PN-ABF-722

FINANCIERA IBEROAMERICANA S.A.
AND
FINANCIERA DE GUAYAQUIL S.A.
IFI LOAN CASE STUDY
PRE PROJECT NUMBER 940-0002.36

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FINANCIERA IBEROAMERICANA

FINANCIERA DE GUAYAQUIL

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EXECUTIVE SUMMARY

This evaluation is one of a set of nine evaluations of Bureau for Private Enterprise projects. The objective of this evaluation effort is to discover and disseminate lessons that have been learned about the effectiveness of project models that PRE has used up to mid-1987. The evaluation methodology used here is a multiple case study design in which each of the nine projects is treated as an independent case. Standardized data collection guides were used in all case studies.

The research for these studies was carried out over a one year period, from October 1986 to October 1987. Included in the research were the following tasks: (1) review of project documentation and interviews with PRE Investment Officers; (2) identification and review of relevant experiences of other similar projects in the country; (3) conduct of site visits to approximately one-third of sub-borrowers, including interviews with sub-borrowers and examination of sub-borrower business operations; (4) review of documents and conduct of staff interviews in the intermediate financial institution participating in the project.

This evaluation of A.I.D.'s Revolving Fund program in Ecuador was completed for the Office of Program Review of the Bureau for Private Enterprise in August 1987. PRE established a US$ 1.4 million guarantee facility in each of two intermediate financial institutions, Financiera Iberoamericana (FINIBER) and Financiera de Guayaquil (FINANQUIL). The facility provided letters of credit denominated in dollars to Ecuadorean importers. The facilities were designed in response to a critical shortage of foreign exchange credit which had arisen following the economic crisis of 1983. Lending under the project was to target small agribusinesses with fixed assets of less than US$ 300,000. The broader objective was to generate employment and encourage technology transfer by increasing the flow of capital to the agricultural sector.

The issue of underutilization of the guarantee facilities was central to this study. FINANQUIL opened only two letters of credit; FINIBER's maximum utilization of the credit line reached only 27% of the total loan amount. The reasons for this, as identified by the evaluation team, included inadequate loan promotion by the bank, excessively restrictive sub-borrower requirements, and changes in the economic environment after the facility was designed. After the facility began to operate, importers once again had a variety of credit options and had begun to rely on forms of import financing other than letters of credit.

The importance of rigorous in-country monitoring and flexibility in project design were the most salient lessons learned by the evaluation team. Effective monitoring would not only ensure stricter compliance with the guidelines established in the agreements, but would enhance program success by feeding back information on the "fit" between project design and the economic environment. In the

case of Ecuador, the financial market changed considerably after the project was conceived, and this contributed greatly to the program's underutilization. Routine reporting on utilization levels and other management issues, and greater flexibility to make design changes would have ensured greater program success.

I. GENERAL ECONOMIC ENVIRONMENT

Historically, Ecuador has experienced relative financial stability and consistent economic growth, a trend abruptly interrupted by events beginning in 1982. Ecuador's traditional exports are bananas, cocoa, coffee, and beginning in the late 1960s, petroleum. Oil discoveries substantially affected both domestic energy markets and export earnings, particularly following the completion in 1973 of a pipeline connecting oil fields to the port of Esmeraldas.

The success of Ecuador's economic boom beginning in the late 1960's supported the growth of a large government infrastructure, which included state industrial monopolies of petroleum, electricity, telecommunications and the international airline. Three shipping lines were established and large investments made in state owned financial institutions such as the Agricultural Development Bank and the National Finance Corporation (CFN). Through CFN, the government indirectly owned the country's largest cement plant, the largest sugar mills, hotels and industrial parks.

During 1970-1980, the economy had grown at an average annual rate of 8.9%. This tremendous growth was generated from the quadrupling of oil prices since 1973, as well as success in traditional agricultural exports.

Ecuador began to face serious economic difficulties by the end of 1979. During the previous four years, external public debt had more than doubled. By the late 1970's, the exchange rate, which had stood at 25 sucres to the dollar for over ten years, had become overvalued. The GOE did not act at that point to permit the market to decide a more appropriate rate and thus postponed confrontation.

Average Inflation and Real Interest Rates in Ecuador

1963 - 1982

	1963-71	1971-72	1973-82
Average Inflation (standard deviation)	4.5 (1.0)	8.2 (N.A.)	14.2 (3.6)
Average Real Interest on a Savings Account	1.5	-2.2	-7.4

Source: IMF as cited in World Bank 1984 p. 2.

Despite the inflationary environment of the 1970's, Ecuadorean monetary authorities maintained interest rates at the levels of the late sixties: a maximum of 6% on savings deposits and 8% or 9% for the most important categories of time deposits. These rates prevailed until early 1981 when they were increased, but by less than the inflation rate.

The maintenance of low interest rates on deposits and loans and the increasing perception that the sucre was overvalued, led to substantial capital flight prior to the recession in 1982 and following the crisis in 1983.

The 1983 recession was further compounded by the 1980's policy of correcting the balance of payments by relying on increased protection rather than devaluation. Monetary growth averaged 23.3% annually between 1973 and 1982, and about 18% in 1983. During 1980-81, a slowdown began and GDP fell to annual rates of 4.9% and 4.5% respectively, following a previous average of 6%. This slowdown was largely caused by declining oil prices and public expenditures;

the fiscal deficit as a percentage of GNP rose to 7.2% in 1981. Easy access to international credit continued.

A series of events, including a leveling off of export earnings, increasingly negative real interest rates, and an expensive border war with Peru led to an economic slowdown and capital flight in 1981. In spite of the net accumulation of another $1 billion of foreign debt, net international reserves dropped by $340 million. A parallel exchange market began with a 12% premium above the official rate, which climbed to 33% by year's end.

By 1982, the GNP decreased to 1.4%. The GOE initiated measures to reduce the trade imbalance by restricitng imports and strengthening exports, and devaluing the sucre to 33 to the dollar. Term borrowing from foreign banks fell from $387 million in 1981 to $99 million. New credits declined from $185 million in 1981 to $6 million. Petroleum earnings fell $400 million in one year. When Ecuador could not meet its debt obligations, this led to debt refinancing, and foreign reserves fell by $353 million.

With respect to the guarantee facility, Ecuadorean importers could not obtain export credit from other sources during 1982-83. Foreign debt payments were halted and submitted for renegotiation by the end of 1982. These events lay the foundation for the crisis of 1983.

In 1983, there was an estimated negative growth rate of 4.4% per capita GDP. Continued flooding caused by "El Nino" lowered agricultural output by 24% below 1982 levels. Net international reserves declined another $100 million as international lending sources continued to dry up, despite the infusion of an $800 million trade surplus. Inflation soared to 50.3%, and the country was caught up in economic chaos. A new stabilization program was implemented, in which:

- The sucre was once more devalued and in March, 1983, a crawling peg devaluation was begun at a rate of .02 and later .05 sucres per calendar day.

- An official parallel market was established and has remained quite close to the "free rate", a great improvement compared to the exchange situation in 1982.

- Commercial banks and financieras had to rely on credit from the Central Bank as the single source of domestic credit.

It should be noted that the A.I.D. proposal paper on the guarantee facility clearly identified the events of 1981, 1982 and 1983. Since the project did not begin until late 1985, and letters of credit were not opened until 1986, the subsequent developments of 1987 are highlighted below.

The Febres Cordero Administration, recognizing the economic crisis, proposed a six point economic program that continues with remarkable success even now. This dramatic improvement has occurred in spite of a string of uncontrollable setbacks. By 1985, external payment arrears had ceased, overall financial savings went up by almost 60%, liquidity was managed effectively, and inflation reduced to 24%.

The turnaround of 1985 was hit by several unlucky events in 1986-87. The petroleum price decreased from US$26 to $12.60 per barrel, and at times dipped to $7 during 1986. Then, an earthquake struck in March 1987 which destroyed 32 kilometers of the trans-Ecuadorean oil pipeline and knocked out all oil production until

August 1987.

As a result, nominal GDP grew 1.7% in 1986, compared to 3.8% in 1985, so that real GDP fell 1.1%. In 1987, the $570 million loss of oil export earnings combined with falling oil prices and a costly earthquake reconstruction effort will once more cause a massive balance of payments problem. The consumer price index increased by 27.3% in 1986 compared to a 24.4% increase in 1985. Inflation has continued to increase even further in 1987 due to the earthquake.

II. BANKING AND FINANCE

A. Institutional Framework

The Ecuadorean banking and financial system operates within an institutional framework of 31 commercial banks, 12 financieras and/or development banks, 8 savings and loans, 27 insurance companies, 15 savings and loan cooperatives, five major government institutions, and the two stock exchanges, which are largely owned by CFN (a government institution) and are the primary marketplace for trading and fixed instruments. Overall, Ecuador's capital market development is limited. A 1986 study by SRI placed Ecuador in the lower half of 15 countries classified by IFC as being either low or lower middle income countries, based on a ratio of monetary stock plus financial instruments of up to one year of maturity to GDP.

The financial institutions depend on Central Bank credit or GOE instruments. The Central Bank of Ecuador has in fact become the dominant credit granting institution in the Ecuadorean financial system (World Bank, April 1985, page 17).

The Superintendent of Banks regulates and supervises the financial system under Ecuador's general banking law. A recent study, however, found that the conditions of banks under the direct supervision of the Superintendent had deteriorated, and collapse would have been likely had the "letter of the law" been applied since the crisis of 1983. As a result, before 1985 a flourishing extra-legal financial market, called the "mercado extra-bancario", developed.

B. The Commercial Banks

The 31 commercial banks largely dominate banking transactions and capital markets in the country. However, they are "generally quite small and by developed country standards, undercapitalized." The commercial banks are short-term and transaction oriented, and for longer term instruments typically use a closely managed and owned subsidiary financiera, much like Banco Popular/FINIBER, where Banco Popular maintains a 30% equity investment in FINIBER.

C. Financieras

The financieras' original purpose was to finance Ecuador's longer term economic development, where commercial banks were seen as commerce oriented institutions. Since the 1970's, the financieras have faced troubled times. Closely dependent on the Central Bank for credit and prohibited by law from receiving sight and term deposits, they have lost both strength and identity.

The public financieras suffer from their non-performing guaranteed foreign currency loans and their obligatory investments in a variety of government sponsored projects. It has been estimated that as high as 80% of the financieras' combined liabilities were directly or indirectly tied to GOE sources. The government sucretization program, which involved conversion of external debt owed to international financial institutions by private sector debtors into sucres, caused a dramatic rise in the sucre book value of the financieras but substantially increased their debt/equity ratios. Additionally, because perhaps one half of the country's firms faced severe economic problems, there was more pressure on their creditors, including the financieras. There appears to be general agreement that the financieras as a group face many problems and are currently in weakened conditions. However, as the reader may see from the analysis of FINIBER and FINANQUIL, their financial condition is quite strong.

D. Interest Rate Structure, Cost of Money and Liquidity

The policy of subsidizing interest rates began to change in 1981 when the GOE began to gradually increase interest rates on loans and deposits, thus allowing a reduction in the difference between inflation and interest rates. A negative interest rate in real terms continues, nonetheless.

The dramatic economic growth of the 1970's resulted in fairly easy credit terms, with the Central Bank financing credit often 4-6% below the rate of inflation. The ratio of private sector bank credit to GNP grew from 15% in 1973 to the 20% range by the 1970s, to 22% in 1981 and 1982 and about 27% in 1983, which reflected the sucretization program.

The following tables profile key financial and monitary indicators during the 1982-1986 period. As noted above, prior to 1981 the interest rate was subsidized to remain at a nominal rate of between 7% and 9% for many years. The trend of negative real interest rates beginning in 1983 brought with it the "illegal" extra-bancaria system:

ECUADOR
KEY FINANCIAL MARKET INDICATORS

	NOMINAL INTEREST RATE	REAL INTEREST RATE	NOMINAL CHANGE IN SAVINGS	REAL CHANGE IN SAVINGS	INFLATION RATE
1982	15	1.3	29	+13	16.3
1983	19	-29.4	33	-15	48.4
1984	23	- 8.2	61	+31	31.2
1985	23	- 5.0	95	+67	28.0
1986	26	3.0			23.0

	MI			FINANCIAL LIQUIDITY			
	TOTAL (BILLION SUCRES)	NOMINAL CHANGE (%)	REAL CHANGE %	TOTAL (BILLION SUCRES)	NOMINAL CHANGE (%)	REAL CHANGE %	EXCHANGE RATE (SUCRE/$)
1982	60	20.2	3.9	52	16.7	.4	48.89
1983	78	30.4	-11.4	73	41.5	(6.9)	82.94
1984	112	42.1	10.9	79	7.5	(23.0)	97.41
1985	138	23.8	-4.2	85	8.3	(19.7)	115.84
1986	166	20.2	- 2.8	97	13.1	(9.9)	150.80

The first stage of the GOE's credit liberalization effort began in June 1985. Savings and time deposits maturing within 360 days were allowed to float upward for accounts over 100,000 sucres. The second stage of the GOE's liberalization began on August 11, 1986, when interest rates for savings accounts and time deposits for longer terms were allowed to float as well. This strategy raised both nominal and real rates while decreasing the scale of "extra-bancaria" activity.

This second stage of liberalization included sweeping reforms that caused a dramatic increase in the value of the sucre, which held stable until the earthquake. As can be seen, 1986 was also the first year in several to show a positive real interest rate.

The real interest rate during 1986 rose concurrently with continued contraction in financial and monetary liquidity. At that point, the earthquake-related difficulties overwhelmed the effect of these economic policies and structural adjustment efforts.

III. THE LOAN AGREEMENT BETWEEN THE IFIs AND A.I.D.

The Revolving Fund guarantee facilities in Ecuador were developed by the Bureau of Private Enterprise in response to a growing inability on the part of private financial institutions to obtain foreign exchange funds to finance local importers. The aim of the program was to provide short term credit for small- and medium-scale enterprises (SMSEs) in the agribusiness sector, which would enable them to import machinery and other production inputs and, in turn, contribute to employment generation and technology transfer. A secondary objective was to encourage policy change by the government which would improve financial institutions' ability to deliver credit to small businesses.

In Ecuador PRE undertook two Revolving Fund projects to provide credit to SMSEs. In each case PRE worked with a local intermediate financial institution and an international depository bank. These two projects involved the following teams of financial institutions: FINIBER and First Pennsylvania Bank, and FINANQUIL and Swiss Bank Corporation.

Both projects used a similar, rather complex mechanism to guarantee credit to SMSEs. In its simplest form, the mechanism works as follows. First, PRE provided a loan to a local IFI (FINIBER or FINANQUIL), depositing this loan drawn on the Revolving Fund into a blocked account in an international depository bank. The local IFI pays A.I.D. a market rate of interest on the Revolving Fund project account, while the account serves as the collateral that guarantees letters of credit issued to qualifying SMSEs, called sub-borrowers.

The local IFI authorizes the depository bank to issue a Standby Letter of Credit that secures 90 percent of an import credit to an SMSE. Based on this Letter of Credit, the depository bank issues a second L/C in the name of the import supplier and the sub-borrower uses this second L/C to finance its imports. Through this arrangement, the collateral account established by A.I.D. covers 90 percent of the depository bank's total credit risk associated with paying the import supplier.

When this second L/C comes due, the supplier is paid in U.S. dollars by the depository bank. The sub-borrower then pays back the depository bank in sucres through the local IFI at whatever foreign exchange rate is prevailing on the date of the payment. Thus, the sub-borrower bears the foreign exchange risk of the import credits.

If the SMSE borrower defaults on payments, then the local IFI is obligated to repay the credit to the depository bank. If the IFI does not repay the credit, then the depository bank can file for reimbursement from the collateral fund. Thus, the guarantee facility covers most of the depository bank's credit risk, but none of the local IFI's credit risk.

Lengthy discussions were carried out through 1984 and into 1985 to finalize arrangements with First Pennsylvania Bank for the FINIBER project, and Swiss Bank for the FINANQUIL project. Since normal commercial systems of payment in Ecuador had completely broken down and few dollars were available locally, U.S. commercial banks were reticent about approving letters of credit, not knowing whether the government would soon mandate that dollars could not go out for payment. Also, the original design of the program required the international depository bank to assume 50% of the risk on all sub-loans; it was not until this was lowered to 10% that two banks could be located.

A. Financiera Iberoamericana (FINIBER)

The agreement signed between FINIBER and A.I.D. in September 1984 established that A.I.D. provide a US$ 1.4 million loan to FINIBER and that this loan is to be deposited into a collateral account in First Pennsylvania Bank. For two years following the execution date, the funds were to serve as collateral to secure commercial letters of credit opened for FINIBER sub-borrowers. The financiera unconditionally agreed to repay First Pennsylvania for all costs resulting from the issuance of these letters of credit.

In the event of sub-borrower default, FINIBER is obligated to repay the outstanding amount of the letter of credit to First Pennsylvania Bank. If the financiera is unable to make payment within thirty days of the due date, then the depository bank may request repayment from the collateral account. It is only in a situation where the financiera is unable to repay the outstanding amount that the depository bank may request reimbursement from the collateral account.

The agreement also requires FINIBER to pay interest to A.I.D. on the outstanding principal, at an annual rate equal to the yield on qualifying investments, less the depository bank fees. Interest is paid every six months. In addition, FINIBER pays a utilization fee for the guarantee facility equal to two percent per annum of the average amount in the collateral account, and a one-time facility fee of US$ 7,000, payable within thirty days of the agreement execution date.

With respect to repayment of principal, the financiera or local IFI must repay the loan within ten years of the first disbursement in sixteen equal semi-annual installments. The first such payment is due 28 months after the first interest due date.

