Ex post evaluation – Paraguay

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Sector: 24030 – Formal sector financial intermediaries
Project: Credit Line for Micro-Finance – Investment and Complementary Measure (BMZ No.: 2006 65 075*, BMZ No.: 2006 70 232)
Implementing agency: Agencia Financiera de Desarrollo (AFD)

Ex post evaluation report: 2020

All figures in EUR million	Project (Planned)	Project (Actual)	CM (Planned)	CM (Actual)
Investment costs (total)	6.30	6.02	0.50	0.50
Counterpart contribution	1.28	1.00	0.00	0.00
Funding	5.02	5.02	0.50	0.50
of which BMZ budget funds	5.02	5.02	0.50	0.50

* Random sample 2016

Summary: The project included a loan to the Republic of Paraguay for funding selected, qualified financial intermediaries (FIs) to extend credit to micro and small businesses (MSBs) via the state-owned apex institution (Agencia Financiera de Desarrollo; AFD), which at the time was in its development phase. This was accompanied by a Complementary Measure (CM) to strengthen the AFD's MSB support activities.

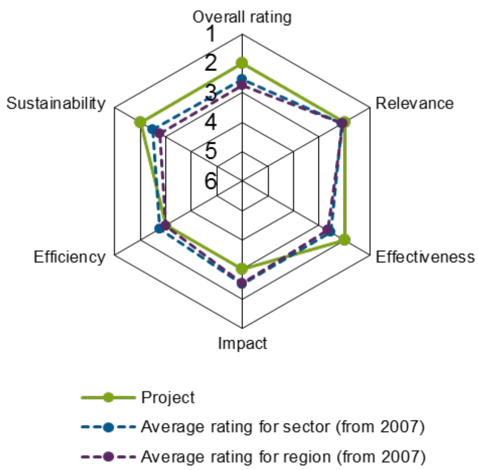
Objectives: The project objective was to help improve MSBs' access to credit, with an increased emphasis on medium and long-term credit resources and rural MSBs. In addition, the CM was intended to strengthen the institutional structures of the AFD and the on-lending FIs, as well as promoting the development of lending technologies. In this way, the FC measure aimed to boost the competitiveness of MSBs and deepen the financial sector in Paraguay (development objective).

Target group: The project's target group was MSBs with up to 20 employees and annual turnover of up to USD 150,000. At least 30% of the loans were to be issued to rural MSBs, with women making up at least 50% of the customers.

Overall rating: 2

Rationale: The FC project helped to expand the AFD's MSB financing activities. The AFD operates efficiently and was able to use the FC financing to reinforce its business activities in this sector while reaching under-served market segments through the FIs – especially in rural areas. The rate of interest for the FIs was market-based, although the FIs themselves charged relatively high interest rates. Due to a government-instituted partial debt release for MSBs in the agricultural sector, some FIs in the FC programme restructured their portfolios and withdrew from this segment.

Highlights: –



Rating according to DAC criteria

Overall rating: 2

Ratings:

Relevance	2
Effectiveness	2
Efficiency	3
Impact	3
Sustainability	2

Relevance

As early as the project appraisal report in 2006, it was noted that the lack of access to adequate financial services – especially medium and long-term services – represents the key problem for micro and small businesses (MSBs) in Paraguay. The availability of medium and long-term loans is seriously limited, especially in rural areas. The lack of adequate and needs-based finance dampens MSB growth and makes it difficult to realise long-term investments.

The banks, *financieras* (finance companies) and credit unions participating in the programme – hereinafter referred to as financial intermediaries (FIs) – were primarily funded through short-term investments. As a result, most FIs did not enjoy planning certainty over their ability to tap into new market segments. The FC measure was fundamentally a suitable means of addressing these challenges in Paraguay's financial sector.

The results chain envisaged the project and complementary measure (CM) facilitating access to medium and long-term credit resources for the MSBs, allowing them to expand and safeguard their business activities, as well as boosting their competitiveness. As a result, the project was intended to encourage economic development and employment in the MSB sector. It was hoped that the increased focus on rural areas would give a targeted boost to MSBs, whose development until then had been greatly hampered – in particular, owing to a lack of financing opportunities. In this spirit, with approval from the AFD, the implementation agreements stated that at least 30% of the programme funds were to be issued to rural MSBs outside the metropolitan population centres of Gran Asunción and Ciudad del Este. We still consider this provision relevant.

