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## Corporate Evaluation

# Evaluation of Direct Support to SMEs by the IIC

IDB Inter-American Development Bank

IIC Inter-American Investment Corporation
A Member of the IDB Group

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# Evaluation of Direct Support To SMEs by the IIC

Office of Evaluation and Oversight (OVE)

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# Acronyms and Abbreviations

| | |
|---|---|
| AEF | Africa Enterprise Fund (IFC) |
| DFI | Development finance institution |
| EBRD | European Bank for Reconstruction and Development |
| FI | Financial intermediary |
| GDP | Gross domestic product |
| GTA | Group technical assistance |
| IDB | Inter-American Development Bank |
| IDBG | Inter-American Development Bank Group |
| IFC | International Finance Corporation |
| IIC | Inter-American Investment Corporation |
| FIs | Financial intermediaries |
| ITA | Individual technical assistance |
| LAC | Latin America and the Caribbean |
| MDB | Multilateral development bank |
| OVE | Office of Evaluation and Oversight |
| SBRL | Small Business Revolving Line |
| SDI | Small Direct Investment Program |
| SEF | Small Enterprise Fund (IFC) |
| SMEs | Small and medium-sized enterprises |
| SPV | Special purpose vehicle |
| SLP | Small Loan Program |
| TA | Technical assistance |
| TASP | Technical Assistance and Strategic Partnerships |

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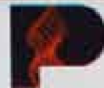

The IIC mainly supported SMEs that had been operating for several years. For FINPYME, the median enterprise age at the time of approval was 15 years, and most companies had been operating between 11 and 29 years. For regular SME operations, the median age was 7 years.

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# Executive Summary

**This evaluation assesses the work of the Inter-American Investment Corporation (IIC) in directly supporting small and medium-sized enterprises (SMEs). The evaluation reviews the origins and evolution of the IIC's direct support[1] to SMEs and assesses the relevance, development results, and financial results of this support. It also reviews the IIC's internal procedures for managing direct support, as well as the experience of other MDBs with direct support to SMEs. The evaluation covers all approved IIC direct lending operations to SMEs from 2006 to 2015 (prior to the merge-out) and disbursed IIC FINPYME technical assistance (TA) operations during the same period.**

The recent IDB Group (IDBG) private sector merge-out has substantially broadened the IIC's activities, extending its role beyond its core mandate of SME support while focusing attention on the question of how best to support SMEs in a context of scarce resources. The IIC is currently developing a strategy to expand its reach to SMEs and increase its impact by seeking ways to efficiently address the barriers that limit their growth. Additionally, the FINPYME Credit program, a streamlined direct financing mechanism for SMEs, expired in May 2016 and was temporarily extended pending completion of this evaluation. This evaluation fills an important information gap for defining the way forward.

## Context of the Evaluation

SMEs accounts for a significant part of GDP and employment in developing countries; however, the contribution to employment growth has been a matter of debate of economic policy and research for decades. While much debated, the predominant view is that certain constraints faced by SMEs are characterized by

market constraints and that government and MDB interventions may in some cases thus be justified and potentially beneficial. SMEs cite many constraints to their growth, with access to finance featuring prominently. Several barriers explain these access to finance constraints in Latin America and the Caribbean (LAC), including the high levels of job informality, low bankability of SMEs, limited competition among financial intermediaries (FIs), and weakness in regulatory environments and financial infrastructure. However, there is considerable disagreement about which types of SMEs should be targeted by SME interventions, and there are few systematic evaluations on the effectiveness of SME interventions.

Most MDB financing for SMEs has been channeled indirectly through FIs, as interventions through FIs reach more SMEs more efficiently, and can also ensure more sustainability in access to finance. MDBs recognize that working with local FIs draws on their comparative advantages: lower processing times and transaction costs, local knowledge and networks, local currency finance, and product cross-selling with the dual advantage of being able to earn income and having better information about the SMEs being supported. In addition, if SME support becomes a profitable business line for the local FI, this can have sustainable, long-term impacts well beyond the life of an individual operation. Technical assistance, guarantees, and corporate value chain operations have been other instruments used by MDBs to support SMEs indirectly.

Other MDBs have focused almost exclusively on providing support to SMEs indirectly though FIs. One of the main reasons is that no MDB has managed to operate the direct SME financing business in a financially self-sustaining manner. IFC, the MDB with by far the most experience in direct SME lending, has migrated to an almost complete reliance on providing financial support to SMEs through FIs, realizing that it cannot reach scale and thus make a systemic difference through direct SME financing.

## Evolution of Direct SME Support in IIC

IIC is the only MDB with an explicit mandate to support SMEs, and it has provided such support both directly and indirectly via financial intermediaries. The 1984 IIC Charter lays out a preference for the IIC to support SMEs, but does not include an explicit mandate for the form of such support. Nevertheless, the IIC's Board of Executive Directors and IIC Management subsequently interpreted the IIC's role as including direct SME support. The gradual increase in the FI sector limit stems from the realization that direct SME support needs to be balanced with operations offering lower risk and operational cost compared to the revenue earned.

