The Investment Support Activity of the Productive Development Project, El Salvador

Interim Report: Implementation from 2007 to 2011

Final Version: March 30, 2012

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EXECUTIVE SUMMARY

Funded by the Millennium Challenge Corporation (MCC) and implemented by El Salvador's Millennium Challenge Account (known as FOMILENIO in Spanish), the main objective of the Productive Development Project (PDP) is to assist in the development of profitable and sustainable business ventures for poor individuals and organizations that benefit these individuals in El Salvador's Northern Zone. Between 2007 and 2012, the PDP will use nearly $72 million in allocated funds to provide approximately 13,500 individuals with technical and material assistance and create an estimated 11,000 full-time equivalent jobs. One of the PDP's three large-scale activities is the Investment Support Activity, which is designed to provide investment capital to support the Northern Zone's dairy, fruit, horticulture, handicrafts, tourism, forestry, and coffee sectors. As stated in the 2006 MCC-El Salvador compact in which it was established, the goal of the Investment Support Activity is to "make investment capital available to poor individuals and organizations that benefit poor inhabitants of the Northern Zone, who, due to insufficient collateral and lack of liquid assets, are not able to finance their investments." Provided in the form of multi-year loans, this investment capital is intended to reduce poverty by enabling the creation of profitable and sustainable business activities that generate employment and significantly raise borrowers' income.

Loans granted under the Investment Support Activity were approved and formalized between 2009 and 2011, and these loans are not required to reach maturity until September 2016. With supervision from FOMILENIO, the state-owned Multi-Sector Investment Bank (known as BMI in Spanish) currently implements the Investment Support Activity through a trust fund.[1]

Research Questions and Methods

In 2007, MCC contracted with Mathematica Policy Research to evaluate the Investment Support Activity. In this interim evaluation report, we analyze three primary research questions related to the design and implementation of the activity from 2007 to 2011:

- How was the activity designed and why was it designed in this way?
- How was the activity implemented and did implementation meet initial expectations?
- Did the activity produce the desired results, including job creation and increased income among loan recipients?

This study draws from several qualitative and quantitative sources, including program manuals, monitoring data, FOMILENIO and BMI reports, and in-person interviews with FOMILENIO, BMI, and MCC staff, as well as interviews with ten Investment Support loan applicants (five loan recipients and five non-recipients) and members of the Productive Development (PD) Investment Committee, which approved all loans under the activity. To facilitate comparisons between loan recipients and non-recipients, each recipient was paired to a non-recipient with similar productive activities, requested loan amount, projected internal rate of return (IRR),[2] and application date. Mathematica staff conducted most interviews in El Salvador during May and July 2011.

[1] In January 2012, BMI changed its name to Banco de Desarrollo de El Salvador, or BandeSal. However, it is referred to as BMI throughout this report.

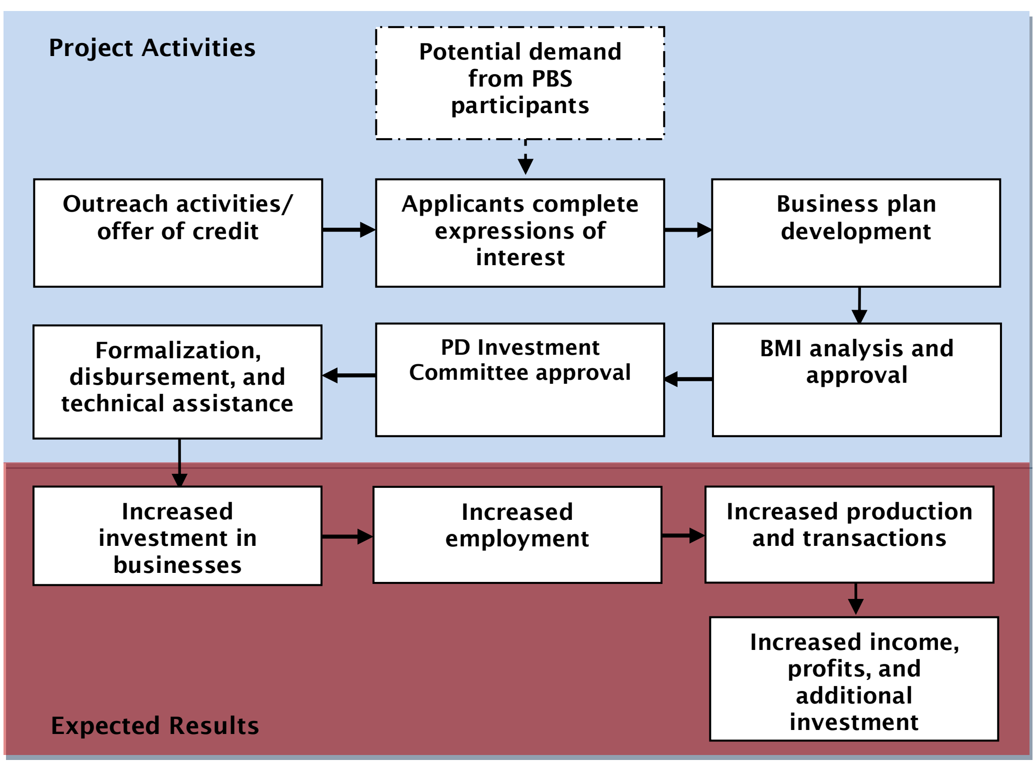
[2] The IRR of an investment is the discount rate at which net present value of costs of an investment equals the net present value of the benefits of the investment.

Design and Implementation Findings

Design Summary. In the MCC-El Salvador compact, a total of $21 million was allocated to the Investment Support Activity: $17 million for investment capital, $2 million for a related technical assistance fund, and $2 million for administration. As it was designed, the Investment Support Activity would directly address the economic constraint of limited access to credit in the country's Northern Zone, particularly for activities related to agricultural and other productive sectors. According to a former FOMILENIO employee who helped develop the PDP, the Investment Support Activity's targeted investments were intended to serve as a complement to technical and material assistance provided to small producers under the largest activity of the PDP, the Production and Business Services (PBS) activity. Small producers who received technical and material assistance under PBS (as well as producers who did not receive PBS assistance) could apply for Investment Support funds to finance viable and innovative business ideas. As prescribed in the compact, BMI would implement the investment support program through a suitable financial vehicle managed by BMI and financed with grants from FOMILENIO.

Figure 1 provides a visual representation of how the Investment Support Activity was designed to achieve its key objective of economic development. First, potential borrowers—including PBS participants—express interest in credit and compose a business plan. Once the plans are submitted, they are analyzed by BMI staff. Plans determined to be viable by BMI progress to the PD Investment Committee, comprised of public and private sector representatives. The committee then ranks and approves or rejects applications, and approved projects begin the process of loan formalization and disbursement. Using disbursements, borrowers make capital investments in their enterprises and likely employ additional workers for construction and new business activities. As a result of the additional investment, loan recipients are expected to have higher production, income, and profits.

Figure 1. Investment Support Logic Model



Source: FOMILENIO program manuals.

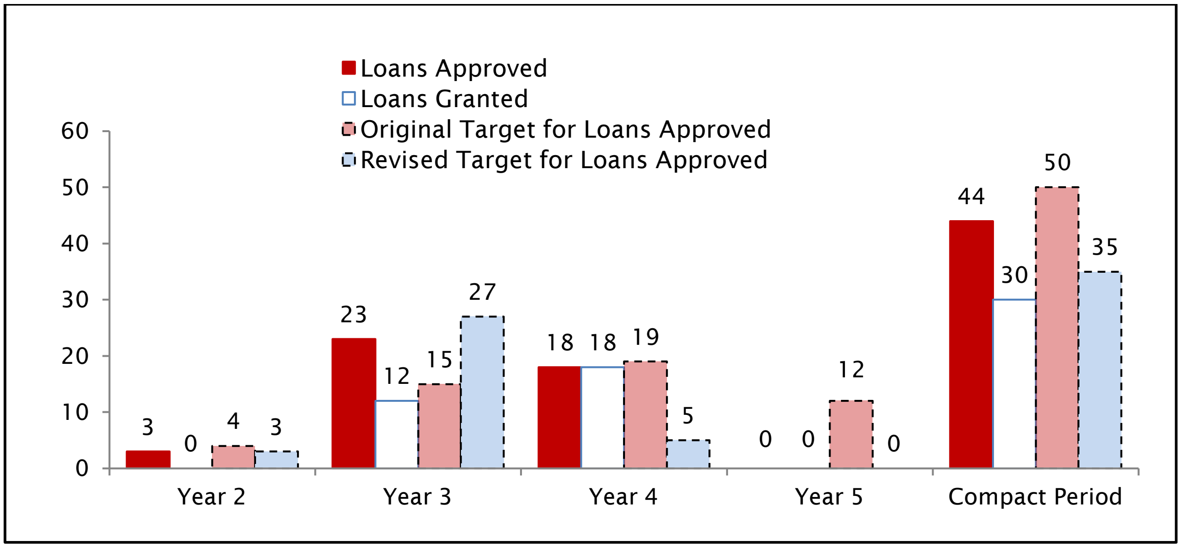
Implementation Summary. Around one-and-a-half years after the MCC-El Salvador compact entered into force in late 2007, BMI and FOMILENIO formed the Trust Fund to Support Investment in the Northern Zone (known as FIDENORTE in Spanish), which would administer loans under the Investment Support Activity. Under the fund's charter, BMI assumed all major responsibilities related to the development and administration of FIDENORTE loans and FOMILENIO committed to financing the fund's investments and operating costs, composing a communication plan, and forming the PD Investment Committee. The charter also specified the financial product to be offered under FIDENORTE, a loan with a minimum amount of $50,000 (U.S. dollars) and an annual interest rate of around 8.25 percent. This minimum loan amount represented a compromise between FOMILENIO and MCC preferences, as FOMILENIO had originally favored a lower minimum amount of $10,000 targeting small producers, and MCC had originally favored a higher minimum loan amount, around $250,000, to target high-return investment opportunities.[3]

FIDENORTE lending officially commenced in early 2009, but initial implementation was characterized by low levels of outreach and a small number of viable applications. After a successful outreach campaign in late 2009 and a decision to contract consultants to develop business plans, BMI presented several viable projects to the investment committee in late 2009 and early 2010. By the mid-term review of all FOMILENIO activities in March 2010, 13 proposals worth $2.4 million were approved by the investment committee. Because of concerns regarding BMI's ability to develop a pipeline of projects in the remaining compact period, FIDENORTE investment capital funding was cut in March 2010 to $8.5 million—a reduction of 50 percent relative to the original funding. FIDENORTE implementation after the mid-term review was strong compared to previous implementation periods, as BMI and FOMILENIO established and strengthened processes to develop and analyze business plans and submit loan applications to the investment committee for their approval. Thirty-one loans worth $5.0 million were approved between the mid-term review and April 1, 2011, the last date new loans were approved.

The original lending target for the Investment Support Activity was 50 approved loans worth $17 million. After the mid-term review in early 2010, this target was revised downward to 35 approved loans worth $8.5 million. With 44 approved loans worth $7.4 million, FIDENORTE surpassed its revised target of 35 approved loans, but fell short of its revised goal of $8.5 million in approved funds (Figures 1 and 2). With 30 loans worth $5.7 million granted by September 30, 2011, actual FIDENORTE lending was notably lower than the number and amount of loans approved by that date (Figures 2 and 3).

[3] In this context, high-return investment refers to loans made in the interest of generating the largest possible economic and social impact, usually in the form of job creation and increased income.

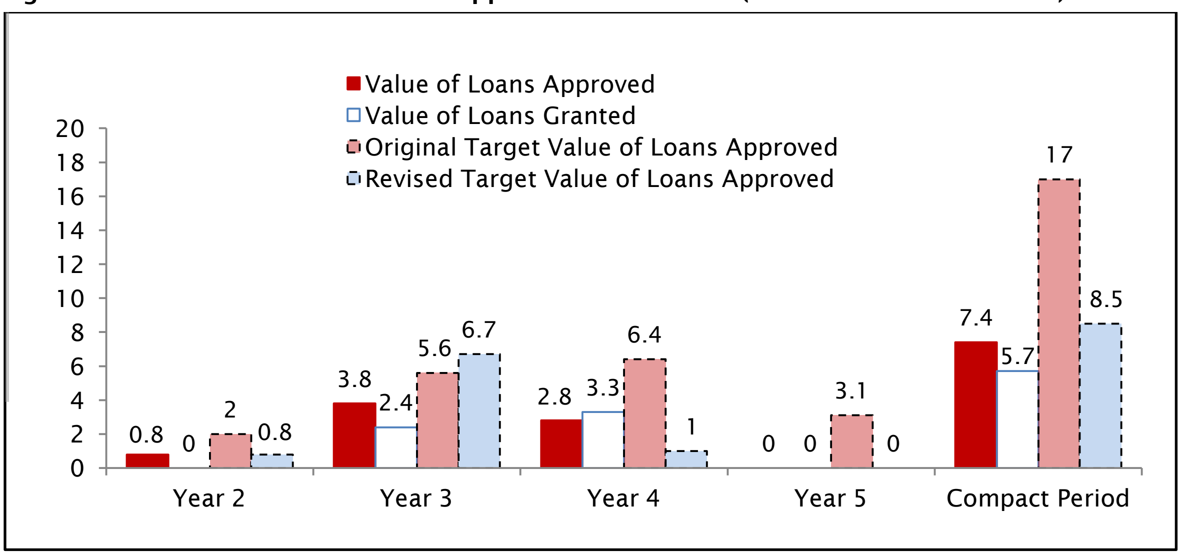
Figure 2. Number of FIDENORTE Loans Approved and Granted



Source: FOMILENIO and BMI administrative records.

Notes: The dates for Year 2 are October 2008 to September 2009; Year 3 is October 2009 to September 2010; Year 4 is October 2010 to September 2011; Year 5 is October 2011 to September 2012. No loans were planned for Year 1 of the compact (October 2007 to September 2008). In addition, no new loans will be approved during Year 5.

Figure 3. Value of FIDENORTE Loans Approved and Granted (in Millions of U.S. Dollars)



Source: FOMILENIO and BMI administrative records.

Notes: The dates for Year 2 are October 2008 to September 2009; Year 3 is October 2009 to September 2010; Year 4 is October 2010 to September 2011; Year 5 is October 2011 to September 2012. No loans were planned for Year 1 of the compact (October 2007 to September 2008). In addition, no new loans will be approved during Year 5.

Table 1 presents loan characteristics of all 44 projects approved by the investment committee. Across all sectors, the average loan size was around $170,000, with an annual interest rate of 9.1 percent and a maturity period of 68 months. Among all approved loans, loan sizes ranged from $50,000 to $723,000, and annual interest rates ranged from 8.2 percent to 12.4 percent. On average, a typical FIDENORTE loan took 292 days (or almost 10 months) to progress from initial application to formalization.

Table 1. Characteristics of Approved FIDENORTE Loans (Averages)

	Average	Minimum	Maximum
Loan Size (U.S. Dollars)	$169,713	$50,000	$723,000
Interest Rate	9.1%	8.2%	12.4%
Projected Internal Rate of Return (IRR)	16%	13%	25%
FIDENORTE Contribution	56%	26%	70%
Debt-Equity Ratio	1.2	0.1	3.1
Maturity Period (in months)	68	48	96
Days from application to formalization	292	126	430

Source: FOMILENIO administrative data and BMI presentations made to the PD Investment Committee between 2009 and 2011.

Notes: Sample size is all 44 loans approved by the PD Investment Committee.
Maturity period includes loans' grace period.

Conclusions

Implementation Assessment. The Investment Support Activity fell short of its original lending targets—both in value and number of loans approved—due to delays in establishing the trust fund and defining the investment product; a lack of capacity to compose and analyze viable business plans; BMI's limited experience as a first-tier lender; and a lengthy and complex loan development and approval process. Despite these obstacles, BMI and FOMILENIO performed several implementation tasks remarkably well and demonstrated an ability throughout the implementation period to make midcourse corrections. For example, BMI designed and implemented a successful outreach campaign in late 2009 when it became clear that the activity did not have a sufficient pipeline of projects in development. Particularly after the mid-term review, the investment committee also performed its core responsibilities efficiently and capably.

With 30 loans granted as of September 30, 2011, the level of the activity's actual lending appears modest in proportion to its high administrative costs of approximately $800,000 (around 14 percent of the value of all granted FIDENORTE loans). However, each of these loans represents a large investment on the part of FOMILENIO and BMI in technical assistance and business plan development, technical and financial analysis, customer service, and in-person monitoring.

Based on administrative data and interviews with applicants and program staff, it appears that the Investment Support Activity has served its target population of poor producers—particularly poor farmers with some level of working capital—as well as enterprises that benefit poor individuals. From an implementation standpoint, providing both types of groups with assistance and credit represents a diversified investment in business endeavors in the Northern Zone. However, it is difficult to argue that the activity targeted those organizations with insufficient capital and liquid assets to finance their investments, as mandated in the compact. Despite these findings, interviews with applicants and other stakeholders suggest that several FIDENORTE loan recipients in the handicrafts and tourism chains could not have secured credit outside of FIDENORTE. In this sense, the activity complied—at least to some extent—with its original spirit of providing credit to organizations and individuals who otherwise could not have financed their investments.

Also to some extent, the Investment Support Activity fulfilled its original objective of providing investment capital to individual and collective producers who also received technical and material assistance under the PBS Activity of the PDP. Fifteen of the 44 FIDENORTE loans approved belonged to PBS participants, primarily tomato and dairy producers.

Results Assessment. The ultimate goal of the Investment Support Activity is to reduce poverty by enabling the creation of profitable businesses that generate employment and raise income. As to whether the activity has successfully generated investment, employment, and additional income, our interviews revealed that through the use of FIDENORTE credit, all five interviewed FIDENORTE loan recipients reported increased productive investments and additional employment, three recipients experienced increased production and sales, and two recipients reported higher net incomes (Figure 4). In contrast, paired non-recipients had not experienced these positive outcomes on the same scale (or at all in the case of increased net income). However, because we do not have a valid comparison group for loan recipients or a sufficiently large sample size, we cannot attribute these recipient/non-recipient differences in outcomes to FIDENORTE credit. Considering these limitations, the comparisons of recipients and non-recipients merely suggest the potential positive effect of FIDENORTE credit on these key outcomes. As most borrowers are still completing investments from their business plans, more detailed information regarding sales, income, and employment should be collected in future rounds of data collection.

Figure 4. Outcomes of Interviewed FIDENORTE Loan Recipients versus Non-Recipients

	Loan Recipients	Non-Recipients
Investment	Four of five recipients invested FIDENORTE funds in their businesses and all five invested a portion of their own money.[a]	One of five non-recipients invested funds from a non-FIDENORTE credit and two of five non-recipients invested their own funds in their businesses.
Employment	All five recipients reported employing additional full-time workers in recent months, ranging from one full-time worker to 10 full-time workers.	Two of five non-recipients reported employing additional workers in recent months. One of these individuals received credit through another bank.
Production and Sales	Three of five recipients experienced higher production and/or sales.	One of five non-recipients experienced an increase in tomato production and sales.
Net Income	Two of five recipients experienced higher net income related to FIDENORTE credit.	None of the non-recipients experienced an increase in net income since applying for FIDENORTE credit.

Source: Interviews with FIDENORTE applicants conducted in July 2011.

[a]One loan recipient had not received a disbursement at the time of in-person interviews, and thus had not yet invested FIDENORTE funds.

Lessons Learned

A central theme of the Investment Support Activity is that different development approaches and perspectives among MCC, FOMILENIO, and BMI regarding the activity's loan recipients, minimum loan size, and interest rate produced an unclear vision of the activity's target population and loan product, spent valuable human resources throughout implementation, and caused the uneven application of loan conditions from 2009 to 2011, to the extent that initial loans approved in 2009 were likely subsidized and the last loans approved in 2011 more resembled market-based financial products. In light of these findings, a key lesson learned from the FIDENORTE experience is that the tension between pro-poor targeting and high-return lending—as well as the tension between minimizing financial risk and assuming additional risk to serve a particular target population—should be discussed, finalized, and codified before project implementation, if possible.

Another key finding regarding the activity's implementation is that by all accounts, BMI did not have the capacity to fulfill its function as a first-tier lender when trust fund operations began in early 2009. This situation may have been avoided with the inclusion of stronger positive and negative incentives in BMI's implementing entity agreement to enhance the bank's internal capacity preceding implementation. Positive incentives could have included the provision of targeted technical assistance to BMI staff before and during program implementation. Negative incentives could have included requirements to build technical capacity and submit a comprehensive operations plan preceding implementation, accompanied by well-defined consequences if such requirements were not met.

I. INTRODUCTION AND STUDY DESCRIPTION

A. Summary of the Investment Support Activity

The Productive Development Project (PDP) is one of three large-scale projects financed under the 2006 compact between the Millennium Challenge Corporation (MCC) and the Government of El Salvador. Administered under the supervision of the Millennium Challenge Account (known as FOMILENIO in Spanish), the main objective of the PDP is to assist in the development of profitable and sustainable business ventures for poor individuals and organizations that benefit these individuals in El Salvador's Northern Zone. Between 2007 and 2012, the PDP will use nearly \$72 million in allocated funds to serve approximately 13,500 individuals and create an estimated 11,000 full-time equivalent jobs. The PDP comprises three activities: Production and Business Services (PBS); Investment Support; and Financial Services. The PBS Activity offers pre-investment studies, training and technical assistance, in-kind contributions of agricultural and genetic materials, legal assistance, and other business development services to small farmers and business owners. The Investment Support Activity offers investment capital for competitively selected business proposals. Finally, the Financial Services Activity supports two loan guarantee programs targeting micro-, small-, and medium-sized enterprises, as well as a small technical assistance program to financial institutions.

