide services to small farmers.

These components will achieve an integrated strategy of bringing assistance to microentrepreneurs at urban, rural, farm gate and coastal levels in selected regions. They also build on an important centrally-funded USAID projects.

1. Grant Funds to FED and CorpoMicro:

As discussed earlier, there are two institutions in Ecuador which have stated their intention of transforming themselves into financial intermediaries, viz., Fed and CorpoMicro. To achieve this transformation, the equity of both institutions must be increased substantially and each must comply with GOE requirements, principally regulatory requirements emanating from the Superintendency of Banks. Both institutions are very optimistic about their prospects for transformation, although it is unlikely that CorpoMicro's transformation will occur before mid-1995, while FED's may require another six months.

FED's equity currently stands at US\$1.1 million. It's objective is to become a full-fledged bank, similar to BancoSol in Bolivia, catering exclusively to microenterprises. Ecuadorian law requires equity in the amount of US\$6.0 million, fifty percent of which must be available at the time FED petitions the Superintendencia de Bancos for status as a bank. FED believes that during 1995 it will have US\$2.0 million of its own resources on hand. Participation by international organizations and local businesses is expected to ensure that FED reaches its goal of fifty percent of the required equity by mid-1995. FED expects to receive financial and technical assistance from ACCION/AITEC, with which FED is officially affiliated. Support from USAID will be crucial.

A Cooperative Agreement may be executed with FED for credit activities. Alternatively, the Mission may choose to make a grant to ACCION for investment in FED through a convertible debenture or shareholding mechanism; In either case, the funds will be used for microenterprise lending.

CorpoMicro, currently controlled by the Superintendency of Banks as a Guarantee Corporation, has the immediate objective of becoming a financial intermediary. Its current equity stands at US\$100,000 and while its membership and some private sector groups are expected to provide financial assistance, again USAID support will be crucial. Clearly, it is consistent with Agency policy and the Mission's strategic objectives to render appropriate assistance in efforts to transform NGOs and other local entities into financial intermediaries for microentrepreneurs.

The Mission will sign a Cooperative Agreement with CorpoMicro for onlending to NGOs involved in microenterprise lending. Grant funds will also be made available for CorpoMicro to contract with an institution(s) skilled in microenterprise lending and institutional development. Appropriate technical assistance will be provided to CorpoMicro and to NGOs dedicated to microenterprise credit programs.

It will be a condition of the grants that the funds be onlent to microentrepreneurs, in the case of FED directly and in the case of CorpoMicro through the other NGO's. The transformation of both entities to financial institutions will be achieved following approval from the Superintendency of Banks.

2. Technical Assistance/Training

a. Technical Assistance/Training to NGOs

The current institutions which provide technical assistance and credit to microentrepreneurs can be divided into two major groups, viz. financial institutions and NGO's. Full service financial institutions, such as the commercial banks, do not view lending to microentrepreneurs as central to their business. Rather, such lending is generally seen as fulfilling a social responsibility. Consequently, only a fraction of commercial bank resources are devoted to microentrepreneurs. Even more problematic, commercial banks are not open to capturing savings from very small depositors and have no programs in place to do so.

As GEMINI has noted, "The potential participation of the formal banking sector in micro- and small-scale enterprise lending is limited by two factors: declining or continued low levels of liquidity in the banking system and the cost of making and servicing small loans. These are practical limitations that have nothing to do with desire, motivation, or lack of understanding. Unless solutions to these two problems are found, the formal banking system (in Ecuador) will not significantly expand its loan activities in this sector."

Specialized technical assistance and appropriate training will be provided to CorpoMicro under a contract between CorpoMicro and a U.S. organization skilled in the institutional development of local organizations involved in microenterprise lending who desire to transform themselves into financial intermediaries. The U.S. contractor may also be responsible for providing appropriate technical assistance and training to FED, in coordination with ACCION, and to selected NGOs who will onlend to micro-enterprises and to small farmers.