Recognizing the advantages of FI operations, IIC nonetheless has continued to work directly with SMEs, citing the absence of longer-term financing and the high developmental impact of these operations. IIC has recognized that direct SME

support on its own is not financially sustainable and that it requires cross-subsidies from revenue sources from other business activities, a leaner organization, more local presence, and faster processing times. Additionally, while representing a limited volume of approvals, direct support allows IIC to operate in those member countries where opportunities for larger operations are limited.

The IIC approved a total of 177 direct SME lending operations from 2006 to 2015, amounting to a total of about US$219 million. This represents 37% of all lending operations and 6% of the total lending amount approved by IIC during the period. Of these direct SME lending operations, 112 (for US$29 million) were operations under the FINPYME Credit program, and 65 (for US$190 million) were regular direct SME lending operations. The average operation size was about US$261,000 for FINPYME Credit and US$2.9 million for regular SME operations. Amounts approved for SME financing via FIs have greatly exceeded those for SME direct lending operations. In terms of number operations approved, IIC approved more direct SME operations than SME on-lending operations (via FIs) in 2008 and all years from 2011 on. In addition to lending, the numbers and disbursed amounts of SME TAs have increased dramatically since the establishment of a dedicated TA business support area. OVE estimates that the IIC disbursed a total of 2,520 TAs under the FINPYME umbrella between 2006 and 2015, amounting to US$10.3 million.

## Patterns of Direct SME Support

There is little evidence that IIC's direct SME lending has been guided by a coherent and comprehensive SME strategy. IIC's local presence in certain C&D countries, coupled with active direct SME lending (particularly through the FINPYME Credit program), has contributed to increasing approvals in those C&D countries. C&D countries accounted for 81% of the number of total SME lending approvals during 2006-2015, and A&B countries for 19%.[2] However, there was a different distribution by volume – 50% each for C&D and A&B countries, reflecting the fact that FINPYME transactions were significantly smaller than regular SME operations. In total, IIC supported 19 countries through direct SME lending.[3] From 2006 to 2015, IIC supported SMEs in 20 sectors, ranging from oil, gas, and mining to services and education. For FINPYME Credit, the main criterion to select SMEs has been whether the company complied with the pre-established financial ratios and other business criteria, but there has been no clear strategy or guidance in terms of priority sectors or types of SMEs to be supported.

Through direct lending operations the IIC reached 120 SMEs[4] in LAC from 2006 to 2015, indicating the limited capacity of this approach to reach scale and have a systemic impact. FINPYME TAs were disbursed in all 26 IIC borrowing countries, benefiting approximately 7,200 enterprises.[5] Most TAs (98%) were not linked to loan operations, and SME advisory services have not been managed as a critical dimension of IIC's SME business.

The IIC mainly supported SMEs that had been operating for several years. For FINPYME, the median enterprise age at the time of approval was 15 years, and most companies had been operating between 11 and 29 years. For regular SME operations, the median age was 7 years; however, this is partly because some clients (18%) were newly-established Special Purpose Vehicles, and it is questionable whether such clients should be classified as SMEs. Additionally, 70% of clients in regular SME operations were owned by a larger firm or group. For enterprises with FINPYME Credit, the median number of employees at the time of approval was 40 and the median sales US$1.7 million. For regular SME operations, the median number of employees was 54 and the median sales US$4.9 million. The financing has largely supported capital investment (81%), which has been identified as an important constraint in LAC. However, the IIC provided mostly loans denominated in US dollars, which in some countries has been identified by companies and investment officers as a disadvantage compared to local FIs. All senior IIC SME loans were secured with collateral. IIC also tried to offer collateral-free subordinated loans under the FINPYME Credit program, but this resulted in negative financial performance. FINPYME Credit operations had a median tenor of 60 months (5 years) and a fixed interest rate of 7.6%. SME regular operations had a median tenor of 82 months (almost 7 years), and most of the projects had a variable interest rate with a median spread of 4.9%.

## Operational Procedures

IIC did recognize the need for more efficient and standardized procedures for lending to SMEs, though these procedures applied only to FINPYME Credit and not to other SME direct lending. FINPYME Credit applied specific and standardized criteria for its investments, and was more successful in applying financial standards than other MDB SME finance programs reviewed in the context of this evaluation. The program also incorporated some best practices identified in other MDB SME programs: staff exclusively committed to the program, local processing, and central control and management to ensure quality control and consistency. Regular SME operations have not been managed as part of a coherent program and have followed the same procedures and documentation requirements as larger corporate operations. TA programs have not had procedures and systems to effectively manage the volume of operations, despite their significant growth over time, and significant problems of lack of information and tracking remain.

