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A DEVELOPMENT BANK'S SUCCESS WITH MICROFINANCE: BANCO DO NORDESTE'S CREDIAMIGO

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Background

Headquartered in Fortaleza, the development bank Banco do Nordeste was established in 1952 to support regional development in northeastern Brazil, the poorest region of Brazil. Today, Banco do Nordeste is a combination of a development, investment and commercial bank with 174 branches covering over 1,955 cities in the region. A mixed capital company, with more than half of its shares owned by the federal government, and the balance owned by private shareholders, Banco do Nordeste finances over 77% of all the rural and industrial loans in the Northeast.¹

Brazil's Microcredit Market

An estimated 15.7 million people in Brazil work in the informal economy as microentrepreneurs, outnumbering formal sector entrepreneurs by more than three to one. Of these informal microentrepreneurs 93% run profitable businesses. However, 84% of these microentrepreneurs did not have access to credit.²

Origins of CrediAmigo (a BOP business)

When asked why Banco do Nordeste decided to launch a microcredit institution, executive director, Stelio Gama Lyra Junior responds simply “we are a development bank; it was a logical step”.³ The fast growth and success of the CrediAmigo program suggest that he might be right. After only three years in operation, CrediAmigo had already become Latin America's second largest microcredit institution both in terms of number of loans and the amounts invested.⁴

¹ Banco do Nordeste website, <http://www.bnb.gov.br/english/bank/index.htm>

² Banco do Nordeste's Microcredit Programme”, A Banco do Nordeste Presentation

³ Interview with CrediAmigo, Executive Director, Stelio Gama Lyra Junior, July 22 2003

⁴ Banco Do Nordeste: New Banking Models for Regional Development

For leaders at Banco do Nordeste, the successful performance of "social banks" in countries like Bangladesh, Indonesia, Bolivia and Peru, reinforced the importance of microcredit in supporting informal economic sectors and improving income distribution. Since these countries' economies have similar characteristics to those of the northeast region of Brazil, the World Bank and Banco do Nordeste believed that this format could be effective in northeast Brazil as well. Also, Banco do Nordeste and the World Bank concluded that due to the country's recent economic stability, this was an opportune time for the Bank to start a microcredit program, which would provide technical capacity-building, institutional development, environment development and saving/financing techniques, all converging to the development of local communities. As such, in November 1996 at a meeting in Fortaleza, the World Bank and Banco do Nordeste decided to initiate a collaborative process to jointly implement a local development program based on the idea of microcredit. Motivated by the finding due to the restrictive regulation of Brazil's Banking Systems small informal companies – family owned and small properties – were not being served by the Bank's financing activities, Banco do Nordeste and the World Bank decided to develop and launch a pilot low-income bank, targeting micro entrepreneurs from informal sectors.⁵

In 1997 Banco do Nordeste began its efforts to establish a world-class microfinance program. It began by sending a team of senior Banco do Nordeste managers to visit a number of established microcredit institutions in various countries including Indonesia, Chile and Bolivia. Partly due to the unsuccessfulness of Banco do Nordeste's previous highly subsidized individual lending program, Banco do Nordeste chose to adopt the solidarity group lending model, whereby a group of individuals provide collateral or loan guarantee through a group repayment pledge.

⁵ Email from CrediAmigo Executive Director, Lucia Barbosa, October 22,2003

Under this model, if one group member defaults, the other group members make up the payment amount. This “moral collateral” replaces the traditional requirement for physical collateral.

Banco do Nordeste also sought help from ACCION International, a non-government organization with expertise in microlending around the world, in the design of its microcredit program.⁶ With assistance from ACCION, Banco do Nordeste surveyed microenterprises and began development of pilot loan products to meet their needs.⁷ Within the same year, Banco do Nordeste launched CrediAmigo in a pilot phase at five of its branch offices.

Pilot Project

The pilot program offered customers a single loan product – a 90-day loan to individual clients organized in solidarity groups of on average five borrowers who cross-guaranteed each others' loans. Payment was required every 15 days. The interest rate charged for this microloan was considerably higher than the rates Banco do Nordeste charged to its conventional borrowers. However, they were still far below the rates of informal money-lenders.⁸ In addition, to encourage prompt repayment, CrediAmigo offered an interest rebate and new loans within 24 hours to groups that consistently paid on time.