As stated in the MCC-El Salvador compact, the goal of the Investment Support Activity is to provide poor individuals and organizations that benefit them with much-needed investment capital. Provided in the form of multi-year loans, this investment capital is intended to reduce poverty by enabling the creation of profitable and sustainable business activities that generate employment and significantly raise borrowers' income. Since early 2009, the Multi-Sector Investment Bank (known as BMI in Spanish) has administered the activity through the Trust Fund to Support Investment in the Northern Zone (known as FIDENORTE in Spanish).[4] Originally set at \$21 million, the budget for the activity was revised to \$9.7 million following the mid-term review of all FOMILENIO activities in early 2010. As with all activities funded by the compact, the Investment Support Activity will end in September 2012. However, loans granted under the activity are not required to reach maturity until September 2016.

B. Study Rationale

In 2007, MCC contracted Mathematica Policy Research to evaluate the Investment Support Activity. After studying the activity's design and initial implementation, Mathematica staff determined that a rigorous impact evaluation of FIDENORTE activities was not possible for the following reasons: First, because FIDENORTE credit was available to all eligible producers in the Northern Zone, it would be impossible to construct a comparison group of eligible producers that were similar to FIDENORTE loan recipients on all dimensions except for access to FIDENORTE credit. Second, even if a viable comparison group were available, small sample sizes would preclude

[4] The Multi-Sector Investment Bank is owned by the Government of El Salvador. Established in 1994 with assistance from the Inter-American Development Bank, the primary objective of the BMI was to supply much-needed medium- and long-term capital to private sector enterprises in an efficient, fair, and transparent manner. Before its involvement with the Investment Support Activity, BMI functioned exclusively as a second-tier lender or an institution that lent to other financial institutions, which in turn lent to private citizens, companies, and other organized groups. In January 2012, BMI changed its name to Banco de Desarrollo de El Salvador, or BandeSal. However, it is referred to as BMI throughout this report.

sufficient statistical power to estimate program impacts. As an alternative, Mathematica staff proposed and employed a mixed methods evaluation design to document the activity's implementation and results.[5] The main objective of this study is to document the original plan for the Investment Support Activity; the evolution of the activity from 2009 to 2011; the FIDENORTE loan application process; characteristics of applicants' business plans and loans; and preliminary findings regarding borrowers' investments and business outcomes following receipt of FIDENORTE credit. These findings could serve as a resource for MCC staff as they formulate similar credit programs in future compacts.

Mathematica will also design and implement a follow-up study of the Investment Support Activity, scheduled for completion in late 2012 or early 2013. The focus of this second study will be to document changes in borrowers' investments and business outcomes up to three years following their receipt of FIDENORTE credit. This study will also document borrowers' repayment, as well as the use of FIDENORTE reflows to finance academic scholarships after the termination of the compact period.

C. Research Framework and Methods

To guide our analysis, we used a research framework composed of the following three broad research questions (and their corresponding sub-questions) related to the design and implementation of the Investment Support Activity from 2007 to 2011:

1. **How was the Investment Support Activity designed and why was it designed in this way?** What were the key objectives, activities, and outcomes? What was the target population? What key players and considerations were involved in the activity's design?
2. **How was the activity implemented?** What were the primary implementation phases of the activity? What were the primary steps of the loan application and approval process? Did the activity meet its targets for the number and value of loans approved? Did the activity serve its designated target population?
3. **Did the activity produce its desired results?** Did borrowers increase their productive investments, income, and employment following their receipt of credit?

This study draws from several qualitative and quantitative data sources, including program manuals, administrative data, FOMILENIO and BMI reports, interviews with FOMILENIO, BMI, and MCC staff, as well as interviews with 10 applicants (5 loan recipients and 5 non-recipients) and members of the Productive Development (PD) Investment Committee, which approved all loans under the activity. To compare recipients and non-recipients,[6] each loan recipient was assigned to a non-recipient applicant with similar productive activities, requested loan amount, internal rate of return (IRR), and application date.[7] While loan recipients and non-recipients had similar businesses

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[5] Mixed methods evaluations feature a combination of qualitative and quantitative analysis.

[6] Due to the small sample sizes and likely systematic differences between credit recipients and non-recipients, these comparisons of borrowers and non-borrowers were made for descriptive purposes only.

[7] The IRR of an investment—also known as the financial internal rate of return (FIRR)—is the discount rate at which the net present value of the costs of an investment equals the net present value of the benefits of the investment. For the PDP, an IRR of 14 percent was set as a minimum threshold to prioritize and select investments. The IRR differs slightly from the economic rate of return (ERR), which is generally used by MCC to evaluate potential compact investments. Whereas the IRR includes only costs and benefits experienced by the decision-maker (in this case, BMI and

and loan applications, non-recipients were fundamentally different from recipients in that they were rejected for credit due to collateral issues (as in the case of three non-recipients) or they chose not to accept a FIDENORTE loan (as in the case of two non-recipients). Mathematica staff conducted most interviews in El Salvador during May and July 2011 and completed additional interviews by phone in July 2011. (See Appendix A for a list of all non-applicants interviewed.)[8]

D. Roadmap

The rest of this report is organized as follows: In Chapter II, we provide a summary of the Investment Support Activity's original design and objectives. In Chapter III, we describe the activity's primary implementation phases, from initial preparations in 2007 to final loan approvals in early 2011. After providing this overview of the activity's design and implementation, we describe the loan application and approval process in depth in Chapter IV. Next, Chapter V provides a summary and analysis of FIDENORTE business plans and approved loans. In Chapter VI, we present a summary of borrowers' investments and business outcomes, and in the last chapter we provide lessons learned and conclusions.

(continued)
the PD Investment Committee), the ERR includes all costs and benefits experienced by all parties, including positive and negative externalities.

[8] To protect their identities, the names of applicants are not provided in this report.

II. DESIGN OF THE INVESTMENT SUPPORT ACTIVITY

From 2005 until the MCC-El Salvador compact was signed in November 2006, the technical secretary of the president of El Salvador worked with MCC staff to develop the general PDP design. Given BMI's strong institutional capacity regarding lending and productive development, the technical secretary also involved various BMI staff members in this process. By 2006, a series of consultations between MCC staff, the technical secretary, and BMI staff solidified the basic objective, organizational structure, and budget of the Investment Support Activity of the PDP. Below is a summary of these basic features of the activity and how they were established.

A. Objective

As stated in the compact, the goal of the Investment Support Activity is to "make investment capital available to poor individuals and organizations that benefit poor inhabitants of the Northern Zone, who, due to insufficient collateral and lack of liquid assets, are not able to finance their investments." (See Appendix B for the compact's full description of the Investment Support Activity.) As mentioned previously, this investment capital is intended to reduce poverty by enabling the creation of profitable and sustainable business activities that generate employment and significantly raise loan recipients' income. Another key objective of the activity is to increase private investment in the Northern Zone. Stakeholders generally define private investment as the sum of the credit amount and borrowers' counterpart contributions to their investments.

As they were designed, the Investment Support Activity and the Financial Services Activity would directly address the economic constraint of limited access to credit in the country's Northern Zone, particularly for activities related to agricultural and other productive sectors. Preliminary financial studies had found that Salvadoran banks had available capital as well as the inclination to provide credit to strong clients. However, banks were reluctant to invest in the agricultural sector due to inherent risks in agricultural investments. The Investment Support Activity's offer of investment capital would fill this financing gap in the Northern Zone for small- and medium-sized productive businesses, and guarantees and other incentives provided under the complementary Financial Services Activity would induce existing lending institutions to make small loans in the region to finance informal productive activities and small-scale businesses.

As with the PBS Activity of the Productive Development project, assistance under the Investment Support Activity was restricted to the fruit, horticulture, dairy, tourism, forestry, handicraft, and coffee value chains. According to an MCC staff member, the value chains represented in the PBS and Investment Support activities were target value chains selected by BMI for their high potential for economically viable business endeavors in the Northern Zone. Even before compact negotiations began, BMI staff had conducted economic analyses of the Northern Zone that supported the decision to focus on the value chains listed above.

According to a former FOMILENIO employee who helped develop the PDP, the Investment Support Activity's targeted investments were intended to serve as a complement to technical and material assistance provided to small producers under the PBS Activity of the PDP. As originally envisioned by authors of the PDP, the Investment Support Activity would finance PBS participants' innovative and viable business ideas that were outside the scope of PBS's structured assistance.[9] Small- and medium-sized businesses outside of PBS were also intended targets for the activity, as the program's infrastructure investments—particularly the new highway linking several departments in the Northern Zone—were expected to produce viable business opportunities in the region. An MCC representative corroborated that this was the original intent of the Investment Support Activity, but added that the activity's initial budget of $21 million was just a portion of the $88 million in investment capital originally proposed by BMI.

B. Implementation Guidelines

The compact also provided some basic guidelines to govern the implementation of the Investment Support Activity. First, the activity should support a demand-driven, competitive process to provide capital to critical investments in key value chains in the Northern Zone. Second, the activity should require potential proponents to make proposals to compete for support based on transparent selection criteria, including a minimum economic return threshold, technical feasibility, and financial need. Third, proposals should be reviewed, ranked, and recommended for approval by an investment committee according to these established criteria. As implied in the compact, competition between applicants would ensure that the most promising business ideas in the zone would secure funding. In addition, many key criteria cited in the compact, particularly the economic return threshold and technical feasibility, were oriented toward selecting the most financially and technically viable projects in the zone. However, because financial need is also cited as a key selection criterion, it is evident that the compact proposed some degree of balance between financing the most viable business plans (as measured by economic return thresholds and technical feasibility) and benefiting underserved populations (as measured by financial need).

C. Target Population

Closely related to the activity's eligibility criteria is its target population. As defined by the compact, the Investment Support Activity should provide investment capital to poor producers and enterprises that benefit them. The compact also states that "underrepresented groups such as small farmers, women, and youth will receive preference in the assessment of potential beneficiaries of the Investment Support Activity." Upon examining these statements, it is evident there is a potential tension in the compact between directly benefiting poor producers with loans and providing loans to the enterprises that benefit them. However, the document provides some guidance on resolving this tension with its mandate to "encourage alliances, joint ventures, and other forms of collaboration between more established enterprises and smaller/disadvantaged organizations and individuals in the Northern Zone." By emphasizing collaborations between established enterprises and disadvantaged individuals, the compact does not state a preference between serving either of these two groups. Rather, it implies that collaborations between the two should produce optimal business outcomes because such collaborations would lead to faster start-up and increased chances of success and sustainability.

[9] In Section 2(b) of Schedule 2 to Annex I, the compact provides additional information on the purpose of the Investment Support Activity. It states that the activity will "provide capital to critical investments required for successful operation of a business activity that is part of a value chain … in the Northern Zone."

D. Implementing Institution

The compact also defined the institution that would administer the Investment Support Activity. BMI would implement the investment program through a suitable financial vehicle funded with grants from FOMILENIO. Largely because of its financial expertise and private-sector orientation, BMI was chosen as the implementing organization for the Investment Support Activity (as well as the other activities of the PDP). BMI personnel were particularly motivated to handle the activity because it would provide them with their first opportunity to identify and develop viable business plans as a first-tier lender. They could apply this experience to the design and implementation of their proposed economic development fund, which would be established in the next few years.

E. Initial Funding and Timeline

As outlined in the compact, a total of $21 million was originally allocated to the Investment Support Activity: $17 million for investment capital, $2 million for a technical assistance fund to support applicants and loan recipients, and $2 million for administration costs. The objective of technical assistance was to provide borrowers with continued technical and financial assistance, either in the application phase or once loans were disbursed. As outlined in the compact, the $21 million was to be distributed across four years of the compact period: $4.20 million was designated for the second year (2008-2009), $7.35 million for the third year (2009-2010), $7.35 million for the fourth year (2010-2011), and $2.10 million for the fifth year (2011-2012). Funding was allocated in this way to allow for the organization of the activity in the first year, some moderate lending in the second year, and the majority of lending in the third and fourth years once demand levels and administrative processes were well established. In addition, the compact prescribed that all loans administered under the activity reach maturity by nine years after the compact entered into force, or September 2016.

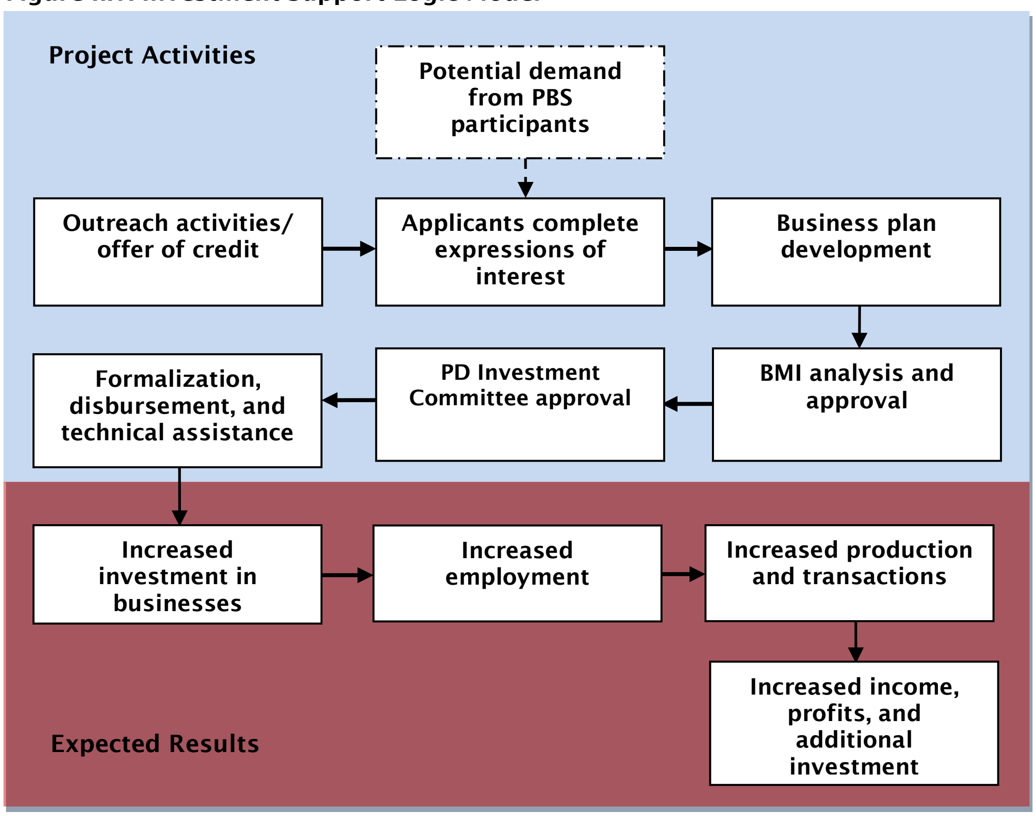
F. Relationships between PDP Activities

As stated earlier, a substantive intersection between the PBS and Investment Support activities was envisioned in the compact. It states that applicants assisted in developing a business plan under the PBS Activity may submit those business plans for award consideration under the Investment Support Activity. As PBS was originally designed, service providers would help small business owners produce viable business plans as part of their standard technical assistance package, and business plans that met basic FIDENORTE criteria could be submitted directly to BMI for analysis and potential approval. In this sense, the Investment Support Activity would benefit from built-in demand from PBS. However, the compact clarified that investment support applications were not restricted to PBS participants because many viable business ideas outside of PBS were also anticipated.

Concerning the relationship between the Investment Support and Financial Services activities, the two activities were envisioned as supplementary investments to increase the supply of credit to the Northern Zone. Whereas the Investment Support Activity would finance direct capital investments to productive enterprises, the Financial Services Activity would provide guarantees to foster small- and medium-sized loans to individuals and small enterprises engaged in modest productive activities. Together, the two activities would offer a broader range of loan sizes to a larger segment of producers than either activity in isolation.[10]

The logic model below (Figure II.1) provides a visual representation of how the Investment Support Activity would achieve its key objective of economic development, as outlined in the compact and original operations manuals. First, potential borrowers—including PBS participants who desire investment loans—express interest in credit and compose a business plan. Once the plans are developed and submitted, they are analyzed by BMI analysts. Plans determined to be viable by BMI progress to the PD Investment Committee, where they are ranked and approved or rejected. Approved projects begin the process of loan formalization and disbursement. Using disbursements, loan recipients make capital investments in their enterprises (with Investment Support funds as well as their own) and likely employ additional workers for construction and new business activities. As a result of the additional investment, borrowers have higher production (or more business transactions in the case of tourism enterprises), increased income, and higher profits. These profits can be reinvested into borrowers' businesses or used to foster other investments in the Northern Zone.

Figure II.1. Investment Support Logic Model



Source: FOMILENIO program manuals.

[10] The Financial Services Activity was composed of PROGARA Norte, guarantees through Sociedad de Garantías Recíprocas (SGR), technical assistance to financial organizations, and agricultural insurance. PROGARA Norte offered guarantees for smaller-sized loans, usually between \$2,000 and \$4,000, to small (and usually informal) businesses. In contrast, SGR offered formalized small and medium enterprises a mutual guarantee arrangement for larger-sized loans in which risk was pooled among member borrowers.

III. IMPLEMENTATION OF THE INVESTMENT SUPPORT ACTIVITY

Implementation of the Investment Support Activity from 2007 to 2011 can be divided into four distinct phases:

- Initial preparations
- Phase I (limited implementation)
- Phase II (general implementation prior to the mid-term review)
- Phase III (general implementation following the mid-term review)

In this section, we summarize the most salient program activities, decisions, and developments in each phase. (See Table III.1 for a summary of the activities, loan approvals, and key decisions in each implementation phase.)

A. Initial Preparations (September 2007–February 2009)

During 2007 and 2008, the first service provider for the PDP, SNC-Lavalin,[11] worked with FOMILENIO and BMI staff to refine the design of the Investment Support Activity and plan its implementation. During this period, SNC-Lavalin and FOMILENIO staff envisioned that PBS participants would generate the most demand for Investment Support loans. In particular, SNC-Lavalin and FOMILENIO staff assumed that PBS pilot projects would provide the Investment Support Activity's first batch of loan applications.[12] As a result, fully developed plans for the Investment Support Activity were delayed until after PBS pilot projects were under way.

1. Defining the Financial Product

During 2008, SNC-Lavalin was given the task of providing key inputs to determine the financial structure and product of the Investment Support Activity, including a diagnostic of financial institutions and a study of resources and potential investment opportunities in the Northern Zone. According to FOMILENIO staff, however, this task was not performed satisfactorily.[13] As a result, FOMILENIO staff took a leadership role in defining the activity's structure and financial product in late 2008. At this time, FOMILENIO and MCC staff agreed that activity's investment support would take the form of loans, as opposed to royalty contracts, equity investments, or private stocks.

[11] SNC-Lavalin is an engineering firm based in Montreal, Québec. The firm was contracted in 2007 to conduct studies related to the PBS and Investment Support activities and formalize these activities' implementation designs. In the first phase of its contract, SNC-Lavalin developed the PDP operational structure, management, basic project approach design, as well as conducted studies and diagnoses of institutional, economic, social and geographic characteristics in the Northern Zone. During the second phase of its contract, SNC-Lavalin provided technical assistance to FOMILENIO in managing and monitoring the implementation of the components of the PDP.

[12] From an original applicant pool of 51 proposals, a total of 10 PBS pilot projects were selected for funding in 2008. The rationale for these pilots was to begin disbursing funds in the Northern Zone for the dairy, fruit, horticulture, and coffee value chains, among others, and to document lessons from these pilot projects that could be applied to full-scale PBS implementation.

[13] For example, rather than providing input on how the activity's trust fund should be established and structured, Lavalin's documents defined a very basic timeline for when the trust fund would be established and when lending would commence.

Of all these investment options, loans appeared to have the strongest regulatory and legislative framework. In addition, MCC policies prohibited some forms of investment, such as private stocks.

During this phase, there was some confusion regarding BMI's expected role in the Investment Support Activity. According to SNC-Lavalin's PDP operations manual submitted in July 2008, BMI would administer credit through financial intermediaries, or local banks that would identify investment opportunities and secure BMI's approval to formalize and administer loans. This planned use of local banks was corroborated by some FOMILENIO staff, who mentioned that original documents drawn up by SNC-Lavalin and FOMILENIO in 2008 designated that FIDENORTE credit would be administered through intermediary lending institutions under BMI's supervision. According to FOMILENIO staff, MCC had a large role in the decision to implement the activity without financial intermediaries. In early 2009, MCC staff determined that intermediary financial institutions did not have the ability to perform the core functions of the FIDENORTE loan process, including identifying and analyzing investment opportunities, finalizing loan agreements, and supervising investments. As such, MCC staff recommended that BMI handle all key functions, and FOMILENIO and BMI staff agreed to this request. Made in January 2009, this decision would have implications regarding BMI's ability to perform its responsibilities once the trust was formed in March 2009, particularly the functions of identifying and analyzing viable investment opportunities.

Also during this phase, the activity's minimum loan amount was a contentious issue. In the interest of meeting the credit demands of small producers—including producers served under PBS—FOMILENIO proposed a minimum loan amount of $10,000. In contrast, in the interest of granting high-return loans—or loans with the most potential to create employment and increased income—MCC envisioned a minimum amount of $250,000. After a series of meetings, a compromise of $50,000 was reached in late 2008. To some extent, this compromise mitigated the activity's inherent tension between benefiting established businesses and financing the most high-return business plans on one hand and serving poor and underrepresented populations on the other. A minimum loan amount of $50,000 could be accessed by strong individual producers as well as by groups of small producers served by PBS, and much larger loans could be granted to established businesses for high-return investments well over $50,000.

Also during this time, FOMILENIO and BMI established a default interest rate for FIDENORTE, defined as the existing BMI interest rate corresponding to the loan's maturity period, plus two points. BMI used this existing rate when lending to other financial institutions in its primary role as a second-tier financial institution. An additional two points were added to this rate to account for the risk inherent in FIDENORTE investments, which was higher than the risk of BMI's traditional loans to financial institutions. BMI and FOMILENIO staff reasoned that this default rate—around 8.25 percent—was an attractive interest rate for their target population, which they generally understood to be small producers served by PBS.[14]

During these preparations, FOMILENIO, BMI, and MCC did not specify any minimum level or acceptable range of collateral required for FIDENORTE credit. However, these stakeholders reached an agreement that collateral would be required for FIDENORTE credit, and this collateral

[14] In general, interest rates reflect the cost of capital, operational costs, lending risk, and profits. Because BMI's operational costs were fully covered through its contract with FOMILENIO and profits were not anticipated, FIDENORTE interest rates reflected only the cost of capital (BMI's base interest rate) and the estimated lending risk of the target population (2 additional interest points).

could take the form of an individual signature, pledge, mortgage or bond. Similarly, no minimum or maximum grace period—the amount of time between the borrower's first disbursement and the date the first principal payment is due—was defined at this time.

