

**MULTILATERAL INVESTMENT FUND
PROJECT ABSTRACT**

REGIONAL

I. BASIC PROJECT DATA

Country/Region: Regional

Program Name/Number: RG-M1082: Enhancing Financing to small and micro business enterprises in El Salvador and Nicaragua through innovative techniques.

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Date of Request: January 18, 2006

Beneficiaries: 1) Banco Uno El Salvador and Banco Uno Nicaragua
2) Micro and small enterprises in El Salvador and Nicaragua.

Executing Agency: Banco Uno El Salvador and Banco Uno Nicaragua

Financing Plan:

A. Long Term Loan		
MIF loan (Window IIIB)	US\$	Up to 5,000,000
IIC (to be determined)	US\$	10,000,000
Total		15,000,000
C. Technical Assistance		
MIF TA (Window IIIA)	US\$	150,000
Grupo Uno Financiero	US\$	220,000
Total	US\$	370,000

Tentative Dates: Due Diligence: April 2006, EVP: June 2006

II. BACKGROUND AND PROBLEM STATEMENT

A. Background

- 2.1 Historically, the strong growth of microfinance in LAC was driven by the so-called “upscaling” of informal NGOs into regulated banks and finance companies. Much of the industry’s momentum to date has derived from the effort of microfinance institutions to develop the disciplined credit methodologies, low transactions costs and high operating standards that would enable them to formalize, thereby making it possible to capture client deposits and become sustainable.
- 2.2 However, while the industry has made great strides, microfinance institutions are still only meeting an estimated 10% of total demand. The new consensus among microfinance practitioners is that the only way

to meet this demand is through the aggressive entrance into the market by commercial banks and the leverage, outreach, infrastructure and technology they can provide (“downscaling”).

- 2.3 Commercial banks have a number of advantages in serving the microfinance sector, including: (i) physical and human infrastructure, (ii) market presence and brand recognition, (iii) access to long-term and low-cost funds, and (iv) low cost structure¹. However, for the successful introduction of microfinance, commercial banks also need to develop specific market expertise, industry appropriate credit methodologies, trained and incentivized credit officers, etc.
- 2.4 Some commercial banks have already been very successful through this downscaling. Examples include Banco Pichincha, Ecuador; Bancolombia and Banco Caja Social, Colombia; BHD and Banco Ademi from the Dominican Republic; Banco de Credito and Banco del Trabajo, Peru. In Haiti, MIF assisted Sogebank in launching its microfinance activities through its service subsidiary, Sogesol, which is now one of the most successful downscaling cases in Latin America. Banco del Café (Bancafé), Guatemala, also received MIF’s technical assistance to deepen its process of downscaling (MIF/AT-363). Bancafé’s micro and small business loans called “Banca MIPyME” increased from \$144,253 in 2002 to \$30 million in March 2005, accounting for 5% of the total loan portfolio.

B. The Problem

- 2.5 The downscaling model has so-far shown the most success in South America. Indeed, 15 of the 17 most important downscaled banks are in this part of the LAC region. On the other hand, most Central American banks, with the exceptions of Banrural and Bancafé in Guatemala and Banco del Café in Honduras, have not yet been persuaded of the attractiveness of this market. The downscaling by commercial banks in Central America is still rare partly due to the fact that banks in Central America are in the process of integration and recently started to look into more business opportunity from its traditional corporate finance market to small and medium enterprise sectors as the competition for its main business has increased.
- 2.6 Through its own market analysis, Grupo Financiero Uno (GFU) realized that about 15% of its credit card customers in Central America use their cards for small and microenterprise activities such as purchasing of materials or services for business purposes. To capture this market, GFU’s senior management has decided to launch its own small and microfinance business. GFU has a strong market presence in the credit card business in Central America and corporate financing, however, it does not have expertise in micro and small business financing.
- 2.7 To be successful in microfinance, GFU needs to (i) adapt new loan processing and disbursement procedures to the functioning of microenterprises, and to (ii) introduce a new banking culture for microfinance. Not all past downscaling efforts have been successful in the region. These failures are mostly attributable to internal factors such as inability of adopting new operational procedures for microfinance. Research indicates that many of the failures could have been avoided if these institutions have been supported by adequate technical assistances². GFU is well aware of MIF’s contributions to the development of microfinance in the region, and requested MIF’s technical assistance and loan to launch micro and small business loan program.

¹ Lopez, Cesar and Elisabeth Rhyne. (2003). The Service Company Model: A New Strategy for Commercial Banks in Microfinance. *Insight*, No.6: ACCION International.

