

USAID/ECUADOR

STRATEGIC OBJECTIVE No. 4

MICROENTERPRISE ASSISTANCE AND STRENGTHENING

CLOSE-OUT REPORT

I. BACKGROUND DATA

- A. Activity Title: Microenterprise Assistance and Strengthening Results Package (MAS RP)
- B. Activity Number: 518-0121
- C. PACD: Original September 30, 2001
Revised September 30, 2000
- D. Implementing Agencies
 - Corpomicro
 - Fundación Alternativa
 - Banco Solidario
 - People to People Health Foundation (Project HOPE)
 - Catholic Relief Service (CRS)
 - Foundation for International Community Assistance (FINCA)
 - Cooperative for Assistance and Relief Everywhere (CARE)
 - Seed Capital Development Fund (SCDF)
 - Banco del Pichincha, CREDIFE
- E. Area Assisted
 - Country: Ecuador
 - Provinces: Carchi, Imbabura, Pichincha, Cotopaxi, Tungurahua, Azuay, Loja, Manabi, Guayas, El Oro.

II. PROGRAM STATUS

A. Contribution

In 1996 USAID embarked on a systematic effort to increase microentrepreneur access to financial services in Ecuador, earmarking \$6.5 million for microenterprise activities between 1996 and 2000. USAID's plans to increase access to financial services include:

- Strengthening institutions implementing village banking programs.
- Upgrading microcredit delivery systems of NGOs and financial institutions, and
- Promoting the establishment of financial institutions targeting the needs of microenterprises.

By the end of the program, the obligations versus expenditures are as follows:

VENDOR	AGREEMENT	OBLIGATED	EXPENDED	UNLIQUIDATED
SEED CAPITAL	CA-518-0121-A-61840	1,200,000.00	1,200,000.00	-
SEED CAPITAL	CA-518-A-00-96-00184	90,000.00	90,000.00	-
CRS	CA-518-0121-A-61850	970,000.00	970,000.00	-
FINCA	CA-518-0121-A-61860	970,000.00	970,000.00	-
HOPE	CA-518-0121-A-61880	970,000.00	970,000.00	-
CARE	CA-518-0121-A-61960	1,115,000.00	1,078,142.50	36,857.50 *
FUNDACION ALTERNATIVA	CA-518-A-0098-00109	300,000.00	268,173.72	31,826.28 *
FUNDACION ALTERNATIVA	CRANT-518-G-0097-00226	100,000.00	100,000.00	-
ACCION INTERNACIONAL	AWARD-518-G-97-00307	60,000.00	60,000.00	-
ACCION INTERNACIONAL	PO-518-0-00-98-00121	53,000.00	53,000.00	-
ACCION INTERNACIONAL	PO-518-0-097-00272	84,256.00	84,256.00	-
TECHNICAL ASSISTANCE	NGOs	123,733.51	123,733.51	-
TRAVEL	VARIOUS	8,164.17	8,164.17	-
MISSION SUPPORT	PERSONNEL	454,375.60	454,375.60	-
TOTAL		6,498,529.28	6,429,846.30	68,683.78

* These amounts are in process of deobligation

III. PROGRESS TOWARD ACHIEVEMENT OF PROGRAM PURPOSE

A. Background

Experience worldwide shows that microentrepreneurs represent a vast tool of hardworking people who, given access to minimal resources, can evolve into a formidable force contributing to job creation, poverty alleviation, democratic stability, and economic growth. The World Bank's 1995 Ecuador Poverty Report showed that the pool of existing and potential microentrepreneurs was over 1.1 million people, with about 450,000 microenterprises (over half of these were owned and operated by women), whose businesses require reliable financial institutions and services. . By promoting the financial sustainability of existing financial institutions, USAID helps to create viable banking and loan resources for the poor, particularly women.

Since 1995 Ecuador's informal sector has grown quickly, and the number of microentrepreneurs, has without doubt, also grown considerably. USAID/Ecuador designed activities to bring quality financial services to the poor, helping them to bring stronger microenterprises to improve their incomes and quality of lives. The ultimate customers of the program were poor Ecuadorians (especially women) who have been traditionally shunned by the private banks and exploited by loan sharks.

