SCBF 2015-03 October 2017

Microleasing pilot for the agroindustrial sector with Financiera Fondo de Desarrollo Local in Nicaragua

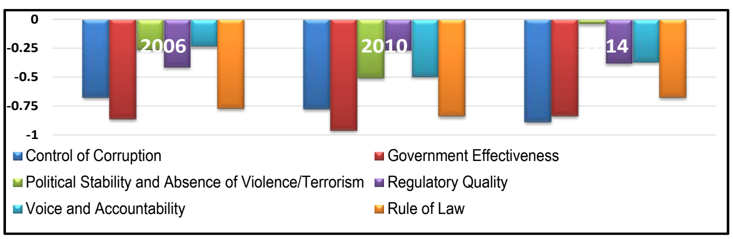
1. DEVELOPMENT RELEVANCE

Economic and poverty context

After hitting a record 5,1% growth of gross domestic product (GDP) in 2011, Nicaragua experienced a slow down to 4,7% in 2016 and a reduction of the annual inflation rate from 6.6% in 2012 to 3.5% in 2016. However, the country still faces significant challenges in economic matters, such as low productivity, low added value to production and high levels of informal employment (65% of the employed population). General poverty dropped from 42.5% to 29.6% between 2009 and 2014, extreme poverty fell from 14.6% to 8.3%, and extreme rural poverty from 26.6% to 16.3%. Among the factors that explain this reduction are the dynamism of the economy, the increase in employment, family remittances and the socio-productive capitalization programs of poor families promoted by the government. The World Bank notes that "poverty levels remain high and Nicaraguans are highly vulnerable to falling again" in that condition.

Table 1: Population and economic indicators[i]	
Population in million *(2016)*	6.15
GDP growth *(2016)*	4.7%
Inflation *(2016)*	3.5%
Trade balance *(% of GDP) (2016)*	-18%
Foreign direct investment (net) *(% of GDP) (2016)*	6.7%
Net ODA received *(% of GNI) (2015)*	3.7%
Remittances received *(% of GDP) (2016)*	9.6%
Economic Freedom Index[ii] *(Rank among 186 countries) (2017)*	107
Poverty indicators	
GDP per capita *(USD) (2016)*	2'151.4
Gini Index *(0= equality 100= inequality) (2014)*	47
International poverty rate *(2014); at 1.90 USD/day)*	6.2%
National poverty rate *(2014)*	29.6%
National rural poverty headcount rate *(2014)*	50.1%

Table 2: Governance indicators[iii], Nicaragua (2006-2014)



Financial sector context

Recently, a study of the "Situation of Financial Inclusion in Nicaragua and Proposal of Government Action" [iv] has been concluded, promoting policies of financial inclusion. At the same time, the Central Bank of Nicaragua (BCN) is conducting a survey to measure access and usage of financial services as well as usage of mobile devices to gain a deeper understanding of needs and constraints and a basis for progress monitoring in the future. BCN has also started to offer workshops for academia, government actors and the private sector in order to promote financial education and inclusion in Nicaragua.

The most recent data from Global Findex[v], gives the following indicators from 2014, resp. 2016:

Account *(age 15+)*(2014)	Formal savings *(age 15+)*(2014)	Formal borrowing *(age 15+)*(2014)	CPIA financial sector rating *(1=low to 6=high)*(2016)	Microscopio global (2016)
19%	8%	14%	2.836	Position 15/55

The banking sector regulated by the Superintendence of Banks and Other Financial Institutions (SIBOIF), regulates 12 financial institutions: seven commercial banks, one development bank and four financial companies, with 614 offices nationwide. The National Microfinance Commission regulates 35 microfinance institutions (MFI), with a total of 211 branches. There are an estimated 380 savings and credit cooperatives with rural coverage. To give greater access, three banks have established non-bank agents and mobile payments but the low-income population still makes little use of such services.

Partner financial institutions

Financiera FDL and Bancentro Lafise were identified as ideal partners to approach the target group from two sides, via an MFI and via a commercial bank. During the intervention, the collaboration with Lafise was stopped due to lack of interest shown by the new contact person assigned for the project. As a replacement for Lafise, Fundeser, an MFI oriented towards the rural sector with high experience in the dairy processing sector, was brought on board.