Examples of the kinds of technical assistance envisioned during the life of the project are program planning, administering microenterprise credit programs, modern techniques of design and operation of management information systems (MIS), modern methods of accounting and financial analysis, cost-reduction techniques and sub-sector analysis.

b. T. A. and Training to Microentrepreneurs/Small Producers

Technical Assistance provided by NGOs to microenterprises are standard elements of the NGO's activities and although no USAID funding is anticipated for this purpose, such training must be targeted to the needs of the client. Services should be simple, useful and quick. Such services may include basic training in preparing the borrower to apply for and manage credit well, helping to form guarantee groups, and, perhaps, limited training in production and marketing. Beyond these very specific and very simple types of training NGOs may offer to their microenterprise client, there appears to be no conclusive evidence that more generalized training programs are useful, productive and welcomed by the beneficiaries.

3. PL-480

It is estimated that a total of approximately of US\$1.0 million in local currency remains to be programmed. The USAID/Ecuador Mission and the GOE are interested in finding ways to program a significant amount of these funds for microenterprise development. The mechanism of approval for use of PL-480 funds requires submission of a proposal to a bi-partisan committee through a separate executive. These funds may be more suited to use in the plantain and baby banana project being proposed by PROEXANT.

4. Village Banking

This key project component will be carried out by FINCA, under a matching grant from A.I.D./Washington, scheduled to be signed in September 1994. The Mission is impressed with FINCA's record of accomplishment in village banking in other countries around the world. USAID/Ecuador strongly supports the matching grant to FINCA and will provide further assistance through a US\$900,000 Cooperative Agreement. USAID/Ecuador officials recently met with FINCA visitors to discuss areas of mutual interest and to seek initial agreement regarding the Cooperative Agreement's activities. The Cooperative Agreement will be described in the Project Paper.

5. International Travel (Bolivia)

During the course of project implementation, CorpoMicro and FED will begin the process leading to their transformation to financial intermediaries. Representatives of these organizations will be aided in this effort not only by the project's providers of technical assistance, but equally important from direct contact with institutions (e.g. BancoSol and PRODEM in Bolivia) which have already made the transition.

Funds are provided in the project to finance travel and related costs for representatives of selected NGOs to visit PRODEM and BancoSol in Bolivia for several days. PRODEM was started in La Paz, Bolivia with initial funding from USAID, the PL-480 program, the Bolivian Fondo de Inversiones Sociales de Emergencia, the Bolivian private sector, and the Calmeadow Foundation. Since its creation in 1984, to offer access to credit and training to microenterprises, PRODEM has met with almost continual success. By the end of 1988, PRODEM's 15 employees had processed loans to 13,300 microenterprises and by 1990, PRODEM opened new offices in Santa Cruz and El Alto. Currently, PRODEM has provided loans totaling US\$27,592,000, with an average loan size of US\$273. Seventy-seven per cent of PRODEM's clients are women and the default rate is near zero. Only US\$1,650 has not been recovered since 1987.

PRODEM was so successful that it recognized it could no longer meet the growing demand for credit and other financial services without fundamental institutional changes. Therefore, PRODEM began the process of legally converting itself from an NGO which offered credit and basic services to microenterprises, to a bank which offered credit and compulsory savings. BancoSol officially began operations in February 1992. To this day, BancoSol is the only bank in Bolivia which has no minimum deposit to open a savings account. Although there are many institutional and financial questions still facing BancoSol, it remains one of the few examples in the world of the successful transformation of a small NGO with limited financial services to a successful bank for microenterprises.

6. Evaluation

Project evaluation is an essential component of all USAID projects. A mid-term evaluation, conducted at around the two year point, will be useful in determining which, if any, mid-course corrections need to be made; which assumptions no longer are valid; and whether national policy changes incurred since the project was initiated imply changes in project goals/objectives.

A final project evaluation is standard USAID policy. Final evaluations are essential to determine the degree to which the project's goals and objectives were realized and if not, why not. The USAID Administrator's emphasis on results has serious implications both at the mid-term evaluation point and at the final evaluation stage. Lastly, a final evaluation provides an important list of "lessons learned". Such information can be of major importance to other Missions and PVOs and NGOs who may be contemplating similar projects in other parts of the world.