Eligible sub-borrowers are those businesses with the following characteristics:

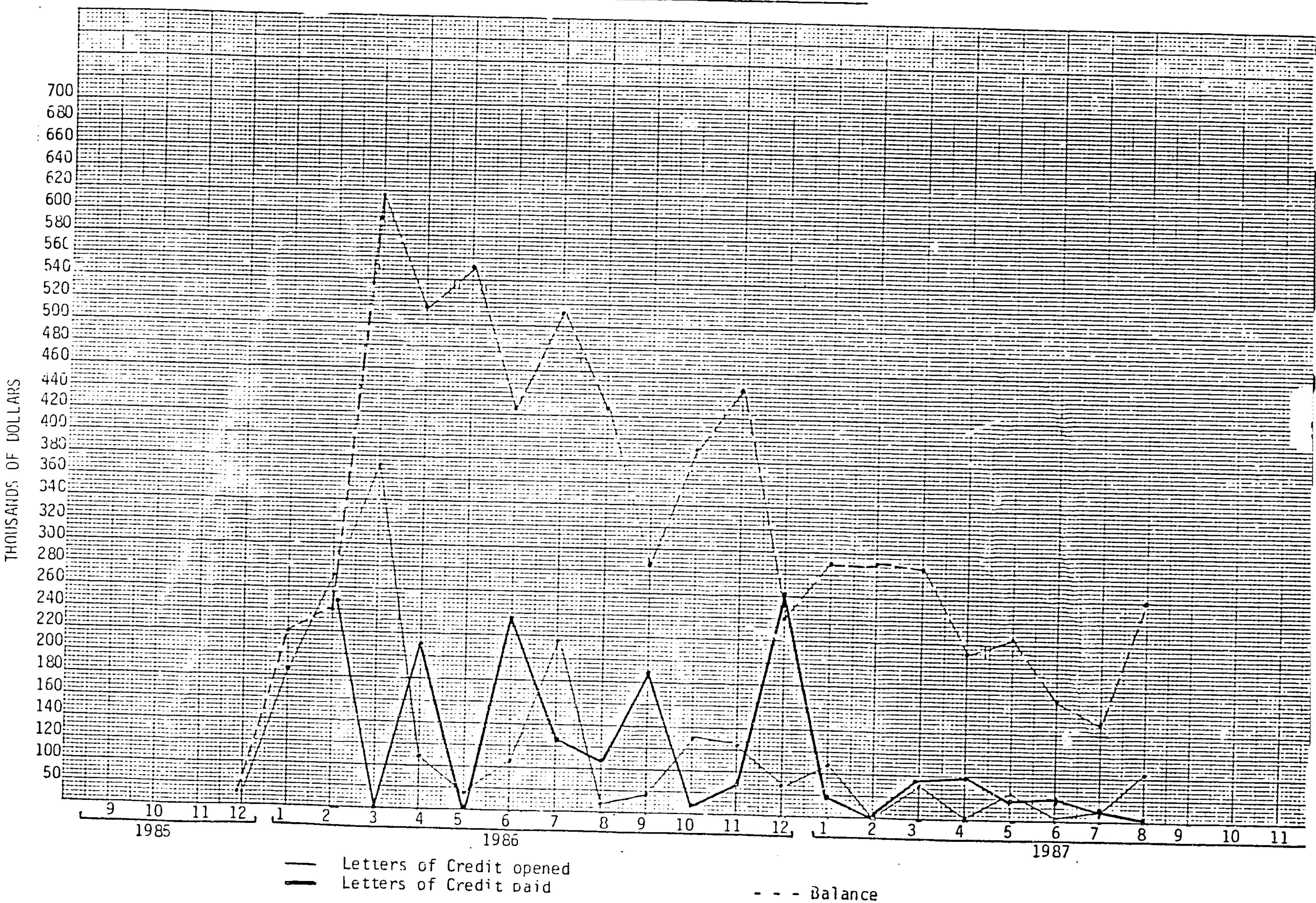
1. 100% private ownership;
2. At least 51% Ecuadorean ownership;
3. Fixed assets, excluding land and buildings, of less than $300,000;
4. Involved in agriculture and agribusiness activities.

FINIBER identified these clients and, in certain instances, set up longer term financing to cancel letters of credit.

The Tripartite Agreement between A.I.D., FINIBER, and First Pennsylvania Bank was signed in September 1985, and the first letter of credit opened in December. FINIBER was actively involved in the design of the letter of credit facility. Raul Daza, former FINIBER president, travelled to the U.S. and met with A.I.D./W and First Pennsylvania Bank and collaborated in the early stages of program development. The US$ 1.4 million line reached maximum utilization in March 1986, at $378,000. The following charts indicate level of use and trends in usage:

TRIPARTITE AGREEMENT BETWEEN AID, FINIBER, AND FIRST PA. BANK

UTILIZATION OF RF CREDIT LINE



TRIPARITE AGREEMENT BETWEEN A.I.D., FIRST PENNSYLVANIA BANK AND FINIBER
UTILIZATION OF CREDIT LINE

LETTER OF CREDIT #	DATE OPENED	IMPORTER	TYPE OF BUSINESS	FIXED ASSETS*	AMOUNT OF L.C.	AMOUNT PAID	MRCHDSE. IMPORTED
758	12/03/85	Metain	Injectable metals for fixtures	$500,000	$33,280	$33,280	Hot metal Injecting machine
772	01/07/86	Indurama	Kitchen Appliances	$1.02 million	$63,342	$63,757	Parts for kitchen appliances
776	01/24/86	E. Orejuela	Rose Exporter	File misplaced	$92,560	$93,203	76,288 rose plants
769	01/--/86	Ind. El Tunel	Bakery	$500,000	$23,310	$23,310	Bakery oven
768	01/--/86	Condecuero	Leather	$130,000	$8,251	$8,251	Materials for leather working
771	02/06/86	Indurama			$20,100	$20,100	Refrigerator condensors
775	02/19/86	Icaro	Air taxi, flight training	$500,000	$250,000	$250,000	Aerocom-mander
777	03/06/86	Cedal	Aluminum lamination	$1,335,000	$101,526	$99,286	60 T aluminum Ingots
778	03/11/86	Cortyvis	Curtains	$913,140	$11,250	$11,077	Generator
779	03/21/86	Matelec C.A.	Computers, communica-tions systems	$48,200	$7,937	$8,009	Intercom-munications
780	03/27/86	Indusur	Agricultural machinery importer (commercial)		$48,725	$47,695	5 tractors
781	03/27/86	Indusur			$128,000	$119,830	5 tractors

LETTER OF CREDIT #	DATE OPENED	IMPORTER	TYPE OF BUSINESS	FIXED ASSETS*	AMOUNT OF L.C.	AMOUNT PAID	MRCHDSE. IMPORTED
788	04/21/86	Indurama			$108,807	$108,807	Parts for kitchen appliances
800	05/23/86	Cortyvis			$40,607	$43,803	Dying machine for textiles
809	06/18/86	Extractos Andinos	Food additives	$400,000	$103,200	$103,200	Vegtable and fruit drying machine
814	07/03/86	Oxidos de Plomo	Battery manufacturer	(see Ind. Dacar)	$148,645	$141,272	Production Inputs for batteries
815	08/08/86	Retme	Industrial machinery repair	$50,000	$26,067	$26,607	Dynamic equilibrium machine
818	07/18/86	Extractos Andinos			$13,736	$13,736	Granulating machine
820	07/23/87	Matelec			$21,960	$22,210	Telephone equipment
821	07/21/86	Matelec			$6,704	$6,951	Telephone equipment
825	8/20/86	Extractos Andinos			$22,656	$22,656	1 (one) generator
828	09/11/86	Alocirga	Agricultural Producer	(See Extractos Andinos)	$20,450	$22,080	Agricultural machinery
830	09/22/86	Indurama			$22,941	$22,434	Parts for kitchen appliances
832	09/26/86	Extractos Andinos			$3,861	$3,881	Vegetable cutter

LETTER OF CREDIT #	DATE OPENED	IMPORTER	TYPE OF BUSINESS	FIXED ASSETS*	AMOUNT OF L.C.	AMOUNT PAID	MRCHDSE. IMPORTED
834	10/08/86	Rosinvar	Rose exporter	$250,000	$60,000	$60,000	Rose plants
837	10/28/86	Cortyvis			$18,000	$18,000	Artificial fibers
840	11/12/86	Hilacril	Textile manufactuer	$331,000	$92,400	$52,085	44,000 kilos fibers
842	11/26/86	Incoagro	Agricultural products (commercial)	$32,000	$32,337	$32,337	8,022 kilos herbicides
844	12/03/86	Matelec			$14,300	$14,300	Electrical appartus for telephones
847	12/16/86	Condecuero			$8,061	$8,061	Machinery for shoe construction
850	12/29/86	Palmeras de Los Andes	Palm oil producer	$2.5 million	$32,250	$32,240	75,000 African palm starts
85[illegible]	01/08/87	Indurama			$13,148	$13,148	Parts for kitchen appliances
853	01/13/87	Industrias Dacar	Battery manufacturer	$57,000	$24,897	$24,897	Battery accumulators
859	01/16/87	Condecueco			$21,397	$21,397	Machinery for shoe manufacturing
862	01/21/87	Indusur			$45,400	$45,400	5 tractors
876	03/04/87	Indusur			$23,115	$23,960	3 motors
881	03/19/87	Indurama			$52,402	$52,402	Parts for kitchen

LETTER OF CREDIT #	DATE OPENED	IMPORTER	TYPE OF BUSINESS	FIXED ASSETS*	AMOUNT OF L.C.	AMOUNT PAID	MRCHDSE. IMPORTED
884	05/07/87	Indurama			$43,360	—	Iron sheets
888	05/06/87	Indusur			$21,111	—	Generators, motors, convertors
894	07/21/87	Condecuero			$11,467	—	2,500 yds. Innersoling for shoes
002	08/04/87	APCI	Drainage pipe manufacturer	$680,000	$93,073	—	Cement mixer
003	08/06/87	Metain			$9,355	—	Foundry boxes, molds

* Fixed Assets excludes land/buildings

B. Financiera de Guayaquil (FINANQUIL)

Discussions on the guarantee facility began at FINANQUIL toward the end of 1983, led by Drago Pamucina and Norman Page, who were both with A.I.D. until 1984. The agreement between A.I.D. and FINANQUIL provided for a $1.4 million loan, and was signed in September 1984. This agreement also provided that the loan would be deposited in a blocked account in Swiss Bank to serve as collateral for FINANQUIL's import credits to qualifying SMSEs. A mechanism for capturing liquidity through bonds, with a treasury bill counterguarantee by A.I.D. was also proposed, but was impossible at the time.

The Tripartite Agreement between A.I.D., FINANQUIL, and the Swiss Bank Corporation was not signed until December 1985, again due to the fact that the original design of the facility required the commercial bank to assume fifty percent of the risk on all letters of credit opened under the program. The final Tripartite Agreement granted Swiss Bank a security interest in the collateral account equal to 90 percent of Swiss Bank's credit exposure under the program.

Since the beginning of the project, only two letters of credit have been opened, totalling $188,188.

All details of the FINANQUIL program, and provisions in the agreements concerning the collateral account, sub-borrower criteria, defaults, interest and bank fees, and repayment of principal are the same as FINIBER with the exception of the fees charged to sub-borrowers in connection with opening letters of credit. These include:

- a $100 negotiation commission;
- a one-time acceptance commission of 1.5% of total letter of credit;
- a minimum commission of .75% for opening the letter;
- if letter of credit is refinanced, the interest charged is either 1% over the prime interest rate, or 1% over the LIBOR rate quoted by Swiss Bank, London;
- no cash collateral required.

The 1986 World Bank report on Ecuador indicates that by 1984, the availability of credit for imports in the agricultural sector had slowly increased to 1982 levels (the year before the crisis). Had these guarantee facilities been in place prior to 1984, utilization of the lines might have been more significant. Once external credit was again available to potential borrowers, competition with the guarantee facilities became greater, and demand diminished.

IV. IFI ORGANIZATION AND OPERATIONS

A. FINIBER

FINIBER was established in 1977 by a group of private investors and Banco Popular, and is one of twelve private financieras in Ecuador. As of June 1987, assets totalled US$ 37.3 million, which ranks it sixth among the financieras. For additional financial information, please refer to Appendices A and B. FINIBER's portfolio is divided among the following activities:

FINIBER
PORTFOLIO CLASSIFICATION BY ECONOMIC ACTIVITY
(IN MILLIONS OF SUCRES, US $1= S/200)

ECONOMIC ACTIVITY	December 1986 Value	%	July 1987 Value	%
Food and Beverage	634	7.3	577	6.6
Textiles, Clothing, Leather	620	7.1	748	8.5
Wood/Furniture	185	2.1	116	1.3
Graphic Industries	222	2.5	231	2.6
Chemicals & Derivatives	444	5.1	374	4.2
Non-metallic Minerals	237	2.7	222	2.5
Metal Industries	204	2.3	182	2.1
Metal Products	379	4.3	374	4.2
Electrical Products	237	2.7	176	2.0
Misc. Manufacturing	364	4.2	263	3.0
Total Manufacturing	3,526	40.3	3,263	37.0
Construction Industry	1,170	13.4	1,287	14.6
Transportation	105	1.2	129	1.5
Machinery and Production Inputs	505	5.5	492	5.6
Tourism	161	1.8	164	1.4
Community Services	131	1.5	109	1.2
Agriculture	1,633	18.7	1,743	19.8
Livestock, Fishing and Poultry Industries	1,080	12.4	1,214	13.8
Banks and Financial Institutions	--	---	147	1.6
Other	430	4.9	266	3.0
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	8,741	100.0	8,814	100.0

Since the inception of the guarantee facility FINIBER has undergone significant administrative changes. Raul Daza, the former President of FINIBER who was active in the development and implementation of the program, moved to Banco Popular on the eve of a proposed merger with FINIBER (Banco Popular owns 30% of the financiera), and was replaced by Santiago Pizarro in April 1987. Gloria Espinel, former Manager of Operations, joined Banco Continental and was replaced by Susana Varea in April 1987. Since issuance of the first letter of credit in December 1985, all of the credit officers have left and been replaced. A lapse of roughly six to eight months passed during which all credit officer positions were vacant. Nonetheless, administrative and policy procedures governing the guarantee facility have remained essentially the same throughout its operation.

Mr. Pizarro indicated that since the start of the project he has improved the operation of the Credit Department and the procedures for identifying viable loans. New credit officials have been assigned, although the position of credit manager still remains vacant. (Mr. Pizarro temporarily performs these functions).

FINIBER serves as a conduit for delivery of numerous forms of development assistance credit in Ecuador. Among the major sources are the following:

1. <u>World Bank #2096</u> - medium- and long-term loans (five to ten years) to promote development of intermediate and large scale industry. This is a $60 million program, with

financing to be directed toward the purchase of fixed assets.

2. Inter-American Development Bank #422 and #688 - medium- and long-term loans (five to ten years) to promote export manufacturing and agroindustrial development. This is a $35 million credit line designated for equipment acquisition and industrial construction.

3. A.I.D. 518-T-058 - medium- and long-term loans (five to ten years) to promote development of small businesses in the agricultural sector. The $8 million loan program is to be used to purchase fixed assets excluding land.

4. A.I.D./FEDEXPOR - short-term loans (one year and non-renewable) of up to $12,500 to finance feasibility studies and technical assistance for agricultural projects. The total program is $300,000.

5. Andean Development Corporation/IDB-IC-144 - short-, medium- and long-term loans to promote export manufacturing, import substitution, and improved industrial output through import of machinery. Combined ADC/IDB funding equals $500 million.

6. World Bank 2221/FOPINAR (National Fund for Small Business and Handicrafts) - short- and medium-term loans to provide operating and investment capital to small-scale industry and artisans with fixed assets of less than $125,000.

The financiera also manages a number of credit lines through the Central Bank, such as development bonds, a rediscount facility for the fishing industry, production acceptances and rediscounts, and "fondos financieros" for agriculture, livestock, fisheries, tourism, mining and export development.

Besides these credit programs, Finance Manager Fabian Flores knew of no other existing or proposed programs which target small businesses, and expressed his belief that there is very little concern for small business development in the Ecuadorean banking sector.

Operationally speaking, the guarantee facility is treated just like any other line of credit by bank officials, the only difference being that one additional telex is sent to A.I.D./W to report the opening of letters of credit. Mr. Flores stated that FINIBER and A.I.D. have the same development objectives, although he knew nothing about the specific objectives of the Revolving Fund. The profitability from service fees of all letter of credit programs to the financieras is roughly the same, because the government has established fixed commissions that banks can charge for letters of credit. These commissions are 1 percent trimestrally and 4 percent annually.

The operation of the guarantee facility is integrated into the regular operations of FINIBER, the only difference being their adherence to the procedures outlined in the agreement. In certain cases the bank passes additional charges associated with the guarantee facility directly to customers.

Although the line of credit provided an additional lending alternative for FINIBER, there is no obvious evidence suggesting that this resulted in a net increase in the bank's lending to small businesses, despite the fact that FINIBER has had positive experience with small businesses in the past, and such businesses have evidenced pay-back records better than those of larger businesses.

Susana Varea, Operations Manager, has primary oversight responsibility for the guarantee facility. She had been with FINIBER for four months at the time of this study, and brings to the institution ten years of international banking experience which she acquired at Banco Continental. Ms. Varea's responsibilities include management of credit lines through the Central Bank, and oversight of external credit operations. She supervises eight operations officers whose responsibilities are divided into Central Bank transactions, letters of credit, liquidation of new operations, and collections. It is this department's responsibility to process all documentation for opening letters of credit and insurance, and do all accounting related to the guarantee facility.

