The Second Story

Wholesale Microfinance in Latin America

Marguerite Berger
Alison Beck Yonas
María Lucía Lloreda

Inter-American Development Bank

Washington, D. C.

Sustainable Development Department
Best Practices Series

Cataloging-in-Publication provided by the
Inter-American Development Bank
Felipe Herrera Library

Berger, Marguerite.

The second story : wholesale microfinance in Latin America / Marguerite Berger, Alison Beck Yonas, María Lucía Lloreda.

p.cm. (Sustainable Development Department Best practices series ; MSM-119)

1. Financial services industry--Latin America. 2. Small business--Latin America. 3. Inter-American Development Bank. I. Yonas, Alison Beck. II. Lloreda, María Lucía. III. Inter-American Development Bank. Sustainable Development Dept. Micro, Small and Medium Enterprise Division. IV. Title. V. Series.

332 B433—dc21

Marguerite Berger is a Senior Advisor in the Micro, Small and Medium Enterprise Division (MSM) of the Sustainable Development Department in the Inter-American Development Bank. Alison Beck Yonas is a consultant in MSM. When this report was written, María Lucía Lloreda was also an MSM consultant.

March 2003

This publication (Reference No. MSM-119) can be obtained through:

Micro, Small and Medium Enterprise Division
Mail Stop B-0600
Inter-American Development Bank
1300 New York Avenue, N.W.
Washington, D.C. 20577

e-mail:	sds/mic@iadb.org
Fax:	202-623-2307
Web site:	http://www.iadb.org/sds/mic

Foreword

Microfinance is a development success story. In Latin America, the IDB has been a supporter from the earliest days of the region's experiments with microcredit in nongovernmental organizations. Its most important contribution, however, has been to promote the development of private microfinance institutions that are regulated and supervised by the relevant authorities in their countries. This support has extended much- needed financial services –savings as well as credit- to hundreds of thousands of microenterprises, enabling them to consolidate and grow.

As this paper point out, the first story told about microfinance concerned the creation of individual retail financial institutions that cater to microenterprises. Much has been written about these microfinance institutions, and some of them have become legendary in development circles. But there is a second story to be told about institutions that are well known: this is the story of wholesale microfinance. Over the last 15 years, the IDB has invested in 17 wholesale microfinance programs that seek to develop microfinance by channeling resources through a wholesale, apex or second-tier financial institutions to individual lenders that work with microenterprises.

Of interest to policymakers, staff of development agencies working with microfinance, and the banks, finance companies, credit unions and nonprofits that provide services to microenterprises and lobby in favor of the microfinance industry, this paper reviews the rich experience of IDB's loans over the past 15 years. If focuses on: Colombia, El Salvador, Paraguay and Peru, countries that account or eight of the 17 microglobal loans and present an interesting range of outcomes and trend over time.

Drawing on project documents, evaluations, surveys and interviews with participating financial intermediaries and second-tier institutions, this paper tells the story of the IDB's microenterprise global credit program. The purpose of the paper is to garner lessons from this experience that can be applied to future efforts to promote microfinance, especially those that involve a wholesale mechanism.

The paper explores how market conditions, and program design and execution elements have determined the IDB program's success in meeting their dual objectives: expanding microenterprise access to financial services and strengthening financial institutions' capacity to serve microenterprises. It identifies the key factors that can spell success or failure for wholesale microfinance programs.

Alvaro Ramírez
Chief
Micro, Small and Médium Enterprise

Contents

Executive Summary

The Microfinance Global Credit Program (MG Program) of the Inter-American Development Bank (IDB) is an important chapter in the story of microfinance development in Latin America. The Program provides financing to commercial banks and other formal financial intermediaries to facilitate their entry into the microenterprise market. It is the largest wholesale microfinance program in Latin America.

The IDB has designed and implemented 17 MG programs in 12 countries in Latin America. During the period 1990 to 2001, the IDB approved more than $534 million in financing for these programs, and disbursed over $356 million through second-tier institutions. These institutions in turn to lent to over 100 first-tier financial intermediaries and nearly half a million microenterprises. Such a wholesaling mechanism can theoretically channel more resources to the microenterrpise sector more efficiently than can separate smaller operations, and is therefore a very attractive model for development agencies interested in having a big impact while streamlining their own operations.

Purpose of the Report

The purpose of this report is to identify lessons from the IDB's MG Programs that can be applied to future programs for expanding microfinance, particularly those that rely on wholesaling mechanisms. Although drawing from the experience of all 17 MG programs financed by the IDB, the report provides an in-depth analysis of the MG Program in four countries of the region: Colombia, El Salvador, Paraguay, and Peru. These four countries account for 8 to 17 MG programs, and one third of total IDB resources invested. They present an interesting range of experiences, and they span the full time period of the program, allowing for consideration of trends over time.

Defining Success

This report assesses the success of the MG programs on three dimension: (i) expanding microenterprise access to financial services by broadening and deepening financial services to independent enterprises of progressively smaller scale, and, specifically, to microenterprises owned and operated by low-income people and other underserved populations, (ii) institutional development, that is, strengthening financial institutions' capacity to serve this clientele, including the entrance of lenders not previously serving the microenterprise sector into this market or expansion of microfinance operations by those already serving microenterprises; and (iii) promoting or reinforcing regulatory reform to develop the microfinance market.

Factors Behind the Results

This paper explores the factors that contribute to the success, or otherwise, of the MG programs and their components. The main factors that affect the outcome of the MG wholesale microfinance programs are divided into two main categories: market conditions (or the environment for microfinance in the country) and the design and execution of the programs themselves.

With respect to market conditions, the paper reviews the effect of: (i) the size and concentration of the microenterprise sector, that is, the potential market for microfinance services; (ii) public policy and the legal and regulatory framework that governs financial institutions and their operations, including the role of local and foreign governments in financing IFIs that lend to microenterprises; and (iii) the stage of development of the microfinance industry, including the existence of industry leaders or models for microfinance.

The second set of factors analyzed, those related to project design and execution, are more directly within the control of policy makers and project teams. They include: (i) the objectives which define the program; (ii) the choice of the executing agency and its capabilities as well as the complexity of the credit regulations and mechanisms used for program execution; (iii) the eligibility criteria used to screen IFIs wishing to participate in the program and performance thresholds for continuing access to program funds; (iv) the cost of program resources; (v) transaction costs and restrictions placed on the use of program resources, especially those related to targeting microenterprises; and (vi) the availability of technical assistance to help interested financial institutions develop viable microfinance services.

Results of the MG Programs

This review of the IDB's MG programs shows that a wholesale, apex or second-tier mechanism can be used successfully to reach large numbers of microenterprises with financial services without damaging the performance of the participating retail lenders, when certain conditions are met.

The MG programs reviewed here aim to increase the sustainable flow of resources to the microenterprise sector through formal financial institutions. And, although performance varied across the four MG countries highlighted here and evolved over time, as a whole the Mg programs can be credited with many positive out-comes. They reach smaller business and more women borrowers than other credit operations in their countries. They bring new borrowers into the formal financial system, and new lenders into microfinance. The MG programs are most successful in developing specialized microfinance institutions and finance companies that had previously engaged in consumer lending, and less so in attracting existing commercial banks to downscale their operations to the micro level or in helping nonregulated NGO microfinance institutions to submit their operations to regulatory exigencies. The programs have contributed to a change in the perception of the microenterprise sector and have brought the sector closer to formal financial markets. They also help to further the agenda for reform of regulations and supervisory norms to create an enabling environment for microfinance.

The Second Story

Microenterprises with fewer than 10 employees are one of the main sources of employment in Latin America and the Caribbean and they account for more than 90 percent of all businesses in the region. However, their lack of access to financing remains a formidable obstacle to improving their productivity, earnings and the quality of the jobs they create. In order to address this problem, international development agencies and governments have contributed significant resources over the past twenty years to the development of microfinance —financial services specifically tailored to microenterprises.

The first story of microfinance concerns the creation of individual retail financial institutions that cater to microenterprises. Judging by the notoriety of some of these specialized institutions, their performance and outreach to microenterprises, this story appears to be a successful one. The second story —which is the subject of this paper— concerns the use of wholesale or apex mechanisms to channel resources to a range of existing retail financial institutions. This story is less well known, and its success has not yet been established.

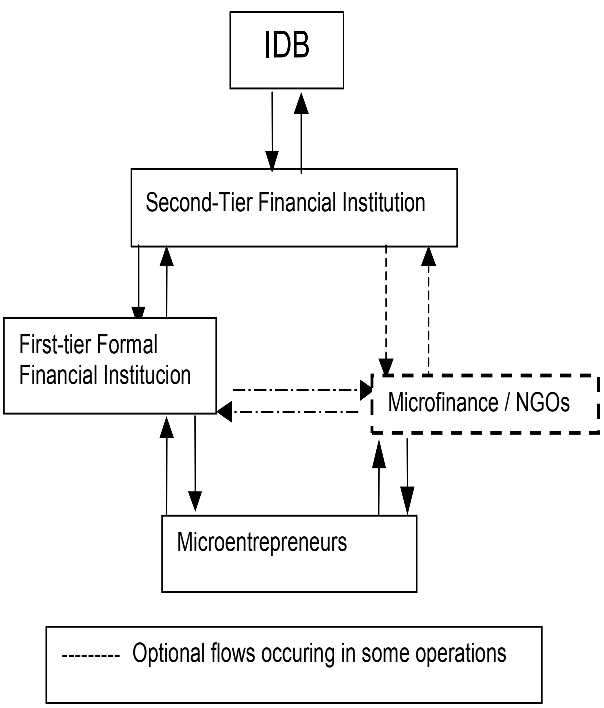
The Microenterprise Global Credit Program of the Inter-American Development Bank (IDB) is an important chapter in the wholesale microfinance story. The program provides financing to commercial banks and other formal financial intermediaries to facilitate their entry into the microenterprise market. It is the largest wholesale microfinance program in Latin America. Unlike the specialized microfinance institutions that received financing specifically earmarked for them, the intermediary financial institutions (IFIs) participating in the Micro Global Credit Program are not chosen in advance. They choose themselves (as long as their overall financial performance is sound) by electing to tap the Microenterprise Global Credit funds through a local wholesale, apex, or second-tier institution (a national development bank or fund).

Over the last 15 years, the IDB, a pioneer in support to microfinance in Latin America and the Caribbean, has invested in 17 wholesale, or second-tier, financing facilities to promote microfinance. The IDB began its support for microfinance in the late 1970s by providing soft loans and grants to individual NGOs and credit unions that lend to microenterprises. Through its Small Projects Program, the IDB has financed over 300 such institutions in Latin America and the Caribbean. By the late 1980s, a number of the microlenders that had been supported by the IDB (most notably PRODEM, Procrédito and FIE in Bolivia; Accion Comunitaria and the Cajas Municipales in Peru; Corposol/Finansol and Women's World Banking in Colombia; and AMPES in El Salvador) had grown to the size of small banks. Many of these organizations created their own regulated financial institutions: PRODEM created Banco Sol; Procrédito, Caja los Andes: Acción Comunitaria, MiBanco; and AMPES, Financiera Calpiá. This raised the prospect of developing microfinance services on a sustainable (or even a commercial) basis throughout Latin America.

During the 1960s and 1970s, the IDB supported numerous targeted credit programs for agriculture and small business which operated with subsidized funds and interest rate ceilings and undermined the deposit mobilization and overall soundness of the participating financial institutions. Despite this history of failure, the IDB sought a new kind of targeted credit program to ramp up the microfinance industry. The goal was to move beyond the slow development of individual microlenders that still remained largely outside formal financial markets, and help create a microfinance industry with a range of service providers.

The IDB's Microenterprise Global Credit programs (MG programs) were created for this purpose. Rather than investing in the creation of new, specialized financial intermediaries, the programs took the other road to expanding microenterprise access to financial services: helping existing financial institutions find ways to extend services to new customers that they had heretofore overlooked. In contrast to the targeted credit programs of the past, the MG programs provided financing to qualified first-tier lenders at rates approximating the marginal cost of funds in the market and lenders were permitted to freely set the interest rates they charged to microenterprise borrowers.

Figure 1
Wholesale Microfinance Model for IDB MG Programs



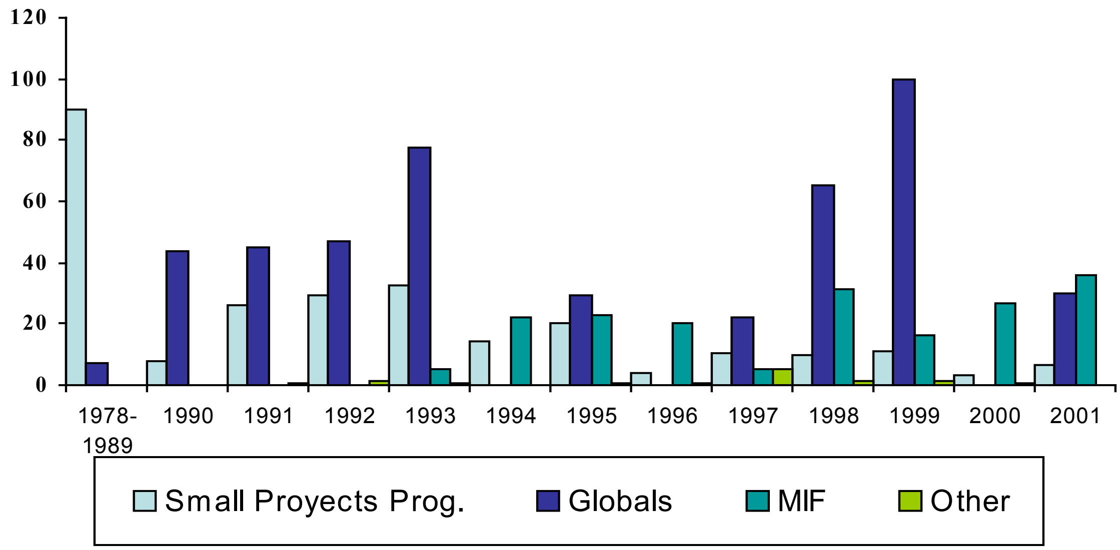
As shown in Figure 1, the MG programs utilize a two-tier structure to accelerate the expansion of microfinance services toward the microenterprise sector. A second-tier institution channels financial resources through retail lenders, first-tier intermediary financial institutions, which in turn lend directly to microenterprises. Such a wholesaling mechanism can theoretically channel more resources to the microenterprise sector more efficiently than can separate smaller operations, and is therefore a very attractive model for development agencies interested in having a big impact while streamlining their own operations. The financial resources may also be accompanied by technical assistance in support of the first-tier institutions' efforts to improve their services and financial performance.

From 1990 to 2001, the IDB approved more than US$534 million in financing for these programs, and disbursed over US$356 million through second-tier institutions. These institutions in turn lent to over 100 first-tier financial intermediaries. As shown in Figure 2, MG programs became the IDB's main instrument for the development of microfinance in Latin America and the Caribbean in the 1990s.

Purpose and Focus

The purpose of this report is to identify lessons from the IDB's MG programs that can be applied to future programs for expanding microfinance, particularly those that rely on wholesaling, or apex, mechanisms. Although drawing from the experience of all 17 MG programs financed by the IDB, the report provides an in-depth analysis of the MG programs in four countries: Colombia, El Salvador, Paraguay and Perú. These four countries account for 8 of the 17 MG programs, and one- third of total IDB resources invested.

Figure 2
IDB Funding for Microenteprise Projects, 1978-2001
(in millions of dollars)



The year 2001 does not include US$900 million program in Brazil.

They present an interesting range of experiences, and they span the full time period of the program, allowing for consideration of trends over time.

The investigation of these programs is based on the review of existing project documentation, including the MG pProgram evaluations, interviews with IDB project team leaders and other staff members who designed the MG programs, and surveys of the participating financial intermediaries and second-tier institutions. All project documents of 17 MG programs were reviewed, and additional information was gathered from the sources listed in the bibliography.

This report poses as its central question whether the IDB's MG Programs have contributed to financial deepening in the countries in which they have been implemented. The particular aspect of financial deepening that interests us here is that of extending the reach of financial services down to customers from lower socioeconomic levels than traditional bank clients, and in particular to microenterprises with no previous access to these services. This includes the expansion or broadening of financial services and products for the microenterprise sector, increasing the number of microenterprise clients served, and extending the reach of services to marginalized groups or regions of the country. This type of financial deepening is not to be understood as a transitory phenomenon. As used here, the concept presupposes that the provision of new services to new clients can be sustained over time and has a positive impact on the market for financial services and the participating intermediaries

Development of the IDB´s Microenterprise Global Credit Program

The Microenterprise Global Credit programs are loans to national governments, with resources channeled through their central bank, to participating first-tier institutions. The executing agency is in most cases a department within the Central Bank itself or a state-owned development bank, which serves as the apex, wholesaler, or second-tier bank. The funds are lent through a variety of mechanisms, such as discounting, auction, or line of credit. Participating first-tier financial most of which are privately owned institutions lend directly to microenterprises, and include commercial banks, finance companies, municipal savings banks, credit unions, and in one case, nongovernmental organizations.

Since the IDB's first MG program was approved in 1986, the principal objective of each program has been to expand credit for small and microenterprises, including those owned by women, the poor and other groups that do not have access to traditional credit products offered by the formal banking system.

The MG programs are designed to promote: (i) downscaling, or a greater participation by formal financial intermediaries in microfinance; (ii) upgrading, the development, institutional strengthening and consolidation of newly created formal financial institutions dedicated to microfinance; and (iii) complementary policy reforms which will reinforce objectives (i) and (ii). Thus, MG programs support the development and strengthening of the microenterprise sector, not by simply channeling credit to the sector, but by developing sustainable services and institutions to achieve the insertion of microenterprises into the formal financial markets.

As successful microfinance organizations began to show that they could provide loans to this market on a sustainable basis and, in some cases, even make a profit, many governments in Latin America began to take interest in fostering this type of development in their countries. They included microfinance on the national agenda and sought IDB support for its development. Although nongovernmental organizations (NGOs) were the pioneers in microfinance, the IDB and its borrowing countries sought to move beyond subsidized NGO programs and to provide microenterprises with access to the formal financial markets. The MG Programs were designed to have a greater impact on the sector by working through formal financial intermediaries. The benefits of involving more formal, regulated institutions were several: greater transparency in reporting, tougher performance standards; and the ability to leverage other financing and mobilize deposits, as well as provide savings and other products to the microenterprise sector.

Because the focus was on attracting commercial banks and other formal IFIs to the microenterprise market, and because the program sought to provide targeted credit without sacrificing institutional sustainability and profitability, the limits on loan size were set considerably higher than the conventional definition of microcredit. In most cases, the maximum loan size was set between $7,500 and $15,000. In order to discourage a clustering of loans toward the top limit, each program defined not only a maximum loan size but also a maximum average loan size to which participating IFIs had to adhere. The maximum average size was generally set at one-half the top limit or less. In order to keep their average loan size within the program limits, IFIs that made larger loans would therefore be obliged to make many small loans.

Only a few commercial banks were lending to the microenterprise sector when the first MG program was designed. The idea was that with the right incentives, more banks would see the sector as a valuable market, and would begin to invest their own resources. It was believed that banks' reluctance to reach down to smaller business customers was due to the start-up cost of microfinance technology – training staff and implementing systems to manage a high volume of small loans with minimal collateral and to the risk of making such loans without the appropriate microfinance technology. To encourage participating IFIs to invest in microfinance, some MG programs included a technical cooperation component that defrayed part of the banks' cost of launching or developing their microfinance operations. Providing commercial financial institutions with start-up grants, albeit with the objective of helping the poor, was a difficult idea to sell internally at the IDB, and was a major innovation of the MG program.

What Constitutes Success?

This report assesses the success of the MG programs on three dimensions: (i) expanding microenterprise access to financial services; (ii) institutional development —strengthening financial institutions´ capacity to serve this clientele; and (iii) promoting or reinforcing regulatory reform to develop the microfinance market. The results are summarized below, focusing mainly on programs in the four countries analyzed in depth.

For the purposes of this study, a successful MG program is one that contributes to the development of a microfinance industry: (i) the entrance of lenders not previously serving the microenterprise sector into this market or expansion of microfinanance operations by those already serving microenterprises; and (ii) a broadening and deepening of the coverage of financial services to independent enterprises of progressively smaller scale, and, specifically, to microenterprises owned and operated by low-income people, women and other underserved populations.

The other major aspect of a successful program concerns the financial and institutional performance of participating IFIs. Program resources were intended to extend financial services to new clients while simultaneously maintaining performance levels of participating intermediaries (e.g. portfolio quality, operational efficiency and financial returns), or even improving them. Although it is difficult to isolate the effects of MG program resources on institutional performance from the effects of policy changes, external economic factors, or internal changes that would have taken place without the program, all MG programs explicitly include the objective of building solid intermediary financial institutions (IFIs) that will continue their support for microenterprise development even after MG program resources have disappeared.

Policy reform should perhaps not be listed as part of the definition of success, as it is not an end in itself, but a means to develop the microfinance industry and expand access to financial services that microenterprises need in order to grow. However, the IDB's experience with microfinance over the past 25 years has shown that policy and regulatory reforms are fundamental for ensuring sustainable microfinance. Some of the MG programs reviewed include policy and regulatory reform as part of their objectives, some include specific policy reform components, and others have indirectly served as an impetus to reform.

To measure success or failure on these three dimensions, this report addresses questions such as the following: Did IFIs broaden coverage by serving new clients and those who traditionally have had less access to credit, such as women and rural microentrepreneurs? Did IFIs deepen their market, by providing credits to smaller businesses and poorer clients? Did new lenders enter the microfinance market? Did existing specialized microlenders grow and develop new services? Did participating IFIs develop permanent institutional capacity for lending to microenteprises in a sustainable or profitable way? Did the market develop by becoming more competitive with lower rates and new products? Did policies favorable to sound microfinance develop with support from the programs? The answers to these questions varied considerably across the 17 MG programs financed by the IDB, as shown in Table 1, which gives an overview of these programs and their main results.

Table 1
Overview of MG Program Results

Country	Approval Date	Completion Date	Total Financing (000 US$)*	IDB Financing (000 US$)	Total TA Funding (000 US$)*	Number of Partici-pating IFIs	Number of NGOs	Number of Credits	Ave loan size US$	1995 YPC
Colombia	12/01/86	08/01/91	10,000	7,000	n.a.	6	19	3,750	3,100	1,705
Uruguay	11/01/90	12/01/93	13,130	9,200	3,130	7	0	1,021	8,500	3,142
Colombia	12/01/90	02/01/93	22,000	15,000	2,000	8	34	26,900	740	1,705
Ecuador	12/01/90	03/01/95	21,700	19,500	3,700	16	0	10,400	1,700	1,371
Argentina	10/01/91	03/01/97	65,000	49,000	5,000	32	0	9,510	9,412	5,896
Chile	03/01/92	09/01/93	20,000	15,000	3,000	1	0	2,024	939	3,542
Guatemala	05/01/92	ongoing	12,500	10,000	3,300	4	0	5,317	1,825	974
Costa Rica	11/01/92	12/01/98	17,600	13,000	3,300	5	0	6,531	1,114	1,003
Paraguay	11/01/92	07/01/96	14,700	12,500	2,700	8	0	11,295	1,300	1,513
Colombia	11/01/93	11/01/97	50,810	30,600	810	19	39	108,421**	581	1,705
Nicaragua	11/01/93	11/01/00	29,500	23,600	4,500	7	0	10,716	766	466
ElSalvador	11/01/93	07/01/97	30,000	24,000	0	15	0	45,503	660	1,275
Peru	09/01/95	05/01/98	39,650	27,750	3,950	16	0	31,038	1,017	2,084
Peru	09/01/98	10/01/01	42,860	30,000	0	15	0	71,336	750	2,084
Paraguay	01/01/99	ongoing	25,000	22,200	3,000	14	0	44,584	688	1,513
Argentina	07/01/99	ongoing	200,000	100,000	4,000	10	0	1,824	11,513	5,896
Bolivia	10/01/98	ongoing	43,750	35,000	25,150	3	0	9,100	754	911
TOTAL	---	---	**658,200**	**443,350**	**67,540**	**---**	**---**	**399,270**	**---**	---
AVG	---	---	**38,718**	**26,079**	**4,221**	**12.65**	**---**	**23,486**	**1,176**	---

**includes both IDB and counterpart funding*
***includes reflows*

How the Story Ends: Results of the MG Programs

Although a sequel is still in production, we can say that, so far, the IDB's wholesale microfinance story has a *relatively* happy ending. For the most part, the Microenterprise Global Loan programs reviewed in this report did succeed in expanding financial services to the microenterprise sector, and helping to consolidate sustainable institutions to continue these services into the future. In most cases, they did so without harming the overall financial performance of the participating IFIs. Of the four countries studied, the overall success of the MG programs was high in Peru and Paraguay, moderate in El Salvador and low in Colombia.

Expanding Microenterprise Access to Financial Services

The programs reviewed here met their objectives in terms of improving microenterprise access to credit from regulated financial institutions, although only marginally in Colombia. They served to expand the operations of existing microfinance institutions and, to some extent, they helped increase the number of IFIs engaged in microfinance. They increased the numbers of microentrepreneurs with formal sector credit and extended the reach of financial services to smaller enterprises, low-income borrowers, women and, to some extent, rural populations.

The MG programs were able to reach more microenterprise borrowers more quickly than the independent microfinance operations supported by the IDB's small projects and the Multilateral Investment Fund. As shown in Table 1, the number of micro and small enterprise loans ranged from 1021 in Uruguay to more than 70,000 in Colombia and Peru. The four countries that are the focus of this study represent the cases of greatest outreach (as measured by number of loans and number of borrowers) within the MG program as a whole.

The low average loan size observed in most of the programs supports the conclusion that program resources reached microenterprises previously underserved by IFIs. The average loan size was below per capita income for 7 of the 8 MG programs reviewed in this study, the exception being the first program in colombia. In Peru and El Salvador, average loan size was one-half or less the level of income per capita at the time of the programs, and in the most recent programs in Colombia and Paraguay it reached a level of only one-third. Furthermore, project evaluations have shown that in most cases, MG resources reached new clients, not just existing borrowers of the participating institutions, and that these new clients operated smaller businesses and had lower incomes than other IFI borrowers. Average loan sizes (which can be a proxy for size of borrowers' businesses) ranged from a low of $581 to a high of $11,513.

The MG programs were very successful in expanding women's access to credit, especially when compared to other IDB credit programs. Women received over 40 percent of the loans in the four countries studied. According to a recent evaluation, the El Salvador MG presented the most pro-poor results of any MG program for which data is available, with 50 percent of its borrowers below the poverty line. This reflects the composition of the Financiera Calpiá portfolio, since this IFI accounted for nearly 80 percent of the loans under the program. The low average loan size of the El Salvador MG, $660, is due to the participation of Calpiá; the other participating IFIs had among them an average loan size of US$4,000.

Not all of the MG programs had good outreach to smaller businesses and low-income people. In three cases not featured in this study (Argentina, Uruguay and Costa Rica), the evidence points to limited outreach to smaller borrowers. In Argentina, for example, average loan size was $9400 in the first MG program and reached $11,500 in the second program before the recent crisis. Informal sector enterprises did not have access to subloans, and the evaluation of the first MG found that loans went mainly to existing clients of the participating IFIs. These results show that the existence of a wholesale credit mechanism is not sufficient to trigger the development of microfinance.