Regular SME operations have not been processed faster than other corporate operations, and processing times have been high in comparison to commercial financing standards. In addition, from 2006 to 2015, 20.5% of approved FINPYME Credit operations were cancelled or dropped before disbursement, a higher rate than those for other SME loans (13.8%) and large corporate loans (13.5%). The principal reason for cancelling FINPYME loans (56%) was issues arising with client guarantees discovered during the legal due diligence process following loan approval. In another 33% of cases, the client preferred an alternative financing mechanism or obtained local financing.

## Financial Additionality and Results

Operational documents provide little information on IIC's financial additionality, as IIC rarely documented the prior credit conditions of its SME clients (e.g. tenor, interest rate, collateral). The results of the client survey suggest that almost all SMEs (84%) had access to credit before the IIC, mostly from commercial banks. The terms of those previous loans varied by type of client. For FINPYME clients the median tenor of previous loans was 60 months (the same median tenor as FINPYME loans), and the tenors for most loans ranged from 45 to 75 months. For regular SME clients, the median tenor of previous loans was 72 months (about a year shorter than the median tenor of regular IIC SME loans), and the prior tenors typically ranged from 14 to 135 months. For those clients with previous access to credit, the IIC provided longer tenors than alternative sources of financing for 36% of FINPYME Credit and 50% of regular SME clients. The fact that most non-FINPYME SMEs (70%) were owned by another firm or group that usually guaranteed the loans also calls into question the financial additionality of these operations. While most clients surveyed (68%) reported that the IIC loan helped them access new sources of credit, most of them reported similar credit conditions before and after IIC's support.

One reason often given for working directly with SMEs is the high developmental impact of these operations, but in practice IIC has focused little on either selecting SMEs for maximum development impact or tracking development outcomes. Most operations aimed to increase sales, production, and employment, but operations rarely explicitly included specific indicators to measure progress toward these objectives. IIC supervision reports focused almost exclusively on clients' financial performance. OVE built a database for basic business performance indicators (sales and employment) from different sources. A little more than half of FINPYME Credit clients (54%) increased annual sales, but OVE found limited information to assess increases in employment. Most non-FINPYME SME clients increased both sales and employment (81% and 84%, respectively). However, these results cannot necessarily be attributed to IIC support.

Given the almost total absence of clear objectives and monitoring and evaluation systems, it is not possible for IIC to know whether the objectives it intended to achieve through the TA strategic programs were met. No strategic program has established results frameworks or defined outcome indicators to measuring the effectiveness of TA. Monitoring activities are almost exclusively limited to disbursements, and reporting is not consistent among programs. Only two strategic programs have done more systematic monitoring and evaluation (GREENPYME and Mujer Empresaria). In general, management of the knowledge generated through TA programs has been weak.

The financial cost of FINPYME Credit has been comparatively higher than that of other IIC products, reflecting the higher risk of these small operations. From 2006 to 2015 the average loan loss provision (as a percentage of the amount of

The financial cost of FINPYME Credit has been comparatively higher than that of other IIC products, reflecting the higher risk of these small operations.

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outstanding loans) for FINPYME Credit operations was 12.3% and for other SME operations 8.5%. In contrast, the average loan loss provision for corporate operations was 6% and for FIs 2.8%. FINPYME Credit program doubled its total provisions since 2012 because of worse risk ratings. In addition, write-offs of FINPYME Credit operations have been higher than those of other IIC products, and they increased significantly in 2014 and 2015, partly because of the negative financial performance of the subordinated loans introduced in 2013. While the net financial margins were positive during the evaluation period, OVE's profitability analysis indicates that neither FINPYME Credit nor regular SME support are financially sustainable, with estimated annual losses of about US$0.8 and US$3.6 million, respectively, after accounting for operating and overhead costs.

## Recommendations

Based on the findings of this evaluation, OVE has three recommendations for IIC management.

1. Do not continue providing direct loans to SMEs. The findings of this evaluation regarding development effectiveness, IIC additionality, and IIC financial performance do not provide support for a continuation of IIC's direct SME lending (whether FINPYME Credit or regular SME lending). Financial

institutions and other intermediaries have clear comparative advantages in reaching a larger number of SMEs more efficiently and in ensuring more sustainable support. Therefore, if IIC identifies markets or segments with important financing gaps, supporting SMEs only indirectly through intermediaries is justified on grounds of both efficiency and effectiveness.

**2.** Coordinate with IDB to identify the most effective ways for the IDB Group to support SMEs, both in the aggregate (in an IIC SME strategy that is coordinated across the IDB Group) and at the industry, regional, country, and/or local level. This should include analysis of key barriers and related market failures limiting the growth of SMEs, and identification of the IDBG instruments best suited to address these barriers. IIC support (provided indirectly as noted in recommendation 1) should be used to address only those barriers for which IIC has a comparative advantage. The justification for IIC engagement should be clearly articulated and the results of such engagement regularly monitored and reported.

