A case study evaluation of five BIO financial sector investments in Ecuador and Peru

Executive summary

Client: Belgian Investment Company for Developing Countries SA/NV (BIO)

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Executive Summary

Objective

The Belgian Investment Company for developing countries (BIO) aims to support the development of the private sector which will contribute to welfare creation and poverty reduction. To achieve this BIO uses different investment instruments and provides related support to financial institutions whose objectives are expected to coincide with that of BIO. BIO regularly evaluates its operations to draw lessons for future investments. In 2018/2019 an evaluation was undertaken of the BIO investments in selected Latin American countries. This evaluation of five investments in respectively Peru (investments in Acceso Crediticio and Cooperativa Pacífico) and Ecuador (investments in Banco D-Miro, Banco Pichincha and Vision Fund) is both:

- Backward-looking, with a focus on effectiveness and additionality of BIO's investments; and
- Forward-looking, to distil lessons learnt and provide practical recommendations for improvement of its development effects and future directions.

The evaluation provides BIO staff, management, Board of Directors and other stakeholders, particularly the Belgian State, with information on the effectiveness of its operations to stimulate human and economic development in Peru and Ecuador, lessons to be learned and practical recommendations to BIO staff.

Methodology

A Theory of Change was developed for this evaluation and an evaluation matrix prepared along the OECD-DAC criteria. The evaluation team collected data and information from both primary and secondary sources through desk research, in-depth interviews with BIO staff, senior management and (senior) staff of the five financial institutions, focus group meetings with end-clients of the financial institutions and a digital survey amongst a larger group of end-clients of the financial institutions.

To be able to answer the evaluation questions, from both retrospective and prospective angles, the evaluation team looked at all data from three viewpoints:

- BIO level;
- Financial institution level; and
- End-client level.

The first layer focused on the financial institution identification, screening and investment process of BIO in the light of the development goals targeted and expected results attained. The second layer focused on the five financial institutions in which BIO has invested and the effects attained as a result of BIO's support. The third layer focused on the development effects at the level of the end-clients and the appreciation of the (new) services rendered by the financial institution.

Four out of the five investments were made in the period 2015-2017, with two of BIO's investments in Peru, i.e. Acceso Crediticio and Cooperativa Pacífico in 2017. Given the short period of time since the investments materialised and the moment of evaluation, the development effects and impact to measure were limited and related conclusions must be read with some restraint.

Context

BIO's investments in Ecuador were made in the period 2015/2016 when the financial sector was facing serious problems due to the difficult political and economic environment. The investments supported financial institutions to tackle these problems. The investments in Peru were made in 2017 and reflected BIO's intention to seek new opportunities with an innovative character in a rather saturated microfinance market in a booming economy. The key characteristics of BIO's investment and of the five financial institutions are summarised in Table 1.

Table 1: Overview five BIO investments and characteristics financial institutions

	Acceso Crediticio	Cooperativa Pacífico	Vision Fund	Banco D-Miro	Banco Pichincha
BIO investment					
First contact	Prospect mission BIO staff (in 2016)	Prospect mission BIO staff (in 2016)	Via INCOFIN (in 2014)	Desk screening (in 2014)	Well-known bank (in 2015)
Year approved	2017	2017	2015	2015	2016
Amount	USD 10 million	USD 10 million	USD 2 million	USD 5 million	USD 15 million
Type of instrument	Senior loan in USD (Hedged locally by FI to local currency (PEN)	Senior loan in USD	Senior loan	Unsecured senior loan	Subordinated loan (to be considered as quasi equity)
Tenor	7 years	7 years	3.5 years	4 years (extended with 18 months)	7 years
Reason BIO established relationship	Innovative character and ecological focus; reaching out to urban, financially excluded poor	Cooperative character and strength of institution in cooperative sector; leadership role in cooperative sector	Social focus and international network; social and economic activities combined; participation of women in loan portfolio	Social focus, microfinance institution (MFI) legally registered as bank operating in peri-urban areas with clear focus on less privileged clients	Leading role of bank in the country; could give good image to BIO as well; large outreach to SME sector probably to micro enterprises as well
Financial institution					
Present status	Graduated from MFI/ NGO into NBFI (Entidad de Desarrollo de la Pequeña y Mediana Empresa (EDPYME)) owned by individuals	Leading entity in formal cooperative sector	Registered and formalised as bank but operating as MFI	Microfinance bank fully – bank under restructuring funding arrangements with external funders	Leading general and privately-owned bank in country with 28% of the total market in terms of total assets
Specific client groups	Mainly taxi drivers; car owners that have less	Clients are also member of the cooperative; members belong mainly to the	Focus on poor individuals in rural areas; strong focus on women	Deprived persons / poor in the semi- urban areas in the coastal area	General public; no specific target groups