The impact of the MG programs has not been as strong in terms of expanding microenterprise access to financial services on a national scale. Table 2 presents data on microfinance from the most complete source for such information, the *Microbanking Bulletin*, in comparison with the estimated number of microenterprises in each country. The data are incomplete, being based mainly on reports from specialized microfinance institutions and considering all microenterprises including those that may not be deemed creditworthy, even by specialized microlenders. How-

Table 2
Share of Microenterprises in Latin America with MFI Credit

Country	Date of Household Survey	Number of Single-Person Firms	Number of Firms with 1-5 Employees	Total Number of Microenterprises	Number of Microenterprises With MFI Credit	Share of Microenterprises with MFI Credit
Bolivia	1999	1,300,313	62,008	1,362,321	379,117	27.83%
Nicaragua	1998	377,148	40,422	417,570	84,285	20.18%
El Salvador	1998	606,569	60,617	667,186	93,808	14.06%
Honduras	1999	832,941	58,239	891,180	107,054	12.01%
Chile	1998	1,069,139	138,045	1,207,184	82,825	6.86%
Guatemala	1998	1,328,476	93,238	1,421,714	71,187	5.01%
Costa Rica	1998	232,328	78,891	311,219	12,794	4.11%
Ecuador	1998	1,396,139	298,524	1,694,663	65,719	3.88%
Dominican Republic	1998	1,315,016	77,172	1,392,188	49,437	3.55%
Colombia	1999	5,726,653	775,152	6,501,805	219,240	3.37%
Paraguay	1998	319,113	668,213	987,326	30,203	3.06%
Peru	1997	4,102,561	2,763,632	6,866,193	185,431	2.70%
Panama	1999	267,854	21,150	289,004	6,390	2.21%
Mexico	1998	8,503,552	1,770,393	10,273,945	67,249	0.65%
Uruguay	1998	314,891	27,018	341,909	1,600	0.47%
Brazil	1999	16,567,943	2,421,810	18,989,753	62,485	0.33%
Argentina	1998	1,807,615	103,555	1,911,170	4,940	0.26%
Venezuela	1999	2,906,975	340,296	3,247,271	2,364	0.07%
Latin America - Total Firms		**48,975,225**	**9,798,375**	**58,773,600**	**1,526,128**	
Latin America - Weighted Average Share[a]						**2.60%**
Latin America - Unweighted Average Share[b]						**6.15%**

Source: Westley (2001); Household surveys tabulated by IDB, Department of Research; Christen (2000). Christen's data refer to the second half of 1999 and cover most of the larger specialized financial institutions and NGOs lending to microenterprises, but do not cover most credit unions, finance companies or banks that do not specialize in microfinance. Data for the number of microenterprises with MFI credit for Panama were obtained by Westley from IDB loan files.

[a] *Calculated as the total number of microenterprises with MFI credit multiplied by the total number of microenterprises.*

[b] *Calculated as the unweighted average of the 18 individual country percentages shown in the final column.*

ever, they do allow for a rough approximation of microenterprise access to credit in Latin America.

In El Salvador, for example, the microenterprise sector is not large in total number, but even after the impressive growth of Calpiá and entrance of other lenders into the market, there is still considerable room for expansion in the market. In Peru, access is below 5 percent, but the microenterprise sector is considerable. Paraguay is a much smaller country; however, access to microfinance is also below 5 percent. Even doubling these percentages to allow for underreporting of microfinance leaves less than 10 percent of microenterprises with access to credit in the four countries.

In Bolivia, a country that has adopted microfinance-friendly regulatory reforms and received large international contributions for its microfinance institutions, more than one-fourth of microenterprises has access to formal credit, yet there has been no wholesale, or second-tier, microfinance program until very recently. Although Bolivia is an exceptional case in the region, that experience does demonstrate that it is possible to develop a microfinance industry without a wholesale credit program.

Development of Microfinance Institutions

The medium to long term impact of the MG programs on the IFIs engaged in microfinance was strong in the cases of Paraguay, Peru and El Salvador, and limited in the case of Colombia. MG resources clearly helped leading microfinance institutions (MFI) to dramatically expand their microfinance operations, especially in El Salvador and Peru.

IFI Performance. In Peru, the MG program helped consolidate the microfinance business of the *cajas municipales*, and provided incentives for finance companies affiliated with banking groups to enter the market. In Paraguay, newly regulated finance companies were able to target the underserved microen-terprise market niche and rapidly expand their operations there, while simultaneously improving their financial performance.

Although not the only factor in institutional success, it can be argued that the access to resources assisted Financiera Calpiá to achieve its market leader position in El Salvador, as it transformed from an NGO to a formal finance company.

Colombia provided the exception to the rule. In this country, the MG resources did allow (unregulated) microfinance NGOs to expand their operations dramatically and, in the case of the participating Women´s World Banking affiliates, even helped them to achieve sound financial performance. However, these resources also served to limit participating NGOs' interest in establishing regulated subsidiaries. One institution that did so had serious financial problems, which were not detected by the second tier's review of participating IFIs, nor by the supervisory authorities, until they had become critical. Finally, the legacy of the first two MG programs in Colombia tended to push some institutions toward a credit *cum* training model of microfinance, which aggravated the situation of the participating IFI that went into bankruptcy.

For IFIs that participated in the MG programs for the entire execution period, performance levels on key indicators of arrears, efficiency and profitability were maintained. For others that dropped out, lack of interest in the program was equally as important an explanatory factor as deterioration of performance. However, it would be unfair to ascribe the positive outcomes with respect to financial performance to the programs, since poorly performing institutions were not allowed to participate from the beginning. One spectacular example of failure of a microfinance institution during the Colombia program–Finansol–

cannot be attributed to the MG program per se, although the program may have disguised problems in the institution or even aggravated them.

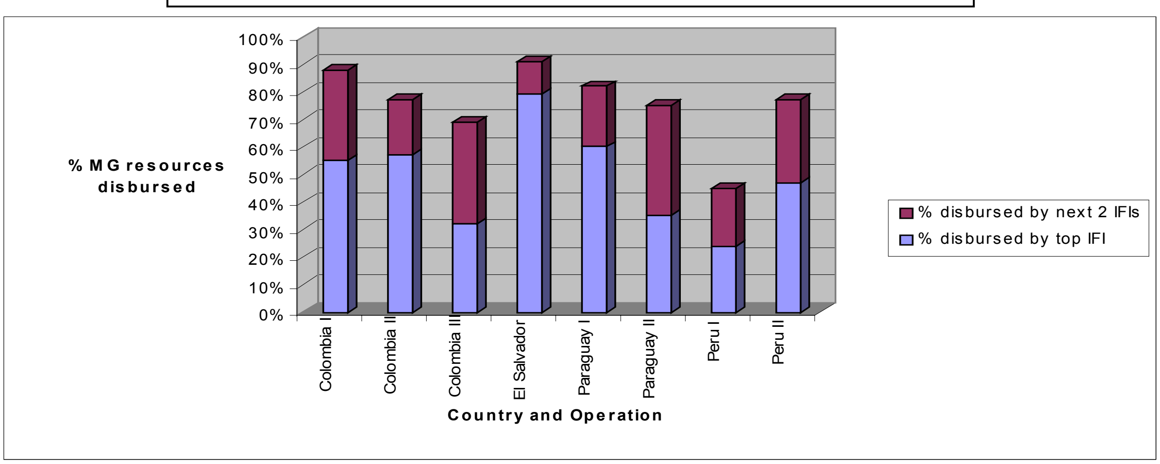
Concentration of Resources. Although an impressive number of IFIs participated in the MG programs in the four countries studied, from a low of 8 in Paraguay to a high of 19 in Colombia (plus 39 NGOs in Colombia), there was a clear pattern of concentration of program resources in a small number of IFIs as shown in Figure 3. In El Salvador 91 percent of MG resources were used by the top 3 participating IFIs and 79 percent by one specialized microfinance institution, Financiera Calpiá. In Colombia, the top 3 participating institutions (1 finance company and 2 NGOs) used 69 percent of MG III resources. The first MG in Peru presented the least concentration in this regard, with 54 percent of its resources used by the top 3 institutions (2 commercial banks, and 1 municipal savings bank). But in the second MG, 75 percent of resources are concentrated in the top 3 IFIs (2 municipal savings banks and 1 commercial bank). In Paraguay, 82 percent of resources were concentrated in the top 3 institutions in MG I, but that figure fell to 75 percent so far in MG II.

These results can be misleading, however. With the exception of Peru, concentration of program resources in the top three and even the top one participating institution tended to decline over time (see Figure 3). And in all cases, except in El Salvador, the top institution changed over time. This would tend to indicate that already existing MFIs are first out of the gate to capture MG resources, but others become interested over time.

To achieve the overall goal of the MG programs (expanding the reach of financial services to more and smaller microenterprises) it is not just the quantity of participating IFIs, but their quality that matters. The first Argentina MG (the least successful program in terms of outreach to microenterprises) had 32 participating IFIs. In Colombia, where the sustainability of microfinance was weak, 19 IFIs and 39 NGOs participated in the third MG. On the other hand, only 8 IFIs participated in the successful MG I in Paraguay. In El Salvador, where 15 IFIs participated, one IFI disbursed nearly 80 percent of the funds and was highly successful in outreach and performance.

However, the wholesale mechanism is designed to induce a significant number of institutions to participate and most of the MG programs sought to expand the number of microlenders, especially in the commercial banking sector. Competition among microfinance providers is also important

Figure 3
Concentration of MG Resources



to increase efficiency and reduce interest rates paid by microenterprise borrowers. The cost of setting up and maintaining a two-tier wholesale mechanism must also be considered. Taking into account these factors, the programs can be considered to have mixed results with respect to development of a retail microfinance industry.

Commercial Bank Participation. Although most of the MG programs were designed to encourage the banking sector to enter the microfinance market, they had only limited success in reaching this objective. The MG programs did manage to expand microlending in regulated financial institutions, but the leading participating IFIs were mainly finance companies, including specialized microfinance institutions and municipal savings banks. In only 3 of the 8 MG programs studied were there commercial banks among the top 3 participating IFIs. Peru was the exception to this rule. Commercial banks there accounted for 50 percent of microcredits in the first and second MG programs. Those that were most successful in developing microfinance (Banco Orion and Banco del Trabajo) built on their experience providing consumer credit to lower income wage workers. Recent experiences of institutions outside the scope of this report, such as Banco del Desarrollo in Chile and BanGente in Venezuela, suggest that commercial bank involvement in microfinance may be more likely to occur through subsidiaries or, as in the case of Banco Sol, through upgrading of former NGOs and other specialized microlenders.

Technical Assistance. Of the MG programs that are the focus of this study, technical assistance to financial institutions provided as part of the wholesale program was successful only in the Paraguay case, according to evaluations and interviews with participating IFIs. However, in two other cases, significant technical assistance provided to leading MFIs before the MG program played a significant part in the success of the lead institutions under the program. In the El Salvador MG program, there was no technical assistance component for MFI capacity building, although the lead IFI in the program received extensive technical assistance (before and during the program) from other sources, including other programs financed by the IDB. In Peru I, execution of the technical assistance component was delayed and there was a lack of interest from commercial banks and the municipal savings banks, the main participating institutions in the program. In Colombia, technical assistance was targeted to the training NGOs in MG I, was focused on microenterprise production in MG II and was used primarily by NGOs in MG III. The technical assistance components had similarly mixed results in the other MG programs that were not the main focus of this study.

Facilitating Regulatory Reform and Complementary Public Policy

Regulatory reform was both a component and a determinant of the success of the IDB´s MG programs. Although included as a specific objective only in the third Colombia MG program and the second Paraguay MG, improvement of the regulatory and supervisory environment for microfinance was also addressed by technical assistance components in both Peru programs.

There is evidence that the MG programs provided leverage or impetus to reform processes that improved the environment for microfinance in the countries where they were carried out. In two of the countries studied, the MG programs explicitly included policy and regulatory reform components, which provided technical assistance financing to upgrade government capabilities to regulate and supervise microfinance. In the case of the first Peru MG, the support focused on supervision of the municipal and rural savings banks (CMACs and CRACs) and in the second Paraguay MG it was focused on the credit unions. These two operations also financed institutional development that improved the environment for microfinance by improving information on borrowers and thereby allowing lenders to better control risk. A case in point is the expansion of reporting and strengthening of the central credit registries (risk centrals) in the two countries. For subsequent operations, similar measures were included in financial sector reform loans and MIF projects that were approved parallel to MG programs.

The MG programs had indirect effects on regulation in other countries, arising from the growth in their microfinance sector. The growth of MFIs in the last decade has prompted government authorities throughout Latin America to enact new legislation or create new regulations for microfinance, and adapt their supervision practices to the distinctive characteristics of microfinance. In Colombia, growing microfinance NGOs and finance companies, supported by the third MG program, successfully lobbied their government for recent changes in the usury laws that had severely limited lending to microenterprises by formal IFIs. In El Salvador, the rapid rise of Financiera Calpiá (supported by the MG program) a MIF investment and other donors, increased attention to microfinance and nonbank financial entities in the development of the country's new banking law.

Factors of Success

Why has the second story of microfinance turned out the way it has? This section explores the factors that contributed to the success, or otherwise, of the MG programs and their components. The insights gained from the MG experience can help guide the IDB and other donors that use second-tier mechanisms, such as these, to further encourage the extension and deepening of microfinance without harming IFIs or financial markets.

Over the fifteen years of the IDB's MG Program, profound changes have taken place in the financial institutions and markets of LAC, affecting the outcomes of the MG programs. Similarly, their results have been affected by project design and execution mechanisms.

The main factors that affected the outcome of the MG wholesale microfinace programs can be divided into two main categories: market conditions – or the environment for microfinance in the country – and the design and execution of the programs themselves.

Market conditions include the following: (i) the size and concentration of the microenterprise sector, that is, the potential market for microfinance services; (ii) public policy and the legal and regulatory framework that governs financial institutions and their operations, including the role of local and foreign governments in financing IFIs that lend to microenterprises; and (iii) the stage of development of the microfinance industry, including the existence of industry leaders or models for microfinance.

The second set of factors to be analyzed, those related to project design and execution, are more directly within the control of policymakers and project teams. They include: (i) the objectives which define the program; (ii) the choice of the executing agency and its capabilities as well as the complexity of the credit regulations and mechanisms used for program execution; (iii) the eligibility criteria used to screen IFIs wishing to participate in the program and performance thresholds for continuing access to program funds; (iv) the cost of program resources; (v) transaction costs and restrictions placed on the use of program resources, especially those related to targeting microenterprises; and (vi) the availability of technical assistance to help interested financial institutions develop viable microfinance services. The influence of each of these "factors of success" on the outcome of the MG loan programs is discussed below.

Market Conditions

Table 3 summarizes the conditions present in the four countries that are the focus of this study. The greatest variation in conditions is to be found in the regulatory environment, where Colombia presented the most difficult conditions and Peru the most propitious. With regard to subsidized competition bankrolled by donors and governments, conditions were again least favorable for commercial microfinance to emerge in Colombia and most favorable in Peru and Paraguay. The microenterprise sector was relatively large in the four countries, and microfinance industry development was low to medium.

Size of the Microenterprise Sector. The MG programs reviewed in this report operated in countries with a large microenterprise sector that presented a sustained demand for relatively high

Table 3
Microfinance Market Conditions

	Colombia	El Salvador	Paraguay	Peru
Microenterprise Sector	Medium/large	Medium	Large	Large
Regulatory env.	Poor	Medium/good	Medium	Good
Donor/Government Subsidies	High	High	Low	Medium
MFI Industry Development	Medium	Low	Low/med	Medium

cost financing, and these MG programs were successful in meeting their outreach objectives. Although the first Colombia MG program was not very successful in reaching out to microenterprises, the third program was very successful in this regard. However, it appears that the failings of the first Colombia MG were not due to a lack of sufficient latent demand from microenterprises, but rather to other factors.

The other MG programs not examined in depth in this report were generally successful in reaching clients with demand for small loans, with the exception of Argentina, Uruguay and Costa Rica. In these countries, the share of microenterprise in the economy is significantly lower than the regional average.

In Table 4, data from household surveys of the late 1990s show that there were over 55 million microenterprises in Latin America, counted as independent, one-person firms and those with up to five employees.[1] One-third of all persons employed in the region were microentrepreneurs, and the microenterprise sector as a whole (owners plus workers in microenterprises) provided one-half of total employment.

[1] The IDB uses another common definition of microenterprise, which is that of businesses with up to 10 employees. Latin America is characterized by a highly skewed distribution of businesses by size and only a small percentage of the region´s businesses are found in the 5-10 employee range.

However, the importance of the microenterprise sector varies widely across the region. The classic microenterprise markets (small countries where there is a greater concentration of microentrepreneurs than the regional average, the share of microenterprise employment is above the regional average and microenterprises employ more workers than larger enterprises) are Bolivia, Ecuador, Guatemala and Paraguay. Of these, only Paraguay is included in this study. However, two other countries, Peru and Colombia, both have very large numbers of microenterprises, and the share of microenterprise employment is above the regional average. El Salvador presents a case close to the average in concentration of microentrepreneurs, and above average levels of employment in microenterprises. Judging from these simple measures, it would appear that the four countries are attractive markets for microfinance, contributing to the success of the MG programs.

Public Policy and the Regulatory Environment. The public policies and the regulatory environment of a country directly affect the microenterprise sector and the success of wholesale microfinance programs. Certain regulatory regimes create a favorable climate for microfinance. Conditions that allow for competition among commercial lenders while promoting the safety and soundness of the banking sector are conducive to establishing a strong microfinance industry.

Table 4
Size of the Microenterprise Sector in Latin America

Country	Total Population Employed	Employees in Microfirms	Microentrepreneurs (self-employed or employers)	% microentrepreneurs in employed population	% total employment in microenterprise
Argentina	8,472,326	2,576,668	1,993,756	23.5	53.9
Bolivia	3,496,094	1,049,269	1,315,492	37.6	67.6
Chile	5,342,491	1,163,468	1,104,358	20.7	42.4
Costa Rica	1,300,005	293,678	290,838	22.4	45.0
Ecuador	5,397,961	1,939,434	1,624,392	30.1	66.0
El Salvador	2,261,034	625,250	649,969	28.7	56.4
Guatemala	4,128,172	1,401,622	1,336,957	32.4	66.3
Honduras	2,299,005	597,756	878,642	38.2	64.2
Mexico	37,819,704	15,931,247	9,349,290	24.7	66.8
Nicaragua	1,368,422	483,499	414,130	30.3	65.6
Panama	968,607	170,335	279,660	28.9	46.5
Paraguay	2,150,605	604,041	961,485	44.7	72.8
Peru	11,490,104	1,475,868	6,655,038	57.9	70.8
Uruguay	1,103,725	198,145	228,733	20.7	38.7
Venezuela	8,836,952	1,527,905	3,100,012	35.1	52.4
Brazil	68,860,744	n.a.	17,727,954	25.7	n.a.
Colombia	15,244,004	n.[a]	6,061,120	39.8	[a]a.
Dominican Rep	2,841,226	n.a.	1,281,275	45.1	n.a.
All reporting countries	**183,381,180**	**n.a.**	**55,253,099**	**30.1**	**62.4**

Source: Household surveys, 1999-2000, tabulated by the Research Department, Inter-American Development Bank.

Removal or liberalization of interest rate controls, elimination of subsidized public sector credit programs, restriction of related lending, stricter standards for capital adequacy, and improvement of accounting and reporting by financial institutions are measures that help achieve both sets of goals. However, there are areas where the two may appear to be in conflict, such as minimum capitalization (if levels are set too high, microfinance is restricted, but if too low, IFI safety and soundness will be compromised) and classification of credit risk and the associated schedule of provisions (if based solely on type of security or collateral provided, microfinance is restricted, but authorities may feel that using risk based supervision, which can favor the usually low-arrears microfinance portfolios, is too risky).

In addition, public sector IFIs using subsidized credit may provide unfair competition to private microfinance and make the near-market rate resources used in MG programs, comparatively unattractive. Property laws and business registration requirements are also key regulatory factors that have an impact on the microenterprise sector and its ability to obtain formal financing.

The Latin American country that has been most successful in extending microfinance outreach to a broad segment of microenterprises, is characterized by a financial regulatory and supervisory regime that favors microfinance, while maintaining relatively strict standards for financial institutions. The Bolivian model of microfinance expansion has been based largely on specialized microfinance institutions, rather than the extension of microfinance products to the existing commercial banks. However, its regulations and supervision practices have also made it easier for banks to engage in microlending, and the largest specialized microfinance institution is a bank.

A range of conditions prevailed in the four countries analyzed. In Peru and Paraguay, the regulatory environment permitted specialized microfinance institutions to flourish, while the environment was not as favorable in El Salvador, and was unfavorable in Colombia.

In Peru, financial regulations allowed existing commercial banks and municipal savings banks (*cajas municipale*s) to move into micro and small business lending. And the approval of the first MG loan coincided with the creation of the EDPYME, a new type of regulated financial intermediary specializing in micro and small enterprise lending.

In Paraguay, financial reforms that preceded the approval of the IDB´s first MG program strengthened regulation and supervision of financial intermediaries, putting pressure on the existing semiformal lenders, known as *cajas de crédito*, to transform themselves into regulated finance companies. Competitive pressures led these maverick institutions to look for new markets beyond their traditional consumer finance base.

During the MG program, El Salvador was characterized by a new, rapidly evolving financial sector, which had seen the creation of many new banks and finance companies in the wake of privatization. Although it was subsequently raised, the level of initial capitalization required of regulated IFIs was low enough to allow the nonprofit organization, AMPES, to create a for-profit finance company which absorbed the microcredit portfolio that had previously been managed by AMPES.

Colombia presented a very difficult regulatory environment for microfinance throughout the duration of the three MG programs. The most important obstacle to its expansion was the existence of low mandatory ceilings on interest rates, which tended to push banks toward larger loans and away from small ones. Subsidized government loan programs and loan guarantees also limited the prospects for development of a microfinance industry. And high levels of minimum capital, even for finance companies restricted to term deposits, made it difficult for large microfinance NGOs to establish regulated entities.

The level of donor involvement in microfinance varied greatly in the four countries studied. El Salvador presented the case of heaviest donor involvement, in the form of concessional resources from the United States, Germany, the European Commission, and the IDB as well as other smaller donors. Peru had moderate levels of support from European foundations, the United States, Germany and the IDB, but no systematic donor-funded programs at the national level. In the case of Paraguay and Colombia, donor support for microfinance was low and mainly focused on individual institutions funded through small grants. However, in Colombia, the government invested heavily in microfinance, as compared to other countries, through the use of guarantee funds, subsidized loans to IFIs and NGOs, and the participation of state-owned banks. In Colombia and El Salvador competition from subsidized sources tended to limit the potential for commercial microfinance and make most NGOs (with the exception of AMPES/Calpiá and Corposol/Finansol) reluctant to abandon their position as recipients of subsidies to embark on the risky course of creating regulated MFIs.

Development of the Microfinance Industry. The level of development of the microfinance industry must be examined to determine its role in program design and implementation. The types and number of institutions, the composition of the institutions´ credit portfolios and client coverage, as well as the financial performance of institutions will make a difference in the program to be implemented. The industry could be in an incipient stage, without experienced microfinance institutions; or the predominant experienced microfinance institutions could be nonregulated, nongovernmental organizations. Formal financial intermediaries (either commercial banks or specialized IFIs) may or may not have experience in the sector.

The existence of institutions with microfinance experience contributed to the successes of the MG programs studied. In some cases, the predominant experienced microfinance institutions were nongovernmental organizations with goals of financial sustainability and return on capital. Even when they were unable to participate in the program, they offered successful examples and standards for competition. In other cases, formal financial intermediaries had previous experience that was strengthened through the program. In El Salvador, the existence of just one industry leader served to motivate competition, although this competition only began to emerge after the MG program there concluded. In the majority of cases, success required a certain degree of maturity of the industry.

The microfinance industry was already most developed in Peru, where the existence of a number of NGOs with a history of collaborating with the banking industry had even drawn some interest in the market from commercial banks. More importantly, the municipal savings banks, owned by local municipalities in a number of secondary cities (i.e., cities other than Lima) had specialized in small transactions in their local areas and, quickly adapted to microfinance with help from German technical assistance. Finally, the creation of the EDPYME model pushed former NGO lenders into formality, although most remained very small and somewhat precarious.

In Colombia, a solid base of relatively large NGO microlenders evolved over the course of the three MG loans, in part thanks to the resources these loans provided. There was also a very important commercial bank, owned by a foundation with a social mission, that was particularly important in providing small-scale savings services, and to a lesser extent, credit to microentrepreneurs. Despite the regulatory difficulties, two finance companies were created during the second MG program. However, one of these was nearly bankrupt and, along with the second one, tended to specialize in small business lending after its recovery.

El Salvador's microfinance industry was characterized by a relatively large number of small, donor-dependent microfinance NGOs. A finance company had recently been created by an NGO when the IDB's MG program began, and this institution dominated the microfinance industry in the country during the program.

In Paraguay, the institutional base was the weakest, but the MG programs coincided with the transformation of a number of informal lenders into regulated finance companies looking to tap new market niches.

Program Design and Execution

Even when the story begins with the best of intentions, as embodied in its stated objectives, the details of design and execution bring twists and turns to the plot that affect the outcome of a wholesale or apex microfinance program. The MG programs were no exception. The study of 8 IDB MG programs showed that six factors are particularly important to their outcome: (i) the program objectives; (ii) the choice of the executing agency and its capa-bilities, as well as the complexity of the credit regulations and mechanisms used for program execution; (iii) the eligibility criteria and performance indicators used to screen IFIs wishing to participate; (iv) the cost

Figure 4:
Goal and Objectives of IDB Microfinance Projects

Objective I: Improved access to financial services for microenterprises
Objective II: Institutional development of institutions lending to microenterprises.

Overall Goal: Positive impact on microenterprises

of program resources; (v) transaction costs and restrictions placed on the use of program resources; and (vi) the availability of technical assistance to help interested financial institutions develop viable microfinance services.

Objectives. The objectives of the MG programs are remarkably similar, with the exception of the first two programs in Colombia, which specifically focused on small enterprises and did not explicitly include institu-tional sustainability of participating IFIs among their objectives. For the countries studied, most of the eight programs shared the objectives of: (i) increasing access to credit for microenterprises (or micro and small business in Colombia); and (ii) improving institutional development of institutions lending to microenterprises.

Some programs included additional objectives. One goal of the El Salvador program was to contribute to the transformation of NGOs into formal financial intermediaries by complementing savings mobilization efforts. Both programs in Peru included the observance of environmental requirements in the specific objective. The second Paraguay program included the goal of improving the regulatory environment for access to formal credit, and expanding the participation of other financial institutions, specifically credit unions. The final program in Colombia also included regulatory changes as a specific objective. Figure 4 illustrates the main objectives of most of the MG programs.

Executing Agency and Second Tier. There are various options for the placement of the executing agency for a second-tier microfinance program. MG Programs adopted three different models, placing the project execution unit within a state-owned development bank, the central bank or a government ministry, but none used a private apex institution. Although all three of these models have positive and negative features, the most common option has been to use an existing state-owned, second-tier financial institution. In a number of cases, such as Guatemala, Costa Rica, Argentina and the first MG program in Colombia, the MG created a temporary project implementation unit within an existing ministry to execute day-to-day operations, although financial execution was handled by the central bank.

The four countries studied here present examples of the three different second-tier models. In Peru, the executing agency was located in a second-tier development bank. Although the Colombia and El Salvador MG programs began operations with more complicated institutional arrangements (creating a project implementation unit in the Ministry of Planning and the Ministry of Finance respectively)they had conformed to the development bank model by the end of their execution periods. In Paraguay, in the absence of an appropriate second-tier lender, the program was executed by a special project implementation unit inside the central bank.

Interviews with participating IFIs in the MG programs revealed that, independent of the executing agency model used, the efficiency of that agency was a key determinant of the success of the wholesale micro-finance program. An overall government commitment is required, as well as the commitment of the executing agency itself. Where there is limited commitment to the program from the Ministry of Finance, the second-tier lender, or another involved in the program, it will not be given the necessary attention, authority or counterpart resources to operate professionally and efficiently. Of the four countries reviewed, the commitment and efficiency of the executing agency were outstanding in Peru and Paraguay. Changes in the executing agency made things more complicated in El Salvador and Colombia, but had a negative impact only in Colombia. The change may not have affected the El Salvador program because the vast majority of MG funds went to one IFI.