The Credit Department is divided into an Agricultural Loans Division, Industrial Loans Division, and a division for other loans. The Credit Department identifies potential clients for guarantee project coverage and does a preliminary credit analysis. Depending on the type and quantity of the loan requested, various "levels" of approval are required. First level clearance is obtained from the manager of credit. Presently this position is vacant, so all determinations are passed directly to the Executive President. Loans in excess of $800,000 and letters of credit in excess of $1,600,000 require the approval of the Executive Commission. Once the loan is approved, the loan officer issues an "operations request" to the Legal Department. The Legal Department reviews each company, and sets individual requirements. Credit officials also manage loan collections. If sub-borrowers become delinquent in repayment and the credit official is unable to rectify the situation, the case is turned over to the Legal Department.

There is a direct relationship between the level of guarantee facility use and bank staff time required to administer the project. When the facility reached peak utilization in early 1986, credit officials reported that approximately eight employees devoted 50% of their time to the program. Now that utilization has dropped significantly, these same employees devote about 10% of their time to the program. It seems from this estimate that either management of the guarantee facility consumes a great deal of staff time, or estimates are somewhat high. The operational aspects of the program are handled at the level of operations assistant, program decisions are made at the level of manager, and overall management and credit approvals are done at the executive level.

All managers interviewed expressed a need for better training of credit officers. As mentioned previously, all employees in the Credit Department are recently hired. They require training in international banking transactions and credit analysis, a solid background on the mechanics of letters of credit, and a familiarization with the objectives of the guarantee facility, so as to be able to provide better guidance to clients. The need for this type of comprehensive training is even greater given the change of administration in FINIBER. Former credit officers had received no official orientation on the objectives of the A.I.D. project, and new employees are not at all familiar with the project.

The Executive President determines all financial policies for the financiera. Individual financial institutions have little flexibility in setting interest rates, because these are established by the Junta Monetaria and the Central Bank.

The commission charged to letter of credit recipients through this program is 2.48% of the total amount of the letter of credit (1% to FINIBER; 1.48% to First Pennsylvania Bank). FINIBER charges customers another 4% commission annually. The rate charged on loans for financing the repayment of the letters of credit is the prime rate plus 2 percent. Depending upon the financial situation of the client, the amount of the letter of credit, and the availability of different lines of credit to FINIBER, a variety of loan and repayment arrangements may be made for the sub-borrower. The duration of the loan may be anywhere from 180 days to 18 months. The A.I.D. Security Interest section of the agreement binds the financiera to the payment of 100% of all letters of credit opened under this program.

Letters of credit through First Pennsylvania Bank require the sub-borrower to pay 10% of the total dollar amount as cash collateral. For other types of loans, the average amount is 50-100% of the value of the credit. Depending upon the client's history with the bank and the amount of credit, the collateral may be a personal guarantee, pledged, or mortgaged property. If the amount of the loan is small and the client's record with the bank good, personal guarantees may be accepted.

There is no promotion done by FINIBER for the guarantee facility. Credit is channeled to promote development in economic sectors that are of interest to the bank. This has, at times, resulted in letters of credit being opened for clients not in the agricultural sector, contrary to the project agreement guidelines. Management officials felt that the agreement had given them the flexibility to do so.

Credit officers evaluate requests and may give recommendations for approval. An internal handbook is used to complete the analysis. The Credit Department has a micro-computer program which does financial analysis of clients, and calculates internal rates of return, various production indices, and overall feasibility of loans. The average turn-around time from application acceptance to approval is four to five days.

The Credit Committee is comprised of the Executive President and the "Credit Platform". This platform includes the credit manager, the assistant manager concerned and an analyst who represents the sector of the loan (agriculture, industrial, or "other"). The President may approve general loans up to $800,000 and letters of credit up to $1,600,000. For loans or letters of credit above these amounts, the approval of the Executive Commission is required. There is a lapse of approximately fifteen days between the time of application approval and disbursement.

Prior to approval of any loan, a site visit is made by a Credit Department officer to observe how the business is run, and to speak with management and workers. Machinery is inventoried to determine its value, and a check is made of the firm's bookkeeping procedures. Those businesses which receive financing from FINIBER are visited at least once a year to assure that financing has been utilized for approved purposes.

There are no specific funds marked for technical oversight, and the technical advisor position in the Credit Department has been vacant for one year. The manager of finance commented that it was difficult to become involved in the operations of a business once a loan has been granted.

FINIBER trade credits are usually collateralized so that collateral can be sold if the borrower is delinquent in loan payments. Procedures also exist whereby companies may be placed into receivership or sold if delinquent.

The Credit Department makes the initial efforts to collect delinquent loans, through mailing notifications and making follow-up telephone calls. If twenty days pass and payment is not received, the business receives a communication from the Executive President. If payment is still not received after ten more days, the case is turned over to the Legal Department. Credit managers reported that no such measures have been taken in connection with the guarantee facility because there have been no defaults.

B. FINANQUIL

Financiera de Guayaquil, established in July 1976, is one of the most important financieras in the Guayaquil area. As of June 1987, assets totalled $49 million, which ranked it fourth among the twelve leading financieras in Ecuador. For additional financial information, please see Appendices C and D. Guayaquil is the industrial center of the country. The following table, which indicates portfolio activities for the semester immediately preceding the evaluation activities, reflects FINANQUIL's strong involvement in the industrial sector:

FINANQUIL

January, 1987 - June, 1987

Classification of Total Portfolio Credit, Both New and Existing
(in 000 sucres)

SECTOR OF ECONOMIC ACTIVITY	JAN.	FEB.	MAR.	APR.	MAY	JUN	6 MONTH TOTAL	%
Agriculture, Livestock, Fisheries	63,778	32,974	71,199	66,437	75,513	319,036	628,937	17.8
Mining	3,430	---	5,000	---	2,000	14,380	24,810	.7
Manufacturing	116,773	283,438	220,098	168,529	406,738	763,561	1,959,137	55.4
Construction	36,042	55,437	18,300	63,117	96,467	376,268	645,631	17.2
Restaurants and hotels	5,888	23,811	7,321	11,817	12,543	64,507	125,887	3.5
Transport, Storage and Communications	---	---	---	---	---	491	491	.01
Financial Entities in Real Estate and Employee Services	18,670	19,053	27,300	28,425	40,850	41,038	175,336	4.2
Community Services	2,500	10,839	8,218	3,780	9,124	10,003	44,464	1.1
	247,081	425,552	357,436	342,150	570,240	1,589,684	3,532,098	100.0

FINANQUIL serves as a conduit for delivery of numerous forms of development assistance credit for Ecuador. Among the major sources are the following:

1. Central Bank credit lines:

   A. Rediscount facilities for industry, agriculture, fisheries, and construction (6-36 months at 18% interest). Obligations for 1986 totalled US$ 5.5 million.

   B. Bank acceptances in the industrial and agricultural sectors (260 day maximum at 3% interest). Obligations for 1986 totalled US$ 1.5 million.

   C. Fondos Financieros for industry and agriculture (6-36 months at 18% interest). Obligations for 1986 totalled US$ 3.2 million.

   D. Development Bonds for agriculture and fisheries (5-10 years at 18% interest). Obligations for 1986 totalled US$ 2.1 million.

In the past, ceilings on these credit lines were fixed based on the capital and reserves of the institutions. Four years ago, "cupos", or limits, began to be set by the Central Bank, which make the ceilings significantly lower than they would have been if based on capital and reserves.

2. FOPINAR (National Fund for Small Business and Handicrafts), for fixed assets and working capital (2-10 years at 23% interest). Obligations for 1986 totalled US$ 444,000.

3. Guarantees for customers, other financieras, government entities, and commerical firms.

4. Loans with third party resources.

5. Forms of capturing resources, such as treasury contracts and financial certificates.

6. Inter-American Development Bank/Andean Development Corporation Industrial Reactivation Program. For importation of production inputs, fixed assets and working capital (2 years at 26% interest). Program funds total US $80 million IDB/$24 million ADC.

7. World Bank Industrial Finance Program. Funds may be used to finance 100% of imports, 70% of the cost of imported goods purchased on the local market, and 35% of local infrastructure costs.

8. IDB/CAF Global Industrial Credit Loans for medium scale businesses; this program is pending formal signing. The financiera will have autonomy to approve loans up to US $1 million.

Unlike FINIBER, the bulk of FINANQUIL management and staff has years of experience with the financiera. Primary responsibility for the A.I.D. project belongs to Ramon Espinel, Manager of Special Programs. Mr. Espinel's time is distributed between Inter-American Development Bank, Andean Development Foundation, World Bank, FOPINAR, Corporacion Financiera, the Central Bank, and A.I.D. credit programs. At this same level of management there is an Investment Manager, an Administrative and Finance Manager, and a Manager of Systems.

The highly organic structure of the Credit Department can be observed by the manner in which the client load is distributed among credit officials. Clients are graded according to their level of indebtedness, and the number and complexity of their business operations. Based on this, the workload is distributed among credit officials. No distinction is made by sector of economic activity.

Credit officers advise clients on credit options, conduct credit analyses, and manage the cancellation of the letters with Swiss Bank. FINANQUIL's Systems Analyst is developing a computer program to assist the officials in credit analyses. These evaluations are reviewed with the appropriate manager before presentation to the Credit Committee.

Requests for letters of credit are approved by the Credit Committee, comprised of the financiera's five managers. A consensus must be reached for all approvals. Gonzalo Hidalgo, Manager of Investments, described this as quite simple, given that managers know one another well and have a clear understanding of approval procedures. If there is disagreement, the client review process continues until consensus is reached.

Once the letter of credit is approved, the Operations Department gathers necessary documentation to open the letter; the same department also manages loan monitoring and collection. If Operations encounters difficulties in collection, the case is turned back to the Credit Department. Routinely, credit officials receive payment profiles on clients from the Operations Department.

Just as with FINIBER, the operation of the guarantee facility is integrated into the regular operation of the financiera. The letter of credit application process is considerably longer for new customers than for those with established credit records at FINANQUIL. Information collected for credit reviews may be broken down into four categories:

1. Background documentation on company: structure and organization, registration of the firm, determination of fiduciary responsibilities, shareholder data, legal responsibilities of managers and administrators and corporate bylaws;

2. Financial information: financial statements, credit reports from banks and financieras with whom client has had relationships;

3. Specific project information: Details of project, previous experience, market research, supply relationships.

4. Letter of Credit documentation: application form, importation permit, Central Bank tax clearance form, insurance policy.

On the basis of these the credit official analyzes the financial situation and credit needs of the client. Documentation such as import declarations, insurance endorsements, invoices, letters of credit applications, promissory notes, and guarantees are reviewed. Provided that the client is found creditworthy, the officer identifies appropriate credit alternatives.

A technical inspection is done of new clients' production facilities. FINANQUIL usually contracts the Ceraguay Company to do this type of inspection. Ceraguay assesses production costs, asset values, production technologies, and other operational factors. FINANQUIL officers also make site visits of plants and production facilities on an ad hoc basis. It was reported that some Ecuadorean banks actually place a technical person in a client's business to monitor operations, but FINANQUIL does not follow this practice.

The turn-around time from initiation of the letter of credit application process to approval varies depending upon availability of information. Often there are delays of several weeks in receiving client reports from other financial institutions. Credit officials found it difficult to estimate average time required. If the applicant for a letter of credit is already a client of the financiera, the processing of completed documentation takes as little as two to four days. Likewise, if a portfolio of global credit has already been approved for a client, the letter of credit clearance is extremely fast.

The operations officer responsible for international banking transactions issues the letter of credit through the treasurer's office in the Accounting Department. The treasurer sends a telex to Swiss Bank advising them of the issuance of the letter of credit and the specific the amount, payment conditions, and name of the payee. The bank confirms receipt of the telex and debits the costs of the letter of credit. When the machinery exporter is paid by Swiss Bank, the financiera receives an "advice of payment", which indicates the amounts to be paid by FINANQUIL and the payment dates. The sub-borrower then must repay the Swiss Bank in sucres.

Both recipients of the A.I.D. letters of credit had long standing business relationships with FINANQUIL, had the money to immediately cancel the letters, and required no financing. In these instances, clients are encouraged to open "treasury contracts" with the financiera for a time period which coincides with the opening and cancellation dates of the letter of credit, so that their money can earn interest.

Since the signing of the project agreement, there have been two letter of credit transactions for a total of $188,188. The financiera found the sectors and size of the businesses stipulated in the A.I.D. project agreement to be excessively restrictive. There was very little demand for import letters of credit from small agro-industrial businesses with fixed assets of less than $300,000. Second, in recent years the availability of letters of credit has increased significantly, both from European banks and international lending institutions. The terms of the latter are particularly favorable in that the IDB and World Bank programs offer long term financing. According to Ramon Espinel, Manager of Programs, "There's a lot more elasticity in other letters of credit, and there aren't a lot of requirements to fill."

Fifteen days prior to payment deadlines, the Correspondence Department sends a "payment reminder" to the sub-borrower. A similar type of standardized notice is sent again one week prior to payment date. If no payment is received one week following payment date, the Credit Department calls the client to discuss the account. If the situation still remains unresolved, the credit manager determines further action to be taken. This may include involvement of the Legal Department, which explains to the client potential legal action. The legal mechanism exists to foreclose or liquidate a business.

V. LOAN DISBURSEMENT AND IMPACT ON SUB-BORROWERS

As of August 1987, 42 letters of credit had been opened under the A.I.D. guarantee facility at FINIBER, six of which originated from the branch office in Guayaquil. A total of 18 businesses had been served, many of whom had opened various letters of credit. The average letter of credit size was $46,285, with the largest being $250,000, and the smallest $3,881. As can be seen in the chart on pages 17 through 20, five of the sub-borrowers were from the agricultural sector, and 13 were involved in light industry. All of the sub-borrowers, with the exception of Palmeras de los Andes, were located in urban areas, or in the outskirts of major cities.

The management of both FINIBER/Quito and FINIBER/Guayaquil expressed an unwillingness on the part of the financiera to assume additional risk in selecting guarantee facility participants. The shared perception was that although the collateral account protected the depository bank from 90% of loss should the financiera default, it in no way shields the financiera from loss should the sub-borrower default. Jaime Pesantes, Manager of FINIBER/Guayaquil, said that he would not consider opening a letter of credit for anyone who was less than an A1 customer.

A review of 18 FINIBER sub-borrowers was done, based on site visits to 14 businesses and information provided by the financiera. Average fixed assets, based on figures provided by 16 businesses, were $577,896 The largest business reported fixed assets of US$ 2.5 million, and the smallest US$ 32,000. Ten of the sixteen businesses reported fixed assets which were higher than the $300,000 limit established in the agreement. Both FINANQUIL sub-borrowers were in the agricultural sector and had fixed assets of less than $300,000. All of the businesses examined used the import credits to purchase capital goods or materials used in their business.

It is important to note that by the time the guarantee facility was in place in December 1985, two significant changes had taken place in the financial arena. First, prospective borrowers had a variety of credit alternatives with more favorable terms available, and second, many businessmen had devised other payment arrangements with exporters, which eliminated the forward exchange risk associated with letters of credit.

In spite of the low level of utilization of both credit facilities, positive impacts were registered in other areas such as policy dialogue, which can be directly attributed to PRE's presence in Ecuador. For example, Jim Finucane, former Private Sector Officer in USAID/Ecuador, explained that discussions with the Finance Ministry aimed at developing an adjustable rate instrument for import credit contributed to the Monetary Board's acceptance of public sector bonds. These discussions were the first steps in a second phase of the FINIBER project. Although a final decision had not been reached by late August concerning the A.I.D. bond facility, much activity has gone on to encourage significant policy dialogue.

VI. FACTORS CAUSING UNDERUTILIZATION OF THE GUARANTEE FACILITY

There are four principal reasons for the dramatic underutilization of the guarantee facility:

1. Macroeconomic and financial market assumptions of the PRE guarantee project did not prove true. In fact, certain economic conditions turned out to be the opposite of what was expected.

2. Since the guarantee project was financed by AID/W, officers in the financieras and USAID took minimal administrative or monitoring responsibility for the project, and bank staff were less fully committed to implementation of the project than they might otherwise have been.

3. The financieras received little operational background on the project, which contributed significantly to a lack of internal and external promotion of the facility.

4. The staff of the financieras felt that the conditions in the agreement were overly restrictive, particularly given the change in macro-economic conditions.

These factors are presented below in the order of their impact on underutilization.

<u>Trends in Imports</u>

1. Macroeconomic and financial market assumptions of the PRE guarantee project did not prove true. In fact, economic conditions turned out to be the opposite of what was expected.

Two assumptions made about agribusinesses in rural Ecuador were primary reasons for implementing this project.

1. They had no access to foreign exchange with which to finance necessary production inputs on a short-term basis.*

2. They did not have access at present <u>or</u> in the foreseeable future to long-term credit denominated in local currency to finance start-up or expansion activities.**

* Based on USAID PID 518-0019
** Based on World Bank study, June 29, 1984

The target group selected for guarantees was "small agroindustrial clients of the borrowers for the importation of production inputs considered essential to the operations of those clients." (A.I.D./PRE Investment Proposal, August 1984, p. 2).

Based on the project's assumptions, which projected that low credit liquidity for imports of agricultural capital equipment would continue into the foreseeable future, imports of such goods would have shown a downward trend during the period. Actually the opposite occurred, as the following table abstracted from a recent World Bank study indicates:

ECUADOR - MERCHANDISE IMPORTS 1982 - 1986

(Million US$ F.O.B.)

	1982	1983	1984	1985	1986
Capital Goods for Agriculture	28.6	8.6	14.0	29.3	30.5
Machinery & Tools	17.0	5.2	9.5	9.7	
Transport & Tractors	9.0	1.7	3.3	14.1	
Other Equipment	2.6	1.7	1.2	5.5	

(Source: World Bank, April, 1987, page 93).