	Acceso Crediticio	Cooperativa Pacífico	Vision Fund	Banco D-Miro	Banco Pichincha
	access to formal banking sector	(higher strata) of the Japanese community in Peru; concentrated on medium-sized enterprises			
Operating area	Mainly in Lima and gradually more in other larger cities – first planning to expand to Trujillo	Mainly in Lima and willing to gradually move to some rural areas but indirectly through cooperation with rural cooperatives	Mainly in the Ibarra area (Province Imbabura)	Semi-urban in coastal zones (near Guayaquil)	Nation-wide operational
Key products	Conditional loans (loans for taxi with Liquefied petroleum gas (LPG)/ natural gas vehicle (NVG) tanks) that looks like quasi leasing; consumer loans; loans to purchase small trucks and buses	Loan and saving products; payment and transfer services; accounts receivable financing (working capital), a kind of factoring); mortgages for housing (Fiducia Inmobiliaria); consumer loans	Village bank loans; solidarity group loans; individual loans	Microfinance loans and group loans; social products for persons with HIV and disabilities; capacity-building and financial education	All banking products

In terms of development objectives, the five investments in Ecuador and Peru are expected to:

- Lead to local economic growth;
- Induce (financial) inclusiveness;
- Contribute to the fight against climate change and preservation of natural resources; and
- Promote environment and social governance best practices and result in improved gender relations (the latter being considered transversal goals).

Lessons learned and recommendations

Careful selection of financial institutions reduces the need to invest in bringing about structural changes in the financial institutions

Some of the financial institutions in this study have very clear development objectives similar to or in line with those of BIO. The more logical approach will be to carefully select financial institutions that have development objectives similar to or are in line with those of BIO. If financial institutions show that they are financially sound and incur limited risks, BIO can be rest assured that the development objectives will be adhered to.

No structural shifts in the financial institutions are then needed, and technical assistance can be kept to a minimum and have no effect on the overall strategies, policies or objectives of the financial institutions. The present pre-selection mechanisms of BIO and its monitoring and evaluation system are in line with this approach.

Recommendation 1: Continue to select financial institutions carefully to ensure development effects

- Define clearly the development objectives and be specific about target groups to be reached (more than just micro, small and medium-sized enterprises (MSMEs)).

Development Finance Institutions (DFIs) as BIO play a catalysing role with investments in niche financial sector markets

The position BIO has as a relatively small DFI compared to fellow DFIs is often an advantage. Especially in niche markets DFIs as BIO can effectively operate as one of the first investors and play a catalysing role by making the financial institution more attractive for fellow investors.

This also implies that once other DFIs followed and provided (additional) financing to the financial institution first supported by BIO, the latter might consider its role as played and needs to seek new investment opportunities.

Recommendation 2: Enhance the catalysing role with investments in niche markets

- Once other DFIs followed BIO and provided (additional) financing to the financial institution first supported by BIO, the latter might consider its role as played and seek new investment opportunities.