The selection of a second-tier or executing agency is not an easy choice. Placing the management of the program with the central bank has the advantages of providing direct access to the discount mechanism, and guaranteed repayment from the IFIs' central bank accounts. However, central banks have a monetary function that should not be diluted with operational responsibilities. Both ministries and state-owned development banks may be susceptible to political pressures and plagued by inefficiency. Many state-owned banks have had financial difficulties, and the very financial sector reform that aids the MG programs includes the reduction of state involvement in the banking system. Depending on the country context, finding a private sector institution may be not be possible: banks often are not interested; and most of the NGOs that have been tapped as wholesalers by development agencies have transitioned into first-tier microlenders.

Despite the high degree of success of the Paraguay project execution unit, it is not a viable model for other MG programs. Even in Paraguay itself, as reforms further separate monetary, supervisory and development finance functions, the responsibility for the MG program must pass to another entity. In the three other countries studied, a public sector development bank was the executing agency, if not at the beginning of the program, by the time of its conclusion (as was the case in Colombia). In Colombia, conflicts of interest arose between two different roles of the second-tier bank, which was also partial owner of one of the IFIs participating in the MG program. The second-tier institution was just beginning its operations in El Salvador, and required considerable technical assistance, provided by a separate project, in order to manage the MG and other programs. In Peru, the second-tier lender has been the most successful of those studied. It is a large, well-run and financially sound institution, and has enough support to effectively and efficiently manage a second-tier microfinance program. In Paraguay, as in many other countries of the region, such institutions no longer exist or are exhibiting poor financial performance that would make them ineligible to execute an IDB-funded credit program.

Attracting and Selecting Participating Institutions

Another critical design element is choosing the target group of financial institutions and then providing the proper incentives to attract them to participate purposefully in the program, while maintaining sound financial performance. There are five main dimensions to this: institutional eligibility, which refers to the type of legal institutionality that is permitted for first-tier lenders; performance standards that must be met in order for IFIs to qualify and continue to participate in the program; the cost of funds (i.e., the terms and conditions of loans offered to participating IFIs); transaction costs that participating IFIs must bear and targeting requirements for the use of program resources, and the availability of technical assistance to build IFI capacity in microfinance.

Institutional Eligibility. The selection of institutions that participate in the program will have an impact on the type of client reached, and on the geographical area served. The choice of working with only supervised financial institutions, or allowing nonformal financial institutions, such as NGOs, is an important one. The MG programs generally limited eligibility to institutions that were regulated as financial intermediaries and supervised by the Superintendency of Banks. Exceptions were made in the case of Colombia, where credit unions, which were supervised by the Superintendencia de Economía Solidaria were eligible in their own right (in the third program), as were microfinance NGOs. The reasons for these restrictions were largely based on a desire to bring microfinance into the mainstream financial sector, especially in deposit taking institutions that could provide not only credit but also savings services. The borrowing governments and the IDB's technical experts were also concerned that the financial performance of the participating institutions be transparent, comparable and easily verified, which is more likely to be the case for supervised financial institutions, but generally not so for NGOs.

As shown in table 5, the types of institutions participating in MG programs in the four countries were similar, with the exception of Colombia. There was also considerable variation in the case of credit unions, which were eligible in countries where supervision of these institutions was carried out by the banking superintendency or another suitable body. It should be noted that in Colombia, financial problems were widespread in the credit union system following the execution period of MG III.

Although restricted institutional eligibility may have prevented competent institutions among NGOs and credit unions from participating in the MG programs, thereby limiting outreach to some needy areas, it increased the programs' abilities to screen for financially viable institutions, with better chances at sustainability. But given the low rates of downscaling by commercial banks, future programs in countries with an undeveloped microfinance industry may want to consider a design facilitating the entry of a broader range of nonbank financial institutions under clearly defined conditions.There was insufficient experimen-tation with this approach in the countries studied to analyze its effectiveness.

Performance Standards. The MG programs defined a relatively standard set of financial performance indicators that would be used to screen IFIs applying for program funds, with the most important being portfolio at risk, and profitability (generally ROE). IFIs were required to meet certain targets for these measures and maintain their performance at or above the target level to continue in the program. As shown in Table 6, despite the fact that the financial performance indicators used were similar, specific eligibility thresholds for these indicators varied across the four countries studied. El Salvador's MG program had the strictest criteria, and Peru and Colombia the loosest. However, in El Salvador some standards were relaxed during execution, bringing them more into line with those of other MG programs.

Table 5
IFI Eligibility Criteria

	Institution						
MG Program	**Commercial bank**	**Finance company**	**Credit union**	**Municipal savings bank**	**Specialized MFI**	**NGO**	**Supervision Requirements**
Colombia II	✓	✓				✓	▪ Supervised by Superintendency of Banks (SBS) or Cooperative authority.
Paraguay I	✓	✓					▪ Supervised by SBS. ▪ Eligible to rediscount external lines of credit in CB.
Colombia III	✓	✓	✓			✓	▪ Supervised by Superintendency of Banks (SBS) or Cooperative authority. ▪ Not under penalty, surveillance or rehab plan of SBS
El Salvador	✓	✓					▪ Supervised by SBS. ▪ Eligible to rediscount external lines of credit in CB.
Peru I	✓	✓		✓	✓		▪ Supervised by SBS. ▪ Not under penalty, surveillance or rehab plan of SBS.
Peru II	✓	✓		✓	✓		▪ Supervised by SBS. ▪ Not under penalty, surveillance or rehab plan of SBS.
Paraguay II	✓	✓	✓				▪ Supervised by SBS. ▪ Comply with CB requirements for type of institution.

Table 6
IFI Performance Standards*

Country	Capital Adequacy	Savings/Deposits	Indebtedness to Second Tier	Arrears/PAR Portfolio at Risk over *x* Days	Profitability	Other
Colombia II				PAR within Bank Superintendency limits		
Colombia III				PAR 180 not more than 10%		NGOs and Credit Unions scored according to specific criteria
El Salvador	Equity above legal minimum	MG loan amount may not exceed 25% of savings deposits		PAR 45 not more than 3%		
Paraguay I	Not less than 8% of risk-weighted assets			PAR 30 not more than 10% PAR 90 not more than 3%	Positive real ROE	Portfolio classified as C, D or E by banking superintendency not greater than 10%
Paraguay II	Not less than 10% of risk-weighted assets			PAR 60 not more than 10% PAR 90 not more than 3%	Positive real ROE	
Peru I		For CMACs and Credit Unions: Second tier loans from all programs may not exceed total deposits	For banks and finance companies: second-tier loans from all programs may not exceed 33% of liabilities; For CRACS and EDPYMES: second-tier loans from all programs may not exceed 3 times equity	The ratio of an IFI's delinquent portfolio to total gross loans outstanding must not exceed 12.5%, or 30% more than the average value of the banking system, eliminating the maximum and minimum values	Positive real profits	
Peru II		For CMACs and Credit Unions: Second tier loans from all programs may not exceed total deposits	For banks and finance companies: second-tier loans from all programs may not exceed 33% of liabilities; For CRACS and EDPYMES: second-tier loans from all programs may not exceed 3 times equity	The ratio of an IFI's delinquent portfolio to total gross loans outstanding must not exceed 10%, or 30% more than the average value of the banking system, eliminating the maximum and minimum values	Positive real profits	

* These performance standards were applied in addition to the minimum standards set by the country's banking superintendency.

Strict selection and monitoring of program participants aided MG program performance by defining clear rules of the game for participating IFIs and focusing their attention on performance as well as outreach to microenterprises. With the exception of the El Salvador case discussed above, exclusion from the MG program was the clear and automatic consequence of failure to maintain sound financial performance. These strict standards and consequences helped to avoid the problems previous targeted credit programs experienced with deterioration of the participating IFIs and reduced the scope for political interference.

In some cases, performance targets were drawn from standard IDB credit regulations for large multisector loan programs, which did not take into account the special characteristics of microfinance institutions, even very successful ones, and ultimately disqualified some sound IFIs. For example, the predominant IFI in the El Salvador program, Financiera Calpiá, surpassed project limits on borrowing from the secondtier. In Costa Rica, the most committed bank had arrears just over program limits, although its microfinance arrears were very low and overall arrears were average for the financial sector in the country. Flexibility could be introduced during execution, however. In El Salvador, Financiera Calpiá was given more time to comply with program standards that would have excluded its par-ticipation. In Colombia, the rules of the third MG loan that excluded NGOs were also revised during execution to permit their participation. Key standards for micro-finance, such as delinquency limits, were not relaxed. These examples point to the need to set performance standards consistent with microfinance per se.

Terms and Conditions of Loans. The pricing of funds is also an important determinant of institutions´ willingness to participate and the incentives they have to maintain sound business practices and performance as financial intermediaries. Past targeted credit programs around the world erred by offering subsidized interest rates to participating IFIs, which saved them the trouble of mobilizing resources elsewhere, weakening them by leading them to become dependent on these concessional funds.

However, as shown by the MG programs, wholesale microfinance can have significant transaction costs, such as those involved in meeting screening, disbursement, reporting, oversight, and environmental requirements. The trick is to get the price of funds at a level that will take account of these transaction costs, but still not displace savings mobilization or distort the market with subsidized funds.

The range of pricing of MG program resources to participating IFIs and the final microenterprise borrowers is shown for the four countries studied in Table 7. With the exception of the first two Colombia loans, which financed IFIs at subsidized rates and had a ceiling for interest rates that could be charged to the final borrowers, the pricing model tends to be fairly uniform across countries. It is based on a term deposit rate (generally 180 days) plus an allowance for the effect of reserve requirements that would have applied to such deposits. Participating IFIs are then permitted to set the interest rates they charge to their micro-enterprise customers, allowing the IFIs to cover their costs and profits.

It is difficult to summarize quickly the range of terms and conditions prevailing in the 8 MG programs studied. Table 7 lists the methods used for pricing MG resources to IFIs and from IFIs to microenterprises, and provides illustrative nominal interest rates for these loans from particular institutions (the top three IFIs in terms of credit disbursements under the program) at particular points in time. As the table shows, interest rates tend to be high for microfinance, reflecting the high unit cost of making very small loans.

Table 7
Pricing Methods and Rates

MG Program	Cost to IFI (method)	Cost to IFI (rate)	Interest rate charged to microenterprises (method)	Average interest rate charged to microenterprises (rate)*	National interest average rate for all lending**
Colombia I (average 1986-1991)	Fixed	17%	Fixed	24%	41.9%
Colombia II (average 1990-1993)	Fixed time deposits less 3%	30%	Fixed time deposits plus 3%	36%	43.2%
Paraguay I (6/30/97)	180d. CDs adj. by res. req.	18%	Determined by IFI	Monthly rates of top 3 IFIs: Familia, 4.0% Vision, 4.7% Bco Nacl. del Trabajo 3.3%	28.1%
Colombia III (average 1993-1997)	Fixed time deposits plus 1%	29.6%	Determined by IFI	Annual rates of top 3 IFIs: WWB, 53%, Actuar Antioquia, 33%, Fund. Sto. Domingo, 17%	39.0%
El Salvador (average in 1997)	180d. deposits adj. by res. Req.	12.5%	Determined by IFI	Calpiá 36% annual rate	16.1%
Peru I (3/31/98)	360d. fixed term deposits adj. by res. req.	Avg. 7.7% (foreign currency)	Determined by IFI	Annual rates of top 3 IFIs in foreign currency: CMAC Arequipa, 34.5%; Bco. Orion, 59%; Bco Weise, 20%	15.6%***
Peru II (3/31/00)	Same as Perú I	Local: 18.8%, Foreign: 8.5%	Determined by IFI	Annual rates of top 3 IFIs: Bco. del Trabajo, 152%; CMAC Piura 90%; CMAC Sullana, 2%	28.1%
Paraguay II (12/31/01) .	180d CDs adj. by res. req.	20.1%	Determined by IFI	4.7% monthly for all IFIs	28.3%

** Interest rates are nominal rates in local currency, unless otherwise specified*
** Interest rates are nominal rates in local currency, unless otherwise specified*
*** IMF International Financial Statistics. Colombia rate is defined as weighted average loan rate of banking system. El Salvador rate is the rate charged by commercial banks on loans of one year or less. Peru rate is the average rate charged by commercial banks on loans of 360 days or less. Paraguay rate is the commercial bank loan rate.*
**** TAMEX, average rate for foreign currency lending as of 3/31/98.*

In the MG programs studied, the rates charged to participating IFIs by the second-tier lender were attractive, but it is not clear if they were low enough to constitute a disincentive to deposit mobilization. The programs also offered longer term financing than participating IFIs could obtain in the market which gave them a cushion to experiment with new microfinance products without facing the immediate demands of short-term financing.

As the case studies indicate, spreads were high for IFIs participating in 5 of the 8 MG programs studied, but operating costs were also high for the participating IFIs, due in large measure to the very small size of the loans to microenterprises.

Participating IFIs were allowed to freely set interest rates charged to microenterprise borrowers, except in the first two MG programs in Colombia. Even this country, however, some institutions got around this problem by assessing additional fees. In the first MG, the low nominal ceiling on interest rates charged to the micro and small enterprises was significantly below prevailing bank rates. This created excess demand for the funds and mistargeting away from smaller businesses. As the rates were negative in real terms, they also caused a rapid decapitalization of program resources. According to an evaluation of the Colombia experience, the restricted spread of 6 to 7 % was a major disincentive to the participation of banks in the programs. A restricted spread also limited the success of the MG program in Ecuador. A government-imposed ceiling on commercial lending rates in Colombia aggravated the spread problem for regulated institutions, and discouraged their participation in the third MG program, despite the removal of the program's ceiling on spreads.

Transaction Costs and Lending Restrictions. Despite attractive interest rates and loan terms, some IFIs may choose not to participate in wholesale microfinance programs because of the transaction costs associated with paperwork, disbursement, and screening of borrowers to meet program targets with respect to size of business borrowers, environmental impact, etc. These costs are not included in the interest rate paid by participating IFIs, but they can lower efficiency and increase operating expenses for the IFIs.

High transaction costs incurred by IFIs wanting to participate in MG programs discouraged entrance and prompted withdrawals of some, according to interviews with IFIs. By and large, the subloan procurement and environmental classification requirements used for the MG programs are similar to those used for larger IDB loans targeting larger businesses with financing for fixed capital. These requirements appear to be too costly for the large number of tiny working capital loans financed by the MG programs, placing an onerous burden on the IFIs.

In Colombia, for example, the IFIs that participated in the MG programs already had an interest in lending to microenterprises, either because of their statutes, ownership or missions. Traditional commercial banks were not as willing to incur the transaction costs necessary to access the funds, including lengthy paperwork and processing delays, and the negative image of a government program potentially leading to repayment problems. One of the most onerous burdens cited by these banks was the requirement for environmental evaluation of each subloan. IFIs were required to classify microenterprises according to environmental risks, refer them for special training, and confirm that they received certification for improvement measures before any subsequent loan. The third Colombian MG was modified in execution to address this issue by requiring microfinance clients to assume the responsibility of complying with national norms, and leaving the guidance and enforcement of these norms to the proper institutions. This solution could provide a model for future operations.

Table 8
Microenterprise Eligibility Criteria

MG Program	# of Employees	Total Assets (US$)	Land holdings	Sales (US$)
Colombia I	10 or less	less than US$20,000	--	Monthly sales less than US$5,500
Colombia II	10 or less	less than US$20,000	--	--
Paraguay I	10 or less	Less than US$10,000	--	Annual sales no greater than US$45,000
Colombia III	10 or less	fixed assets less than US$15,000; US$30,000 for coops/assocs.	--	--
El Salvador	10 or less	less than US$15,000	--	--
Peru I	10 or less	less than US$20,000	10 arable hectares of less	--
Peru II	10 or less	Less than US$20,000	--	--
Paraguay II	10 or less	Less than US$20,000	--	Annual sales no greater than US$100,000

In Paraguay and Peru, electronic reporting streamlined program participation. In Peru, the use of a line of credit from the development bank, as opposed to a rediscount mechanism, had a similar effect. Also in Peru, the environmental component of the project emphasized environmental education and assistance by knowledgeable NGOs, thereby easing the concerns of IFIs which were obliged to act as environmental agents in other MG programs.

One factor influencing the outcome of second-tier programs like the IDB´s micro global credit program loans is the overt targeting of resources to certain types of borrowers. Even though such programs start from a premise of targeting, as evidenced by their very names, there is disagreement about how narrowly the target borrowers should be defined. Of the 17 IDB MG programs, 10 were designed to explicitly allow small businesses (larger than micro) to receive loans from participating IFIs. The main targeting tools used related to loan size, although guidelines were provided on the definition of microenterprise on the basis of employment, assets and sales.

Table 8 shows the criteria used for limiting business eligibility to borrow from the MG program, while Table 9 shows the loan size limits used. These criteria were deliberately set to encompass a broad range of microenterprises and loan sizes and extend beyond the limits typically cited for microenteprises and microcredit in the literature. These broader ranges of eligibility meant participating IFIs could mix smaller and larger loans in order to better manage their risks and costs. And, as Table 9 shows, the resulting levels of average loan size tended to conform to a more conventional definition of microcredit.

Table 9 summarizes the targets used in the 8 loans analyzed in this report. The maximum loan size permitted ranged from a low of $7000 in the first Paraguay MG program to a high of $15,000 in El Salvador. A ceiling for average loan size was included in 5 of the 8 loans, ranging from a low of $2500 in the first Paraguay MG program to $7500 in El Salvador.

Although the size of loans IFIs could make to micro and small enterprises was maintained at a relatively low level in all of the 8 MG programs studied, the average loan size was well below these limits, except in the first Colombia MG. While some IFIs that were interviewed for this study did cite the targeting requirements and loan size limits as features that discouraged them from participating in the programs, especially in Colombia, surprisingly, this was not a widespread concern. It is likely that this confirms the finding that the IFIs that participated actively in the programs tended to be those with a preexisting interest in microfinance, and therefore the loan ceilings were not a deterrent to them.

Technical Assistance (TA). To address the multi-faceted needs of program participants, almost all of the MG programs included a technical cooperation component, with El Salvador being a notable exception. As shown in Table 10, these nonreimbursable funds have covered technical assistance for executing agencies, for IFIs and even for microentrepreneurs. Executing agencies may require help with program management, and may provide an important leverage effect by passing on technical expertise to participating retail IFIs.

The most common use of the funds was for assistance to IFIs. Resources to IFIs were used to provide transfer of new credit technology, software for management information systems, and subsidies for start-up of new branches. All of the MG Programs that included a technical assistance component have utilized a centralized, supply-driven model for technical assistance, with delivery running through one provider.

Technical Assistance to IFIs. In Latin America, technical assistance has played a crucial role in the development of microfinance institutions and the microfinance industry as a whole. In the MG programs studied, technical assistance was made available through a variety of models. In some cases, there had been significant previous industry development through heavy and sustained technical assistance, in which case the subsequent MG loans to IFIs help to accelerate their growth (as was the case in El Salvador and Peru). In Paraguay on the other hand, the MG Program offered the technical assistance needed to help with the initial development of the microfinance industry, and follow-on MG financing then helped to maintain momentum.

Table 9
Lending Restrictions by Type of Business and Loan Size, Compared with Actual Average Loan Size

Country	Micro or Small	Maximum Loan Size (US$)	Maximum Average Loan Size (US$)	Actual Average Loan Size (US $)
Colombia I	Small	7,500	n.a.	3,100
Colombia II	Small	10,000	n.a.	740
Paraguay I	Micro	7,000	2,500	1,300
Colombia III	Small	7,500 (15,000 for cooperatives)	n.a.	581
El Salvador	Micro	15,000	7,500	660
Peru I	Micro	10,000	5,000	1,014
Peru II	Micro	10,000	5,000	747
Paraguay II	Micro	12,000	3,000	709

Table 10
Technical Assistance

Country	TA to Policymakers	TA to Second Tier Financial Institution	TA to Microfinance Institutions	TA to Microenterprises
Colombia I	None	None	Assistance in training materials	None
Colombia II	None	None	None	Establishment of five production development centers for technology transfer and training, research and information dissemination
Colombia III	Workshops to introduce changes to National Plan for Microenterprise Development	Installation and training on MIS software	Develop entrepreneurial and environmental protection training materials, MIS and credit technology training	None
El Salvador	None	None	None	None
Paraguay I	None	Installation of automatic rediscounting mechanism and systems and procedures for monitoring loans and reporting on IFIs	Subsidies for new branch startups, management assistance and product development, staff training, site visits, installation and training for MIS, workshops on environmental awareness and increasing participation of women	Training through vouchers
Paraguay II	Analyze credit union capacity and design supervision requirements for credit unions, study to improve regulatory framework for microenterprises	Develop central credit registry, Capacity building in IFI management, environmental training for staff and research and marketing to increase the participation of women	Subsidies for new branch startups, management assistance and product development, staff training, environmental training, installation and training for MIS	None

Depending on the target IFI group, the design of the technical assistance program may require different components. Targeting IFIs that are converting to formal financial institutions, such as NGOs to finance companies, or EDPYMEs in Peru, will have to consider the issues facing those institutions: new ownership requirements, new culture of sustainability, including deposit mobilization. Those targeting banks to downscale might consider the adoption of new credit technology, MIS adjustments, different monitoring requirements and incentive systems for loan officers. A demand-driven approach for IFIs has not been tried and may prove to be more effective at addressing these different needs with different TA providers and services, especially given the failure of more banks to participate.

The first Paraguay MG program provided direct subsidies to participating IFIs through the TA component, in addition to subsidized training and advisory services from the German firm, IPC. These subsidies and high quality technical assistance were instrumental in attracting IFIs to the program at the beginning, as they helped to defray part of the costs of opening new branches closer to microenterprises and the adoption of new IT solutions required to manage a plethora of small accounts.

The first Paraguay technical assistance program for IFIs was the leader among all the programs studied. The combination of a high quality team and good timing resulted in a very successful outcome. In Colombia, however, the technical assistance was used only by NGOs, not formal financial institutions. In Peru´s first program the technical assistance component was implemented too late relative to the disbursement of the loan funds. In the case of El Salvador, no technical assistance component for IFIs was included in the MG program, although the lead institution in that program received significant technical assistance funding from other sources prior to and during the MG program. Thus, timing of technical assistance may be just as important as the type of assistance offered.

Technical Assistance to Borrowers. Technical assistance was provided to microenterprise borrowers of MG programs in only 2 of the 8 programs studied, the second Colombia and first Paraguay programs. In the first Colombian case, access to credit was tied to completion of training by micro and small business owners. Furthermore, the NGOs and government agencies providing training and technical assistance to these business owners had a hand in selecting and monitoring the borrowers. This interweaving of responsibilities had negative consequences both for repayment and for transaction costs borne by the borrowers. The low reimbursements for training costs also tended to concentrate training in the main government training institution in the country.

In Paraguay, in contrast, training was provided independently of credit. Prospective trainees received vouchers that covered part of the costs of training from registered training institutions and individual providers. The providers had freedom to set their own prices for training, so the cost of courses varied considerably, as did the variety offered. Courses were evaluated by the participants and the results were publicly available, allowing interested microentrepreneurs to select wisely. There was a high demand for the courses, although they were not required for obtaining a loan. This experience indicates that a demand-driven mechanism provides better support for training and technical assistance at the microenterprise level. The new MG program in Bolivia builds on this experience while testing other models of decentralized training and technical assistance for micro and small enterprises.

The Moral of the Story: Conclusions and Lessons for the Future

This review of the IDB's MG Programs shows that a wholesale, apex or second-tier mechanism can be used successfully to reach large numbers of microenterprises with financial services without damaging the performance of the participating retail lenders — when certain conditions are met. The moral of the story is that the wholesale model works, sometimes.

The MG programs reviewed here aimed to increase the sustainable flow of resources to the microenterprise sector through formal financial institutions. Performance varied across the four MG countries highlighted here, and evolved over time. Nevertheless, as a whole the MG programs can be credited with many positive outcomes. They reached smaller businesses and more women borrowers than other credit operations in their countries. They brought new borrowers into the formal financial system, and new lenders into microfinance. The MG programs were most successful in developing specialized microfinance institutions and finance companies that had previously engaged in consumer lending, and less so in attracting existing commercial banks to downscale their operations to the micro level or in helping non-regulated NGO microfinance institutions to submit their operations to regulatory exigencies. The programs contributed to a change in the perception of the microenterprise sector and brought the sector closer to formal financial markets. They also helped to further the agenda for reform of regulations and supervisory norms to create an enabling environment for microfinance.

The story of wholesale or second-tier microfinance programs that emerges from IDB´s experience tells us that the most important factors in successful programs are:

- a large, concentrated microenterprise sector where microenterprises account for a significant share of employment and businesses,
- an incipient microfinance industry with at least one model microfinance institution and three financial institutions with a demonstrated commitment to undertake or expand microfinance operations,
- a facilitating regulatory environment where it is possible to develop microfinance as regulated and supervised financial services, through specialized financial institutions and/or appropriate regula tions and supervision practices for all IFIs,
- an effective executing agency with authority, transparency and resources to manage the program,
- efficient procedures for IFI selection, monitoring, disbursement and repayment of funds, in order to keep transaction costs low to participating IFIs,
- strict, transparent and relevant selection criteria and performance monitoring targets for participating IFIs that take account of the unique characteristics of microfinance, especially as regards operating costs and control of arrears,
- proper pricing of resources to participating IFIs with interest rates charged to IFIs pegged to market-determined deposit rates to avoid disincentives to savings mobilization, but remain attractive to

new entrants into the microfinance market,

- IFI flexibility in setting interest rates to borrowing microenterprises to allow IFIs to cover the high unit costs of microfinance and avoid disincentives to program participation, and

- high quality, targeted technical assistance to assist participating IFIs in adopting and adapting microfinance technology and improving their management and financial performance.

These factors fairly well represent the necessary conditions for success. But even when some of them are not fully met, it may still be possible to develop a successful wholesale program, if the design works around limitations in these conditions. For example, lack of a model microfinance institution in Paraguay was balanced by the push and pull factors of changes in the regulatory environment (which obliged key nonformal lenders to formalize) and outstanding technical assistance (which offered much needed support for the development of microfinance services). In El Salvador, the lack of technical assistance in the program was balanced by parallel technical assistance from other sources, although the assistance was concentrated in the program´s one lead institution.

Some of these factors —the microenterprise sector, the institutional base, the macroenconomic and regulatory environment— are outside the control of a wholesale microfinance program. However, they must be taken into account in the decision to undertake the program or not, and in the design of the program. A second group of factors relates explicitly to the design and execution of a wholesale microfinance program: the choice of executing agency, pricing of funds, transactions, technical assistance, IFI eligibility criteria and performance benchmarks. It is in these areas that the story of IDB's wholesale microfinance program can provide the most valuable lessons for future programs.

There is one final set of factors for which it has not been possible to give guidance for future wholesale microfinance operations, based on the review of the eight MG programs studied here. Important parameters remain to be defined, such as: how broad and deep microfinance access should be for the industry to be considered mature enough to warrant "graduation" from such wholesale models; and how narrow or broad the targeting of resources should be to signal participating IFIs to expand services to smaller and lower income borrowers without imposing excessive transaction and opportunity costs. Although it was not the subject of this review, another undefined parameter relates to the impact measures that could be used to assess the development effectiveness of such programs beyond their immediate impact on the development of the financial sector.

Nevertheless, the story of IDB´s experience with wholesale microfinance programs does yield a number of important lessons for future programs of this type.