² Valenzuela, Liza. (2002). “Getting the Recipe Right: The Experience and Challenges of Commercial Bank Downscalers.” In Deborah Drake and Elisabeth Rhyne (eds.), *The Commercialization of Microfinance: Balancing Business and Development*. Kumarian Press.

C. The Program Rationale and Additionality

- 2.8 The project is part of the MIF/IIC micro, small, and medium sized enterprises (MSME) Finance Facility whereby MIF and IIC cooperate to provide technical assistance and financing to expand the provision of credit to MSME sector. Under the Facility, MIF and IIC have agreed to work together to seek out private financial institutions that (1) are willing to commit their own human and financial resources to develop specific MSME finance programs, and, (2) could benefit from a combination of MIF and IIC technical assistance and financing to strengthen their capacity to work with the MSME sector.
- 2.9 The Facility's goal is to improve the ability of the region's financial system to increase outreach to micro, small and medium sized companies, and to develop methodologies that enable them to do so effectively and in a cost-efficient fashion. The MIF has helped banks in the region to downscale their operations in order to serve micro and SME clients with loan and technical assistance.
- 2.10 The project is to assist GFU to start a micro and small finance lending business. Through Banco Uno, El Salvador and Banco Uno, Nicaragua, GFU will launch its pilot program of offering financing to micro and small business entrepreneurs for their working capital and term loans for business related investment. The project is innovative, as GFU will use its credit cards to provide financing to these markets. GFU plans to expand this program to other banks in Central America if the pilot program is successful. In addition, GFU will offer an optional savings account attached to the credit card that could be used as back-up to pay debts when needed.

III. PROGRAM OBJECTIVES AND DESCRIPTION

A. Objectives

- 3.1 This project consists of (a) a MIF technical assistance designed to help Grupo Financiero Uno develop the technology and know-how to optimally serve the new market segment, and (b) a MIF and IIC loan to the Group, aimed at increasing its outreach to the MSME sector. Through this coordination, the MIF and IIC will help catalyze the downscaling of the GFU's operations by increasing its outreach to microenterprises. This project falls within the MIF/IIC MSME Finance Facility framework.

B. Description

- 3.2 MIF will assist GFU to "downscale" to microfinance with a loan and a technical assistance. MIF will provide TA to both Banco Uno El Salvador and Banco Uno Nicaragua, and offer up to \$5 million loan to Banco Uno Nicaragua. GFU projects its micro and small business portfolio will grow to \$46 million in the next 5 years for these two banks. Since the funding needs are significant and the project is in line with MIF/IIC MSME Finance Facility, MIF invited IIC to consider lending to GFU. After consultations among MIF, IIC, and GFU, IIC has agreed to consider providing funding first to Banco Uno El Salvador. Nicaragua has a high sovereign risk and the GFU will launch a new lending programs, IIC opts to provide financing first to Banco Uno, El Salvador where the sovereign risk is much lower. The sovereign risk of El Salvador is close to an investment grade (BB+), while Nicaragua does not even have a sovereign rating assigned by S&P and Fitch. It has only a low speculative rating of Caa1 from Moody's. In the future, IIC will consider providing funding to Banco Uno Nicaragua if the new micro and small finance lending business proves to be successful in Nicaragua.
- 3.3 The budget for a technical assistance (TA) is estimated at around \$370,000. MIF will finance up to \$150,000 and GFU will provide its counterparty funding of up to \$220,000. The TA has three components:

- 3.4 Component I (Market Analysis, Products Development and Internal Audit): This component will finance (a) market research, including surveys, investigation and focus groups, preferably using MIF's assessment and experience in other countries as a benchmark, (b) the process of the product(s) definition and identification for small and microenterprises, and (c) the development of specific strategies to be used to supply a new alternative financing to this market segment. The consultant or consulting firm will be hired to implement this component.
- 3.5 Component II (Operations and Procedures): This component aims at strengthening the loan origination and administration of the microfinance loan portfolio. Under this component, the technical assistance will help finance the purchase of software that will support: (a) the adoption a new small business score-card system to be integrated as a part of the GFU's existing credit card process/system, (b) the development of a new collections management (including a system of alarms according to the new parameters to alert loan officers, evaluate default risk, and maximize the efficiency of collections activities), and (c) the development of new client segmentation tools (such as for targeting credit renewal candidates, identifying potential clients that are likely to be declined etc.).
- 3.6 Component III (Recruitment and training of loan officers): This component will finance: (a) the recruitment and training of 20 new loan officers and 10 telemarketing officers, in credit analysis techniques, (b) 2 or 3 verification experts that dedicate their time to business verification and caliber, and (c) collection officer's training according to new policies and collecting techniques for this segment.

