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BRINGING MICROFINANCE SERVICES TO THE POOR: CREDIAMIGO IN BRAZIL

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Among policymakers and economists, there is a widely-held perception that microenterprises¹ face severe financing shortages that limit their growth opportunities. Resolving the problems of access to finance as well as the high cost of financing has become the main objective of many government programs.

With a view to increasing access to credit for microenterprises in the Northeast Region of Brazil, the World Bank has supported Banco do Nordeste's CrediAmigo microfinance program since 1997. This note describes how Banco do Nordeste initiated CrediAmigo as part of its restructuring strategy and how the program has expanded to become the largest microfinance provider in Brazil. To date, many lessons have emerged, both from CrediAmigo and the World Bank project that supports the program.

Unsatisfied Demand for Microfinance Services

Brazilian private banks and non-bank financial institutions offer a variety of credit products targeted to

micro and small enterprises. These products typically carry very high interest rates and require collateral. Banking networks also leave many areas, particularly poor and remote regions in the Northeast and North of Brazil, underserved. About 57 percent of all municipalities in these regions have no access to a bank branch, compared to a national average of around 30 percent. Although in many other Latin American countries, microfinance institutions have been able to partially fill the gap left by larger institutions, in Brazil, only a small fraction of the potential demand for microfinance appears to be satisfied by the current supply.

Momentum to Expand Microfinance Services

Until 1997, the development of microfinance services in Brazil lagged substantially behind other Latin American countries. This was due in part to, (i) the long period of high inflation which prevailed before the Real Plan pegged the currency to the dollar, (ii) restrictions on the ability of NGOs to serve as

CrediAmigo : A success story

Valcenira Araújo do Nascimento. When boutique owner Nirinha (as she is known) applied to CrediAmigo, her goal was to stop paying for goods on credit and to expand her business. With monthly sales of around R\$2,000, working capital of R\$1,200 (not counting R\$3,800 in receivables), she suffered when her customers didn't pay their bills on time. With the help of her husband, the couple dedicated all their time to the boutique. Net profit was about R\$620, the principle source of the household's income. Today, Nirinha is on her 11th loan, and has renovated the boutique and hired a nephew to better serve the growing number of customers. In addition, she opened a videogame shop, providing the household with a second source of income. Working capital has increased to R\$12,662, with the store making on average R\$3,200 per month, and R\$8,000 in the busiest months. Net profit has also increased to R\$1,300. With the help of CrediAmigo, Nirinha was able to take the risk necessary to achieve success in her business.

financial intermediaries and mobilize external financing, and (iii) a strict usury law limiting interest rates charged by NGOs to unsustainably low levels.

Three significant events prompted the emergence of the CrediAmigo initiative. First, in November 1996, the World Bank met with the senior management of Banco do Nordeste to discuss access to finance in the Northeast and review microfinance experiences in other countries. After agreeing on operating principles for a sustainable microfinance program, the Bank supported Banco do Nordeste's efforts to initiate a microfinance program through an existing loan for technical assistance and training. Second, in 1997, Comunidade Solidária, a public body created in 1995 to strengthen civil society initiatives in Brazil, organized a large political debate on the potential role that micro-credit could play in Brazil. The meeting concluded that micro-credit could play a strategic role in terms of employment and income distribution, but that its expansion required a different approach from that typically associated with credit operations. Third, Banco do Nordeste's objective to achieve its regional development mandate fostered interest in seeking viable ways to reach microenterprises without relying on subsidized credit lines.

A Northeast Microfinance Development Project

In 1997, and emerging from a major period of reform, Banco do Nordeste, led by a new president with extensive experience in the private sector, was looking for ways to satisfy its regional development mandate more efficiently.

Following the successful model of the Bank Rakyat Indonesia's (BRI) Unit Desas in Indonesia, CrediAmigo was established as an autonomous unit within Banco do Nordeste. Banco do Nordeste sought technical advice from ACCION International, a group with considerable experience in solidarity group lending. With ACCION's assistance, Banco do Nordeste surveyed microenterprises and developed pilot loan products adapted to their needs. ACCION also helped prepare training material and selection criteria for Banco do Nordeste's future (outsourced) microfinance lending officers.

