

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

ECUADOR

**SOCIAL ENTREPRENEURSHIP PROGRAM
PROPOSAL FOR FINANCING AND TECHNICAL-COOPERATION
FUNDING**

**IMPROVING LIVING CONDITIONS FOR MICROENTREPRENEURS
IN PERIURBAN AREAS OF GUAYAQUIL**

(SP/TC-03-06-02-5)

This document was prepared by the project team consisting of Luciano Colombara, Project Team Leader; Edgar Carvajal (COF/CEC); Kevin McTigue (LEG/OPR); Leyda Fajardo (LEG/OPR); Michael Steidl, consultant; and Margarita Reyes (SDS/MSM), who helped produce the document.

IMPROVING LIVING CONDITIONS FOR MICROENTREPRENEURS IN PERIURBAN AREAS OF GUAYAQUIL

(SP/TC-03-06-02-5)

EXECUTIVE SUMMARY

Executing agency: Misión Alianza

Amount and source:	Reimbursable financing:	US\$ 500,000
	Nonreimbursable technical-cooperation funding:	US\$ 200,000
	Local counterpart funding:	<u>US\$ 775,000</u>
	Total:	US\$1,475,000

The resources will be drawn from the net income of the Fund for Special Operations (FSO).

Terms and conditions:	Amortization period:	10 years
	Grace period:	3 years
	Execution period:	36 months
	Disbursement period:	42 months
	Interest rate:	4%

The grace period will only apply to amortization of the principal, not to interest payments. The reimbursable financing will be denominated in dollars of the United States of America.

Problem to be addressed: Isla Trinitaria and Paraíso de la Flor are two of the marginal neighborhoods in the periurban area of Guayaquil with the worst socioeconomic conditions. Of their approximately 400,000 residents, 85% live below the poverty line. Access to services in these areas is even more difficult than in others because of the problem of violence. The formal economy is present only in certain areas close to the main thoroughfares where government services and security are concentrated.

Most residents do not have jobs in the formal economy, with 45% of the economically active population being employed in microenterprises. There are some 70,000 mostly informal microenterprises, which suffer from the usual problems in the sector, such as a lack of access to timely sources of financing. It is

estimated that over 25,000 microenterprises in Isla Trinitaria and Paraíso de la Flor are in need of credit services. Of these, less than 10,000 currently have access to microcredit. D-MIRO, a microcredit program run by Misión Alianza, is the only organization with a stable, organized presence in the neighborhoods and accounts for 90% of the supply of microcredit in the area. In fact, for the near future, D-MIRO represents the only alternative for financing for microentrepreneurs in the two neighborhoods, apart from moneylenders, since microfinance institutions (MFIs) are not interested in large-scale microlending in the area.

Consolidation and expansion of the microentrepreneurs' activities will depend on the supply of microcredit by D-MIRO, but the organization's lending resources are limited. It is currently experiencing certain problems in its credit services that will increase as it expands its portfolio and the number of clients served. Weaknesses in its microfinance management are limiting its capacity to manage credit and have led to a significant increase in the interest rate and fees it charges. Other factors contributing to the high lending rate are certain inefficiencies in its administrative systems that result in significant administrative costs. D-MIRO has a credit technology and institutional rules that have proven highly effective for its carefully selected clientele. However, its loan processing is costly for clients due to the paperwork required, protracted response times, and delays due to the various visits to D-MIRO offices required.

Objectives: The **general objective** of the project is to improve the socioeconomic conditions of low-income microentrepreneurs through sustainable expansion of the supply of microcredit in periurban areas of Guayaquil.

Its **specific objectives** are to: (i) expand the supply of microcredit for low-income microentrepreneurs in Isla Trinitaria and Paraíso de la Flor; and (ii) improve the pricing and quality of the financial services available for microentrepreneurs in the two neighborhoods.

Description: The purpose of the proposed operation is to help meet the demand for credit on the part of low-income microentrepreneurs in the Isla Trinitaria and Paraíso de la Flor neighborhoods. Through the project, microentrepreneurs will thus receive more credit on better terms and conditions. As a result, they will be able to consolidate and expand their economic activities, thereby improving their living conditions.

1. Financing component (IDB: US\$500,000; D-MIRO: US\$500,000): The purpose of the financing component is to increase the resources available to expand credit services for low-income

microentrepreneurs in Isla Trinitaria and Paraíso de la Flor. The resources will be used to increase placements by D-MIRO by over US\$1.2 million over the three-year project execution period, including capitalization of the interest received on loans financed with project resources. The goal of this component is to increase the number of borrowers in the two neighborhoods by 3,000, with an average credit of US\$400.

2. Technical-cooperation funding (IDB: US\$200,000; D-MIRO: US\$275,000): In addition to the financing component, technical-cooperation will be provided in order to help strike a balance between a sustainable supply of credit services and the affordability of the services for the low-income clients targeted. It will be used for managerial advisory services, several short-term consulting contracts, internships and exchanges with MFIs in the region, participation in international events, procurement of computer hardware and software, the introduction of technological innovations, and reorganization of D-MIRO offices. The technical-cooperation component will focus on three main areas of activity: improving management structures; improving administrative systems; and improve credit procedures. A significant reduction in financial costs and delays for the microentrepreneurs is expected. To ensure that the Bank contribution is transferred in its entirety to the end-beneficiaries of the project, an amount equal to the Bank's technical-cooperation funding under the project will be invested in community development activities in the project area by Misión Alianza during the amortization period for the Bank financing.

