



BANCO DO NORDESTE

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Accelerated Microenterprise Advancement Project

This case was prepared by Anita Fiori and edited by Robin Young using existing documents and publicly available data on Banco do Nordeste's CrediAmigo program and microfinance in Brazil. A complete bibliography that includes all sources is included.



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Accelerated Microenterprise Advancement Project (AMAP) is a 4-year contracting facility that USAID/Washington and missions can use to acquire technical services to design, implement, or evaluate microenterprise development, which is an important tool for economic growth and poverty alleviation.

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1 Introduction

After six years of operations, the Banco do Nordeste's (BN) microfinance program—known as CrediAmigo—today is one of the largest microcredit operations in Latin America and appears to be one of the leaders in the region based on key performance indicators.

The BN CrediAmigo case demonstrates the potential for rapid growth and outreach of a microcredit program within a state-owned retail bank (SORB) and the need for coordination between bank management and donors supporting such initiatives.

One apparent lesson from the Banco do Nordeste case is that multilateral donors must adapt the timing of loan disbursements to the optimum pace of implementation of a microfinance project. It also points out that training of personnel from both the donor and the financial institution is essential for project progress and success. Finally, the case is a reminder that despite its success to date, the program faces ongoing challenges regarding growth and maintenance of good financial performance.

2.1 The Economy and the Legal Environment—Brazil

Brazil is a country of contrasts. It is the eighth largest economy in the world. However, with a gross domestic product (GDP) per capita of almost \$2,800, it maintains one of the highest levels of income inequality on the planet¹ and more than one-third of the 176.9 million Brazilians² live below the poverty line.³

The 1970s were considered the “miracle decade”⁴ for Brazil. With an annual economic growth rate of over 7 percent, the country’s industry expanded like never before. As a result, today more than 54 percent of Brazilian exports are based on manufactured products, and 29 percent are commodities.⁵ The “lost decade”—as the 1980s were known throughout Latin America—resulted in high inflation and increasing levels of foreign debt. With the end of Brazil’s military dictatorship in 1984, democracy was reestablished in the country.

In 1994, Fernando Henrique Cardoso was elected president and the “Real Plan” was implemented, which controlled inflation and the levels of internal and external debt. In 2003, former labor union leader Luis Inacio Lula da Silva was elected president. The current government is maintaining Cardoso’s macroeconomic achievements and the country’s agreements with the International Monetary Fund. However, it still faces great challenges concerning the design and implementation of poverty alleviation projects in Brazil.

2.2 Microfinance Market

A little-known fact is that modern microfinance—using specialized loan officers and uncollateralized lending—began in Brazil. The oldest microloan program in Latin America began in 1971 in Recife, Pernambuco. Called *Projeto Uno*, it financed thousands of microbusinesses through Banco Economico—which at the time was a public bank. The program ended in the early 1980s, but left a legacy of a few committed nongovernmental organizations (NGOs) that still operate in the Northeast region of the country.

¹ According to the World Bank, Brazil has the fourth highest income inequality level of the world, behind only Sierra Leone, the Republic of Central Africa, and Swaziland.

² Source: Development Ministry of Brazil. 2004. www.desenvolvimento.gov.br. March.

³ 30.1 percent of Brazilians live with less than half of the \$100 minimum monthly salary. Saboia, Ana, and Barbara Cobo. 2004. “Um Panorama Recente da Desigualdade no Brasil a Partir dos Dados da PNAD 2002.” Rio de Janeiro: IBGE. pp. 23 and 36.

⁴ During the 1970s, the annual level of economic growth was over 7 percent a year.

⁵ Ibid.

Brazil is estimated to have more than 9.5 million microenterprises,⁶ representing 95 percent of the number of enterprises in the country. More than 50 percent of these microenterprises are informal and they are responsible for employing more than 53 percent⁷ of the economically active population.

More than 70 percent⁸ of the Brazilian population lacks access to financial services and only 2 percent of microentrepreneurs are assisted by financial institutions.⁹

While these data demonstrate the huge potential market for microfinance, obstacles on the supply side of financial services make Brazil an intriguing and challenging market for microfinance. Following are some reasons why.