Policy and Regulatory Environment

Wholesale microfinance programs are most effective when used in conjunction with policy reforms to improve the environment for microfinance, or in countries where such reforms have already been undertaken, as seen in Peru and Paraguay. In Colombia, interest rate ceilings and government involvement in subsidized microfinance had the effect of keeping formal lenders from reaching down to smaller business borrowers and discouraging NGO microlenders from transforming themselves into regulated IFIs.

Wholesale microfinance programs should provide support for financial sector reform processes that improve competition among financial institutions – formal financial institutions are only likely to enter this market in a serious way when faced with competitive pressures. Modernization of regulations governing financial institutions and supervision practices should also be supported by the programs so that microcredit portfolios (composed of many very small loans with very low arrears but limited real collateral) are not made financially non-viable. Such support can be provided as a component of the wholesale program itself, or through parallel financing.

As for the question of whether the existence of a specialized microfinance institution under supervision of the banking authorities is a necessary condition for the success of microfinance wholesale programs, the answer is no. Of the four countries studied, only Peru had a specialized regulated microfinance institution, the EDPYME, and such MFIs together did not even represent 10 percent of the operations of the second MG program. In Paraguay, El Salvador and Colombia, specialized microfinance institutions were formed as finance companies under existing regulations. Colombia's regulated MFIs were not as successful in reaching down to microenterprises due to other legal and regulatory barriers discussed above. The Colombian case does show that one option for working around an unfavorable regulatory environment is to allow non-regulated NGO microlenders to participate in the wholesale program, although this will reduce both incentives and pressure for better regulation and formalization of these lenders.

Although guarantee funds were not a major focus of this study, the Colombian experience confirms that they are not a suitable substitute for lack of collateral on the part of microenterprise borrowers. Used in conjunction with the first two MG programs, Colombian guarantee funds increased risk-taking by IFIs, contributed to high levels of arrears and therefore weakened those wholesale programs. Specialized microfinance products and technologies appear to provide a better guarantee of repayment, as shown by the experience of successful micro-lenders in the MG programs. Improving information on microenterprise borrowers, through central credit registries and the like, is a better means for helping lenders manage the risks of lending to these clients, making this a fruitful area for policy/regulatory support in wholesale microfinance operations.

Participating Institutions

Different types of institutions are capable of providing financial services to microenterprises on a sustainable basis. The MG experience showed that regulated financial intermediaries can be successful in providing access to microfinance. In particular, finance companies and savings banks are likely to find the microenterprise market attractive. The Colombia case showed that some NGOs are also capable of providing sustainable microfinance services. But their inability to mobilize deposts and limited links to financial markets make it difficult for them to expand without continued access to wholesale funds from governments and international donors.

If the IDB's past experience is a guide, leadership in microfinance will not come primarily from the commercial banks, but from smaller finance companies, savings banks, and MFIs created specifically to serve the microenterprise sector. The latter type of institution has generally counted on donor support for R&D and their start-up phase as nonprofit organizations. In the past, these institutions have required heavy subsidization by donors and/or governments, which is not available under a wholesale loan program. The wholesale model works best with more mature MFIs.

The MG experience shows that it is highly unlikely that the two- tier mechanism will provide resources from a regulated IFI to an unregulated NGO for on-lending to microenterprises on any significant scale, creating in effect, a third tier. In Colombia this problem served as a justification for allowing NGOs direct access to the second tier. But transparency in reporting by these NGOs could not be assured and no clear path existed for formalization. The Colombia case also showed that when wholesale resources are available indefinitely, this can serve as a major disincentive to formalization. The lesson here is that if non-regulated MFIs are permitted to borrow directly from the second-tier lender, their participation in the wholesale program should be used as a tool to move them toward regulation, and the program must be carefully designed to do this.

Executing Agency

A strong executing agency commitment and lean and efficient operations of the unit charged with management of a wholesale microfinance program are important for guaranteeing program success and reducing transaction costs to the participating IFIs. The choice of the appropriate second tier institution or executing agency is a difficult one, however, and there may not exist appropriate institutions in all countries to permit the creation of wholesale microfinance programs.

No one type of second-tier institution clearly emerges as the ideal for wholesale microfinance programs, although as is the case for IDB´s MG programs, practical considerations will likely dictate a preference for state-owned development banks. The choice must be analyzed within the context of the available institutions in the country and the commitment of these institutions to the objectives of the program.

Two different institutional models – a development bank as second tier in Peru and the Central Bank in Paraguay – had the commitment, the authority and the resources to execute the program effectively and efficiently. These findings suggest that such factors are more important to success than the type of institution per se.

Performance Benchmarks

As shown in the El Salvador case in particular, wholesale microfinance programs should be designed with the standard performance benchmarks of microfinance, not those used for traditional commercial loans. While these two groups utilize the same performance indicators, the two groups require some different benchmarks for these indicators. However, most other benchmarks would be the same. The most important differences are in the areas of operating costs (they are higher for microfinance) and arrears (they should be kept lower in microfinance), and these in particular should be reflected in selection and monitoring of participating IFIs.

Pricing Wholesale Resources

Terms and conditions of second-tier loans must be attractive but high enough to avoid creating disincentives to deposit mobilization for participating IFIs, particularly since typical participating IFIs are only beginning to develop savings products. IFIs should be permitted to freely set interest rates to microenterprise borrowers in order to enable them to recoup the high cost of such lending. Over time, competition among participating IFIs will serve as a check on interest rates.

Transaction Costs

The transaction costs associated with borrowing from a second-tier institution can be substantial, especially when targeting, reporting, environmental and other requirements are at odds with the organizational structure and capabilities of participating IFIs and the characteristics of microfinance products. Great care should be taken to ensure that these aspects of a program are designed to work as efficiently as possible and are compatible with the operations of the participating IFIs. One means of reducing these transaction costs that has proven effective is the use of a line of credit from the second-tier institution, rather than a rediscount mechanism. Computarized reporting systems and the use of environmental information and training as opposed to screening by IFIs, are also important tools.

Targeting

Client targets and loan size ceilings appear to be effective signaling devices for attracting IFIs that have a serious interest in microfinance, but they do not appear to create undue disincentives for participation in second-tier programs, as long as lenders have flexibility in setting interest rates to final borrowers. On the other hand, there is no evidence that the ceilings (of $10,000 to $15,000) were set so high that IFIs would be induced to neglect microenterprise borrowers. Narrower targeting was not explored either, nor is there sufficient information on the distribution of borrowers by size and socioeconomic status to fully probe this finding. Use of loan size targets that established both maximum and maximum average loans was an innovation of the IDB's MG program, and it appears to have been effective in allowing lenders to make more profitable larger loans while including a significant volume of much smaller loans.

Technical Assistance

Technical assistance to IFIs entering the microfinance market or consolidating and expanding their operations is one of the keys to success of a wholesale microfinance program. Technical assistance is a particularly valuable component of wholesale programs when the development of the microfinance industry is low, as was the case in Paraguay, where technical assistance was absolutely critical to program success. As IDB's overall experience shows, the quality of technical assistance is more important than the possibility of obtaining such assistance at very low cost, and technical assistance is most useful when tailored to the characteristics and capabilities of different institutions. However, as seen in the case of the Peru MG program, it is difficult for supply-driven technical assistance programs, executed by one provider, to meet these standards. Therefore, subsidies for technical assistance should be provided in a way that allows the recipients to select the type of expertise they need for strengthening their operations and requires them to contribute a share of the cost. Technical assistance need not be part of the wholesale program itself, but should be coordinated in time and quickly accessible by IFIs that are interested in participating in the program.

If providing support for training and technical assistance to microenterprises, wholesale microfinance programs should clearly separate training and technical assistance activities from financial operations. The Paraguay program was very successful with this approach, using a voucher training program for microenterprises that were not required to be borrowers from participating IFIs. Likewise, microenterprise borrowers were not required to complete training in order to borrow. Separating training and technical assistance from financing allows for greater flexibility of a wholesale program to respond to the differing needs of microenterprises for financial and non-financial services at different points in time.

Is a Second Tier Necessary?

Although the IDB's MG programs showed that wholesale microfinance programs can be successful in expanding and deepening the reach of financial services for microenterprises, such second-tier operations are not necessarily the most efficient way to develop the microfinance industry. Since 70 to 90 percent of MG resources went to one to three industry leaders, which tended to be institutions that had already demonstrated their interest in the microfinance market, it would have been possible to provide financing to each of these IFIs with individual private sector operations of the IDB Group. On the other hand, the industry leaders may not always be easy to spot in advance, and even when they are, a two-tier model provides political cover by making financing potentially open to all IFIs in a country, even if a very small number utilize the resources. It also allows other IFIs observing from the sidelines to enter the market relatively quickly and test new products and clients they might have considered too risky before.

For achieving the goal of broadening and deepening the reach of financial services to microenterprises, the quality of the institutions involved is as important as the quantity of institutions. Once the development of microfinance has moved beyond the monopoly situation typical of its early stages, a wholesale model can speed up the development of competition, thus improving credit conditions for microenterprises. But large numbers of participating IFIs do not necessarily spell success for the program. The most successful MG countries studied, Peru and Paraguay, had three or four strong institutions participating in the program. Bolivia, the star of microfinance in Latin America, is dominated by four specialized MFIs, of which one is a spin-off from the largest MFI. However, the concentration of resources found in the cases studied in this report is a concern from the point of view of a wholesale program. Establishing a wholesale machinery may be a costly way to support a small number of institutions, and therefore the decision to utilize a wholesale microfinance program should be carefully weighed against other alternatives.

Development of the Microfinance Industry

The wholesale model works well in a market where there is at least one visible IFI successfully lending to microenterprises. Microfinance leaders serve as examples for other IFIs that may consider entering the market.

Even when they are the industry leaders, new microfinance institutions need financing over a sustained period in order to consolidate (e.g., Calpiá in El Salvador and the Cajas Municipales in Peru). It takes many years to build up the deposit side of their operations and to get access to institutional investments that depend on local market conditions. Donor "capital" and technical assistance come in at an early stage but often the donors' interest wanes after one or two project cycles. At this point, loaned resources help give breathing room for specialized IFIs to consolidate their operations, as happened in El Salvador and Peru. Wholesale microfinance can be a good second generation MFI upgrading tool to strengthen specialized IFIs, but care must be taken to avoid making these MFIs indefinitely dependant on development assistance.

When wholesale microfinance programs are working well, it is still important to consider the eventual exit strategy for this form of development assistance. Development agencies, like to bet on winners, but wholesale program that continues indefinitely could be subject to many of the same problems that plague state-owned retail financial institutions.

It is difficult, however, to determine the appropriate exit point —when the development of the industry can be considered mature enough to make any further investment of development resources yield little value added. Based on the experience of microfinance in Latin America, and leaning heavily on the Bolivian case, a suitable definition of maturity should include:

- transparent MFI performance data is readily available and can be compared across institutions,
- accurate information is available to lenders on borrowers' indebtedness and behavior,
- MFIs are linked to formal financial markets,
- both credit and deposit products are available to microenterprises,
- there is a critical mass of microenterprise clients in the financial system, and
- competition among IFIs creates incentives for IFIs to keep costs down and gives borrowers alternatives.

This definition of "maturity" does not deal with one of the thorniest issues facing development agencies that support wholesale programs: how deep should financial services go in a mature microfinance industry. Pushing out the frontier of financial services to reach smaller businesses and lower income clients, not just more microenterprises, is a major motivating force behind development assistance for microfinance. One option for addressing this concern could be to demand improved targeting by participating IFIs in successive wholesale operations, making this part of the exit strategy. However, any such demand must be balanced against possible negative impacts on the financial performance of the participating IFIs and increasing transaction and opportunity costs which could provide incentives for IFIs to move up market, not down. Although inusfficient data was available to fully address this issue in the review of IDB´s MG programs, it is interesting to note that average loan sizes fell in all three countries with successive MG programs, despite the fact that the maximum and the maximum average loan sizes were reduced in only one country and were actually raised in another.

As with most aspects of development assistance, devising an exit strategy is a tricky business. Even though it may not be possible to specify the exact parameters that would trigger an exit, it is possible to conclude with two overriding principals. First, wholesale microfinance programs are transitional interventions to promote the development of a private microfinance industry. Repeated wholesale operations do not guarantee this development and may forestall it. And second, the exit strategy for these programs should involve careful incorporation of measures to move the microfinance industry toward maturity.

Bibliography

Inter-American Development Bank Official Bank Document. 1996. Annual Report on Portfolio Management: Global Microenterprise Loans. Washington D.C.

Christen, Robert. 2001. Ocassional Paper No. 5. Consultative Group to Assist the Poorest World Bank. Washington, D.C.

Hemmers, Irina. 2000. Evaluation of Global Microenterprise Loan Operations: Presentation of Summer Internship Project. Washington D.C.

Poyo, Jeffrey. 2001. Funcionan los modelos de Segundo piso para el desarrollo de las microfinanzas? Experiencia de FondoMicro. Presentation at the Fourth Inter-American Microenterprise Forum. Santo Domingo, Dominican Republic.

Levy, Fred D. 2001. Occasional Paper No. 6: Apex Institutions in Microfinance. Consultative Group to Assist the Poorest, World Bank. Washington D.C.

Westley, Glenn. 2001. Can Financial Market Policies Reduce Income Inequality? Sustainable Development Department Technical Paper Series No. MSM-112. Inter-American Development Bank. Washington, D.C.

The authors reviewed Inter-American Official Bank Documents for all of the Global MicroCredit Programs, including Project Documents, Project Completion Reports, Progress Reports, and Evaluations.

Interviews

Arrivillaga, Guillermo. IADB. Lima, Peru.
Castro, Mariano. Banco de Trabajo. Lima, Peru.
Flores, Luis. BMI. San Salvador, El Salvador.
Guillamón, Bernardo. IDB. Washington D.C.
Howell, Hunt. IDB. Washington D.C.
Lodoño, Rosario. IDB. Washington D.C.
Peña, Jesus.
Portocarrero, Felipe.
Rodrigues, Ana Maria. IDB. Washington D.C.
Silva, Alex.
Young, Robin. DAI. San Salvador, El Salvador.

Annex A

CASE STUDY:
Colombia

The Colombian case is the only example of IDB-funded MG programs in which non-regulated credit institutions, such as NGOs, were permitted to participate. The evolution of the MG programs in Colombia reflected changes in accepted microcredit technology and served as an important guide for these programs in other countries (see Table A.1 for a synthesis of the results of the three programs in Colombia). The programs consisted of credit funds to qualifying intermediary financial institutions and incorporated varying degrees of training services for microenterprises, as well as a technical assistance component for program implementation and institutional strengthening of participating IFIs. The programs were some of the first attempts to link microenterprises to the formal financial markets through a large-scale loan. The first Micro Global Credit Program began in Colombia in 1986 with a $7 million loan plus $3 million in local counterpart. The second MG Program was approved in 1991 for a total amount of $20 million ($14 million in IDB

Table A.1
Results of MG Programs in Colombia

Indicators	MG I (as of 8/91)	MG II (as of 2/93)	(as of 10/01)
Program amount	$7 million IDB $3 million counterpart	$14 million IDB $6 million counterpart	$30 million IDB, $20 million counterpart
Beginning/Ending dates	Dec.86 / Aug 91	Dec. 90 / Feb. 93	Nov. 93 / Nov. 97
Total # subloans	3,750	26,900	108,421
Average loan size	$3,100	$740	$581
Maximum loan size	$7,500	$10,000	$7,500 individual, or $15,000 for cooperatives.
Sector coverage	65 percent industry, 30 percent services, 5 percent retail	88 percent industry, <1 percent services, 11 percent retail	55 percent retail, 25 percent industry, 20 percent services
Executing agency	Central Bank	Central Bank	Instituto de Fomento Industrial
Institutional eligibility	Banks, finance companies and, indirectly, training NGOs	Banks, finance companies and, indirectly, credit NGOs	Banks, finance companies, credit NGOs and credit unions
# participating institutions	6 IFIs, 19 training NGOs	8 IFIs, 34 credit NGOs	58 IFIs (19 banks and finance companies, 39 NGOs and credit unions)
percent participation of top IFI ($ disbursed)	55 percent (Financiacoop)	57 percent (CFD)	32 percent (Finamérica)
Portfolio at risk over 30 days of top IFI	31 percent (as of 6/30/91)	15 percent (as of 3/31/93)	9.9 percent (as of 12/31/98)
Technical assistance	Microenterprises	IFIs and Microenterprises	Executing agency, IFIs, and microenterprises
General objective	Support the development of the small business sector through increased credit coverage and technical assistance.		Improve access of small and microenterprise sector to financial services on a permanent basis.
Specific objective	na		Promote significant changes in government policy and implementation strategies limiting microenterprise integration into the formal financial markets.

**Performance for MG III includes $13 million in reflows.*

funding), and the third MG program was approved in 1993 for a total amount of $50 million ($30 million in IDB funding).

The failures and successes of these three MG programs helped to highlight the performance of successful financial intermediation by a few specialized microfinance institutions in Colombia. The first program reflected the context of a traditionally training-driven microenterprise services industry with subsidized lending, and the second and third programs were designed using the lessons learned to improve upon earlier performance. They were refined in terms of the microenterprise target group, interest rates, training, participating institutions and use of guarantee funds. Table A.2 shows the evolution of the MG programs in Colombia in terms of these variables. The programs gradually moved toward market-based interest rates, de-linking of training and credit, participation of non-regulated financial institutions and the reduction in public sector guarantee funds.

MG I Program

The first MG program, totaling $10 million, was considered a success in terms of quick disbursement, but did not fully meet the objectives of providing access to marginalized groups. Program resources could be used only for manufacturing and service businesses in urban areas, and for retail trade only when financing fixed assets. This effectively limited financing for retail-based microenterprises, which rely heavily on working capital, many of which are owned by women. As a result, 73 percent of the resources were for fixed assets, and only 5 percent for retail trade businesses.

The structure of the program required all credit clients to undergo training and receive technical assistance from NGOs that were deemed eligible by the National Planning Department (DPN) of the Central Bank. This requirement biased the end users to those that would benefit from eligible training, usually the larger microenterprises. The linking of training and credit also limited the program to one microcredit methodology and biased the program toward training-led NGOs, leading to a concentration of participants. As shown in Table A.3, the *Instituto de Financiamiento y Desarrollo Cooperativo de Colombia* (Financiacoop) was the principal IFI, disbursing 55 percent of the program resources. Financiacoop together with the publicly-owned *Corporación Financiera Popular* (CFP) accounted for 77 percent of the funds disbursed.

Table A.2
Evolution of MG Programs in Colombia

	MG I	MG II	MG III
Beneficiaries	Manufacturing, services, and limited commerce.	Manufacturing, services and commerce	Multisectoral, including agriculture
Type of subloans	Working capital and investment. Only fixed assets for commerce sector.	Working capital or investment.	Working capital or investment.
Interest rates	Negative in real terms	Positive, but below market	Market
NGO participation	Training-based	IFIs loan to NGOs that used primarily solidarity lending	Direct access for credit NGOs and credit unions.
Public and private guarantee funds	Low use of guarantee funds	High use of loan guarantees and minimal analysis	Portfolio guarantees. Minimize public sector fund use.
Linking of training and credit	Training required for credit	Training not required but subsidized	No training in program.

Table A.3
IFI Participation in MG I (as of 8/91)*

IFI	percent Disbursements
Financiacoop	55
C.F.P.	22
Coopdesarrollo	11
Bancoquia	8
Uconal	3
Banco Colpatria	1
Total	100

Source: IPC 1993, p.11.
** Percentages refer only to $7 million IDB- funded portion of program.*

Table A.4
IFI Participation in MG II (as of 3/31/93)

IFI	% Participation of disbursements	% Portfolio at risk (over 30 days)
C.F.D.	57	15
Banco Union	10	0
Banco Cooperativo	10	11.3
Caja Social	8	n.a.
COOPCENTRAL	7	14.6
Banco Colombia	7	0
COOPDESARROLLO	1	23.8
Banco Uconal	<1	0

Source: Project Completion Report, IDB and National Planning Department (DNP), 1993.

The first MG also had the participation of six banks, 18 NGOs and the national training institute, SENA. Many of the banks relied on training-based NGOs to manage credit repayment but without requiring the NGOs to take any of the credit risk. They also relied on public guarantees from institutions that did not have microcredit experience. As a result, portfolio arrears were very high. For example, the external consulting firm, IPC, found that as of June 30, 1991 arrears rates for Financiacoop for this program were 31 percent and for Coopdesarrollo were 60 percent (IPC, 1993, p.13, using Superin-tendency definition of arrears).

MG II Program

The second program, approved in 1991, doubled the credit resources to $20 million. This operation encouraged competition by permitting a wider participation of institutions representing diverse credit methodologies. IFIs could lend program resources to credit-granting NGOs to be on-lent directly to the target group. Not surprisingly, it was difficult for NGOs to access IFI funds, due to their nonregulated status. IFIs required letters of credit from NGOs for 100 percent of the institutional loans, to minimize their risk of default (IPC, 1993, pg. 25). The majority of those NGOs that did participate used the solidarity lending approach, and greatly expanded the reach of the funds to lower income microenterprise segments. The program did not require clients to receive training, but NGOs received subsidies according to the number of clients trained.

The MG II disbursed 26,900 credits for $19.9 million in 18 months, instead of the four years that were programmed. In all, 8 formal financial institutions participated, and of those eight, three of them accounted for 77 percent of the resources, while the CFD[1] disbursed 57 percent of the resources alone (IDB and DNP, Project Completion Report). See Table A.4 for details.

The IFIs channeled the program resources through a total of 34 NGOs. Six of those NGOs using solidarity lending accounted for 88 percent of the number of credits and 36 percent of the resources. These were Corposol, Fundacion Santo Domingo and the Actuares of Antioquia, Tolima, Quindio and Caldas. There were 28 traditional NGOs (training-based) that disbursed 12 percent of credits with 64 percent of resources. The average loan size for the solidarity-based NGOs was $305, with 96 percent for working capital, while the average loan size for the traditional NGOs was $3,980, with 30 percent for working capital (see Table A.5 for details).

The MG II had success incorporating credit-based NGOs, which significantly increased the number of credits and clients in the target group, with lower levels of delinquency. However, the program did not increase participation by regulated IFIs, or credit transparency; it did not lower transaction costs nor did it free interest rates for IFIs, and it increased the use of public guarantees.

Rural access was not improved, and 47 percent of the resources were disbursed in Bogotá. There was no strategy or resources for strengthening nontraditional financial institutions, although it was an objective of the program. Although data measuring portfolio at risk is conflicting, an IPC evaluation estimated that as of July 1992, there was a portfolio at risk over 30 days of 26.7 percent for the program as a whole (IPC 1993, p.30). Portfolio at risk over 30 days as of March 31, 1993 ranged from 0percent in Banco de Colombia, Banco Unión, and Banco Uconal (who lent to

[1] CFP changed its name to Corporación Financiera para el Desarrollo.

Table A. 5
NGO participation in MG II as of 3/31/93

NGO	# credits	Average loan size ($)
Corposol	14,616	251
Fundación Santo Domingo	6,176	430
Actuar-Quindio	1,067	139
Actuar-Antioquia	679	499
Actuar-Caldas	757	180
Actuar-Tolima	428	659
Subtotal	23,723	305
percent	88	
Training-based NGOs (28)	3,177	3,980
percent	12	
Total	**26,900**	**739**

Source: Project Completion Report, IDB and DNP, 1993.

solidarity NGOs) to 14.6 percent in Coopcentral, 15 percent in C.F.D., and 23.8 percent in Coopdesarrollo, as shown in Table A.4. Corposol, a solidarity NGO, had portfolio at risk of 1.8 percent. The sharp contrast in results by institution changed perceptions about the proper way to do microlending and how to structure MG programs.

MG III Program

The third MG program benefited from the experiences of partially implemented MG programs in Ecuador, Chile, Argentina, Uruguay, Guatemala, Costa Rica and Paraguay, as well as previous Colombian programs. The program eliminated direct operational subsidies for training, restricted the use of government subsidized guarantees, and liberalized the interest rate structure, all in an attempt to strengthen the development of a market-based approach for the provision of financial services to microenterprises.

The program provided credit resources totaling $50 million to be channeled through regulated financial institutions and nonregulated financial institutions such as NGOs and credit unions. This was the first time that nonregulated IFIs were permitted to directly access MG program resources, and that credit unions (which were not regulated by the banking superintendency in Colombia) were permitted to participate. Participation of regulated IFIs was much greater and somewhat less concentrated than in MG I and II. Nineteen regulated and 39 nonregulated institutions participated. As shown in Table A.6, the top IFI, Finansol/Finamérica, disbursed 32 percent of the funds and the top three IFIs accounted for 68.4 percent of the funds. The program was completed in 1997, and as of October 31, 2001, it had disbursed a total of $63 million, including reflows, for a total of 108,421 credits, with an average loan size of $581 (Instituto, 2001)[2].

As of August 1996, the most important IFI of the MG III was the commercial finance company, Finansol (currently Finamérica), with disbursements of approximately $10.6 million and an outstanding balance with the executing agency, the *Instituto de Desarrollo Industrial*, in MG III of $3.4 million (IDB Aide Memoir,

[2] Information on average credit terms is not available for the program, but in 1998 the average credit term of the most active participant, Finamérica, was 11 months (Microrate, 2001).

Table A.6
Participation of top ten IFIs in MG III
(Accumulated disbursements as of 10/31/01)

IFI	Disburse-ments ($MM)	% Participa-tion	Total # Loans Disbursed	Average Loan Size ($)
Regulated institutions				
Finansol/Finamérica	20.24	32	32,231	628
Financiera Compartir	3.5	5.6	856	4,093
Subtotal Regulated	23.7	37.6	33,087	717
Other Regulated	2.3	3.6	3,409	673
Total Regulated	26.0	41	36,496	714
Nonregulated institutions				
Fund. Mario Santo-domingo	11.8	19	21,093	557
Fundacion WWB Cali	11.1	18	26,562	417
Fundacion WWB Popayan	2.1	3.3	3,783	547
Fundacion WWB./Manga	1.9	3.0	4,948	375
Corp. Accion por Antioquia	1.3	2.1	2,208	592
Corp. Accion por el Tolima-Actuar	1.2	1.9	2,115	563
Corp. WWB Medellin	1.15	1.8	3,413	337
Microempresas de Antioquia	1.1	1.7	778	1,400
Subtotal 8 top non-regulated	31.5	50.8	64,900	485
Other Non-regulated	5.4	8.4	7,025	774
Total Non-regulated	36.9	59 percent	71,925	514
TOTAL IFIs	63	100 percent	108,421	581

Source: Instituto de Fomento Industrial, 2001.

Oct. 1996). Finansol was a creation of Corposol, the predominant NGO participant in the MG II. Corposol used the solidarity methodology of the ACCION International network and was extremely successful. In 1992, Corposol's portfolio was approximately $4 million, serving 25,000 clients, with a portfolio at risk over 30 days of a maximum of 2 percent (IPC 1996). At this time, the institution expanded rapidly and diversified into construction, insurance, advisory services, rural business and marketing. In 1993, to gain the advantages of formal financial mediation, Corposol bought the commercial finance company (CFC)[3] FENIX, which eventually became known as Finansol. Corposol maintained 70 percent ownership and exerted substantial influence on the finance company, preventing its autonomous development into a specialized microfinance intermediary. Corposol also provided mandatory training to Finansol customers for a fee, which created incentives for Finansol to expand its clientele very rapidly.

[3] CFC is a type of regulated financial intermediary with lower minimal capital requirements than a bank.

Management fraud and oversight problems were first detected in 1995. A sharp increase in finance costs (from 19.2 percent in 1994 to 40 percent in 1995), over-indebtedness, and a deteriorating portfolio exacerbated the situation and, by the end of 1995, portfolio at risk was 24 percent (IPC, 1996). During the first eight months of 1996, Finansol lost approximately $7 million. Due to the accounting practices of Corposol, which assumed some of Finansol's costs on its books, Finansol escaped intervention by the Superintendency of Banks. Corposol was dissolved, and fresh outside investors resuscitated Finansol, under the new name of Finamérica. As of December 31, 1998, Finamérica's portfolio at risk over 30 days was 9.9 percent.