At first glance it appears that there was indeed a crisis in this sector during 1983, yet the ability or "liquidity" to finance agricultural equipment rebounded by 63% in 1984 and by 240% in 1985 as compared to 1983. In fact, liquidity must have been present even earlier than the table suggests because the World Bank is using F.O.B. figures. A conservative estimate would suggest that such deals are actually "cut" six months earlier. Allowing for that time lag, and given that it is the availability of financing for imports that is most relevant here, real liquidity for importation probably resembled the adjusted table that follows:

IMPORT OF CAPITAL GOODS FOR AGRICULTURE
AT THE TIME DEALS ARE MADE FOR LETTERS OF CREDIT
(MILLIONS U.S. $)

	June-June 1981 1982	June-June 1982 1983	June-June 1983 1984	June-June 1984 1985	June-June 1985 1986	June-June 1986 1987
Capital Goods for Agriculture	28.6	8.6	14.0	29.3	30.5	same level as 1986 according to Banco Central del Ecuador "Informacion Estadistica Mensual" August 15, 1987, p. 30.
Machinery and Tools	17.0	5.2	9.5	9.7		
Transport and Tractors	9.0	1.7	3.3	14.1		
Other equipment	2.6	1.7	1.2	5.5		

It would seem, based on this data, that liquidity to finance imported agricultural equipment returned in an abrupt manner beginning in June 1983. In the following table, agricultural sector imports are compared with durable goods imports in all sectors.

Between 1982 and 1986, durable imports fell 20% and total imports dropped 16%, while imported agricultural capital goods increased by 3%. This suggests that agricultural equipment imports overtook other sectors during this period, running contrary to the declining supply of M1 as well as constricted credit supply during the same period for all of Ecuador.

IMPORTS

("BIENES DE CAPITAL AGRICOLA")
(THOUSANDS OF US$ C.I.F.)

	1982	1983	1984	1985	1986	Change in import level 1982-1986
Agriculture (Bienes de Capital Agricolas)	34,107	10,876	17,592	34,101	35,048	+ 3%
Durables	85,350	51,546	59,988	58,246	67,514	-20%
Total Imports (Durables & Non Durables)	2,168,952	1,487,426	1,616,285	1,766,724	1,810,224	-16%

Source: Banco Central del Ecuador Informacion Estadistica Mensual "Importaciones Realizadas por el Banco Central del Ecuador Agosto 15, 1987, page 30. (Author's adjustments.)

Given that imports of agricultural capital goods increased significantly during the period covered by the project, importers must have been making extensive use of other import credit programs. It is therefore unusual that the FINANQUIL guarantee facility was so heavily underutilized. Explanations for this are suggested in the following sections.

Recent Trends in Sources for Financing Import

Interviews with Central Bank staff, borrowers, bank managers, economists and other experts revealed several recent trends in sources of import financing. They are:

1. The 1986 Trade Finance Facility in the Central Bank;
2. Letter of Credit Programs financed by I.D.B. and the World Bank;
3. Entry of several foreign banks with credit programs;

4. A trend away from using L/C's as a form of financing imports and toward cash payment terms ("al contado"), in many cases supported by medium and long term sucre loans.

All four of the above import financing sources were preferred by agricultural capital goods importers during the period under consideration.

Foreign banks have become very active in recent years within the import financing area. Terms vary, but many programs are more attractive than the terms offered under the A.I.D. project.

The first two programs under the Central Bank and Citibank/World Bank/IDB have given the importer much better terms than A.I.D.'s. Both offer protection against appreciation of the dollar, thus limiting forward exchange rate exposure during the L/C period. In addition, these programs provide short-, medium- and long-term sucre loans to back up the L/C when it becomes due. The A.I.D. program, on the other hand, provides no sucre financing as part of the package.

It is more than likely that a new trend in forms of import finance has emerged, replacing the traditional dependence on L/Cs backed up by sucre loans. Two factors support this trend: the negative real interest rate makes sucre loans more desirable because in almost all cases the cost of the imported goods drifts upward between the time the L/C is opened and closed. More than one business studied here has been seriously harmed by this exposure to exchange rate risks associated with L/C trade financing arrangements (See case of INDURAMA on page 52).

There has been a uniformly negative trend in the value of the sucre over the 1982-1987 period, except from September 1986 to March 1987. This trend makes importers who use letters of credit denominated in dollars the losers in forward markets. It is noteworthy that prior to the August 1986 GOE policy, importers who used Central Bank lines were sheltered by pegging their exposure to a friendly non-market rate, and, following the new facility, through an arrangement called cupos. While this protection is not too substantial, the A.I.D. L/Cs do not provide their users even that level of protection.

The Director of Central Bank Studies for the International and Exchange Rate Sector expressed the view that the trend away from L/Cs and toward cash payment is occurring on a substantial scale.

2. Since the guarantee project was financed by AID/W, officers in the financieras and USAID took minimal administrative or monitoring responsibility for the project, and bank staff were less fully committed to implementation of the project than they might otherwise have been.

Discussions with staff members of the financieras and USAID seem to support this finding. It also appeared that some of the operational details of the project were not monitored in detail during the early stages of the project by either PRE/Washington or the local USAID.

3. The financieras received little operational background on the project, which contributed significantly to a lack of internal and external promotion.

The financieras commented that their first task upon signing the agreement was to translate it for operational purposes. There was no A.I.D./financiera briefing or promotion program associated with the project. Under these circumstances it was difficult for the banks to promote the project either internally or externally.

At FINIBER the credit department did not begin to implement the project until several months after signing the agreement. It seems the project started simultaneous with announcements of substantial staff lay-offs. It took over four months for the new team to present the A.I.D. facility as one of the credit options for their clients. These factors were corroborated in many interviews with bank staff.

4. The staff of the financieras felt that the conditions in the agreement were overly restrictive, particularly given the changes in macro-economic conditions.

The interpretation of guidelines regarding target population was quite different in the two participating banks. FINIBER, having made a decision to encourage utilization of the loan despite its limitations, undertook action based on a much less restrictive view of selection criteria for sub-borrowers. While the project with FINIBER was also substantially underutilized, the decision to relax criteria did result in much higher utilization than that experienced at FINANQUIL. One of the consequences of this change, however, was that FINIBER's sub-borrowers used L/Cs to purchase such items as an airplane, aluminum ingots, and kitchen cabinet supplies. While these loans clearly stretched the limits of the project's original targetting, they ostensibly contributed to local value added and resulted in no defaults.

FINANQUIL credit officers, by way of contrast, adhered strictly to the sub-borrower requirements. As a result, their level of utilization was much lower than FINIBER's, and they opened only two letters of credit.

Conclusions Regarding Underutilization

The structural factors at the financial market and macroeconomic level were the significant factors driving underutilization. Had the liquidity crisis of 1983 continued during 1985 and 1986, credit demand would have been high and this would have encouraged excellent utilization in spite of the other three negative influences noted above.

In spite of the low level of utilization of the guarantee facility, positive impacts were registered in other areas, which can be directly attributed to PRE's activity in Ecuador. For example, Jim Finucane, former Private Sector Officer in USAID/Ecuador, explained that discussions with the Minister of Finance to encourage approval of an adjustable rate instrument led to the Monetary Board's acceptance of public sector bonds. Although a final decision had not been reached by late August concerning the A.I.D. bond facility, significant policy dialogue has occurred.

VII. BORROWER PROFILES

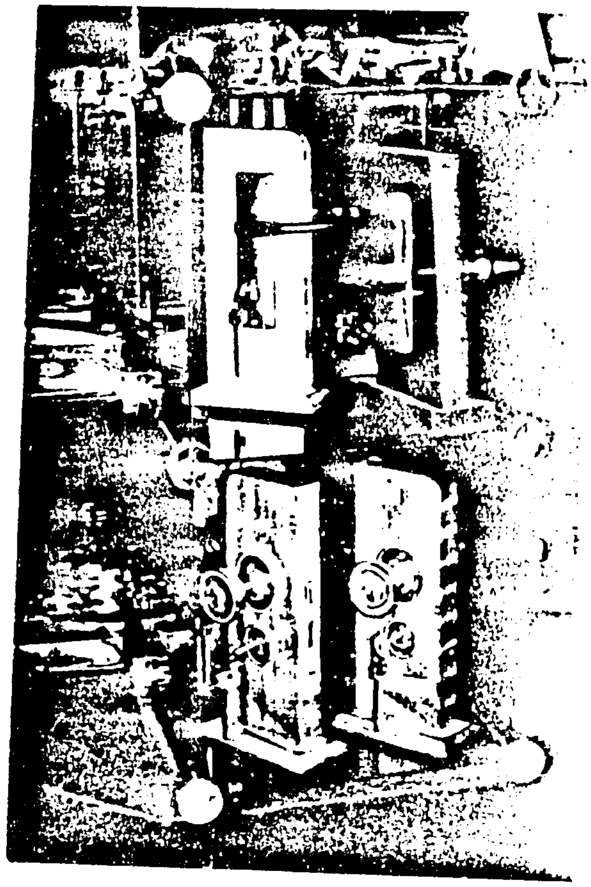
The following pages provide brief descriptions of the sixteen sub-borrowers visited. They are intended to capture something of the flavor of the individuals involved, and their unique business situations. Statistical information on these enterprises is presented in tabular form on pages 16 -19.

METAIN

Owner: Santiago Llado

Letters of Credit: $33,000
$ 9,355

Purpose: Purchase foundry and mold boxes and a metal press



SOME OF THE MANY USEFUL PRODUCTS MADE FROM ZAMAK

Llado started Metain in 1979 and is 70% owner (his brother and father own the remaining 30%). Prior to this he had a woodworking plant, and got into injectable metals by a rather circuitous route. He had gone to France to discuss an industrial carpentry venture with a French company. Upon realizing that his production capability was far below his prospective partner's requirements, Llado began investigating other possibilities. He had seen locks, hinges, and door handles being made of Zamak, an alloy made of 94% zinc, 6% aluminum, copper, and magnesium. Llado knew nothing like this existed in Ecuador, and was impressed with its multiple uses. After visiting two plants in France and one in Spain, he made arrangements to import a machine from Spain with a combination of 40% personal investment and 60% FINIBER (Fopinar) and Fondo Financiero financing, and opened METAIN. Llado explained that in 1979 it was very easy to open a small business because there was ample credit available.

Metain manufactures locks, hinges, door handles, parts and pieces for industry, bathroom accessories, and has recently diversified into an attractive, low cost line of furniture, shelving and closet organizers. Their production policy has changed considerably in response to worsening economic conditions in the country. Initially, the line was made up of very specialized products. Since purchasing power is constantly dropping for many Ecuadoreans, Metain moved into manufacturing larger, more durable products, such as beds which can be purchased for $50.00.

There are two other small businesses that produce fixtures in Ecuador, although Metain controls about 80-90% of the fixtures market. They have not begun to export because of limited production capacity. Since the market is relatively small, production is always rotating from product to product.

Sales in 1986 were US$ 445,000. The largest impediment faced by manufacturers in this area is the tremendous amount of contraband which floods the market. "Containers are regularly diverted from the U.S. and the merchandise sold at greatly undercut prices. We industrialists are clobbered by customs duties."

Llado knows his market and has a clear understanding of the financial environment in Ecuador. His efficiently run operation is moving to a new location, where they will have a flatter area to restructure the production line.

INDURAMA

Treasurer: Marcelo Velez

Letters of Credit:	$ 63,342
	$108,807
	$ 22,941
	$ 51,564
	$ 13,148
	$ 43,360
	$ 20,100

Purpose: Purchase parts & pieces for kitchen appliances, metal sheeting, and 1,000 refrigerator condensers

Indurama is located in the outskirts of Cuenca, the third largest city of Ecuador, considered by many to be the most charming spot in the country. Sergio Jaramillo holds 61% ownership, and the remaining 39% is divided among 25 shareholders. The business was started in 1972 by five individuals with US$ 300,000 in mostly private capital. Approximately 300 employees (10 women) work two shifts, and manufacture gas stoves, refrigerators, and water heaters. Studies are being conducted to determine the viability of expanding to washing machines. Currently Indurama controls 25% of the national market, and does no exporting. Fixed assets are reported at US$ 1.1 million. Efforts are under way to restructure the company, so no large scale expansion is planned for the immediate future. This was necessitated by a $1.5 million loss which the company had to absorb in 1982. Indurama incurred this loss as a result of its lack of control over financial exposure against the floating dollar which took a sudden and unprecedented rise against the sucre during this time.

According to Marcelo Velez, treasurer of Indurama, the business has received credit from Banco Popular, Ecuafinanza, La Previsora, Banco de Pichincha and FINIBER. "The advantage of dealing with FINIBER is that service is extremely fast and efficient", he said. FINIBER offered them a line of credit from the onset to cover the payment of letters of credit.

Sales have grown steadily from $1.3 million in 1984, to an estimated $5.05 million for 1987. Velez predicts continued sales growth and expansion for the company.

INDUSTRIA "EL TUNEL"

General Manager: Santiago Saenz

Letter of Credit: $23,310

Purpose: Purchase a baker's oven

"El Tunel" is a tidy, cheerful bakery shop located in a middle class neighborhood north of Quito. Santiago Saenz, the general manager and one-third owner, is a young, energetic individual who takes his business very seriously. Saenz is a civil engineer by training, and was working with a prestigious engineering consulting firm when, one day in 1982, his brother and brother-in-law proposed that they go into business together. They had learned through friends that the owner of "El Tunel", a well known name in bakeries in the Quito area, was interested in selling the business because of family problems. At that time, the bakery had two locations; within two years they had expanded to a third, and are presently working on a fourth which will open by the end of this year.

In the first year of business, 1983, Saenz doubled the sales of the previous owner. Last year's sales were in excess of $225,000. "I achieved this by improving the quality and appearance of our products, making the bakery shops more cheerful, and paying a lot more attention to the employees," he explained. He now sells and produces considerably more with 31 employees than the original owner did with 38. In spite of this, Saenz views his employees as the most problematic aspect of the business. Production costs are extremely high in bakeries, roughly 65%, and the work is extremely labor intensive. According to Saenz, the average wage worker is unreliable, unproductive and has very low initiative. "It's a constant effort to get workers to arrive on time, optimize ingredients in the production process by wasting less, and productively use their time in the workplace." Of his 31 employees, 21 are women. He considers female employees to be less productive than males, due to pregnancies and national laws which grant them eight weeks of maternity leave with full pay (75% paid by the Social Security System, and 25% paid by the employer), and one additional hour of break time per day over nine months, for nursing.

Saenz and his partners purchased "El Tunel" with 30% personal capital and 70% from short term loans obtained through the Banco Popular. They had also received a $30,000 loan from FINIBER for operating capital and materials, and until obtaining the letter of credit, were quite satisfied with the financiera. Saenz felt that FINIBER gave him bad advice concerning his need to obtain a letter of credit to purchase a $23,000 Italian bakery oven, and did not adequately explain the interest and commissions he would be paying. The business had $23,000 in cash, and could have arranged some sort of direct payment with the manufacturer. Saenz had no experience in buying and importing machinery and knew nothing about letters of credit, so he had FINIBER handle the transaction. Since there was a lengthy "paper trail" between the oven manufacturer in Italy, First Pennsylvania Bank, and FINIBER, when the merchandise arrived at the port of Guayaquil the documentation required for its release from customs had not been processed. This resulted in additional charges of over $800 to Mr. Saenz for 52 days demurrage and telexes to track down the documentation. Generally speaking, Saenz is satisfied with the service he receives from the financiera, but felt that the Credit Department could have better advised him on his credit options.

SAENZ AND WIFE IN FRONT OF THE
ORIGINAL "EL TUNEL" BAKERY

CONDECUERO

Owner: Fabian Izurieta
Letter of Credit Amounts: $ 8,251
$ 8,061
$21,397
$11,467

Purpose: Purchase machines used in shoe manufacturing, machine parts, and shoe lining materials.

Fabian Izurieta began his business in 1980 manufacturing expensive, all-leather dress shoes, but found the demand for his products suffering due to the economic recession. "I saw that I had to make my line more accessible," Izurieta reports. After switching to production of a more "popular", casual shoe, Izurieta was given the Ecuadorean franchise for manufacturing Hush Puppies. Business improved, and Izurieta began to manufacture several different brands of shoes in his factory, which is located 25 kilometers south of Quito in the rural area of Machachi. Later, he added a chain of shoe stores.

As part of the ongoing expansion of his company, Condecuero, Izurieta opened four letters of credit under the A.I.D. guaranty facility. The letters covered imports of machine parts, machines for stretching shoes and attaching heels, and a new type of simulated leather. The machinery, parts and materials he purchased with the help of the A.I.D. letter of credit did not directly increase production but helped him to "rationalize" production and improve quality, Izurieta says. Some of his imports have come from Italy, others from the United States.

According to Izurieta, the advantage of the A.I.D. facility was its low collateral requirement of ten percent. Letter of credit arrangements in Ecuadorean banks frequently require prepayment in full--a requirement which Izurieta emphatically rejects. He feels the credit line should be promoted more energetically, as he judges that a great, unfilled demand for both short- and long-term credit exists in Ecuador. FINIBER is one of several banks with which Izurieta does business. He comments that using the A.I.D. guaranty facility has been very helpful to his business, but adds that the bank did not provide as much information regarding the line's objectives as he would have liked.

The Condecuero operation, with a reported $250,000 in fixed assets, consists not only of the shoe factory and store chain, but includes a tannery and shoe part factory as well. A visit to the main factory finds a dozen workers, three-fourths of them women, cutting leather from patterns or working at sewing machines. In a small loft above the factory floor, a designer cuts patterns for an upcoming line. Information on changes in styles and technology are provided to the company by Hush Puppies' headquarters in the United States. Condecuero managers also travel regularly to the U.S. for seminars on styles and marketing.