**3.** Reorient SME TA programs to address the key constraints limiting the growth of SMEs, and improve SME TA management. TA should be a key element in the new SME strategy, with a more strategic approach that focuses on addressing key barriers limiting the growth of SMEs, in line with recommendation 2. Types of TA should be delineated, with clear objectives and a results framework for each SME TA program. Procedures and systems should be put in place to consistently track and report on SME TA activities.

[1] Direct support means that the IIC's direct client is an SME, as opposed to an intermediary (such as a financial institution, a fund, or a larger corporation) through which SMEs would be reached.

[2] FINPYME Credit operated only in C&D countries, and four countries represented 70% of the number of operations: Nicaragua (24%), Bolivia (19%), Paraguay (15%), and Uruguay (12%). In contrast, regular SME operations were not restricted in terms of country groups. A&B countries accounted for 52% of regular SME operations, and C&D for 48%. Peru (14%), Costa Rica (12%), and Colombia (11%) registered the highest number of approved operations.

[3] Countries without direct loans: Barbados, Dominican Republic, Guyana, Panama, Suriname, Trinidad and Tobago, Venezuela.

[4] This includes only disbursed SME operations, and excludes double-counting of repeated clients, either of renewed or multiple operations.

[5] As the same company could benefit from several TAs, this number is likely to contain considerable double-counting of unique beneficiaries. IIC did not consistently track beneficiaries.

In Latin America and the Caribbean, there are approximately 15 million of SMEs, and the median employment share of SMEs is around 65%.
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# 1 Context of the Evaluation

**This evaluation reviews the work of the Inter-American Investment Corporation (IIC) in directly supporting small and medium-sized enterprises (SMEs) between 2006 and 2015 (prior to the merge-out). Direct support means that the IIC's direct client is an SME, as opposed to an intermediary (such as a financial institution, a fund, or a larger corporation) through which SMEs would be reached. Direct support encompasses lending and technical assistance (TA) activities. This evaluation was included in OVE's 2016-17 work program (RE-492-1) at the request of the Board of Executive Directors of the IIC.**

## A. Rationale

The IIC is unique among multilateral development banks (MDBs) in its explicit mandate to support SMEs.[1] The 1984 Agreement Establishing the Inter-American Investment Corporation (widely referred to as the "IIC Charter") lays out a preference for the IIC to support SMEs. However, the Charter does not specify the form of such support (e.g., direct vs. indirect), and throughout its history the IIC has provided such support both directly (i.e., the IIC's direct client is an SME) and indirectly (via financial institutions, funds, or other entities).

The recent IDB Group (IDBG) private sector merge-out has substantially broadened the IIC's activities, extending its role beyond its core mandate of SME support while focusing attention on the question of how best to support SMEs in a context of scarce resources. The IIC is currently developing a strategy to expand its reach to SMEs and increase its impact by seeking ways to efficiently address the barriers that limit their growth. Additionally, the FINPYME Credit program, a streamlined direct financing mechanism for SMEs, expired in May 2016 and was temporarily extended pending completion of this evaluation (CII/DE-11/16).

In this context, this evaluation fills an important information gap for defining the way forward. The FINPYME Credit program and direct SME support in general have never been systematically evaluated.[2] In 2016, OVE conducted a comprehensive evaluation of the work of the IDBG through financial intermediaries (FIs). This evaluation complements the FI evaluation by assessing the IIC's experience with direct support to SMEs.

## B. Why support SMEs?

SMEs account for a significant part of GDP and employment in developing countries. Global estimates indicate that formal and informal[3] SMEs account for at least 60% of GDP. In low-income and lower-middle-income countries, SMEs contribute 61.5% and 68.5% of GDP respectively. SMEs account for more than half of all formal employment worldwide.[4] In developing countries SMEs are responsible for up to 67% of formal employment. In Latin America and the Caribbean (LAC), there are approximately 15 million of SMEs, and the median employment share of SMEs is around 65%.[5]

The prevailing view suggests that SMEs have a significant role in gross job creation, whereas the impact net of job destruction by SMEs is less clear.[6] While some studies argue that SME job creation tends to outweigh SME job destruction and that net job creation is higher in SMEs than in large firms,[7] other estimates suggest that SMEs' employment generation is no different than that of larger firms when survival rates are taken into account.[8] Results suggest that certain young and small enterprises contribute the most to employment growth.[9] However, most small enterprises do not grow but serve mainly to provide subsistence income for the owner and their family.[10]

