Microfinance in El Salvador

MSBA 5504

Andrea Capella-Castro, Angie Menjivar, Francesco Coccaro, Patrick Kelly

Introduction

For this project, we will focus on the country of El Salvador. We intend to take a deep dive into the economy and the Microfinance situation in the nation. El Salvador caught our interest because we are particularly interested in finding out how Microfinance institutions (MFI) affect the economy of the area and how they work in Latin America. We will be focusing our analysis on the revenue from loans, interest income, loans by gender, and looking at how it has affected the nation.

Background

El Salvador is a vibrant country in Central America. The country is geographically bordering the North Pacific Ocean and is a neighbor to Guatemala and Honduras. Even though El Salvador has the smallest land area, it is still the most densely-populated country on the mainland of the Americas with about 310 people per sq kilometer of land area. No other country besides the Caribbean island nations has a region as densely populated as El Salvador.

San Salvador, the capital city, is the oldest longstanding capital in Central America. El Salvador has a history of colonization where the country was a colony of Spain for 300 years. Due to this, the main language is Spanish accompanied by Nawat, a native language believed to be a dialect connected to the Aztec Nahuatl. Christianity is the major religion in this country, almost

90% of the population practices the religion. Aside from Christianity, other religions are Islam and folk religions. Similar to religion, the culture follows a post-colonization pattern by defining language, skin color, religion, and ethnicity as specific cultural features used for social exclusion and discrimination.

El Salvador is categorized as a developing nation as it does not offer consistent social services to its population. An article explaining the general development of the country estimates that only about 22.5 of every 100 citizens use the internet. The Human Development Index (HDI) determined that El Salvador has a medium upper score of 0.662, signifying that most people will be able to have an adequate life.

Social development and economic growth is a threatened factor by crime and violence in the nation-state, this factor is the main reason why Salvadorans migrate. From 2015 and 2020, the homicide rate fell from 103 per 100 thousand citizens to 20 per 100 thousand, which remains at a high number. In the United States, the homicide rate oscillates from 6 to 7 per 100 thousand citizens.

Economy

In El Salvador, 35% of the population lives below the poverty line. According to World Bank data, economic growth has been steadily growing in recent decades. The economic growth of the country has not been specified in direct growth to GDP. The GDP grew three percent on two occasions over the period of 20 years from 2000 to 2020, but other forms of economic growth were instilled in the data. Some of the reasons are due to the decline in poverty and inequality in the country.

The poverty rate in El Salvador slashed about 40 percent from 2007 to 22 percent in 2019. The most significant decrease in poverty is the extreme poverty rate, which decreased from 13 percent in 1995 to 1.5 percent in 2019. While this doesn't necessarily mean there is no poverty in the country, it does convey how poverty has decreased exponentially throughout the 21st century.

COVID

Like many countries in the world and in Latin America, the COVID-19 pandemic disrupted the lives of millions in El Salvador. Even though El Salvador was one of the quickest countries to implement strong containment measures to prevent massive and shocking infections, the country still struggled.

The Government was quick to respond to the pandemic by approving a robust fiscal stimulus package for households and businesses to cushion the impact. Nonetheless, as seen in almost every country in the globe, the GDP declined exponentially to around 8.1 percent by the end of the year 2020.

Poverty, as mentioned before, was in decline throughout the 21st century. Due to COVID, this no longer remained true. Poverty increased by an astonishing 4.6 percent in just one year from 2019 to 2020. The World Bank calculates that the quick and assertive government relief package prevented poverty from increasing up to almost 8 percent.

MFI in El Salvador 2010-2015

Microfinance has been a vital part of El Salvador's financial landscape for many years, providing small loans to individuals and groups who would not have access to traditional banking services. From 2010 to 2015, the microfinance industry in El Salvador experienced both successes and challenges as it attempted to meet the needs of the country's low-income population.

One of the major successes during this period was the expansion of microfinance services to underserved areas. The government of El Salvador implemented a number of policies to encourage microfinance institutions (MFIs) to expand their reach, particularly in rural areas where poverty rates were the highest. For example, the government established a dedicated fund to support MFIs that were working in underserved areas, providing them with access to low-cost capital and technical assistance.

As a result of these policies, the number of people served by microfinance in El Salvador increased significantly during this period. According to data from the Microfinance Information Exchange, the number of active borrowers in El Salvador increased from approximately 225,000 in 2010 to over 350,000 in 2015.

This represents a growth rate of over 50%, indicating that MFIs were successfully expanding their services to reach more people in need.

