

Financing Social Inclusion: SME Opportunities for Financial Markets

The Inter-American Development Bank (IDB) has pioneered a new way of financing that compounds its developmental impact and responds to the region's unmet demand. Multiple transactions in Latin America and the Caribbean's (LAC's) lowest income countries have revealed the extensive outreach, cost-effectiveness and impact potential of financial institutions.

In 2007, for example, the IDB approved a long-term US\$5 million senior loan and a US\$20 million subordinated loan with Banco de Desarrollo Rural, S.A. (Banrural). We leveraged Banrural's extensive, local outreach to target and adapt products and services to finance traditionally underserved micro, small and medium enterprises (MSMEs) in Guatemala. The IDB's support increased Banrural's MSME portfolio from US\$428 million (270,000 clients) to US\$691 million (341,800 clients) from 2007 to 2010. Its MSME portfolio grew by 61% with a 108% increase in the small enterprise segment.

At the same time, the IDB approved similar financing for BICBANCO in Brazil and G&T Continental in Guatemala, as the IDB's Trade Finance and Facilitation Program (TFFP) realized its potential to increase access to finance for importer and exporter SMEs. The TFFP offered loans, guarantees and trainings to banks in LAC, stimulating SME financing and access to international markets.

The example of Banco Pichincha of Ecuador shows how a bank can respond responsibly to the high demand for credit while diversifying its portfolio and extending maturity. Pichincha received a US\$50 million loan over six years to support financing for housing, small and micro enterprises. Pichincha began to address the challenges of banking the unbanked by developing a centralized system to administer credit, creating a downscaling methodology and hiring experts who understood the product needs of smaller borrowers. Now small business loans are 12% of its portfolio.

Another example includes a 2010 loan approval for US\$25 million to Banco Continental, Paraguay, to address SME's growing demand for capital and extended tenors. According to a recent National Industrial Census, 9 out of 10 enterprises are SMEs, generating 80% of total jobs and 60% of Paraguay's GNP. In spite of their significance, SMEs in Paraguay struggle to access credit and reach markets outside national boundaries. Our financing will support Banco Continental to strengthen liquidity, diversify its long-term funding sources and provide its growing segment of SME clients with capital to overcome traditional barriers to market entry.

Who We Are

The IDB's Financial Markets Division of the Structured and Corporate Finance Department (SCF) seeks to foster a sound and stable financial sector in order to promote economic growth and poverty reduction in LAC. To do so, we offer non-sovereign loans, risk mitigation products, resource mobilization and technical assistance to the region's financial intermediaries (FIs).

As part of our strategy, we launched the *beyondBanking* program to leverage our products and services to encourage sustainable environmental, social and governance practices within our FI clients. *beyondBanking* seeks to promote the *Bank of the Future* – a bank business model that recognizes FIs' catalytic role to lead corporate change and foster an inclusive, environmentally-friendly, transparent and commercially-viable financial sector.¹

beyondBanking includes the following six programmatic pillars that approach sustainable banking holistically and together foster the financial inclusion of SMEs:

- *accessBanking*: Promoting financial deepening strategies
- *clearBanking*: Strengthening corporate governance
- *connectBanking*: Utilizing innovative technologies to access financial services
- *equalBanking*: Encouraging gender equality and diversity
- *learnBanking*: Fostering financial education
- *planetBanking*: Mitigating climate change



¹ For more information, visit www.iadb.org/beyondbanking.

The Financial Sector's Catalytic Role

Financing social inclusion starts in LAC's financial sector.

The financial sector is the engine of financial innovation, capital mobilization, global integration and job creation. *beyondBanking* seeks to use the financial sector's influence to further the business case for engaging SMEs. Banks are considered a critical source of finance for SMEs – market players often excluded from or under-served by financial markets. Facilitating SME access signals a unique opportunity for not only SMEs but also banks - as downscaling offers social and financial gains.

The IDB leverages our existing relationship with client banks and financial instrument expertise to reach end-borrowers. Banks are cost-effective channels with outreach along the supply chain and in high-impact productive sectors, such as renewable energy, energy efficiency, agribusiness, housing, education and trade. The financial sector cuts across economies, geographies and cultures, and, for better or worse, its business principles and practices have a ripple effect economy-wide. As key players in allocating capital, promoting competition, influencing corporate culture and stimulating economic development, responsible bank lending is positively correlated with credit, liquidity and economic growth.

Banks' policy leadership, through participation in voluntary standards, such as the Millennium Development Goals, Global Compact and UN Principles of Responsible Investment, indicates that banks recognize the long-term market incentives, portfolio diversification, risk mitigation, revenue growth and reputational advantages that exist by committing to financial inclusion and sustainability. The IDB's *beyondBanking* program is positioned to help them realize their full potential.

SMEs' Added Value

SMEs play a significant role in economic development, job creation, innovation and competitiveness. The IDB

recognizes that SMEs are vital in the economic supply chain, accounting for 60-75% of employment and 20-35% of GDP in LAC.² Yet unmet demand hinders performance, and the IDB seeks to address access to credit and non-credit financial products – key barriers to SME growth. The LAC SME gap in credit finance for formal SMEs is an estimated US\$125 to US\$155 billion, providing ample space for the IDB, along with other multilateral development banks, the public sector, private investors and organizations to boost SME financing.³

² IDB and MIF. 2008. "High Growth Small and Medium Enterprises (HGSMEs) in Latin America Emerging Economies." Document prepared by IDB and MIF for the OECD Kansas City Workshop, May 8.

³ IFC and McKinsey & Company. 2010. "Two Trillion and Counting: Assessing the credit gap for MSMEs in the Developing World." October.

This is especially relevant to the region's "missing middle" - the segment of the population where SME financial requirements are considered too large for microfinance institutions but too small, risky or costly for traditional banking products. Strengthening SME finance, through *beyondBanking's* financing and technical assistance, has the potential to increase sales and assets, human capital, firm efficiency, diversification of goods and services, technology and social and environmental practices. Coupled with additional revenue sources of entering a new market, downscaling strengthens banks' ability to compete in an increasingly competitive financial marketplace.

SCF's Financial Markets Division offers financial intermediaries products and services that support the *beyondBanking* program:

- Long-term senior and subordinated debt
- Partial credit guarantees
- Risk sharing facilities
- *SMEaccess+ lines*: a joint product launched by SCF/FMK and MIF that integrates credit lines, risk sharing facilities, partial credit guarantees and technical assistance, including capacity-building and information management services, into a cutting-edge product that supports a market-wide demonstration effect
- Technical assistance and training
- Knowledge creation



The IDB – A Leader in Long-term Financing

The Inter-American Development Bank (IDB) is an honest, independent broker with global outreach that prioritizes support for transactions with high demonstration effects and the potential for investor mobilization. The IDB is the leading source of multilateral financing for sustainable economic, social and institutional development projects in LAC.

For more information, visit www.iadb.org.