B. Summary of the Special Objective 2 (Sp02)

USAID/Ecuador's Special Objective No. 2, "Increased access to financial services by microentrepreneurs, with emphasis on women" supported the Agency Strategic Framework through "Access to economic opportunity for the rural and urban poor expanded and make more equitable." It was supported by three Intermediate Results: IR1, "New licensed, for-profit financial institutions serving the needs of

microentrepreneurs;” IR2, “Upgraded microcredit delivery systems to selected financial institutions and NGOs;” and IR3, “Strengthened institutions implementing village banking programs.” Thanks to an effective methodology and the strong commitment by our partners to provide credit to poor clients, the SpO2 met expectations and exceeded indicator targets in some important areas.

C. Program Activities

The Microenterprise Program had six components:

1. Equity investment: USAID/Ecuador-Prime Fund made equity investment through Seed Capital Development Fund (SCDF) and Cooperative for Assistance and Relief Everywhere (CARE) in Banco Solidario, Latin America’s first privately owned bank created to serve the microenterprise sector since its inception. Banco Solidario was established in 1996 through a joint USAID/Ecuador equity investment of \$1.9 million. This investment in Banco Solidario has catalyzed \$2.5 million in additional funding from other financial institutions and NGOs, and \$10.0 million from private citizens, for a total of \$14.4 million, consequently, Banco Solidario met its capitalization required by the Superintendency of Banks.

Banco Solidario also has improved significantly its delivery to financial services to microentrepreneurs, opening ten branches in suburban Quito and in smaller cities across the country. As of September 30, 2000 it had a total of 24,000 microentrepreneur borrowers. External technical assistance in the areas of institutional analysis, microcredit methodology and management information systems have been provided by Accion International through the centrally funded Matching Grant Project. This TA, as well as on-going assistance from SCDF, CARE and Profund is geared toward keeping the bank focused in view of its rapid growth and significant liquidity resulting from its unusually large capital requirement.

2. Technical assistance: TA was provided through a contract with Coopers and Lybrand to CorpoMicro and four of its affiliate NGOs-INSOTEC, CORFEC, Autoempleo, and Fundación Espejo. This Technical Assistance was focused primarily on upgrading the management and information systems of these institutions, and helped develop strategic plans for each one. Similarly, an assessment of the information systems of these four NGOs was conducted in December 1997, and a plan for improving these was developed and partially implemented in FY 1998.

3. Village banking: These activities experienced significant growth through Cooperative Agreements with three U.S. PVOs-Catholic Relief Services (CRS), People to People Health foundation (Project Hope), and Foundation for International Community Assistance (FINCA)-USAID has bolstered their administrative and management capabilities, thereby permitting an important expansion of their village banking programs. Village banking is a methodology designed to reach marginal urban and rural women and promote their empowerment through income-producing ventures. As of September 30,

2000, 1,110 village banks were established, benefiting approximately 27,500 women entrepreneurs (easily surpassing the SO target).

4. **Training center:** A grant in the amount of \$400,000 was provided to Fundación Alternativa during the life of the program for its training center, which provides training to the staff of financial institutions engaged in and/or interested in microcredit, including commercial banks, NGOs, and credit unions. This training center offers state-of-the-art training services locally and regionally to bank and NGO microlending professionals, and will help to promote microenterprise best practices among service providers in the region thereby improving the quality of the financial services they provide.

5. **Technical assistance to formal commercial banks:** In line with the objective of expanding access, USAID/Ecuador encouraged interested commercial banks to provide high quality financial services to this sector. A contract was let with Accion International in September 1997 to educate these banks on microenterprise best practices. USAID/Ecuador has successfully achieved the entry of one formal bank into the sector (it had significantly improved access to credit by microentrepreneurs), and initiated fundamental changes in the attitude of the formal, commercial banks toward microentrepreneurs, who they have traditionally shunned. This institution called CREDIFE (from Banco del Pichincha, one of the largest Ecuadorian banks), initiated operations at the end of 1999. As of September 30, 2000 it had 2,500 microenterprise clients.

6. **Guarantee fund:** Through the CARE/SCDF Cooperative Agreement, a Latin American Challenge Investment Fund (LA CIF) was established in May 1999. This offshore microenterprise guarantee fund is expected to support the microcredit activities in Latin American countries, especially in Ecuador. This Fund is already working in Bolivia, Peru, Nicaragua, and Dominican Republic. In Ecuador it will be implemented as soon as the economic situation of the country improves.

D. Key results

The microenterprise program has helped changed the lives of poor marginalized families in ten out of the twenty-two of the country's provinces, permitting them and their children access to a better standard of living and self-esteem. These clients also report that their improved incomes have enabled them to invest more in education, health care and other basic services. Almost 100% of the SpO's village banking clients have been women, and as a whole 76% of the program's beneficiaries were women.