After four months the pilot seemed to be going well and Banco do Nordeste's management, feeling confident in their test pilot and their ability to move forward with the launch of the CrediAmigo program, swiftly expanded the program from 5 branches to 50 and announced that CrediAmigo would have 100,000 clients by the end of its first year of operation. In retrospect this action was a mistake.

⁶ Where We Work, ACCION International website, http://www.accion.org/about_where_we_work_program.asp_Q_T_E_38

⁷ Susana M. Sanchez, Sophie Sirtaine, and Rita Valente, “Bring Microfinance Services to the Poor: CrediAmigo in Brazil”, En Breve. World Bank. August 2002

⁸ This is standard among microfinance institutions because the cost on a percentage basis of making a small loan is higher than that of making a large loan. The administrative cost is also higher because microfinance loan agents often go door-to-door to solicit new clients and to follow up with existing clients.

Banco do Nordeste's rapid expansion resulted in an equally rapid deterioration of its portfolio quality. Significant loan losses followed. (See Exhibit 1) In an effort to expand quickly, Banco do Nordeste had not focused enough attention on loan officer selection and training. It had also provided the wrong incentives. Loan officers were given quantity-based performance targets instead of quality-based and thus were incentivized to make as many loans as possible with little regard for future repayment prospects. Banco do Nordeste responded to the drop in loan repayment rates by slowing and in some cases stopping new lending and focusing on loan recovery. ACCION helped Banco do Nordeste with its loan recovery strategies as well as with retraining loan officers and branch managers. With this refined focus on quality, CrediAmigo was able to get its loan portfolio back into acceptable repayment rate within six months.

Through this pilot project CrediAmigo learned not to underestimate the complexity of a microlending program. Since then it has focused on growth with quality, carefully managing its expansion, increasing training efforts and realigning its incentive structure.

Real Microcredito Business Model

Overview

With the experience gained through its pilot program, CrediAmigo officially launched its microcredit program and has continued to grow steadily. In fact, it has achieved 40% growth each year since 1998. As of May 2003, CrediAmigo has 123,203 active clients with an active portfolio of R\$72 (US\$ 24.69)⁹ million and an average loan size of R\$ 581.35 (US\$ 199.33).

CrediAmigo offers loans at 3.5% monthly rate (approximately 51% per year). As an incentive for customers to pay on time, CrediAmigo reimburses its customers 15% of their

⁹ Based on exchange rate of 1 USD:0.79 EUR, February 10, 2004. Source: <http://finance.yahoo.com/m5?a=1&s=USD&t=EUR>

interest payment when their loan is paid in-full and on-time.¹⁰ The maximum loan size allowed is R\$4,000 (US\$ 1,371.51).

In the future, CrediAmigo plans to continue to expand its services throughout the northeast of Brazil, as well as offer greater product/service selection such as savings accounts and insurance products.

Human Resources

Because of the inflexible qualification and salary levels of its unionized workforce, Banco do Nordeste chose to outsource its microfinance loan officers.¹¹ This has given Banco do Nordeste greater flexibility in its hiring choices and allowed them to maintain lower costs while maintaining high productivity and quality.

No specific banking background is required to be a CrediAmigo loan agent. Instead, CrediAmigo provides its new hires with extensive training – approximately one month of training per new employee. Training is provided through a combination of classroom, field and online formats and it covers a broad range of areas including accounting, hands-on field training and leadership training. In addition, having learned from the mistakes made during the pilot program, Banco do Nordeste has realigned its incentive structure so that now loan agents' bonuses are heavily tied to repayment performance not just quantity of loans.

Marketing

Target Market

CrediAmigo's target market is divided into three specific segments within urban informal sector microentrepreneurs. These market segments are (in order of number of customers):

- Commerce: grocers, stationary shops, storage businesses, restaurants, snack bars, etc.