After a four-month pilot project, Banco do Nordeste's management supported an expanded program, which grew rapidly from 5 to 52 branches. Although this fast-track experiment was costly for Banco do Nordeste,

due to deterioration in the quality of the portfolio, the management team learned not to underestimate the complexity of microfinance operations. With a renewed commitment to focus on portfolio quality and productivity, in May 2000, the World Bank provided a US\$50 million loan to strengthen CrediAmigo's capacity to grow sustainably and to extend a line of credit for on-lending to microenterprises. The project's objective was to improve the access of micro-enterprises throughout the Northeast Region of Brazil to sustainable, formal financial services.

Results on the Ground

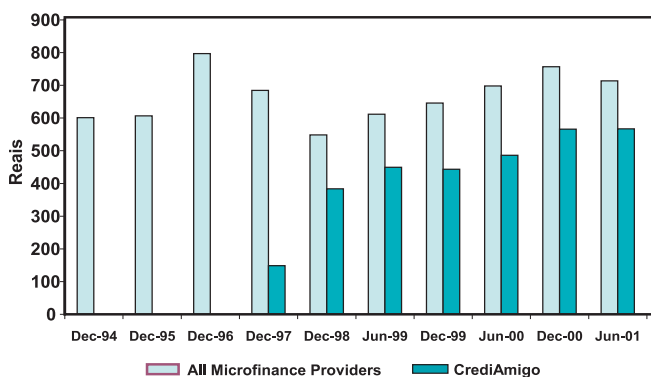
Today, CrediAmigo distributes its products through 164 of Banco do Nordeste's 174 branch network and through 56 one-stop sales points. It offers loans to established micro-entrepreneurs for the financing of their working capital and fixed asset needs. Loans are collateral-free, but are extended using the solidarity group technique to small groups of three to five borrowers who cross-guarantee each other's loan. Solidarity loans usually have a three-month duration. First loans are limited to 300 to 700 Reais (about US\$130 – 300), but repeat loans can be up to 4,000 Reais (US\$1,700). Interest rates are higher than those charged by Banco do Nordeste on larger loans, but substantially lower than those charged by informal money lenders. The program began with a 5 percent flat monthly rate, but this interest rate has decreased to 3.5 percent. The program encourages timely repayment by offering a 15 percent discount on interest payments if all installments are paid on time. To cater to the evolving demands of its clients, CrediAmigo has also introduced individual and investment loans.

As of May 2002, after only four years of operation, CrediAmigo is already among the top microfinance institutions in Latin America in terms of geographical penetration, numbers of clients and depth of outreach. The program has about 100,000 active clients and an outstanding loan portfolio of 56 million Reais (US\$24.2 million), making it the largest microfinance institution in Brazil, well ahead of the second player, CEAPE established in 1987, which had 26,368 active clients in June 2001 and an outstanding loan portfolio of US\$7.4 million. CrediAmigo is active in 702 municipalities of the Northeast giving it wide geographical reach that also acts to reduce transaction costs to borrowers. Its average loan size is only 560 Reais (US\$240), confirming the institution's focus on the really poor. Forty-eight percent of its clients are women.

Aside from Banco do Nordeste's initiative, few public or private banks in Brazil have been active in microfinance. The foreign-owned bank ABN AMRO is developing a small pilot project, but most others are completely absent. Next to CrediAmigo, the market relies primarily on specialized microfinance institutions. There are about 50 to 60 such institutions in Brazil today, of which more than 80 percent have been in existence for less than two years. Most of these institutions are very limited in size. In fact, less than ten cater to more than 2,000 clients.

As a result of the late development of microfinance in Brazil and of the very small size of most institutions, the rapid expansion of CrediAmigo has allowed it to increasingly dominate the market. At the end of 2001, it served nearly 60 percent of those micro-entrepreneurs with access to microfinance services, and held about 45 percent of their outstanding micro-loans (Figure 1).

Figure 1 - Average Loan Size



To assess the impact of CrediAmigo on microenterprise dynamics and household welfare, Banco do Nordeste plans to carry out an impact study. However, anecdotal evidence provided by CrediAmigo's clients indicates that making credit available to microenterprises may have positive effects on their sales volume, employment, and profitability.

Lessons Learned

The success of CrediAmigo allows microfinance practitioners to reach a number of interesting conclusions:

First, it highlights several key conditions for success in microfinance, namely, the necessity to, (i) maintain a commitment for profitability and sustainability, (ii) implement a high-productivity model with low costs, (iii) develop strict control mechanisms and performing management information systems to control loan losses, (iv) maintain interest rates high enough to cover the cost

of administering small loans and their risks, (v) start small and learn by doing, and (vi) develop staff incentives that encourage efficiency and high loan recovery.