SMEs have lower productivity and productivity growth than large firms. which explains why SME job creation does not necessarily translate into faster economic growth in developing countries. Larger enterprises are more productive, benefit from economies of scale, invest in more capital and skilled labor, and are more likely to develop new products.[11] On average, SMEs also tend to offer lower wages, job quality, and security than larger enterprises.[12]

SMEs cite many constraints to their growth, with access to finance featuring prominently.[13] In World Bank Group enterprise surveys, problems related to the business and regulatory environment typically emerge as the principal constraint for SMEs.[14] Infrastructure, including access to electricity and transport, comes second, whereas access to finance ranks third overall. Access to credit seems to be particularly problematic for the smallest and youngest SMEs in developing countries (which, in turn, could offer the most growth potential); 54.6% of them report being credit-constrained, as opposed to less than a quarter (24.6%) of larger and older SMEs.[15] In LAC, about 30% of SMEs rate access to finance as the foremost constraint to growth (Box 1.1). Depending on which type of SME is targeted, improving access to finance, therefore, may or may not ease a truly binding constraint.

**Box 1.1. Access to Finance in LAC**

Smaller firms have about half as much access to finance as large firms. There are approximately 2-2.5 million unserved SMEs in LAC, with a credit gap of US$125-US$155 billion. Less than 40% of smaller firms report having access to credit, compared to 76% of large firms. Similarly, only 21% of smaller firms turned to banks for investments, and they fund only a small portion (12%) of their investments with credit – about half the rate of larger firms.

SMEs face not only tighter access restrictions, but also worse credit terms. A significant gap remains between the interest rates charged to LAC's SMEs and large companies: the gap is above 10% in Colombia and Peru and 4-5% in Mexico, Bolivia, and Guatemala, far exceeding the 1%-1½% gap in developed countries. Availability is often limited to short-term working capital, rather than long-term funding. Collateral requirements are also more stringent for SMEs. Most LAC business loans (72%) require the pledging of collateral. While the average loan-to-collateral-value ratio for SMEs is 49%, large companies are on average granted 62% of the value of the pledged collateral.

*Source:* OVE 2016; World Bank Enterprise Surveys.

Several barriers constrain SMEs' access to finance in LAC.[16] About 30% of LAC jobs are in the informal sector and another 10% are provided by formal firms but on an informal basis, making it difficult to use firms' own information for credit analysis. Small companies also often lack formal accounting and financial sophistication, and they have volatile earnings and higher mortality rates.[17] On the other hand, competition among FIs has been limited,[18] leading to higher interest rates and limiting SMEs' ability to benefit from LAC's overall credit expansion.[19] In its recent evaluation of IDBG support to SMEs through FIs, OVE found that liquidity has not been an important constraint. Liquidity has grown steadily in LAC, particularly in terms of deposits, which are now on par with developed markets. However, this liquidity growth has only been partly reflected in private sector credit, as government borrowing has also increased, including from FIs. Finally, though LAC countries have made substantial progress in financial reform in recent years, weaknesses in regulatory environments and financial infrastructure continue to have a disproportionate effect on smaller borrowers.[20]

While much debated,[21] the predominant view within the development finance community is that certain constraints faced by SMEs result from market failures,[22] and that government or MDB intervention may in some cases thus be justified and potentially beneficial.[23] MDBs' public sector arms focus most often on strengthening the enabling environment for access to finance,[24] with their private sector arms usually providing financing and/or technical assistance to SMEs or financial institutions (or, less frequently, to institutions that oversee aspects of the enabling environment).[25]

Most MDB financing for SMEs has been channeled indirectly through FIs, as interventions through FIs reach more SMEs more efficiently, and can also ensure more sustainability in access to finance. MDBs recognize that working with local FIs draws on their comparative advantages: lower processing times and transaction costs, local knowledge and networks, local currency finance, and product cross-selling (i.e. offering other products, like savings and checking accounts, foreign exchange transactions, and letters of credit) with the dual advantage of being able to earn income and having better information about the SMEs being supported. In addition, if SME support becomes a profitable business line for the local FI, this can have sustainable, long-term impacts well beyond the life of an individual operation. Technical assistance, guarantees, and corporate value chain operations have been other instruments used by MDBs to support SMEs indirectly.

However, there is considerable disagreement about which types of SMEs should be targeted by SME interventions. Many studies argue that mostly young growing enterprises (often referred to as "gazelles") should be targeted given their high potential for employment generation, economic growth and innovation.[26] Others emphasize the importance of also supporting non-growing SMEs, as they provide crucial employment and income in environments where wage employment is not available[27] and since certain support can help smooth income shocks.[28] The target SME market will differ depending on the objectives of SME interventions (economic and employment growth vs. income stabilization).[29] In any event, the jury is still out on the question of whether "gazelles" can effectively be identified ex-ante.