Realistic monitoring and evaluation comprises more than just financial data

Over the past decade(s) the quality of reporting by financial institutions, such as the ones supported by BIO in Peru and Ecuador has improved considerably. Specific reporting requirements from individual DFIs/ investors lead to considerable managerial and administrative costs for the financial institutions.

BIO's monitoring and evaluation is primarily based on verifying the financial performance of the financial institution and the related appraisal of possible (financial) risks that BIO might incur. However, financial reporting by the financial institutions does not provide an actual picture of what is happening at end-client level. Changes at end-client level affecting their repayment capacity are only noticeable in present reporting with relative time delays. The so-called "PAR30 focus" does not tell what really is happening at end-client level.

The effect of monitoring will be enhanced if it is supplemented by critical field observations and direct interviews with and/ or direct data collection from end-clients. By requiring reports on Environmental and Social (E&S) aspects, financial institutions become aware of the importance (in terms of risks and possible added value) of E&S aspects and started to apply such in the approval processes.

Recommendation 3 Enhance the use of reporting

- Accept standard/uniform (general) reporting formats from financial institutions on financial performance and related risk appraisal that they use for various DFIs/ private investors.
- Continue further alignment to other DFIs' reporting and investment appraisal process could lower the burden on financial institutions in the process while improving the means available for improvements in development result monitoring.
- Require financial institutions to report explicitly on the degree to which predefined development objectives are attained.
- Include research and data collection and analysis at end-client level to the general reporting.
- Next to requiring financial institutions to report on E&S, offer assistance to support the internalisation of E&S (e.g. in the form of advice and support to initiate related institutional actions).

Defining clearly the target groups to be attended will increase effects

Some financial institutions work with rather specific definitions of the target groups they intend to reach like is the case with Banco D-Miro (peri-urban poor in the coastal zone) and Vision Fund (deprived poor in rural areas, preferably women) and Acceso Crediticio (informal taxi owners in Lima willing to acquire LPG/NGV driven vehicles). In the case of Cooperativa Pacífico, this is also the case with its implicit preference to attend to the Japanese community in Peru. Only in the case of Banco Pichincha there is no clear description or definition of its preferred client groups to be reached through BIO's investment.

In selecting financial institutions to invest in, it would be effective for BIO to work with financial institutions that either have such clear descriptions and definitions of intended target groups or define more explicitly and precisely which target groups it would like its financial institutions to serve. The way organisations such as Vision Fund or Banco D-Miro have defined their client groups can serve as an example. Attribution of BIO might be shown if the provided M&E reports on the degree to which such target groups are serviced and assuming BIO is key financier for the related operations. Referring to general descriptions of targets groups such as "the missing middle" or to "growth-oriented SME entrepreneurs" can lead to numerous interpretations and different service delivery options, with subsequently losing sight of the purpose of the interventions. Just referring to MSMEs has proven to be too broad and reporting on progress made and possible shifts in reaching specific target groups is then not possible.

Recommendation 4: Improve development results monitoring on target groups

- Define more explicitly and precisely which target groups BIO would prefer financial institutions to serve.
- Work with clear descriptions and definitions of intended target groups.

Defining the purpose of subordination strengthens the effectiveness of the instrument

Subordinated loans are effective once the reason of subordination has been defined explicitly. If it is offered to strengthen the financial structure, overcome a temporary problem or endow the financial institution with term funding to offer similar terms to the MSME sector, this must be explicitly mentioned (and reported on). With automatic repayment based on a pre-set schedule without linking it to the actual reason for subordination, the subordination partly loses its added value and the loan extended ought then to be treated as an ordinary loan.

Recommendation 5: Define and adhere to conditions for subordination of loans

- For subordinated loans to have added value, both partners must define clearly the reason for subordination and define related repayment schedules or rescheduling conditions.
- Once the subordination cannot be justified anymore the loans can best be converted into senior debt.