2. Establishing the FIDENORTE Trust Fund

In February 20, 2009, FOMILENIO, MCC, and BMI finalized and formalized the financial vehicle for the Investment Support Activity: a trust fund called the Trust Fund for Investment Support in the Northern Zone, or FIDENORTE, administered by BMI and financed by FOMILENIO. The fund's legal framework allowed FOMILENIO to define the purpose and use of the fund's resources, as well as BMI's core responsibilities of developing and administering loans to approved clients. Because its charter was a binding agreement between BMI, FOMILENIO, and MCC, the trust fund also provided a legal mechanism by which FOMILENIO and MCC could ensure that BMI performed its assigned responsibilities. The fund's guidelines codified the key characteristics of the loan product, including its minimum amount of $50,000 and interest rate of "BMI plus 2." (See Appendix C for the core characteristics of FIDENORTE loans, as defined by the original operations manual.)

Particularly noteworthy is that the trust fund and loan product were finalized about one-and-a-half years after the MCC-El Salvador compact entered into force in September 2007. Given that loans had to reach maturity by 2016, this left a time period of less than three years in which the activity could develop and approve loans of up to five years. According to interviewed stakeholders, this delay was caused by SNC-Lavalin's lack of guidance regarding the trust fund and loan product, BMI's administrative procedures and lack of leadership in establishing the trust fund, and (to a lesser extent) competing visions among FOMILENIO, BMI, and MCC regarding the fund's appropriate target population and loan product.

3. Defining Selection Criteria

As mentioned above, the 2006 compact provided substantive guidance on the criteria by which applicants would be competitively selected to receive credit under the Investment Support Activity. The compact mandated that proposals be evaluated according to specified criteria approved by MCC, including criteria with respect to financial rate of return; economic rate of return; co-investment level; environmental and social considerations; technical feasibility; and employment and other community impacts. First published in February 2009, the Investment Support operations manual codified several of these criteria and added additional key criteria, including a debt-equity ratio of no more than 4:1 and a credit rating of A1, A2, or B from a recognized financial institution (if applicants had a credit rating). Interestingly, the manual did not define any selection criterion regarding applicants' financial need. This was the only criterion mentioned in the compact that was not established as a fixed norm or criterion for borrower selection in the FIDENORTE operations manual.

4. Division of Responsibilities

Under the fund's charter, BMI assumed all major responsibilities related to the administration of the FIDENORTE trust fund. According to the charter, BMI would assume the role of a first-tier lender, as opposed to its traditional role as a second-tier lender. Also according to the charter, BMI committed to establishing guidelines for developing business plans, conducting outreach activities, preparing monthly financial reports, conducting the technical and financial analysis of business plans, identifying technical assistance needs, presenting proposals to the investment committee, administering loans, conducting monitoring visits, and collecting regular loan payments. Under the charter, FOMILENIO committed to fully financing the fund's investments and operating costs, composing a communication plan, and organizing an investment committee. As outlined in the charter, all loans would be approved by the investment committee, whose members would be appointed by the FOMILENIO board of directors. According to the PD Investment Committee manual, published on July 15, 2009 and modified on May 27, 2010, the investment committee would be made up of five voting members. The committee comprised two individuals from the FOMILENIO board of directors, two from the private sector, and one from a relevant productive sector in the Northern Zone. The committee was tasked with applying the designated selection criteria to either approve or reject each presented proposal.

5. Capacity and Personnel

During this time, FOMILENIO built some administrative capacity to supervise FIDENORTE. One specialist was assigned to work nearly full-time on the Investment Support Activity; two full-time FOMILENIO employees were assigned to handle the Investment Support and Financial Services activities; and one full-time employee was assigned to oversee all three PDP activities. BMI also staffed one half-time analyst and a project director on FIDENORTE. To facilitate closer cooperation between FOMILENIO and BMI staff on the Investment Support and Financial Services activities, the three FOMILENIO staff members assigned to the Investment Support Activity were located at BMI's offices in San Salvador.

6. Setting Program Targets

In late 2008, FOMILENIO staff identified a target of 50 approved loans for the Investment Support Activity. Using historical financial data on loans to small- and medium-sized businesses in El Salvador, they estimated the average size of a FIDENORTE loan to be around $340,000. Next, they divided the activity's total investment capital allotment of $17 million by this average loan amount and determined that 50 loans would be an appropriate target for the activity.

B. Phase I: Limited FIDENORTE Implementation (March 2009–October 2009)

1. Generating Demand

FIDENORTE implementation in early 2009 was characterized by low numbers of outreach activities, applications, and loan approvals. BMI expected to receive applications and business plans directly from PBS participants; consequently, its outreach efforts during this time were modest. But because of delays experienced by PBS during 2008 and 2009, there was little initial demand for FIDENORTE loans. Even when outreach events were conducted during 2009, identifying eligible and interested applicants was challenging. There was a high level of initial interest, but there was a general dearth of qualified applicants who could formulate and present business plans, as well as applicants who needed or desired at least $50,000 in investment financing. As a result of low levels of outreach and demand, only four loans were approved during this eight-month period, with a combined value of $1.1 million.

One PD committee member reasoned that the low initial level of demand for FIDENORTE credit was due primarily to the lack of producers and small- and medium-scale businesses in the Northern Zone that were well positioned to think strategically about their businesses and capital investments. According to the committee member, another primary reason for the low level of demand was BMI's lack of outreach and leadership during most of 2009.

2. Developing and Evaluating Business Plans

Also in 2009, BMI staff struggled with the low quality of business plans submitted by FIDENORTE applicants. Initially, applicants composed business plans based on guidance provided by FOMILENIO on its website. According to BMI staff, these plans were actually preliminary business ideas that required a large amount of financial and technical analysis. As a result, BMI and FOMILENIO decided to contract consultants to develop business plans for viable applicants. FOMILENIO classified these consultations as "pre-investment services," which would be financed with the activity's technical assistance funds. The first three business plans were completed by FIAGRO (a BMI sub-contractor) in August 2009. Also at this time, FOMILENIO contracted five individual consultants to complete such plans. However, when BMI and FOMILENIO analyzed the first business plans completed by consultants, it became evident that these plans often lacked strong technical and financial analysis. In part, this was due to consultants' prior qualifications and work experience. Some consultants had strong financial skills but no technical background, and vice versa. In some cases, input from additional consultants or FOMILENIO technical staff was needed to complement consultants' financial analyses. The involvement of multiple consultants and specialists in the business plan process often generated delays in the completion and submission of these plans to BMI.

Once it received business plans from consultants, BMI was responsible for analyzing the plans and evaluating their viability. Because it did not have in-house capacity to evaluate business plans, BMI contracted with a private company, Garantías y Seguros (GyS), to analyze the technical and financial aspects of consultants' plans. However, GyS's non-agricultural background complicated the analysis and presentation of this type of agricultural business plans, and their analysts took longer than expected to evaluate most business plans. As a result, GyS completed analysis for fewer than 10 plans in late 2009 and early 2010. Consequently, their contract was not renewed in February 2010.

During this phase, the lack of existing capacity to develop and evaluate business plans posed a serious threat to the activity's goal of developing and approving FIDENORTE loans. Because most applicants were unable to develop business plans on their own, the pool of eligible applicants was generally restricted to those few applicants who were assigned a consultant through FIDENORTE. In addition, consultants' limited capacity to develop plans, as well as GyS's inability to analyze these plans in a timely manner, resulted in major delays in presenting viable business plans to the investment committee throughout 2009 and early 2010.

3. Capacity and Personnel

At the beginning of this phase, BMI devoted one full-time analyst, a project director, and some administrative staff to FIDENORTE. These BMI staff members had no previous experience with first-tier lending tasks. One FOMILENIO staff member observed, "When BMI started this work [with FIDENORTE], it was from zero. They had never offered technical assistance or worked with [borrower] organizations." BMI staff was adept at assessing the risk of intermediary financial organizations, but it had little experience assessing the risk of development projects and productive groups as designed under FIDENORTE. As a result, BMI had no established processes to perform nearly all of the several tasks with which it was charged, including outreach activities, business plan analysis, and customer service. For example, BMI did not contract

> "When BMI started this work [with FIDENORTE], it was from zero. They had never offered technical assistance or worked with [borrower] organizations."
>
> *FOMILENIO staff member*

with a customer service representative until late 2009, several months after FIDENORTE implementation began.

According to one FOMILENIO source, stakeholders should have made additional efforts to verify that BMI had the capacity to fulfill its functions as a first-tier lender before the loan program was under way. If BMI did not have the capacity to perform its functions, reasoned the interviewee, stakeholders should have helped the bank build this capacity preceding implementation. According to MCC interviewees, MCC staff and consultants did assess BMI's internal capacity during due diligence in 2006, as well as at other key junctures preceding the trust fund's establishment. These assessments found deficiencies in BMI's ability to administer the Investment Support Activity (in addition to other activities under the PDP). Despite these deficiencies, BMI was viewed as the most suitable organization to analyze and develop the activity's investment loans, primarily because of its overall financial expertise and experience. To mitigate the risks inherent in BMI's management of the PDP, MCC and FOMILENIO staff agreed that the initial PDP contractor, SNC-Lavalin, would assist BMI in conducting diagnostic studies of the Northern Zone and building technical capacity preceding project implementation. As stated previously, SNC-Lavalin did not perform this task adequately, and BMI leadership was also unable to hire qualified staff preceding and during initial implementation. These factors in particular, in addition to the decision to implement the project without financial intermediaries, played a substantive role in BMI's lack of preparation for program implementation in 2009.

In addition, several personnel changes occurred during this initial implementation period, particularly within BMI. Related to the change in government at the national level, the original BMI team leading FIDENORTE administration was replaced by a new team in June/July 2009. The new BMI team experienced some delays as they learned about the program, and BMI's internal committee lost some momentum as a result. According to a member of the PD Investment Committee, the change in personnel resulting from the political transition was at least partly responsible for BMI's lackluster performance during this phase of the project.

Also during this period, FIDENORTE administration shifted between several departments within BMI. Originally, FIDENORTE was organized under BMI's development bank and FOMILENIO's staff members worked in this department. However, the project was transferred in 2009 to BMI's financial products department. When the director of the financial products department resigned in June 2009, the project was returned to the development bank division. The result of these organizational shifts was a general absence of leadership among BMI staff regarding FIDENORTE activities, as well as coordination difficulties between BMI and FOMILENIO regarding key steps in the loan process, including business plan analysis and the formal presentation of projects to the investment committee.

Largely due to personnel issues, reorganizations, and leadership gaps, BMI did not perform all its responsibilities related to conducting outreach, identifying promising investments, analyzing business plans, presenting projects, and administering loans during this period. For example, BMI staff was tasked with identifying all technical assistance needs and presenting technical assistance proposals and any related terms of reference. However, this responsibility was eventually transferred to FOMILENIO because BMI failed to fulfill this function.

4. Committee Deliberation and Approval

Starting with their first meeting in July 2009, the investment committee established norms regarding borrower selection; these norms would be used in conjunction with the core selection criteria established in the FIDENORTE operations manual. The most notable norms included an IRR of at least 14 percent, as well as BMI's approval of the technical viability of the proposed plan.[15] The committee also defined employment generation as key selection criterion, but did not establish minimum norms regarding this requirement.

As it began to consider projects for approval in mid-2009, the committee had no difficulty applying straightforward criteria and norms such as the minimum IRR requirement and counterpart contribution of at least 20 percent. However, regarding less-defined criteria such as the collateral requirement, the committee struggled to define an objective standard to apply to all proposed projects. For the first few loans that it approved, the committee did not require a minimum level of collateral—only the presence of an accepted form of collateral. Over time, several committee members started to feel uncomfortable with the fund's vague collateral requirements, and responded by requiring collateral of at least between 100 and 120 percent of the loan value for approval. According to interviewed stakeholders, this minimum collateral requirement of 100 to 120 percent largely reflected collateral requirements at public and private banks for similar loan sizes.[16] One committee member stated that this development was primarily influenced by the Salvadoran government's auditing agency, which required sufficient collateral to minimize the risk of credits administered by public institutions.

During in-person interviews, FOMILENIO staff and committee members stated that the committee's decision to increase the minimum collateral requirement complicated the project's ability to serve underrepresented, poor populations. Said one respondent, "A stated objective was to reach poor zones…and provide investment capital that poor people really need. At the same time, there was a need to establish a minimum collateral value. This loan requirement changed the borrower profile somewhat, as poor people don't have access to much collateral." Another committee member expressed a similar sentiment, saying that the stricter collateral requirements sacrificed the social dimension of the loans. The member stated, "What's the point of a higher collateral requirement for its own sake? That would make us just like any other bank. If we want a social impact, we should assume more risk."

> "What's the point of a higher collateral requirement for its own sake? That would make us just like any other bank. If we want a social impact, we should assume more risk."
>
> *Investment committee member*

Also noteworthy during this implementation phase (as well as all subsequent phases) is that loan applications were not ranked by the investment committee, rather they were approved or not approved. Because eligible loan applications never exceeded the amount of funding available through FIDENORTE, selecting the most desirable applications from a pool of eligible applications—through ranking or some other method—was not possible. This represented a departure from the compact, which envisioned a ranking process by which the most promising applications would be selected for funding.

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[15] The IRR is roughly equivalent to the economic rate of return cited in the compact.

[16] According to a 2007 Inter-American Development Bank analysis (Zegarra, et. al), collateral requirements of between 100 and 120 percent were still below the average requirement of 144 percent in El Salvador among small enterprises. As such, one could argue that this seemingly stringent collateral requirement was still more lenient than market-based collateral requirements.

C. Phase II: General Implementation Prior to Mid-Term Review (November 2009–February 2010)

1. Generating Demand

In response to a lack of viable business plans from potential applicants, BMI personnel designed and implemented an outreach plan from November 2009 to April 2010. The plan featured community meetings and events with mayors in 11 target municipalities. In each of these municipalities, BMI staff set up "mobile offices" in mayor's offices to provide information regarding FIDENORTE credit to potential applicants and partners as well as collect preliminary information from potential applicants. To disseminate information about FIDENORTE, BMI also organized joint events with FOMILENIO and other banks. According to one BMI interviewee, providing good customer service was a key goal of this outreach effort. BMI staff reasoned that if they were attentive to potential applicants' circumstances and informational needs during these events, farmers and small business owners who attended the events would tell their friends and business partners about the credit opportunity. In addition to events in key municipalities, BMI's outreach campaign also featured radio announcements, brochures, and signs posted in high-traffic areas. All advertisements summarized the nature of FIDENORTE credit and mentioned competitive interest rates.

BMI had some success generating demand with this community-based approach. As a result of this outreach effort, BMI recorded 372 formal expressions of interest as well as a large number of informal information requests. These expressions of interest resulted in the first batch of FIDENORTE business plans in late 2009 and early 2010. In proportion to their outreach efforts, however, demand for FIDENORTE credit was modest. BMI and FOMILENIO staff conjectured that FIDENORTE's focus on investment capital may have played a large role in stifling larger demand for the program. Many small business owners—including many PBS participants—needed loans under $50,000 that included a substantive portion of working capital, and both of these loan features were unavailable through FIDENORTE. Nine loans valued at $1.3 million were approved during this four-month period.

2. Capacity and Personnel

In February 2010, BMI took over the analysis of business plans from GyS and staffed two permanent analysts on FIDENORTE, in addition to a project director, a full-time customer service representative, and an administrative assistant. Because BMI's analysts largely had a generalist financial background, they needed assistance from analysts with a technical background in each value chain. For some projects, they tapped analysts within BMI for technical analysis to supplement their general financial analysis. In other cases, FOMILENIO technical staff working in the dairy and horticulture chains provided technical support.

FOMILENIO personnel also changed during this period. A FOMILENIO specialist who had worked primarily on the Investment Support Activity resigned in December 2009. In addition, a full-time FOMILENIO employee was contracted in November 2009 to assume all coordination responsibilities related to the Investment Support and Financial Services activities. FOMILENIO staff expressed approval for this hiring decision, which was necessary to relieve some of the burden from FOMILENIO's PDP director, whose time was primarily consumed with PBS administration. In December 2009 and January 2010, FOMILENIO's two remaining full-time staff members for the Investment Support and Financial Services activities were transferred from BMI's office to FOMILENIO's office. The rationale for the transfer was that these staff members could work more efficiently with the new coordinator at FOMILENIO's office. This move resulted in closer coordination among FOMILENIO staff, but somewhat compromised the ability of FOMILENIO staff to work side-by-side with BMI staff in outreach, business plan development, and analysis tasks.

3. Additional Changes to the Financial Product

In January 2010, the interest rate for FIDENORTE loans of "BMI plus 2" (or around 8.25 percent) was discontinued and the minimum interest rate was pegged to the average market mortgage rate for El Salvador, which fluctuated between 8.16 and 9.00 percent per year.[17] In addition, stakeholders adopted a new system of calculating the FIDENORTE interest rate as a direct function of the applicant's collateral, credit rating, and grace period. This new system, proposed by MCC staff and developed by FOMILENIO, was adopted in the interest of ensuring that interest rates were not subsidized and that each project's interest rate reflected its appropriate level of risk. In general, MCC attempts to follow a principle of no interest rate subsidies for end users. Given the low interest rates of the first few FIDENORTE loans, as well as the program's fully financed assistance with business plans, MCC staff expressed concern that the credits were subsidized. This new system of calculating interest rates provided MCC staff with some guarantee that future FIDENORTE loans—while always containing an implicit subsidy due to technical assistance—would not be subsidized to such an extent that they could crowd out loan markets in the Northern Zone.

Under this new scheme, an applicant could obtain the lowest available interest rate only with collateral of at least 100 percent of the loan value, an A1 credit rating, and a three-month grace period. Borrowers who had collateral of less than 50 percent, had a credit rating of B (or no credit rating), or desired a longer grace period could receive FIDENORTE loans under this new scheme, but they would pay a higher interest rate to reflect their higher level of financial risk. In general, borrowers' interest rates increased after this change was implemented, to the extent that the average annual interest rate for all FIDENORTE loans from 2009 to 2011 was 9.1 percent. On average, borrowers' grace periods also became shorter after this change, as many loan recipients chose a three-month grace period to avoid interest rate increases associated with longer grace periods.

4. Proposed Modification to the Activity

In late 2009, FOMILENIO staff proposed that FIDENORTE be divided into two specific programs: (1) CADENAS, a continuation of FIDENORTE as originally conceived and (2) PYME (the Spanish acronym for small- and medium-sized enterprises), an on-lending program to banks operating in the Northern Zone with lending targeted toward the PDP's priority value chains. This proposal—called "Plan B" by FOMILENIO and MCC staff—was made in response to the unmet demand for credit of PBS participants observed by FOMILENIO technical staff, as well as pressure from FOMILENIO's board of directors to offer loans under $50,000 to small producers.[18] According to interviews with MCC, its staff was willing to accept the program modifications if FOMILENIO and BMI completed the proper planning procedures. FOMILENIO worked on this

[17] Specifically, this was the weighted average of all mortgage rates in the country, as calculated by the Salvadoran central bank. The rationale for using a mortgage rate was that small business owners most commonly offer their land and homes as collateral for long-term investments.

[18] Since PDP's start, FOMILENIO's board of directors and investment committee were sympathetic to providing credit to small producers. According to MCC staff, FOMILENIO board and committee members became even more sympathetic to this cause after the transition to a new government administration in June/July 2009.

proposal with BMI for several months and produced a revised operations manual in December 2009 that included norms for the PYME component. Officially, FOMILENIO was given the deadline of September 2010 to make PYME operational, but MCC and FOMILENIO sources said that FOMILENIO leadership decided against the PYME component by the mid-term review in March 2010 because the proposal had not progressed in several months and BMI did not appear to support the change.

5. Mid-term Review and Funding Adjustments

When the FIDENORTE trust fund was established, the Investment Support Activity had $21 million in funding, of which $17 million was earmarked for investment capital, $2 million for technical assistance, and $2 million for administration. As a result of the mid-term review, however, FOMILENIO (without objection from MCC) cut investment capital funding to $8.5 million, technical assistance to $400,000, and the administrative budget to $800,000. In addition, the target number of approved loans was reduced from 50 to 35. The rationale for this 50 percent reduction in investment funds was that FIDENORTE would most likely fail to meet its investment targets by the close of the compact, and more realistic targets were needed. Said an MCC interviewee, "FIDENORTE funding and loan targets were reduced because there wasn't a steady pipeline of investment-ready projects to justify the original targets. Within BMI, there was also a lack of a skill-set to develop and manage a steady project pipeline." Developed by MCC and FOMILENIO, the fund's revised $8.5 million investment budget represented a more appropriate investment target, given the average FIDENORTE loan size, the pre-investment pipeline in early 2010, and the compact's mandate that all Investment Support loans reach maturity by nine years after the compact's entry into force (or September 2016).

"FIDENORTE funding and loan targets were reduced because there wasn't a steady pipeline of investment-ready projects to justify the original targets."

MCC staff member

D. Phase III: General Implementation Following Mid-Term Review (March 2010–April 2011)

1. Demand and Loan Approval

Implementation following mid-term review was stronger than previous periods with respect to business plan development, application analysis, and loan approvals. After learning about the credit program through various media and contacts at small businesses, potential applicants began contacting FOMILENIO and BMI staff at higher rates than in late 2009 and early 2010. In addition, applicants progressed through business plan development and analysis phases more quickly during this period, as BMI and FOMILENIO had established a series of processes to facilitate consultant contracting, verification visits, and other administrative functions. Thirty-one loans worth $5.0 million were approved during this fourteen-month period, compared to 13 loans worth $2.4 million approved during the one-year period preceding mid-term review. Approval rates increased in 2011; seven loans were approved between February and April 2011, with April being the last month that new loans could be approved.