1. **Brazil has a sophisticated and profitable financial system.** Brazil, compared to many other Latin American countries, has a sophisticated financial system. Today, more than 100 banks operate throughout the country. Banks are one of the most profitable businesses in Brazil but serve only 30 percent of the total population. The banking system still operates with high spreads and interest rates,¹⁰ which allow it to focus on serving middle- and high-income clients. Despite increasing competition, banks still enjoy large enough profits that they have not been forced by market pressures to look for new market segments. Hence, Brazilian private banks are not yet interested in serving the low-income population.
2. **Brazil has several subsidized credit programs still in place.** The government has launched several heavily subsidized credit programs for urban and rural microenterprises over the past 50 years.¹¹ These programs make microenterprise financing an unattractive business for private bankers as these publicly supported programs charge negative real interest rates for their loans. It is difficult for sustainable and profitable financial institutions to compete in environments in which such subsidized credit schemes exist.
3. **Brazilians prefer buying time over money.**¹² Almost anything can be paid for in installments in Brazil: refrigerators, televisions, cars, houses, clothes, food. The interest rates charged by the retail stores are not low, but the low-income population does not perceive how high they are. Buying goods in installments is considered much more convenient by the Brazilian poor than taking a loan. Paying for goods in installments is easier and faster than applying for a loan.

⁶ Santos, Carlos Alberto. 2004. "Sistema Financeiro e Pequenas Empresas: Diagnosticos e Perspectivas." Brasilia: SEBRAE. p. 34.

⁷ Source: Brasilia: SEBRAE. 2004.

⁸ Banco Nacional de Desenvolvimento Economico e Social (BNDES) Web site: www.bndes.gov.br.

⁹ Nichter, Simeon, Lara Goldmark, and Anita Fiori. 2002. "Understanding Microfinance in the Brazilian Context." Rio de Janeiro: BNDES. p. 16.

¹⁰ It is important to note, however, that interest rates have been declining considerably since the Lula administration took office in January 2003.

¹¹ The most famous current programs are PRONAF – *Programa Nacional de Financiamento da Agricultura Familiar* and PROGER – *Programa Nacional para Geracao de Emprego e Renda*, both aimed at microenterprises.

¹² Development Alternatives Inc. 2002. "Developments" (Spring). p. 3.

The microfinance market in Brazil is not considered to be well developed. There are more than 121¹³ microfinance institutions (MFIs) operating in the country—from banks to NGOs, including credit unions and finance companies. The depth of outreach of Brazilian MFIs is significant (the average loan size in Brazil was R\$869 in 2001, which is less than US\$300), but their breadth is limited. MFIs are far from reaching all of the existing potential microfinance clients of the country: only two of every 100 Brazilian microentrepreneurs have access to microfinance services.¹⁴

In 2000, a regulatory framework for specialized microfinance institutions was instituted in Brazil. These institutions, the Micro Enterprise Credit Societies, are known by their Brazilian acronym as SCMs (*Sociedades de Credito ao Microempreendedor*). These are for-profit financial institutions that are only allowed to offer microcredit—loans up to R\$10,000 (less than US\$3,000)—and are not permitted to mobilize savings. The current government is supportive of microfinance and has recently issued a series of new laws in order to attract new entrants into microfinance—mainly credit unions. In addition, the *Programa Nacional de Microcredito* (national microcredit program) forms part of the current administration's policy package aimed at reducing poverty and income inequality in Brazil. As part of this initiative, the government acts as a first-tier supplier of micro credit through state-owned banks and development agencies. A significant amount of government funds is being channeled to microentrepreneurs through these banks at below-market interest rates.

¹³ Nichter, Goldmark, and Fiori. 2002. p. 16.

¹⁴ *Ibid.*, p. 31.

3 The Banco do Nordeste Model

3.1 History

Banco do Nordeste is a development and commercial bank, founded in 1954 to serve the poorest region of the country—the Northeast. It began by financing agricultural projects and entrepreneurs with funds from federally subsidized credit programs and is the main credit provider for large and small farmers.

Today BN offers a series of diverse banking services that range from financing for large agribusinesses to serving low-income microentrepreneurs through its microfinance program. The bank is known for serving as one of the main channels of disbursement for the *Programa Nacional de Agricultura Familiar* (PRONAF)—the federally subsidized credit program aimed at developing small and micro agribusiness.

In the mid-1990s, Costa de Queiroz became BN's new president. He was responsible for the establishment of a major internal reform effort whose main goal was to modernize and increase the efficiency of BN's operations. In 1998, the bank increased its operational income by 8 percent compared to 1997. The total assets increased by 24 percent that same year, largely because of an impressive increase in credit operations to the private sector (48 percent).¹⁵

The changes implemented by Costa de Queiroz enabled Banco do Nordeste to decentralize its operations and focus on the development of micro and small business in the region. However, the new president wanted more. He wanted BN to serve clients that were even poorer than the bank's previous clients. In order to do that, he started to investigate viable ways to develop a program that could target this market niche.