After several months Fundeser also decided to discontinue microleasing due to a divergence of opinions concerning the added value of microleasing products between the Business and Operations Manager and the General Manager that appeared as the project progressed, despite alignment in the initial stages. In the end, the pilot was only conducted with FDL, resp. FFDL after its transformation.

The Financial Institution Local Development Fund (FFDL), has its origins in the Association of Local Development Fund (FDL), created in 1993 and transformed into a regulated microfinance institution in 2015 and 2016. On May 3, 2016, FFDL started its operations and with funds coming from the FDL Association (70%), Norfund (10%); Oiko Credit (10%); Alterfin (5%) and SIDI (5%), FFDL was the largest microfinance institution in the country. As of June 30, 2017, it had assets of USD 102.8 million, a portfolio balance of USD 85.6 million, 54’338 clients and USD 16.5 million in capital.

Figure 1: FFDL 2017 branch network

The mission of FFDL is "to provide financial services to assist MSMEs, as well as wage earners and urban and rural people, in order to promote financial sustainability and the social and environmental development of our customers". Its vision is "to be the leader at the national level, offering a range of products and services, facilitating financial inclusion and responding to customer demands, in addition to promoting appropriate alliances, either for the provision of financial services or to favor them by relying on the provision of non-financial services"[vi].

2. INTERVENTION APPROACH

Capacity building needs

The credit supply of MFIs in Nicaragua is mainly focused on consumer and trade sectors (57%), agriculture (18%) and only 2% on the manufacturing industry, with limited or nonexistent mechanisms to finance productive assets. Access limitations are non-compliance with requirements such as guarantees, informality and low productivity of the MSMEs. With the support of SCBF, Swisscontact conducted a feasibility study (SCBF FSW-03)[vii] on the potential for microleasing to augment productivity, revenue and competitiveness of small enterprises in agroindustry in Latin America, which identified major opportunities in Nicaragua, specifically for bakery, restaurant and cafeteria owners.

Main activity areas (goals, targets, resources & time frame) and outputs

Swisscontact selected FFDL for the preparation and implementation of the microleasing project. First, Swisscontact led the establishment of strategic alliances and confirmation of the business model by defining roles and responsibilities and signing agreements between the various partners: financial institutions, asset suppliers, technical assistance (TA) providers and insurance companies. A second step concerned the development of the product itself, where FFDL participated (in both directive and operational areas) in the design and pricing of the products, the definition of policies and procedures, and elaboration of the marketing strategy. This process was appropriated by local staff and collected in the handbook. For the implementation of the product, a total of 40 people were trained at the financial institution, equipment providers (Economart & Imisa) and TA providers. A main theme of these trainings was financial management and accounting, where initial difficulties concerning software development and accounting management required additional support. FFDL initially planned to contract external services for the development of the software, but in order to keep costs low decided to develop it with its own staff, where additional support was necessary. Finally, Swisscontact supported the roll-out and related activities, including knowledge management and building further alliances with other partners to widely promote and sustainably establish microleasing.

Institution	Area	Trained	Total
FFDL	Credit officials	6	18
	Branch managers	3	
	Regional managers	2	
	Customer service staff	2	
	Head office managers (Marketing, Credit)	3	
	Accounting, technology & comm staff	2	
Equipment providers	Advisers of foreign sales, room & telesales	13	15
	Sales supervisor	1	
	National sales manager	1	
TA providers	Food specialists	7	7

Table 3: Trainings carried out with different stakeholders

Swisscontact also presented a proposal for additional funds to the Swiss Development Cooperation (SDC) and the Inter-American Development Bank (IDB) and tried to develop alliances with other projects, unfortunately without obtaining positive results. These resources would have been used for TA in non-financial services, especially in the productive process, to allow MSMEs to better leverage the available technology and financial products, ultimately reducing the time needed to reach each business' productivity and income objectives.

Due to delays in the software design and FFDL transformation processes, the implementation of the product started only in December 2016, around 12 months after the beginning of the project. By May 2017, 16 microleasing contracts out of the targeted 420 were in place with a total value of USD 66'150. Two clients fell in arrears and had the leased equipment withdrawn, which prompted the Board of Directors at FFDL to pause the placements of the product and await the review of the Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOIF) in June 2017 to re-evaluate the results.