Setting explicit development objectives avoids automatic renewal of financing

By explicitly setting the purpose and development objectives of financing offered by DFIs (or for any impact investor) and insisting on related well focused reporting specifying the degree to which these objectives are attained, financial institutions will continuously value the financing received and not assume that it can be renewed automatically. Once other DFIs followed and have provided (additional) financing to the financial institution first supported by BIO, BIO might consider its role as played in case its original development objectives have been attained. It can then use the repaid funds to seek new investment opportunities.

Recommendation 6: Set explicit development objectives in renewal of financing

- Explicitly set the purpose and development objectives of financing offered and request on related well focused reporting specifying the degree to which these objectives are attained.
- In working with financial institutions that seek follow-up financing, BIO needs to communicate clearly the reasons why it would renew its financing and under which conditions. Renewal only ought to take place if actions are warranted to attain the original or adjusted development objectives and have been agreed upon.
- During monitoring and evaluation visits to the financial institutions stress (in addition on monitoring the financial performance) the importance of the development objectives initially identified and considered as justification for the financing by BIO.

It pays off to synchronise financing with technical assistance

Experience from other financing programmes aspiring to introduce structural changes in financial institutions – i.e. in their strategies, policies and in (development) objectives – is that more than just offering (term) loans is needed. In these cases, the financing must be accompanied by considerable technical assistance (in the form of advice, consultations and in some case investments in hardware and (often expensive) organisational development process, including reorganisation).

DFIs that offer technical assistance in combination with financing have learned that the decisions to assign both needs to be synchronised and that there must be a clear joint implementation plan. Without interlocking of financing and technical assistance not much can be expected in terms of introducing changes in financial institutions or in seeking to reach out to new target groups (e.g. reaching out to the lower income farming communities) or working in value chains which have been studied and supported by other development actors.

Although BIO’s strategy is demand-driven when it comes to technical assistance, a proactive attitude of BIO staff is instrumental in facilitating the process to materialise technical assistance.

Recommendation 7: Improve complementary effect of technical assistance

- Make a distinction between technical assistance expected to enhance the effectiveness of the financing operations made possible by the investments and additional technical assistance.
- Interlock the directly related technical assistance with financing and discuss technical assistance in earlier stages.
- Continue to take a proactive role in the technical assistance process by clarifying the benefits the financial institution might have while safeguarding the demand-driven approach.
- Actively support the financial institution to use technical assistance when this will contribute to mutually desired product / service innovations or organisational changes (leading e.g. to starting operations in a new sector or for a new target group or offering new product under new terms).
- Explore joint opportunities of co-financing technical assistance with other DFIs technical assistance programmes.
- Explore possibilities with financial institutions to use technical assistance in support financing offered to their end-clients (e.g. financial education).

Cooperation with non-financing development actors enhances the effectiveness of financing

Investing in financial institutions serving specific value chains that have received technical assistance and support over longer periods from non-financing development actors has proven to be effective. Money/ capital is best invested when it builds upon the body of knowledge built up through preceding development processes. Consultations and cooperation with non-financing development actors are the first steps in effectively selecting financial institutions and the related sectors and value chains to support.

The presence of Belgian development actors in for instance Peru and Ecuador offers opportunities for BIO to continue financing the private sector in selected value chains with a moderate risk exposure.

Recommendation 8: Boost cooperation and communication with other (Belgian) development actors

- Communicate strategy, proposition, activities (ex-ante and post) and results towards other Belgian development actors.
- Communicate technical and quality requirements expected to be delivered by other Belgian development actors to make related financing feasible and effective.
- Consider appointing a single point of contact within BIO for the Belgian government agencies to streamline the communication processes from both ways and in this way improve visibility and the identification of future opportunities.
- Build on the knowledge and local presence of other (Belgian) development actors and seek collaboration with external parties with market knowledge and local presence could assist to attain the development results either through being a pipeline generator or providing first-hand market knowledge in the investment appraisal process.