The credit unions in MG Program III showed mixed performance, with portfolio at risk ranging from a low of 1.4 percent in Credifenalco to a high of 40.7 percent in Solidarios, as of May 1996 (IPC, 1996). In 1998 there was the first case of a credit union missing a payment to the Instituto, and portfolio at risk within the *Instituto's* credit union portfolio reached 5 percent (IPC, 1998). Credit unions were in a crisis after a case of diverted funds undetected by the government regulatory body in charge of their supervision, DANCOOP, causing a loss of confidence in the sector. In June 1998, the Superintendency of Banks began to supervise the 57 most important credit unions, while the rest are under the responsibility of the newly created Superintendency of Cooperatives.

Comparative Program Results

The MG programs in Colombia progressed to a broader coverage of the microenterprise sector, but not necessarily to building sustainable institutions. The initial program had a design bias toward fixed assets, high average loan size and high transaction costs, with the result that the final beneficiaries were from the higher micro and small enterprise strata. With the gradual opening of the programs to more sectors, such as commerce and agriculture, and to allowing working capital loans, as well as incorporating credit NGOs, the MG programs eventually reached smaller microenterprises. The average loan size decreased with each MG program, from $3,100 to $740 to $581. Moreover, program design changes helped to reduce portfolio at risk somewhat.

Although the number of new clients reached is difficult to determine, an external evaluation of MG I theorized that there was likely more substitution of clients than new ones, since the largest participant, Financiacoop, already had a large base of clients in the target group. Moreover, the extremely low interest rates attracted already "bankable" clients to the program (IPC, 1993, p.16). Likewise, an external evaluation in 1996 concluded that commercial banks were most likely using the MG Program III resources to service existing clients, and credit unions were accessing new clients, with higher loan amounts and longer terms. NGOs were reaching more of the lower income clients (IPC, 1996).

Probably the most notable success of the MG programs in Colombia was the advancement of the microfinance industry. Although the most successful microfinance institutions (MFIs) have historically been NGOs, which received assistance and grew before the MG program, the lessons learned from the first MG program helped to influence the separation of training and credit and promote the successes of NGO microcredit providers. The Colombian network of Women's World Banking (WWB) is an example of successful microfinance, with a return of 5.6 percent on its average portfolio, and a portfolio of $15.1 million and 33,000 clients as of May of 1998 (IPC, 1998).

The sustainability of the NGOs participating in MG III was called into question in a 1998 expert evaluation (IPC, 1998) due to the NGOs' dependence on subsidies, except for the group of WWB affiliates. Financial margins for the MG program funds were not enough to cover these NGOs' intermediation costs, except for WWB. Fundación Santo Domingo had a negative margin (–12 percent), while the margin for Actuar Antioquia was 3.6 percent, Microempresa Antioquia was 0.6 percent and WWBs were 24 percent. Given that in 1997 the ratio of administrative costs to total assets of the most important Colombian commercial banks was more than 13 percent, and for the most efficient microfinance organizations it was 20 percent, the margins of these NGOs (except for WWB) are not enough to cover costs and maintain the institution. On the whole, development of the microfinance industry in Colombia has been compromised by large, subsidized NGOs with no incentives to increase efficiency. This inefficiency is exacerbated by federally mandated interest rate ceilings, which decrease transparency.

Microenterprise Sector

According to the Colombian government, there were an estimated 916,000 microenterprises in 2001, consisting of no more than 10 employees, with assets up to $59,000, employing 1.8 million workers. If one person businesses (the self-employed) and other informal businesses are included, the total rises to over 6 million. Small and medium enterprises (with 10 to 199 employees) comprised 50,000 productive units with 1.35 million employees.

The MG Program I defined microenterprises as businesses with less than 10 employees, total assets less than $20,000, and monthly sales volume of less than $5,500. However, the program credit regulations limited access for informal and lower income microenterprises. Credit requests were to be accompanied by an income statement and balance sheet, an investment plan and cash flow projections, certification of participation in an eligible training course, a cosigner for credits above $1,500 and two cosigners for loans more than $3,000. Banking regulations required business and bank references, certification from the Camara de Comercio that the business was at least three months old, and guarantees (IPC 1993).

To be considered eligible for the MG Program II, microenterprises (called small businesses in the program) could have no more than 10 employees, total assets less than $20,000, were required to have an identifiable workplace and a reasonable measure of business efficiency. The MG Program III modified this definition by requiring that fixed assets (excluding real estate) be no more than $15,000 (for associations or cooperatives, fixed assets of no more than $30,000 and legal incorporation were required).

Macroeconomic Environment and Financial Sector

Microenterprise development in Colombia has taken place largely within the context of subsidized credit, heavy involvement of the government in the financial sector, and a large number of specialized institutions. After a severe financial crisis in 1982, 70 percent of the financial industry was nationalized. Interest rate controls, forced investments, and relatively high reserve requirements contributed to high interest rates for the final credit client because of commissions and fees, which drove up effective rates.[4] In the 1990's the

[4] 1992 interest rate ceilings were 35 percent annual for short term – up to 18 months, but with forced savings, costs really were 40-45 percent annual (IPC, 1993, pg. 46).

Table A.7
Participating institutions and portfolio composition of the Instituto de Fomento Industrial as of May 31, 1998

Type of Institution	# clients	Outstanding Portfolio ($MM)	percent
Regulated (banks)	29	16.3	24
Cooperatives	55	24.9	36
NGOs	21	27.2	40
Total	105	68.4	100

Source: IPC, 1998, Table 2.

banks were privatized and were supervised under stringent new regulations, while the economy was opened to international competition and subsidies in the financial sector were reduced.

Since the 1990s, the traditionally noncompetitive Colombian financial sector has consolidated and gradually become more competitive –external investment, mergers and acquisitions of national banks, modifications in the regulatory framework such as lower reserve requirements, proposals to increase minimum capital requirements, and new competitive pressures have led to a search for new market segments and products (IPC, 1998). This has resulted in lower financial margins and a move toward less specialization and segmentation.

Consolidated Microfinance Sector

In the microfinance sector, the country has a tradition of training-based NGOs, due to the success and influence of the Carvajal Foundation, one of the first NGOs to successfully promote the model that requires training and technical assistance in order to receive credit approval. As a result, many programs were oriented toward this lending model, and supported these types of NGOs. In time, credit-based NGOs began to show success lending to microenterprises by using a credit methodology of small initial loans that gradually increase based on prompt repayment. At the end of 2000, the microfinance sector in Colombia was serving 140,000 clients with a portfolio of $65 million. The microfinance sector is comprised of: (i) approximately 50 NGOs, dominated by the Emprender network, the five Women's World Banking affiliates, and the Mario Santo Domingo Foundation, which together account for 63 percent of the national microfinance portfolio and 86 percent of clients; and (ii) two CFCs, Finamérica and Financiera Compartir, which account for 37 percent of the portfolio and 14 percent of clients. Finamérica and Financiera Compartir are the only specialized microfinance institutions that are regulated and supervised by the Superintendency of Banks. Nevertheless, two commercial banks maintain an interest in serving low-income clients, Banco Caja Social and Megabanco. The Banco Caja Social, with a long tradition in capturing individual savings deposits, estimates that it serves more than 60,000 microenterprise clients. Megabanco, created in 1998 from the merger of several cooperatives and cooperative banks, has shown an interest in deepening its involvement in the sector.

Public Policy and Regulatory Environment

Colombia is relatively unusual in that the government has worked closely with NGOs and the private sector in policy development and program execution for the sector. The government launched a National Plan for Microenterprise Development (PNDM) in 1984, with the goals of improving access to financial services, improving training services, as well as promoting marketing services and enhancing the productivity of microenterprises. Nevertheless, there has been low penetration of the microenterprise market compared with other countries. This is in part due to negative regulatory structures, such as stringent risk classification and interest rate ceilings. In addition, the existence of subsidized credits for low income and informal clients has stunted the development of a thriving microcredit sector.

Executing Agency

The executing agency for MG Programs I and II was the Central Bank. Within the Central Bank, the Industrial Credit Department (DCI) was responsible for managing the components and determining eligibility of participating IFIs. The National Planning Department (DNP) acted as the coordinating agent, responsible for coordinating with other programs, maintaining a management information system, and administering the technical cooperation components. Heavy information requirements and rapid disbursements overwhelmed the DNP's information systems. Furthermore, the DNP did not have legal authority to require submission of portfolio information from participating institutions.

The MG Program III was originally designed in the same manner, but in 1995, the Instituto de Desarrollo Industrial became the executing agency. This transfer of responsibility from the Central Bank to the Instituto delayed the implementation of MG Program III. The Instituto, a traditional state-owned development bank, was created in 1940 in support of the industrial sector. Over the years, its focus widened to include other sectors, and ultimately the decision was made that it would gradually evolve to function as a second-tier bank. As part of the National Plan for Microenterprise 1994-1998, the Samper government assigned to the Instituto the responsibility of managing the Program for Financing Small and Medium Enterprise (PROPYME), and the Program for Financing Urban Microenterprises (FINURBANO), with the goal of disbursing $700 million from each program. Along with the funds for MG III, in 1996, the reflows from MGs I and II were transferred to the Instituto as part of FINURBANO. The Instituto had positive financial results, and business management better than many state-owned banks, but its multiple roles, including equity investments in MFIs also receiving Instituto loans have led to some complications. However, participating IFIs agreed that the leadership of the executing agency contributed to the success of MG Program III.

Complex Program Execution and Participation Arrangements

To participate in MG II, IFIs had to be established according to Colombian law and subject to supervision of the Superintendency of Banks and DANCOOP, supply any necessary supplementary credit to carry out the program, maintain portfolio at risk within the limits accepted by the Superintendency of Banks (over 180 days no greater than 10 percent), and have an information system for the program. NGOs had to be registered in the National Plan for Microenterprise Development, be authorized by the DNP and the Central Bank to take part in the program, have assets of at least $50,000 (marketing organizations could have $30,000), and supply all necessary information to the Central Bank, DNP or the IDB. NGOs were also required to enter into individual participation agreements with IFIs.

The MG Program III was initially designed to follow the same disbursement and participation mechanisms as MG Program II, but for the first time, allowing credit unions to borrow from IFIs and on-lend to microenterprises. However, with the implementation of the national FINURBANO program, the Instituto was mandated by law through the National Plan for Microenterprise Development to disburse credit to microenterprises according to pre-established targets. Because of this pressure, in MG Program III, NGOs and credit unions were permitted to access program resources directly from the Instituto. This actually was counterproductive to encouraging the transformation of NGOs to formal financial intermediaries, as NGOs could now access lines of credit, which previously was reserved only for formal institutions. As seen in the Table A.7, a large percentage, more than 75 percent in 1998, of the Instituto's clients are non-regulated institutions. This exposed the Instituto to greater risk than normal, due to the lack of transparent information available on nonregulated institutions.

Over time, the design of the MG programs was improved to provide a framework for better communication and division of responsibilities between parties. In the first and second MG programs, IFIs did not develop information systems or analysis capacity for microlending since they subcontracted to NGOs, which did not have the proper incentives to enforce contracts, and the overall program had an inadequate information monitoring system, which prevented careful portfolio tracking. Not surprisingly, IFIs were experiencing high levels of portfolio at risk since they were not analyzing and monitoring loans adequately and did not have sufficient knowledge of their clients. In MG III, the institutions responsible for monitoring and collection were also taking the appropriate credit risk.

Incentives/Disincentives for Participating

Excessive Transaction Costs

All of the IFIs that participated had an interest in lending to this market segment, either because of their statutes, ownership or mission. Traditional commercial banks were not willing to incur the high transaction costs necessary to access the funds, including additional paperwork, relatively longer processing times, and the negative image of a government program potentially leading to repayment problems. One of the most onerous burdens for these banks was the requirement for environmental evaluation of each subloan. IFIs were required to use a classification system to identify high-risk microenterprises, and refer them to an environmental training program. Completion of the program and certification that improvement measures were being taken was required for subsequent loans.[5] National environmental legislation was introduced in 1993-94, which designated guidelines for environmental protection and compliance (IPC, 1996). The MG III program was modified to require microenterprise clients to comply with the new national norms.

The FINURBANO program had less restrictive credit regulations, with maximum loan sizes of $40,000. The Instituto de Fomento Industrial used the reflows from the MG programs to lend under these more permissive guidelines, and banks preferred to borrow from FINURBANO even though interest rates charged were slightly higher than the MG (IPC, 1996).

Move Towards Market-Based Pricing

The MG I was an expensive program because of required technical assistance, and the delegation of credit administration (identification, application, loan appraisal, supervision and collection) to NGOs. Nevertheless, nominal

[5] Certification was required for those microenterprises in the highest risk category, with balances over $3,500 upon receiving the second loan (PD III, pg. 25).

interest rates to the final client were fixed at 24 percent and were negative in real terms[6], leading to a decapitalization of program resources.[7] The 24 percent interest rate was apportioned in the following manner: 7 percent for IFIs, 12 percent for training NGOs, 0.5 percent for the executing agency, 2 percent for IDB repayment and 2.5 percent for maintenance of value. The terms of the IDB loan were 2 percent interest, with a 30-year amortization period. During 1989-1991, the nominal bank interest rates were 20 percent above the program rates (Ibid, p.17), which caused demand for these funds from bankable clients, not the program target group. A spread of 7 percent was not enough to attract private commercial bank participation (Ibid, 44).

Furthermore, the counterpart funds, provided by the CFP, only had a spread of 4 percent for the training institutions. The only training institution that would work with this was the public training organization, SENA, which did not charge a spread. As shown in Table A.8, the interest rate structure of the MG programs changed over time.

Rates to IFIs in the MG II were fixed to the average 90-day deposit rate (DTF), and were positive in real terms, but still lower than the market.[8] IFI margins were lowered to a maximum of 6 percent to comply with the ceiling on spreads for Central Bank lines of credit to the banking system. This did not prevent banks from charging nontransparent fees and commissions and using other methods of increasing lending income. Including these fees, average bank spread during the period of the program was 9.8 percent. Only 8 of the 56 eligible regulated IFIs participated due to the low margin.

The design of the third MG program incorporated elements to help IFIs to cover costs and receive an adequate spread without pricing funds lower than cost of savings mobilization. The IDB loan had a variable interest rate, with a 20-year amortization period. Interest rates to regulated IFIs were DTF plus 1.8 percent and to non-regulated IFIs they were DTF plus 3.3 percent. Rates were adjusted quarterly and freely negotiated with the final client. Although nonregulated IFIs paid a premium compared with regulated IFIs, the MG funds were an additional source of capital, and less expensive relative to other funds they could access.

Use of Public Guarantee Funds

The excessive use of guarantee funds distorted risk taking and contributed to high arrears levels in MG Programs I and II. An evaluation of the MG program I estimated that 30-40 percent of the MG subloans were guaranteed. The National Guarantee Fund (FNG) and FOMENTAR, a fund owned primarily by the cooperative sector, guaranteed many of the loans. The third existing fund, FUNDESCOL, an affiliate of the Swiss foundation FUNDES, had limited exposure compared with the other two. The government expanded the role of the FNG in the execution

[6] Inflation was 26 percent in 1989, 32 percent in 1990 and 27 percent in 1991 (IPC, Feb. 1993).

[7] The IDB-funded program resources of $7 million are estimated to have been decapitalized to $5.5 million, presumably from program initiation to the time of the report (IPC, 1993, pg. 9, 21).

[8] Rates from the Central Bank to IFIs were DTF-3 points (DTF is 90-day deposit rate) if the IFI was lending directly to the final client, and DTF-5 points if the IFI lent to an NGO. The rate from IFIs to final clients was the variable rate of DTF-3, plus a maximum of 6 points. The rate from IFIs to NGOs was the variable rate of DTF-5 plus a maximum of 8 points, which was apportioned as a maximum of 2 points for the IFI and a maximum of 6 points for the NGO, for credit management. In both scenarios, the rate to the final client was DTF+3 points, which in 1990 was an effective rate of 41 percent. This was still low; for example, the NGO Actuar charged commissions and forced savings and so had effective annual rate of 66-160 percent (IPC, 1993, pg.33).

Table A.8
Comparison of Interest Rates of Colombia MG Programs, 1986-1997

MG	**IFI spread**	**NGO spread**	**Interest rate to microenterprise**	**DTF (average 90 day)**	**Market lending rate * (average)**	**Market bank spread (average)**	**Inflation (average)**
I (Average 1986-1991)	7 % fixed	12 % fixed	24 %t fixed	32.4 %	41.9 %	9.6 %	24 %
II (Average 1990-1993)	Maximum 6 %	Maximum 6 %	DTF+3	33.4 %	43.2 %	9.8 %	29 %
III (Average 1993-1997)	Charged DTF+1.8	Charged DTF+3.3	Market (WWB 53 %, Actuar Antioquia 32.6 %, Fund. Sto. Domingo, 17%)	28.6 %	39 %	10.5 %	21.3 %

Source: Project Documents and IMF International Financial Statistics.
** Weighted average of banking system by loan amount.*

of MG II. The microenterprise portfolio in the FNG before the MG Program II was less than 5 percent, but increased to around 30 percent during the program. The FNG approved loan guarantees of 70-80 percent of loan amount, based solely on the analysis undertaken by the IFIs, but IFIs were still relying for the most part on NGO knowledge of the clients and were not completely responsible for credit administration.

Bank guarantees were also used in MG Program II to allow NGOs to access IFI loans and cost around 4 percent annually (IPC, 1993, pg. 34). Around 60 percent of Banco Cooperativo's volume was guaranteed, with 80 percent of the guarantees provided by Fomentar and 20 percent by FNG. The CFP is one-third owner of the FNG,[9] and was almost exclusively using it for its loan guarantees. The CFP had 23 percent of its loans guaranteed by the FNG in 1989, 57 percent in 1990, and 74 percent in 1991. In 1992, the CFP did begin to use Fomentar and Fundescol, but less extensively.

The MG III supported the transformation from individual to institutional guarantees and promoted reform of the public sector guarantee program. The design of MG Program III did permit the FNG to participate in the program, but its participation was conditional upon certain reforms, and a midterm review of its participation. At the time, private guarantee funds were increasingly providing portfolio guarantees rather than individual loan guarantees.

Separation of Training and Credit Activities

Training was required in MG Program I in order for microenterprises to receive loans. The MG Program II attempted to de-link credit and training somewhat. Although microenterprises were not required to undergo training, they were ideally to have received training and be receiving ongoing assistance. NGOs were paid a flat fee of $330 for each microenterprise trained, which did not help improve transparency in costs by indicating the actual cost of training, and did not help

[9] Other 2/3 belongs to Ministry of Development through the Banco de Comercio Exterior, which is one of the Central Bank funds for economic development (IPC, 1993, pg. 31).

NGOs to become more competitive or improve their services. NGOs were penalized ex-post if they did not train a certain number of microenterprises and if their clients showed high rates of delinquency. However, information systems were not sophisticated enough to adequately penalize NGOs for poor performance after the fact. The omission of training activities in MG Program III focused the program squarely on credit activities.

Technical Cooperation

For the Executing Agency

To help with the significant changes of MG Program III, the program included a technical cooperation component to help the executing agency with program management. The $810,000 component, of which $600,000 was funded through the IDB, financed workshops to introduce the changes of MG Program III into the PNDM and strengthen DNP's ability to manage information from program participants. This technical assistance was later applied to the Instituto de Fomento Industrial when it became executing agency. The Consorcio Chemonics-Econometria implemented the technical assistance for the Instituto through the development of management information software and a risk assessment guide for the Instituto to evaluate nonformal IFIs. However, there was no technical assistance provided directly to the staff managing the funds, but rather to a temporary working group, which would seem to lessen the impact of technology transfer. Nevertheless, the emphasis of the technical assistance provided through the MG programs was on IFIs.

For Intermediary Financial Institutions and NGOs

MG Program I included a component of the technical cooperation that assisted in designing environmental protection control systems for microfinance NGOs. Even with this assistance, IFIs did not have appropriate mechanisms in place to comply with environmental impact improvements. MG Program III included assistance to nonbank microfinance intermediaries in credit technology, support for management information systems and cost accounting. The Consorcio Chemonics-Econometria implemented the technical assistance for IFI institutional strengthening through the development of a manual for IFIs to evaluate credit recipients. NGO program participants reported that the technical assistance was a major attraction to the program, and was beneficial, especially the credit technology transfer and management information systems improvements. The MG Program III also included assistance in preparing entrepreneurial development and environmental protection materials for microenterprises.

For Microenterprises

The technical cooperation component in MG Program II was designed to strengthen the production capabilities of microenterprises. The $1 million program for the National Planning Department created five production development centers specializing in garment-making, wood products, and metalworking, as well as provided a technology guidance service for information gathering for microenterprises.

Leasons Learned

The Colombian MG programs incorporated lessons learned to move from credit for fixed investment targeted to manufacturing to multisectoral, from negative real interest rates to market rates, from compulsory training to delinking training from credit, from only regulated banking intermediaries to permitting the inclusion of NGOs and credit unions, from use of public guarantee funds for individual credits to private portfolio guarantees.

The problems encountered in the execution of the Colombian MG programs provide important information for future programs of this nature.

- The direct link between lending and training increased costs, and possibly arrears for participating institutions, may have led to an overly rapid expansion of their client base (e.g. Finansol).

- A lack of oversight and refinancing limits allowed for over-indebtedness (e.g. Finansol).

- Ceilings on interest rates and spreads, as well as high transaction costs, limited bank participation.

- Political goals for microfinance may have negatively affected the wholesale programs by sacrificing reach to lower income microenterprises in favor of larger volumes of lending.

- The programs lacked incentives for banks to perform good risk assessment and management because of the mandated use of NGOs and the excessive use of guarantee funds.

- Linking of training activities with credit allowed for distorted risk management and credit recovery.

However, these lessons were instructive in the design of the more recent MG programs and in the development of the microfinance sector in Colombia. They created an impetus for legal changes, as well as contributed to the strengthening of two regulated MFIs. The MG programs in Colombia were innovative in allowing the credit-granting NGOs to participate and to set a standard for other institutions to follow. They built on the successes of previous IDB Small Projects with these NGOs, allowing for successive IDB support, such as the Social Entrepreneurship Program and the MIF Line of Activity and other programs.

Bibliography

Austin, James and Enrique Ogliastri. 1996. Corposol Case Study. Harvard Business School. Boston, MA.

Austin, James, Roberto Gutiérrez, Mark Labie, and Enrique Ogliastri. 1997. Finansol Case Study. Harvard Business School. Boston, MA.

Departamento Nacional de Planeación. 1993?. Informe de Terminación de Proyecto: Programa Global de Crédito para la Microempresa II. (848/SF-CO). Bogotá, Colombia.

Econometría S.A. 2000. Corporación para el Desarrollo de la Microempresa: Identificación de los Componentes para el Programa Global IV. Washington D.C.

Inter-American Development Bank Official Bank Document. 1990. Colombia: Global Credit Program for Small Business II (CO-0086). Washington D.C.

Inter-American Development Bank Official Bank Document. 1993. Colombia: Global Microenterprise Credit Program (CO-0037). Washington D.C.

Interdisziplinare Projekt Consult GmbH. 1993. Misión Preparatoria para un Micro-Global III en Colombia. Frankfurt, Germany.

Internationale Projekt Consult GmbH. 1996. Revisión del Desempeño del Programa Global de Crédito para la Microempresa III: Colombia. Frankfurt, Germany.

Internationale Projekt Consult GmbH. 1998. Borrador de Análisis de las políticas de promoción de los servicios financieros y de capacitación para la microempresa en Colombia: Evaluación de los resultados y opciones estratégicas". Washington D.C.

Annex B

CASE STUDY:
El Salvador

El Salvador's Microenterprise Global Credit Program totaled $30 million in credit resources ($24 million IDB and $6 million counterpart). Contrary to the typical structure of the MG Programs, this credit program did not have an accompanying technical assistance component to help financial institutions to enter the microfinance market. Although program implementation was delayed due to changes in the executing agency, the program resources were disbursed in two and one-half years, instead of the four years originally scheduled. The most notable characteristic of the El Salvador MG program is that the finance company, Financiera Calpiá, accounted for close to 80 percent of the funds disbursed. The program did contribute to financial deepening in El Salvador in the sense that the resources allowed some microenterprises to access formal financial resources for the first time, and did contribute to the emergence of an industry leader which would help to promote commercial microfinance in the country. Table B.1 synthesizes the program's results.

Table B.1
Results of MG Program in El Salvador

Indicators	El Salvador MG Program
Program Amount	IDB - $24 million, Counterpart – 46 million
Terms of IDB loan	Two loans: 1) $16 million at variable intereste, 25 year term, 4-year grace period; and ii) $8 million at 1% for 10 years, and 2% thereafter, 40-year term, 4 years grace.
Beginning/ending dates	November 93 / July 97
Total # subloans	45,503
Average loan size	$660
Type of loan	90% working capital, 10% fixed assets
Institutional eligibility	Banks, finance companies
# participating institutions	15 IFIs
% rural	36%
% women	76% in program evaluation sample
% participation of top IFI	78.8% Calpiá
Maximum loan size	$15,000, average $7,500
Technical assistance	None
Objectives	Increase the flow of credit from formal financial sector to microenterprises. Complete the conversion of NGOS into formal finance institutions.

MG Program Coverage

During 1994-1997, the MG program financed a total of 45,503 loans for $29.9 million. It is estimated that these loans benefited at least 16,000 clients. The average size loan was $660, 90 percent of the funds were for working capital, and 64 percent of the credits were in the country's central zone, including the capitol city, San Salvador.

An evaluation of the program found that from a sample of program beneficiaries, MG credits were the first access to the formal financial market for 30.4 percent of clients, and that 76 percent of these clients were women (IDB/ Ayala, WP-7/98, p.32). The same evaluation found that 49 percent of the number of loans and 76 percent of the resources went to the nonpoor (medium and high income), however, "the MG was the only source of formal credit for the very poor and subsistence poor. The MG poverty impact is real, additive and substantial compared to a control group, but the proportion of the financial resources delivered to the poor is small" (IDB, EVO 1999, p.5).

IFI Participation

Although 21 financial institutions were eligible, 15 actually disbursed credits, and 7 were participating by the end of the loan period. Financiera Calpiá disbursed 78 percent of the resources during the program period, and the top three IFIs together disbursed 90.5 percent of the funds. Table B.2 shows IFI disbursements and average loan sizes during the program. From a review of average loan sizes, it can be surmised that the increased access for the poor was due to Financiera Calpiá, with an average loan size of $546, compared with the next lowest of $2180.

Emergence of Industry Leader

The MG program did not immediately have the desired impact on the microfinance Indus

Table B.2
IFI Participation in El Salvador MG Program (1994-1997)

IFI	% Total Disbursements	Average Loan Size $
Financiera Calpiá	78.85	546
Banco Agrícola Comercial	7.11	2,180
Banco Salvadoreño	4.54	3,517
Banco de Crédito Inmobilario	3.23	3,328
Banco Cuscatlan	2.59	3,767
Banco de Comercio	2.18	2,589
Banco de Construcción y Ahorro	0.56	3,427
Banco Hipotecario	0.28	4,183
Unibanco	0.21	7,009
Banco Desarrollo	0.14	2,908
Financiera Inespro	0.10	10,086
Banco Promeria	0.09	3,192
Banco Corporativo Corfinsa	0.05	2,724
Banco Ahorromet	0.03	2,571
Financiera Industrial y Comercial	0.01	2,971

Source: BMI, 2002.

try market. The focus on existing formal financial institutions prevented some of the most serious microcredit providers, such as NGOs and credit unions, from participating. Instead of enticing banks to increase their microloans, or broadening the formal financial market by facilitating the transformation of NGOs to finance companies, the MG Program's input was largely limited to one institution. The availability of the MG resources helped to enable, in part, the emergence of the finance company Calpiá as an industry leader, which over time had a positive effect on the microfinance market in El Salvador.