Another success during this period was the improvement in the quality of microfinance services. In order to ensure that MFIs were providing high-quality services to their clients, the government implemented a number of regulations and oversight mechanisms. For example, the Superintendency of the Financial System (SSF) established a set of guidelines for MFIs, including requirements for loan disbursement, repayment, and interest rates.

As a result of these regulations, the microfinance industry in El Salvador became more transparent and accountable, which helped to build trust among clients and investors. This, in turn, helped to attract new capital to the industry, which enabled MFIs to expand their services even further.

Despite these successes, the microfinance industry in El Salvador also faced a number of challenges during this period. One of the major challenges was the issue of overindebtedness among borrowers. Many borrowers took out multiple loans from different MFIs, leading to a situation where they were unable to repay their debts.

The government of El Salvador established a credit bureau in 2012, which allowed MFIs to share information about their borrowers. This prevented borrowers from taking on more debt than they could afford, as MFIs could see how much debt a borrower already had, before approving a new loan.

Another challenge during this period was the impact of natural disasters on the microfinance industry. El Salvador is prone to a range of natural disasters, including hurricanes, earthquakes, and volcanic eruptions. These events can have a significant impact on the livelihoods of low-income families, many of whom rely on microfinance loans to support their businesses.

The government of El Salvador established a disaster risk management fund in 2011, which provided MFIs with access to emergency funds in the event of a natural disaster. This helped to ensure that MFIs could continue to provide services to their clients even in the wake of a disaster.

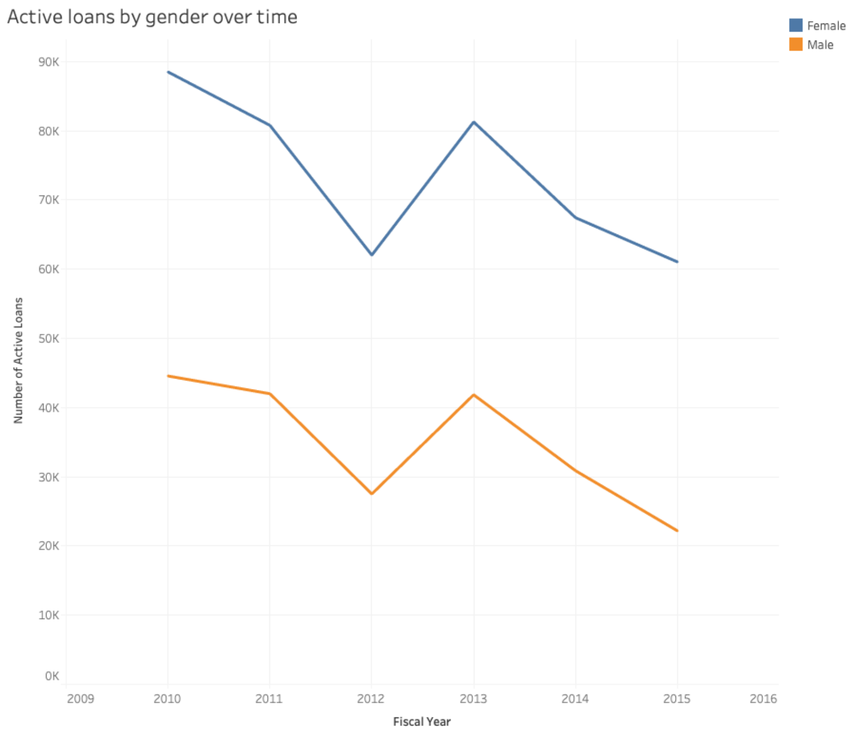
In conclusion, from 2010 to 2015, the microfinance industry in El Salvador experienced both successes and challenges. While the industry was able to expand its reach to underserved areas and improve the quality of its services, it also faced challenges related to overindebtedness and natural disasters. Despite these challenges, the microfinance industry in El Salvador remains an important part of the country's financial landscape, providing essential services to low-income families and small businesses.

2010-2015

As we decided to focus on the years of 2010-2015, we had found out that 2012 played a significant role within our research. In 2012, the government launched a program called "El Salvador Adelante," which aimed to promote economic growth and social inclusion through the expansion of microfinance services. Due to the implementation of new programs from the government, programs directed in helping women to improve their businesses, which ultimately increased their incomes, and gained financial independence.

