

From skepticism to success: The World Bank and *Banco do Nordeste*

by Bonnie Brusky

Despite an initial reluctance to undertake a microfinance program within a large state bank, the World Bank chose to take a chance on an apparently risky endeavor. The risk paid off. This case study tells the story of how it happened.

Overview

In 1996, Northeast Brazil's largest financial service provider, Banco do Nordeste (BN), initiated efforts to serve the region's estimated 5.3 million micro-entrepreneurs. By December 2002, CrediAmigo had 118,000 active clients and was the largest microfinance program in Brazil—the closest competitor had less than 10,000 active clients. The success of CrediAmigo has been aided by the World Bank (WB) since the program's inception. Although the WB eventually made a US\$50 million loan to BN, it was the World Bank's management of technical resources that proved most critical in building the biggest and arguably most successful microfinance program in Brazil.

The Emergence of CrediAmigo

A favorable institutional environment. Created in 1954, BN is a development, investment, and commercial bank serving one of the poorest regions of Brazil. (Northeast Brazil has 46.5 million inhabitants, or roughly 30 percent of the country's total population.) BN's goal is to promote regional economic integration and reduce social inequality by providing a range of financial and non-financial services. The institution is a mixed-capital company that is majority owned by the federal government.

As a result of macroeconomic changes in the mid-1990s, BN underwent important internal reforms. The reforms led to a new president who was strongly committed to micro- and small entrepreneurs. To establish a closer relationship with this segment, BN streamlined and decentralized its operations, while emphasizing client-responsiveness and improved productivity through investments in human resources and technology. The result was an institutional environment favorable to supporting microenterprise. It was in this climate that BN embarked on developing a microcredit program.

An attractive market opportunity. Microfinance presented an attractive market opportunity for BN. Despite the large potential market for microenterprise finance, the sector had been slow to develop in Brazil. In 1997, BN estimated that only 2 percent of microenterprises in the Northeast had access to formal credit. In the absence of large MFIs, the region's microenterprises had little choice but to rely on expensive usury and supplier credit. Even today, the microfinance sector in Brazil is characterized by very low market penetration compared to its Latin American neighbors. Penetration in Peru, for example, is 30 percent; in Chile, 27 percent; and in Bolivia, 100 percent.

A timely partnership. BN approached the WB in November 1996, just as the Bank was looking for an opportunity to support microfinance in Brazil. Given the lack of existing microfinance programs in Brazil and the large-scale apex operation being implemented in the country by the Inter-American Development Bank, the WB decided to explore the commercial banking route.



Floriano, (Piauí) Brazil. Ana Maria Barbosa Teixeira in the variety store she acquired with several CrediAmigo loans. (Banco do Nordeste Photo Archive.)

While BN had the stature and outreach required to launch a commercial microfinance program, the fact that it was a large state bank raised red flags for WB staff. The list of failures of big, state-run credit programs is long; they are often subject to political interference, inefficient management and poor performance. At the same time, the list of state institutions providing efficient, large-scale microfinance is relatively short. Could the BN prove to be one of the exceptions?

Six years into operations, with 165 branches across the region, the program is the largest in Brazil and the second largest in Latin America. Its performance indicators are within international standards and growth remains strong (FY2002 saw active clients increase by 39 percent and total portfolio size increase 44 percent). However, CrediAmigo still has a long way to go to reach a significant percentage of its target market.

Working through the Doubts: Decisions made by the World Bank

While not responsible for CrediAmigo's success, the World Bank task team played an important role in the program's evolution.¹ Bank staff made a number of key decisions that were critical to building a successful working relationship between the two institutions. A conversation with Task Manager Steven Schonberger, summarized below, offered insight on what led to these decisions.

Decision 1. Technical experts were enlisted to assess project viability. It became clear in initial discussions that BN was prepared to alter its traditional operating procedures and adopt internationally accepted best practices in microfinance. However, the WB task team realized that it did not have the expertise to fully determine whether BN could viably implement these practices. To ensure that the project was assessed properly, the team called upon the technical expertise of CGAP.

¹ The WB team was led by task manager Steven Schonberger, who was supported by numerous other staff members including, at first, Luis Coirolo, followed by Connie Benard, Division Chief of Rural Development; Iranai Escolano in procurement; Susana Sanchez, Financial Economist; Tulio Correa, Financial Management Specialist; and a group of peer reviewers including economists Carlos Cuevas; Jacob Yaron, Brazil Financial Sector Specialist; Stephen Alber; and CGAP microfinance experts Robert Christen and Richard Rosenberg.

"[The decision to call on microfinance experts] was an acknowledgement that we were not practitioners and therefore not sufficiently qualified to assess this business opportunity."

Decision 2. The project started small. A visit to BN by the World Bank task team (accompanied by CGAP experts) concluded that there were more factors working in BN's favor than against it. The internal reforms had been successful, the management team was dynamic and committed, and the bank possessed an extensive physical infrastructure. Tentatively hopeful of success, the task team proposed a slow start based on a small pilot project. There was a risk that BN might desire to implement wide coverage of microfinance in a short time, before the management model had time to solidify. Indeed, accustomed to thinking big, the BN staff was initially resistant to the pilot proposal. However, a willingness to listen to the technical advisors and a commitment to building a solid microfinance program helped them overcome initial concerns.

Decision 3. Donor staff received training in microfinance. Once it was clear that the project would be pursued, WB staff invested time in training, aiming to become more effective advisors to BN. The Task Manager and Division Chief—who were financial, but not microfinance, specialists—decided to attend the three-week Microfinance Training Program in Boulder, Colorado (USA). Developing internal knowledge of microfinance would also allow the World Bank to lessen its reliance on external consultants. "However," adds Schoenberger, "this internal donor capacity should never be confused with expert, practitioner capacity to directly advise the MFI on operational issues and strategies."