The project was intended to have an immediate poverty alleviation effect by enabling a wider section of the population on low incomes to access financial services. It would also hopefully help to modernise the public banking sector by strengthening the AFD through institutional development and creating a loan product tailored to MSBs and the on-lending FIs as part of the CM. In addition, the project was to play a role in promoting a stable and well-functioning financial system in Paraguay by sustainably increasing the supply of needs-based financial services and improving the funding base for the participating FIs. We deem these impact assumptions, which underpin the appraisal concept, to be fundamentally appropriate.

In the year when the programme appraisal report was compiled, there were already Paraguayan government programmes promoting MSBs. The most important programme at that time was the Programa de Desarrollo Empresarial para las Pequeñas y Medianas Empresas (PR-100), which was supported by the Inter-American Development Bank (IDB). The government (headed since 2018 by President Benítez) still regard MSB promotion as key to increased economic growth, and thus launched the Plan Nacional de Promoción y Formalización para la competitividad y desarrollo de las MIPYMES 2018-2023 – an action plan to promote MSBs.

Furthermore, the project took into account the sectoral strategy paper of the German Federal Ministry for Economic Cooperation and Development (BMZ) on sustainable economic development. The project focused on two of the paper's three pillars: private sector promotion via the micro-finance credit line, and financial sector development, with special backing from the CM aimed at supporting the AFD. The sectoral strategy paper clearly notes that a dynamic private sector is essential for economic growth. In this context, it is crucial that the investment and business climate for MSBs be improved. Positive movement in this direction was made by the micro-finance line and the CM. In addition, the project was well matched with the agreed focus area for development cooperation in Paraguay – rural development.

The donor coordination brought to bear in the project was also suitable for achieving the project objectives. This included the IDB, which also works with the AFD, and the good governance efforts undertaken by the Gesellschaft für Internationale Zusammenarbeit (GIZ).

Given that rural MSBs made up more than 45% of the total economy in 2006 and had increased financing needs at the same time, the target group was sensibly selected.

Overall, we rate the project's relevance as good.

Relevance rating: 2

Effectiveness

The project objective was to help improve MSBs' access to credit, with an increased emphasis on medium and long-term credit resources and rural MSBs. In addition, a CM was intended to strengthen the institutional structures of the AFD and the on-lending FIs, as well as promoting the development of lending technologies.

The attainment of the project objectives defined at the project appraisal is summarised in the table below:

Indicator	Status PA, target PA	Ex post evaluation
(1) At least 30% of the loan portfolio financed from the FC programme is issued with terms longer than two years.	Status PA (2006): N/A. Target: 30%. Year 1: 10%. Year 2: 20%. From year 3: 30%.	Achieved (40%).
(2) At least 70% of the loan portfolio financed from the FC programme is issued outside the two major conurbations of Gran Asunción and Ciudad del Este.	Status PA (2006): N/A. Target: 30%.	Achieved (82%).
(3) The participating FIs' portfolio at risk (>60 days) is below 7%.	Status PA (2006): 8-9% (>30 days). Target: 7%	Achieved (6%).
(4) The funding applications for MSB finance are processed by the AFD within ten working days.	Status PA (2006): N/A. Target: maximum of 10 days.	Achieved (7 days).
(5) At least four FIs participate in the programme.	Status PA (2006): N/A. Target: minimum of four.	Achieved. A total of six FIs participated in the credit line and four FIs participated in the CM.
(6) At least 50% of the ultimate borrowers are female.	Status PA (2006): N/A. Target: minimum of 50%.	Achieved (61%)

In total, 40% of the loan portfolio financed from the FC programme is issued with terms longer than two years (indicator 1).

The indicator objective for the participating FIs was achieved, with two FIs benefiting from both the credit line and CM, while four others benefited from the credit line alone and two from the CM alone. It was hoped that the four FIs benefiting from the CM would serve as role models in the Paraguayan micro-finance sector.