2. Intersection of the PBS and Investment Support Activities

During this implementation phase as well as previous phases, there was limited intersection between PBS and the Investment Support Activity. One service provider helped four PBS-assisted groups design business plans, but they did not qualify due to a suboptimal credit rating, an IRR lower than 14 percent, or the fact that the loan only covered investment capital (and most of these applicants requested some portion of working capital). However, by July 2011 at least 15 PBS participants were approved for FIDENORTE loans (primarily related to tomato and dairy production) and four PBS participants received substantive assistance from PBS service providers in developing business plans. One service provider in particular, The Cooperative League of the United States of America (CLUSA), was particularly successful in developing small producers' business plans and facilitating their progression through the application process. In total, around one-third of approved FIDENORTE borrowers were also PBS participants. Although this was not the level of interaction originally envisioned between the two activities, PBS participants represented a sizable portion of FIDENORTE applicants and borrowers.

3. Capacity and Personnel

BMI's capacity to administer FIDENORTE also grew in this phase. By May 2010, BMI's two analysts were highly capable of analyzing the technical and financial aspects of business plans. According to one investment committee member, BMI finally succeeded in analyzing and presenting business plans efficiently and effectively during this phase of implementation. This view was corroborated by FOMILENIO staff. Despite these gains in capacity, however, BMI still had a fractured structure for managing FIDENORTE activities during this phase. Analysts were still housed in a different department at BMI than the FIDENORTE director. In addition, another department within BMI was in charge of handling loan approvals. According to FOMILENIO staff, it was difficult to coordinate with BMI among these different departments, particularly because several BMI staff members involved in FIDENORTE had several core projects outside of FIDENORTE.

Also during this period, FOMILENIO staff developed an efficient division of labor. Two FOMILENIO staff members made supervisory and monitoring visits to borrowers and contracted consultants, while the activity coordinator visited borrowers with repayment difficulties and handled all reporting tasks to MCC. This division of labor continued until the activity coordinator's contract expired in early July 2011.

4. Committee Deliberation and Approval

Whereas stakeholders generally characterized the investment committee as inefficient and unfocused during the first year of FIDENORTE implementation, all interviewed stakeholders agreed that in 2010 and 2011, the committee members worked very effectively, due in large part to the leadership of the new committee director who arrived in 2009. The new director made the application of evaluation criteria more efficient and uniform, and was instrumental in influencing BMI staff to develop and present more projects. Also after the new director arrived, each member of the committee came to specialize in a different aspect of analysis, including technical aspects, procurement issues, and financial analyses. This specialization served the committee's analysis of each project's risks and bottlenecks.

By all accounts, the investment committee generally applied the designated selection criteria objectively in making a decision to approve or reject applicants during this period. However, one project presented in late 2010 presented a potential political dilemma because the applicant organization had several high-profile members and a high degree of financial and human capital. The proposed project requested $1 million in funds and planned to generate 80 new jobs. Although the project complied with all selection criteria, it was rejected by the committee. According to FOMILENIO staff, the committee made this decision because the applicant did not conform to the activity's original target population of poor producers who could not otherwise obtain credit.

Besides this particular case, one MCC staff-member recalled the case of an additional applicant who was denied credit in mid-2009 for being "too rich," as defined by the investment committee. Several stakeholders were dissatisfied with the committee's decisions regarding these applicants, as these rejections due to applicants' apparent lack of financial need were not based on objective, established selection criteria.

5. Final Funding Deadline

During this period, FOMILENIO leadership set a deadline of April 1, 2011 for the final day of approval for FIDENORTE loans. The rationale for this decision was that FOMILENIO leadership wanted to finalize the FIDENORTE budget and fully account for obligated funds before 2012, the last year of the compact. In addition, there was a contractual constraint to approving new loans in the last year of the compact (October 2011 to September 2012). As stated in the compact, all FIDENORTE loans had to reach maturity nine years after the compact's entry into force (September 2016). This would have demanded a loan period of less than five years for any loan approved in 2012—a maturity that was probably too short for a large portion of FIDENORTE business plans. As of the end-date of April 1, 44 projects were officially approved by the investment committee.

Table III.1. Summary of Investment Support Implementation Phases

Project Phase	Summary of Activities	Key Players	Major Decisions	Rationale for Decisions
Design Phase (2005-November 2006)	The objective, scope, budget, and implementing partners of the activity are defined.	BMI and MCC representatives and the technical secretary of the government of El Salvador.	Investment Support Activity budgeted at $21 million.	This amount of money was judged to be the sufficient amount of investment capital needed to complement PBS investments.
			BMI was chosen as the implementing partner for the Investment Support Activity.	BMI was judged to be the institution with the expertise and capacity to administer a credit program.
Initial Preparations (September 2007- February 2009)	Very limited outreach, as demand from PBS was envisioned. Key aspects of the financial instrument and loan product are defined.	Three FOMILENIO staff members located at BMI offices and a small BMI staff of one half-time analyst and a project director.	A trust fund framework was chosen to administer funds under the Investment Support Activity.	A trust fund allowed FOMILENIO to define the purpose of funds and BMI's responsibilities. The fund's legal structure also introduced a mechanism for accountability.
			Minimum FIDENORTE loan size set at $50,000.	This limit represented a compromise between FOMILENIO's goal of smaller loans and more intersection with PBS, and MCC's goal of larger loans and high-return investments.
			Interest rate set at BMI rate plus 2, or around 8.25 percent	This rate was determined by BMI to be a fair way to account for borrowers' risk, while providing an attractive interest rate for the target population.
Phase I: Limited Implementation (March 2009- October 2009)	Very limited demand and poor quality business plans. Four proposals and $1.1 million approved.	Change in BMI personnel: a new team starts in June/July 2009. BMI hires customer service associate in September 2009 and staffs one full-time analyst on FIDENORTE.	FOMILENIO began to contract outside consultants to complete business plans.	Applicants' business plans did not meet basic standards of quality.
			BMI proposed an outreach plan in the Northern Zone in which staff will visit key municipalities with business potential.	Low levels of demand posed a large threat to meeting approval targets.
Phase II: General Implementation Prior to Mid-Term Review (November 2009- February 2010)	Aggressive outreach started November 2009. Moderate demand, but difficulties contracting consultants to develop plans and slow analysis of plans. Nine proposals and $1.3 million approved.	Two FOMILENIO staff-members move to FOMILENIO office. One full-time staff person hired by FOMILENIO to supervise Investment Support and Financial Services activities. BMI staffs two full-time analysts on FIDENORTE, in addition to a project director, a full-time customer service associate, and an administrative assistant.	Change in interest rate, now calculated as a function of the grace period, collateral, and credit rating.	MCC and FOMILENIO determined that the interest rate should be calculated according to each applicant's risk.
			FOMILENIO staff proposed an alternative financial product (PYME), but the proposal was not formalized.	The proposal—supported by the FOMILENIO board—was motivated by a desire to serve small producers. The long delay and lack of commitment from BMI were cited as the main reasons the proposed PYME was not formalized.
			In February 2010, the investment fund was cut from $17 million to $8.5 million and the target number of loans was reduced from 50 to 35.	Slow progress toward final lending target and lack of capacity on the part of BMI to manage the loan pipeline.
Phase III: General Implementation Following Mid-Term Review (March 2010- April 2011)	Higher levels of demand and approval than previous phases. 31 proposals and $5.0 million approved.	BMI has similar staffing to Phase II.	A final deadline of April 1, 2011 set for FIDENORTE approvals.	FOMILENIO leadership wanted an accurate measure of all funds allocated to FIDENORTE loans. In addition, the compact mandated that all loans must reach maturity nine years following the compact's entry into force and this deadline did not allow for the approval of five-year loans in 2012.

Source: FOMILENIO implementation reports and interviews with BMI, FOMILENIO, and MCC staff, and FIDENORTE applicants during May and July 2011.

IV. THE FIDENORTE APPLICATION PROCESS

In this chapter, we document key steps in the FIDENORTE loan application process and highlight findings regarding applicants' progression through the process. In addition, we summarize applicants' overall perceptions of the application process.

A. Key Steps in the Application Process

The FIDENORTE loan application and approval process is composed of the following 11 steps. (Consult Figure IV.1 for a complete flowchart of these steps.)

1. BMI conducts **outreach** through a variety of community events in targeted municipalities, radio announcements, brochures, and other dissemination methods. During outreach activities, BMI personnel explain the features and requirements of FIDENORTE credit to potential applicants and ask applicants to provide some information on their business ideas.

2. Applicants complete and submit **information sheets** during outreach events detailing their business ideas, expenses, and requested loan amounts. This information is used to assess applicants' basic eligibility for FIDENORTE credit.

3. Applicants requesting business plans submit a **pre-investment proposal** to BMI. The proposal details an applicant's location, business idea, and desired loan amount. FOMILENIO uses this proposal to further evaluate the applicant's eligibility and assign a consultant to develop a business plan.

4. If requested by an eligible applicant, a FOMILENIO staff member **assigns a consultant** to work with the applicant to produce a business plan.

5. A **business plan** is completed either by the applicant, a consultant contracted by FOMILENIO, BMI staff, a PBS service provider, or a consultant contracted by the applicant. If contracted by FOMILENIO, business plans are usually completed and submitted within 90 days of the pre-investment proposal. During business plan development, consultants work intensively with applicants to estimate their current income and costs, predict their income and costs following the proposed investments, and construct accurate IRRs.

6. BMI analysts receive and **analyze the business plan**, assessing its technical and financial viability. This analysis is usually accompanied by one or two visits to the applicant's place of business, as well as several sensitivity tests to assess the robustness of the technical and financial assumptions. For all business plans that meet a minimum threshold of technical and financial viability, an interest rate is calculated based on the applicant's collateral, credit rating, and desired grace period. All viable projects are presented to the BMI internal committee. The committee rejects or approves plans, or proposes adjustments to plans and loan conditions. Once adjustments have been discussed with applicants, business plans are reintroduced to the committee for approval.

7. Projects approved by BMI's internal committee proceed to the **PD Investment Committee,** where they are approved or rejected according to the committee's established rules and selection criteria. Projects over $500,000 must secure approval

from the FOMILENIO board of directors in addition to the PD Investment Committee.

8. Applicants learn about the conditions of loans approved by the investment committee, and decide whether they will proceed with the loan **formalization** process. In this process, applicants sign paperwork and their collateral is registered by BMI staff and the appropriate financial institutions. Collateral arrangements must appear in a public registry to complete the formalization process.

9. BMI requests and administers **disbursements**. If no formalization complications are foreseen, the first disbursement can occur before the full formalization process is completed.

10. BMI conducts the **supervisory visits** before all future disbursements to verify the use of credit. If credit is not used as specified in the original business plan, a modification is presented to the investment committee. FOMILENIO staff members also conduct monitoring visits to ensure that clients are making investments according to their business plan.

11. FOMILENIO finances **technical assistance** as necessary. If FOMILENIO and BMI detect a technical assistance need and/or the borrower requests such assistance, a proposal is submitted to FOMILENIO, and a FOMILENIO staff member solicit bids from potential contactors. Technical assistance can be contracted for a wide range of needs, including marketing and brand development, business administration, and assistance with businesses' technical aspects. A panel, composed of FOMILENIO staff, the borrower and other stakeholders, evaluates consultants' applications and chooses a suitable service provider. Next, the chosen consultant submits a financial proposal and a contract is negotiated and signed. The borrower pays 20 percent of the technical assistance fee and FOMILENIO pays 80 percent.

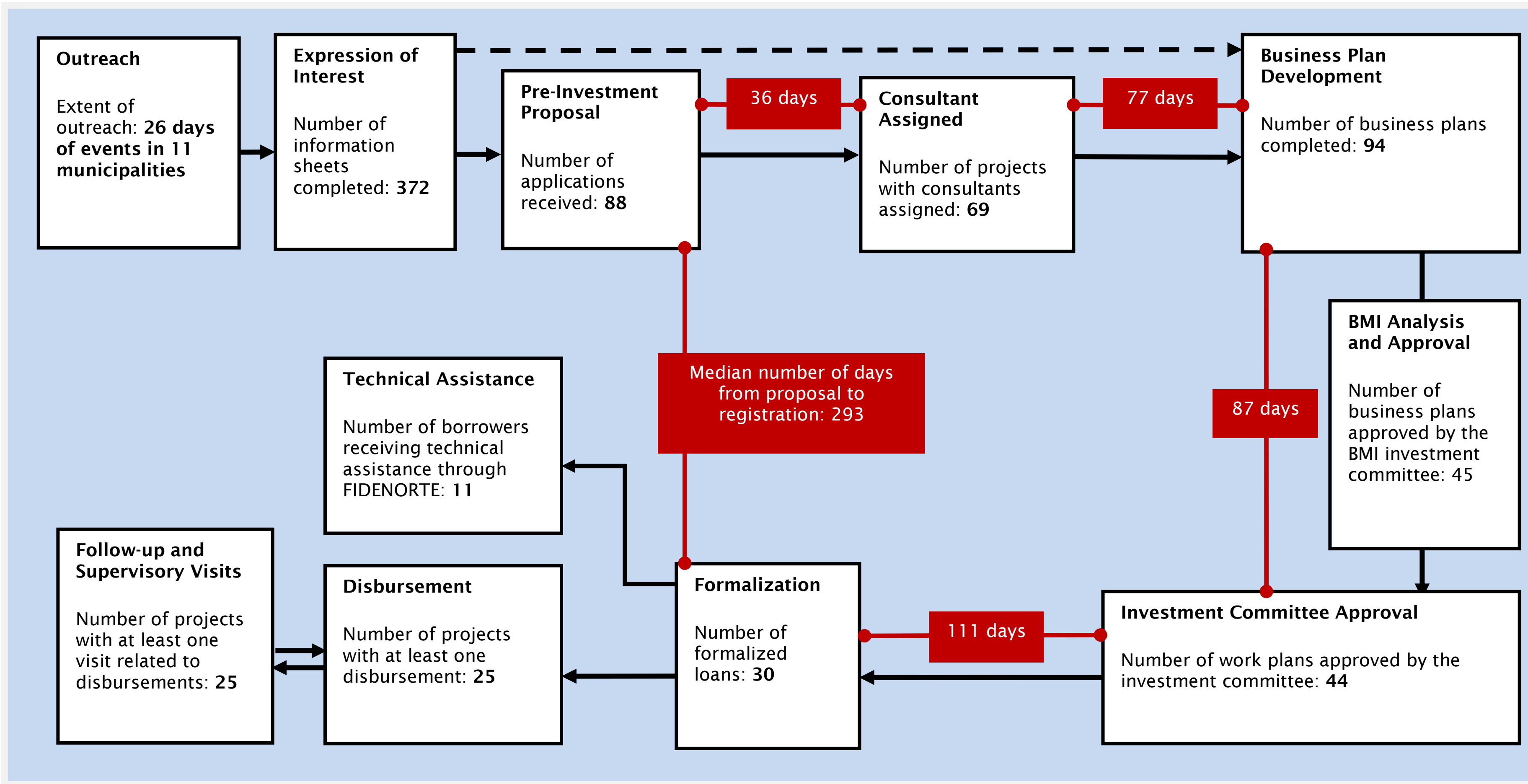
B. Applicants' Progression through the FIDENORTE Process

Using administrative data provide by BMI and FOMILENIO, we documented the length of time required for a typical loan application to complete the 11 steps listed above.[19] Overall, a typical FIDENORTE loan took 293 days (or almost 10 months) to progress from initial application to formalization of the loan. (See Figure IV.1.) However, some of the last FIDENORTE loans approved in 2011 completed the application and approval process in a much shorter period. For example, one applicant completed the entire application and approval process in about six weeks.

At a median of 36 days, the shortest reported time period between key steps in the application process was the period between submitting a pre-investment proposal and assigning a consultant to complete a business plan. Some delays in assigning consultants did arise if a business plan required the skills and experience of a particular consultant, and that consultant was already occupied with another plan. However, this was not common.

[19] We use the median interval between steps to represent the length of time required for a "typical" loan to complete each step.

Figure IV.1. Flowchart of FIDENORTE Loan Process



Source: BMI and FOMILENIO administrative records as of September 30, 2011.

Note: All reference periods reported are median values, as the median is the best reflection of the amount of time to complete each step for a typical loan application.

At a median of 111 days, on average, the longest step in the loan process was the interval between committee approval and formalization. This step often required substantive paperwork and collaboration between several parties. In cases in which public agencies were required to sign off on environmental or water usage considerations, the formalization process could take several months. Formalization also required that mortgages and other collateral be published in an official registry, which could take several weeks to complete.

Out of 372 official expressions of interest originally collected by BMI staff, only 44 loans were approved by the PD Investment Committee. This is an approval rate of just over 10 percent of all applicants who formally expressed interest. In practice, BMI also reported a high number of informal expressions of interest of which there is no record. Accounting for these numbers, we can conclude that the number of approved FIDENORTE loans represents a small fraction of all applicants and potential applicants who expressed initial interest in the program.

Also interesting is that the most rigorous analysis of business plans occurred in BMI's internal investment committee, which approved slightly less than half (45 of 94) of all submitted business plans. In contrast, the PD Investment Committee approved nearly all BMI's proposed loans, rejecting only one applicant approved by BMI's committee. While not foreseen in the compact, the more substantive role of BMI's committee versus the investment committee in analyzing and approving loans may have been a positive development in that it simplified the investment committee's responsibilities and deliberations.

Also notable regarding the loan process is the large number of individuals and institutions involved in the development and approval of business plans and loans. The typical business plan was developed by applicants and consultants, reviewed by a BMI analyst and FOMILENIO staff, evaluated and modified by a committee of BMI employees, and approved by the PD Investment Committee. The large number of key players involved in these various steps contributed to the nearly 10-month development and approval process for the typical FIDENORTE loan.

C. Stakeholders' Perceptions of the Application Process

Reflecting on the entire application process, many FIDENORTE borrowers described their loan experience as prolonged and bureaucratic. In particular, loan recipients complained about delays related to loan formalization, modifications, and disbursements. One loan recipient also reported that he did not contract technical assistance through FOMILENIO because he viewed the process as too time-consuming. Several FOMILENIO staff and committee members expressed similar sentiments regarding the loan process. One FOMILENIO staff member reasoned that the process could have been shorter if fewer institutions, committees and individuals were involved, or if coordination between FOMILENIO and BMI had been stronger.

Despite these criticisms, all five interviewed borrowers expressed appreciation for intensive assistance with business plans, and most interviewed non-recipients shared this view. Loan recipients and non-recipients alike also praised consultants' expertise and interpersonal skills. Regarding their interactions with BMI and FOMILENIO staff during the analysis phase, most loan recipients viewed BMI analysts and FOMILENIO staff as highly professional and knowledgeable in financial matters. (See Appendix D for a complete summary of stakeholder perceptions of key steps in the loan process.)

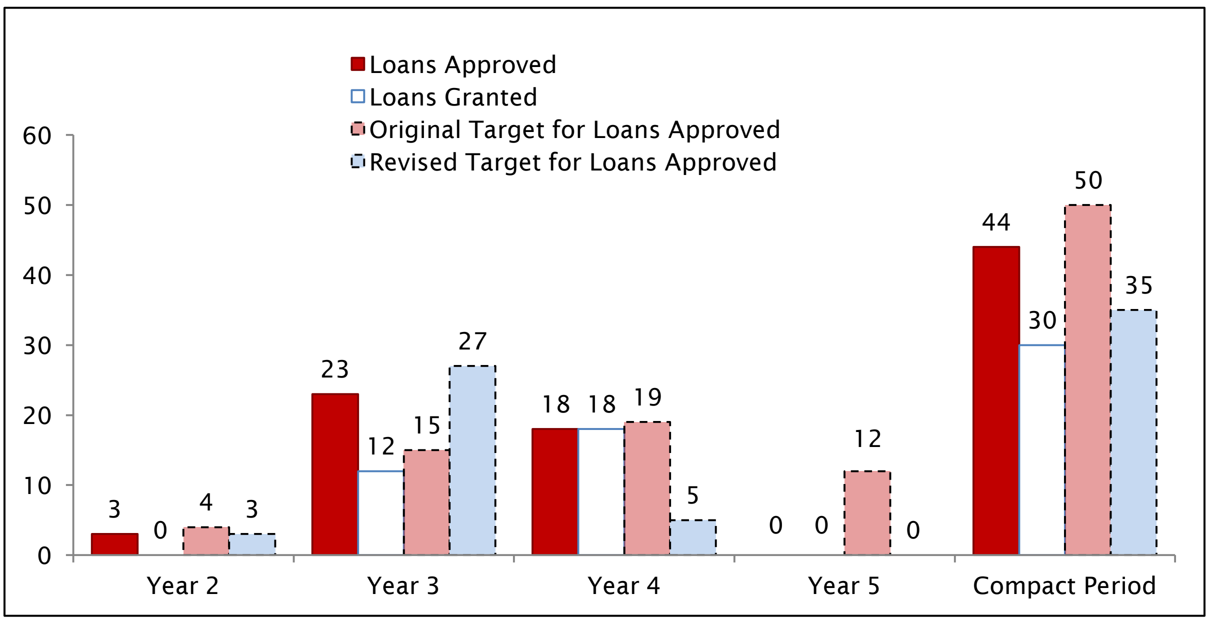
V. FIDENORTE LOANS AND BUSINESS PLANS

In this chapter, we document the number and value of loans approved and granted under the Investment Support Activity, as well as summarize key business plan and loan characteristics. Next we briefly discuss the activity's costs and repayment rates. Finally, we discuss agricultural lending trends in El Salvador from 2005 to 2011 and present stakeholders' perceptions of FIDENORTE's niche in the Northern Zone, as well as their reflections on key FIDENORTE loan characteristics.