There are few systematic evaluations on the effectiveness of SME interventions, and even less and often mixed evidence on which types of interventions are more effective than others.[30] The results of the few evaluations that do exist often cannot be generalized as they are either context-specific or based on unreliable data.[31] Some evaluations of policies targeting SMEs directly or indirectly in LAC have found positive results. In Mexico, for example, an evaluation of government SME programs found positive effects on intermediate outcomes such as training and technology adoption, although impacts on ultimate outcomes such as employment and productivity were not clear.[33] In Colombia, an evaluation of financing to SMEs through a second-tier government bank found positive effects on output value, employment, investment, and productivity.[34] A study on Brazilian public programs for SME support found that directing financing to SMEs via banks was the one instrument (among others, including training and measures aimed at innovation and export promotion) with a positive effect on employment and wages.[35] OVE's recent evaluation of IDBG support to SMEs through FIs[36] showed that outcome variables at the SME level were rarely tracked, and in some cases IDBG support did not even lead to a commensurate increase in the size of the FI's SME portfolio.[37]

## C. Evaluation scope and methodology

The objective of the evaluation is to review and assess the IIC's experience with direct support to SMEs.[38] The evaluation reviews the origins and evolution of the IIC's direct support to SMEs and assesses the relevance, development results, and financial results of this support. It also reviews the IIC's internal procedures for managing direct support, as well as the experience of other MDBs with direct support to SMEs. The evaluation address the following key evaluation questions (Box 1.2):

***Box 1.2. Evaluation questions***

- What have been the origins and evolution of direct support to SMEs by IIC? - What has driven IIC direct support to SMEs? How has the direct SME support portfolio evolved over time? How has direct SME support evolved compared to indirect support?
- How relevant has IIC's direct support been? - To what extent has IIC's direct SME support filled a development need not otherwise met? To what extent have products employed by IIC in directly supporting SMEs been adequate for the constraints or needs to be addressed? What can be said about the magnitude and reach of IIC support compared to development needs? What evidence exists about the additionality of IIC's direct support to SMEs? What do we know about access to alternative commercial sources of financing by SME clients?
- What can be said about the development results of IIC's direct support to SMEs? - What information has been collected on development results? What evidence exists on the development results of IIC's direct SME support operations at the firm level? What evidence exists on the role of IIC's TA in delivering development results? What has been the extent of operation cancellations or droppages, and what evidence exists about the reasons for them?
- What can be said about the financial results of IIC's direct support to SMEs? - How financially sustainable have direct SME operations been in terms of revenues and costs to IIC, according to available data? To what extent have IIC's internal processes and operational structure helped and/or hindered development and financial results of direct SME support?
- What has been the experience of other MDBs with direct support to SMEs?
- Are there any implications stemming from this analysis for IIC going forward?

The evaluation covers all approved IIC direct lending operations to SMEs from 2006 to 2015 (prior to the merge-out) and disbursed IIC FINPYME TA operations during the same period. The evaluation portfolio includes all lending operations in which the direct client of the IIC was an SME, regardless of whether these operations were

part of the FINPYME Credit program or not. The portfolio includes only disbursed TA operations, as information was not available on approved ones. The total loan portfolio consisted of 177 operations (112 FINPYME Credit operations and 65 regular SME operations) for a total amount of US$219 million, and approximately 2,500 TAs disbursed under seven programs (for US$10.3 million) identified by OVE through information provided by the IIC.[39]

Choosing a 10-year period allowed OVE to assess a meaningful number of operations and examine their evolution over time. It also allowed OVE to assess FINPYME Credit, the main IIC direct lending program focused on SMEs, beginning with its establishment in 2006. The operational performance (e.g., cancellations, processing times) and financial results (e.g., revenues, written offs) of direct SME support activities were compared to those of other types of IIC operations (e.g., FIs, Large corporate) during the same evaluation period. The evaluation did not consider equity operations because of their low number during the evaluation period.

For purposes of this evaluation, OVE used the SME definition used by the IIC for corporate operations.[40] The IIC's SME size criteria (Table 1.1) comprise assets, revenues, and number of employees: an enterprise is classified in the corresponding category when its size does not exceed the threshold in at least two of the three applicable parameters.[41]

Table 1.1. IIC's SME definition

| Country | Sector | Employees | | Revenues (in US$) | | Assets (in US$) | |
|---|---|---|---|---|---|---|---|
| | | Small | Medium | Small | Medium | Small | Medium |
| A and B countries | Primary | 200 | 400 | 7,000,000 | 20,000,000 | 7,000,000 | 20,000,000 |
| | Industry | 150 | 350 | | | | |
| | Service | 100 | 300 | | | | |
| C and D countries | Primary | 150 | 250 | 3,000,000 | 10,000,000 | 3,000,000 | 10,000,000 |
| | Industry | 100 | 200 | | | | |
| | Service | 50 | 150 | | | | |

*Source:* IIC's Operating Policy. Updated versions (CII/GP-15-9; CII/GP-15-10).