At the same time, the World Bank was looking for potential local institutions that could serve as partners in order to launch a microfinance program in Brazil. The World Bank decided to establish partnerships with banks, since most of the existing microfinance intuitions operating in Brazil (notably NGOs) were already being financed by a major apex program led by the Inter-American Development Bank.

The World Bank team first met with Banco do Nordeste's managers in 1996. It became clear to the team that BN was seriously committed to the development of the microenterprise sector in the Northeast region. BN and the World Bank agreed on a few guidelines that would serve as the basis for the new microfinance program they would launch together. These guidelines included: (a) the program would charge real market interest rates; (b) staff salaries would be based on results; and (c) the credit decisions would be decentralized.

¹⁵ Banco do Nordeste Web site:
http://www.bnb.gov.br/content/aplicacao/o_banco/demonstrativos_contabeis/docs/dfs-banco-fne-dez-1998.pdf.

3.2 The Pilot

After both banks agreed on the basic guidelines of the program, the World Bank proceeded cautiously as the staff recognized that public banks are not traditionally very successful managers of credit programs aimed at low-income businesses.

For this reason, the program began with a pilot project in five BN branches. In addition, the World Bank supported a training program for its key consultants who were going to be directly involved with the pilot project. The employees trained were later hired by the World Bank and the BN to work on program implementation.

The pilot project was named CrediAmigo and began with the assistance of the recently trained consultants and ACCION International, an American-based NGO specializing in microfinance services. ACCION is well known for its solidarity group lending methodology and BN's pilot adopted it as its first approach to microfinance.

The first loans issued were for up to 90 days, required no collateral and were offered only to those microentrepreneurs who formed solidarity groups. The groups were comprised of five people each and the interest rates charged were above-market rates (but still lower than those charged by money lenders).

The loan officers were recruited and trained by ACCION. A World Bank/Japanese grant fund of US\$900,000 supported the training and other technical assistance from ACCION and other consultants as well as development of an information system.

The World Bank team worked as advisors in order to support the sustainability of the program, and BN was responsible for managing the operations. After only four months of implementation of the pilot project, BN's senior executives decided to expand it to another 50 branches. BN announced this expansion publicly and expanded without sufficient staff training and preparation. This hastened roll-out turned out to be a bad decision.

3.3 The Program

The premature expansion caused significant loan losses because of poor credit analysis. Loan officers were pushed to expand and did not pay sufficient attention to portfolio quality. The focus was on growth and not on risk management, and the portfolio suffered. Losses caused by this early expansion totaled more than US\$2 million. ACCION was called back to help BN to recover and six months later the program was back on track.

The lessons learned from the early expansion of the pilot project caused BN's management to establish new rules for the CrediAmigo program. For example, branches began to be evaluated individually, a new bonus scheme for loan officers (based on portfolio quality) was created, and new specialized World Bank consultants were brought in to assist CrediAmigo.

Later, in 1999, the World Bank team approved a US\$50 million loan for CrediAmigo with the condition that CrediAmigo would maintain good portfolio quality. The World Bank required the program to maintain its portfolio-at-risk over 30 days at no more than eight percent and write-offs for loan losses no greater than four percent.

Today, CrediAmigo has more than 265 branches located in 195 municipalities of the Northeast region. The program is one of the largest in Latin America in terms of number of clients (138,497) and, as of December 2003, it had an active portfolio of R\$85.4 million¹⁶ (US\$28.4 million).¹⁷

CrediAmigo's target market is urban microentrepreneurs. They are involved in small-scale manufacturing, commerce, and services, although the vast majority of clients are dedicated to such service activities as hair dressing and car repair. Almost half of the clients are women (49 percent).¹⁸

The program offers short-term loans of three to six months and longer term loans of nine to 12 months. Eighty-six percent of clients hold group loans. CrediAmigo also offers consulting services to its clients at no additional cost.

¹⁶ CrediAmigo Web site: www.bnb.gov.br/CrediAmigo.

¹⁷ Considering the exchange rate at US\$1.00 = R\$3.00.

¹⁸ WBCSD. 2004. "Banco do Nordeste's Crediamigo: A Development Bank's Success with Microfinance." Geneva. p. 5.