A. Loans Approved and Granted

The original target for the Investment Support Activity was 50 loans approved by the investment committee. After the mid-term review in early 2010, this target was revised to 35 approved loans. With a total of 44 loans approved, FIDENORTE surpassed its revised target of 35 loans (Figure V.1). However, as of September 30, 2011, only 30 of these 44 loans had been formalized and granted. At least 11 approved projects were not formalized because the applicants no longer desired the credit, and at least two were not formalized because the applicants experienced financial difficulties or lacked sufficient collateral. Given the final total of 30 loans granted by September 2011, a total of 14 approved loan applications will not be formalized into loan agreements.

Figure V.1. Number of FIDENORTE Loans Approved and Granted



Source: FOMILENIO and BMI administrative records.

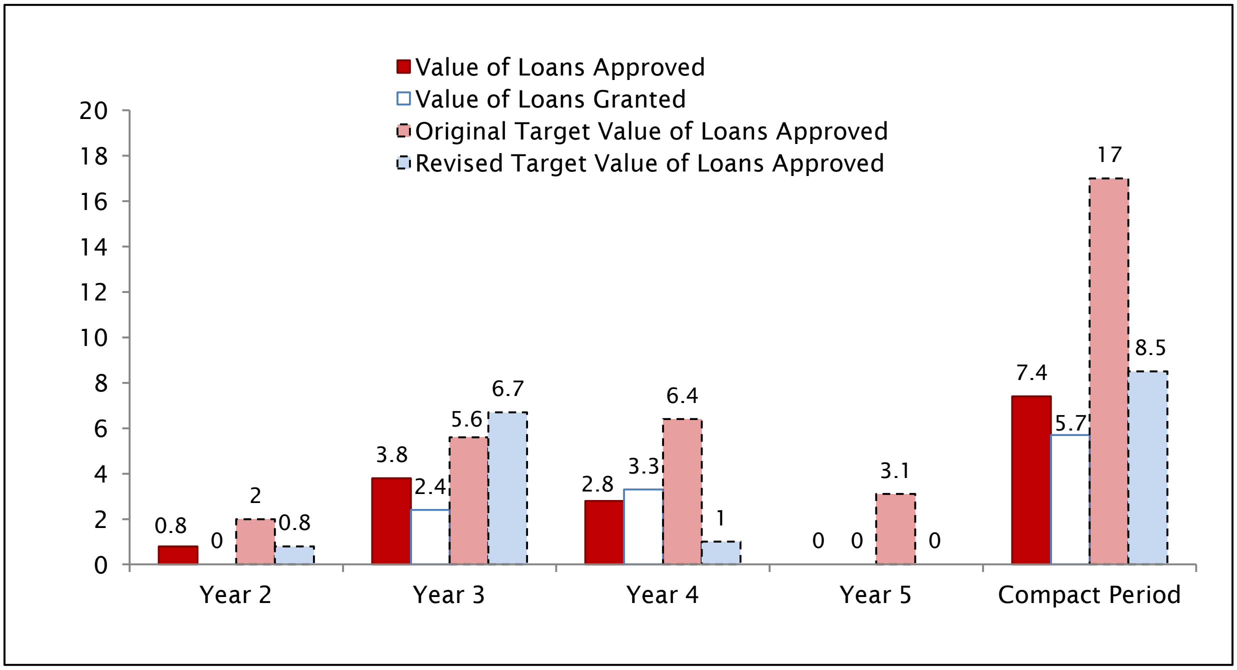
Note: The dates for Year 2 are October 2008 to September 2009; Year 3 is October 2009 to September 2010; Year 4 is October 2010 to September 2011; Year 5 is October 2011 to September 2012.

No loans were planned for Year 1 of the compact (October 2007 to September 2008). In addition, no new loans will be approved during Year 5.

Of the 30 loans granted by September 2011, 25 had received at least one disbursement by that date. Of the four loan recipients who had not yet received disbursements, two were in the process of securing permission from the Ministry of Environmental Affairs for infrastructure investments, one was awaiting the end of the winter season to request a disbursement, and another was planning on requesting a disbursement once their technical assistance contract was finalized.

As illustrated in Figure V.2, the original target for the total value of funds approved was $17 million. This was scaled down to $8.5 million following the 2010 mid-term review. Using this revised target, FIDENORTE lending fell short of this goal with a total of $7.4 million approved (corresponding to the 44 loans approved in Figure V.1). The amount of funding granted as of September 2011 is actually lower at $5.7 million (corresponding to the 30 loans granted in Figure V.1).

Figure V.2. Value of FIDENORTE Loans Approved (in Millions of U.S. Dollars)



Source: FOMILENIO and BMI administrative records.

Note: The dates for Year 2 are October 2008 to September 2009; Year 3 is October 2009 to September 2010; Year 4 is October 2010 to September 2011; Year 5 is October 2011 to September 2012.

No loans were planned for Year 1 of the compact (October 2007 to September 2008). In addition, no new loans will be approved during Year 5.

Considering the large discrepancy between the number and value of loans approved versus those granted, it is clear that the two measures represent somewhat different concepts. Whereas the number and value of loans approved provides some measure of the ability of BMI and the investment committee to develop and approve loans, the number and value of loans granted provides a measure of actual lending, given respondents' disposition and ability to formalize and disburse loans following approval.

B. Business Plan and Loan Characteristics

Next, we take a step back in the loan application process to compare the 44 business plans that resulted in approved loans to the 50 business plans that were submitted to BMI, but did not advance in the process. Table V.1 provides a summary of business plan characteristics among approved and unapproved business plans. Interestingly, there is no notable distinction between plans that were approved and those that were not approved regarding the loan amount requested or projected rate of return. However, approved plans were more likely to involve agricultural and agro-industrial projects, and non-approved plans were more likely to involve tourism projects. Another distinction is that approved projects featured larger numbers of permanent direct jobs (37 versus 11 among unapproved plans, on average), as well as indirect jobs (65 versus 29 among unapproved plans), but not temporary direct jobs (10 versus 22 among unapproved plans). This provides some evidence that high-return projects—or projects with the most promise for generating more jobs and potentially increase income—were favored in the FIDENORTE analysis and selection process.

Despite these suggestive findings, there is no objective method to verify that the analysis and selection process benefited the most promising business endeavors, as prescribed in the compact. In theory, we could compare the IRRs of approved versus non-approved projects to determine if more profitable business plans were favored over less profitable ones. However, the original IRRs calculated in business plans should be interpreted with caution, as many of these calculations changed dramatically once BMI analysts fully examined plans' financial and technical assumptions. On average, IRRs of accepted projects decreased 10 percentage points from the time they were calculated for business plans to the time they were presented to the PD Investment Committee.

Table V.1. Characteristics of Approved and Non-Approved Business Plans

Characteristic	Approved Plans	Non-Approved Plans
Sector		
Tourism	23%	44%
Agribusiness	23%	16%
Livestock	16%	24%
Agriculture	34%	12%
Handicrafts	2%	0%
Other	2%	4%
Average Loan Amount Requested (U.S. Dollars)	$207,434	$214,466
Average Projected Internal Rate of Return (IRR)	26%	25%
Average Expected Employment Created		
Permanent Direct Jobs	37	11
Temporary Direct Jobs	10	22
Indirect Jobs	65	29
Average FIDENORTE Expected Contribution	67%	63%
Number of Plans	44	50

Source: Business plans completed by applicants and consultants between 2009 and 2011.

According to BMI's administrative records, the most common reason listed by FIDENORTE and BMI for non-approval—or the failure of a business plan to progress past BMI's internal committee and the PD Investment Committee—was the technical and/or financial infeasibility of the proposed project, as judged by BMI. A total of 19 of the 50 unapproved projects (38 percent) didn't advance to the PD Investment Committee for these reasons. The second most common reason for failing to advance to the investment committee was the decision on the part of the applicant to discontinue the application process. This occurred in 16 of the 50 unapproved plans (32 percent). Another eight applicants failed to complete project documentation and the remaining applications did not continue to the committee phase for various reasons, including a lack of collateral, taking out credit with another financial institution, and an applicant's death.

Table V.2 presents loan characteristics of all 44 projects approved by the investment committee. Across all sectors, the average loan size was around $170,000, with an annual interest rate of 9.1 percent and a maturity period of 68 months.[20] Among all approved loans, loan sizes ranged from $50,000 to $723,000, and interest rates ranged from 8.2 percent to 12.4 percent.[21]

Table V.2. Characteristics of Approved Loans

	Average	Minimum	Maximum
Loan Size (U.S. Dollars)	$169,713	$50,000	$723,000
Annual Interest Rate	9.1%	8.2%	12.4%
Projected Internal Rate of Return (IRR)	16%	13%	25%
FIDENORTE Contribution	56%	26%	70%
Debt-Equity Ratio	1.2	0.1	3.1
Maturity Period (in months)	68	48	96
Days from application to formalization	292	126	430

Source: FOMILENIO administrative data and BMI presentations made to the PD Investment Committee between 2009 and 2011.

Notes: Sample size is all 44 loans approved by the PD Investment Committee.
Maturity period includes loans' grace period.

Table V.3 presents loan characteristics of all projects approved by the investment committee, organized by sector. As illustrated, the average size of agribusiness loans is larger than loans in other sectors, followed by livestock and agriculture. Overall, interest rates are highest for agribusiness loans, followed by agriculture and livestock. In addition, the proportion of FIDENORTE financing to total financing is highest in the case of handicraft loans and lowest for tourism loans. Loans related to handicrafts and tourism sectors have the longest maturity periods at 78 months and 70 months, respectively. This was corroborated by statements from borrowers and FOMILENIO staff, who explained that investments in these sectors require a longer time period to recover costs, relative to other sectors.

Table V.3. Characteristics of Approved Loans, by Sector (Averages)

Values	Agriculture	Agri-business	Livestock	Handicrafts	Tourism	Other	All Loans
Loan Size (U.S. Dollars)	$174,404	$214,729	$189,270	$86,400	$123,325	$59,500	$169,713
Interest Rate	9.0%	9.9%	8.8%	8.3%	8.7%	8.3%	9.1%
Projected Internal Rate of Return (IRR)	16%	16%	16%	18%	16%	16%	16%
FIDENORTE Contribution	62%	52%	63%	68%	43%	58%	56%
Debt-Equity Ratio	1.5	0.9	1.3	2.5	0.8	2.8	1.2
Maturity Period (in months)	68	67	69	78	70	60	68
Loans	15	10	7	1	10	1	44

Source: BMI presentations made to the PD Investment Committee between 2009 and 2011.

Note: Maturity period includes loans' grace period.

[20] The requested loan amount decreased an average of $42,000 from the business plan to the approval stage. This average decrease in loan amount was the result of modifications proposed by BMI and the investment committee.

[21] These characteristics of the 44 approved loans were very similar to characteristics of the 30 loans granted as of September 2011, with one exception: the average size of granted FIDENORTE loans was higher at $195,000.

C. Costs of the Investment Support Activity

In Table V.4, we present projected and paid costs associated with the Investment Support Activity from March 1, 2009 (approximately the date at which the trust fund was established) until September 30, 2011. The costs in Table V.4 include BMI's monthly fee of $27,000 to administer the fund (which was increased in April 2010 from its previous monthly fee of $17,000, and subsequently reduced in March 2011 to $17,000), all consultant fees for business plan development and analysis, as well as all consultant fees related to technical assistance in marketing, production, and environmental studies.

As illustrated, these projected costs totaled more than $1,130,000 by September 30, 2011, but FOMILENIO paid only around $800,000 of these salaries and fees by this date, largely because a portion of these costs had not yet been billed. Actual paid administrative costs for this period—BMI salaries totaling nearly $542,000—did not exceed the activity's revised administrative budget of $800,000. In addition, total paid technical assistance and business plan costs for this period, around $264,000, did not exceed the activity's revised technical assistance budget of $400,000. Because the Investment Support Activity will continue until 2016, the full costs of the activity over its entire implementation period are not yet known. In particular, projected and paid consultant fees will likely rise substantially in late 2011 and early 2012, given the large pipeline of technical assistance requests received by FOMILENIO in mid- to late-2011.

Table V.4. FIDENORTE Costs (U.S. Dollars)

	Projected	Paid
BMI Salaries	$643,233	$541,908
Consultant Fees for Business Plans and Technical Assistance	$492,798	$264,317
Total Salaries and Fees	**$1,136,031**	**$806,225**

Source: FOMILENIO administrative records.

Note: All costs reported between March 1, 2009 and September 30, 2011.

While FOMILENIO salaries related to the Investment Support Activity were not included in original budget projections, we can estimate these costs and add them to BMI salaries and consultant fees to gain insight into the total budgeted and non-budgeted costs of the activity. We estimate that FOMILENIO salaries for work related to the Investment Support Activity totaled around $214,150 from March 1, 2009 to September 30, 2011, thus bringing total paid costs associated with FIDENORTE to around $1 million for this time period.[22]

The total paid administrative costs of FIDENORTE from March 2009 to September 2011 of around $800,000 represent around 14 percent of the total value of all granted FIDENORTE loans ($5.72 million). This proportion is somewhat comparable to an operating expense ratio (OER)—a loan program's personnel and administrative expenses divided by its period-average gross loan portfolio. OERs are generally used to measure financial institutions' cost-effectiveness, or ability to

[22] Estimated by Mathematica staff, this figure was calculated by multiplying the monthly salary of all FOMILENIO employees who performed work for the Investment Support Activity by the proportion of time they devoted to the activity versus other activities, and multiplying this figure by the number of months they worked at FOMILENIO from March 1, 2009 to September 30, 2011.

use administrative resources efficiently. Compared to OERs of commercial banks that are generally less than 5 percent, FIDENORTE's costs-to-portfolio ratio of around 14 percent is relatively high.[23] Using these administrative costs and the final number of 30 FIDENORTE loans granted during this period, we can also estimate FIDENORTE's administrative costs per client as around $26,875.[24]

MCC and FOMILENIO representatives agree that these high administrative and technical assistance costs are unsustainable given the program's current loan portfolio and range of interest rates. One FOMILENIO employee interviewed conjectured that BMI would actually have to set its annual interest rate at 20 percent to fully recuperate its operating costs. According to this interviewee, the only way the program could feasibly continue is with help from multilateral institutions that could provide a donation to subsidize its costs.[25]

Because FOMILENIO's contracts with consultants throughout FIDENORTE implementation were well documented, we can also determine the average price paid for business plans. FOMILENIO signed contracts worth a total of approximately $226,000 for 61 business plans, yielding an average cost of around $3,700 per plan, or around 2 percent of the value of the average approved loan. Regarding technical assistance unrelated to business plans, FOMILENIO signed contracts totaling over $204,150 in consultant fees to assist 11 borrowers with marketing, production, and environmental studies. This yields an average investment of around $18,560 per loan recipient who received technical assistance.

D. Repayment of FIDENORTE Loans

As of September 30, 2011, FIDENORTE had a repayment rate of nearly 100 percent, in which FIDENORTE borrowers had failed to repay only $412 out of $3,176,783 in disbursed funds. This was a slight improvement from a repayment rate of nearly 100 percent in June 30, 2011, in which FIDENORTE borrowers had failed to repay only $3,092 out of $3,070,772 in disbursed funds. However, it should be noted that by September 2011, most FIDENORTE loans had not completed their grace period, and thus borrowers were making only interest payments on loans. Once larger principal payments are due in future months, repayment rates may decrease.

FOMILENIO staff credited the comprehensive business plan development and analysis process as the primary reasons repayment levels were around 100 percent. During 2011, only two loan recipients had experienced repayment difficulties, one individual and one cooperative. Both borrowers reported that complications related to production and sales caused the delay in repayment. In at least one of these cases, however, FOMILENIO staff believes that nonpayment

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[23] As stated, an OER is defined as personnel and administrative expenses divided by the period-average gross loan portfolio. The gross loan portfolio is the total outstanding amount of all loans. Because we did not have enough administrative data to calculate the period-average gross loan portfolio across all years in which FIDENORTE was in operation from March 2009 to September 2011, we did not calculate the OER for FIDENORTE. However, the proportion of FIDENORTE's administrative costs relative to its entire value of loans granted is a suitable, albeit somewhat inaccurate, proxy for the trust fund's OER.

[24] If we exclude the cost of technical assistance unrelated to business plans, the administrative cost per loan is slightly lower at approximately $24,000. This is the estimated cost of developing, approving, and granting a FIDENORTE loan, outside of any additional technical assistance provided after the loan's formalization.

[25] Because final calculations had not been completed at the time of interviews, estimates on the part of FOMILENIO staff were merely conjectures. Presumably, these estimates assumed no large modifications in average loan amount or the overall size of the FIDENORTE loan portfolio in the short- or medium-term.

was influenced by the loan recipient's belief that because the money was donated, there would be no negative repercussions for nonpayment. BMI's systematic recovery efforts and threats of possible legal action were instrumental in motivating the borrower to pay the large majority of his debt, which was less than $2,000 in late June 2011 and almost fully paid by late September 2011.

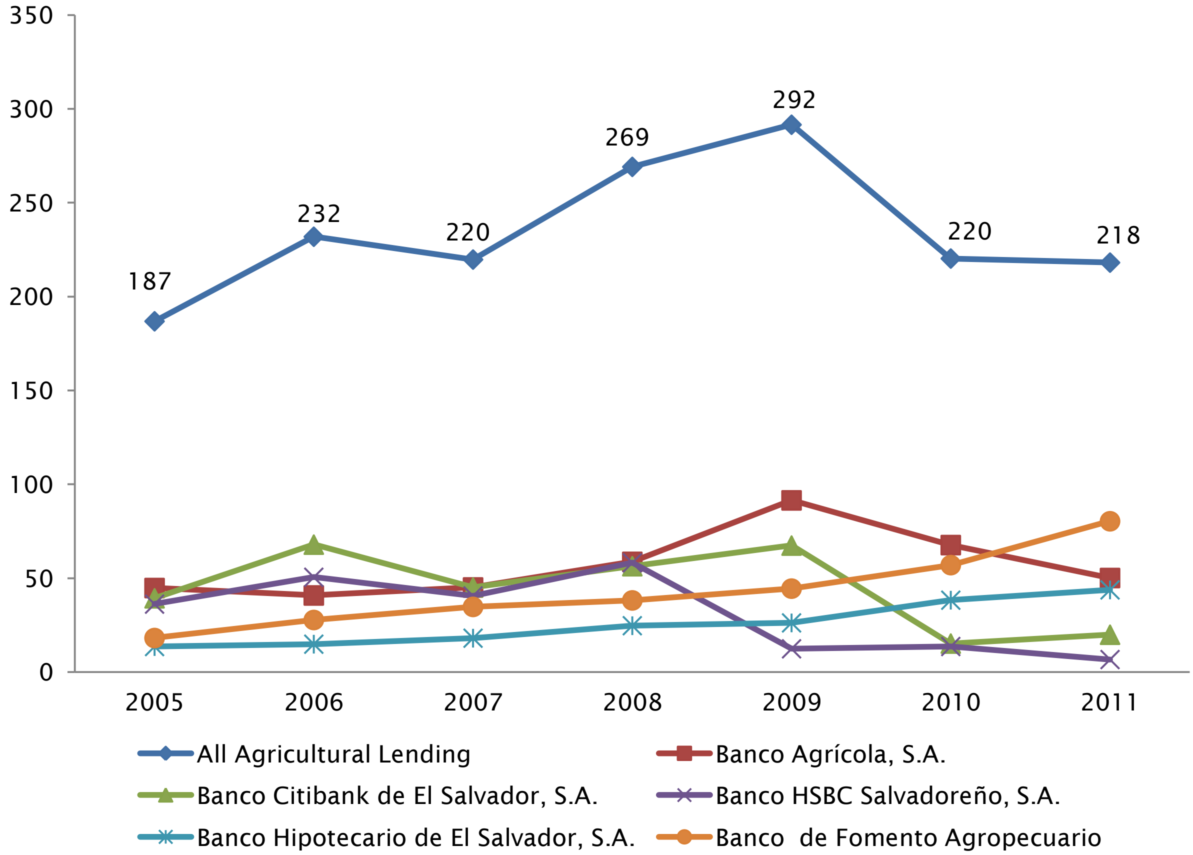
E. The Role of FIDENORTE Credit in the Northern Zone

In this section, we summarize recent agricultural lending trends in El Salvador, compare and contrast FIDENORTE credit with other credit provided by commercial and state-owned banks, and make some basic conjectures concerning whether FIDENORTE borrowers could have found similar credit through other means. This last question is impossible to answer without a strong counterfactual or simulation of what would have happened in the absence of FIDENORTE credit. However, we can synthesize national lending data as well as the opinions of applicants and project administrators to make some informed statements on this topic.

To provide context for FIDENORTE lending during the compact period, Figure V.3 provides an illustration of total agricultural lending in El Salvador from 2005 to 2011, as well as agricultural lending among large financial institutions during this time period. As illustrated, total agricultural lending grew from $187 million in 2005 to $292 million in 2009, but declined sharply in 2010 to $220 million. This overall decline is linked to the declining agricultural portfolios of two large banks, Banco Agrícola and Citibank (formerly Banco Cuscatlán until its purchase by Citibank in September 2008). Also notable is the substantive drop in new agricultural lending from 2008 to 2009 on the part of Banco HSBC (formerly Banco Salvadoreño until its purchase by HSBC in July 2007). The purchase of Banco Cuscatlán and Banco Salvadoreño by Citibank and HSBC, respectively—and the banks' altered investment portfolios following these acquisitions—are likely the largest determinant of the overall decline in agricultural lending in 2010 and 2011 relative to previous years. However, Banco de Fomento Agropecuario (BFA) and Banco Hipotecario, the only public banks featured in Figure V.3, increased agricultural lending during these two years, to the extent that reductions in private banks' agricultural lending were partially offset by agricultural loans from public banks.

In this context, FIDENORTE loans granted in 2010 and 2011 could have played a role in partially offsetting overall declines in agricultural lending to the Northern Zone during these years. However, because disaggregated lending data for the Northern Zone are unavailable, the amount of agricultural lending to the Northern Zone from 2009 to 2011 cannot be quantified and compared to FIDENORTE's loan portfolio of $5.7 million.

Figure V.3. Agricultural Lending in El Salvador from 2005 to 2011 (in Millions of U.S. Dollars)



Source: Superintendent of Financial Records, 2011.