At present, the shoe market is stationary because of the recession, Izurieta reports. Nonetheless, a good publicity campaign has helped Condecuero to continue its steady growth. Izurieta cites in particular the contribution of the production manager of his Hush Puppies division, a woman he describes as the "linchpin" of the organization. Condecuero's payroll of 200 employees includes 160 women. In the company's accounting division, five of the seven employees are women, and in its computer division, four out of five. In the shoe store chain, 18 out of 20 employees are women.

Twenty to twenty-five percent of Condecuero's production goes to its own store, and the rest to 160 client throughout the country. Competition is substantial, both with Taiwanese imports and with several major Ecuadorean shoe factories. Izurieta describes the lack of liquidity and the "high cost of money" as constituting the prime problems of his business. The liquidity situation, he says, often prevents his clients from making their payments on time.

Izurieta earned a MBA at Rollins College in Florida. After serving as general manager of Standard Brands' operations in Ecuador, he started the shoe factory. At present, in addition to running Condecuero, he is the director of Johnson & Johnson's operations in Ecuador.

While clearly a shrewd businessman, Izurieta is also proud of his attention to employee relations. He reports that 70% of his employees have stayed with the company since its inception, and that there is very little absenteeism. According to Izurieta, his factory's efficiency equals 80% of that of American workers, as calculated by such measures as the number of pairs of shoes each worker produces per day. His factory averages 11 pairs per worker per day. A tour of the Condecuero factory grounds passes a field where some employees are playing soccer while others cheer them on, as part of the daily sports break.

WOMEN CUTTING SHOE PATTERNS

INSTITUTO CIVIL AERONAUTICO S.A. (ICARO)

General Manager: Guido Saltos

Letter of Credit: $250,000

Purpose: Purchase one Aerocommander

SALTOS AND THE AEROCOMMANDER PURCHASED WITH REVOLVING FUND L/C

ICARO was begun initially in 1971 as a pilot training school but for many years has been an air taxi business. The majority shareholder and general manager, Captain Guido Saltos, left the Ecuadorean Air Force in order to form this company. Twenty percent of the initial founders are still owners.

ICARO owns airplanes and helicopters primarily for serving companies such as ESSO, British Petroleum, CGG, GEOSUR, TEXCRO, Occidental

Petroleum and other mining and petroleum companies with operations in remote locations. In addition, Mr. Saltos finds growing demand for executive and tourist travel. Topographic studies are an important part of ICARO's business in addition to taxi service. Competition is not a problem for ICARO as the demand is growing and its service is very highly regarded. Loans from FINIBER have permitted ICARO to purchase turbo aircraft rather than the piston aircraft used by its competitors.

Growth is so rapid that ICARO may request other L/Cs from FINIBER shortly. Sales are now $500,000 per year, up from $300,000 in 1985. Mr. Saltos speaks very highly of FINIBER, saying that FINIBER helped the company during very difficult times.

Mr. Saltos opened the most recent L/C with FINIBER to purchase a used Aerocommander aircraft in the United States. The Aerocommander caused a tremendous increase in sales and net employment generation of five -- two pilots and three mechanics. Nineteen full-time employees work at ICARO. Mr. Saltos feels he would not have been able to purchase the Aerocommander without FINIBER's help. ICARO has had no problem repaying the letter of credit due to its profitable growth.

MATELEC

Accountant: Gonzalo Sanchez

Letters of Credit: $ 7,937
$21,960
$ 6,704
$14,300

Purpose: Purchase computers and telephone equipment

Matelec is an office automation equipment company growing at a very quick pace. Through an interview with the chief accountant, Gonzalo Sanchez, it was determined that sales grew from 30,000,000 sucres in 1984, to 200,000,000 sucres in 1987. Mataltec has six owners, with the principal founder holding 50% of the shares. There are now 41 full-time employees compared with 20 in 1984. Fixed assets are reported at less than US$ 50,000.

Matelec sells and installs office equipment and systems such as mini computers, printers, telex machines, office switchboards and other related high technology equipment. The founder actively manages the company, borrowing on his U.S. electronic engineering degree and previous experience as a department manager for IETEL, the Ecuadorean Telephone Company. Matelec is oriented to the domestic market and normally buys its products in sucres from the local Japanese distributors. The company also purchases about 15% of its electronic equipment from Spain. This company is very profitable, with annual finance costs running at around 10%.

Matelec prefers to use sucre loans and buy foreign goods for cash rather than using L/Cs. However, at points wher Matelec has been fully leveraged or otherwise unable to raise the capital for its equipment purchases in Spain, FINIBER has opened L/Cs for the company, and approved a line of credit which Matelec uses to pay off the L/Cs. FINIBER was selected because of the total credit packages offered, not just for the A.I.D. guarantee facility.

Matelec is frequently choked for capital because a large proportion of its sales are on a credit basis. The A.I.D./FINIBER program permits the business to extend itself further than would otherwise be possible. Its market is small and medium size firms, but switchboards are usually sold to larger firms. Matelec also has close relationships with other financieras and commercial banks.

The principal owner of Matelec feels that competition is no problem because demand grows at such a rapid rate. The only bottlenecks are financial leverage and delivering a high quality product.

CORPORACION ECUATORIANA DE ALUMINIO - (CEDAL)

President: Luis Gomez

Letter of Credit: $101,526

Purpose: Purchase aluminum ingots

CEDAL was formed in 1975 by 16 owners; the principal was Luis Gomez. CEDAL is an aluminum extruder begun with a US$ 400,000 start-up, which was used primarily for the purchase of a used extrusion plant in the United States. A U.S. company was expanding production through the purchase of a new plant, and sold its original.

Start-up was accomplished through US$ 40,000 paid-in owners' capital and a US$ 360,000 long-term loan from COFIEC. CEDAL now has 35 owners and is still actively managed by its founder and principal shareholder, Luis Gomez. CEDAL has control of 50% of the Ecuadorean aluminum market and reports that its niche is secure because of its superior product quality. Approximately 20% of sales are from exports to Colombia.

CEDAL's production has resulted in significant import substitution, since Ecuador previously imported extruded aluminum from the United States. Total sales for 1986 were US$5,000,000. Fixed assets are reported at US$ 1.4 million. Employees now total 130.

CEDAL is an old client of FINIBER's and used the guarantee facility for a US$ 200,000 L/C to purchase aluminum ingots and other raw materials from Brazil. CEDAL cancelled the letter according to its 120 day terms with a cash payment. This L/C represents only one month's production for CEDAL. The old company is a "veteran" in the international arena, and has found better credit sources for its monthly US$ 200,000 raw materials order. It continues to do business with FINIBER, but has not opened another letter of credit through the A.I.D. guarantee facility. Financial costs are only 4.5% of sales, which suggests a low level of financial leverage for this very stable and profitable company. CEDAL reports a 15% gross margin on sales.

CORTYVIS

Owner: Sigfried Tieber

Letters of Credit: $ 11,250
$ 43,800
$ 18,000

Purpose: Purchase a generator, fabric dyeing machine, and artificial fibers

TIEBER AND ONE OF HIS NUMEROUS WEAVING MACHINES

Sigfried Tieber has worked in textiles all of his professional life. He started out running a small business in Nicaragua, moved to Costa Rica, and then to Colombia. Ten years ago he bought into an Ecuadorean textile manufacturing business, TEXPAC, which he and his partners sold in 1983. At this point, Tieber independently opened CORTYVIS, which is the largest producer of curtains and sheers in Ecuador. Cortyvis manufactures natural and synthetic threads which are then woven into 24 different styles of draperies and 30 styles of sheers. In addition to being an effective manager, Tieber has an aesthetic flair and designs all of the woven patterned sheers in his line. All draperies are sold domestically, and after only four years of operation, they have captured 50% of the national market.

Tieber says that his rise to success can be attributed in part to his high demand for quality and efficiency, and his use of the latest technology in weaving. "Other companies produce draperies, but they do it on the side, use old machinery and repeat the same old styles", he explained. "There is no other machinery of this kind in the country. I am proud to say that in four years of business, we have never received one complaint." CORTYVIS was approached by Bayer, Inc. and given a license to produce the synthetic fabrics which Bayer markets in Ecuador. Bayer does all of Cortyvis' advertising free. This involves mostly magazine spots and occasional television and radio promotions.

The following figures reflect the solid growth of Cortyvis over the last three years:

	1984	1985	1986
ANNUAL SALES	$297,980	$530,300	$1,212,120
FIXED ASSETS (w/o buildings land)	$ 37,878	$863,640	$ 913,140

(43 employees: 11 women)

FINIBER approached CORTYVIS and offered a variety of credit programs, as well as a two-year credit line to cover 100% of the value of the letter of credit, with no 10% cash collateral required. Tieber described this "courting" as a common occurrence, since there are many banks and financieras, and too few clients. As a shareholder in TEXPAC, he had established an excellent credit relationship with COFIEC (Corporacion Financiera Ecuatoriana) and remarked that, "In all of my years of dealing with the banks, I have never made one late payment". When asked to comment on the underutilization of letter of credit facilities in Ecuador, Tieber quoted a recent article in _El Comercio_ which stated that in the last twelve years, Ecuador has used only 37% of the credit made available by the United States. "There is plenty of money around", he said. "It's just that interest rates and commissions are so high that businessmen would rather make direct import arrangements without the credit".

WORKERS CLEANING AND SORTING VEGETABLES

EXTRACTOS ANDINOS

Founder and General Manager: Ing. Jose Agusto Bermeo

Letters of Credit: $103,200
$ 13,736
$ 22,656
$ 3,881

Purpose: Purchase a fruit/vegetable drying machine, a granulating machine, a generator and a cutting machine

Jose Bermeo, founder of Extractos Andinos, possesses true entrepreneurial spirit. He comes from a long line of agricultural producers who had never been involved in large scale business. Fifteen years ago, he and his brother opened the first business in Ecuador to produce dried fruits and vegetables, and fragrance extracts. Today, their total fixed assets are $400,000 and they employ 35 workers. One employee reported that over the last two years the business has grown tremendously. This expansion has been based both on personal investments by the six partners, and bank financing.

A few small businesses compete in the area of dried fruits and vegetables, although Extractos Andinos is significantly larger than the rest and has always controlled the market. Manufacturing emphasis is not on consumer products, but on inputs for soap and perfume manufacturers, candy, dessert, ice cream and gelatine producers, the soft drink industry and a variety of other food producers. Four years ago, Mr. Bermeo grasped the opportunity to expand into the area of natural coloring. By 1986, his sales had surpassed those of INEXA, the largest manufacturer of coloring agents in the country.

Extractos Andinos has grown tremendously, particularly in exports, since Bermeo purchased his new machinery with financing from FINIBER. In 1986, sales reached $370,000 (107 tons of product). Approximately 20% of total production went to the export market; this year's projections show that it may reach 50%. England, the U.S., Japan and France are Bermeo's major customers.

From the manufacturing perspective, the only problem the business faces is finding a constant supply of primary products. Bermeo feels that they could export considerably more if this could be rectified. To address the problem of insufficient quantity and quality of produce, EXTRACTOS ANDINOS has expanded into the production area as well, and now has 230 hectares under cultivation. Nestle provided them technical assistance in developing better crop varieties. They had found that with contract production, there were too many delays and too little quality control, and no credit available for importing primary goods.

Bermeo approached FINIBER because he knew that the financiera specialized in financing for business development. The credit officer told him about the A.I.D. guaranty facility after he had applied and been approved for a global credit line to import machinery. The duration of the loan he received from FINIBER is ten years and he makes loan payments every six months. Bermeo describes it as a "soft loan with easy conditions", and has no difficulty making payments. In the past, he has received other small business loans from COFIEC, FINANZA, and BANCO POPULAR. "Our business is growing by leaps and bounds thanks to our new machinery", said Bermeo.

RETME COMPANY, LIMITED

Owner: Russell Thomson

Letter of Credit Amount: $26,067

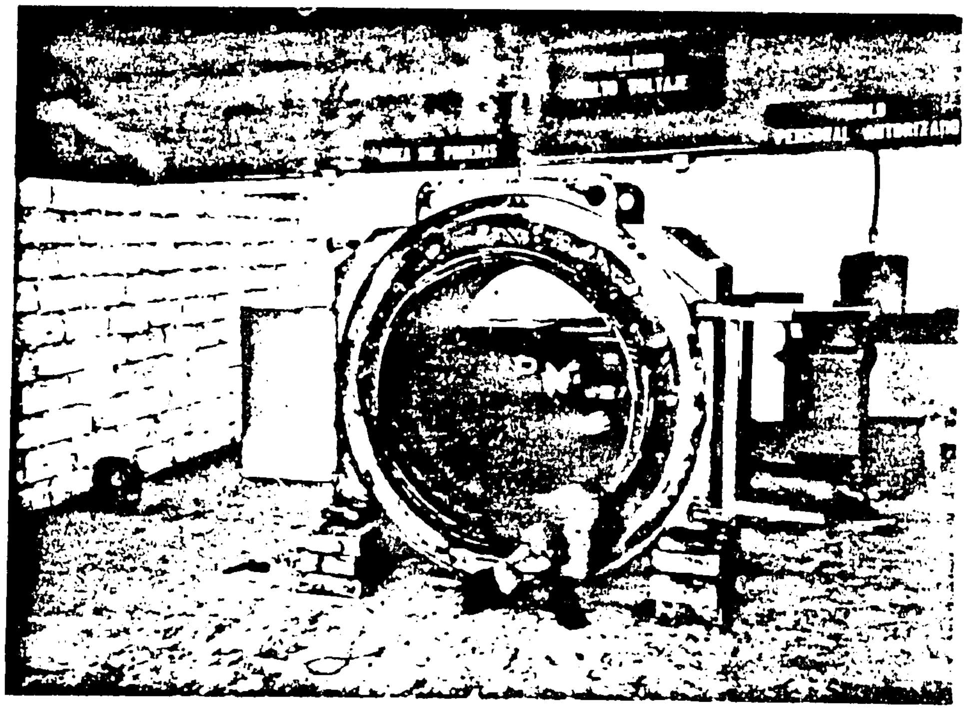
Purpose: Purchase a dynamic balance machine

A visit to the Retme machine service shop, located thirteen kilometers south of Quito on the Panamerican Highway, finds a large warehouse where about twenty young men are industriously employed in various tasks. Some are wrapping copper wire, others cleaning machine parts, and one is using a new dynamic balance machine to test the weight of a generator component.

Retme is an electrical apparatus service center, devoted to the repair of what its owner, Russell Thomson, terms "rotating machines", which include generators, electrical motors, and oilfield equipment.

The Retme shop, according to Thomson and the mechanical engineers who work for him, is the first in the country to offer complete repair of large electrical machinery used in industries such as oil, steel, textiles, and public utilities. "Before Retme," reports engineer Vinicio Betancourt, "these repairs had to be performed in pieces by separate shops, or sent to Colombia or Peru."

Thomson, who founded Retme in 1982, is a Scottish emigre married to an Ecuadorean. In 1986, Thomson received an A.I.D. guaranteed letter of credit for $26,000 through FINIBER to cover purchase of a dynamic balance machine from a U.S. exporter. The machine is a testing instrument used to gauge the balance of a piece of equipment, and is a critical part of the repair process.



A MACHINIST IN THE MIDST OF MAKING REPAIRS

Thomson's use of the guaranty facility was part of an expansion plan which he financed largely through a loan from FOPINAR, an Ecuadorean government agency which promotes small businesses. As a result of the overall expansion, Retme was able to increase the number of machines it services from 40 to 70 per month. The company's annual sales increased from $400,000 to 600,000. Thomson estimates that one third of the sales increase is attributable to the increased capacity provided by the dynamic balance machine. "This machine by itself will pay off the loan of 16 million sucres (U.S. $85,000) from FOPINAR," Thomson confidently reports.

Also as a result of the expansion, the company grew from 25 to 35 employees, including two electrical engineers and two mechanical engineers. Employment of women increased from two to four workers. Retme employs women as treasurer, computer operator and administrators. Thomson reports that he tried to introduce women in the repair shop as reel winders, training them to wrap and insert the copper wire which is used extensively in the machines repaired in the shop. He stopped hiring them when he found that male employees became distracted, but plans to try again, as he found the women workers "nimble, conscientious, and easily trained."

Though Thomson apologizes for the "messiness" of the Retme shop, it is quite neat considering the volume of machinery it contains, all in various stages of repair. Each part is numbered to facilitate reassembly and prevent confusion of one machine's parts with another.

One of the shop's mechanical engineers cites the use of incentives as a reason for the Retme workers' efficiency. Employees regularly receive a bonus when a piece of repair work in which they have participated proves "right the first time" and is not returned to the shop.

Within the next few months, Thomson plans to open a second shop in Guayaquil. There are also tentative plans for setting up an additional facility to service Ecuador's eastern jungle regions.

Thomson estimates that eight additional employees will be hired in the first year of the Guayaquil shop's operation, with 20 more added in the second year.

Thomson associates with FINIBER because connections with the financiera through family and friends. The A.I.D. letter of credit guarantee offered an added security which was important to his supplier, a small U.S. manufacturer. Thomson had had no problem in obtaining credit in the past, but found the letter of credit facility particularly attractive because of the speed with which he was able to complete arrangements with the financiera for its use. The letter of credit was approved in July 1986, the machine ordered and manufactured to his specifications, and shipped in September. Thomson has used other letters of credit through local banks for imports, but these arrangements are often prohibitively time-consuming.

ROSINVAR

Partner: Gustavo Penaherrera

Letter of Credit: $60,000

Purpose: Purchase rose bushes

During the past four to five years, Ecuadorean entrepreneurs have discovered a new export commodity which capitalizes on the country's temperate year-round climate. Hoping to emulate the success of neighboring Colombia in flower exports, a number of Ecuadoreans are experimenting with the cultivation of roses for export. By mid-1987, eight to ten rose plantations had been established in the valleys north of Quito.