L. Financial Requirements (Millions US dollars)

- | | | |
|----|-------|--|
| 1. | \$0.6 | Project Management, Evaluation and Audit |
| 2. | \$1.8 | CorpoMicro (credit) |
| 3. | \$1.0 | FED (credit) |
| 4. | \$0.7 | Technical Assistance/Travel/Training |
| 5. | \$0.9 | Village Banking |

 \$5.00 Total

The distribution of funds by fiscal year and the balance of funds from other sources required by FED and CorpoMicro to reach the required equity is:

Distribution of Funds by Fiscal Year (Millions of US\$)

Year	FED	CorpM.	FSN's	Evaluat.	Trav.	T.A.	Vill.Bnk	Total
FY95	0.500	0.700	0.080		0.20	0.150		1.450
FY96	0.500	0.500	0.085		0.40	0.150		1.275
FY97		0.600	0.090	0.070	0.40	0.150	0.100	1.050
FY98			0.095			0.150	0.400	0.645
FY99			0.100	0.080			0.400	0.580
Tot. AID	1.000	1.800	0.450	0.150	0.100	0.600	0.900	5.000
Apple Match FY 95	0.500							
FY 96	0.500							
Equity Dec.95		0.200						
Transfer of loan portfolio for shares	3.100							
Local/ Foreign Invest. promoted by CorpoMicro		0.500						
Local/ Foreign Invest. Promoted by ACCION	0.650							
ACCION Invest.	0.250							
Other Donors	0.00	0.500						

Total	6.000	3.000						

Alternative Option if Additional Funding Becomes Available:

Distribution of Funds by Fiscal Year (Millions of US\$)

Year	FED	CorpM.	FSN's	Evaluat.	Trav.	T.A.	Vill.Bnk	Farm Credit	Total
FY95	0.500	0.700	0.080		0.20	0.150			1.450
FY96	0.500	0.500	0.085		0.40	0.150			1.275
FY97		0.600	0.090	0.070	0.40	0.150	0.100		1.050
FY98			0.095			0.150	0.400	0.500	1.145
FY99			0.100	0.080			0.400	0.500	1.080
Tot.									
AID	1.000	1.800	0.450	0.150	0.100	0.600	0.900	1.000	6.000
Apple Match									
FY 95	0.500								
FY 96	0.500								
Equity Dec.95		0.200							
Trans. of loan port- folio	3.100								
Local/ Foreign Invest.		0.500							
Local/ Foreign Invest.	0.650								
ACCION Invest.	0.250								
Other Donors	0.000	0.500							
Total	6.000	3.000							

H. Issues

- a. Is the Concept Paper leading to an overly complex project by inclusion of too many players, e.g., CorpoMicro, FED, NGOs, FINCA, and PL-480?
- b. In view of the pending AID/W-FINCA matching grant, should USAID/Ecuador execute a Cooperative Agreement with FINCA for an identical program and if so, when should it start? Are there better uses for these funds, such as directing them to the agricultural sector?
- c. In order to facilitate project design and implementation, a micro-enterprise sector study should be carried out under the Fundacion Ecuador component of the Policy Dialogue and Implementation project. Key questions include, but are not limited to, the following:
 - How many microenterprises are there in Ecuador?
 - How are these microenterprises distributed, rural vs. urban?
 - Which geographic areas and types of business are currently covered and which will be covered by FED and CorpoMicro under the MAS project?
 - Which segment and areas will be covered by FINCA, under both the USAID/W-FINCA Matching Grant and the USAID/Ecuador-FINCA Cooperative Agreement?
 - Which segments/areas likely will be covered by the forthcoming IDB program through the commercial banks?
- d. Parameters for measuring results need to be incorporated into the project monitoring and evaluation plan.
- e. During project design, a determination should be made as to whether a geographic and/or sector focus is appropriate.
- f. An analysis of the role that Ecuador's private and state development banks have played in microenterprise credit should be undertaken. The analysis should review the banks' total loan portfolio that is allocated to microenterprises compared to the amount of loans provided by the NGO's. The analysis should identify the banks' percentage of total loan portfolio allocated to microenterprises.
- g. Does USAID policy/statute permit granting funds to private, non-profit organizations for the purpose of such organizations holding shares in non-governmental financial institutions involved in microenterprise credit programs?
- h. Should there be a maximum loan amount on credit provided by project counterparts to microentrepreneurs resulting from USAID/E assistance? If so, what restrictions should be placed on project counterparts?
- i. The Project Paper should analyze the savings mechanism proposed by CorpoMicro.
- j. The Project Paper should include an assessment of the potential role of credit unions in assisting microentrepreneurs.
- k. The Project Paper should include a summary of the GEMINI project's worldwide lessons learned in microenterprise development programs, particularly credit and savings programs.