Financiera Calpiá was created by AMPES, an NGO that which began its credit program in 1988, with technical assistance from the German Agency GTZ and Internationale Projekt Consult (IPC). The IDB was also one of the key funders of AMPES through its Small Projects Program. In 1995, AMPES transferred its portfolio to a finance company it created, Financiera Calpiá. Although Financiera Calpiá had a number of committed investors, including the Multilateral Investment Fund (MIF), the MG program became the most important source of funds for the new company, nearly 75 percent of Calpiá's active portfolio by June 30, 1996 (Maciel, 1996, Anx 1, p.3). Extensive technical assistance introduced sophisticated management systems, and helped to establish the structure of a tripartite management team. The use of appropriate credit technology, which the other IFIs participating in the MG were lacking, allowed Calpiá to lower the cost and risk of thousands of small loans (Maciel, 1996, Anx 1, p.2).

Calpiá was an important source of demand for the MG program. After the MG program, Calpiá decreased its dependence on the Banco Multisectorial de Inversiones (BMI) funds by increasing deposit mobilization, as shown in Table B.3. Whereas in 1996, the first year that Calpiá was able to capture deposits, they comprised 3.8 percent of total liabilities and BMI funds comprised 51 percent, by the year 2000, deposits were 56.5 percent of total liabilities and BMI funds were only 12 percent.

During the MG program, Calpiá grew consistently and profitably, with efficient operations and low portfolio at risk, as shown in Table B.4. Financiera Calpiá exhibited excellent performance and customer service, and has become the standard by which other MFIs in El Salvador measure their success. Its ability to profitably lend to the microenterprise sector has spurred more competition than the incentives of the MG program were able to do.

Table B.3
Structure of Financiera Calpiá Liabilities (as of 12/31)

	1995	1996	1997	1998	1999	2000
Deposits/Total liabilities (percent)	0	3.8	8.8	15.2	33.6	56.5
BMI debt/Total liabilities (percent)	47.4	51.2	46.9	37.6	33.6	12.3
Other debt/Total liabilities (percent)	49.3	39.7	40.1	44.4	29.9	28.1
BMI debt/Total equity (percent)	131	122	154	125	118	43

Source: Calpiá Annual Reports.

Recently, Calpiá has suffered some losses, due to the major earthquakes in January of 2001, and the provisions that had to be made for those losses. As many microfinance organizations in El Salvador were similarly affected, there has not been an accompanying loss in market share. Calpiá has also had major governance and management changes in the past year, with a new president, management and Board of Directors. Financiera Calpiá is planning to convert to a bank in the near future.

Table B.4
Calpiá Performance Indicators During MG Program

	1995	1996	1997
Outstanding loans	12,060	18,051	24,629
Return on equity	10%	30%	25%
Return on assets	2.7%	8.5%	6.4%
Operating costs / Average gross portfolio	22%	20%	15.8%
Portfolio at risk over 30 days	1.8%	2.6%	2.7%

Source: Microrate

Large Microenterprise Sector

The dense microenterprise sector in El Salvador provided significant demand for microfinance services, easily absorbing the MG Program funds. The protracted conflict in El Salvador during the 1980s increased poverty levels above those seen at the end of the 1970s. The subsequent economic adjustment program also exacerbated the situation, increasing unemployment and the size of the informal and microenterprise sectors. In 1990, the Planning Ministry estimated that the informal sector was 51 percent of the urban economically active population, or 423,400 workers, an estimate that was considered to be low (IDB, PR-1946, p.4). Household surveys from the late 1990s indicate there were 650,000 microenterprises in the country, providing employment to over 1.2 million. Women workers account for 44 percent of those employed in the informal sector, putting El Salvador's women in the labor force as one of the highest in LAC. Since women also have less schooling, they remain in the informal sector longer. To finance their businesses, the majority of microenterprises were fulfilling credit needs through the informal financial sector, using moneylenders or supplier credits.

Favorable Macroeconomic Environment

The relatively stable economic environment in El Salvador since the peace process of 1989 has allowed for sustained growth of microenterprises and microfinance organizations, immediately before, during, and after the MG program. The adjustment programs of the 1990s supported the liberalization and privatization of the financial sector, and the IDB supported these reforms through its Sectoral Investment Program (PSI). In 1991 new laws were introduced to strengthen the financial system, including a Financial Institutions Law, Central Bank Law, and the Financial System Superintendency Law. Interest rates and exchange rates were liberalized to become market-driven. In 1993, the financial market was opened to new financial institutions. As part of these changes, one of the goals of the MG program was to help this process of developing the formal financial market by adding liquidity to institutions, thereby alleviating the credit constraint for microenterprises.

These reforms have had favorable results, with resumed economic growth, and decreasing fiscal deficits and inflation. For the years 1991-2000, average GDP growth was around 4 percent, compared with the negative 0.4 percent average during the 1980s. Inflation decreased from 24 percent in 1990, to 0.5 percent in 1999, and 4.3 percent in 2000. In 2001, the United States dollar was made the official currency. Low country risk and an investment grade rating have allowed for favorable credit terms and access to international credit. Nevertheless, El Salvador still continues to have some of the worst socioeconomic indicators in Latin America. In early 2001, two earthquakes, one month from each other, devastated the country, negatively affecting the microenterprise and financial sectors, among others.

Mixed Microfinance Institutional Base

El Salvador, unlike the majority of countries in the region, had a number of traditional commercial banks with microfinance departments prior to the IDB's MG program. These were started in the 1980s when banks were nationalized. Banco Cuzcatlán, Banco Agrícola Comercial, Banco Salvadoreño, Banco de Comercio, and Banco de Desarrollo e Inversión all had separate small and microenterprise departments. From 1990 to 1993, these commercial banks increased their loans to the sector by 37 percent. However, small business lending had crowded out microenterprise lending, partly because these banks still used collateral-based credit analysis, not microcredit technology, and they did not differentiate interest rates based on risk or size of loan. This made microenterprise lending comparatively risky and unprofitable. By the end of 1992, the small and microenterprise portfolio of these banks consisted of 10,545 loans for $71.7 million, with an average loan size of $6,796, almost double the 1990 level (IDB, PR-1946, p.13-14).

With privatization in 1992, the priority for commercial banks became the healthy growth of their traditional business. Overall liquidity was not a problem for commercial banks, so there was no pressure to downscale or participate in the MG program. The banks did not have the systems in place to make thousands of small loans efficiently, and the MG program did not provide the technical assistance to cover the initial start-up costs. The banking sector has undergone a period of consolidation since the MG program –many of the program participants were either involved in mergers or closed. Currently, the financial sector is relatively healthy, with average ROE of 9.9 percent, and portfolio at risk over 90 days of 4.9 percent (Central Reserve Bank of El Salvador).

The development-banking sector included the Investment and Guarantee Fund for Small Business (FIGAPE), Agricultural Development Bank (BFA), and the Credit Union Federation (FEDECREDITO). In 1992, the small and microenterprise portfolios of these institutions totaled 25,500 loans for $15 million and average size of $590.[1] However, the quality of the portfolio was poor and the institutions themselves were having financial difficulties.

In 1992, the nonregulated financial system was more successful in microlending, and included savings and loans cooperatives and NGOs. However, the fact that these institutions were not under supervision by the Superintendency of Banks presented a higher risk.

[1] Excluding loans to salaried workers and agricultural loans.

Fifty of the savings and loan cooperatives belonged to a federation, FEDECACES, with total assets of $24 million. Small and micro-enterprise credits comprised 60-65 percent of the portfolio, with an average loan size of $576. The savings and loan cooperatives captured member deposits totaling $10.2 million (IDB, PR-1946, p.11).

NGOs in El Salvador started providing microcredits in the 1980s due, in large part, to the violent disruptions of the period which made it difficult for microenterprises to access credit. The three most successful microcredit NGOs were the Center for Microenterprise Support (CAM), the Small and Microenterprise Program (PROPEMI) of FUSADES, and the Association of Medium and Small Salvadoran Entrepreneurs (AMPES). AMPES was the most successful, with 1,700 outstanding loans, maintaining an average loan size of $446, and the ability to cover its costs (IDB, PR-1946, p.39). However, without the authority to mobilize savings deposits, AMPES was dependent upon donors and soft loans. At the time of the MG program, the US Agency for International Development (USAID) was scaling back their support for small and microenterprise within its overall strategy for the country.

AMPES, CAM and PROEMI/FUSADES were examples of institutions utilizing a specialized microcredit technology to maintain a low portfolio at risk, even without collateral. Even though NGOs charged more than the banks did for smaller loans, reaching rates of 30-50 percent annually, compared with banks' rates of 19 percent in 1993 and FEDECACES' rate of 24 percent, they recognized that retail sales and service activities, even informal ones, were productive and legitimate businesses needing the credit and able to pay it (IDB, PR-1946). All three of these NGOs planned to convert into finance companies.

Today microfinance in San Salvador is very competitive, with NGOs, cooperatives and even some banks competing for clients. However, the sector is not yet competitive in terms of interest rates, which are still high, covering high operating costs. Although commercial banks see examples of profitable microfinance, and view it as a means of portfolio diversification, the investment and commitment required to be successful have prevented all but a few traditional banks from moving into the microfinance sector. Banco Agrícola and Banco Salvadoreño are two that appear to be committed to developing their microfinance business. Currently, both the IDB and USAID have programs to provide technical assistance and training to these banks and others willing to commit their own funds.

Favorable Design

The MG program included certain design elements to target only microenterprises, not small enterprises, and to facilitate women's access to program resources. For purposes of the program, a microenterprise was considered to be a business with ten employees or less and total assets equivalent to less than $15,000, excluding those in the professional sectors such as medical and legal practices. Maximum loans to microenterprises were $15,000 and the average size loan for each IFI could not exceed $7,500. In 1998, after IDB's project was completed, the definition of a microenterprise was changed to total annual sales of $65,000 or less, instead of total assets (IDB PCR, p.9). The average size loan was later changed to a maximum of $9,000 (BMI, 2002).

The program was designed to increase the participation of women by allowing loans to the commerce and service sectors, where women are the predominant microentrepreneurs. By financing working capital, the resources were most likely to target these same sectors. Finally, the program allowed the participation of part-time microenterprise owner/operators, many of which are women.

Executing Agency

The program executing agency was originally the Central Bank, but with changes in the Central Bank Law, the BMI, a government development bank, became the executing agency. The program utilized a rediscount mechanism, with ex-post evaluations of representative samples of subloans. The IFIs bore all of the risk for repayment of loans to BMI. As the executing agency, the BMI was responsible for verifying the eligibility and debt capacity of each IFI, and the compliance of the IFI with the norms and credit regulations of the program. The BMI was required to submit progress reports each semester.

The BMI was a newly created entity, with general institutional strengthening needs, and without experience managing this type of credit line. To facilitate the transition from Central Bank to BMI execution, the IDB financed a technical assistance program for the BMI through alternative donor funds,[2] but not related to microenterprise lending or technology.

Selection and Monitoring of Participating IFIs

IFIs in the MG program were required to be under the supervision of the Superintendency of Banks, which prevented NGOs and credit unions, institutions more predominant in rural areas, from participating. The financial performance criteria for participants also prevented the weaker public financial institutions from participating. For each IFI, the maximum share of the MG resources could not exceed 25 percent of its savings and time deposits; therefore, new institutions without a mature stock of deposits were required to show that they had appropriate infrastructure to capture deposits. Portfolio at risk was to be less than 3 percent of the total portfolio (more than 45 days overdue), and IFIs had to have an equity base above the legal required minimum.

Because the MG program utilized the standard IDB loan regulations, which were designed for traditional lending operations, it did not adapt well to some of the characteristics of microfinance organizations. Calpiá was required to adjust to the credit regulations by December 31, 1996, but had a low deposit base, as it had just started accepting deposits. An extension was granted until December 31, 1997 to allow the finance company to continue to participate.

Some participating banks made loans of up to $15,000 (the program limit) to *cajas de crédito*, to be on-lent to microenterprises. The *cajas* used their A portfolios as guarantees. However, this was not a widespread practice, due to the weakness of many of the *cajas* (Maciel, 1996, p.3).

Favorable Terms

The interest rate charged to IFIs was a variable rate, tied to the market. It was the average rate for 180-day deposits adjusted for the reserve requirement. The actual rate charged by BMI ranged between 11.5 percent and 14.5 percent, which was higher than inflation. Even though the rate was tied to the market, 60 percent of participating IFIs reported that these were the least expensive funds to which they had access (IDB, EVO WP-7/98, p.18).

[2] The Japanese Trust Fund financed this technical assistance, ATN-JF-5125-ES.

To allow IFIs to cover their costs, they could freely determine the rate charged to the final client. As an example of rates charged by the commercial banks, as of June 30, 1997, when the rate from BMI to IFIs was 12.5 percent, the average interest rate charged for loans to microenterprises with MG Program resources from Banco Agricola was 19.8 percent, the average of Bancorp was 22 percent, the average of Bancasa was 16.6 percent, and from Banco Salvadoreño it was 17.5 percent (BMI Progress Report). At the same time, the lowest interest for individual credit was 14 percent for Banco Agricola, while Calpiá was charging 36 percent (IDB, EVO WP-7/98, p.10).[3] Subloans were in local currency and could not exceed 48-month terms.

Table B.5
El Salvador Market Interest Rates

	1995	1996	1997
Market deposit rate %	14.37	13.98	11.77
Market lending rate %	19.08	18.57	16.05
Avg. market spread %	4.71	4.59	4.28
Inflation %	10.07	9.8	4.46
BMI rate to IFIs %	14.5	14.5	12.5
*Calpiá MG rate to clients	36-48%	36-48%	36%

Source: IMF International Financial Statistics and BMI,
*Maciel 1996 and IDB (WP-7/98)

Excessive Transaction Costs

The increased participation of banks was impeded by excessive transaction costs in terms of both rediscounting and environmental requirements. Since the BMI did not have a management information system that could process the IFIs' information, all of the credit information for rediscounting and monitoring was recorded and transferred manually, a drain on resources for the IFIs and the BMI, which often requested previously submitted information. The exception was Calpiá, which had developed its own software to monitor and report on loans, permitting BMI easy analysis of data, and ultimately faster rediscounting.

IFIs were also deterred from participating because of the MG program's environmental requirements. The resources were only permitted to finance activities that were allowed by national environmental standards. Every subloan request included an environmental classification, and if a subloan presented a high environmental risk, the subborrower was required to take the proper measures to prevent or mitigate the ecological effects of the activity. During program execution, BMI submitted reports to the IDB of the environmental effects of projects financed, based on samples from participating IFIs. This was the same requirement in place for larger IDB loans, but in the context of thousands of much

[3] An evaluation in July 1996 found that there was a distinct difference between the lending of Calpiá and the other participants. Calpiá was lending at an effective rate of 36-48 percent annual, with an average loan size of $578, for terms between 7 and 12 months, without guarantees, and using IPC credit technology. Commercial banks were lending at effective rates of 17.5-25 percent annual, with average loan size of $2,250, for 12-48 months, using housing and A class portfolios in the case of lending to Cajas de Credito, or traditional bank credit analysis, thereby excluding most informal sector borrowers (Maciel, 1996).

smaller loans it was a difficult requirement for the IFIs to comply with. Actual environmental assessments are expensive, and the program did not include training for credit officers in environmental screening of loan applicants.

Lack of Technical Assistance for IFIs

The MG program did not include a technical assistance program to help with technology transfer to IFIs. During the design phase of the MG program, a review of the existing programs providing technical assistance and training in the country for MFIs and microenterprises concluded that with 8 government and 30 private institutions providing these business development services to microenterprises, there already existed an overabundance of programs to strengthen the administrative capacity of microenterprises (IDB, PR-1946, p.24). Furthermore, the existing IFIs were deemed to have the necessary technology for microlending, and technical assistance to help NGO MFIs to upgrade was not included. Commercial banks were continuing to use traditional credit analysis, and focusing on small enterprise, rather than microenterprise. Since they were already operating under the assumption that this was indeed microfinance, they saw no need to change their operating procedures for the purposes of obtaining the MG funds and did not avail themselves of existing technical assistance.

The years of intense technical assistance that Calpiá received from GTZ, IDB and MIF, as well as the provider, IPC, did have a positive effect on the institution, and ultimately on the MG program, as Calpiá was the only institution that truly performed as envisioned in the MG program design. Two IPC consultants worked full time in the institution, providing continuous feedback and motivation. However, this assistance was financed outside the MG program.

Lessons Learned

More research is needed in the analysis phase of program preparation to identify how to get commercial banks interested in microfinance. Alternatively, if it is determined that they will not participate at the desired level, program design should focus on other participants.

In the case of El Salvador, a credit line to Calpiá would have developed the industry in a similar manner, with lower administrative costs. However, readily available financing is the key to expanding operations of recently created formal MFIs.

El Salvador's MG program suffered from the lack of technical assistance. Although its inclusion would not have guaranteed downscaling by banks, it may have increased their participation in the program. The MG program benefited from the generous technical assistance that others provided previously and concurrently to Calpiá. This technical assistance, along with MG credit resources, had a major impact on microfinance in El Salvador.

Credit resources alone do not create competent microfinance retailers. Loan funding must be made available to institutions with the capacity for reaching microenterprises, or be coordinated with a technical assistance program to transfer microfinance technology to existing formal IFIs.

Favorable policy environment is fundamental for healthy expansion of microfinance. This includes the ability to set interest rates freely, at a level sufficient to cover operating and financial costs. Transaction costs should be kept at a minimum. For example, in order to induce IFIs to participate, programs should automate reporting, streamline disbursements, and locate environmental components in institutions with the capability for executing them, not with IFIs.

IFI selection and performance criteria should be consistent with microfinance. The most important IFI in the program had problems meeting the criteria, although their operational results were within the performance ranges for efficient microfinance institutions.

Bibliography

BMI. 1997. Informe de Progreso: 1 de enero-30 de junio de 1997. Programa Global de Crédito para la Microempresa (780/OC-ES, 915/SF-ES). San Salvador, El Salvador.

Financiera Calpia. 1995-2000. Audited Financial Statements. San Salvador, El Salvador.

Inter-American Development Bank Official Bank Document. 1993. El Salvador: Programa de Crédito Global para Microempresas (ES-0037). Washington D.C.

Inter-American Development Bank Official Bank Document. 1998. Informe de Terminación de Proyecto: Programa de Crédito Global para la Microempresa (780/OC-ES, 915/SF-ES). Washington D.C.

Inter-American Development Bank and Ayala Consulting. 1998. Estudio de Caso: Programa Global de Crédito a la Microempresa (GMC), El Salvador (WP-7/98). Washington D.C.

Inter-American Development Bank Official Bank Document. 1998. Evaluation of Global Microenterprise Credit: Summary of Three Case Studies – Ecuador, Paraguay, and El Salvador (CF-4/98). Washington D.C.

Inter-American Development Bank Official Bank Document. 1999. Impact Assessment Review Peer Review Draft: El Salvador Global Microenterprise Credit Program (GMC). Washington D.C.

Maciel, José. 1996. Programa Global de Crédito para la Microempresa: Situación actual en El Salvador y Nicaragua. Washington D.C.

Annex C

CASE STUDY:
Paraguay

Paraguay had two successful MG programs: the first was approved in 1992, and the second, in 1997 (see Table C.1 for an overview of programs). Both programs focused on expanding microenterprise access to the formal financial sector, with a credit component channeled through an automatic rediscount mechanism to selected intermediary financial institutions (IFIs), and a technical assistance component to support participating IFIs and microenterprises.

Participating commercial banks and finance companies became active suppliers of credit to microentrepreneurs, and changed the perceptions of traditional bankers about lending to microenterprises. The success of the IFIs that participated in the first phase of the program produced a demonstration effect for others that later began to downscale their operations to serve this traditionally underserved market.

The MG programs also facilitated the introduction of microcredit technology to IFIs, which allowed for significant reductions in credit risk and administrative costs. Similarly, the innovative Voucher Training program for microentrepreneurs associated with the MG programs in Paraguay has helped create a market for training services for microentrepreneurs and has had a demonstration effect for other countries.

The MG I Program

The first MG program credit component totaled $12 million ($10 million IDB and $2 million IFI counterpart), with an accompanying nonrefundable technical assistance component that totaled $2.7 million ($2.5 million IDB and $0.2 million IFI counterpart, see Table C.2). Approved in November 1992, it began disbursement in mid-1994 and ended disbursement in July 1996.

The general objective of the first MG was to increase the flow of credit to microenterprises at market interest rates through regulated intermediary financial institutions. Its specific objectives were: the creation of an increasing and autonomous channel of loans to the microenterprise sector through regulated IFIs; the promotion of a favorable regulatory environment for microcredit; and the development of institutional frameworks that would guarantee continuous access to credit and technical assistance by microenterprises. The MG program was specifically targeted to microenterprises with less than $20,000 dollars in assets.

The program achieved the objective of increasing the flow of funds to microenterprises through 8 regulated IFIs, mainly in the capital city, Asunción. By the end of the program in July 1996, the participating IFIs had provided 11,295 subloans with an average loan size of $1,328 and an average term of 15 months. The average asset size of the microenterprises was $4,400, which shows that the program reached the target market. According to a Banco Central de Paraguay (BCP) survey, 91 percent of the subloans of MG I financed retail trade and services activities, and only 9 percent financed manufacturing and agricultural activities. Table C.2 shows the participating IFIs, their active loan portfolios, interest rates and portfolio at risk as of June, 1997. By then, over 15,000 loans were outstanding, the average local currency interest rate was 4.3 percent and portfolio at risk over 30 days averaged 6.6 percent for the program as a whole.

The MG I proved to be a success by disbursing credits rapidly and effectively in a short time period (two years), obtaining a favorable reaction from both the microentrepreneurs and participating IFIs, offering resources at market rates, and having an efficient executing agency, the Unidad Técnica Ejecutora del Programa (UTEP) within the Central Bank. An outstanding technical assistance component was provided by the German consulting firm, IPC, which brought to Paraguay experience gained in working with the Cajas Municipales in Peru.

The results of the MG I were not as promising in other respects. For Financiera Familiar, the leading IFI of the program (with 60 percent of program resources), microenterprise loans comprised 23 percent of its total portfolio. It was followed by Financopar, with microcredits comprising 10 percent of its total portfolio.

Table C.1
Results of MG Programs in Paraguay

Indicators	MG I (as of 12/31/96)	MG II (as of 12/31/01)
Program Amount	Credit funds: $ 10 million IDB, $2 million counterpart. Technical Assistance: $ 2.5 million IDB, $0.2 million counterpart.	Credit funds: $ 20 million IDB, $2 million counterpart. Technical Assistance: $ 2.2 million IDB, $0.8 million counterpart.
Terms of IDB loan	Ordinary capital, variable rate, 5-year amortization period	Ordinary capital, variable rate, 20-year amortization period
Dates of Operation: Beginning, Ending	November 1992, July 1996	January 1999, Ongoing
Total # Subloans	11,295	44,584 active
Average subloan term	15 months	13 months
Maximum Loan Size	$ 7,000	$ 12,000
Average loan size	$ 1,328	$ 688
Sector coverage	91 % retail trade & services, 9 % manufacturing & agriculture	90 % retail trade & services, 10 % manufacturing & agriculture.
Type of loan	Fixed assets, working capital	Fixed assets, working capital
Participating institutions	8 regulated IFIs	14 regulated IFIs
Institutional Eligibility	Banks and finance companies	Banks and finance companies
percent participation of top IFI	60 % Financiera Familiar (Dec. 94)	44 % Visión de Finanzas
Portfolio at risk over 30 days of top IFI	8.3 % (as of 6/30/97)	2.7 % (as of 12/31/01)
Technical Assistance	To Exec. Agency (UTEP), IFIs and Microenterprises	To Exec. Agency (UTEP), IFIS, and Microenterprises
General Objective	Increase the flow of credit at a reasonable price for microenterprises through regulated financial institutions and according to market mechanisms.	Support the development of the productive capacity and entrepreneurship of microenterprises.
Specific Objectives	Create access to credit for microenterprises through regulated institutions; promote knowledge of special requirements of microcredit; and develop a new institutional framework to guarantee microenterprises access to continuous credit and TA.	Facilitate access to credit for microenterprises through regulated institutions and according to market mechanisms, consolidate channel of credit to microenterprises and improve regulatory environment for access to formal financial system; support change in commercial banks to improve supply of microcredit; and expand participation of other financial institutions, including credit unions.

However, for the rest of the participating IFIs, the microenterprise portfolio represented less than 5.5 percent of their total net portfolio, evidence of limited institutionalization of microfinance. Second, the high interest rates set by the IFIs were evidence of high operating costs. Third, all major participating IFIs were located in Asunción, and focused on the urban market, thereby limiting rural coverage.

The MG II Program

The MG II had a credit component of $22 million ($20 million IDB funds and $2 million IFI counterpart) and an accompanying technical assistance component of $3 million ($2.2 million IDB funds and $0.8 million counterpart). The MG II started disbursement in January 1999, and by December 2001 the majority of the funds had been disbursed through fourteen participating IFIs. Although the technical assistance program which was part of MG I and led by the IPC ended in March 2001, the UTEP, which continued as the executing agency for the second program, managed the program independent of external consultants.

The specific objectives of the MG II were to facilitate access to credit by microenterprises through regulated financial institutions, in accordance with market mechanisms; consolidate an autonomous and continuous channel of credit to microenterprises and reduce the regulatory obstacles that restrict access to formal financial markets; support changes in commercial bank practices to increase supply of credit to microentrepreneurs; and expand the participation of other financial institutions, including credit unions, once their institutional and regulatory structure allows them to participate in the program.

By December 2001, an accumulated total of 115,000 loans had been provided at an average monthly interest rate of 4.6 percent and average term of 13 months. The total number of outstanding loans was 44,584, with an average loan size of $688 (see Table C.3). The low average loan size is evidence that the MG program II is reaching the target group. As of September, 2001, the total outstanding micro-

Table C.2
MG Program I Major participant IFIS as of 06/30/97

IFI	Length of time in MG program	Evolution of Outstanding Loan Portfolio			Monthly Effective interest Rate (local currency)	Portfolio at Risk more than 30 days
		Months	# Active Loans	Volume (US $'000)		
Familiar	30 months	Dec. 94 Jun. 97	339 7,999	412 8,332	4.0 %	8.3 %
Visión	18 months	Dec. 94 June 97	51 3,018	62 4,297	4.7 %	2.1 %
Fincresa	30 months	Dec. 94 June 97	228 1,378	127 1,393	4.8 %	7.5 %
Banco Nac. de Trabajo	30 months	Dec 94 June 97	323 1,151	547 1,468	3.3 %	9.0 %
Interfisa	12 months	Dec. 94 June 97	96 1,028	84 868	5.8 %	2.7 %
Others	24 months	Dec 95 June 97	305 703	367 808	4.5 %t	12.0 %
Total	30 months	June 97	15,277	17,166	4.3 %	6.6 %

Source: UTEP, BCP

Table C.3
MG II Participant IFIs as of December 31, 2001

IFI	Credits in portfolio	Average balance ($)
Visión de Finanzas	15,202	701
Financiera Familiar	8,854	550
Interfisa	7,674	681
El Comercio	5,023	413
FIGESA	2,571	864
Banco Regional	2,254	838
Multibanco FINCRESA	1,687	523
Financiera Itacua	1,319	1,062
Total	44,584	688

Source: UTEP, BCP

enterprise portfolio of participating institutions had reached $32 million while only $10 million had been rediscounted from the Central Bank. This is evidence that the IFIs were already using their own funding sources (70 percent), suggesting that microcredit had become a sustainable product. As in the first program, credit reached mostly the retail trade sector (69 percent), although it expanded in other sectors such as the service sector (21 percent), manufacturing sector (10 percent) and rural sector (1 percent). Most of the microenterprises were one to two employee firms. Data from an evaluation report dated April 1999, indicated that 61.4 percent of the microenterprises that received credit had one employee, and 21.2 percent had two employees.