¹⁰ "Banco do Nordeste's Microcredit Programme", A Banco do Nordeste Presentation

¹¹ Susana M. Sanchez, Sophie Sirtaine, and Rita Valente, "Bring Microfinance Services to the Poor: CrediAmigo in Brazil", En Breve. World Bank. August 2002

- Trade: shoemakers, carpenters, artisans, bakers, etc.
- Service: hairdressers, garages, car services, etc.¹² (See Exhibit 2)

CrediAmigo currently targets only the urban market which it sees as less costly and complicated.

It does not target rural entrepreneurs or farmers.

Product

CrediAmigo offers its customers both financial products and services and business training and consulting services. CrediAmigo's product offering includes both short-term (3-6 months) and long-term (up to 18 month) loans. Although, CrediAmigo began by offering only solidarity group loans, in response to customer demand, it now offers both group loans and individual loans. 86% of its customers have group loans, while the remaining 14% have individual loans. The individual loans tend to be offered to customers that have established a strong repayment record through CrediAmigo's group loan product. The maximum credit line offered is R\$4,000 (US\$ 1,371.51).

In addition, to providing microcredit, CrediAmigo also provides its customers with consulting services at no additional cost to help them run their businesses more efficiently. This provides not only a benefit to the customer but also helps to reduce default risk by improving the customers' ability to manage their own business effectively.

Pricing

CrediAmigo charges a 3.5% monthly interest rate on its microcredit loans, approximately 51% annually. It also offers a 15% bonus for customers that pay off their loans on time. To ensure the long-term financial sustainability of CrediAmigo, its interest rate is high enough to compensate for the higher transaction cost and risk associated with microcredit. (See Exhibit 3)

¹² "Banco do Nordeste's Microcredit Programme", A Banco do Nordeste Presentation

At the same time, the rate is considerably lower than the rate that microentrepreneurs could get elsewhere (usually their only alternative is to borrow from an informal-lender at rates as high as high as 300%).¹³ As a result customers benefit from lower interest rates than they could get elsewhere, while CrediAmigo builds a financially sustainable and profitable business.

Promotion/Placement

CrediAmigo uses both traditional and market-specific communication strategies to promote its offerings. In addition to using television and radio ads, CrediAmigo also promotes its services by holding information sessions at local schools, churches and other public gathering places. During these information sessions, CrediAmigo presents the benefits of its microcredit program. CrediAmigo also goes door-to-door to local microbusinesses to better understand the financial needs of its current and potential clients and advise them on the best products for them.

In the bank branches, there is a separate physical space within the bank that is dedicated to CrediAmigo, keeping the CrediAmigo program distinct from the traditional Banco do Nordeste services but still leveraging the brand recognition of Banco do Nordeste.

Program Results – Triple Bottom Line

Financial Results

From 1998 to 2001, CrediAmigo's number of clients grew at least 40 percent each year, and its active portfolio also grew considerably each year.¹⁴ However, due to a stagnant economy in Brazil, CrediAmigo ended 2002 with an active portfolio of US\$ 34.6 million, US\$ 2.7 million below its 2001 year end amount.¹⁵ (See Exhibit 4) Notwithstanding the decline in growth, CrediAmigo remains in strong economic standing. Return on Assets as of December 2002 was

¹³ Mario Osava, "Brazil: Huge Market for Small Loans", ProutWorld News

¹⁴ Mario Osava, "Brazil: Huge Market for Small Loans", ProutWorld News

¹⁵ Where We Work, ACCION International website,

http://www.accion.org/about_where_we_work_program.asp_Q_T_E_38

0.95% and its Portfolio-at-Risk > 30 days was 2.39%. In addition, its cost per borrower was US\$ 76, compared to a peer group (Latin American Microcredit Enterprises) average of US\$ 197.¹⁶ And despite its decline in growth, CrediAmigo reached full financial self-sufficiency in July 2003. (Financial self-sufficiency is defined as the ability to pay all costs, including financial costs, from interest income).¹⁷

Social Results

CrediAmigo plans to perform a social impact assessment to determine the impact its program has had on microenterprises and household welfare. While it has not yet conducted this complete assessment, client surveys have shown that CrediAmigo's loans have a positive impact in the lives of its borrowers, with an average increase in family income of 52%.¹⁸