The implementation of the FC project – and, by extension, the specific Mi Crédito KfW product for the participating FIs – was based on the AFD's already established Mi Crédito product in terms of its application structure and process. The six FIs participating in the FC product were among the ten FIs that had been accredited for the AFD's Mi Crédito product. The FIs primarily used the FC credit line for medium to longer-term loans. The terms and conditions of the two Mi Crédito products for MSBs were in a very large part based on each other.

As originally envisaged, the AFD's counterpart contribution was 20%. The investments supported by the FC measure – and, in particular, the Mi Crédito KfW product – were distributed among the following sectors of the economy:

- 23% went to arable and pastoral farming
- 12% went to the service sector
- 65% went to the retail sector, and
- just 1% went to the industrial sector

An analysis of the distribution of loans between urban and rural areas clearly shows that the project prioritised rural areas outside metropolitan population centres, with 83% of all Mi Crédito KfW finance going to rural borrowers. In addition, a gender-disaggregated analysis reveals a strong focus on female borrowers (indicator 6), who made up 61% of the ultimate borrowers.

The credit line was met with strong demand from the Paraguayan FIs. As a result, an agreement was reached with the AFD – the funds repaid after complete disbursement would be used on a revolving basis for three years, while the loan approval criteria would continue to be applied. To this end, working together with the consultants from the CM, the bank set up a dedicated account to receive repayments from the programme, which were then ultimately due to be re-deployed.

Despite the measure's delayed start, a high level of effectiveness is signified by the achievement of the indicators, the harmonisation of processes for the Mi Crédito and Mi Crédito KfW products, and the positive development in the sector.

Effectiveness rating: 2

Efficiency

The AFD was founded as a promotional bank in 2006. It has extensive experience in both the MSB sector and other sectors that are important for national economic development. Its organisational structure is clear and involves flat hierarchies. The AFD has been supporting the MSB sector since it was founded. The Mi Crédito finance product for MSBs had been established prior to the FC financing (with IDB support). The AFD maintains excellent relationships with its partner banks, *financieras* (finance companies) and credit unions. Its staff are open to suggestions for improvement. Due to the flat hierarchies, fast application processing times (indicator 4) and good relationships with other FIs, we rate the AFD's working style as highly efficient.

We rate the management of the FIs that received loan funds via the project as efficient and sustainable. The FIs fulfilled all the project's parameters and criteria, as well as submitting documents for AFD enquiries promptly and properly. Although most of the FIs faced challenges during the financial crisis and partial debt release for MSBs in the agricultural sector (2016), they have still been able to grow or maintain a stable course in recent years. However, some FIs have withdrawn from the agricultural MSB segment.

Specifically, the partial debt release was the result of demonstrations by agricultural MSBs due to worsening economic and climate conditions, unfair competition due to goods smuggled from Brazil and Argentina, falling productivity and growing debt. Three of the project's FIs were affected by this as they had larger portfolios in the agricultural micro-credit sector. Some of these FIs' shareholders changed during the crisis, and one FI merged with another FI that had not benefited from the project. However, none of the project's FIs had to cancel their credit line with the AFD, with the FIs instead carrying out restructuring efforts in their sectoral portfolios. All the same, one of the effects of the partial debt release was that some FIs – in particular, one that was highly active in the sector – withdrew completely or partially from MSB business in the agricultural sector. Strictly speaking, this partial debt release was a government restructuring plan offered to the FIs by a state bank. This bank developed a finance product with an appropriate term and interest rate for implementation. However, the plan did not provide the desired solution for the FIs affected, which had wanted different, more extensive methods of implementation. As a result, the restructuring plan caused the ultimate borrowers to have even poorer repayment rates for their loan liabilities. Ultimately, FIs that were affected had to write off loans equivalent to millions of USD in value.

The Mi Crédito product's interest rates were subject to an annual review. During the project appraisal, it had been agreed that the interest rate to be charged would reflect the market rate. The interest rates on the Mi Crédito KfW product were 10% in 2012, 9% between 2013 and 2015, and 8% in 2016 (average: 9.1%). This was at a similar level to the Mi Crédito product, whose rate was 10.1% between 2012 and 2016 (the FC project implementation period), with differences caused by the varying loan terms. Consequently, the interest rate that the FIs paid the AFD for the Mi Crédito KfW product was in line with the normal market rate.