Environmental and social review:

The guidelines for review of social and environmental impact for IDB microenterprise operations were taken into account in preparing this proposal, pursuant to the suggestion made at meeting 06-04 of the Committee on Environment and Social Impact (CESI) held on 13 February 2004.

Beneficiaries:

The project goal is to directly benefit over 13,000 low-income microentrepreneurs in the Isla Trinitaria and Paraíso de la Flor neighborhoods, albeit to varying degrees, during the three-year project execution period. Participation by women will be actively promoted by D-MIRO. As a result of the project, the family income of the microentrepreneurs is expected to increase by over 40% with respect to the baseline figures.

Risks:

The proposed operation must take into account two significant external risks: (i) *risk*: macroeconomic policy, foreign trade policy, and local government policies affecting the areas may change radically during the life of the project; *mitigating factor*: since it is

impossible to determine how this risk may develop and consequently to plan any concrete activities to mitigate it, the executing agency will monitor such possible external events and may propose initiatives within the scope of the project; (ii) *risk*: violence in the project areas may affect work in the neighborhoods targeted; *mitigating factor*: D-MIRO takes the necessary measures to ensure the safety of its staff, and in general, will continue to enjoy the relationships and acceptance it has developed because of the content of its activities and the way they are carried out and because the organization is associated with community development work and support for the construction of low-cost housing.

**The Bank's
country
strategy:**

The country paper dated 3 December 2001 identifies four development challenges for Ecuador and strategic areas of Bank activity: (i) economic stability; (ii) poverty reduction; (iii) private-sector participation in the provision of infrastructure; and (iv) modernization of the State. The proposed project is consistent with the strategy and will contribute to the second strategic objective, poverty reduction.

**Coordination
with bilateral
development
agencies:**

The project will supplement ongoing projects and initiatives in Ecuador being carried out by other international organizations and bilateral agencies, especially the SALTO Project (Strengthening Access to Microfinance and Liberalization Task Order), financed by the United States Agency for International Development (USAID). The proposed project will maintain ongoing contact with the SALTO project. In addition, Misión Alianza will coordinate its activities with the Norwegian Agency for Development Co-operation (NORAD), which supports its activities in Ecuador.

Rationale:

The proposed project is justified because it will: (i) increase income and mitigate poverty in marginal neighborhoods considered the neediest urban areas in Ecuador; and (ii) help improve the availability, pricing, and quality of the supply of credit in the area by supporting professionalization of the only organization providing financial services to low-income microentrepreneurs in the two of the neediest neighborhoods in the country that have social indicators far below the national average.

Special contractual clauses:

As a condition precedent to the first disbursement under the financing component, Misión Alianza will submit evidence to the satisfaction of the Bank that the D-MIRO board of directors has approved an effective pricing policy for the interest rates to be charged to clients that will ensure a gradual reduction of the rates over the project execution period.

As conditions precedent to the first disbursement under the technical-cooperation component, D-MIRO will submit the following documentation to the satisfaction of the Bank: (i) a revised plan of operations for the project; and (ii) a copy of the agreement for investment in community development between D-MIRO and the Misión Alianza community development program (DE-CO).

D-MIRO will submit the baseline data and proposed performance indicators for approval within six months after signature of the agreement at the latest. No more than 50% of the technical-cooperation may be spent without at least 30% of the reimbursable financing having been invested. Misión Alianza will ensure that disbursements and execution under the financing and technical-cooperation funding components are coordinated throughout the project execution period, and will indicate in the semiannual progress reports how the two components are mutually complementary.

Revolving fund:

The Bank will establish a revolving fund in the amount of up to 20% of the reimbursable financing in order to ensure rapid, timely provision of the financing. A revolving fund for the technical-cooperation component will be established in the amount of up to 10%.

Reports and evaluations:

Baseline data: In order to monitor and evaluate the project activities and its performance, upon project initiation, D-MIRO will hire the services necessary to establish the baseline data and compile socioeconomic information on the project end-beneficiaries. This information will be periodically updated by D-MIRO.

Reports: D-MIRO will submit *progress reports* to the Bank's Country Office within 60 days after the end of each six-month period, along with a final report within 60 days after the last disbursement. The reports will include a review of performance and process indicators benchmarks and of the progress achieved in project implementation. The reports will also include information to help the Bank verify and monitor: (i) the local counterpart contribution, which is to gradually increase; (ii) transfer to the microentrepreneurs of the economic benefits achieved through the lower interest rates charged; and (iii) the US\$200,000 investment in community development activities by

D-MIRO. During execution of the reimbursable financing component, within 120 days after the end of each fiscal year, D-MIRO will submit to the Bank *audited financial statements on the financing component*. In addition, within 120 days after the term for disbursement of the technical-cooperation funding, D-MIRO will submit the respective financial report audited by independent authorities.

Evaluations: The Bank will use resources from the technical-cooperation funding to hire consulting services to conduct a mid-term evaluation after 18 months of project execution and a final evaluation after 36 months.

The Bank will review the findings and recommendations of the progress reports, evaluations, and audits. Should any significant deficiencies be detected, the Bank may suspend new disbursements until D-MIRO has taken satisfactory measures to correct them.