"I wanted to learn the key issues... enough to evaluate potential consultants and their work, which would be needed to directly assist Banco do Nordeste."

Decision 4. Donor involvement was initially limited. During the pilot phase of 1997-1998, the WB task team did not monitor daily operations. It aimed to keep BN management focused on achieving sustainability, leaving operational decisions entirely to BN project staff. The decision to play the role of potential investor was partly motivated by the frequent resistance exhibited by BN staff to donor technical advice. The "toned-down" posture of the WB had the added effect of conferring a certain

amount of trustworthiness to the task team. “By being honest with them that WB staff were not the source of operational advice, we gained some credibility in terms of directing them to good practitioners,” Schonberger said. The CGAP expert put BN in contact with several leading technical assistance providers and microfinance institutions in Latin America. BN then visited several of these organizations in search of an institution to develop its microfinance lending products.

“WB task team visits were generally short (one week or less)... Focus was on reviewing program performance: challenges faced by BN management and how they were addressing these challenges. WB staff were under strict orders not to provide any direct operational advice, though we sometimes indicated other programs or documents for BN to look at.

When Robert Christen of CGAP began providing direct support to BN, we separated WB missions from the technical advisory visits. We did not want to divide the attention of BN senior management. We also wanted it clear that the WB would act as a financier based on demonstrated performance. CGAP's role was to work directly with BN management to achieve that performance. However, the two roles were quite distinct. We did not want the possibility of a loan being seen as leverage to force agreement on CGAP recommendations.”

Decision 5: Facing trouble, the task team did not flee, but sought to understand. Positive results of the pilot project encouraged BN to expand the microfinance program after only four months, moving from five to 50 branches over the next year. The WB team, CGAP, and TA providers all warned against rapid expansion and pointed out the risks it involved. To emphasize this warning, Bank staff told BN that further support was contingent on portfolio quality. Yet BN went ahead with its expansion plans, eager to launch the CrediAmigo program. In the rush to roll out the program, however, loan repayment was neglected and, as many feared, portfolio quality dropped. The institution incurred approximately \$750,000 in loan losses. It took six months of intensive re-training of managers and loan officers to get the portfolio back on track.

While the WB team felt they had good reason to withdraw support, they chose to maintain the relationship. Because of the training they had received, the Task Manager and

Division Chief were aware of the risks of consolidating a microfinance program and were able to assess the situation in all its complexity. They observed that BN rapidly internalized its painfully learned lessons and that management commitment to CrediAmigo remained solid. The partnership continued.

“The training helped us move beyond the dogmatic reaction of many in the World Bank (and MFI community) that [the unsuccessful expansion] proved that it was a bad idea to work with a public bank... The course gave us the tools and confidence to form our own assessment on which we based our decisions and were able to defend to World Bank management.”

Decision 6: A performance-based contract was signed. In 1999, the task team agreed to assess BN’s eligibility for a US\$50 million loan, based on the Brazilian bank’s success in following technical assistance recommendations, the quality of its operational systems, and its three-year working relationship with the World Bank. Approved in May 2000, the loan is subject to a performance-based contract that requires BN to meet two key performance indicators: Portfolio-At-Risk > 30 days no greater than 8 percent and loan losses no greater than 4 percent. As always, BN remained responsible for day-to-day operations.

In the process that led to the loan disbursement, the WB invested only \$150,000 of its own budget, plus \$300,000 from a reprogrammed loan. It also helped BN to secure a \$900,000 grant from the Japanese government and a \$50,000 technical support grant from CGAP. BN contributed about \$5 million of its own funds to the CreditAmigo project during the same period. Since the loan was disbursed, the WB has maintained a limited role

	<i>CrediAmigo Dec. 2002</i>	<i>MBB Peer Group (LA Large Broad) Nov. 2002</i>
ROA	0.95%	0.4% (adjusted)
PAR > 30 days	2.39 %	3.9%
Cost per borrower	US\$76	US\$197

Sources: CrediAmigo; *MicroBanking Bulletin* No. 7 (November 2002).

as a funds administrator while CGAP and TA providers continue to work directly with BN.

Benefits of the World Bank Relationship

Banco do Nordeste staff view their relationship with the WB favorably, and attest to having reaped a number of benefits, including:

- access to high-quality technical assistance
- the opportunity to learn from successful MFIs around the world
- the possibility to undertake market research and impact assessments to refine and adjust the CrediAmigo product
- increased credibility and recognition of Banco do Nordeste as a sustainable provider of microfinance

“The partnership between Banco do Nordeste and the World Bank has been characterized by our common commitment to the development of the microenterprise sector. From the beginning, the World Bank has offered relevant support and sought to provide adequate solutions in line with BN objectives.”

Rita Valente, former CrediAmigo manager

Conclusion

In the case of BN, effective donor assistance focused on appropriate technical assistance and performance-based funding criteria. Initial WB investment in the CrediAmigo program was small and directed toward institution-building. Most WB input consisted of linking BN with technical experts and patiently supporting the Brazilian bank through a pilot program and an unsuccessful early expansion. In sum, the WB spent four years working with BN management, waiting until both its commitment and capacity were proven before disbursing a large loan for the microfinance program.

The success of CrediAmigo shows that donors can foster sustainable microfinance institutions by concentrating on quality technical assistance and giving microfinance providers the time and resources needed to institutionalize microfinance best practices.

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- Banco do Nordeste website: www.banconordeste.gov.br
- Photograph on page 1 reprinted with permission of Banco do Nordeste.*
- Bonnie Brusky is an independent consultant in microfinance. This case study is based on interviews with World Bank staff member Steven Schonberger, former CrediAmigo manager Rita Valente and the secondary sources cited above.*