FFDL decided at the beginning of November 2017 to stop the placements of microleasing, as the supervision body had encountered legal risks in their microleasing contracts, although previously approved. FFDL therefore prioritized a traditional credit for MSMEs, for which assets can be offered as collateral[viii] but without a TA or insurance component. FFDL may take up the microleasing product at a later stage, as they see the benefit for their clients, especially being packaged with TA and insurance, but due to legal uncertainties the product is perceived as too risky and costly for the institution.

In addition, a total of 87 micro-entrepreneurs from bakeries were trained in financial literacy. In cooperation with the Nicaraguan Association of Microfinance Institutions, a workshop was organized for the technical staff of the Chamber of Microfinance Institutions (ASOMIF) and credit managers of three microfinance institutions. The workshop addressed product design, business model and forms of operations, with the goal of facilitating future replications.

At the closure of activities, studies for the measurement of results and the systematization of the experience were carried out and presented to the project partners on August 9, 2017.

3. RESULTS ACHIEVED AND NOT ACHIEVED

Client level

Customer satisfaction: Information was collected from ten of the sixteen clients. All 10 respondents appreciated the opportunity to acquire physical capital (related to the food preparation and service sector, refer to the customer profiles in this section for examples of capital acquired) due to relaxed loan requirements and positively evaluated the customer service provisions, the credit-officer follow-ups and the overall microleasing service.

A contract for the maintenance of equipment with the supplier is mandatory in the microleasing contract to ensure the durability and quality of equipment over the long term. However, all 10 respondents considered the mandatory maintenance costs to be exorbitant. Three respondents ultimately cancelled their microleasing contracts and obtained loans for the equipment instead as they felt maintenance could be done at a lower cost with competing companies.

Change in quality of life: Nine of ten of respondents reported growth above 30% in both sales and monthly income using physical capital acquired through the leasing contract. Other indicators could not be evaluated.

Changing customer's business performance: Nine respondents reported increases in production and monthly sales above 30%. This improvement in performance is attributed to better working conditions and reduced processing times from adequate physical capital investment, leading to increased productivity and quality improvements, ultimately followed by increased sales. Six of the MSMEs reported diversifying their products and boosting employment by at least 50%. Two MSMEs reported stable employment figures and two MSMEs reduced employment over this period.

Customer profiles

Enterprise	Client	Productive Asset	Cost
Bakery Sabor y Arte	María Eugenia Canda Rivera	DYNASTY Mixer 20 Lts Band	USD 1'273

Maria Eugenia started operations three years ago. The food processing area inside her house in Managua and she employs four people. Before the microleasing contract, Maria Eugenia used a small blender to process 650 kilos of flour per month, and made cakes and other baked goods. With the newly acquired mixer, which processes 3.9 tons per month, she was able to diversify her offering to 12 products. Monthly sales increased from USD 740 to USD 4'700.

Enterprise	Client	Productive Asset	Cost
Cafetería Aroma´s Café	Nancy Abigail Martínez Iglesias	Professional coffee machine for two groups	USD 3'000

Nancy Abigail started operating her café three years ago in Somoto Madriz and she employs three people. Before receiving the microleasing contract, Nancy Abigail used a second-hand coffee machine, incurring losses due to the poor state of the machine. She offered cappuccino, café americano and espresso. After acquiring the professional coffee machine, she diversified her offering, greatly improved her coffee products, ultimately increasing sales from USD 1'450 to USD 2'700 monthly.

Partner financial institution level

The project strengthened specific areas in FFDL's finance department including their understanding of leasing products and accounting procedures specific to leasing, which differs significantly from typical credit operations. In addition, the program created the links with new suppliers necessary for the leasing business model. Due to the low volume of operations carried out within the project, the product had no impact on the social and financial performance indicators of the institution.

Typical FFDL branch

Financial sector level

There was no general impact on the deepening of financial inclusion, or imitation effects. Nonetheless, Banco Lafise, although they cancelled a direct collaboration with Swisscontact, started to offer leasing of bakery equipment through agreements with equipment providers introduced to them through this intervention. Their product was launched with a clear focus on SMEs only.