OVE gathered evidence using a mix of methods.[42] The methods included a portfolio review of operations to gain a cross-cutting view of IIC's work, and document desk reviews of operations complemented by client surveys. The evaluation also used analysis of processes and available financial data of IIC direct SME support activities, including operational revenues and fees, loan loss provisions, and written-off amounts. Additionally, OVE conducted desk reviews of IIC and peer DFI strategy, policy, and guideline documents; relevant OVE or other evaluations; and other applicable reports and publications. These desk reviews were complemented by management and staff interviews, both inside and outside of IIC.

For lending operations, the evaluation conducted desk reviews of representative random samples of operations approved between 2006 and 2015, complemented by a client survey. Since loan characteristics for FINPYME Credit and regular SME operations are different, OVE estimated an appropriate sample size for each group. Using a 90% confidence interval and a 10% error margin, the sample size was 42 for FINPYME Credit and 33 for regular SME operations. The document desk review gathered information regarding: (i) client characteristics (e.g., number of employees, sales); (ii) main loan terms and conditions (e.g., interest rate, tenor, security instruments); (iii) intended use of proceeds; (iv) financial additionality (including the availability and characteristics of commercial financing before the IIC's operation); and (v) loan/development objectives, associated indicators, and results monitoring. The desk review was complemented by online and telephonic client surveys to gather additional information on alternative sources of financing (before and after the IIC loan), associated TA, and achievement of loan objectives.

The absence of information systems or consistent tracking practices made it very difficult to evaluate IIC's TA operations. IIC did not consistently track whether beneficiary enterprises met its SME definition, and all data (e.g., number and executed amount) had to be collected manually by the IIC's TA staff and OVE. Most TA programs did not even collect relevant information on operations, such as operational documents and records of beneficiaries. Given the substantial information gaps, the desk review included only samples of selected FINPYME TA strategic programs (GREENPYME, Mujer Empresaria, and Strategic Planning (ExportPlus))[43] that have information of reasonable quality, including some TA documents (e.g., report of activities, plan of operations) and basic records of beneficiaries. In this context, the samples were illustrative rather than statistically representative. The desk review checked the specific information gathered by these programs and whether activities were executed as expected. The desk review was complemented by client surveys to gather additional information, mostly related to the use of the products and tools supported by the TAs.

2

One of IIC's technical assistance strategic programs is FYNPYME  Mujer Empresaria, launched in 2013 and focusing exclusively on women-owned business.
*© IIC*

# 2 Evolution of Direct SME Support in IIC

## A. Origins of direct SME support by the IIC

**The 1984 IIC Charter lays out a preference for the IIC to support SMEs, but does not include an explicit mandate for the form of such support (e.g., direct vs. indirect). Article I, section 1 of the IIC Charter states: "The purpose of the Corporation shall be to promote the economic development of its regional developing member countries by encouraging the establishment, expansion, and modernization of private enterprises, preferably those that are small and medium-scale, in such a way as to supplement the activities of the Inter-American Development Bank." Article I, section 2 states that the IIC shall assist in the financing of enterprises (preferably SMEs, from section 1) "alone or in association with other lenders or investors," and article III, section 1 authorizes – but does not require – the IIC to "make direct investments, through the granting of loans, and preferably through the subscription and purchase of shares or convertible debt instruments, in enterprises located in regional developing member countries, and make indirect investments in such enterprises through other financial institutions," again not specifying whether the IIC should support SMEs directly or indirectly.**

Nevertheless, the IIC's Board of Executive Directors and IIC Management subsequently interpreted the IIC's role as including direct SME support. The IIC's first operating policy (CII/GN-27-10) from 1989 states, for example, that the IIC

"will preferably undertake operations with small and medium-sized enterprises," and various later reports, business plans, and operating policy updates continued to include direct SME support explicitly as part of the IIC's activities.[44]

The need for supporting SMEs directly was in part driven by sector exposure limits, which restricted the IIC's ability to finance SMEs indirectly via FIs. The sector exposure limit for FIs, initially set at 10% of IIC's net worth or portfolio (same as for all sectors) (CII/GN-27-10), was increased to 30% in 1991 (CII/GP-4-2; CII/GP-6-4) and to 40% in 2000 (CII/GP-6-15). To be able to reach the Nuevo Leon commitment[45] of tripling lending to SMEs via FIs, in 2004 the Board approved a waiver for exceeding the 40% FI sector limit (CII/GP-6-17; CII/GP-6-18). This waiver remained in force until a 2008 update to the IIC's Operating Policy (CII/GP-15-10) increased the FI sector exposure limit to 75%.[46]

The gradual increase in the FI sector limit stems from the realization that direct SME support needs to be balanced with operations offering lower risk and operational cost compared to the revenue earned. Numerous IIC documents and external review reports recognize that direct SME support on its own is not financially sustainable,[47] and that it requires a much leaner organization (CII/GN-180-7), more local presence,[48] and faster processing times (CII/GN-224-21) than are typically possible for an MDB based in Washington, DC. In addition to financial considerations, the IIC has emphasized that many more and smaller SMEs can be supported via FIs than directly by the IIC (CII/GP-6-15; CII/GN2428).