In addition, CrediAmigo's average loan size is consistently below the average for microfinance providers, indicating that CrediAmigo is reaching individuals at the lower end of the economic pyramid. (See Exhibit 5) As further evidence that CrediAmigo is reaching individuals who were previously underserved by the market, a 2001 study showed that 71.7% of CrediAmigo's clients were first time bank borrowers.¹⁹

Challenges

CrediAmigo faced a number of challenges early on. One of CrediAmigo's first challenges was simply acquiring customers. Initially CrediAmigo managers had thought that because there had been such a large number of microentrepreneurs that did not previously have access to credit, when CrediAmigo publicized its offering of credit to local microentrepreneurs

¹⁶ Bonnie Bursky, "From Skepticism to Success: The World Bank and Banco do Nordeste", CGAP Direct Donor Information Resource Centre, April 2003

¹⁷ Interview with CrediAmigo, Executive Director, Stelio Gama Lyra Junior, July 22 2003

¹⁸ Where We Work, ACCION International website,

http://www.accion.org/about_where_we_work_program.asp_Q_T_E_38

¹⁹ "Banco do Nordeste's Microcredit Programme", A Banco do Nordeste Presentation

credit that the customers would come to them. This was not the case. CrediAmigo quickly realized that they would have to go to the customers and educate them on the benefits of microcredit instead of waiting for the customers to come to them.

As a result of this problem being solved, CrediAmigo was faced with its next major challenge. It was growing too quickly and without adequate controls and procedures. Although this was a costly mistake, it provided a valuable lesson that has helped CrediAmigo remain focused on running a profitable business, focusing on quality of growth.

Now, CrediAmigo is facing another challenge – the stagnant Brazilian economy. This year, CrediAmigo is in a position to lend double the amount of loans granted in 2002, but the level of demand will depend on a resurgence of economic growth. Microbusinesses in commerce and services, tend to be the first to feel the effects of economic stagnation.²⁰ Since these sectors make up the majority of CrediAmigo's borrowers, the effect on CrediAmigo could be very significant. CrediAmigo has already started to feel the affects of this when its 2002 loan portfolio fell just short of its 2001 level. In addition, to not attracting new customers, CrediAmigo is finding that many existing customers are not reapplying for loans once they finish paying off their previous loan.²¹ It now remains to be seen how long the economic problems will last and how intense the effect will be on CrediAmigo's customer base.

Key Lessons & Opportunities

Lessons Learned from the CrediAmigo Program

CrediAmigo's early encounter with uncontrolled growth, provided a valuable lesson about the importance of focusing on quality of growth and of having appropriate procedures in place to effectively manage growth. As a result this early mistake, more specific policies were

²⁰ Mario Osava, "Brazil: Huge Market for Small Loans", ProutWorld News

²¹ Interview with CrediAmigo, Executive Director, Stelio Gama Lyra Junior, July 22 2003

implemented to streamline the lending process. The number of clients that an agent was allowed was set at 300. Training was increased; today all new agents receive approximately one month of training when hired. By providing effective and replicable procedures that could be applied in each branch CrediAmigo increased productivity and significantly improved its portfolio quality, demonstrating that with proper planning and appropriate policies, training and incentives in place, microcredit institutions can maintain very high repayment rates.

Perhaps an even more important lesson learned from this same incident is the value of careful planning and testing. In any new enterprise mistakes are bound to occur. Careful planning and starting small with a pilot program before launching a new program will save significant time and money and allow managers to learn from their mistakes. This ultimately results in a stronger product and organization in the end.