Notes: Total 2011 lending is projected, based on lending trends between January and September 2011.
Banco Salvadoreño became Banco HSBC in July 2007.
Banco Cuscaltán became Banco Citibank de El Salvador in September 2008.

In Table V.5, we compare and contrast agricultural credit programs in El Salvador that were available to producers in the country's Northern Zone from 2009 to 2011. Using the limited metric of maximum interest rate, we find that FIDENORTE maximum interest rates were lower than major banks' maximum rates for multi-year loans to finance productive activities.[26] However, FIDENORTE's total funding of $8.5 million was much lower than major banks' agricultural lending, which ranged from $108 million to $182 million from 2009 to 2011. Also notable are the low-interest agricultural loans introduced by BFA in mid-2011. With official interest rates of 8 and 9 percent for multi-year dairy and horticulture loans, respectively, these loans are similar to FIDENORTE's average interest rate of 9 percent. However, because these credit lines became available after new FIDENORTE lending had ceased, potential FIDENORTE borrowers never chose between FIDENORTE and these BFA loans. Rather, BFA appears to have introduced a

[26] Unfortunately, banks' average interest rates for multi-year agricultural loans were not available though the Superintendent of Financial Records. Due to limited data availability, maximum interest rates for loans of over one year for productive activities are reported and compared in Table V.5. This comparison should be interpreted with caution, as maximum interest rates often do not reflect average interest rates, and loans for productive activities include agricultural loans as well as non-agricultural business loans.

series of loan products that are very similar to FIDENORTE loans following the cessation of FIDENORTE lending in mid-2011.[27]

Table V.5. Comparison of Agricultural Credit Programs in El Salvador

Program/Bank	Purpose	Total Funding	Financing Available	Annual Interest Rates	Maturity Period
FIDENORTE	Investment capital for dairy, horticulture, tourism, handicrafts and other productive sectors.	$8.5 million available from 2009 to 2011.	Minimum of $50,000.	Average of 9% across all loans from 2009 to 2011, with a maximum rate of 12.9% beginning in early 2011.	4-8 years.
Banco de Fomento Agropecuario	Investment and working capital for dairy, horticulture, tourism and other productive sectors.	$182 million from 2009 to 2011 (25% of all agricultural lending).	Amounts as of June 2011: • Dairy loans: up to $950 per animal. • Horticulture loans: up to 80% of total investments. • Tourism loans: up to 100% of working capital and 80% of capital investments.	Maximum rates for loans of over one year for productive activities ranged from 12.6% to 18.9% from 2009 to 2011. Official rates as of June 2011: • Dairy loans: 8.0% • Horticulture loans: 9.0% • Tourism loans: 10.0%	Periods as of June 2011: • Dairy loans: up to 8 years • Horticulture loans: 3 years • Tourism loans: 4-15 years
Banco Agrícola	Investment and working capital for coffee, sugarcane, and other productive sectors.	$209 million from 2009 to 2011 (29% of all agricultural lending).	Not available.	Maximum rates for loans of over one year for productive activities ranged from 17.5% to 18.5% from 2009 to 2011.	Contingent upon the productive activity and income stream.
Banco Hipotecario de El Salvador	Investment and working capital for coffee, sugarcane, horticulture, and other productive sectors.	$108 million from 2009 to 2011 (15% of all agricultural lending).	Horticulture loans: up to 80% of the cost of capital investments.	Maximum rates for loans of over one year for productive activities ranged from 21.8% to 29.5% from 2009 to 2011.	Maximum of 10 years for loans financing productive equipment.

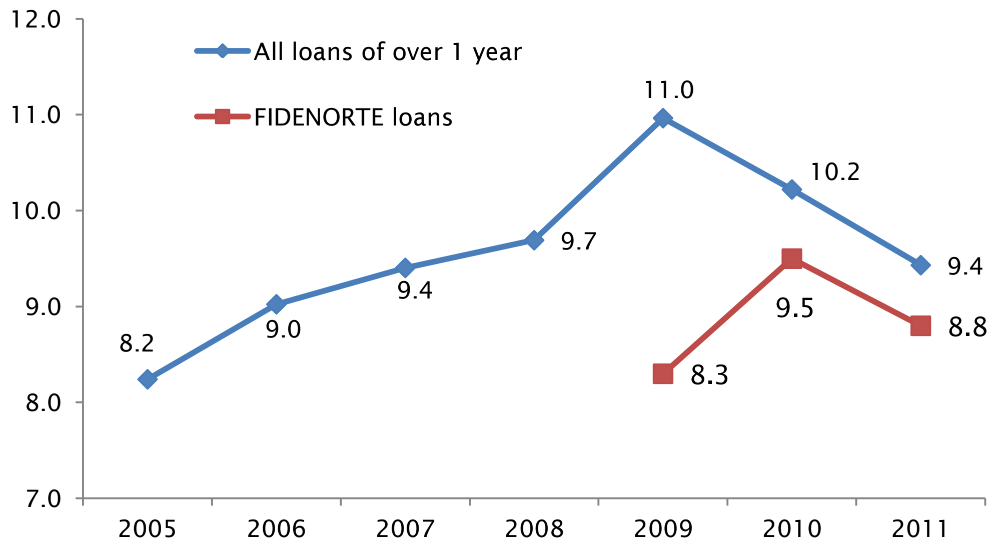
Sources: FIDENORTE administrative records, Superintendent of Financial Records and promotional documents from Banco de Fomento Agropecuario, Banco Agrícola, and Banco Hipotecario de El Salvador.

In Figure V.4, we compare FIDENORTE interest rates with national interest rates for all loans with maturities of over one year, including agricultural loans, non-agricultural business loans, mortgage loans, and personal loans. As illustrated, average FIDENORTE interest rates in 2009 were nearly 3 points below national interest rates. This gap was nearly closed in 2010 as FIDENORTE rates moved to within 1 point of national rates. This reflects the decision on the part of

[27] There is no evidence that BFA's new agricultural credit lines were influenced by FOMILENIO loan conditions and lending to the Northern Zone. Interestingly, BFA's general manager served on the PD Investment Committee, which approved all FIDENORTE loan applications.

FIDENORTE stakeholders in early 2010 to use a key mortgage interest rate as the base rate for all FIDENORTE interest rate calculations. As illustrated, the increase in FIDENORTE's average interest rate from 2009 to 2010 provides additional evidence that the program likely offered subsidized interest rates during 2009, but these subsidies were largely discontinued in 2010 and 2011.

Figure V.4. Comparison of FIDENORTE and National Annual Interest Rates (in U.S. Dollars)



Source: Central Reserve Bank of El Salvador and Stock Exchange of El Salvador (BVES).

Note: 2011 interest rate for all loans of over 1 year is current as of October 28, 2011.

To further compare FIDENORTE credit and other credit lines in the Northern Zone, we asked FOMILENIO, BMI, and MCC staff, as well as all interviewed loan applicants, about the availability of similar credit in the region. First, there was a discrepancy between applicants' accounts of the availability of similar credit in the region and accounts from FOMILENIO, BMI, and the investment committee. Whereas most sources at FOMILENIO, BMI, and the investment committee said FIDENORTE loan conditions were unique and highly competitive in the zone, some loan recipients and non-recipients expressed confidence that they could probably have found a similar loan to FIDENORTE at a state-owned bank, with even better interest rates and a longer maturity period. Many of these statements were motivated by recent advertisements from Banco de Fomento Agropecuario (BFA), which mentioned an annual interest rate of 4 percent and loan periods of up to 15 years for loans related to agricultural production.[28]

However, when most applicants were asked about the availability of credit at the time they applied for FIDENORTE credit, they conceded that FIDENORTE conditions were favorable compared to alternate loans from state-owned and private banks. One loan recipient said that although he did not research many alternatives, he was confident that FIDENORTE's interest rate

[28] Advertised at an annual interest rate of four percent, these new BFA loans are likely highly subsidized. As a result, they appear much more attractive to potential borrowers than FIDENORTE interest rates. Upon further investigation, however, BFA loans with four percent interest rates are restricted to short-term loans to finance the production of basic grains. As such, these loans are not comparable to FIDENORTE credit. Featured in Table V.5, BFA loans related to dairy, horticulture and tourism investments make for a more appropriate comparison with FIDENORTE loans. These BFA loans finance similar investments to FIDENORTE loans and feature similar interest rates and maturity periods.

was lower than other banks. Particularly for loans in the dairy and horticulture sectors, a higher loan amount appeared to be available through FIDENORTE than through other banks. For example, one applicant declined a $120,000 loan from FIDENORTE in favor of a $60,000 loan through a state-owned bank to finance the construction of nine greenhouses for tomato production. This was the largest loan size she could obtain outside of FIDENORTE, even with a strong credit history, sufficient collateral, and strong personal ties to several people in the banking sector.[29] Another borrower stated he was confident he could have obtained a loan from another bank to finance the purchase of cattle and milking equipment, but the loan amount most likely would have been lower.

In addition, nearly all recipients and non-recipients noted that FIDENORTE credit was unique from any other credit in the Northern Zone in that it featured flexible payment schemes and offered assistance with business plans. One interviewed loan recipient stated that this assistance probably makes FIDENORTE credit more attractive than any other loan on the market, as he calculated that his effective interest rate was around 3 percent after accounting for the monetary value of FIDENORTE assistance with business plan development.

When asked about FIDENORTE's niche in the market, FOMILENIO and BMI staff highlighted the fact that FIDENORTE loans can finance new activities in which the borrower does not have experience, whereas several other banks require several years of experience in the proposed productive activity. In addition, FOMILENIO and BMI staff stated that FIDENORTE loans have financed investments in the tourism and handicrafts sectors that most likely could not have been financed through other means, given most banks' aversion to loans in these sectors. This view was shared by interviewed applicants who proposed tourism projects. Contrasting FIDENORTE credit with credit from private banks, FOMILENIO and BMI staff agreed that private banks in El Salvador simply do not make loans for productive activities served by FIDENORTE. Rather, these commercial banks largely provide loans for consumption, strictly based on an analysis of individuals' ability to pay their debt.

Synthesizing these reports and financial data, we can conclude that by virtue of its technical assistance with business plans and highly competitive interest rates, FIDENORTE credit occupies a unique niche in the Northern Zone. Regarding whether borrowers could have found similar loans outside of FIDENORTE, there is some evidence that borrowers working in dairy and horticulture sectors could have found loans through state-owned banks, but they would have received a smaller loan amount from these banks (or would have faced less attractive loan conditions relative to FIDENORTE). In addition, FIDENORTE was most likely one of few loan options that borrowers could have accessed from 2009 to early 2011 for capital investments in tourism and handicrafts. In this sense, the activity complied—at least to some extent—with its original spirit of providing credit to individuals and organizations that could not have otherwise financed their investments.[30]

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[29] The applicant rejected the FIDENORTE loan largely because its grace period and interest rate were not as competitive as the loan conditions she secured through another state-owned bank.

[30] Despite these general findings, it is difficult to conclude that borrowers most likely would not have financed their investments outside of FIDENORTE, even if they could not have found a similar loan. One borrower who took out a FIDENORTE loan for a tourism project highlights this issue. During the interview, the borrower mentioned that he had enough capital to complete his investments without FIDENORTE funding, but he accepted the loan as a way of motivating himself to complete construction in a timely manner.

F. Additional Stakeholder Perceptions of FIDENORTE Loan Conditions

Overall, interviewed loan recipients and non-recipients reported high satisfaction with the loan amount available through FIDENORTE, and no interviewed applicants reported being offered a smaller loan than requested or desired. Applicants also found the program's flexible payment arrangements attractive in comparison with other loans in the market, as they had the ability to tailor their payments according to their investments, sales, and liquidity over the loan period. One borrower also praised the absence of commission fees in FIDENORTE loans, stating that this feature alone made his FIDENORTE loan more attractive than previous loans.

According to interviewed applicants, the most unattractive features of FIDENORTE loans were their relatively short grace period, high collateral requirements, and lack of working capital. In particular, applicants who requested loans related to tomato production stated that the grace period was too short to allow for greenhouse construction, planting, cultivation, and sales. In addition, three of five interviewed non-recipients cited complications due to collateral requirements as the primary reason they did not receive or accept FIDENORTE credit. Regarding working capital, several interviewed applicants said the unavailability of working capital through FIDENORTE presented complications for their businesses. During interviews, most loan recipients and non-recipients agreed the optimal allocation was 15 to 20 percent for working capital and 80 to 85 percent for investment capital. (See Appendix E for a more complete summary of applicants' perceptions of FIDENORTE loan conditions.)

Stakeholder Perceptions of FIDENORTE's $50,000 Minimum Loan Amount

Interviews with FOMILENIO, BMI, and investment committee members revealed that FIDENORTE's minimum loan amount of $50,000—a compromise between MCC's desire for a larger amount and FOMILENIO's desire for a smaller amount—was judged by several stakeholders as non-optimal. First, FOMILENIO staff and investment committee members stated that the loan's lower threshold of $50,000 was too high in that it effectively denied credit to a large portion of producers served under PBS, as well as other small business owners with viable business ideas. Loans of between $5,000 and $50,000—including a portion of working capital—would have been appropriate for this target population.

In another sense, the minimum requirement of $50,000 was too low, according to one FOMILENIO interviewee. Because business plans developed through FIDENORTE are a large investment, argued the interviewee, only projects over a pre-defined threshold such as $100,000 or even $200,000 should have been assisted through the Investment Support Activity. In addition, higher loan amounts would have produced less administrative costs per loan, which could have improved the activity's prospects for financial sustainability. One committee member agreed that the FIDENORTE loan amount was too low, as large investments of over $250,000—which were originally envisioned by MCC—would have produced the most impact in the Northern Zone in terms of employment. However, the committee member stated that unfortunately, there were not enough potential investment opportunities of this magnitude in the Northern Zone to meet the activity's original target of $17 million.

Given these considerations, one FOMILENIO representative conjectured that a segmented approach to credit could have been implemented to serve the full spectrum of credit needs among PBS participants and enterprises in the Northern Zone. Such an approach could have featured at least two types of financial products: loans between $5,000 and $50,000 (similar to FOMILENIO's PYME proposal) and loans over $50,000. Loans below $50,000 would provide PBS participants and other small businesses with much-needed investment and working capital. To minimize administrative costs, such loans could be administered by intermediary lending organizations. These loans would not require detailed business plans, particularly when related to established business models such as milk production. Similar to its current loan product, FIDENORTE could have also provided loans over $50,000 to primarily finance capital investments. Only loan amounts over a certain threshold—perhaps $100,000—would require business plans, and these larger loans would be administered through BMI. Such an approach could have met the needs of a variety of producers and businesses inside and outside the PBS Activity, while minimizing administrative costs and spending valuable resources on business plans only when necessary.

Synthesizing these findings, it is difficult to determine whether FIDENORTE's minimum loan amount was appropriate for its target population, particularly due to the activity's inherent tension between serving PBS participants and established businesses. Given the wide range of potential FIDENORTE borrowers (from small producers to established businesses), the segmented approach proposed by FOMILENIO may have been preferable to FIDENORTE's single loan product of at least $50,000. However, the viability of such an approach would depend on quantitative cost-benefit and/or constraints analyses that weigh issues related to unmet demand in credit markets, potential crowding-out scenarios, potential duplication with the Financial Services Activity, and program sustainability.

VI. INVESTMENT, EMPLOYMENT, AND OTHER KEY OUTCOMES

To gain insight on the possible effects of FIDENORTE credit as well as the availability of credit in the Northern Zone, we interviewed ten FIDENORTE applicants: five loan recipients and five non-recipients. Two interviewed applicants (one loan recipient and one non-recipient) were dairy farmers, four interviewed applicants (two loan recipients and two non-recipients) produced tomatoes, and four interviewed applicants (two recipients and two non-recipients) had tourist locales. Each of these ten applicants was selected because he or she resembled another applicant in terms of productive activities, requested loan amount, projected IRR, and application date, but was distinct from this other applicant regarding receipt of FIDENORTE credit. This resulted in five matched pairs of applicants, in which each of five recipients was paired with a non-recipient who had a similar business plan and loan request. In this chapter, we examine the reported investments, employment, and income of borrowers following receipt of FIDENORTE credit, and compare them with the reports of their paired non-recipients since applying for FIDENORTE credit. However, these comparisons are not meant to be interpreted as impact estimates, nor are differences between recipients and non-recipients attributable to FIDENORTE. (See Figure VI.1 for a summary of these comparisons.)

Throughout the interviews, two different profiles of applicants emerged: poor small business owners versus middle-class established business owners. Poor small business owners were characterized by modest living conditions, apparent low levels of education, modest production, a lack of working capital, limited knowledge regarding credit and business administration, and employment of three or fewer individuals. (However, it should be noted that these small business owners had stronger production and higher income than typical PBS participants, who generally operate at subsistence levels.) In contrast, middle-class established business owners where characterized by apparent high levels of education, apparent access to credit outside of FIDENORTE, employment of as many as ten individuals, and a reliance on consultants and other outside experts to handle the technical aspects of their business. Both dairy producers, two tomato producers, and two applicants with tourist projects fit the profile of small business owners, whereas two tomato producers and two applicants with tourist projects fit the profile of established business owners.[31]

Next, we report on applicants' investments, employment of workers, production, sales, income, and other outcomes. We also report on borrowers' repayment of FIDENORTE credit.

A. Investment

With the exception of one borrower who had not yet received a disbursement, all interviewed borrowers reported using FIDENORTE loans to complete a substantive portion of the investments listed in their business plans. Both loan recipients with tourist projects constructed or improved their swimming pools and renovated their facilities. (However, neither of these borrowers had completed construction of the cabins outlined in their business plans.) One loan recipient with a

[31] Fortunately, recipients who were small business owners were matched with non-recipients who were also small business owners, and recipients who were established business owners were matched to non-recipients who were also established business owners (except the two tourism pairs). This helped minimize comparisons between systematically different applicants.

dairy project bought new cattle, a storage tank, and machinery, and one borrower with a greenhouse project nearly finished the construction of four industrial greenhouses. All five interviewed borrowers also spent their own funds—ranging from $3,000 in the case of a tomato production project to $100,000 in the case of a tourism project—on investments related to their businesses. Some of these investments were not foreseen in original business plans. For example, one borrower spent $15,000 to hire a project manager and a consultant to facilitate greenhouse construction and tomato production—expenses he did not originally budget in his business plan because he planned to assume these responsibilities. Overall, loan recipients made investments strictly according to their business plans, or they modified their business plans retroactively under the investment committee's supervision to reflect actual investments.

In contrast, non-recipients with tourism and dairy projects had not made any substantive investments outlined in their business plans (or outside their business plans).[32] However, one non-recipient spent $16,000 to build one of five proposed greenhouses despite not receiving FIDENORTE credit. Another applicant who opted for credit from another bank over FIDENORTE credit made substantial investments in building the greenhouses outlined in her business plan, drawing from an alternate loan as well as personal savings. In summary, all five interviewed FIDENORTE borrowers reported making substantive investments in their business, and only two of five non-recipients reported making similar investments.

B. Employment

In addition, all five interviewed borrowers reported employing new workers since they received credit, including 10 new full-time temporary workers in the case of both loan recipients with tourism projects, 6 new full-time permanent workers in the case of the dairy project, and 3 new full-time temporary workers in the case of one tomato production project. These levels of employment were similar, but slightly lower than the number of new jobs projected in business plans. For example, the borrower in the dairy project projected 7 full-time employees and hired 6, and the two borrowers with tourism projects projected 12 and 13 new full-time employees, and each reported employing 10 individuals at the time of interviews. The borrowers expected that a large portion of temporary jobs would cease once construction was complete, but that several permanent positions would remain at most projects—particularly tourism and dairy projects—as more personnel would be needed for business administration and production activities, respectively.

In contrast, only two of the five interviewed non-recipients reported employing new workers following their application for FIDENORTE credit, and one of these individuals was the recipient of a similar loan through another bank. The other non-recipient reported offering only one additional full-time job after applying for FIDENORTE credit.

C. Production, Sales, and Income

Among both borrowers with tourism projects, sales had increased since they received FIDENORTE credit. One borrower estimated that recent improvements had generated an additional $3,000 in net monthly income. If this net income increase persists throughout 2011, the borrower will far exceed original projections of $9,000 in net capital flows for the first year of investments. The other interviewed borrower with a tourism project reported regular monthly

[32] One non-borrower with a tourism project build a modest swimming pool, but he estimated that the costs of the pool were minimal, as he completed all construction himself.

income from events hosted at his locale.[33] The loan recipient with a dairy business also reported a substantive increase in production of around 300 additional bottles of milk produced per day, and an increase of $600 in monthly net income. With a net monthly income of less than $1,400 per month, this borrower was unlikely to meet first-year sales projections of $102,000. At the time of the interview, however, the borrower had not yet received some new machinery that would greatly diminish labor costs associated with milk production. Regarding other interviewed borrowers, neither loan recipient with tomato production projects had produced or sold tomatoes at the time of the interview. As such, their production and sales had not changed since receiving FIDENORTE credit.[34]

In contrast, non-recipients with tourism projects reported no or minimal production and sales following their application for credit, and a non-recipient with a dairy business reported no increase in production and a slight decrease in net income over the past few months. One exception to this general pattern among non-recipients is the individual who financed a greenhouse with his own savings. With one large crop, this individual made a net income of $7,000. With one more production cycle, the individual hoped to fully recuperate the $16,000 he spent to build the greenhouse. At the time of the interview, however, he had a negative net income related to tomato production.

D. Repayment

Four interviewed borrowers had loan payments scheduled before July 2011, and none of these four reported any repayment difficulties. Two borrowers reported that they made FIDENORTE payments with savings and alternate income sources because their businesses were not yet generating sufficient income to cover loan payments. In contrast, two loan recipients reported that additional income generated by their FIDENORTE investments was already sufficient to cover loan payments, despite the fact that they had not yet completed all investments outlined in their business plans.