	MIF	Counterpart contribution	TOTAL
1. Market Analysis and Product Definition	\$33,200.00	\$49,800.00	\$83,000.00
2. Operations and Procedures	\$52,000.00	\$78,000.00	\$130,000.00
3. Recruitment and Training	\$19,200.00	\$28,800.00	\$48,000.00
Contingencies	\$33,720.00	\$50,580.00	\$84,300.00
Management	\$8,000.00	\$12,000.00	\$20,000.00
TOTAL	\$146,120.00	\$219,180.00	\$365,300.00

IV. COST AND FINANCING

- 4.1 The MIF contribution will be for a loan of up to \$5 million to Banco Uno, Nicaragua. The proceeds of the loan will be used to the expansion of its micro and small business loans. MIF will also provide \$150,000 technical assistance to Banco Uno, El Salvador and Banco Uno, Nicaragua with the counterpart funding from GFU of \$220,000.

V. EXECUTING AGENCY

- 5.1 The executing agencies are Banco Uno, El Salvador and Banco Uno, Nicaragua. Both banks are a part of Grupo Uno Financiero (GFU), one of the leading retail financial groups in Central America. Founded in 1987 by a group of Central American shareholders, the Group provides retail banking, credit cards, insurance, and asset management services through a network of affiliated companies in El Salvador, Honduras, Nicaragua, Costa Rica, Guatemala, and Panama. As of June 30, 2005, the total assets and equity of GFU were \$1.4 billion, and \$160 million, respectively. GFU recorded its profit of \$21 million for the first half of 2005. The consolidation of its 6 banks and 4 credit card companies is now under process.

- 5.2 GFU has the largest market share of VISA cards in Central America and it continues to keep up its competitiveness in information technology, regional delivery, marketing and best practices in order to position itself for rapid growth within the region. To improve financial infrastructure and expand the credit card business portfolio, GFU obtained provided \$30 million loan from IFC in April 2005 as the senior loans to Banco Uno, Panama and Banco Un, El Salvador.
- 5.3 The two beneficiaries of MIF's technical assistance are Banco Uno, El Salvador and Banco Uno, Nicaragua. They are the second and third largest affiliates of GFU as is shown below. They constitute 1/3 of GFU's total assets and profits.

	(June 30, 2005, US\$ 1,000)				
	ASSETS	LOANS	DEPOSITS	EQUITY	PROFITS (6 months)
Banco Uno Guatemala	207,290	116,261	138,259	25,518	2,217
Banco Uno El Salvador	280,464	203,783	192,940	30,973	1,477
Banco Uno Honduras	166,274	87,105	92,863	11,763	1,053
Banco Uno Nicaragua	240,442	121,346	198,773	22,096	5,447
Banco Uno Costa Rica	74,494	41,535	54,714	10,072	1,340
Banco Uno Panama	462,607	344,202	343,874	60,345	9,094
TOTAL (GFU)	1,431,571	914,232	1,021,423	160,765	20,628

VI. MAJOR ISSUES

- 6.1 **Credit Analysis:** A thorough financial evaluation to assess credit methodology, quality of assets, solvency, gapping analysis, liquidity situation is being carried out for each of Banco Uno, El Salvador and Nicaragua. The due diligence must be completed, special emphasis will be given to review the decision making process of the credit allocation. IIC will lead the financial analysis, and coordinating with MIF, the structure of the transaction and the terms and conditions. Final agreement on the terms and conditions of the loans must be agreed upon.
- 6.2 **Operational Risk.** GFU will start a new lending program to microfinance and it is important to make sure that it has the institutional capability to carry out this new business. The mission will carry out a thorough institutional analysis of Banco Uno, El Salvador and Nicaragua during due diligence.

VII. ENVIRONMENT & SOCIAL ISSUES

- 7.1 As a financial intermediary, GFU will manage its operations in accordance with IDB/MIF environmental and social guidelines for MIF operations with financial intermediaries. As a part of fulfilling the requirements of these guidelines, GFU will be expected to participate in a MIF/IDB-approved training course on environmental and social review for financial intermediaries and elaborate a social and environmental management system for the company. In addition, MIF recently commissioned the development of a specific manual for social and environmental monitoring and due diligence for financial intermediaries that will be used by GFU. Each officer of the company when performing the due diligence in potential companies will use this manual.

VIII. ACTION PLAN

- 8.1 The following is a preliminary schedule for the Project's approval process:

CESI	April 2006
Due Diligence	April 2006
Donors Committee	June 2006