One of the newer additions to this fledgling market is Rosinvar, the brainchild of engineer Gustavo Penaherrera and his three partners. The partners, two of whom are economists and two mechanical engineers, are all present and past employees of the Ecuadorean National Finance Corporation (CFN). Each had ten years of experience in planning financing for other businessmen's projects for the CFN. Finally, they decided to put this experience to work in setting up their own rose cultivation and export business.

The four partners studied their investment options carefully before choosing the rose project. "We analyzed the country's comparative advantage," Penaherrera recounted. "With only one climate, we had the possibility of year-round production. Besides that, we had the advantages of available labor and inexpensive land." In addition, their work in the CFN had made the partners well aware of the country's urgent need to promote businesses which generate foreign exchange.

Penaherrera and his partners used the A.I.D. letter of credit to cover imports of rose bushes from Israel, which constituted the initial planting and the start-up of their business. Rosinvar received the letter of credit in October 1986, obtained its shipment of rosebushes from Israel in December, and began selling flowers in May 1987. By mid-August, Rosinvar had a payroll of fifteen workers, including eight women.

Rosinvar's owners resorted to the PRE letter of credit as a means of bridging an extensive period of delays in receiving a loan through the A.I.D. Mission. The letter was arranged within a week, which contrasted with months of waiting for the Mission loan. They termed their experience with the letter of credit very good, although they were unaware at the time that the letter was guaranteed by A.I.D.

The Rosinvar plantation, located an hour north of Quito, consists of 1.5 hectares and 90,000 rosebushes. Ninety percent of the roses are sold to flower brokers in New York and Los Angeles; the rest are sold within Ecuador. The partners are planning an expansion to two hectares which will contain 20,000 additional plants. Aside from its 1.5 acre greenhouse, the Rosinvar operation consists of refrigeration chambers, a classification room, a drip irrigation system and a fertilization system with a high pressure portable pump. Rosinvar's growing methods were largely learned from its Israeli suppliers. The partners acquired a new method of planting from the Israelis, which involves covering the bushes' roots with water. This forces air out of the soil so that air pockets do not damage the roots.

Rosinvar's harvesting process begins with cutting the roses and discarding any bad buds. The roses are then taken to the classification room where any imperfect petals are removed. The roses are washed and classified by stem length, from 70 to 90 centimeters. After classification, the buds are wrapped in plastic and boxed in units of 25. They are taken to the refrigeration chamber, placed in pre-chilled boxes and transported to the airport. Rosinvar sends two or three shipments, each consisting of 20 to 30 boxes, to the U.S. each week.

Penaherrera and his partners hope to initiate export to Europe, and are discussing the possibility of a package deal with other growers in Ecuador. "We don't really compete with other Ecuadorean growers," Penaherrera reports. "Our real competition comes from Colombia and Holland. The growers in Ecuador help each other a lot." Ecuadorean rose producers pool information, marketing tips and plans through two associations, one composed of flower cultivators and one of exporters.

Penaherrera reports that business is good. "Our flowers are of excellent quality, and we expect good harvests for next year, especially in winter." They look forward with particular anticipation to the big Valentine's Day flower-buying splurge in the United States.

Rosinvar's owners find that their biggest problem is international transport. They use Ecuatoriana Airlines, which has only one cargo plane. "That's where we compete -- with shrimp!" Penaherrera jokingly complains. He adds that the growers' association hopes to arrange for a plane to be used exclusively for flower exports. Other problems are posed by import tariffs and other barriers to the entry of their flowers into the United States.

While he terms Rosinvar's experience with the A.I.D. letter of credit facility "very good," Penaherrera hopes the necessity of using it again will not arise. He cites the risk of fluctuations in the exchange rate over the six-month period of a letter of credit. Rosinvar's owners hope to forego the use of credit in the future and use the company's own revenues as their main source of foreign exchange.

PALMERAS DE LOS ANDES

General Manager: Solomon Gutt

Letter of Credit Amount: $32,500

Purpose: To import African palm starts

Solomon Gutt is the embodiment of many of the personal characteristics one associates with successful businessmen. He is cool, intelligent, big-thinking, and extremely cautious in revealing information regarding his business. Gutt arrived from his native Colombia in 1972 to expand the family palm oil business to Ecuador. The initial start-up consisted of 1000 hectares of cultivation and an oil extractor. Since then, Palmeras de los Andes has constantly grown and expanded. Today he has 7,000 hectares of palm, and five separate businesses involved in extraction, refining, marketing and sales, and distribution. The ownership of the company is shared by Gutt and 15 shareholders.

Palm oil and palm kernel oil are produced, which are either refined and sold as oil, or made into shortening, margarine, or soap. All products are consumed domestically. Sales last year were between $35 and $40 million. There are approximately 200 palm oil producers in Ecuador and Gutt places his firm among the top five. An equilibrium has been reached where all that is produced is consumed, so there is little competition per se, and "producers treat one another as colleagues", according to Gutt. There is significant competition, however, in the market for finished products, where twelve "very well run" businesses are in contention.

Fixed assets for the Palmeras de los Andes operation are $2.5 million and are estimated at $50 million for Gutt's total operation. He employs over 2,000 people, predominantly men. His interpretation of Ecuadorean labor law is that the legislation opposes the employment of women in agriculture.

Gutt expressed concern over government regulation of private sector activities in Ecuador, which is exacerbated by the fact that palm oil projects are very long-term (up to ten years). "It takes a minimum of five years to realize profit from a plant, during which time one is constantly threatened by price freezes, changes in laws governing land ownership and labor, and currency devaluations. At this point, I should have about 500,000 hectares under cultivation, but the government is constantly intervening and threatening to expropriate."

INDUSTRIAS DACAR

Owners: Azucena and Carlos Danin

Letter of Credit Amount: $ 25,000

Purpose: Purchase electrical accumulators

In the midst of a grimy battery factory, Azucena Danin looks out of place as she moves about in her white pumps and elegant dress. After a brief conversation, one quickly realizes that she possesses the brains and determination in this working couple, who are the owners of Industrias Dakar. Twenty six years ago, Carlos started a very small business importing battery plates, oxides and other materials to produce components for battery manufacturers. A dozen years ago, after considerable prodding, Carlos relented and allowed Azucena to become involved in the business, as Administrative Manager. Since then, Industrias Dacar has grown considerably. They now produce car, truck, and boat batteries, and have about a 15% share of the national market. "We may be a small producer, but we are first in quality," claims Carlos. Selling battery plates to other manufacturers still represents about one-third of total sales, which reached $450,000 in 1986.

In the national market, their biggest obstacle is the mentality that whatever is foreign is better. "We've just got to work a lot harder to win people's faith", laments Azucena. Word of mouth is their best form of advertising. A large share of the market is controlled by LUX, which distributes Bosch in Ecuador. EXDI, Inc. is a close second with Willard batteries. Beyond this, there are three other battery manufacturers of roughly the same size as Dacar.

Industrias Dacar has expanded incrementally into adjacent shop space, and has reached a point where a relocation is necessary. Construction has begun on a new 10,000 square meter shop in an industrial park on the outskirts of Guayaquil. This has restricted the company's capital, along with the non-availability of credit for importing production materials. At times this paralyzes production, and has been a major impediment to increasing sales. "We sell all that we produce, and not infrequently have gotten tied up when we were short of capital to import materials", Carlos described. In response to this, eleven months ago they obtained start-up funds from FOPINAR (through FINIBER) to create OXIDEPLO, which will produce lead oxide both for their own use in battery manufacturing and for sale to other national producers.

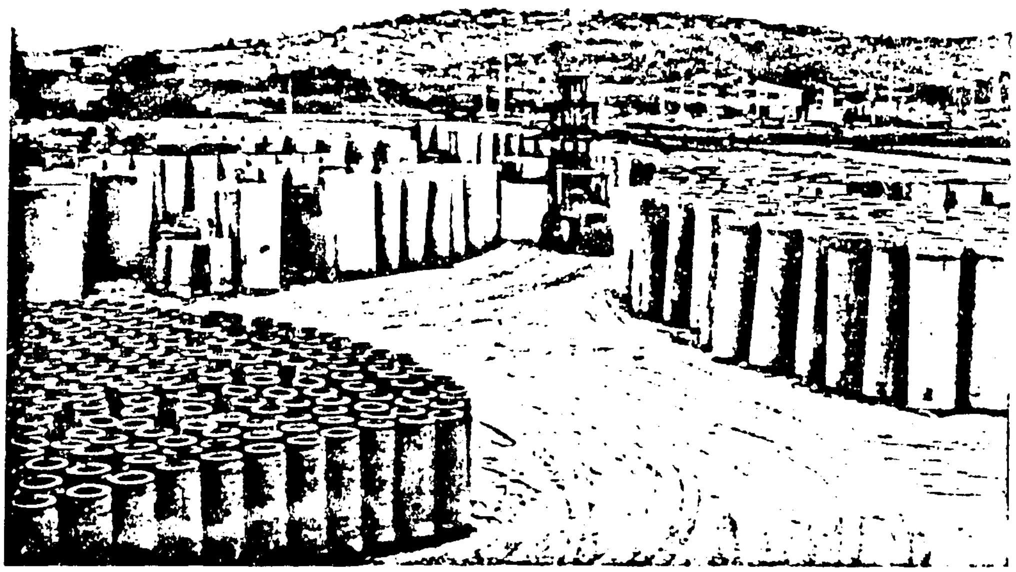
Carlos and Azucena have received financing from Banco de Fomento (an A.I.D. financed low-cost business start-up loan), FINANQUIL and FINIBER (FOPINAR). They used the guarantee facility out of necessity -- it was the only line available to them at the time. They found it be an extremely costly credit alternative. A 2.48% commission plus additional charges is costly for a small business, according to Danin. There was a five month delay in manufacturing the electric accumulators they imported, so they were charged another 2.48%. In spite of financial constraints, Carlos and Azucena are optimistic about the future of their business.

ANDINA DE PRODUCTOS DE CONCRETO INDUSTRIALIZADOS (APCI)

President: Lautaro Aspiazu

Letter of Credit Amount: $ 93,073

Purpose: Purchase a cement mixer



CEMENT DRAINAGE PIPES READY FOR DELIVERY

Andina de Productos de Concreto Industrializados (APCI) produces cast concrete drainage pipe for construction. The operation of American Pipe Company Inc. was purchased by Aspiazu, his son and nephew (51.2% shareholders), and three other partners (48.8%) in 1984. The purchase was financed 100% through FINANQUIL, Filanbanco and Banco del Pacifico, and all loans were paid within a year. Another loan was obtained from FINIBER (World Bank financed) to import machinery to make smaller gauge pipe (6" to 36"). Aspiazu is an industrial engineer with extensive international business background. He worked fifteen years as general manager for United Fruit in Central America, and for twelve years prior to the APCI purchase, represented a Swiss elevator manufacturer in Ecuador. An employee who has been with the operation twelve years described him as having "an excellent understanding of banking", and reported that the financial management of the business had improved immeasurably since Aspiazu took over the firm.

FINIBER brought the A.I.D. guarantee facility to Aspiazu's attention. APCI currently has $400,000 in other loans from the financiera, and an excellent pay-back record. Aspiazu explained that many businesses avoid using letters of credit because "the exchange rate is all over the place, and business people are fearful that, even in two months, it will go through the ceiling".

APCI's market is restricted to the coastal area where it has about 50% of the cement drainage pipe market. Freight costs are too high to make inland transport profitable. Two other competitors, slightly smaller in size, split the remaining business. Over the past three years, sales have jumped considerably:

1984: $ 404,000 1985: $ 606,000 1986: $ 1.6 million

Half of the company's sales are through government contract, and half go to contractors and land developers. Sales are down in 1987 because normal purchasing was affected by the rupture of the oil pipeline in March. The most problematic aspect of the operation is that, although the company receives a huge volume of business from the government, it is extremely slow in paying. APCI is anxiously awaiting a four million dollar contract from the local government of Guayaquil for a major sewage pipe replacement project. Because of inflation, a "readjustment" clause is written into all contracts. Unless payment is made immediately, the customer is subject to the prevailing price at the time of payment. On the average, selling prices are adjusted 25% each year.

Aspiazu is always looking for ways to make business more profitable. The land where the business is currently located has appreciated in value considerably, so they are moving further out and planning a housing development for the site where a three-month stock of drainage pipe stands.

RIJALI (FINANQUIL)

Proprietor - Jorge Ripalda

Letter of Credit Amount: $17,000

Purpose: Purchase baby turkeys

From one day to the next, Jorge Ripalda took a quantum jump from being a carefree student at the University of Michigan to having full responsibility for a huge hacienda. Jorge's father died suddenly in 1982, leaving him at the helm of the family business. Rijali is comprised of a dairy farm with 2,500 head of a special breed of tropical dairy cattle, a small milk and yogurt processing plant, 150 horses which are sold and used for breeding a pure domestic strain of horse, a turkey farm, and extensive cultivations of animal fodder.

Ripalda's father purchased the hacienda 20 years ago, and started the turkey business 12 years ago. At that time, he was the only turkey producer on the coast, and produced 4500 birds. Rijali continues to import hatched turkeys and fatten them for sale. The company expects to sell 14,500 birds this year and presently has no interest in expanding into production.

In 1979, Pavilandia came into existence, which created competition for Rijali in the coastal turkey market. Pavilandia went out of business after two years due to the fact that it grew too fast, and had pushed unit costs too high by purchasing costly freezing machinery. In 1981-82, two more producers came into the market. One failed due to poor management, and the other, which was also involved in hatching, failed because of unreliability in the supply of necessary ingredients for baby turkey food. Two years ago Rijali again became the sole turkey producer on the coast. Its only other domestic competition is a producer in Quito. Rijali does 70% of its business on the coast, and 30% in Quito. Sales for 1986 reached $250,000; fixed assets are estimated at $120,000. There are seven employees who work directly with the turkeys.

Ripalda has his own freezing and packaging plant in Guayaquil. From there, the turkeys are moved to two sales points in Quito and Guayaquil, where they are sold to wholesalers. Turkey is considered a luxury in Ecuador, which is understandable when one considers that an average-weight turkey costs US$ 40. For the most part, turkeys are consumed only at Christmas time and are often given by employers in "Christmas baskets".

Ripalda has dealt exclusively with FINANQUIL since he took over the business, and commented that his father had a lengthy business relationship with the financiera up until his death. Rijali was one of two businesses that fit the criteria of the A.I.D./FINANQUIL agreement, so the financiera suggested that he use the guarantee facility for imports. The L/C was part of a financial package that includes domestic letters of credit and loans for working capital.

Ripalda's major complaint about the turkey business is the high cost of a balanced poultry diet. The only alternative is to make and pelletize feed to satisfy their own requirements, which he is actively researching.

ORINCUSA (FINANQUIL)

General Manager - Gabriel Roca

Administrative Assistant - Aide de Chicaiga

Letter of Credit Amount: $137,000

Purpose: Purchase fertilized chicken eggs

Orincusa is one of a group of four businesses involved in the production of broilers. Orincusa's role is to complete the first step of the process, which is importing fertilized eggs for incubation and hatching. This aspect of the business was started only two years ago to ensure a steady and reliable supply of chicks to the other businesses. After the eggs are hatched, they are moved to Pubenza for seven weeks of fattening, on to Peaza for slaughtering and packaging, and finally to Portipollo for sales and distribution (these are the sister companies). By the end of the year, Orincusa hopes to be doing its own egg fertilization as well.

Presently, 36,000 chickens are hatched weekly, 80% of which are sold to Pubenza. This is significantly lower than the 54,000 requested by the sister company. The largest problem confronted by Orincusa is the non-availability of fertilized eggs, which frequently has stalled production. There are simply not enough

SHELVES OF EGGS IN AN INCUBATOR

produced domestically to satisfy the demand, so the business has had to resort to importing the eggs from the U.S. The inconvenience and cost of this transaction makes it a less than desirable alternative. The constantly rising exchange rate is also a factor due to the narrow price margin for chicken. To make matters worse, a series of shipments from Georgia scheduled for June, July, and August were suspended because a heat wave in the south killed large numbers of poultry. As a result of this, Orincusa is branching out, and will have 10,000 of its own reproducers by December. All of the technical people and equipment are in place and finishing touches are being done on the infrastructure. This is an important move for the company, since sales this year have suffered due to the unavailability of eggs. Last year, weekly sales were well over $16,000 and in 1987 have only averaged $12,000.

Orincusa's sister company, Portipollo, faces stiff competition in the coastal chicken market. Its largest competition is Fernandez C.A. of Manavi, which has 25 incubators (as compared to Orincusa's six), and fertilizes their own eggs. Fixed assets for Orincusa's part of the operation are $150,000.

The entire chicken operation is owned by Guillermo Castro and his five children. Gabriel Roca, General Manager, explained that Castro has been a client of FINANQUIL for many years, and started the business with an IDB loan targeted for fixed assets. The letter of credit under the guarantee facility was opened to import 28,000 fertilized eggs from Georgia. There were considerable difficulties with the shipment. The cargo plane made an unplanned stop in Panama, where the eggs were taken off the plane and set on the runway. The additional movement and exposure to heat resulted in a 50% loss. Although the letter of credit was cancelled with Swiss Bank, Orincusa had to request a loan from Finanquil to keep up with the scheduled payments. Its claim has yet to be settled with the insurance company.

Gabriel Roca, a Pfizer pharmaceutical representative turned chicken hatchery manager, has learned an impressive amount during his three months on the job, and prides himself on the active interest he takes in anything related to poultry. "It'll be open highways for us once we set up a reliable, ongoing supply of fertilized eggs. The only way to do this is to take the matter into our own hands", he explained. Here is an excellent example of a businessman who has turned a problem into a business opportunity.