Nevertheless, the banking crisis derailed new programs for USAID-assisted microenterprise lending by two large national banks, Banco de Credito and Filanbanco, that went into receivership with the Deposit Guarantee Agency (AGD). One of the largest surviving banks, Banco del Pichincha, received training support with USAID funds and started its own microlending program through CREDIFE. Finally, Fundación Alternativa and its training center continued providing training to the staff of national and international financial institutions currently engaged (or interested in) microcredit.

In total the SpO reached 54,000 poor (and mostly women) clients with credit assistance, surpassing original targets. Two of the three village banking institutions achieved 100% self-sustainability (full cost recovery) by the end of FY 2000 and the third reached almost 80%, indicating excellent prospects for their continued effective engagement in this sector beyond the termination of USAID/Ecuador's assistance. In addition, these partners also were working to identify new sources of funding to expand operations, either local (e.g. Banco Solidario) or international (e.g. Citizens Energy, CODESPA, Citicorp Foundation, FOMIN (IDB), Ecoenterprises Fund (The Nature Conservancy)).

E. Prospects for long term sustainability

Microcredit activities were initiated in FY 1996 with a major USAID contribution to CARE and the Seed Capital Development Fund for equity investment in Banco Solidario, a fully private bank created to serve Ecuador's microenterprise sector. At the conclusion of this SpO, Banco Solidario had improved the delivery of financial services to microentrepreneurs through ten branch offices in the Quito area, Guayaquil and other small cities. Similarly, the SpO's village banking partners have experienced significant growth and have moved forward in achieving sustainability. Prospects for future successful USAID activities in this field are excellent.

Several actions were taken to verify the reliability of our partner's data collection processes and USAID/Ecuador conducted financial reviews of our three village banking partners. They were found to be processing and providing information to USAID appropriately and implemented all recommendations from these reviews.

F. Gender consideration

In the village bank component of the Program, almost 100% of the beneficiaries were poor women. In the case of Banco Solidario and CREDIFE, this percentage was 50%, and as a whole 76% of the program clients were women. The Program therefore appears to be very effective at assuring significant full participation by women, and does not in any way exclude them through its activities.

It is apparent that the methods for delivering NGO financial assistance that were utilized under the Program were effective in achieving a high percentage of female participation in the Program.

IV. LESSONS LEARNED

Non-governmental organizations in Ecuador have structural weaknesses that limit their utility in development of fully self-sustaining financial intermediaries serving as stable sources of credit for micro and small businesses. Legal prohibition on mobilizing savings deposits denies NGOs (except for cooperatives) access to domestic savings. Although some NGOs may have limited access to commercial bank loans, this is only in relation to the amount of resources they have been able to capitalize from past donations and

retained earnings. NGOs and credit unions can play an important role by using the dedication and altruism of their staffs to create innovative channels for reaching micro entrepreneurs.

A second tier financing institution can only survive if it has access to resources at sufficiently cheaper rates than do its first level borrowers that it can generate the margins needed to cover its expenses. Careful financial planning is required before promoting creation of a second tier organization, to assure that there is a true economic niche for it.

Microentrepreneurs are able and willing to pay extremely high interest rates for short periods of time, and this can make an attractive market for commercial lending. NGOs are regularly making loans at high interest rate per month for very small loans of up to a year, with monthly payments. The interest rate is frequently based on the original amount of the loan, however, doubling the effective rate. In addition, commissions are charged up front.

NGO providers of credit have a limited range of financial services. As microenterprises grow, they require larger loans that the NGOs are designed to supply, and they require secure places for their savings. They also require investment capital that can help them meet their longer term needs, at more reasonable rates. Again, either the NGOs must begin to consider a transition to a different type of financial structure to support the growth of their clientele, or other types of organizations must be encouraged to move in and meet this need.

The micro enterprise universe is quite diverse and has different needs. It is commonly assumed that loans to micro enterprises quickly translate into increased employment.

V. PROJECT EFFECTIVENESS

The Program exceeded expectations for most of the project indicators, and it appears that the existing achievements may be sustainable. The indicators were designed to measure the outreach of the program, and the program attained the large, broad audience of microbusiness that was the target of the program.

The MAS Program was designed to be a key element in the USAID/Ecuador program to promote increased economic opportunities for the poor people. By creating a sustainable source of funding serving a significant percentage of the micro businesses in Ecuador. USAID intended to make an important contribution to this goal. The program has had far more impact than planned, and the contribution toward the program goal is commensurable with the level of resources expended.