E. Other Outcomes

Interviewees generally reported some degree of personal satisfaction resulting from their experience with FIDENORTE credit. Loan recipients as well as non-recipients expressed appreciation for the opportunity to work with consultants and learn more about cost and sales projections. One recipient remarked that through his interactions with consultants and BMI, he had come to think more strategically about his short- and long-term business operations.

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[33] Due to ongoing construction costs at the time of the interview, this second borrower had not yet experienced a positive net income related to FIDENORTE credit. As a result, this borrower was not on track to meet total income projections in the first year of nearly $109,000.

[34] In our design for the Investment Support Activity, we also proposed measuring changes in value chain integration—or borrowers' interactions with suppliers and buyers—following receipt of FIDENORTE credit. At the time of data collection, it was too early to detect any real changes in value chain integration in the dairy and horticulture value chains, as many investments were still in progress. However, several FIDENORTE loan applicants in these chains mentioned that they were currently in preliminary discussions with suppliers of inputs and potential buyers, including El Salvador Produce and Lácteos de la Zona Norte, two producer-owned businesses strengthened under PBS. Future rounds of data collection could include questions about whether these discussions resulted in lower input prices and/or higher sale prices.

Figure VI.1. Outcomes of Interviewed Loan Recipients versus Non-Recipients

	Loan Recipients	Non-Recipients
Investment	Four of five recipients invested FIDENORTE funds in their businesses and all five invested a portion of their own money.[a]	One of five non-recipients invested funds from a non-FIDENORTE credit and two of five non-recipients invested their own funds in their businesses.
Employment	All five recipients reported employing additional full-time workers in recent months, ranging from one full-time worker to 10 full-time workers.	Two of five non-recipients reported employing additional workers in recent months. One of these individuals received credit through another bank.
Production and Sales	Three of five recipients experienced higher production and/or sales.	One of five non-recipients experienced an increase in tomato production and sales.
Net Income	Two of five recipients experienced higher net income related to FIDENORTE credit.	No non-recipients experienced an increase in net income since applying for FIDENORTE credit.

Source: Interviews with FIDENORTE applicants conducted in July 2011.

[a] One loan recipient had not received a disbursement at the time of in-person interviews, and thus had not yet invested FIDENORTE funds.

In summary, our interviews with FIDENORTE applicants corroborate that through use of FIDENORTE credit, all five borrowers reported increased productive investments and additional employment of workers, three reported experienced increased production and sales, and two reported higher net incomes. In contrast, paired non-recipients did not appear to have experienced these positive outcomes on the same scale (or at all in the case of increased net income). However, because we do not have a valid comparison group for borrowers or a sufficient sample size, we cannot attribute these recipient-non-recipient differences in outcomes to FIDENORTE credit. Considering these limitations, the comparisons of loan recipients and non-recipients merely suggest the potential positive effect of FIDENORTE credit on these key outcomes. Because many borrowers are still in the investment and construction stages of their business plans, more detailed information regarding sales, income, and employment should be collected in future rounds of data collection.

Additional Outcomes: A Discussion of BMI's Development Fund

As previously mentioned, BMI was in the process of establishing an economic development fund when it became involved in designing the Investment Support Activity. BMI was interested in establishing this development fund under the model of the Brazilian Development Bank (BNDES), a first-tier public bank that has played a fundamental role in stimulating the expansion of Brazilian industry and infrastructure since its establishment in 1952. A development fund was seen by BMI leadership as a way to diversify its role in the financial system, particularly because BMI's key function as a second-tier lender had diminished in recent years due to the greater liberalization of international capital flows.

A large factor in BMI's decision to administer the FIDENORTE trust fund was the belief on the part of the bank's leadership that the activity would inform the design of this development fund. Through FIDENORTE investments, BMI staff hoped to strengthen its capacity to identify and develop viable business ideas that may not necessarily secure financing through other banks. This strengthened capacity was not identified as an explicit outcome of the Investment Support Activity, but MCC staff viewed this learning opportunity as a potentially positive outcome of the activity.

In interviews, BMI staff emphasized that their experience with FIDENORTE has been particularly beneficial, as they have learned several lessons regarding outreach, administrative procedures, business plan analysis, and loan conditions that they will apply to their development fund. For example, BMI leadership has designated the optimal allocation of investment versus working capital as 85 percent and 15 percent based on its experience with FIDENORTE clients. In addition, BMI's proposed design for its development fund is very similar to the originally proposed structure of FIDENORTE, in which BMI would administer loans through financial intermediaries.

On the other hand, BMI's experience with its own development fund may have negatively affected the bank's long-term commitment to the FIDENORTE trust fund. During 2011, FOMILENIO staff noted that BMI leadership was not interested in proposing a plan to grow the FIDENORTE loan portfolio in future years, which was a potential scenario posed by FOMILENIO. Now that BMI (currently known as the Development Bank of El Salvador, or BandeSal) has learned key lessons from FIDENORTE and has a newly authorized economic development fund, there appears to be little incentive for the organization to assume increased responsibility over the FIDENORTE trust fund.

VII. CONCLUSIONS AND LESSONS LEARNED

A. Implementation Assessment

To assess the Investment Support Activity's implementation comprehensively, we evaluated the fulfillment of each of the following key implementation aspects outlined in the compact and initial plans: (1) reaching lending targets, (2) serving the target population, (3) implementing a demand-driven, competitive application process, and (4) applying transparent selection criteria.

1. Reaching Lending Targets

The Investment Support Activity fell short of its original lending targets due to several factors, including delays in establishing the trust fund and defining the loan product; a general lack of capacity to compose and analyze business plans; BMI's limited experience as a first-tier lender; and the activity's lengthy and complex loan development and approval process. Below we describe each of these factors in more detail.

a. Delays in establishing the trust fund and defining the loan product

Due to inadequate performance of the initial contractor charged with designing the Investment Support Activity, a lack of leadership from BMI, as well as competing visions among stakeholders regarding the appropriate target population and loan product, the FIDENORTE trust fund and loan product were not established until February 2009, about one-and-a-half years after the MCC-El Salvador compact entered into force in September 2007. This delay resulted in lost opportunities in late 2008 and early 2009 to develop, present, and approve FIDENORTE loans.

b. Lack of capacity to compose and analyze business plans

A lack of capacity on the part of small- and medium-sized business owners in the Northern Zone to develop viable business plans had serious implications for FIDENORTE lending targets. Because most applicants were unable to develop high-quality business plans on their own, the pool of eligible applicants was generally restricted to those applicants who were assigned a consultant through FIDENORTE. In addition, consultants' limited capacity to develop plans, as well as BMI's and GyS's difficulties with analyzing these plans, resulted in major delays in presenting viable business plans to the investment committee throughout 2009 and early 2010. As a result, very few projects were approved during this period, to the extent that all stakeholders agreed in early 2010 that FIDENORTE's original lending targets could not be met.

c. BMI's limited experience as a first-tier lender

BMI's inexperience as a first-tier lender created obstacles at nearly every stage of the loan process, including outreach, business plan analysis, loan registration, disbursement, and loan monitoring. Because BMI had no established capacity to perform any of these responsibilities when the activity began, new staff was hired and new protocols and processes were developed over the course of implementation. The delays generated by these midcourse modifications—and in particular the delay in rolling out outreach activities—had a detrimental effect on the number of viable applicants BMI was able to attract in 2009 and early 2010. This dearth of initial applicants resulted in a weak pipeline of loan applications, and ultimately a modest number of loan recipients when new lending ceased in 2011.

d. Lengthy and complex loan development and approval process

The loan development and approval process was nearly 10 months in length for the typical FIDENORTE loan and involved several institutions and key steps. Most business plans were developed by applicants and consultants, reviewed by a BMI analyst and FOMILENIO staff, evaluated and modified by a committee of BMI employees, and approved by the PD Investment Committee. This lengthy and complex application process inhibited the project's ability to meet lending targets, as evidenced by the sizable portion of applicants who chose to discontinue the process after several months of business plan development and analysis. Faced with this prolonged and labor-intensive process, several applicants secured funding elsewhere or chose not to pursue an investment loan for their businesses.

Although it is difficult to assess the contribution of each of these factors to the activity's inability to meet lending targets, we can reason that lack of capacity in the Northern Zone to compose viable business plans—or the lack of qualified demand in the region—was a serious structural obstacle to meeting lending targets. However, this lack of capacity could have been overcome with more timely and intensive outreach efforts to target potential borrowers, as well as a more flexible and tailored approach to assist borrowers with business plan development. Given its dearth of experience in these areas and inability to contract appropriate staff in a timely manner, BMI was simply not capable of performing these roles during the FIDENORTE implementation period. As such, the combination of these two factors—low levels of qualified demand in the region and BMI's lack of capacity and leadership—was probably the largest determinant of the activity's modest lending levels.

Despite these obstacles, BMI and FOMILENIO performed several implementation tasks remarkably well and demonstrated a capacity throughout the implementation period to make midcourse corrections when necessary. First, BMI designed and implemented a successful outreach campaign in late 2009 when it became clear that the activity did not have a sufficient pipeline of projects in development. In addition, BMI and FOMILENIO successfully contracted personnel capable of producing and analyzing business plans in late 2009 and 2010 when applicant-produced plans were found to be incomplete and initial analysts did not produce high-quality work in a timely manner. After the mid-term review, BMI effectively analyzed and proposed business plans to the investment committee and complied with all major responsibilities associated with registering, disbursing, and monitoring loans. In addition, FOMILENIO complied with its core supervisory and monitoring responsibilities and fulfilled the key role of facilitating borrowers' access to technical assistance once loans were approved. By all accounts, the investment committee also performed its review and approval responsibilities efficiently after the mid-term review, largely as a result of the new committee director's strong leadership.

As BMI, FOMILENIO, and the investment committee became more adept at performing their functions in 2010 and 2011, the large majority of FIDENORTE loans were analyzed, approved, and granted. With 30 loans granted as of September 30, 2011, the level of actual lending appears modest in proportion to its high administrative costs from 2009 to 2011. However, each of these loans represents a large investment on the part of FOMILENIO and BMI in technical assistance and business plan development, technical and financial analysis, customer service, and in-person monitoring.

2. Serving the Target Population

Overall, the Investment Support Activity effectively served its target population of poor individuals and organizations that benefit poor inhabitants of the Northern Zone. Based on 10 in-person interviews with applicants and a thorough review of administrative data, it appears that FIDENORTE has served both poor individuals—particularly poor farmers with some level of working capital—as well as established enterprises that benefit such individuals.[35] From an implementation standpoint, providing both types of groups with assistance and credit represents a diversified investment in business endeavors in the Northern Zone. However, there were few cases in which poor producers and enterprises that benefit them worked in collaboration under FIDENORTE, as envisioned under the compact. Given the dearth of established businesses in the Northern Zone and the different incentives and needs of established businesses vis-à-vis poor producers, forming these collaborations may have proven more difficult than originally planned.

However, it is difficult to argue that the activity targeted individuals and organizations with insufficient capital and liquid assets to finance their investments, as mandated in the compact. This is particularly true when considering the increasingly high collateral standards applied by the investment committee as implementation progressed. By mid-2010, the investment committee would not consider applicants with collateral of less than 100 to 120 percent, despite a revised interest rate calculation method in which applicants with collateral of less than 50 percent could still secure a loan with a higher interest rate. Not only was the committee failing to target applicants with insufficient collateral by this time, it was actually excluding applicants with less than 100 percent collateral from consideration for FIDENORTE credit. Despite these findings, there is some evidence that several FIDENORTE borrowers in the handicrafts and tourism chains could not have secured credit outside of FIDENORTE. Taking this into account, we can conclude that FIDENORTE effectively targeted and served a population that faced serious constraints to accessing credit—constraints that were largely the result of the sector in which applicants operated, not necessarily a lack of collateral or liquid assets. In this broader sense, the activity complied—at least to some extent—with its original spirit of providing credit to individuals and organizations that could not have otherwise financed their investments.[36]

Also to some extent, the Investment Support Activity fulfilled its original objective of providing investment capital to individual and collective producers who also received technical and material assistance under the PBS Activity of the PDP. Of the 44 FIDENORTE loans approved, 15 loans (34 percent of all approved loans) were granted to PBS participants, primarily related to tomato and dairy production.

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[35] Although a standard definition of poverty was not applied to all interviewed applicants, "poor" borrowers are approximately defined as interviewed borrowers who had modest living conditions (including dirt floors and a lack of indoor plumbing), educational attainment of less than elementary school, and net annual incomes of less than $10,000.

[36] The question of whether borrowers could have found funding elsewhere is related to, but distinct from, the question of whether borrowers could have financed their investments without FIDENORTE credit. To answer either question with confidence, a valid comparison group and a larger sample size would be necessary.

3. Implementing a Demand-Driven, Competitive Application Process

To the extent possible, BMI and FOMILENIO followed the compact's mandate to support a demand-driven, competitive process to provide capital to critical investments in target value chains in the Northern Zone. Because all proposals and business ideas originated with applicants, it is clear that program implementers supported a demand-driven application process. However, it is difficult to assert that the process was competitive by nature because there was never a shortage of financing available through FIDENORTE and proposals were never ranked or compared. This has important implications for the activity because as it was envisioned, competition between applicants would be the primary mechanism through which the most promising business plans would achieve funding. However, given the dearth of eligible applicants, there was no compelling rationale to introduce competition into the FIDENORTE selection process. Such competition would have only decreased the number of loans approved and granted, further compromising the fulfillment of lending goals. As such, BMI and FOMILENIO should not be cited for failing to introduce competition into a process in which competition was not feasible or desirable.

4. Requiring and Applying Transparent Selection Criteria

Throughout implementation, BMI and FOMILENIO followed the compact's mandate of requiring applicants to develop a business plan and report on well-established criteria. In addition, the Investment Support Activity largely followed the compact's guidelines of approving or rejecting loans based on these established criteria, with one or two exceptions. In at least one instance, an applicant organization that complied with all of the key eligibility criteria was denied by the committee because committee members judged that the applicant likely could have found funding elsewhere. This should not be interpreted as a grave misstep on the part of the investment committee because its decision was motivated, in part, by the activity's original spirit of providing poor populations with investment capital. However, it is reasonable to assert that if the committee intended to apply a pro-poor criterion, such a criterion should have been included in the FIDENORTE operations manual and applied objectively across all applicants.

B. Results Assessment

Regarding the ultimate goal of the Investment Support Activity, the compact states that investment support is intended to reduce poverty by enabling the creation of profitable and sustainable business activities that generate employment and significantly raise income. As to whether the activity has successfully generated employment and raised income, our interviews with loan recipients corroborate that through use of FIDENORTE credit, all five interviewed borrowers reported increased productive investments and employment generation, three borrowers reported increased production and sales, and two loan recipients reported higher net incomes. In contrast, paired non-recipients did not report experiencing these positive outcomes on the same scale (or at all in the case of increased net income). Unfortunately, we cannot conclude from these findings that FIDENORTE credit has shown a positive impact on employment generation and net income for two key reasons. First, we do not have a sufficient sample of borrowers and applicants to create viable estimates of employment and income increases. Secondly, non-recipients do not serve as a valid comparison group for loan recipients because several of these non-recipients appear to have fewer assets and working capital, higher risk for default, and fewer entrepreneurial characteristics compared to recipients. Considering these limitations, our comparisons of recipients and non-recipients merely suggest the potential positive effect of FIDENORTE credit on these key outcomes. As many borrowers are still in the investment and construction stage of their business plans, more detailed information regarding sales, income, and employment should be collected in future rounds of data collection.

C. Lessons Learned

A key finding regarding implementation of the Investment Support Activity is that when the FIDENORTE trust fund was established in 2009, BMI did not have the capacity to fulfill its function as a first-tier lender, or even a plan to establish this capacity. Due to this lack of capacity and planning, implementation during 2009 and early 2010 was deficient. Perhaps this situation could have been avoided with the inclusion of stronger positive and negative incentives in BMI's implementing entity agreement. Regarding positive incentives, FOMILENIO and BMI could have collaborated in 2007 and 2008 to identify BMI's specific technical assistance needs related to Investment Support implementation, and FOMILENIO could have committed to financing this assistance in its agreement with BMI. Examples of potential technical assistance from which BMI could have benefited prior to implementation include training and assistance to develop a staffing plan, outreach plan, administrative procedures to guide the loan application and disbursement processes, and/or a customer service protocol.

Regarding negative incentives, FOMILENIO could have included (and enforced) stipulations in BMI's implementing entity agreement that required BMI to build capacity and submit a comprehensive operations plan preceding implementation. To be effective, such stipulations could have been accompanied by well-defined consequences if requirements were not met. For example, FOMILENIO could have included a stipulation in BMI's agreement that the bank could not receive disbursements until they hired sufficiently qualified staff preceding lending activities, as determined by MCC and FOMILENIO. As stated above, FOMILENIO did provide BMI with some general technical assistance and additional staff preceding and during implementation. Because these positive incentives did not appear to improve implementation, perhaps a stronger emphasis on negative incentives during initial implementation would have been a preferred course of action.

Another key lesson learned is that all stakeholders could have benefited from more detailed discussions during 2007 and 2008 to better define the target population, the loan product and the responsibilities of each institution. In particular, some consensus around the program's target population could have avoided tensions that persisted throughout implementation among MCC, FOMILENIO, and the investment committee concerning whether credit should be directed to small producers or established enterprises. Given MCC's preference for larger-sized loans to established businesses and FOMILENIO's preference for smaller-sized loans to small producers, perhaps these discussions would not have produced one well-defined target population. However, this finding may have generated a complementary credit program such as FOMILENIO's proposed PYME modification much earlier in the activity's implementation.

Interestingly, nearly all disagreements between MCC and FOMILENIO regarding the program's target population and loan product can be traced to two inherent tensions among MCC, FOMILENIO, and BMI regarding FIDENORTE: one tension between making high-return loans (loans with the most potential to generate employment and increased income) and targeting the poor, and another tension between minimizing financial risk and assuming a higher degree of financial risk to serve a particular target population. Generally, MCC staff favored making high-return loans and minimizing financial risk, and FOMILENIO and BMI staff favored targeting the poor and assuming higher financial risk as a result of this targeting. MCC's priorities implied one financial product: larger loan sizes, unsubsidized interest rates, and market-based collateral requirements, whereas FOMILENIO and BMI's priorities implied smaller loan sizes, subsidized interest rates, and flexible collateral requirements.

Because the tension between these priorities remained unresolved in the design and implementation phases of the Investment Support Activity, stakeholders had an unclear vision of the activity's target population, financial product, and selection criteria throughout implementation. In the interest of generating high-return loans, MCC staff favored a minimum loan size of $250,000, whereas FOMILENIO originally proposed a smaller loan size of $10,000 to ensure that PBS participants would have access to credit. In an attempt to provide a desirable interest rate for disadvantaged clients, BMI and FOMILENIO set the interest rate at "BMI plus 2," whereas MCC eventually secured the adoption of a more market-based approach in which the interest rate was calculated as a function of the applicant's grace period, debt rating, and collateral. The result of these interest rate, grace period, and collateral requirement modifications was that FIDENORTE conditions were applied unevenly from 2009 until 2011, to the extent that initial loans approved in 2009 were likely subsidized and the last loans approved in 2011 more resembled market-based financial products. More importantly, a high level of human resources among FOMILENIO, MCC, and BMI staff was spent on resolving these issues—and discussing potential program modifications such as the PYME proposal—throughout 2009 and 2010. As a result, resources were diverted from monitoring and strengthening implementation through enhanced communication, improved processes, or technical assistance.

As previously mentioned, the compact contained instructions that could have helped resolve these tensions in that it mandated that applicants be evaluated according to a minimum economic return threshold as well as financial need. By including both types of criteria, the compact provided an objective mechanism by which the tension between these two priorities—high-return investment as well as pro-poor targeting—could be resolved in the selection process. Unfortunately, this criterion of financial need was not codified in the FIDENORTE operations manual nor applied objectively by the investment committee.

In light of these findings, a key lesson learned from the FIDENORTE experience is that tension between pro-poor targeting and high-return lending—as well as the tension between minimizing financial risk and assuming a higher degree of risk to reach a particular target population—should be discussed and finalized before project implementation, if possible.[37] If future investment projects identify both pro-poor and high-return priorities, examining and answering the following two questions during the development stage could help resolve these tensions:

1. Can both pro-poor and high-return priorities be served with one financial product or are two (or more) products necessary to emphasize each priority separately? Would combining both priorities in the same financial product have any negative implications regarding the size of the eligible applicant pool?
2. If one financial product is desired, what is the best way to combine pro-poor criteria (such as some objective measure of financial need) with criteria related to financial feasibility and internal rate of return?

[37] To some extent, the tension between pro-poor and high-return lending is best addressed by determining which of these two priorities better achieves MCC's ultimate goals of employment creation and increased economic income. This is a difficult issue to resolve because it requires precise definitions of outcomes, an analysis of economic data, and some value judgments concerning the equitable distribution of new jobs and income increases.

Finalizing answers to these questions and codifying them in program manuals and implementation policies before project implementation would provide MCC and its implementing partners with fixed guidelines regarding all programmatic lending. Forming a common vision among MCC and implementing partners during this stage regarding the target population and loan product would also pay large dividends, as this common vision could guide key implementation decisions and preclude the necessity of midcourse modifications to financial products and lending programs.