- l. Should the Project emphasize that FED and CorpoMicro's institutional outreach plans to rural/agricultural areas be strengthened?
- m. During project design, in addition to the resources provided under the MAS project, the USAID Mission should assess the potential role of PL-480 in providing additional assistance to small farmers.

KEY DESIGN CHARACTERISTICS OF SUCCESSFUL MICROENTERPRISE PROJECTS

- Based on belief that the rural and urban poor make good and profitable financial clients.
- Based on experience that provision of financial services, as opposed to targeted credit, offers greater chances for developing a large customer base, a self-financed capital base, and achieving institutional sustainability.
- Projects which employ the "enterprise expansion" model reach the largest number of beneficiaries at the lowest cost per beneficiary and the lowest cost per dollar loaned. These programs have the best chance of achieving financial and institutional sustainability.
- Focus on a single missing ingredient, rather than attempting to address multiple constraints (can't be all things to all people).
- Savings mobilization is just as important as credit in meeting the financial needs of rural and urban poor.
- Recognize that NGOs which become financial intermediaries must use savings as their principal source of capital.
- Give support to established enterprises; do not attempt to create new enterprises.
- Give priority to addressing the needs of specific industries/problems.
- Keep training and any TA to beneficiaries simple and appropriate to needs; build on existing knowledge.
- Do not make attendance at training courses a prerequisite to obtain credit.

The Members of ASOMICRO

Corporacion Femenina Ecuatoriana (CORFEC):

CORFEC'S principal objective is to assist women entrepreneurs through programs which provide credit, technical assistance and training in efforts to raise the beneficiaries economic, social and cultural standards.

Statistics:

• No. of credits disbursed	1,355
• Total amount disbursed	US\$470,000
• Active portfolio	US\$146,500
• Delinquency rate	1%

Fundacion Austral de Microempresas (FADEMI)

FADEMI was created to generate employment opportunities for the informal sector, with particular emphasis on services, artisans, production and small agricultural producers. It is active in the southern provinces of Ecuador.

Statistics:

• No. of credits disbursed	854
• Total amount disbursed	US\$1,176,358
• Active portfolio	US\$2,719,513
• Delinquency rate	2.5%

Fundacion Autoempleo:

Provides credit services for working capital and training and technical assistance for microenterprises in the city of Guayaquil.

Statistics:

• No. of credits disbursed	528
• Total amount disbursed	US\$725,963
• Active portfolio	US\$775,880
• Delinquency rate	2.5%

Fundacion Ecuatoriana de Desarrollo (FED):

Created in 1968, FED is one of the oldest NGOs in Ecuador involved in a variety of development activities. In recent years, FED has concentrated all its efforts on microenterprise credit activities.

Statistics:

• No. of credits disbursed	17,217
• Total amount disbursed	US\$8,034,640
• Active portfolio	US\$3,256,100
• Delinquency rate	2.7%

Fundacion Eugenio Espejo (FEE):

FEE promotes a variety of integrated programs, which include micro-enterprise development. FEE makes solidarity-type and individual loans to microenterprises.

Statistics:

• No. of credits disbursed	5,052
• Total amount disbursed	US\$1,578,533
• Active portfolio	US\$789,266
• Delinquency rate	5.0%

Fundacion Vicente Rocafuerte (FVR):

The principal objective of this institution is to facilitate economic and socially-oriented projects in cities and rural zones of the coastal areas of Ecuador. In particular, FVR has concentrated its efforts on income-generating projects in rural and urban areas of Guayas province.

Statistics:

• No. of credits disbursed	623
• Total amount disbursed	US\$240,466
• Active portfolio	US\$82,969
• Delinquency rate	6.0%

Instituto de Investigaciones Socio-Economicas y Tecnologicas del Ecuador (INSOTEC):

INSOTEC promotes technological and investigative development of the small productive sector to stimulate social and economic development. It operates credit programs in many cities throughout the country.

Statistics:

• No. of credits disbursed	172
• Total amount disbursed	US\$235,995
• Active portfolio	US\$203,969
• Delinquency rate	4.3%

GLOBAL ASOMICRO STATISTICS:

• No. of credits disbursed	25,801
• Total amount disbursed	US\$12,461,955
• Average amount of credit	US\$483
• Active portfolio	US\$ 7,974,097
• Delinquency rate	3.4%

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