The Program put special emphasis to assure that NGO participants in the program would in fact adopt measures required to improve their managerial and organization capabilities oriented to their self-sustainability.

In general, the credit programs in the participants NGOs appear to be well managed. However, loan supervision in some cases appears insufficient, particularly in light of rapidly expanding portfolios.

Program management systems of the NGOs appear modern and conscientiously implemented. They appear to have the necessary staff and reasonable costs for the level of program activities.

Inability to capture savings deposits is an organizational constraint to development of the NGOs.

In line with the microlending methodology, the uncollectable loans are very small. In the village banking component, it is almost zero, due to the methodology utilized.

VI. BENEFIT/COST OF THE PROGRAM

The quality of the NGOs portfolio appears sound, and the yield is in keeping with the agreed interest rate policy.

USAID and its partners addressed adequately the common perception concerning the feasibility of the original project design.

The project is cost effective and is sustainable on a long-term basis. In effect, is viable at its present cost structure as a channel to lend capital at commercial rates to the microentrepreneur. It is realistic that the partners could obtain borrowed private bank capital and lend it at rates adequate to cover its costs.

Alternative approaches to creation of a fully self-sustainable financial system serving the SME sector that directly mobilize domestic savings would have been more cost effective.

Data on program impact was systematically collected. Several actions were taken to verify the reliability of our partner's data collection processes and USAID/Ecuador conducted financial reviews of the three village banking partners. The program didn't do surveys of employment generation in the SME sector however, there is a reasonable basis to conclude that the program had a positive impact.

The success achieved in the program was due primarily to the fact that the SME lending NGOs have proven to be capable of performing this role on a sustainable basis.

The MAS program has had a favorable financial impact on the participating NGOs and on their clients. This conclusion is based on field trips and analysis of the financial situation of the partners.

VII. OTHER DONOR PROGRAMS

The World Council of Credit Unions (WOCCU) is indirectly serving the microenterprise sector, providing technical assistance worth \$500,000 annually to 23 credit unions whose members include microentrepreneurs. Other institutions like the IDB, World Bank, GTZ, and COSUDE are also potentially interested in implementing microenterprise programs. The Ecuadorian government expects to initiate a pilot microenterprise loan program oriented to the country's poorest women, and USAID and other donors will need to keep engaged on this effort to insure complementarity and consistency (e.g. on issues related to interest rates) as well as maximum impact.

VIII. MAJOR CONTRACTORS AND GRANTEES

USAID's/Ecuador assistance to microentrepreneurs was implemented through U.S. and Ecuadorian NGOs: CARE, Accion International, Fundacion Alternativa, Development alternative Inc., Carana Associates, SCDF, CRS, FINCA, Project Hope, and Banco Solidario.

IX. SUMMARY OF CONCLUSIONS

Analysis of the long-term sustainability of microfinance institutions should take into consideration that real interest rates in Ecuador are high, and that over time they should tend to decrease.

To the extent the NGOs become reliant on unsustainable subsidized interest rates, they will fail to undertake measures required to improve their operating efficiency. Subsidized programs of this nature inevitably fall prey to partisan political pressures, which would distort the nature of the SME NGOs.

Continued provision of some level of technical assistance and training support is necessary for the viability and future growth of SME lending NGOs. Provision of this assistance should be based on at least partial cost recovery planning, however.

X. SUMMARY OF RECOMMENDATIONS

The new SO to help reduce poverty should focus on microfinance activities as our most effective means to achieve results, building on previous experience and targeting increased effort towards historically excluded population.

Some of the issues this program may need to address could include development an improved regulatory environment for microfinance services, confronting constraints such as Ecuador's current interest rates ceilings.

Increased training and technical assistance may also be important, both to lending institutions (to strengthening the quality of their microfinance assistance) and to support entities such as the Superintendency of Banks (to improve the regulatory environment).

Widespread replication of microfinance services will also be required at the national level if the Mission is to achieve the kinds of results it strives for. This will likely require increased analysis of better ways to engage the formal banking sector, and potentially groups like credit unions, in provision of microfinance services (though much could continue to depend to the country's macroeconomic context).

XI. POST COMPLETION ACTIONS

Although the Microenterprise Assistance and Strengthening Program ended successfully on September 30, 2000, the Mission decided to carry out an evaluation, with a view toward designing a new SO to help reduce poverty. The lessons learned from this evaluation will help immeasurably with that design, as well as with important insights to assist with implementation of microfinance activities under the Southern and Northern Border SpOs.