Overall, the three dominant IFIs show that the microcredit product produces good results. As of December 31, 2001, more than six years since the beginning of the first MG program, the microenterprise portfolio represented a significant percentage of these IFIs' total portfolio, as shown in Table C.4. Portfolio at risk for more than 30 days was no more than 7.7 percent (for Visión), and portfolio at risk for more than 90 days was no more than 3 percent (for Familiar). Compared to traditional IFIs in Paraguay, these were lower rates of loan delinquency. Additionally, compared to traditional commercial banks average net income was only slightly lower: 10.2 percent for microfinance intermediaries compared to 10.5 percent for traditional formal financial intermediaries[1].

Prior to the execution of MG program, most of the financial intermediaries were dedicated to other market segments. Such is the case of the three dominant IFIs: Visión de Finanzas, Interfisa Financiera and Financiera Familiar, which, by the end of the last disbursement of the MG I program, had established specialized microfinance loan officers within a more traditional organizational structure. For these institutions the primary reason why they participated in the MG program was the diversification of their client base, and the possibility to supply services to a new market segment. These IFIs represent an example of finance companies downscaling. Other commercial lenders entering the microenterprise market as a result of the MG programs include Finansud & General S.A, El Comercio Financiera and the Banco Regional.

Both MG programs targeted mainly urban microentrepreneurs, specifically in the capital

[1] UTEP presentation report "Funcionan los modelos de segundo piso para el desarrollo de las icrofinanzas?" for the IV Microenterprise Forum, Innovations for Microenterprise Development, November 2001.

Table C.4
Participation of Microcredit in Total IFI Portfolio
December 31, 2001

IFI	Share of Total Portfolio (%)	Portfolio at Risk (>30 days) (%)	Portfolio at Risk (>90 days) (%)
Visión de Finanzas	32	7.7	2.7
Financiera Familiar	19	6.2	3.0
Grupo Interfisa	15	4.4	2.8

Source: UTEP, BCP

city, Asunción. The second MG program aimed at expanding services to rural microenterprises with limited success. It was able to disburse 40 percent of the program resources to the cities outside Asunción, and to a very limited number of rural microentrepreneurs (less than 1 percent of the microenterprise portfolio reached rural microenterprises). Some participating IFIs are continuing to expand microfinance to rural areas through the IDB/MIF funded Line of Activity for individual IFIs.

Microcredit Grows Under Recession

The first MG program in Paraguay was developed in the context of an economic recession after a period of high growth in the eighties. In 1989, the new government adopted a structural reform package to stabilize the economy, reduce fiscal deficit, liberalize interest rates, and introduce open market operations. Inflation rates decreased from 44 percent in 1990 to 11 percent in 1992. Average GDP growth rose during 1989-1991 to 3.7 percent, but decreased during 1990-95 to 3.1 percent. Unemployment rose and production decreased in the agricultural sector as well as other productive sectors. This led the traditional IFIs to explore new markets, offering credit to a large and growing informal microenterprise sector. The MG I program was a catalyst for enabling interested IFIs to open new markets by channeling fresh funds to reach microenterprises.

The second MG program was developed in a fragile macroeconomic environment due to serious difficulties in the financial sector and slow growth. The agricultural sector experienced low productivity and regional trade; public sector investment also decreased. Due to the financial sector problems there was a credit squeeze, causing interest rates to rise, and demand from private enterprises to contract. However, the MG II provided fresh funds and continuous technical assistance to the selected participant IFIs.

Financial Sector

During the 1990s Paraguay had an incipient financial sector, inadequate regulation of financial movements, and underdeveloped capital markets. Due to the rapid inflow of money associated with drug smuggling, a large number of banks and finance companies emerged. By 1995 Paraguay's financial market consisted of 13 foreign banks, 20 national banks, 68 finance companies, 40 insurance companies, and 183 financial cooperatives. For Paraguay's small economy this was an overexpansion of financial intermediaries.

Since 1995 Paraguay has been experiencing a financial crisis, a situation that has led to the closing of 9 banks, and over 30 finance companies (financieras). By 2001, the financial sector was comprised of 10 foreign banks, 9 national banks, and 22 finance companies.

Several types of financial sector reforms were implemented, including the liberalization of interest rates, and insurance deposits, the elimination of subsidized interest rates, and the implementation of improved prudential regulations and supervision for the banking sector (including independent external audits, and capitalization based on portfolio risk), financial reporting and rating of financial institutions. In addition, the government introduced the new Central Bank Law, and a Bank and Financial Entities Law, which established strict requirements of minimal capitalization and financial provisioning. The process of consolidation of the financial sector continued with mergers and liquidation of some institutions.

The Paraguayan government's stabilization policies had a positive impact on the financial sector. Savings deposits increased significantly due to increased consumer confidence, and there was an increase in credit for private firms. However, financial reforms were very slow. Even though interest rates had been declining, they were still very high, and the structure of the short terms for bank deposits constituted an obstacle to the market of long term deposits and thereby an obstacle for economic growth.

Microcredit surged amidst this unstable financial environment. The declining growth of the agricultural sector, changes in banking regulations which liberalized the financial system and eliminated interest rate ceilings, the pressures of competition, and a growing demand for credit from microenterprises have created an incentive for IFIs to explore other market segments in search of new clients.

Large Microenterprise Sector

The microenterprise sector represents a large portion of economic activity in Paraguay. In 1990 microenterprises accounted for 64 percent of the economically active employed population of the country. A 1998 household survey showed that there were an estimated 987,326 microenterprises in Paraguay, most of which are informal. The majority of these enterprenerus are small traders, farmers and independent workers. They resort to self-employment as a way to survive in the face of high unemployment. Apart from family, friends and informal money lenders, these microenterprises lacked access to financing to expand their businesses, and thus constituted a ready market for microfinance services.

An Incipient Institutional Base

Before the MG program, a number of non-regulated institutions had experience in serving the microenterprise sector by offering short terms loans at very high interest rates. This existing institutional framework included private credit providers (money lenders, family members and relatives), the Cajas de Credito--that offered a substantial number of small consumer loans to urban salaried workers and to small enterprises, and the public sector banks including Banco Nacional de Fomento (BNF) and the Banco Nacional del Trabajo. These banks received massive transfers of capital (subsidies) from the government to compensate for high losses, and had severe structural problems including low productivity and high administrative costs. The Fundación Paraguaya de Cooperacion y Desarrollo (FUPACODE), affiliated with ACCION International, was the only financial NGO that provided credit and technical assistance to microenterprises in Paraguay. Unlike in other countries where the IDB approved MG programs, the impetus for microfinance in Paraguay came from the Cajas de Crédito, and local consumer lending companies that wanted to expand their market.

Effective Executing Agency

The Unidad Técnica Ejecutora del Programa (UTEP) of the Central Bank of Paraguay (BCP), was created as a special executing unit to administer the funds of the MG loan programs and their technical assistance components. With the assistance of Internationale Projekt Consult (IPC), a German consulting firm, this office was very effective in the execution of the two programs. A staff of five managed and monitored the performance of the participating IFIs. The UTEP's effectiveness and leadership in the program contributed significantly to its success. The location of the UTEP inside the Central Bank (CB) and its leadership by experienced CB staff made disbursement of loan funds efficient and thereby reduced the transaction costs for participating IFIs. Reporting by IFIs was facilitated by the use of formats stored on diskettes.

Selection Criteria, Supervision and Monitoring

Even in the midst of a financial crisis, the program executing agency, with the support of the Superintendencia de Bancos (SB), enforced strict selection criteria for participating IFIs, and conducted rigorous auditing and monitoring of performance during MG I, such as: i) IFIs should be regulated financial institutions subject to the supervision of the Superintendencia de Bancos; ii) IFIs should maintain a capital adequacy ratio of at least 8 percent of risk-weighted assets; iii) IFIs should maintain portfolio at risk over 30 days of no more than 10 percent; iv) IFIs should maintain portfolio at risk over 90 days no greater than 3 percent; v) profits must not be negative; and vi) the portfolio classified in categories C, D, and E cannot be greater than 10 percent.

MG II required that IFIs: i) be regulated by the SB; ii) show evidence of the capacity to evaluate and administer microcredits; iii) maintain a capital adequacy ratio no less than 10 percent; iv) maintain portfolio at risk over 60 days no greater than 10 percent; v) maintain portfolio at risk over 90 days no greater than 3 percent; and vi) show profits greater than or equal to zero.

The strict enforcement of the selection criteria contributed significantly to the success of the program, but did prevent many institutions from participating. Six finance companies and two commercial banks were selected and participated in the first MG, and 14 IFIs were selected for the second MG Program. After two mergers and the buyout of some portfolios, the cancellation of some IFIs from the program, and the addition of a new finance company, the number of participating IFIs has been reduced to a current level of nine: Financiera Familiar, Multibanco, Visión de Finanzas, Interfisa, Figesa, El Comercio, Financiera Itacua, Regional, and Financiera Financentro.

The Cajas de Crédito, credit unions and FUPACODE were not permitted to participate in the MG programs due to their nonregulated status. However, several of the most prominent Cajas de Crédito were transformed into finance companies and became the leading participants in the MG programs. It was hoped that in MG II, rural microenterprises could be reached through credit unions. Credit unions have traditionally played an active role as financial institutions serving low-income clients. These institutions still required significant institutional strengthening, and were in the process of being regulated by the SB. A technical cooperation from the Multilateral Investment Fund (MIF) was granted to the SB to help strengthen the credit unions to enable them to be more efficient in their operations. Eight credit unions, five from the capital city and three from other cities, are being audited and strengthened under this initiative, so that they might eventually be able to participate in the MG program. The future participation of the credit unions would be an important help to the MG program in reaching more rural microenterprises.

Small and Flexible Microfinance IFIs Develop in Search of New Market Niches

The IFIs that participated in both phases of the MG program were small and flexible financial intermediaries with an interest in expanding financial services. After the second phase of the MG program, three IFIs have been recognized as leaders in the Paraguayan microfinance market. These are Financiera Familiar, Visión Financiera, and Interfisa Financiera, which represents a case of a finance company "downscaling."

The dominant IFI during the first MG, Financiera Familiar, was previously a Caja de Crédito that benefited from the liberalization polices, transforming into a Financiera. As of September 31, 1986, it had 6,476 active microenterprise clients and a loan portfolio of $6.3 million, which represented 23 percent of its total loan portfolio. Now with 70,000 clients, Financiera Familiar is the leading consumer credit institution in Paraguay, and has a focus on expanding through market niches, including 8,500 microenterprises. In the first phase of the program, it accounted for more than 50 percent of the MG program portfolio. Due to its continuing use of consumer credit technology, Familiar had a negative experience with the microenterprise sector. This led to high operating costs and high default rates. However, in the second phase of the MG program, Familiar adopted microcredit technology by eliminating its billing department, and introducing variable pay (incentive scheme) for loan officers. The results were very positive, ranking this IFI as the second dominant IFI of the MG II program.

In the MG II, Financiera Visión became the most active IFI. Visión started the program in December 1996 and today it is the microenterprise market leader with a portfolio of $14 million and 15,000 clients. It has expanded its outreach through the expansion of its agencies throughout the country. It currently has 19 agencies in the major cities and towns. Initially Visión used consumer credit technology and by 1997 high default rates led the IFI to a total change to microcredit technology.

Interfisa Financiera, with 22 years of experience in the financial sector, started providing credit to the microenterprise sector in 1996 through the MG program. Interfisa was dedicated to corporate banking but was being pushed aside by competition and was attracted to the microfinance market with the support of the MG program. It began offering a limited number of microcredits through a centralized and specialized unit, led by its general manager. After a pilot program, Interfisa experimented with a new microcredit technology obtaining positive results, thereby convincing its management and shareholders of the risk management capabilities and profitability inherent in new microcredit product. Interfisa has downscaled operations with 15 percent of its loan portfolio aimed at the microenterprise market.

Table C.5
Active Loans and Interest Rates in MG Programs, 1994-2001

	Dec. 94	Dec. 96	Dec. 97	Dec. 00	Dec. 01
No. of active loans	567	7,667	19,779	37,183	44,584
Average monthly interest rates	7.8 %	5.5 %	4.5 %	5.7 %	4.7 %
Annual commercial bank loan rate	35.5 %	31.9 %	27.8 %	26.8 %	28.3 %
Annual interest rate from BCP to IFIs			18 %*		20.1 %

*Source: UTEP, BCP. * As of June 30, 1997*

Competitive Industry

Both MG programs emphasized the importance of allowing the IFIs to set interest rates freely to cover costs and earn profit margins. The interest rate charged by the Central Bank to IFIs was 18 percent as of June 30, 1997 (MG I), and 20 percent as of December 31, 2001 (MG II). The commercial lending rate was 28.1 percent as of June 30, 1997, and 28.3 percent as of December 31, 2001. Due to high operating costs, the sub-loan interest rates were usually high. The average monthly interest rates ranged from 7.8 percent in December 1994, to 4.6 percent in June 2001, in local currency. Interest rates on microloans have been significantly reduced, thanks to the economies of scale that the IFIs have achieved due to an increase of the microenterprise portfolio and to the competition between IFIs. The following Table shows the growth in subloans, and the gradual reduction of interest rates.

Technical Assistance

The MG assisted in covering start-up costs for investments in computer systems and training, and provided technical assistance to IFIs to set up appropriate technology for microlending. The Technical Assistance component of the MG I had the following specific objectives: i) support the executing agency; ii) transfer microcredit technology to participating IFIs; iii) bring technical assistance to microentrepreneurs; iv) create environmental awareness among microentrepreneurs and the IFIs and increased participation of women; and v) help the Central Bank and SB in regulatory reform of supervision of microcredit.

The technical assistance component of MG II was designed to: i) transfer microcredit technology to participating IFIs; ii) identify and reduce regulatory and institutional impediments to microenterprises' access to credit; iii) strengthen cooperatives that are eligible for the credit program; iv) help with environmental impact review of microenterprises; and v) stimulate the participation of women in the program.

The German consulting firm IPC provided highly effective technical assistance to the UTEP in the areas of finance and management information systems. The UTEP received support in developing a rapid and agile rediscounting system, elaborating an accounting manual and registry of loan operations, designing and implementing statistical and reporting standards, designing an evaluation mechanism and coordinating consulting services of the program.

IPC supported the implementation of technology transfer to participating IFIs by training loan officers and providing technical advice for the installation and use of information systems for micro-loan management. As part of the training, external consultants accompanied loan officers to visit clients who were in arrears. Training was provided to 167 new loan officers, creating a new practice in the country. By June 2001, over 500 loan officers were trained. This training included the transfer of knowledge in the use of software for the administration of the loan portfolio. According to an IDB survey, IFIs recognized that the institutional strengthening component of the program supported the credit component, which was useful first in helping to build new branches, train the loan officers, provide technical assistance at management level, and install a computerized system.

Voucher System for Microenterpise Training

Unlike other MG technical cooperation programs, the Paraguay programs included a subcomponent for microenterprises, which partially financed training courses for up to 8,000 microentrepreneurs by providing a direct subsidy to the target group in the form of a voucher. The rest of the costs were absorbed by the microentrepreneurs. 15,125 vouchers were distributed, going beyond the program's goal. Technical, production and business development courses were offered to microentrepreneurs, targeting more than 85 percent beneficiaries, who considered that the voucher program was useful for the supply of courses.

This innovative demand-driven training system allowed microentrepreneurs to choose the training courses and providers. A total of 41 training institutions offered 1,303 courses, averaging 17 hours per course. The Enterprise Support Center and the Regional offices of the Ministry of Industry and Commerce distributed the vouchers, which were valued at approximately $20 each. On average, this amount covered up to 60 percent of the total cost of each course.

Participation of Women Microentrepreneurs

More than 50 percent of one-person microenterprises, and 45 percent of the total number of microenterprises in Paraguay are led by women entrepreneurs. The first MG program was successful in providing services and technical assistance to women microentrepreneurs, putting an emphasis on training loan officers to serve women clients. In fact, 50 percent of total credits were provided to women entrepreneurs. Similarly, 40 percent of the credits provided under the MG II program reached women entrepreneurs.

The technical cooperation component introduced the training courses aimed at women microentrepreneurs through a specialized government agency known as the Secretaria de la Mujer, allowing 14,000 women entrepreneurs to use vouchers for training.

Impact on the Environment

The technical cooperation included an evaluation of the environmental impact of the activities of client microentrepreneurs. A case-study report on 100 microentrepreneurs who received the program funds showed that the program funds did not produce negative impacts on the environment.

Lessons Learned

For IFIs participating in the MG programs, the major contribution of the programs was their support for these IFIs' entrance into a new market segment and/or the growth of a new client base. Financial intermediaries credited the MG programs with changing their perception towards microenterprise clients and allowing them to develop a new microfinance technology in their loan operations. Participating IFIs were able to develop trust in a new sector and learned that atomizing risk is good business.

According to an IDB survey, the main reasons given by IFIs for participating in the MG programs were:

- Access to new sources of long-term financing at market interest rates, and

- Techncial assistance to develop new products and services for the microenterprise market.

Other reasons cited, which were outside the control of the MG programs themselves, included:

- Falling productivity and revenues in larger enterprises, making the growing microenterprise sector more attractive.

- Competition among commercial banks and finance companies for traditional market segments.

Although the MG programs helped address major obstacles that traditional IFIs faced in lending to microenterprises, a few of the participating IFIs considered that some of these obstacles continued to limit the expansion of credit services to microentrepreneurs. The most often cited obstacles were:

- Perceptions that microenterprises were high risk businesses.

- High operating costs associated with lending to microenterprises.

- The absence of a centralized credit registry for smaller loans in the country (although this was one of the objectives of the MG II program, it was not implemented).

- A legal and regulatory framework which inhibited credit unions from entering the microfinance market (although included in the MG II program, this component could not be executed).

Despite the reservations of a few IFIs, the preceeding comments from participating IFIs and the statistics presented at the outset of this case study show that the Paraguay MG programs were successful in expanding the numbers of microenterprises access to formal sources of credit, while avoiding negative impacts on participating financial institutions. Important lessons can be drawn from the factors that contributed to the success of the Paraguay MG programs:

- The availability of longer-term financing to IFIs was an attractive incentive for their participation, even though the interest rates charged to these IFIs were set at market levels.

- IFIs participating in the MG progams were able to freely set interest rates on loans to microenterprises at a level sufficient to cover their costs and generate profits.

- Competition among IFIs in traditional markets pushed them to explore new market segments.
- Financial reforms provided an incentive for certain semi-formal IFIs –the Cajas de Crédito– to become regulated finance companies that participated in the MG programs.

- High quality technical assistance offered by the firm IPC and financial incentives to defray start-up costs helped interested IFIs overcome barriers to entry into the microfinance market.

- The leadership of the executing agency – the UTEP office in the Central Bank– and the efficiency of its operations facilitated active participation by interested IFIs.

- The strict eligibility criteria and performance standards for participating IFIs ensured that these IFIs' performance was not adversely affected as a result of their participation in the MG programs.

Bibliography

Raul Duarte, Fleming. 2001. Funcionan los modelos de segundo piso para el desarrollo de las microfinanzas? Programa Global de Credito para la Microempresa II Etapa, Unidad Técnica Ejecutora de Programas. Presentation at the Fourth Inter-American Microenterprise Forum. Santo Domingo, Dominican Republic.

Raul Duarte, Fleming. 2000. Comercialización de Microfinanzas: Bancos Comerciales Proporcionando Servicios Microfinancieros. Asunción, Paraguay.

Banco Central del Paraguay, Unidad Técnica Ejecutora del Programa. 1998. Memoria, Resultados y Perspectivas, Préstamo BID #707/OC-PR. Asunción, Paraguay.

Inter-American Development Bank Official Bank Document. 1992. Paraguay: Programa de Crédito Global para Microempresas (PR-0013). Washington, D.C.

Inter-American Development Bank Official Bank Document. 1997. Paraguay: Programa de Crédito Global para Microempresas II (PR-0094). Washington, D.C.

Duarte-Giménez, Graciela. 1999. Programa Global de Crédito para la Microempresa. Evaluación Intermedia II Tramo.

Banco Central de Paraguay. 1997. El Programa Global de Crédito para la Microempresa: Objetivos y Resultados.

Inter-American Development Bank Working Document and Ayala Consulting. 1998. Estudio de Caso: Programa Global de Crédito a la Microempresa, Paraguay (WP-4/98). Washington, D.C.

Schor, Gabriel. 1996? Draft Version: Commercial Financial Institutions as Micro Lending Partners. Some Lessions of the Micro Global Program in Paraguay.

Annex D

CASE STUDY:
Peru

Peru's first Microenterprise Credit Global Program was from 1995-1998 for $35.7 million ($25 million from the IDB and $10.7 million as counterpart funds). A second program, from 1998-2001, was designed based on this successful experience, for $42.86 million ($30 million of IDB funding and $12.86 million counterpart). Due to the success of these programs and the continued demand for funds, the Government of Peru requested a third MG program. Instead of a separate program, a microenterprise credit component was incorporated into a larger Multisector Credit Program to fulfill this need.

MG programs contributed to an expansion of credit to the microenterprise sector and to the sustainability of microfinance intermediaries (MFIs) in Peru. The programs also had a far-reaching effect by expanding the credit risk data system to include credits under $4,500, thereby helping to lower the risk of microlending.

The MG credit resources were targeted to reach those groups that were traditionally underserved. As shown in Table D.1, the average loan size was $1,017 in the first program and $750 in the second, over 40 percent of the loans went to women, close to 85 percent went to areas outside of metropolitan Lima, and 15 percent were for agriculture. An outside evaluation estimated that nearly half of the amount disbursed in MG I went to new clients (Chully 1998). Participating IFIs stated that the program helped to "extend credit to microenterprise and to the agricultural sector, increase working capital for these clients, improve their circumstances, and teach them a culture of repayment", as well as "increase the number and amount of credits."

Macroeconomic Environment

The first MG program in Perú (1995-1998) was developed in the context of the country's recovery from hyperinflation and the recession of 1988-1992, as well as political stability and decreased violence. The recovery created an environment in which banks were more willing to expand their markets. By 1994, inflation was 15.4 percent, down from 7,650 percent in 1990. However, real GDP at the end of 1994 was still 7 percent below the 1987 level. Between 1993 and 1995, the economy grew 8.9 percent annually, enabling businesses to grow and to demand and utilize credit. Nevertheless, in 1995, it was estimated that half of Peruvians were poor and that around 20 percent were living in extreme poverty. During the economic crisis, as families employed new strategies for survival, the microenterprise sector grew.

The second MG program (1998-2001) was affected by the international financial crisis of 1998, exacerbated by El Nino. In 1998, GDP grew by only 0.3 percent, and by 3.8 percent in 1999. Credit was restricted, causing interest rates to rise, and demand was contracting. Bank arrears were rising, reaching 8.8 percent by March 1998, up from 7.9 percent at the end of 1996. Arrears were even higher in consumer and microfinance portfolios. Average return on equity in the banking sector dropped from 9.9 percent in 1998 to 4.1 percent in 1999. This downturn caused a consolidation of the banking sector and increased caution

Table D.1
Basic Indicators of MG I and MG II

Indicators	MG I (as of 6/30/98)	MG II (as of 9/30/01)
Program Amount	Credit: $25 million IDB, $10.7 million counterpart. Technical Assistance: $2.75 million Swiss Development Cooperation Agency, $1.2 million counterpart.	Credit: $30 million IDB, $12.86 million counterpart. Technical Assistance: N/A
Terms of IDB loan	2 percent annual interest, 30-year term, 7-year grace period	Variable rate of IDB cost of funds + .75 percent (close to 7 percent), 25-year term, 3.5-year grace period + commissions of 1.75 percent
Beginning/Ending dates	September 1995 - May 1998	September 1998 – October 2001
Total # subloans	31,038	71,336
Average loan size	$1,017	$750
Maximum loan size	$10,000/ avg. $5,000	$10,000/ avg. $5,000
Sector coverage	67 percent retail, 12.5 percent service, 9.4 percent agriculture, 8 percent industry	52.8 percent retail, 21.2 percent service, 15.5 percent agriculture, 6.3 percent industry, and 4.2 percent transport and other
Type of loan	74 percent working capital 26 percent fixed assets	80.2 percent working capital 19.8 percent fixed assets
Institutional eligibility	Banks, finance cos., CMACs, CRACs, EDPYMEs	Banks, finance cos., CMACs, CRACs, EDPYMEs
percent rural	85 percent outside Lima	82 percent outside Lima
percent women	45 percent	43 percent
# participating IFIs	16 (5 banks, 7 CMACs, 3 CRACs, 1 EDPYME)	15 (2 banks, 9 CMACs, 1 CRAC, 3 EDPYMEs)
percent IFI concentration	Top IFI 24 percent (CMAC Arequipa); Top 3 IFIs 54 percent (Banco Orion 18.3 percent, Banco Wiese 12.4 percent)	Top IFI 43 percent (Banco del Trabajo); Top 3 IFIs 76 percent (CMAC Piura 23 percent, CMAC Sullana 10 percent)
Portfolio at risk of top IFI	CMAC Arequipa –5.1 percent	Banco del Trabajo –6.8 percent
Technical assistance	Executing Agency, IFIs, Microenterprises, Financial system	None
General objective	To "broaden access to formal credit for formal and informal urban, suburban and rural microenterprises, with a view to fostering the ability of the low-income population with entrepreneurial talent to utilize the economic opportunities available in the country."	
Specific objective	To "equip the intermediary financial institutions (IFIs) participating in the programs to be able to meet, in a self-sustaining fashion and to an increasing degree, the credit demand of microenterprises, also using local resources for this purpose, with due observance of environmental requirements."	

towards small and microlending on the part of banks, and had a negative impact on. However, the MG funds enabled specialized IFIs to continue lending to microenterprises during the crisis.

Vibrant Microenterprise Sector

The size of the microenterprise sector in Peru is estimated at 1.4 million urban microenterprises (with less than 10 workers) and 1.4 million rural microproducers (with less than 10 hectares). Lima is estimated to have around 768,000 microenterprises, with 67 percent consisting of one employee. Approximately 80 percent of Peruvian microenterprises are informal and employ six million people, or 75 percent of the economically active population, accounting for 40 percent of GDP.[14] Women account for between 45-50 percent of the informal sector workers. This is one of the densest microenterprise sectors in the region, which has favorably affected demand for the MG program resources.

[14] IDB, Doc RE3-00-005. Case study, 2000.

For the purposes of the MG programs, microenterprises were defined as having no more than 10 employees, and total assets of no more than $20,000, or with no more than 10 arable hectares of land, excluding property.

Financial Market

The Peruvian financial system was devastated by the economic crisis of the early 1990s, resulting in the failure of the state development bank and many credit unions. The banking sector also consolidated dramatically during this period, as the number of banks decreased from 25 during the first MG program, to 15 presently. The financial sector also currently includes 5 finance companies, 14 Municipal Savings and Loan Banks (CMACs), 11 Rural Savings and Loan Banks (CRACs), 13 Small Microenterprise Development Institutions (EDPYMEs), and the credit unions. EDPYMEs, created in 1996, are under the supervision of the Superintendency of Banks, but none are permitted to capture deposits from the public.

At the time of the first MG program, less than 2 percent of the total microenterprise sector was estimated to have access to formal or even semiformal financial services. Traditional commercial banks perceived lending to the sector to be overly risky and costly. Credit history information was not maintained by the Superintendency of Banks for loans below $4,500, and banks did not have specialized credit technology developed for processing large numbers of small loans. This caused lending rates to be high and access difficult.