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APPENDIX A

IN-PERSON AND PHONE INTERVIEWEES
MAY AND JULY 2011

Fondo del Milenio (FOMILENIO)

- Mauricio Pérez, PDP Financial Services Coordinator
- Isabel Rodríguez, Monitoring and Evaluation Analyst
- Iliana Castro, Financial Services Coordinator
- Xenia Panameño, Monitoring and Evaluation Officer

Productive Development Investment Committee

- Teodoro Romero, Advisor for the Family Agriculture Plan, Ministry of Agriculture
- José Antonio Peñate, General Manager, Banco de Fomento Agropecuario

Multi-Sector Investment Bank (BMI)

- Mabel de Soundy, Development Bank Director
- Annalya de Escalón, Systems Administrator

Millennium Challenge Corporation (MCC)

- Kenneth Miller, Deputy Resident Country Director, El Salvador
- Sarah Crawford, Senior Program Officer, Private Sector Development

Other Interviewees

- Samuel Salazar-Genovez, Director of PROinnova, the Salvadoran Foundation for Economic and Social Development (FUSADES)

APPENDIX B

SECTION 2(B) OF SCHEDULE 2 TO ANNEX I OF THE MCC-EL SALVADOR COMPACT, DESCRIPTION OF THE INVESTMENT SUPPORT ACTIVITY

Project Activity: Investment Support (the Investment Support Activity)

To attract private investment in and various types of financing for high-value economic activities in the Northern Zone, the Investment Support Activity will utilize MCC Funding to support a demand-driven, competitive process to provide capital to critical investments required for successful operation of a business activity that is part of a value chain that will be located in and/or benefit poor inhabitants in the Northern Zone. The goal of the Investment Support Activity is to make investment capital available to poor individuals, and organizations that benefit poor inhabitants of the Northern Zone, who, due to insufficient collateral and lack of liquid assets, are not able to finance their investments. This investment support is intended to reduce poverty by enabling the creation of profitable and sustainable business activities that generate employment and significantly raise income.

Specifically, MCC Funding will support the administration and funding of an investment support program providing investment capital for the development of competitively selected business proposals. The Government, through BMI, will implement the investment support program through a suitable vehicle managed by BMI and funded with grants from FOMILENIO.

The Investment Support Activity will require potential proponents to make proposals to compete for support based on transparent criteria, including, without limitation, a fully developed business plan and the provision of a significant contribution either of their own or of their business partners' resources. These elements help ensure that resources are directed to the most promising business endeavors, encouraging alliances, joint ventures, and other forms of collaboration between more established enterprises and smaller/disadvantaged organizations and individuals in the Northern Zone. This also is expected to lead to faster start-up and increased chances of success and sustainability.

Beneficiaries assisted in developing a business plan under the Production and Business Services Activity may submit those business plans for award consideration under the Investment Support Activity; however, investment support applications may also be submitted by candidates that have not received assistance under the Production and Business Services Activity or otherwise under the Productive Development Project. Proposals will be reviewed, ranked and recommended for approval by the PD Investment Committee. Minimum eligibility (pass/fail) criteria will be defined subject to MCC approval, including a minimum economic return threshold (returns must be higher than the rate defined in Annex III to this Compact), technical feasibility, and financial need. Proposals will be evaluated according to specified criteria approved by MCC, including criteria with respect to the following: (i) financial rate of return; (ii) economic rate of return; (iii) co-investment level; (iv) environmental and social considerations; (v) technical feasibility; and (vi) employment and other community impacts.

The Investment Support Activity will be governed by and must adhere to rules and procedures documented in the PD Operations Manual. The capital investments made must be designed to be liquidated, whether by repurchase by the recipient, fulfillment of a note or contract, purchase by third parties, or in another manner, on terms appropriate for a capital investment as regards the size of planned liquidation payments, and as early as reasonably possible consistent with estimated cash flows of the business activity in which the investment is made, all according to terms established at the time of the award and in adherence to the principles outlined in the PD Operations Manual. At the conclusion of the second year of the Compact Term, an assessment will be made and appropriate changes enacted, if necessary, in the structure and funding of the Investment Support Activity.

Prior to the end of the fourth year of the Compact Term, FOMILENIO and MCC must complete a plan for the disposition of financial assets generated by the Investment Support Activity. This plan must entail either a liquidation of assets or a program to be managed by a fiduciary agent. The selection of the liquidation agent or fiduciary agent must be completed no later than six months prior to the end of the Compact Term. No financial asset created under the Investment Support Activity during the Compact Term can have an original maturity that is later than the date that is nine years from the date of Entry Into Force. All financial assets must be liquidated or transferred (as per the aforementioned plan) prior to the date that is ten years after the date of Entry Into Force.

APPENDIX C

ELIGIBILITY CRITERIA AND FINANCING CHARACTERISTICS, FIDENORTE OPERATIONS MANUAL, FEBRUARY 20, 2009

A. ELIGIBILITY CRITERIA

- The applicant resides in one or more of the 94 municipalities in the Northern Zone and carries out commercial activities that benefit inhabitants in the Zone. If the applicant is located outside the Northern Zone, he/she/it must carry out commercial activities that benefit the value chains in the Zone, or he/she/it must intend to invest in activities associated with the value chains prioritized by PDP.
- Has status as a legal entity and a formal accounting system.[38]
- Dedicated to productive and/or commercial activities in value chains in one of the following sectors: animal husbandry, agro-industry, dairy, tourism, or handicrafts.[39]
- Has verifiable financial solvency.
- Compliant with all requirements established in the guides for business plan development, and their appendices.
- Debt/equity proportion of no more than 4:1 after the proposed investment.
- If the applicant has a debt rating, it must be A1, A2, or B, according to the risk assessment norms of the financial system superintendent, and he/she/it cannot have bad references in the credit bureaus accepted by the trustee. For legal entities, this should be true for the enterprise as well as its stockholders.[40]
- Private enterprise: funding of state, municipal, university, and non-governmental organizations is prohibited.[41]
- If the applicant has an associated project with multiple producers, it must benefit from technical assistance from the FOMILENIO PDP contractor.

B. FINANCING CHARACTERISTICS

- $50,000 minimum loan amount.
- 70 percent is the maximum percentage of investment that can be financed with FIDENORTE credit.
- 20 percent of the total investment value is the minimum counterpart contribution. This contribution can be in cash or stock.

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[38] By 2010, the FIDENORTE operations manual had added "or is willing to formalize this system" to this requirement.

[39] By 2010, the FIDENORTE operations manual had added "or other productive sectors with potential in the Northern Zone" to this requirement.

[40] By 2010, the FIDENORTE operations manual had added "If the applicants do not have such a rating, FIDENORTE will assign them one using the norms of the financial system superintendent as a reference point."

[41] Any mention of non-governmental organizations was deleted from later drafts of the FIDENORTE operations manual.

- End-user interest rate: generally the BMI interest rate plus 2 points, which will be adjusted according to any change in the BMI rate.[42]
- Maturity and grace periods: defined by the analysis of the applicant's business plan. The maturity date cannot exceed September 19, 2016.
- Disbursements: There can be one or more disbursements, as defined in the business plan. For each disbursement, the end-user should sign a document stipulating the disbursement conditions.
- Collateral: individual signature, pledge, mortgage or bond from Garantías y Servicios, when refinancing is not provided through a support program granting guarantees and bonds in the Northern Zone, financed with FOMILENIO resources.[43]
- Payment: the periodicity of principal and interest payments is subject to projected progress with the business plan; payment can be subordinated to an obligation to the financial organization that is sharing the project's risk with FIDENORTE.

[42] By 2010, this was changed to "the interest rate will be established by the BMI committee in accordance with methodology approved by MCC, which will be communicated to BMI by PDP management. Once the rate is applied, it is fixed."

[43] This was revised to "individual signature, pledge, mortgage, or any other collateral requested" in later versions of the operations manual.

APPENDIX D

STAKEHOLDER PERCEPTIONS OF THE FIDENORTE LOAN PROCESS

This appendix summarizes the perceptions of MCC, FOMILENIO, BMI, investment committee members, loan recipients, and non-recipient applicants regarding key steps in the FIDENORTE loan process. (Consult Table D.1 below for a summary of all findings.)

A. OUTREACH

FOMILENIO, MCC, and investment committee members agreed that BMI's outreach efforts throughout most of 2009 were deficient. However, many respondents stated that once BMI committed to a community-based outreach campaign in late 2009, its efforts were very effective in disseminating information to potential applicants. In addition, BMI's emphasis on customer service throughout the campaign was noted by at least one applicant. The applicant said, "I went over and [BMI staff] gave me a presentation on cash flows, greenhouses, and their [lending] experiences … it was a very in-depth explanation."

> "I went over and [BMI] gave me a presentation on cash flows, greenhouses, and their [lending] experiences…it was a very in-depth explanation."
>
> *FIDENORTE applicant*

While acknowledging BMI's strong outreach efforts in late 2009 and 2010, one FOMILENIO staff member said some viable applicants did not learn about FOMILENIO until too late, as evidenced by expressions of interest from several strong businesses just after the application period ended in early 2011. The staff member conjectured that BMI's primary outreach partners, mayors' offices, may have limited the number of potential applicants invited to meetings and events in 2009 and 2010. For example, potential applicants who did not share a mayor's political affiliations may not have been invited to participate.

B. PRE-INVESTMENT PROPOSALS

BMI used pre-investment proposals to determine people's business ideas and desired loan amounts, and to assign consultants to compose business plans. The proposals were useful to determine eligibility based on a few key criteria, including a proposed loan of at least $50 thousand, a project in one of the designated value chains, and a substantive counterpart contribution. However, one FOMILENIO staff member stated that to some extent, these pre-investment proposals could have been used to determine which proposals did not need business plans, either because they were technically infeasible or dealt with a well-established business model. The interviewee reasoned that using pre-investment proposals in this way could have reduced the program's administrative costs.

C. BUSINESS PLANS

FOMILENIO staff reported difficulties with contracting consultants to develop business plans, both in the quality of plans and timeliness in which they were submitted. Throughout implementation, FOMILENIO staff tried several arrangements, including contracting individual consultants for single plans as well as contracting companies to develop several plans simultaneously. Overall, FOMILENIO had more success contracting individual consultants for single plans because contracting companies to produce several plans generated delays and often resulted in heterogeneous quality of plans.

Overall, applicants reported highly positive experiences with consultants hired to complete business plans. All applicants reported that the consultants were very professional and qualified, and two applicants mentioned that business plans were completed in less than two months. Even borrowers who reported a long timeframe for business plan completion reported high satisfaction with the process. One loan recipient reasoned that her business plan took nearly six months to complete, but that the process was iterative and highly productive. As such, the borrower did not feel that the business plan development phase was prolonged or inefficient.

D. BMI ANALYSIS AND APPROVAL

FOMILENIO and BMI reported a large bottleneck in the analysis phase of the loan process, particularly in 2009. This bottleneck was due largely to the initial lack of qualified analysts as well as the sizable pool of business plans created from targeted outreach effort in late 2009. In 2010, finally FOMILENIO and BMI contracted an individual who possessed all the necessary skills to provide a strong analysis of plans. Due to his previous experience in a multilateral organization, this person had a multi-dimensional understanding of risk, including the technical, financial, and political circumstances of each proposed business. According to FOMILENIO, this was the optimal profile for a FIDENORTE analyst.

One interviewed applicant had harsh criticism of BMI's analysis of his business plan. According to the applicant, he was contacted by a BMI analyst nearly a year after he submitted his business plan to GyS, the original contractor for business plan analysis. The BMI analyst explained that the applicant was still eligible for credit, and that BMI would soon request additional information. Next, the analyst informed the applicant that his plan had been approved with an annual interest rate of nearly 11 percent. The analyst explained that this relatively high rate was the result of the applicant's collateral of less than 120 percent of the loan value. The applicant was upset that the analyst did not explain this relationship earlier because he had another property that could have served as better collateral, and thus could have obtained a better interest rate. Out of frustration with the process, the applicant declined the loan.

Despite this one negative account, several interviewed borrowers said that BMI conducted a thorough and professional analysis of their business plans. One loan recipient remarked that he appreciated that BMI staff visited his locale and verified information in his business plan, as this third-party verification helped assure the individual that his assumptions and investment plans were reasonable.

E. INVESTMENT COMMITTEE APPROVAL

One committee member reported that in the first phase of FIDENORTE's implementation, the committee's work was characterized by inefficiency, even in the most basic committee functions. The committee had difficulty finding a time that all members could meet, and the members did not have a fixed definition of how to establish a quorum. The member thought the committee's decision making was slow and its two-hour meetings would produce few results. Also, there did not seem to be uniform criteria that could be applied objectively to determine each project's payment schemes, maturity periods, and special conditions. In addition, FOMILENIO staff mentioned that several committee members had personal beliefs about how businesses in particular sectors should work and dwelled on details such as the cost of minor investments.

However, committee members, FOMILENIO, and BMI staff agreed that in 2010 and 2011, the committee members worked very effectively, due in large part to the leadership of the new committee director. The new director made the application of evaluation criteria more efficient and uniform, and was instrumental in influencing BMI staff to develop and present more projects. One

BMI staff member said, "When the new director came in, we became much more orderly because the pressure came directly from the committee. They said plainly, 'When are you going to bring us more projects?' " Also after the new director arrived, each member of the committee came to specialize in a different aspect of analysis, including technical aspects, procurement issues, and financial analyses. Whereas this specialization sidetracked the committee's work in previous years, it now served the committee's analysis of each project's risks and bottlenecks. In addition, BMI staff also facilitated productive committee meetings in 2010 and 2011 by training analysts to present projects more effectively, to the extent that they focus on only those general conditions that were important to discuss in committee meetings.

> "When the new director came in, we became much more orderly because the pressure came directly from the committee. They said plainly, 'When are you going to bring us more projects?' "
>
> *BMI staff member*

F. FORMALIZATION

Perhaps the largest bottleneck in the loan process involved collateral registration and loan contract formalization. Loan recipients experienced long delays in submitting paperwork regarding mortgages and formalizing collateral arrangements. In addition, one interviewed loan recipient noted that there was no set protocol for registering collateral or determining the necessary proportion of land titles that should be applied to the loan. Another recipient noted that the formalization of his contract was delayed by a vacation taken by a BMI staff member.

G. DISBURSEMENT

Some borrowers expressed that the disbursement process was bureaucratic and time-consuming. One loan recipient mentioned that she had to travel to San Salvador several times to complete disbursement paperwork. Once, she was obligated to return to San Salvador to re-sign a disbursement form because the disbursement was not completed on the designated day. Another recipient mentioned that he was waiting until his contact at BMI was back from vacation so he could request his first disbursement.

H. FOLLOW-UP AND SUPERVISORY VISITS

Regarding BMI's supervisory visits, one loan recipient mentioned that he appreciated BMI's regular visit, and noted that BMI analysts were very astute in noting all changes that had occurred since their previous visit. Also regarding follow-up visits, one committee member mentioned that in addition to BMI's work, the committee should have provided more follow-up to each loan recipient to make sure they were complying with the business plan and making their payments.

I. CONTRACT MODIFICATIONS

Several contract modifications have taken place throughout implementation, including granting additional funds for additional activities, moving funds from one activity to another, and modifying collateral arrangements. Some borrowers complained that contract modifications were too often required—even with minor changes—and the bureaucracy of passing a modification through the committee was not necessary. However, several borrowers expressed appreciation that modifications were possible.

J. TECHNICAL ASSISTANCE

During interviews, it became clear that several loan recipients were not aware of the availability of technical assistance services through FIDENORTE. After learning about the opportunity, several borrowers expressed strong interest in receiving technical assistance, particularly for marketing and branding services. Another borrower reported that he was previously interested in technical assistance through FIDENORTE, but he lost interest after learning more about the process. The loan recipient wanted to contract a consultant directly, but FIDENORTE guidelines mandated that a panel organized by FIDENORTE analyze technical proposals and select the most qualified candidate. The borrower reported, "If I did the proposal and then it went to the committee, I'd lose another two months … so I just contracted [a consultant] on my own."

"If I did the proposal and then it went to the committee, I'd lose another two months … so I just contracted [a consultant] on my own."

FIDENORTE borrower

Table D.1. **Summary of Stakeholder Perceptions of the FIDENORTE Loan Process**

	Best Practices and Positive Feedback	Bottlenecks and Common Criticisms
Outreach	BMI's community-based outreach campaign in late 2009 was viewed as effective by most respondents.	BMI's method of working with mayors' offices may have limited the scope of its outreach activities.
Pre-investment proposal	The proposals were an effective filter to determine applicants' basic eligibility.	Pre-investment proposals did not provide enough information to determine which projects did not merit a business plan.
Business plans	Overall, applicants reported very positive experiences with consultants hired to complete business plans.	FOMILENIO reported difficulties with contracting consultants to develop business plans, both in the quality of plans and timeliness in which they were submitted.
BMI analysis and approval	Several interviewed borrowers said that BMI personnel did a thorough job during analysis visits and were highly professional. In 2010, BMI hired an analyst with an optimal profile for analyzing business plans: experience assessing various dimensions of risk at a multilateral development organization.	A large bottleneck in the analysis phase of the loan process was due to the initial lack of qualified analysts as well as the large number of business plans created from targeted outreach effort in late 2009.
Investment committee approval	The new committee director improved the committee's efficiency and standardized application of criteria to determine loan characteristics.	Some members had no prior financial experience and some deliberation was too detail-oriented. Both factors hindered efficient deliberation.
Formalization	None reported	Approval from public agencies and formalization procedures would often take several weeks.
Disbursement	None reported	BMI staff member's vacation schedule complicated disbursements for at least one borrower. Another loan recipient complained about traveling to San Salvador for disbursements.
Follow-up and supervisory visits	One borrower reported appreciating BMI's verification of his investments.	One committee member expressed a desire to be more involved in monitoring borrowers' progress with investments.
Contract modifications	Modifications are possible if borrowers' business plans change.	Modifications could cause bottlenecks because they required approval from the investment committee.
Technical assistance	Borrowers appreciated the availability of highly subsidized assistance through FIDENORTE.	The process of assigning a consultant was viewed as bureaucratic by at least one borrower.

Source: Interviews with BMI, FOMILENIO, MCC staff and FIDENORTE applicants conducted in May and July 2011.

APPENDIX E

APPLICANTS' PERCEPTIONS OF LOAN CONDITIONS

Interviews with FIDENORTE applicants—both loan recipients as well as non-recipient applicants—produced some common themes regarding applicants' perceptions of FIDENORTE loan conditions. These findings are presented below and summarized in Table E.1.

A. INTEREST RATE

Examining the loan's interest rate, most applicants claimed that the FIDENORTE interest rate was comparable to a market interest rate for a similar or slightly smaller loan size. Many interviewees expressed their confusion with these conventional interest rates, given that the money was donated. Said one respondent, "It's just hard to connect these two ideas. The money is donated, but the loan's interest rate is like any other bank. I just don't see the help."

> "It's just hard to connect these two ideas. The money is donated, but the loan's interest rate is like any other bank. I just don't see the help."
>
> *FIDENORTE applicant*

B. LOAN SIZE

Overall, borrowers were satisfied with their loan amount and felt the loan covered a sufficient portion of their investments. Only one loan recipient expressed some disapproval of the minimum loan amount of $50,000. Given the large demand among many producers for smaller loans, he was surprised that loans for $10,000 or $15,000 were not available through FIDENORTE. The borrower mentioned that FOMILENIO staff knew about this demand since the beginning of the project, as small producers participating in PBS expressed the need for smaller loans in several meetings as early as 2008. However, no other applicant or loan recipient expressed this sentiment.[44]

C. MATURITY PERIOD

Particularly in the dairy and agricultural sectors, applicants believed the FIDENORTE maturity period was too short. Several borrowers said they would have preferred a loan period closer to seven or eight years. One borrower expressed that his main criticism of FIDENORTE credit was actually the combination of a moderately high interest rate and his loan's five-year maturity. The combination of the two factors created a lot of pressure to produce and sell tomatoes and repay the loan quickly.

D. GRACE PERIOD

Five of ten interviewed applicants stated that their loan's grace period was particularly unattractive compared to previous loans or similar loans in the market. Three applicants who proposed investments in tomato production stated that FIDENORTE's grace period did not give them enough time to produce and sell tomatoes according to their business plans. Another applicant expressed concern that the grace period was too short for his proposed tourism project, which would not generate sufficient sales until a year after credit receipt. Two interviewees suggested that a

[44] There was probably little disapproval of the minimum loan amount among this sample of interviewees because nearly all interviewees requested credits of larger than $50,000. If the interview sample included Activity 1 producers, this sentiment would likely be more common.

grace period of one year would have been optimal, as opposed to their grace periods of three and seven months.

E. COLLATERAL REQUIREMENTS

Several applicants who were not approved for loans expressed dissatisfaction with FIDENORTE's collateral requirement of between 100 and 120 percent of the loan amount to secure the lowest interest rate. Three of five non-recipients said they did not continue the application process as a result of complications related to their collateral. One applicant did not have enough money to register his property in his name. Another applicant mentioned that BMI's estimate of his property's value was much lower than he originally thought, and this had negative implications for his loan's interest rate.

F. UNAVAILABILITY OF WORKING CAPITAL

Several applicants said the unavailability of working capital through FIDENORTE presented complications for their businesses. Said one borrower, "Working capital is the lifeblood of any business. You can have $10 million in contracts but without the money to pay a $1 debt, you're finished." The importance of working capital was also mentioned by a member of the investment committee, who said the loan's lack of working capital may have some negative implications for the sustainability of many borrowers' projects. According to the committee member, loan recipient businesses in some sectors require working capital at key milestones in the production cycle and would have benefited from a substantial portion of working capital built into their loan. BMI staff echoed this sentiment and mentioned that their financial products for their proposed investment support programs will feature a portion of investment capital and a portion of working capital. During interviews, loan recipients and non-recipients agreed the optimal allocation was 15 to 20 percent for working capital and 80 to 85 percent for investment capital.

> "Working capital is the lifeblood of any business. You can have $10 million in contracts but without the money to pay a $1 debt, you're finished."
>
> *FIDENORTE borrower*

G. PAYMENTS

Three of five borrowers said that the flexibility in determining monthly installment payments and other bi-yearly payments was an attractive feature of FIDENORTE credit that other banks did not offer. This flexibility helped borrowers structure payments according to their businesses' short- and medium-term projections.

H. NO COMMISSION FEES

One borrower expressed approval that FIDENORTE loans do not feature commission payments. This stood in contrast to some of the loan recipient's previous loans with private banks.

Table E.1. Summary of Applicants' Perceptions of Loan Conditions

Attractive Characteristics	Unattractive Characteristics
Available loan size	Relatively short maturity period and grace period
Flexible payment arrangements	High collateral requirements
No commission fees	Interest rate that resembled market rate
	Unavailability of working capital to complement investment capital

Source: Interviews with FIDENORTE applicants conducted in July 2011.

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