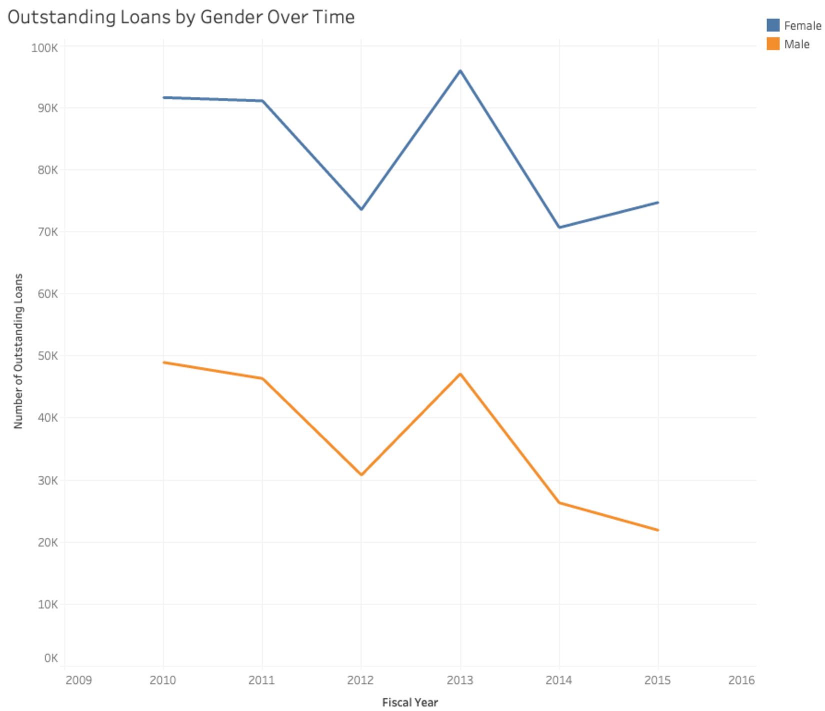
The figure above displays a graph of revenue over time. As we can see, $3,450,163 income revenue comes from interest. High interest rates charged by some microfinance institutions, made it difficult for borrowers to repay their loans.

We decided to also look into the relationship between active loans and gender.



The figure above represents active loans by gender over time. Microfinance institutions in El Salvador often provide loans to women without requiring collateral, which can be a major barrier for women entrepreneurs who do not have assets to pledge as security. This made it easier for women to access credit and start or expand their businesses. Compared to men, about 38,800 active loans are held by women.

Lastly, we decided to look into outstanding loans by gender in El Salvador.



The graph above represents outstanding loans by gender. Looking closely at 2012, we can begin to see the effects of the government program, El Salvador Adelante, as rates of the MFIs start to increase. From 2010-2014, the variance in trends remains the same. Women borrowers often faced higher interest rates than men, despite being more reliable borrowers.

Conclusion

Many microfinance institutions implemented programs specifically designed to support women entrepreneurs and help them grow their businesses. Some microfinance institutions in El Salvador offered training and education programs to women borrowers, providing them with skills in financial management, entrepreneurship, and marketing.

Based on our data, it can be said that in El Salvador from 2010 to 2015, microfinance played a significant role in empowering women through access to financial services.

References:

7 Interesting Facts about El Salvador | Enjoytravel.com. https://www.enjoytravel.com/us/travel-news/interesting-facts/interesting-facts-el-salvador.

Alexander, Lynsey. “The El Salvador Economic Crisis.” *The Borgen Project*, Lynsey Alexander Https://Borgenproject.org/Wp-Content/Uploads/Logo.jpg, 9 Apr. 2020, https://borgenproject.org/the-el-salvador-economic-crisis/#:~:text=El%20Salvador%20is%20a%20small%20country%20in%20Central,to%20aid%20the%20fight%20against%20violence%20and%20poverty.

“Confidus Solutions.” *Demographics in El Salvador - Confidus Solutions*, https://www.confiduss.com/en/jurisdictions/el-salvador/demographics/#:~:text=Demographics%20of%20El%20Salvador%201%20Population%20In%20El,in%20El%20Salvador%20speak%20the%20Spanish%20language.%20.

“Demographics of El Salvador.” *El Salvador Demographics 2021 - StatisticsTimes.com*, https://statisticstimes.com/demographics/country/el-salvador-demographics.php#:~:text=The%20Sex%20Ratio%20in%20El%20Salva dor%20in%202021,population%20is%2053.22%25%20compare%20to%2046.78%25%20male%20population.

“El Salvador's Economic Shackles.” *World Finance*, https://www.worldfinance.com/strategy/el-salvadors-economic-shackles.

“Growing Mfis in El Salvador.” *CentralAmericaData*, https://centralamericadata.com/en/article/home/Growing_MFIs_in_El_Salvador.

Peter. “26 Interesting Facts about El Salvador.” *The Facts Institute*, 12 Feb. 2023, https://www.factsinstitute.com/countries/facts-about-el-salvador/.

“Overview.” *World Bank*, https://www.worldbank.org/en/country/elsalvador/overview.