Second, it demonstrates that, when these conditions are met, a "downscaling" strategy (consisting of targeting lower income individuals or smaller businesses) may be a profitable commercial banking line of business.

Third, CrediAmigo's success demonstrates that a down-segment strategy may help revitalize public banks with decreasing profitability or increase that of unprofitable rural branch networks, provided that the conditions listed above are met. In many countries public banks have extensive branch networks which cannot be made profitable based on their current activities, putting a serious drain on what are often weak parent institutions. Microfinance requires specific skills that these banks do not always possess, but may nevertheless be an interesting business opportunity for them providing that adequate training is offered and "self-competition" from their own subsidized lines of credit is avoided. A microfinance strategy may also help restore, at least partially, the profitability of ailing development banks. That said, a microfinance program cannot be seen as a panacea for all financial difficulties, especially when it accounts for a small share of assets.

Fourth, it confirms the potential benefits arising from the use of a large pre-existing branch network to distribute products and that this allows a much faster roll-out of microfinance services. This suggests that banks with similar networks are potentially good candidates to develop large-scale microfinance services, provided they also have the right management incentives and controls. An alternative, developing partnerships that allow microfinance specialists to distribute their products via bank networks, may also be an option worth examining.

Finally, the program demonstrates that development of a world class microfinance program requires a continued commitment through conceptualization, design, piloting, and initial expansion, with a continued focus on risk management. External financing is required to develop the appropriate infrastructure and systems if these are not available beforehand and also to permit expansion of outreach. However, it is also clear that financing is best used where strong commitment exists and where throughout preparation has laid a solid foundation for the program.

Conclusions

The success of CrediAmigo is not limited to its expansion. Its portfolio quality and staff productivity are also at levels normally associated with international best practice. Only 3.7 percent of its loans are overdue, using a strict 30-day portfolio-at-risk measure. Its annualized loan loss rate is also 2.7 percent, even after fully provisioning all loans with payments 90 days or more overdue. As to productivity, loan officers with nine months or more of experience are each handling an average of 313 clients.

Profitability is also progressing well, despite the program not benefiting from any direct subsidy.² Salary expenses as a percentage of the loan portfolio decreased from 68 percent in December 1998 to 19 percent in May 2001. CrediAmigo's effective yield on the loan portfolio (interest income to average loan portfolio) dropped to 63 percent in May 2001 from 78 percent in December 1998. About 85 percent of CrediAmigo's 164 branches are operationally sustainable, and the program as a whole is expected to reach full financial sustainability in 2002.³

Overall, clients appear to be extremely satisfied with CrediAmigo's services despite high interest-rates⁴. CrediAmigo presents a high loan renewal rate (about 85 percent), and there are an increasing number of new clients per loan officer, indicating that continued access to microfinance is both essential and sought after. Quick turnaround on loan decisions and associated low transaction costs for borrowers may partially explain the high degree of client satisfaction. Surveys of client satisfaction confirm that clients rate CrediAmigo's services as very good: about 93 percent are satisfied with the program

These factors support the view that the program can achieve long-term sustainability. In the near future, the challenge for CrediAmigo is to gain legal institutional independence from Banco do Nordeste.

In this regard, Banco do Nordeste has established institutional structures consistent with increasing the managerial, financial, and legal independence of CrediAmigo and is investigating viable alternatives with the Central Bank.

Notes

¹ The Brazilian Geographic and Statistic Institute (IBGE) defines a micro-enterprise as an industry with up to 19 employees or service-related or commercial concerns with up to 9 employees, and a small enterprise as those with up to 99 employees in industry and 49 employees in services and commerce.

² CrediAmigo only benefits from "in-kind" subsidies from Banco do Nordeste, all stemming from its right to use Banco do Nordeste's network, know-how and infrastructure. These "in-kind" subsidies are registered as costs in CrediAmigo's program.

³ Operational self-sufficiency refers to the ability of the institution to cover via its operating revenues all its operating costs, except financial costs. Its financial self-sufficiency refers to its ability to cover all operating expenses including the cost of funds.

⁴ according to the 1999 survey by the Technical Office for Economic Studies of the Northeast (ETENE)

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