Competent Institutional Base

An extensive network of specialized financial institutions has been lending to the sector, including some banks and finance companies, CMACs, CRACs, nongovernmental organizations (NGOs), EDPYMEs, and credit unions – with at least 40 specialized regulated institutions.

Mibanco is the only commercial bank specialized in microfinance, and Financiera Solución is the only finance company specialized in microfinance. The most successful nonbanking financial inter-mediaries have been the CMACs, which date back to 1982 and are majority-owned by the municipality in which they are located. They operate outside of Lima, in areas and with clients that the banking sector has not traditionally reached. Microcredits comprise around 68 percent of their total portfolio and the CMACs had combined assets of $319 million as of September 30, 2001. The CMACs have been examples to the rest of the formal financial sector, showing that profits can be made from microfinance activities, even during the shocks from El Nino and the Asian crisis.

Less developed, but contributing to extending the reach of microfinance, are the CRACs, started in 1993, and focused on the rural economy. As of September 30, 2001, microcredits comprised around 79 percent of their total portfolio, and the CRACs’ combined assets were $95 million. The CRACs have suffered from a lack of effective oversight and an excessive dependence on funding from the state-owned development bank, COFIDE. NGOs also lend to the sector and some have been recipients of IDB small projects, but they were not permitted to participate in the MG programs since they are not regulated institutions. The more successful NGOs have converted to EDPYMES, and by the start of the MG Program II, there were seven of these EDPYMES, rising to 13 by the end of 2001. Finally, savings and loans cooperatives also have microenterprise clients, but they have gone through periods of adjustment and some of the most important have been closed.

Table D.2
IFI participation in MG I (as of 6/30/98)

IFIs	$ Disbursed	percent Disbursed	Average Loan Size (3/31/98)*	Portfolio at Risk percent
Banks	**16,438,500**	**50.2**	**903**	
Regional del Norte	728,500	2.2	4,681	7.6
WIESE	4,000,000	12.35	4,392	5.8
Orion	6,000,000	18.25	631	5.9
Del Trabajo	3,700,000	11.3	485	5.5
República	2,010,000	6.1	4,058	2.3
CMACs	**14,100,000**	**43.06**	**1,140**	
CMAC Tacna	850,000	2.59	1,112	3.5
CMAC Cusco	900,000	2.77	1,005	5.6
CMAC Arequipa	7,750,000	23.66	1,320	5.1
CMAC Piura	2,500,000	7.63	780	7.0
CMAC Trujillo	1,500,000	4.58	1,282	15.3
CMAC Ica	400,000	1.22	2,112	10.4
CMAC Maynas	200,000	.61	1,121	5.1
CRACs	**1,920,000**	**5.86**	**1,882**	
CRAC Selva Central	920,000	2.81	1,388	3.2
CRAC Del Sur	400,000	1.22	2,894	6.6
CRAC Cañete	600,000	1.83	2,741	20.9
EDPYMES	**290,000**	**.88**	**2,310**	
Credinpet	290,000	.88	2,310	11.7
TOTAL	**32,748,500**	**100**		

Source: COFIDE, Progress Report as of 6/30/98.
** Evaluation of MG I, Chully and Portocarrero, Aug. 1998, as of 3/31/98.*

Despite this diversified base of MFIs at the time of the preparation of the MG programs, there was room to improve services, increase efficiency, and develop a competitive market, as interest rates and demand were still extremely high.

Effective Supervision and Regulation

The financial sector as a whole, and the microfinance sector in particular, have been favorably affected by the structural reforms of the 1990s, which liberalized interest rates and introduced the application of the Basle criteria. Successive banking laws have strengthened the Superintendency of Banks and Insurance (SBS), increased competition and helped to create a more stable financial environment. Liberalized interest rates have helped microlenders to cover costs. The Banking Law of 1996 brought CMACs and CRACs under the supervision of the SBS, permitted SBS to intervene in nonformal IFIs, and created a new type of formal IFI, the EDPYME. The reforms also strengthened the Credit Registry of the Superintendency of Banks and Insurance. The financial system showed evidence of improvement with increased liquidity of the banking sector as a percentage of GDP, from 5.1 percent in 1990 to approximately 20 percent in 1998.

Efficient Executing Agency

The programs were implemented through the Development Finance Corporation (COFIDE), a second-tier public institution, which allocated funds to eligible IFIs by means of a simplified financing mechanism based on

Table D.3
MG Program II (as of 9/30/01)

IFI	$ Disbursed	% Disbursed	Avg. Loan Size $	Portfolio at Risk percent*
Banks	**26,194,000**	**49**	**659**	
Del Trabajo	23,121,000	43.2	591	6.8
WIESE	3,073,000	5.7	5,046	13.5
CMACs	**22,931,000**	**42.9**	**790**	
CMAC Arequipa	2,039,000	3.8	1,206	5.1
CMAC Huancayo	563,000	1.1	863	5.2
CMAC Ica	1,109,000	2.1	967	10.4
CMAC Paita	543,000	1.0	375	6.5
CMAC Pisco	358,000	0.7	695	9.1
CMAC Piura	12,176,000	22.8	731	6.5
CMAC Santa	171,000	0.3	772	4.1
CMAC Sullana	5,536,000	10.3	882	8.6
CMAC Tacna	436,000	0.8	1,061	4.8
CRACs	**252,000**	**0.5**	**1,313**	
CRAC San Martin	252,000	0.5	1,313	12.3
EDPYMES	**4,134,000**	**7.7**	**1,743**	
Crear Tacna	578,000	1.1	1,894	11.4
Edyficar	3,312,000	6.2	1,742	9.5
Proempresa	244,000	0.5	1,476	9.1
TOTAL IFIs	**53,511,000**	**100**	**750**	

Source: Evaluation of MG II, Chully 2001.
**SBS*

advances and strict ex-post controls. This was the first time MG funds were offered without a rediscount system.

COFIDE's basic function is attracting and intermediating funds to finance investments in public and private infrastructure, and loans to small entrepreneurs and farmers, through IFIs or development organizations. COFIDE underwent a major restructuring in 1990, cutting staff from 570 in 1990 to 114 in 1994. In 1994, COFIDE's total assets were $544 million, with a 3 percent arrears rate, and 2.9 percent return on capital.[15] By the start of the second MG, in 1997, COFIDE's assets had reached $1.18 billion with a rate of return of 1.4 percent, and a 1 percent arrears rate.

COFIDE's experience with multiple credit lines and the simplified disbursement mechanism of the MG programs allowed for the rapid and efficient implementation of the programs, to the benefit of the participants. In the first year, 66 percent of the funds of the first program were disbursed, and both MG programs disbursed the total of their credit funds ahead of schedule. Most participating IFIs express the opinion that COFIDE's performance has been instrumental in helping more credit to reach the final beneficiaries. COFIDE was also responsible for qualifying and monitoring participants.

[15] COFIDE sold its delinquent portfolio to the Ministry of Economy and Finance in 1994. The previous arrears rate was 36 percent and return on capital was zero (IDB, 1995, PR-2074, p. 33).

Strict Selection and Monitoring of Participants

Relatively strict eligibility requirements and periodic monitoring of performance ensured that participating institutions were viable. To qualify for MG program resources, IFIs had to be supervised by the SBS and not be under special action, that is, not have any suits pending with COFIDE. They were required to fulfill requirements regarding portfolio at risk, net profits, and level of current obligations with COFIDE.[16] These criteria were checked each quarter to make sure that performance levels were maintained. Most participants agree that the eligibility criteria were an important factor in helping to expand credit to microenterprises on a sustainable basis, because they ensured that only financially sound IFIs could participate. However, these criteria clearly limited the number of participants. New institutions, such as EDPYMEs, were at a disadvantage in qualifying, and more than half of the nonbanking IFIs did not participate in the program, mainly because they could not meet the requirements. As of Septmber 30, 2001, 10 of 12 CRACs could not comply with portfolio quality criteria. At the same time, 8 of the 12 CRACs and 8 of the 13 EDPYMEs did not show a net profit.

IFI Participation

Each program had almost the same number of participating IFIs, 16 in the first and 15 in the second, but the latter was much more concentrated. The top IFI in MG I, CMAC Arequipa, accounted for 24 percent of the funds disbursed, while in MG II, Banco del Trabajo accounted for 43 percent of the funds disbursed. Tables D.2 and D.3 show the breakdown of disbursements by type of IFI in each program. In each program, close to 50 percent was disbursed through commercial banks, and close to 45 percent through CMACs. In MG I, CRACs disbursed 6 percent and EDPYMEs less than 1 percent. In MG II, EDPYMEs disbursed 7.7 percent, while CRACs only disbursed 0.5 percent of the program resources.

Although banks disbursed the largest amount of program funds, with the lowest average loan size, bank performance in the MG programs did not demonstrate significant downscaling by commercial banks. Without the participation of Banco Orion and Banco del Trabajo, bank average loan sizes would be the highest in the program; over $4,000 (see Tables D.2 and D.3). Banco Orion and del Trabajo were originally consumer-oriented banks, and already focused on small, short-term loans.[17] For them, competitive pressures in traditional lines of business and increased foreign investment in the banking sector spurred competition and new product development in the small and microenterprise market. The three traditional banks that participated in the programs did not truly adopt microfinance technology; they lent larger amounts to larger microenterprises, for longer terms and at lower rates. Peruvian commercial banks had enough challenges with their tradi-

[16] Detailed requirements stipulate that the ratio of an IFI's delinquent portfolio to total gross loans outstanding must not exceed 12.5 percent, or 30 percent more than the average value of the banking system, eliminating the maximum and minimum values. Net profits may not be negative, and aggregate balance of obligations to COFIDE: (i) for commercial bank, finance corporation, leasing company, or consumer credit company, exceed 33 percent of total liabilities; (ii) for CMACs, exceed total deposits; (iii) for CRACs, exceed three times equity, and CRACs that have been operating over two years must show that financial debt to COFIDE is no more than 60 percent of total liabilities; (iv) for EDPYMEs, exceed three times equity; and (v) for credit unions, exceed total deposits.

[17] Both Banco del Trabajo and Banco Orion entered the small and microenterprise market in 1994. Banco del Trabajo entered the microcredit market lending to salaried workers, moving to independent workers and microenterprise owners due to competitive pressures. Banco Orion originated from a holding company and made all of its loans for the purchase of household electric items from the parent company. Orion eventually was sold.

tional lines of business, that expanding into a new market segment such as microfinance, was not a priority.

Recently, some commercial banks that did not participate in the MG programs have begun to move into the small and microenterprise market, such as Banco de Crédito through its subsidiary finance company, Financiera Solución. Mibanco, the only commercial bank specialized in microfinance, was not able to participate due to MG limits on debt with COFIDE.

CMACs were also major participants in the program. The MG I credits represented more than 15 percent of the outstanding small and microenterprise credits of the CMAC system, as of March 1998. CMACs used the MG program funds to complement their other resources. Because of the relatively lower cost of the funds, some CMACs were able to expand to lower-income sectors, while others that usually serve lower-income sectors offered larger loans.[18] Also, the number of specialized microfinance institutions, such as CMACs and EDPYMEs, increased in the MG II program.

IFI Performance

Portfolio at risk as measured by the SBS was relatively low for the most active IFIs in MG I, as shown in Table D.2. For example, as of June 30, 1998, the top three IFIs, CMAC Arequipa, Banco Orion and Banco WIESE had delinquent portfolios of 5.1 percent, 5.9 percent, and 5.8 percent respectively. The financial crisis of 1998 hurt the entire financial sector and many IFIs experienced a deterioration in portfolio quality. Nevertheless, CMACs were able to show positive returns, and were still able to increase their client base and portfolio. Table D.4 shows performance indicators for IFIs in MG II as of September 30, 2001. Portfolio at risk increased slightly for the top three IFIs; 6.8 percent for Banco del Trabajo, 6.5 percent for CMAC Piura, and 8.6 percent for CMAC Sullana. Operating efficiency was high for most IFIs, except for Banco del Trabajo, and growth and financial returns were healthy.

The percentage of CMACs' microenterprise portfolio financed by the MG program either stayed constant or decreased during the programs, signaling increased use of other resources. CMACs expanded their own mobilization of resources toward microcredit through deposit growth. CRACs and EDPYMEs gained experience and increased scale. A new product for agricultural lending was consolidated in CMACs due to their increased experience lending to the sector with MG program resources. One of seven existing EDPYMES participated in the first program, because the rest had been functioning for less than one year and did not qualify, and three participated in the second program. EDPYMES did not have access to many funds, so the MG program resources gave an important boost to their number of clients.

Favorable Terms

The MG program resources have been appealing because they are stable, medium term sources of financing, at relatively low rates of interest. Loans from COFIDE to IFIs are for a maximum of four years, with one year of

[18] As a result, CMAC Ica, with the highest total average loan size ($2,112), had one of the lowest average loan size ($978) of the other CMACs participating in the MG program, while CMAC Piura, with the lowest total average loan size ($780), had the highest average loan size ($1,432). (Chully and Portocarrero, 1998).

Table D.4
Performance indicators for IFIs in MG II (as of 9/30/01)

IFI	% Dis-bursed in MG II	Portfolio at Risk %	% Adm. Costs/avg. portfolio	ROE %	ROA %	%Gross financial margin/fin. Income
Banking system (15)		**10**	**4.7**	**4.5**	**.43**	**49.4**
Del Trabajo	43.2	6.8	30	10	1.2	74.8
WIESE	5.7	13.5	7.9	0.94	0.09	35.5
CMAC system (14)		**5.9**	**13.2**	**26.3**	**3.8**	**67.8**
CMAC Arequipa	3.8	5.1	12.6	37.9	4.6	69.8
CMAC Huancayo	1.1	5.2	12.4	28.8	4.6	69.5
CMAC Ica	2.1	10.4	13.4	13.6	2.7	67.3
CMAC Paita	1.0	6.5	22.2	23.4	4.5	76.2
CMAC Pisco	0.7	9.1	32.1	17.8	4.5	76.5
CMAC Piura	22.8	6.5	10.2	26	2.6	53.4
CMAC Santa	0.3	4.1	17.5	20.1	3.3	70
CMAC Sullana	10.3	8.6	14.6	22.8	3.9	67
CMAC Tacna	0.8	4.8	14.5	26.3	5.5	70.1
CRAC system (11)		**16.3**	**14.3**	**6.2**	**0.9**	**67.4**
CRAC San Martín	0.5	12.3	17.6	4.4	0.6	70.2
EDPYME system (13)		**8.2**	**18.8**	**5**	**2.1**	**80**
Crear Tacna	1.1	11.4	18.6	7.6	1.7	73.6
Edyficar	6.2	9.5	17.1	16.7	4.2	81.1
Proempresa	0.5	9.1	28.1	3.7	0.9	71.9

grace, in U.S. dollars or local currency.[19] IFIs are advanced funds and have 90 days to disburse the resources or return them to COFIDE. Each subloan may not exceed $10,000 and the average may not exceed $5,000.

The IDB rate to the Central Bank was 2 percent in the first MG program and variable in the second. The minimum interest rate to IFIs is tied to the market, as the average rate payable on fixed-term deposits of over 360 days, in foreign currency, adjusted for the reserve requirement. IFIs assume the credit risk and set their own interest rates to the client. The rates to IFIs have been comparatively low. The rates were never higher than 7.78 percent in MG Program I, or 8.48 percent in the second, compared with 10 percent for short-term external financing for small banks. Interest rates in U.S. dollars as of March 1998 were between 10.5 and 12.5 percent for corporate banking clients, between 16.5 and 20 percent for medium-sized firms, while most personal loans were between 15 and 27 percent, but reaching as high as 120 percent annual in U.S. dollars (Culley and Maisch, 1998, p. 49).

[19] Originally loans could only be in U.S. dollars, but in September 1997, the agreement was modified to allow local currency loans.

COFIDE offered two other credit lines for CMACs, CRACs, and EDPYMEs that were more permissive in terms of acceptable arrears levels, but were less favorable in terms of interest rate and terms. However, CMACs and EDPYMEs utilized the MG funds for a significant portion of their COFIDE funding; approximately 60 percent for CMACs in each MG, and 42 percent in MG I and 65 percent in MG II for EDPYMEs. The MG IFIs comprised 15 percent of COFIDE's portfolio as of March 31, 1998 and 17 percent of the portfolio as of September 30, 2001.

During the MG Program II, external factors have made the terms less favorable as compared to other funding sources. Pension reform measures have resulted in increased savings mobilization by CMACs. This slowed the disbursements of the MG program and it is an indicator of the further development of CMACs. Final rates to subborrowers continue to vary greatly, as seen in Table D.5.

The majority of loans in both programs were for 7 to12 months. For Banco del Trabajo however, 55 percent of credits disbursed under MG II were for loans with 10-to-12-month terms (Chully 2002, p. 47).

The ex-post evaluation of MG II estimates that the effective cost for Banco del Trabajo microcredits ranges from 62 to 235 percent, much higher than the other IFIs charge (Chully, 2002, p. 48). Table D.6 shows that spreads for IFIs in the program are high, and higher in soles. The average spread enjoyed by IFIs for credits in soles is 51 percent, versus 21 percent for U.S. dollars loans. The majority of MG credits are in local currency, thereby increasing returns to IFIs.

Technical Assistance

The first MG program was approved with an

Table D.5
Interest Rates and Terms of IFI Credits to Microenterprises in MG Programs

Type of IFI	Average effective annual interest rate, percent local currency (soles)	Average effective annual interest rate, percent foreign currency ($)	percent of loans 0-6 months	percent of loans 7-12 months	percent of loans 13-18 months	percent of loans 19+ months
MG I (as of 3/31/98)						
Total IFIs	70.8	37.7	16.3	41.4	21.6	20.7
Banks	73.8	41.6	7.9	26.1	33.7	32.3
CMACs	70.4	31.4	18.9	58.7	12.0	10.4
CRACs	63.9	22.7	57.5	30.3	1.9	10.3
EDPYMEs	n.a.	34.5	21.4	75.3	3.3	0.0
MG II (as of 9/30/01)						
Total IFIs	72.5	47.2	20.9	59.3	12.8	7.0
Banks	71.1	46.0	11.0	70.8	12.8	5.3
CMACs	74.5	51.2	34.5	46.6	11.1	7.7
CRACs	n.a.	28.1	4.7	72.2	10.1	13.0
EDPYMEs*	72.9	34.7	9.1	55.6	22.0	13.4

Source: Portocarrero and Chully 1998, p. 9-10; Chully, 2002, p.20, and Annex, pg.2.
** Does not include Proempresa.*

Table D.6
Real Interest Rates in MG II Program
(weighted average from 12/31/98-9/30/01)

	Nominal effective interest rate percent	Equivalent interest rate in local currency percent
Local currency (soles)		
COFIDE to IFI	18.8	18.8
IFI to Mes	69.8	69.8
TAMN (avg. bank lending rate, local currency)	31.2	31.2
IFI spread	51.0	51.0
Difference IFI – TAMN	38.6	38.6
Foreign currency ($)		
COFIDE to IFI	8.5	16.5
IFI to Microenterprises	29.5	39.0
TAMEX (avg. bank lending rate, foreign currency)	14.6	23.0
IFI spread	21.0	22.5
Difference IFI – TAMEX	14.9	16.0

Source: Chully, 2002, pg. 23.

accompanying nonreimbursable technical assistance program totaling $3.95 million ($2.75 million from the Swiss Development Cooperation Agency –COSUDE– and $1.2 million in counterpart funds). The technical assistance program was comprised of four components: (i) strengthening of COFIDE; (ii) technology transfer to IFIs; (iii) increasing environmental awareness and knowledge in COFIDE, IFIs, and microentrepreneurs; and (iv) expanding coverage of the credit rating agency to cover credits below $4,500.

The largest component, the technology transfer to IFIs, was originally designed to help six banks develop microcredit departments. However, the international bidding for the consulting firm experienced significant delays, until a contract was signed with *Facet-Swisscontact-Softek* in June 1998.[20] This consortium of technical assistance providers did not have experience focusing on banks, and was not able to engage commercial banks in the program. By this time, the largest participant, Banco del Trabajo, had already developed its own credit technology that was working exceptionally well. The supply-driven nature of the technical assistance did not provide commercial banks with tailor-made responses to their needs. As a result, the technology transfer to IFIs was refocused to assist non-bank IFIs.

CMACs had been receiving extensive hands-on technical assistance from the German Technical Cooperation Agency (GTZ) since 1985, and were already industry leaders in terms of microcredit technology. In fact, between December 1992 and July 1995, the CMAC microenterprise portfolio increased from $2.7 million and 4,000 clients to $23 million and 30,000 clients. GTZ had also dramatically improved the control and supervision functions of the Federation of Municipal Savings Banks of Peru (FEPCMAC). The

[20] Even though the program prohibited disbursing more than 30 percent of the funds before the technical assistance component became effective, COFIDE used its own funds to keep up the momentum of disbursements, and was reimbursed later.

technical assistance in MG I was finally directed towards six CRACs: San Martin, Profinanzas (Cañete), Señor de Luren, La Libertad, Del Sur and Los Libertadores. Assistance in management, strategic planning, and new product development was complemented by the participation of gender experts, who increased awareness of gender needs in all business areas.

The expansion of the SBS' central credit registry (*central de riesgos*) to include information on loans under $4,500 as part of the MG I technical assistance was important in creating a favorable environment for microlending. Having credit information decreases risk, transaction costs and obstacles to entry in MFI business, promotes competition in the sector, expands access to credit, and helps to limit overindebtedness and promote a culture of repayment. With the resources from the technical cooperation component, by February 1998, the SBS information for loans of $4,500 and below was performing as an Internet-based platform, and managing over 2 million records, with a lag time of 23 days compared to the larger SBS system of 170,000 records with 3 months of lag time. By 1999, 51 financial institutions were reporting to the system, with only 15 outside of the system. Competition has increased in this sector, and by early 1999, three private firms had between 300 and 700 institutional clients and managed approximately 4 million registries each.

Environmental Regulations

The technical assistance component of MG I included basic training for IFI credit officers to identify and evaluate environmental impacts when analyzing credit requests from microenterprises. Credit officers were supposed to recommend to their clients simple, low-cost measures to prevent and improve potential negative environmental impact of their clients' microenterprises. Microenterprises classified as having moderate potential adverse impacts were required to implement the measures recommended by the IFI to qualify for a second loan. In MG II, these requirements were maintained, and a specialized firm was contracted to monitor and ensure that the environmental-related measures taken by the microenterprises were properly implemented. COFIDE was required to submit annually to the IDB an environmental evaluation of a sample of microenterprises financed with program funds, to verify their compliance with the environmental safeguards recommended by the IFIs.

Building Stronger Institutions

The MG Programs in Perú assisted in institutional strengthening, but not in the way that was originally envisioned. The traditional banking sector did not develop permanent microcredit departments to scale down their operations as a result of the programs, but some have entered the microfinance sector through finance company subsidiaries. In addition, the programs did help to consolidate specialized IFIs. As a whole, the nonbank IFIs have developed into a solid base for the microfinance industry, partly thanks to the resources of the MG programs. The majority of the nonbanking IFIs maintained the same average loan size before and after the programs, had the same percentage of microcredit clients and experienced significant portfolio growth. The majority of these participants in the MG programs agree that the credit resources helped them to increase their client base, maintain their active clients, and start moving towards new market segments. As a result of the programs, the newer institutions, the EDPYME, were able to begin to develop better microfinance technologies. These specialized institutions continue to lend to the sector for profitability, portfolio diversification, social interest, to follow their mission, and to serve sectors that traditional banks do not finance.

Lessons Learned

Efficient program design, incorporating low transaction costs, and market-based incentives, with an experienced and efficient executing agency are important to reaching final target population.

Improvements in financial architecture can have a great impact on credit provision. In this case, expanding the central credit registry (*central de riesgo*) of SBS was a cost-effective way of promoting broader access to credit by small and low-income borrowers, especially the self-employed, who have no "salary" to use as collateral. Transparent risk reporting systems such as this one reduce barriers to entry for the microfinance industry.

A favorable regulatory environment, specifically effective supervision of nonbank IFIs (especially in this case CMACs and EDPYMEs) is precondition to success.

A pre-established retail base with strong distribution capacity can quickly take advantage of a wholesale microfinance program to expand reach, growth of portfolio, and introduction of new products. The CMACs, experienced nonbank financial intermediaries, were able to take advantage of the MG funds.

Intensive and specialized technical assistance such as that provided parallel to the MG program through GTZ's work with CMACs is crucial for the success of a second-tier microfinance program. However, supply-driven technical assistance does not meet the needs of sophisticated financial institutions interested in entering a new market.

Strict elegibility requirements are important for the success of a wholesale program. Second-tier institutions do not have the mandate of improving IFI performance, and thus should ensure that only good performers, with chances of being sustainable, are participating.

Wholesale microfinance programs can be particularly effective in helping specialized microlenders (such as the CMACs and EDPYME) to rapidly expand their operations.

Commercial banks with a consumer finance base may be more interested in entering into microlending, and may be more easily able to make the necessary adjustments in credit techonology.

Pricing of funds is important—resources must be attractive enough to entice participants to utilize them, but not so low as to discourage savings mobilization. In the case of Peru, participants expanded operations, as well as increased savings deposits.

Bibliography

COFIDE. 1998. Progress Report as of 6/30/98: Global MicroCredit Program II (Contract #1128/OC-PE). Lima, Peru.

COFIDE. 1999. Informe de Progreso al 12/31/99: Programa de Fortalecimiento Institucional a las Entidades Participantes en el Programa Global de Crédito para la Microempresa (ATN/CS-5074-PE). Lima, Peru.

COFIDE. 2001. Progress Report as of 6/30/01: Global MicroCredit Program II (Contract #1128/OC-PE). Lima, Peru.

COFIDE. 2001. Funcionan los modelos de segundo piso para el desarrollo de las microfinanzas?. Presentation for the Fourth Inter-American Microenterprise Forum. Santo Domingo, Dominican Republic.

Consorcio Fortifica. 1999. Informe de Progreso al 9/30/99: Programa de Fortalecimiento Institucional a las Entidades Participantes en el Programa Global de Crédito para la Microempresa (ATN/CS-5074-PE). Lima, Peru.

Inter-American Development Bank Official Bank Document. 1995. Peru: Global Microenterprise Credit Program (PE-0035). Washington D.C.

Inter-American Development Bank Official Bank Document. 1998. Modification of the Small Enterprise Credit Program and Profile II (PE-0191). Washington D.C.

Inter-American Development Bank Official Bank Document. 1998. Peru: Global Credit Program to Microenterprises II (PE-0189). Washington D.C.

Inter-American Development Bank Official Bank Document. 1998. Peru: Multi-Sector Credit Program: Stage II (PE-0191). Washington D.C.

Inter-American Development Bank Official Bank Document. 1998. Peru: Support Program for Instituto de Formación Bancaria (TC-96-10-08-2). Washington D.C.

Inter-American Development Bank Official Bank Document. 2000. Case Study: IDB-Peru Global Micro-Enterprise Credit Program (RE3-00-005). Washington D.C.

Nunura Chully, Juan and Javier Portocarrero Maisch. 1998. Programa de Crédito Global a la Microempresa, Evaluación de la I Fase y Preparación de la II. Lima, Peru.

Portocarrero Maisch, Felipe. 1997. La experiencia Peruana en el financiamiento de la microempresa y las cajas municipals de ahorro y crédito. Second Inter-American Microenterprise Forum. Lima, Peru.

Portocarrero Maisch, Felipe and Bernd Zattler. 2000. Revisión de la segunda fase del Programa Global de Credito a Microempresas en el Peru y diseño de la tercera fase. LFS Financial Systems. Berlin, Germany.