4. LESSONS LEARNT

There is a broad range of lessons learnt based on this pilot. Unfortunately, serious challenges negatively affected project implementation, resulting in delays and a low volume of leases. In addition to highlighting the importance of partner selection and organizational strengthening of partners, there are additional learnings that can inform the planning and implementation of similar interventions:

A) Key aspects to prepare the ground for a microleasing product

During the systematization of the experience (led by Swisscontact with participation of all partners) the involved actors identified two key elements for understanding the product and forecasting planned involvement

- A **feasibility study** confirming the relevance of the productive assets for a critical mass of potential customers, ensuring a secondary market and guiding the viability of the product in the market.
  The feasibility study of 2013 clearly highlighted the lack of finance for investments in machinery and equipment, with priority to baking and dairy product industries.
- **Organizational strengthening**: FFDL perceived the design and implementation of staff trainings as critical for good piloting practices, in addition to improving institutional know-how.
  The expectation was clearly that most of the technical assistance will be invested on the client side, to allow them to understand, easily access and make fruitful use of the product and asset. In the end the same effort was required for quite general organizational strengthening of even well-established financial institutions.

B) Timeframe & design:

- Calculate **three to four years** when introducing microleasing with existing organizations (vs. green fielding). Even if experiences from other regions are available and integrated in design and implementation it is too complex to implement within 18 months.
  All three projects in Latin America (see 2015-02 and 2015-04 on microleasing in Peru and El Savlador respectively) have shown that a microleasing pilot cannot be implemented in less than two years.[ix]
- As for the **design**, start with a feasibility study and thorough pre-selection of partners, followed by value chain analysis, product development and a longer period of sensitization including small pilots, product adjustments, and trainings. Finalize with roll-out and ongoing systematization.

C) Selection of sector:

- Select sectors and value chains with a **critical mass of clients and a variety of assets**, or implementation and later scaling are unrealistic.

SCBF

- Financial service providers and the asset suppliers should be strongly **involved in selection of sector** and value chains, as they have relevant experience and critical knowledge of the local context.
  The sector was pre-selected by Swisscontact, based on needs observed in anterior projects in Nicaragua and on the data from the feasibility study.
- Client needs and behaviors, include their preferences regarding the leasing product, need to be understood to effectively promote the product and generate demand client demand.
  The project started promoting microleasing via financial institutions and learned that this should happen via asset providers and umbrella organizations, as many potential clients would never approach a bank.

D) Selection of Financial partner:

In addition to the selection criteria outlined in the application, the following aspects should be considered:

- **Solid position** in the microfinance market
  - Ensure common understanding around **expected financial investments** for all involved parties from the beginning. The financial service providers need to understand the costs of extensive staff training and promotion efforts, which exceed those required by traditional loan product requirements.
    *The **software** to handle the microleasing product, accounting standards and the automation of accounting records were great challenges for FFDL, being used to offer general credit products only. IT, legal and other requirements were calculated but underestimated.*
  - Review financial indicators of financial service providers to ensure **sufficient capital for leasing** is available and/or that mechanisms are in place to mobilize additional funding through external sources
  - Qualitative indicators, especially resistance to **organizational change**, and awareness of existing planned external and internal projects (including transformations, etc.) need to be considered carefully.
    FFDL's decision to implement the new product during its transformation into a regulated entity meant the prioritization of regulatory and institutional demands related to these changes over implementation of the microleasing product, which led to cascading delays in implementation progress.
    FFDL was engaged in developing and launching microleasing but did not have the flexibility to quickly adjust the product to clients' needs, even less so after transformation into a regulated institution.
  - **Cost sharing** between the project implementor and the TA recipient need to be clarified and agreed upon according to the local context – organizations used to generous funding are less willing to share the costs.
    FFDL considered it necessary to receive additional funding for development of the software and expert consultation for accounting management specific to microleasing operations. Although there were no funds available for this, having not been agreed upon in advance, Swisscontact supported FFDL with related TA to the extent possible within the scope of the project.
- **Vision of the senior management**, especially their commitment to serve low-income segments of the population and to support their capitalization processes.
  - **All potentially involved departments of a financial service provider** need to be on board and understand the implications of such a pilot.
    The management at Banco Lafise and the operations department at Fundeser confirmed their interest and commitment, but management at Banco Lafise was not able convince their operational staff, and Fundeser operational staff were not able to convince management.
- **Involvement of financial service providers in sector selection,** design and implementation of the new product, and the strengthening of staff capacities
  - Ensure ownership by involving them in the sector selection and clearly **link this to their existing clientele and sector expertise.** Check whether this corresponds to interests of potential asset suppliers and covers real needs of micro enterprises.
  - **Rigorous agreements are required to frame commitment of financial service provider staff.** Need to ensure the senior management, branch managers and the loan officers are fully onboarded. It proved better to have **exclusive microleasing officers** instead of adding microleasing to loan officers' portfolios as microleasing is more complex and difficult to sell.
    *FFDL's **placement strategy** was to identify the two bestselling credit officers per branch. These officers were not specialized in microleasing and had large existing credit portfolios over extensive geographic areas. As microleasing was the most complex product in their portfolio, these officers did not actively promote it to the extent necessary to ensure client uptake. This issue was identified and FFDL was advised to recruit new loan officers without credit experience and an existing portfolio, so they could focus on microleasing; unfortunately, this was not implemented. For future initiatives one solution could be to cover an initial base salary, with incentives for credit officers linked to closed contracts with successful repayment.*
  - Conditions must be created to establish strong links with asset suppliers to **encourage collaboration on both sides.** Microleasing requires strong partners with proper structures in place and loan officers need to understand the asset and the sector, just as asset suppliers need to understand the financial product.