APPENDIX A

FINIBER
PROFIT AND LOSS STATEMENT
(IN '000 SUCRES)

EARNINGS	JULY TO DECEMBER 31, 1985 AMOUNT	PERCENT	JULY TO DECEMBER 31, 1986 AMOUNT	PERCENT	JANUARY 1, TO JUNE 30, 1987 AMOUNT	PERCENT
Interest	402,899	88.9	540,423	87.9	571,219	87.8
Commissions	45,079	10	60,475	10	64,327	9.9
Other Income	4,105	0.9	11,396	1.9	13,631	2.1
Special Income	1,006	0.2	2,330	0.4	1,496	0.2
TOTAL	453,089	100.0	614,624	100.0	650,873	100.0
EXPENSES						
Interest	307,871	67.9	411,097	66.9	455,096	69.9
Commissions	42,005	9.3	31,883	5.2	31,605	4.9
Personnel Expenses	23,911	5.3	29,889	4.9	29,426	4.5
Operating Costs	20,935	4.6	24,706	4.0	22,036	3.4
Depreciation & Mortgage	3,142	0.7	4,298	0.7	5,430	1.0
Special Expenses	260	0.1	229	---	933	0.1
TOTAL	(398,124)	(87.9)	(502,102)	(81.7)	(545,526)	(83.8)
Operational Utility	54,965	12.1	112,522	18.3	105,347	16.2
Uncollectable Credit	(6,319)	(1.4)	(74,104)	(12.0)	(52,945)	(8.1)
Interest & Commissions on Questionable Credit	(14,882)	(3.3)	(36,747)	(6.0)	(51,422)	(8.0)
PROFIT	33,764	7.4	1,671	0.3	980	0.1

APPENDIX B

FINIBER
COMPARATIVE BALANCE SHEET
(IN '000 SUCRES)

ASSETS	DECEMBER/85 AMOUNT	DECEMBER/85 PERCENT	DECEMBER/86 AMOUNT	DECEMBER/86 PERCENT	JUNE/87 AMOUNT	JUNE/87 PERCENT
Cash and Deposits	179,615	3.2	94,187	1.3	105,066	1.4
Investments	----	----	1,592	----	4,324	0.1
Credit due	4,723,320	82.8	5,770,551	82.2	5,522,298	74.0
Credits and Dividends	126,772	2.2	163,650	2.3	565,520	7.6
Uncollectable credits	(68,500)	(1.2)	(157,554)	(2.2)	(210,499)	(2.8)
Customer liabilities under acceptances	166,953	2.9	290,818	4.1	162,449	2.2
Accounts Receivable	99,840	1.8	116,939	1.7	402,862	5.4
Bank Premises	132,169	2.3	132,794	1.9	371,005	4.9
Fixed Assets	64,576	1.1	83,541	1.2	34,434	1.1
Other Assets	279,505	4.9	526,100	7.5	457,027	6.1
TOTAL ASSETS	5,704,250	100.0	7,022,618	100.0	7,464,486	100.0
Conditional Accounts	2,136,775		2,516,640		2,563,751	
GENERAL TOTAL	7,841,025		9,539,258		10,028,237	
LIABILITIES						
Immediate Obligations	77,942	1.4	113,040	1.6	184,136	2.5
Acceptance in Circulation	166,953	2.9	290,818	4.1	162,449	2.2
Bills and Loans Payable	5,736	0.1	21,185	0.3	12,218	0.2
Credit to Other Banks and Financial Institutions	4,084,732	71.6	4,871,055	69.4	5,263,801	70.5
Stocks in Circulation	597,753	10.5	669,139	9.5	692,492	9.3
Capital (paid)	327,400	5.7	385,000	5.5	405,997	5.4
Reserves	64,387	1.1	69,252	1.0	70,672	1.0
Surplus	22,573	0.4	22,364	0.3	1,368	-----
Other Liabilities	356,774	6.3	580,765	8.3	671,353	8.9
TOTAL LIABILITIES, CAPITAL AND EARNINGS	5,704,250	100.0	7,022,618	100.0	7,464,486	100.0
Conditional Accounts	2,136,775		2,516,640		2,563,751	
GENERAL TOTAL	7,841,025		9,539,258		10,028,237	

APPENDIX C

FINANQUIL
GENERAL BALANCE SHEET
(IN SUCRES)

	1986	1985
ASSETS		
Available Funds	407,582,398	372,892,313
Investments	51,405,375	21,089,428
Credit Portfolio	7,213,105,236	6,742,671,391
Liabilities under Acceptances	582,156,375	503,152,720
Credit Due	384,813,543	269,860,837
Property Foreclosed	91,274,474	76,921,421
Fixed Assets	143,116,180	90,588,386
Other Assets	547,211,930	347,045,251
TOTAL	9,420,665,511	8,424,221,747
Conditional Accounts	3,016,397,387	3,109,027,345
LIABILITIES		
Immediate Obligations	(23,954,149)	(109,096,383)
Acceptance in Circulation	(582,156,375)	(503,152,720)
Accounts Receivable	(136,323,569)	(220,819,934)
Credit to other Banks and Financial Institutions	(5,905,705,792)	(5,369,081,700)
Stocks in Circulation and Other Obligations	(782,704,389)	(505,050,000)
Other Liabilities	(993,824,574)	(899,053,844)
Earnings	(995,996,663)	(818,967,166)
TOTAL	(9,420,665,511)	(8,425,221,747)

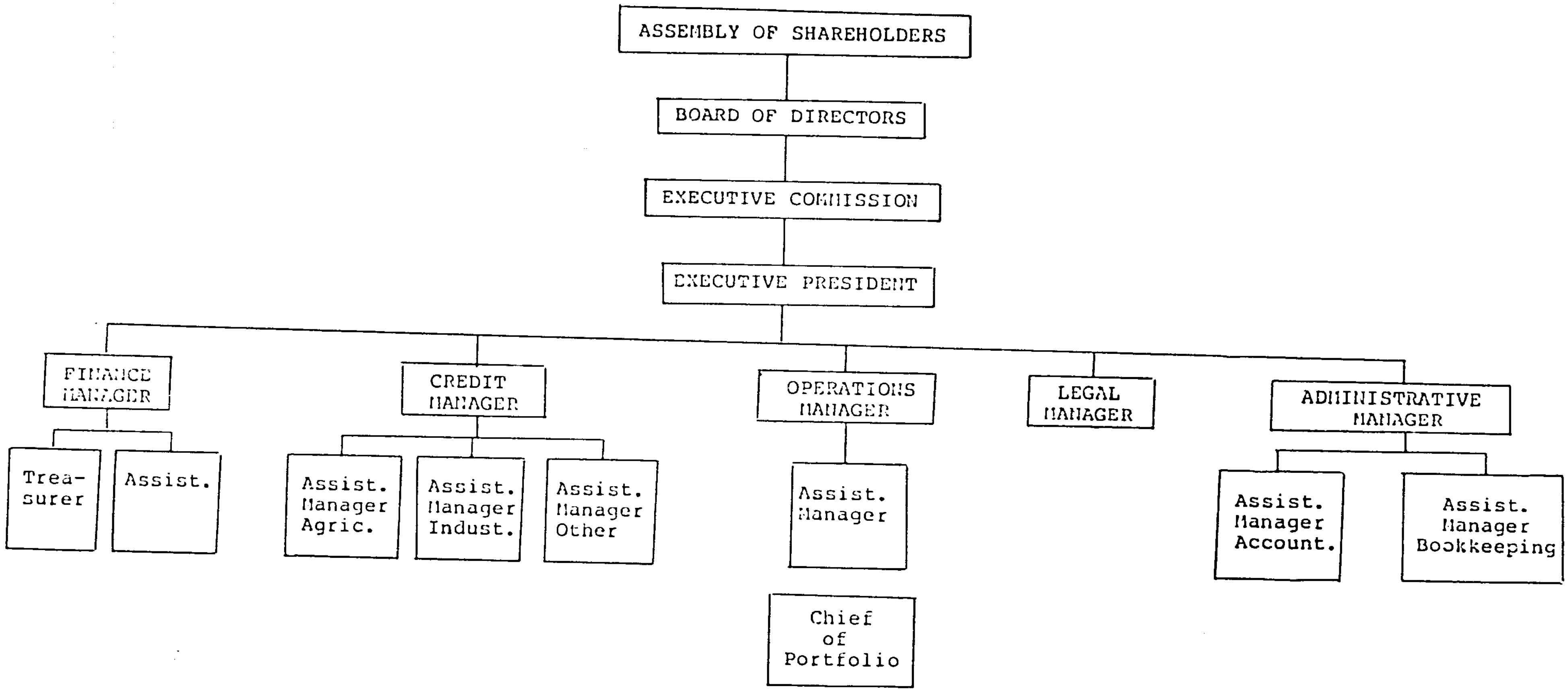
APPENDIX D

FINANQUIL
PROFIT AND LOSS STATEMENT
(IN SUCRES)

	1986	1985
EARNINGS		
Interest	1,331,812,595	1,122,500,229
Commissions	197,254,137	128,945,136
Other Income	49,023,069	3,763,511
Special Income	13,179,306	30,088,064
TOTAL	1,591,269,107	1,285,296,940
LIABILITIES		
Interest & Commissions	(961,126,530)	(724,402,072)
Personnel Expenses	(115,760,150)	(91,454,518)
Operating Expenses	(77,682,290)	(57,935,794)
Depreciation & Mortgage	(133,285,762)	(85,040,666)
Special Expenses	(9,537,578)	(2,817,058)
TOTAL	(1,297,392,310)	(961,650,108)
PROFIT BEFORE EMPLOYEE PROFIT SHARING AND TAXES	293,876,797	323,646,832
EMPLOYEE PROFIT SHARING	44,081,520	48,547,024
TAXES	39,999,724	65,982,038
TOTAL	209,795,553	209,117,770

APPENDIX E

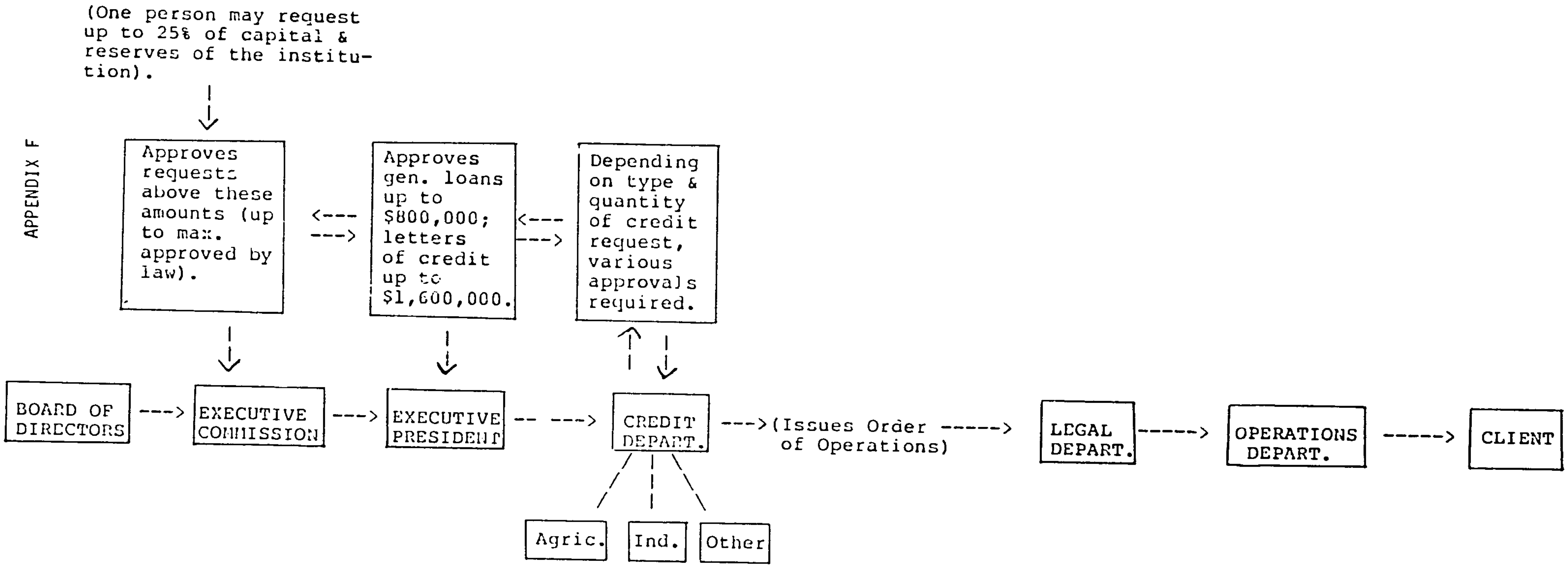
FINANCIERA IBEROAMERICANA - ORGANIZATION CHART



APPENDIX F

FINANCIERA IBEROAMERICANA

FLOW OF ACTIVITIES - OPENING LETTERS OF CREDIT



Credit Depart.:

1. Identifies clients.
2. Performs credit analysis.

Legal Depart.:

1. Reviews firm's documentation.
2. Sets requirements for each company.

Operations Depart.:

1. Completes all documentation for opening letter of credit and insurance.

Client:

Must pay 10% total letter credit as ca collateral + 2.48% (1% to FINIBER & 1. to First PA. Bank).

APPENDIX F (cont'd)

----> Money deposited to 1st PA. Bank account (pays interest).

----> Letter of credit credit opened when merchandise is on boat in U.S. port. Repayment terms of 90-180 days established with supplier.

----> Finiber has 10 days to initiate payment.

----> Finiber routinely requests 60 day extension.

----> Finiber presents documentation to Central Bank to obtain customs authority to release merchandise.

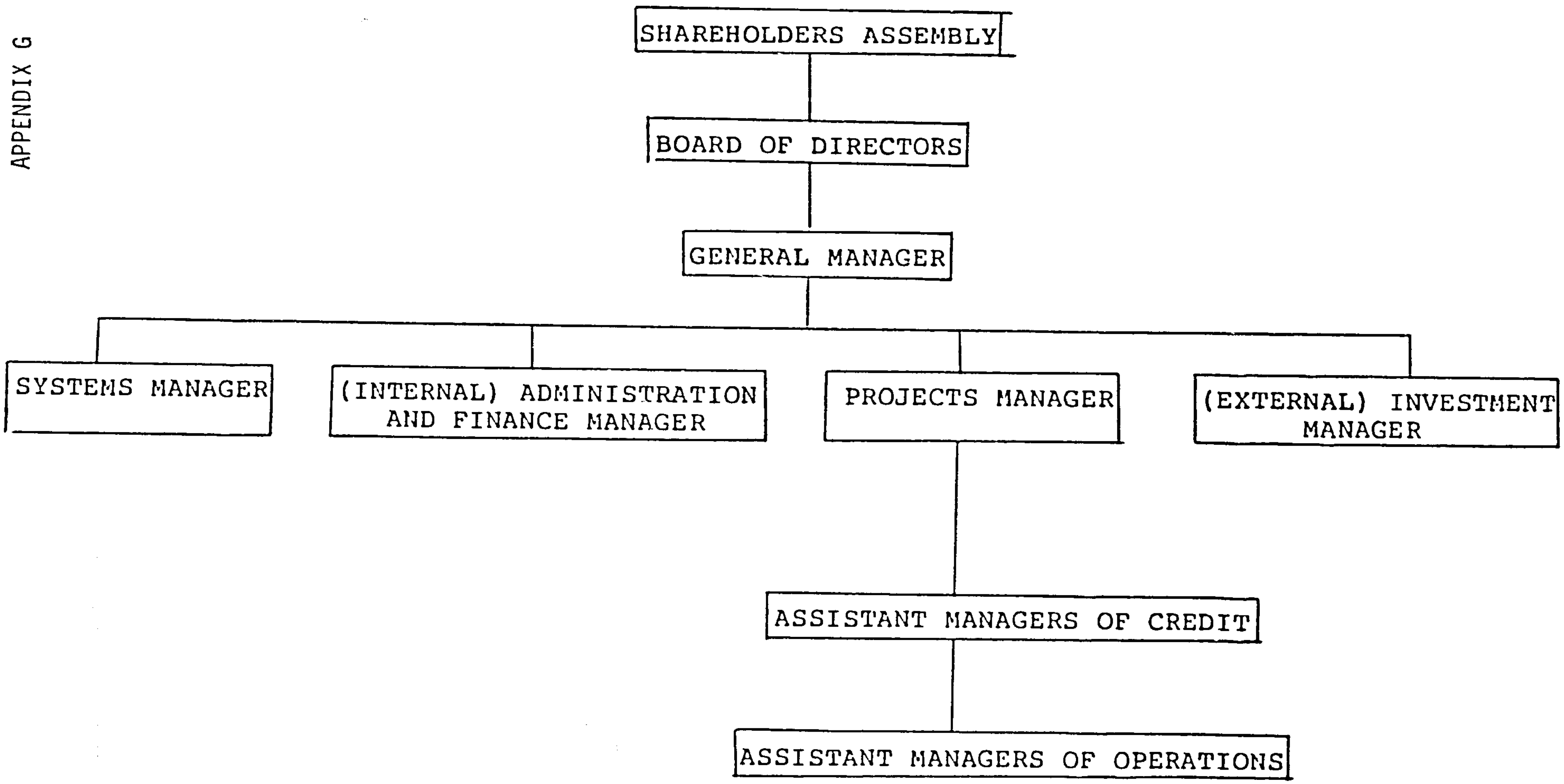
----> Sub-Borrower pays letter of credit with personal funds or obtains loan from FINIBER.

↑

Interest charged is prime + 2% + 1% commission trimestrally and 4% annually.

APPENDIX G

FINANCIERA GUAYAQUIL - ORGANIZATION CHART



APPENDIX H

FINANCIERA GUAYAQUIL

FLOW OF ACTIVITIES - OPENING LETTERS OF CREDIT

Client initiates Contact
↓
ASSISTANT MANAGER CREDIT ------------------> CREDIT MANAGER --------> CREDIT COMMITTEE ------------> ASSIST. MANAGER OPERATIONS --------------> TREASURER ----------> SWISS BANK

ASSISTANT MANAGER CREDIT

1. Reviews documentation from clients, banks, other financial institutions; performs credit analysis.
2. Recommends credit alternatives to client.