On top of the AFD's funding costs, a margin for administrative expenses was factored in, as was a 2% risk margin depending on the FI's risk of default category. In addition, the AFD assumed the foreign exchange risk with loans in local currency. To ensure that this was adequately reflected in terms of interest, an average inflation rate from recent years was factored into the interest rate for loans in Paraguayan guaraníes (PYG). We consider the AFD's margin to be reasonable.

It was only right that the FIs themselves, which also bear the credit risk among ultimate borrowers, be free to set their own interest rates. In the end, they charged rates between roughly 20% and 32.5%. These appear to be appropriate for the sector and are considered attractive by the AFD.

The visits and on-site interviews revealed that the project promoted very sensible investments from a micro-economic perspective, meaning that the funds were deployed effectively as part of the project.

The project was appraised in 2006 and the loan agreement signed in 2008. Implementation did not start until 2012 on account of various management changes and concomitant shifts in priorities within the AFD, as well as coordination problems under the financing agreements and separate agreements. The beginning of the CM was delayed in part due to legal issues surrounding the invitation to tender, meaning that this started later than the credit line. Nonetheless, the revolving use of funds and resultant delays to the credit line led to the two measures overlapping as intended. The FIs participating in the CM were selected based on set criteria and their interest in the measure.

The level of efficiency is generally satisfactory.

Efficiency rating: 3

Impact

The project's development objective was to help improve the competitiveness of micro and small businesses and deepen the financial sector in Paraguay.

Indicator	Status PA, target PA	Ex post evaluation
(1) Percentage of loans granted to the private sector relative to GDP.	Status PA (2006): 12.5%. Target: 20%	Achieved (37%)

The percentage of loans granted to the private sector relative to GDP was used as the development objective indicator. This figure continued to increase between 2006 and 2015 from 12.5% to 37%. The indicator – changed during the ex post evaluation – reflects development in the country as a whole, so is not highly meaningful for the project.

In the meantime, Paraguay has adopted a National Financial Inclusion Strategy (2014) and created a Vice-Ministry of Micro, Small and Medium-Sized Enterprises (MSMEs) within the Ministry of Industry and Trade (MIC). The second pillar of the country's 2030 strategy addresses economic growth and MSME promotion. In 2018, a plan was adopted to encourage MSBs to formalise and participate in the banking system. The Vice-Ministry also established 11 working groups across various, MSB-related issue areas. The banking supervisory authority has set up a department for financial inclusion and managed to ensure that the topic is covered in the school curriculum.

The MSB sector in Paraguay is largely informal (around 70%). For the most part, MSBs operate in the retail sector or are family-based micro-enterprises. 91% of enterprises in Paraguay are MSBs, with most of the public depending on this important income source to earn their living. As a result, the FIs in the MSB finance space have an important role to play. Difficult as it may be to quantify the positive effects on the ultimate borrowers in Paraguay, studies from other countries show the beneficial impacts. Micro-finance bolsters the MSBs' competitiveness. A substantial portion of the funds was used by the credit unions and *financieras*. These FIs traditionally have a strong presence in rural areas and an innovative approach towards the development of new financial products for their customers. Thanks to the FC funds, it was possible for the FIs to offer flexible, longer terms, as well as conditions better tailored to their customers. The MSBs benefited in rural areas, especially in the retail sector.

In recent years, there has been a series of efforts to formalise MSBs and reach customers via the internet. Nonetheless, as mentioned above, some FIs from the FC programme decided to withdraw from the micro-segment. This was due to the experience of the partial debt release for MSBs in the agricultural sector following demonstrations in 2016 and resulting losses incurred by the FIs, as well as the risks associated with this group of customers more broadly. The segment continues to be served by credit unions, public banks and *casas de crédito* (small loan providers), although the latter are unregulated. In light of the comparatively small financing contribution of around EUR 5 million, the overarching developmental impact is appropriate. No information is available on negative effects of the programme. There are still some persistent challenges in the micro-finance sector.