4 Performance Analysis

As shown in Table 1, as of 2002, CrediAmigo had maintained its performance indicators per World Bank requirements. Growth remained strong—over 40 percent a year between 1998 and 2002—and its staff productivity (134 clients per staff member) can be considered good. Moreover, the depth of CrediAmigo’s outreach, using the benchmark loan size indicator, is significant if compared to other large Latin American MFIs. While the average loan size of Latin American MFIs was US\$816 in 2002, CrediAmigo’s was only US\$185.

In terms of profitability, CrediAmigo had good results for 2002: its return on assets was much higher than the average for the region. Operational self-sustainability was positive for that same year. The program is covering its costs through operational revenues, meaning that the income generated from the interest and fees charged for its financial services are high enough to cover its costs.

Table 1: Financial Indicators—CrediAmigo versus BancoSol – 2002

Indicators	CrediAmigo - Brazil	Latin America
Portfolio at risk > 30 days	4.09%	2.6%–4.9%
Loan loss reserve ratio	2.62%	2.8%
Return on assets	2.31%	0.9%–1.0%
Operational self-sufficiency	105.21%	105%–115%
Active borrowers per staff member	132	150–170
Average loan size	US\$185	US\$816

Source: The mix market: www.themix.org; Microbanking Bulletin No. 9.

CrediAmigo’s operational costs are low when compared to other Latin American microfinance operations. Additionally, the majority of CrediAmigo’s personnel is subcontracted and is not hired as Banco do Nordeste employees. BN has implemented this contracting policy due to the high cost of hiring employees due to Brazil’s rigid labor laws.

In 2003, the Lula government launched what is known as *Programa Nacional de Microcredito*—a program aimed at extending the outreach of microfinance products to small and micro entrepreneurs through state-owned institutions or through institutions that use the government loans as their main source of funds for their portfolio. The *Programa Nacional de Microcredito* requires that all institutions (funded by the government) charge nominal interest rates no more than two percent a month over the cost of funds. Before 2003, the institutions charged interest rates that varied from just under four to six percent a month. CrediAmigo, although a microfinance program within a public bank, is exempt as its funds are not provided directly by the government, but political pressures remain and it has been dropping its interest rates.

5 Achievements and Challenges

Today, CrediAmigo is one of the largest programs in Latin America in terms of outreach to clients and it has one of the largest microenterprise portfolios. Its 265 branches cover all of the Northeast region and the program is by far the leader in terms of microfinance services provision in Brazil. CrediAmigo has served as a demonstration for other Brazilian institutions and is an example for state-owned banks in other countries that are willing to offer microfinance services in a sustainable (and profitable) manner.

Nonetheless, challenges remain. The program's depth of outreach is impressive, but its extent is limited given the potential market. At the same time that growth is an objective, the strain such growth places on personnel and systems has been a problem that must be overcome.

The recent regulation and the *Programa Nacional de Microcredito* are causing a new phenomenon in the Brazilian microfinance industry: new actors—besides the traditional NGOs and state-owned banks—are entering into the market. The number of licensed SCMs is growing¹⁹ and private commercial banks like Bradesco and Unibanco are investing in the creation of branches that can offer microfinance services. Despite the vast untapped market in Brazil, if these new entrants do not follow strict lending technologies, the risk of client overindebtedness, at least in some regions, could arise. In addition new government initiatives to control interest rates also threaten the sustainability culture and the ability of CrediAmigo to remain sustainable.

¹⁹ Today there are 41 SCMs operating in Brazil. Source: Banco Central do Brasil: www.bacen.gov.br.

6 Conclusion

The Brazilian financial sector in general and microfinance in particular are complex. However, the CrediAmigo program proves that it is possible to provide sustainable microfinance services in areas where the financial system does not have extensive outreach. CrediAmigo's impressive numbers show that there is an unmet demand for market-based microfinance in the poorest region of the country.

The secret of CrediAmigo's success to date lies in the fact that it has had the support of the World Bank and the commitment of Banco do Nordeste's senior executives. Contracting outside technical expertise to design the products and train staff and customize systems was another key element. Furthermore, a short pilot project was designed and implemented before the launching of the official program. Problems in the somewhat premature and rapid roll-out were detected and corrected. The lessons learned during these initial phases were fundamental for both Banco do Nordeste and the World Bank in understanding the importance of timing and patience for nurturing CrediAmigo.

The program's growth and financial performance are impressive when compared to many Latin American microfinance programs. Nonetheless, with less than five percent of microenterprises in the northeast region having access to formal credit, coupled with the absence of other microfinance suppliers in the region, the growth potential for CrediAmigo is tremendous. Expanding the program while maintaining good financial performance indicators is a permanent challenge for Banco do Nordeste's CrediAmigo.

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