In addition to these general learnings, the CrediAmigo program has provided valuable lessons for the other Banco do Nordeste managers. For example, Banco do Nordeste is using the experience gained under CrediAmigo in areas such as the use of staff incentives and the development of a low-delinquency loan culture.²²

Success Factors

In addition to the key lessons that CrediAmigo learned through its experience with microfinance one of the key factors to success of any project but especially a base of the pyramid project is the support and commitment of senior management. Without serious support from top management a program may be terminated at the first sign of trouble without performing a thorough analysis of the cause of potential solution to the problem. In contrast, with strong management support that focuses on long-term program objectives rather than on short-term

²² Steven N. Schonberger and Robert Peck Christen, "A Multilateral Donor Triumphs Over Disbursement Pressure: The Story of Microfinance at Banco do Nordeste in Brazil", CGAP Focus Note, December 2001

This case was prepared by Yerina Mugica under the direction of Professor Ted London, UNC's Kenan-Flagler Business School, as a basis for class discussion rather than to illustrate the effective or ineffective handling of an administrative situation.

performance, people are able to learn from the inevitable mistakes that occur during program development and as a result the program is improved. It is important to understand that launching a base of the pyramid venture is a complex and challenging mission and that there will be mistakes made along the way. The key is to start small, learn from mistakes and stay focused on the long-term goal.

Venture Scalability/Transferability

There is tremendous growth opportunity for microfinance firms in Brazil. Although CrediAmigo is the second largest microcredit program in Latin America, it serves less than four percent of the estimated total demand for microfinance in northeast Brazil. (see Exhibit 6) Now that CrediAmigo has learned from its early mistake of growing too quickly without appropriate quality controls, it is in a position to strategically increase its operations in a controlled manner that focuses on maintaining loan quality and procedures to manage the complexity of microbanking.

Risks

Two key risks for any microcredit institution are the risk of customer over-indebtedness and general default risk. There is a risk new microlenders with less strict lending practices will enter the market and beyond providing healthy competition that these competitors may create a situation where customers become over-indebted, with the end result being that the customer does not pay back either CrediAmigo's loan or the competing banks' loan. An example of this occurred in the more mature microcredit market in Bolivia among other places. CrediAmigo plans to mitigate this risk by working with the bank regulatory agency to try to ensure that there are regulations in place that would prevent this type of situation.²³

²³ Interview with CrediAmigo, Executive Director, Stelio Gama Lyra Junior, July 22 2003

Finally as with any lending institution, there is always the issue of default risk. However by incorporating loan repayment into its loan agents' incentive plan, CrediAmigo has built a structure that helps ensure high loan recovery rates.

Potential Future Areas of Growth

While offering savings accounts to microentrepreneurs is a good business opportunity during strong economic times, it may also prove beneficial during a period of economic downturn. Offering savings accounts to its existing customers may provide an additional revenue stream for CrediAmigo, while providing a service that helps build a stronger, more economically healthy communities. The benefits to CrediAmigo for offering savings accounts may include:

- i) reducing the bank's cost of capital
- ii) increasing and diversifying the bank's source of income;
- iii) providing resources for loan portfolio growth;
- iv) increasing client loyalty

At the same time the community and customers benefit from savings mobilization. Internal savings is a strong resource for national development at the country level. The same is true at the local community level.²⁴ According to the Consultative Group to Assist the Poor, savings may actually be more important than credit in helping the poor increase their incomes and reduce risk.²⁵ One would also expect that a community with a high rate of savings would have a higher loan repayment level than would a community that only borrows. The example of

²⁴ Eduardo Bazoberry, "Rural Financial Institutions: Savings Mobilization: The Bolivian Experience of the Prodem Private Financial Fund S.A."