We recommend selecting the partner financial institution in a competitive application process in which they elaborate how they will contribute to the project.

E) Selection and collaboration with other partners (asset suppliers, technical assistance providers):

- Include **asset suppliers** when identifying the correct **sector** to target and the specific physical capital to promote via microleasing. Check whether this corresponds with the interests of potential financial service providers and meets the real needs of micro enterprises.
- The **ecosystem of asset suppliers must be considered** when establishing the production chain to guarantee geographical coverage, availability and variety of equipment available, availability of appropriate technical trainings and prompt response to client demand and service requests as necessary.
  - Partner with well-established asset providers who are widely represented in the country, with experience providing after sales services and the ability to quickly meet demand; if there are no such partners available, include capacity building for local informal asset providers. Be aware of frequent personnel turnover and the required training efforts.
  - Microentrepreneurs do not naturally make use of maintenance services. They question the payment for such service as it is considered expensive and not high quality.
  - Calculate the resources required for technical assistance to support the client in asset selection and offer additional training on how to leverage the asset, thereby reaching the productivity and income objectives.
- The technical assistance implementor needs in-depth knowledge of the sector to identify key actors of the business model and establish active links between all involved parties.
  All involved parties highlighted their satisfaction about Swisscontact's in-depth experience of the productive sectors, nonetheless more assistance was needed to establish and maintain links between involved parties.

Many of the listed recommendations were considered in response to challenges anticipated during the design stage, albeit at a more general level, while other challenges arose during implementation. As mentioned, the partner selection, linked to clearly communicated terms and expectations on all sides, is key to ensure a fruitful collaboration.

---

[i] The World Bank Group, Countries overview Nicaragua. http://www.worldbank.org/en/country/nicaragua/overview#1. Accessed Sep 2017
[ii] Heritage Foundation, Index of Economic Freedom, http://www.heritage.org/index/ranking. Accessed Sep 2017
[iii] The World Bank Group, Worldwide Governance Indicators database. Washington, DC. http://databank.worldbank.org. Accessed Sep 2017.
[iv] Banco Central de Nicaragua. https://www.bcn.gob.ni/divulgacion_prensa/notas/2017/noticia.php?nota=561. Accessed Sep 2018.
[v] The World Bank Group, "The global Findex Database". Accessed Sep 2017.
[vi] Financiera FDL. http://www.fdl.com.ni/quienes-somos/institucion-de-microfinanzas-lider/. Accessed Sep 2018.
[vii] Swiss Capacity Building Facility, Feasibility Study Microleasing in Latin America. Accessed Sep 2017. http://scbf.ch/wp-content/uploads/2015/04/SCBF_FSW-03_FeasibilityStudy_LatinAmerica_Swisscontact_Microleasing_final.pdf.
[viii] Financiera FDL – Financial Products, http://www.fdl.com.ni/financial-products/productos-financieros/?lang=en. Accessed Dec 18.
[ix] Swiss Capacity Building Facility, Final Report Microleasing in El Salvador http://scbf.ch/wp-content/uploads/2011/03/SCBF_2015-04_Microleasing_El-Salvador_Swisscontact_FinalReport_07.18_VF.pdf and Final Report Microleasing in Peru http://scbf.ch/wp-content/uploads/2011/03/SCBF_2015-02_Peru_Microleasing_FinalReport_Swisscontact_VF_02.20191.pdf