ASSIST. MANAGER OPERATIONS

1. Accumulates all supporting documentation from client: insurance endorsements, application forms, invoices from exporter, import declaration, promissory note.
2. Opens letter of credit.

TREASURER

1. Handles letter of credit transactions directly with Swiss Bank.
2. Charges client 1.5% of total letter of credit as acceptance commission (minimum $75); $100 negotiation commission; $25 for change made to original documentation; $30 for telex communications.
3. If client cancels letter of credit using 90-180 day extension, interest applied is prime interest rate + 1%.
4. If client wishes to cancel letter of credit immediately, FINANQUIL may propose that client take extensions, deposit money in a "collateral account", and gain interest until letter of credit cancelled.

SWISS BANK

Opens letter of credit at point of embarkation of goods in U.S. port.

APPENDIX I

DATA COLLECTION GUIDE

I. MACROECONOMIC CONDITIONS: IMF, IBRD, BIS, ETC. DOCUMENTS

1. What has been the rate of change in inflation since the financing?

2. What is the forecast for inflation?

3. What is the level and percent of employment? What is the forecast?

4. What has been the rate of change in employment since financing?

5. What has been the level and rate of change in GNP/GDP since financing? What is the forecast?

6. What is the breakdown of employment and GDP by sector?

7. What is the population growth rate? What is the age composition of the population? What is the rural/urban breakdown? Any major changes occurring?

8. What has been the changes in the currency conversion rate since financing? Is there a black market exchange rate?

9. What are the foreign exchange constraints on the economy?

10. What are the government policies regarding:

    a. The private sector
    b. Interest rates
    c. Business financing
    d. Collateralization of loans to SMSE

II. INTERVIEWS WITH CENTRAL BANK AND GOVERNMENT OFFICIALS

1. Please describe the structure of financial markets, credit availability, and subsidies. ______

______

2. What are the major trends in government policy toward the country's financial markets? ______

______

3. Please tell me what you can about the current discussion on interest rate policy. Are interest rates subsidized in any way? What is the prevailing interest rate? ______

______

4. What regulations are there on financial markets? What particular regulations relate to SMSE credit? What regulations concern collateral requirements? Is there ongoing discussion on financial market reform? ______

______

5. What are the trends on privatization of banking institutions? ______

______

6. What are the major institutional changes that are currently happening in your country's financial markets? ______

______

7. What do you think of this project? ______

______

8. Has this project led, or will it lead to changes in provision of credit? ______

______

9. Has this project affected access to credit for small businesses? ______

______

10. Is there a government policy to improve access to credit for small business? How does the PRE project fit in? ______

______

11. Are there other successful small business lending programs here? ______

______

III. INTERVIEWS WITH PRE STAFF

1. Why was this particular project selected? Was it particularly suited to local economic conditions? How did it fit into PRE programming at that time?

2. Why was this project undertaken?

3. In terms of financial and management capacities, how strong would you say that the project IFI is?

4. In what ways was the local IFI involved in project design?

5. In what ways have A.I.D. Mission staff assisted you in the design or implementation of this project?

6. In what ways does the PRE project credit delivery system differ from other credit systems in this country?

7. Have the loan policies of this IFI changed at all during the PRE project period?

8. Have there been any important management changes at the IFI during the period from ____ to ________?

9. (SHOW OBJECTIVES LIST) Of this list, which were the six primary objectives in carrying out this project?

10. Would you say that this PRE project has had any significant impacts on the local economy or credit system? What impacts?

11. Do you feel that investigations preceding the project were adequate? What would have helped?

12. Did you or others in the agency carry out a policy constraints analysis before you made the investment decision?

13. Will the project continue after termination of PRE assistance? How?

14. If you see that the PRE project is not going to meet project objectives, what action can you take?

15. Could you give me any examples of Mission projects that were stimulated by PRE activity?

16. What control do you have over the implementation of this project once you have disbursed the loan?

17. Please tell me about instances when innovative approaches have been taken to solving difficulties caused by government regulations, or changing circumstances.

IV. INTERVIEWS WITH A.I.D. MISSION STAFF

1. How does this project relate to the mission portfolio? Why was this particular project undertaken?____________________

2. Does the Mission consider the project successful? Unsuccessful? If so, why?____________________

3. Is the government interested in the project?____________________

4. (SHOW OBJECTIVES LIST) What do you see as being the six most important objectives of this project? ____________________

5. What have you learned from the project and how would you change it?

6. How much backup and assistance has the Mission provided to this project? Any assistance to other PRE projects? ____________________

8. Has this project in any way influenced other activities in the Mission? ____________________

9. Has this project stimulated any further Revolving Fund projects in country? ____________________

10. Have other host country institutions replicated the programming approach taken by the A.I.D. supported IFI?____________________

11. Has the Mission initiated any new private sector projects?____________________

12. Is there ongoing discussion on increased private sector involvement in development programming?____________________

13. What is the general relationship between PRE/Washington and the A.I.D. Mission here? ____________________

V. AID/PRE DOCUMENTS

Project Loan Information

1. Date of Application ________ 2. Date of Approval ________

3. Amount Approved:

	Before	After
Loan	$__________	$__________
Grant	$__________	$__________
Bank Matching Funds	$__________	$__________
Additional Commitments	$__________	$__________
Other loans/grants	$__________	$__________

4. Term of Loan (months) ______________________________

5. Repayment Requirements: Interest Rate ____%

   Principal Reductions ____________________

6. Date of First Disbursement ________________

7. Amount Disbursed: As of _______ Loan $ _______ Grant $ _______

8. Amount Outstanding $_________ As of __________

9. Current? Yes ___ No ___ If no: Amount in Arrears $ _________

10. Other indicators of the strength and competence of the IFI:

    Total loan arrears $ _______

    Reserves presently $ _______ Last year $ _________

    Value of PRE project portfolio $ _________

11. Any indication that this IFI was involved in the design of this PRE project?

12. Type of loan mechanisms used by project? ____________________

13. Total amount invested in the project by all sources? ____________

14. Any evidence of A.I.D. Mission staff involvement in this project?

15. Primary purpose of loan. ______________________________

    Types of businesses eligible for loans.____________________

    How many applicants were there? _______ How many were accepted? _____

16. Has PRE/I made a field visit? Yes ___ No ___. If yes, date?_______

17. What factors were considered by PRE/I in selection of this project for evaluation? ______________________________

____

18. Did the Bureau for Private Enterprise carry out a structural analysis of the banking sector before you made the investment decision? What were the results? ______________________________

____

Investment Proposal

1. Types of businesses to be financed? ______________________________

2. Basic loan criteria for subborrowers:

Maximum size ________ Minimum size ________
Maximum maturity ________ Minimum maturity ________
Interest rate ________ Collateral ________
Minimum equity participation ________

3. Methods to acquire subprojects.

4. Financial: (review financial statements filed in support of PRE/I loan)

5. Grant component of PRE assistance:

VI. IFI DOCUMENTS

1. Name of Project Organization ______________________________

2. Address _________________________

3. Country _____________

4. Principal Officer ________________

5. Purpose of IFI ____

6. Costs associated with admin. of A.I.D. project _______________

7. List of subborrowers ___________________________________

____

NOTE: If possible, get the following: A profit and loss statement for the PRE funded project, a P&L for the IFI as a whole, and other financial statements for the past 3 to 5 years. If a formal P&L is not available then:

1. Financial information on the IFI as of (date)

   a. Total loan portfolio Amount _____________
   b. No. of loans _________
   c. Average size loan __________
   d. Revenues (Fiscal year ended):
      Total ______________
      USAID Loan funds ____________

   e. Net Profit:
      Total ___________
      USAID Loan funds ____________

2. Ratio Analysis

   a. Profitability (for each fiscal period)
      Net Profit Margin: Net Profit/Total Revenues
      Asset Turnover: Total Revenues/Total Assets
      Asset Leverage: Total Assets/Total Equity
      Return on Equity: Net Profit/Total Equity
      Interest Income on Loans: Loan interest income/
      Average loan portfolio

   b. Solvency (for each fiscal period)
      Financial Leverage: Total Debt/Total Equity
      Liquidity: Cash and Cash Equivalents/
      Short term indebtedness

   c. Loan Quality: Overdue outstanding loans/
      Gross value of loan portfolio

   d. Efficiency: Principal collected during period/
      Principal due during period.
      Amount of payments made
      during period/Amount of
      payment due during period.

Financial Reports

1. Were funds used as required by the loan documents? Does file contain documentation of the use of funds?

2. Were training grant funds used as proposed?

3. Loan information: As Reported As Projected Difference Reason
   Number of Loans ________
   Amount of Loans ________
   Collections ________
   Delinquencies ________
   Other ________

USAID Funded Portfolio

1. Loans disbursed as of ____________ (date)
   Amount ________
   No. ________
   Location: ______ Urban ______ Rural

2. Disbursed loans that are current in payment
   Amount ________
   No. ________

3. Disbursed loans that are delinquent

   Up to 30 days: Amount ____________ No. ____________

   31-60 days: Amount ____________ No. ____________

   61-90 days: Amount ____________ No. ____________

   Over 90 days: Amount ____________ No. ____________

4. Disbursed loans that have had moratoriums on payment and/or been rescheduled: ________ Amount ________ No. ________

5. Disbursed loans that are under foreclosure and other liquidation action: ________ Amount ________ No. ________

6. Pending loan applications

   Amount ____________ No. ____________

7. Remarks ____

____

Subborrower Matrix

Borrower/Loan Number

Rural/Urban

Size

Sector

Export/Import

Assets

Employment

Gender

Sales

New Old

Current

Subborrower Matrix

Borrower/Loan Number

Rural/Urban

Size

Sector

Export/Import

Assets

Employment

Gender

Sales

New Old

Current

VII. INITIAL IFI STAFF INTERVIEWS

Interviews with division chiefs and others responsible for the operation of the USAID funded program will be required.

1. How does the A.I.D. project fit in with the rest of the institution? (do you have an organization chart?)

2. Which department or individual is responsible for management of the USAID funded program?

3. Is this a sole duty or does the department/individual also have other responsibilities?

4. Does this department/individual have authority to hire, dismiss, set salaries, etc.?

5. Which department or individual is responsible for credit analysis and approval of loan requests?

6. Which department or individual is responsible for loan servicing and customer relations?

7. Which department is responsible for loan collection and funds accounting?

8. Which department is responsible for loan accounting and recording?

VII. INTERVIEWS WITH IFI LINE STAFF

Financial Policies

NOTE: These questions should be asked of the individual responsible for management of the A.I.D. funded program.

1. Who establishes policy for the IFI?

2. Does the IFI have discretion to set interest rates on loans?

3. How is the interest rate determined?

4. What are the basic loan criteria?

   Maximum size ____________ Minimum size ______________

   Maximum maturity _________ Minimum maturity ____________

   Maximum grace period ______________

   Processing fee ___________ Administrative fee____________

   Repayment method: Monthly___ Qtrly ___
   Principal plus interest ___

   Equal Amortization ___ Other __________________

   Collateral amount as percent of loan ______________

   Types of collateral required _______________

   Eligible businesses: New ___ Industrial ___
   Agriculture ___

   Retail ___ Wholesale ___ Service ___

   Agri-business ___ Other ____________

5. Equity requirements (as percent of total assets)

6. Ownership/management of business:
   Must owners also be active in management?
   Are there educational or age requirements?
   Must borrowers maintain accounting records?

7. Are interest penalties charged on delinquent loans?

   What? ___________

8. Are prepayment penalties charged for payment prior to maturity?
   What? ___________

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Credit Policies: Loan Division Supervisor

1. Are credit policies for USAID funded subprojects different than other loans of the institution? (NOTE: Evaluator to probe for criteria such as lower interest rate, lower collateral requirements, longer maturities, staggered repayment schedules, etc.) Why?

2. Obtain and review copies of application forms for loans

   a. Promissory note

   b. Collateral documentation (simply characterize)

3. Please explain your policy with respect to collateral.

4. Review project appraisal process:

   a. Is there a review to determine whether stated loan purpose agrees with lending objectives?

   b. What is the source of baseline data for loan appraisal?

   c. Application acquisition and acceptance procedure

   d. Application processing
      Financial analysis
      Technical (production) analysis
      Market analysis
      Management evaluation

   e. What is the time from application acceptance to application approval?

5. What is the composition of the credit committee?

6. What is the time from application approval to first disbursement? From first disbursement to final disbursement?

Loan Servicing, Collection Policies, and Profitability

1. What are the legal requirements in this country for loan collection, foreclosure, and liquidation of collateral?

2. Are field visits made to borrowers?
   Specify period ______________
   Only when delinquent ________ Other ____________

   What happens at these field visits?

3. What technical oversight is there once loans are disbursed?

4. What resources exist for technical oversight? Is there a special technical unit? How much staff time is allocated to technical oversight?

5. Who has the responsibility for loss mitigation from defaulted loans?

6. Are safeguards established for collection of loan repayments?

7. What is the procedure for collection of delinquent loans?

8. How does the bank determine profitability of each loan?

   - cost of funds
   - risk premium
   - administration
   - allowance for bad debt
   - profit margin

   How does this compare to the bank's other activities?

9. Please describe the branch network of this bank.

IX. INTERVIEW WITH MANAGEMENT OF THE IFI

0. Please describe your bank's lending facilities available to SMSE's.

1. Why did you choose to obtain a loan through A.I.D.?
Was your institution involved in the design of this PRE project?

2. Is this program profitable for the bank? If not, why not.
Would you do it again?

3. Do you believe the USAID funded project is meeting its initial goals? Why or why not?

4. Have there been any new mechanisms developed to finance SMSE's recently? What?

5. Have loans been made available to special groups such as women-owned enterprises or rural businesses?

6. Has the operation of the project funded by USAID substantially changed from the initial expectations? In what ways?

7. Has the operation of the project resulted in any change to the way the entire organization is operating? In what ways?

8. What impediments do you see in making this project more successful?

9. What changes, if any, would you like to make in the project to enable you to meet its goals? How would such changes operate? How would those changes enable the project to meet its goals?

10. Have funding levels for activities targeted in the A.I.D./IFI agreement increased?

11. Have the PRE funds used in this project been complemented by any other source, such as another bilateral aid program or your government?

12. Has any other financial institution in the country begun to fund similar subprojects since you started this project? Are they, in your opinion, successful? Are you able to meet the competition from these institutions?

13. Have you made any administrative or policy changes in the project since it started?

14. What innovative approaches have you taken in this project to adapt to problems caused by government regulations and changing economic conditions?

15. How is credit usually provided to PRE project borrowers?
Please describe the lending program for small businesses.

16. Would this group of borrowers have obtained loans if loans from the PRE-assisted project had not been available?

17. What is the range of credit delivery mechanisms offered by your bank?

18. In what ways does the PRE project differ from your usual credit

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operations?

19. Has there been any significant change in your institution's capacity to identify suitable loans in the SMSE sector since the start of this project?

20. Has there been any significant change in your institution's capacity to process and monitor viable loans since the project started?

21. Has there been any significant change in your institution's ability to recover loans in the SMSE sector?

22. Will you continue this type of lending after termination of PRE assistance?

23. How many staff members are involved in the PRE project? What levels of personnel?

24. Do you feel your loan officers are adequately qualified to administer SMSE loans? Could training help them?

Personnel

1. Staff size of PRE supported project.
2. Skill level of PRE project staff.
3. Skill level of general staff loan officers.

X. SUBBORROWER INTERVIEWS

Collection and analysis of quantitative data on subprojects are labor intensive and time consuming activities. The time available to the evaluation team will dictate the extent to which such activity will occur. In general, an evaluator can interview 3 to 4 small and micro scale firms, or 2 to 3 medium scale firms in one day. Since many firms do not have telephones, it will be difficult to make prior appointments and visits will have to be made without knowing if the owner or manager will be present. The number to be evaluated will be determined by the time available to the evaluation team. To insure reasonable representation, consideration would be given in the selection process to the following:

Loan Size: Both large loans and small loans

Industry: To the extent possible, the firms selected should be representative of the industries financed.

Location: To the extent possible, both urban and rural firms.

Loan Type: Loans for working capital, for equipment, and for permanent assets (as applicable).

Maturity: Short term, medium term and long term loans.

Loan Status: Both current and past due accounts.

Credit History: New and old borrowers from this bank.

Asset Value of Business: Large and small.

GENERAL INFORMATION

Through interviews with the sub-borrowers, obtain the following information:

- description of business, what production processes it uses, new technologies.
- background information on the owner(s)/manager(s), such as experience, education, etc.
- credit experience: has it been good or bad, from whom, why this IFI was chosen? Who else could you borrow from? Have they invested their own money in this business?
- what other features of the program were attractive?

	Before loan	At present
Production:		
Units Produced		
Annual Sales		
Assets:		
Total Assets		
What kind of recent purchases have you made?		
Personnel:		
Number of Employees		
Payroll		
How many are women?		

- if this is a new business, what was the owner doing before this?
- has the owner invested in other businesses? Has his/her family been in business?
- does the owner have any other loans? from what sources?
- what were the loan proceeds used for?
- who are your competitors? are they larger or smaller than you? has competition increased since obtaining the loan?
- who are your customers? are they local, regional, national, international (%'s)? how do you market your product(s)?
- in general, how do you feel your firm is doing?
- what are the biggest problems your company faces?
- are you having difficulty repaying the loan?
- how has their loan helped you?
- do you have any other comments?

X. INTERVIEWS WITH OTHER INSTITUTIONS INVOLVED IN INNOVATIVE SMSE LENDING

Note: Conduct an unstructured interview with representatives of other institutions involved in innovative SMSE loan programs.