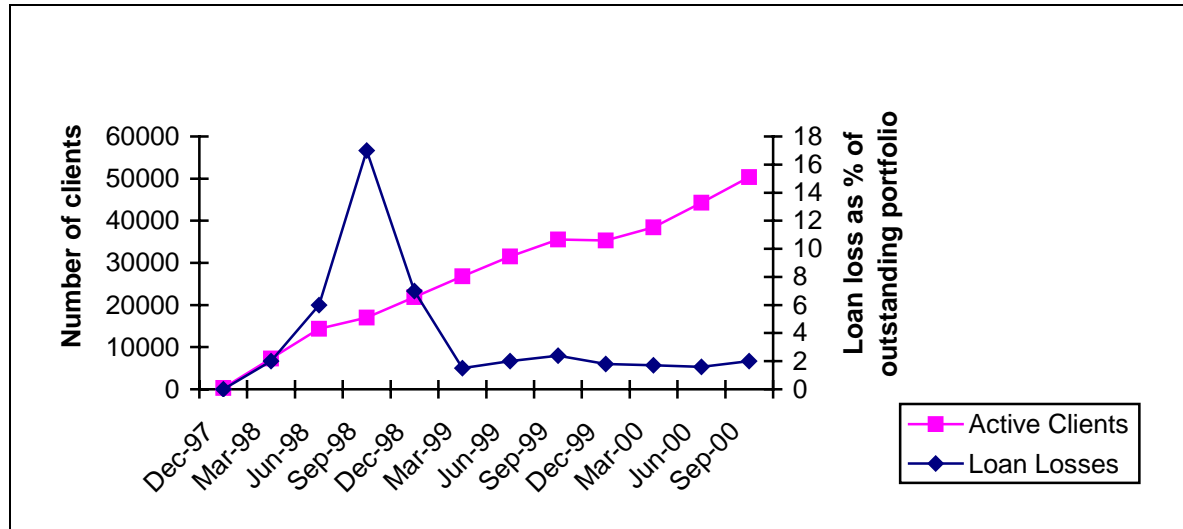
²⁵ CGAP Donor Brief, Note 4, "Helping to Improve Donor Effectiveness in Microfinance, Savings Are As Important As Credit: Deposit Services For the Poor"

other microcredit institutions has shown that acquisition of deposits in communities greatly improves institutional credibility and loan recovery.²⁶

²⁶ Eduardo Bazoberry, "Rural Financial Institutions: Savings Mobilization: The Bolivian Experience of the Prodem Private Financial Fund S.A."

Exhibit 1

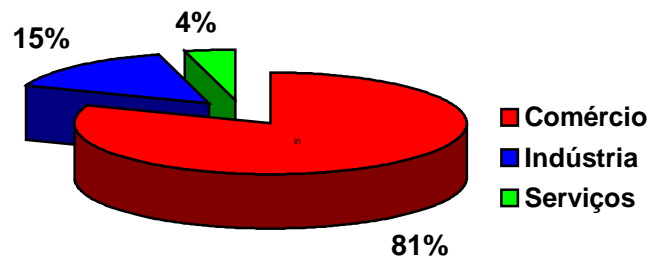
CrediAmigo client growth and loan losses, 1997-2000



Source: Steven N. Schonberger and Robert Peck Christen, "A Multilateral Donor Triumphs Over Disbursement Pressure: The Story of Microfinance at Banco do Nordeste in Brazil", CGAP Focus Note, December 2001

Exhibit 2

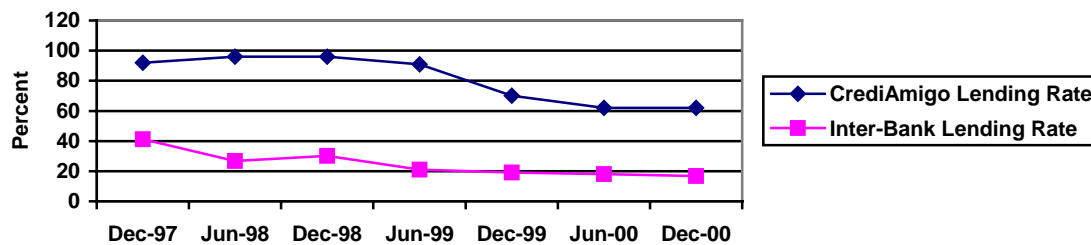
CrediAmigo's Clients by Sector



Source: "Banco do Nordeste's Microcredit Programme", A Banco do Nordeste Presentation

Exhibit 3

CrediAmigo and Brazil Inter-Bank Loan Rates (Annual)



Source: Steven N. Schonberger and Robert Peck Christen, "A Multilateral Donor Triumphs Over Disbursement Pressure: The Story of Microfinance at Banco do Nordeste in Brazil", CGAP Focus Note, December 2001