Given that some FIs have withdrawn from MSB business in the agricultural sector, which is important for Paraguay (as explained in the Efficiency section), we also cannot rate the developmental impact as anything higher than satisfactory.

Impact rating: 3

Sustainability

Mi Crédito was an important finance product that made it possible to develop important practical knowledge in the participating FIs. Several years ago, the FIs had little knowledge of the specific characteristics of micro-finance and the technologies to be used for this purpose. The longer they are active in the sector, the more this knowledge will grow over time.

The availability of longer loan terms gave ultimate borrowers greater choice over their own business activities, with this patient capital improving the sustainability of the investments.

Since the AFD has maintained continuity in its management and key personnel in recent years, the prospects for this product's sustainable future on the market are positive. It is important for the AFD to forge ahead with its continuing development and growth in the micro-finance sector. The AFD plans to keep offering the Mi Crédito product.

Mi Crédito KfW's main advantage over the AFD's Mi Crédito product was that the FIs did not have to provide a guarantee with the FC product and the credit line was extended without the need for collateral. FIs, especially in the micro-finance sector, usually have to produce a guarantee (i.e. pledge assets as collateral) for the loan portfolio. The value of this guarantee depends on the rating the AFD assigns to the given FI. Repayments for the traditional AFD product also depended on the type of activity to be financed (e.g. monthly in the retail sector, quarterly in the agricultural sector). On the other hand, the repayment method for the FC line depended on the analysis of the FIs (instead of the ultimate borrowers) – for instance, with quarterly interest payments and an annual repayment amount. As a consequence, the FC financing presented a lower risk for the FIs and had more flexible options to offer.

It is encouraging that the AFD amended the terms and conditions of Mi Crédito to reflect those of Mi Crédito KfW, except for the repayment method (this change is currently being planned). This is intended to make the loans and terms obtained under the credit line more flexible. The AFD's Mi Crédito product requires the loan terms and amounts to be the same between the ultimate borrower and FI and between the FI and the AFD. By contrast, with Mi Crédito KfW, these repayments could be different from those between the FI and the AFD. For instance, funds could be requested between the FI and the AFD over a term of seven years, with the FI only issuing a three-year loan to the ultimate borrower. The FI could extend new loans with these benchmark figures (term, loan amount) over the remaining term and residual amounts. This flexibility made it possible to add new borrowers or to replace insolvency-threatened companies in the credit line with the AFD. The total amount approved between the FI and the AFD was the only relevant factor. However, this distorted the FC-financed portfolio. The terms for the ultimate borrowers could differ from the credit line's term. The AFD is currently in the process of updating its Mi Crédito product.

Since the start of the programme was delayed, the AFD has been able to develop stand-alone structures in the micro-finance sector in the meantime. It therefore made sense for the CM to focus on structurally promoting selected FIs (instead of the AFD, as was originally envisaged).

All in all, developments in the micro-finance sector should be viewed in a positive light, as the key figures for financial depth are constantly improving and the financial inclusion of all Paraguay's regions has grown as a political priority. In addition, the MIC created a Vice-Ministry of MSMEs and a national plan to formalise MSMEs. A raft of initiatives and policies have been adopted to make progress in the micro-finance sector. Lasting cooperation between the AFD and the participating FIs is essential for safeguarding the long-term future of the project and the finance product. The AFD's continuing political independence remains important in this process.

Overall, we rate the sustainability as good.

Sustainability rating: 2

Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being **relevance, effectiveness, efficiency** and **overarching developmental impact**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

Level 1	Very good result that clearly exceeds expectations
Level 2	Good result, fully in line with expectations and without any significant shortcomings
Level 3	Satisfactory result – project falls short of expectations but the positive results dominate
Level 4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
Level 5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
Level 6	The project has no impact or the situation has actually deteriorated

Rating levels 1-3 denote a positive assessment or successful project while rating levels 4-6 denote a negative assessment.

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability): The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Rating levels 1-3 of the overall rating denote a "successful" project while rating levels 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally "successful" only if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are rated at least "satisfactory" (level 3).