Exhibit 4

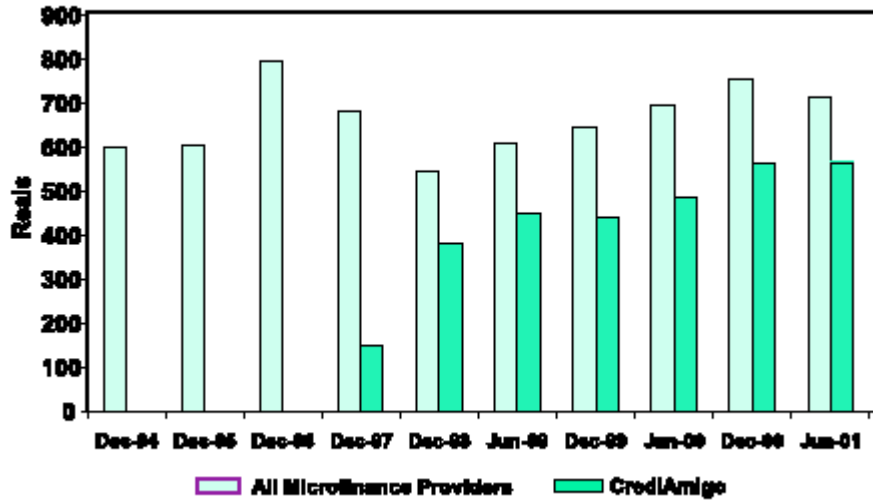
CrediAmigo Program Growth

Year	Active Portfolio	Amount Disbursed	Active Clients	Average Loan Balance	Percentage of Women Clients
1998	\$7,200,000	\$2,730,000	21,846	\$332	NA
1990	\$9,300,000	\$6,420,000	35,222	\$263	46%
2000	\$17,500,000	\$13,160,000	57,967	\$301	47%
2001	\$27,300,000	\$23,850,000	85,309	\$321	48%
2002	\$24,600,000	\$24,630,000	118,995	\$206	49%

Source: Where We Work, CrediAmigo (Banco do Nordeste) ACCION International website

Exhibit 5

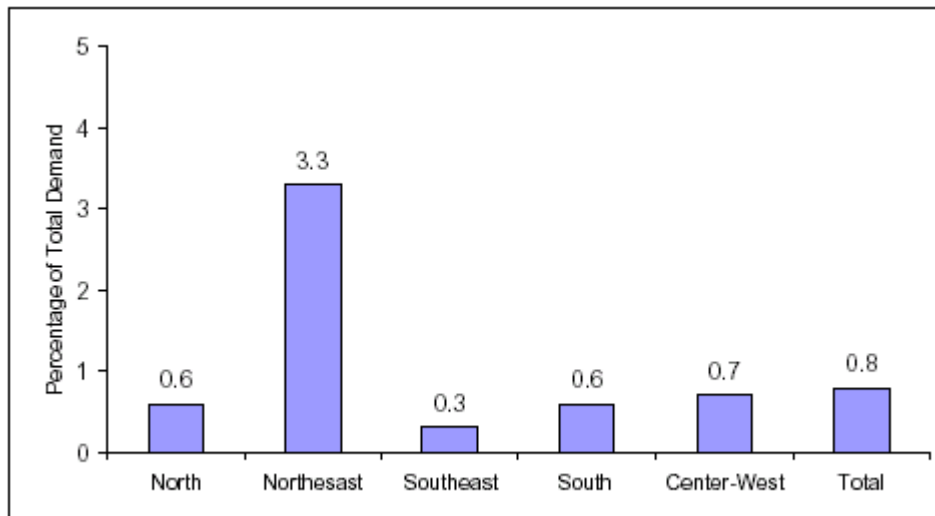
Average Loan Size



Source: Susana M. Sanchez, Sophie Sirtaine, and Rita Valente, "Bring Microfinance Services to the Poor: CrediAmigo in Brazil", En Breve. World Bank. August 2002

Exhibit 6

Microcredit Supply in Brazil as a Fraction of Demand (by Total Size of Loans), by Regions



Source: Jaime Mezzera, "Microcredit in Brazil: The Gap Between Supply and Demand, MicroBanking Bulletin, November 2001