Nevertheless, the IIC continued to work directly with SMEs, citing several reasons. The existence of market failures in SMEs' access to credit in local bank markets, reflecting the absence of longer-term financing at acceptable terms for SME investments and growth, was mentioned by the IIC as a main rationale for the need to finance SMEs directly (CII/GN-189-4; CII/GN-224-2). Other reasons include the high developmental impact of these operations despite their low financial contribution, and the experience and direct insight that feed into IIC's knowledge.[49] Staff also mentioned that direct support to SMEs (both lending/investing and TA), while representing a limited volume of approvals, allowed the IIC to operate in member countries where opportunities for larger operations were limited, and thus additionally helped satisfy certain stakeholder interests.

## B. Lending initiatives

To provide direct financing to SMEs, the IIC recognized the need for more efficient and standardized procedures and created special programs and procedures for these loans. In 2002, the IIC developed the Small Loan Program (SLP) for loans ranging from US$150,000 to US$1.5 million and launched it in only a few countries.[50] The SLP introduced simplified and shortened processing and approval procedures, and was intended to operate through local third-party agents. However, the SLP lasted

only two years, as the fee offered and interest income participation structure failed to generate enough interest from qualified agents, and certain requirements (e.g., the need for audited financial statements) and terms were misaligned with SMEs' capabilities and needs.

In 2006, the IIC introduced a new SME financing initiative to offer senior loans, the Small Business Revolving Line (SBRL) (CII/GN-224-2), rebranded in 2010 as FINPYME Credit. Given the IIC's limited balance sheet and operational capacity, the program covered only selected countries[51] and had narrow size and other terms and eligibility requirements (Table 2.1). In contrast to the SLP, the SBRL was administered by IIC staff based in the region and did not require audited financial statements,[52] and it also relied on a faster and more efficient approval process.[53] In 2010, the SBRL program was rebranded under the FINPYME umbrella as FINPYME Credit (CII/GN-224-14). In 2013, IIC introduced subordinated loans under FINPYME Credit (called FINPYME Credit Plus) that did not require collateral, but charged a higher interest rate to cover the increased risk.[54] In addition to FINPYME Credit, in 2013 the IIC also introduced streamlined internal approval processes for other SME loans not exceeding US$3.9 million ("SME Direct").[55]

Table 2.1. Main Terms and eligibility requirements – FINPYME Credit (formerly called SBRL)

| | |
|---|---|
| **Cumulative program amount** | Up to US$12 million (later increased to US$19 million, then US$23 million; see CII/GN-224-8/10); |
| **Eligible countries** | Group I was initially composed of Costa Rica, Honduras, Nicaragua, Paraguay, and Uruguay (later, Bolivia, El Salvador, and Guatemala were added); see CII/GN-224-8 and CII/GN-224-10. Group II[56] comprised Bahamas, Barbados, Dominican Republic, Guyana, Haiti, Jamaica, Suriname, and Trinidad and Tobago (later, Belize was added); see CII/GN-224-10. |
| **Limit per eligible country** | Up to US$2 million/country for Group I and up to US$2 million for all countries in Group II combined (later increased to US$5 million, then US$7 million, see CII/GN-224-8/10) |
| **Amount per loan** | From US$100,000 to $600,000 |
| **Repayment term** | Senior Loan: Minimum of three, maximum of five years (later increased to 10 years; see Resolution CII/DE-30/07). Subordinated Loans: three to seven years. |
| **Interest rate** | Fixed rates, based on the risk of the operation and market conditions. |
| **Security** | Senior Loans: minimum of 100% matching collateral coverage and personal guarantees from all owners. Subordinated Loans: require personal guarantees from the owner and/or main shareholder (but no collateral) |
| **Main Borrower Criteria** | SME must have been in existence for at least three years, with sales not exceeding US$6 million, and meet certain financial health indicator thresholds. |

The IIC approved a total of 177 direct SME lending operations between 2006 and 2015, amounting to US$219 million. This represents 37% of all lending operations and 6% of the total lending amount approved by IIC during the period. Of these

direct SME lending operations, 112 (for US$29 million) were operations under the FINPYME Credit program, and 65 (for US$190 million) were regular direct SME lending operations (Figures 2.1 and 2.2). The average operation size was about US$261,000 for FINPYME Credit and US$2.9 million for regular SME operations.

**FIGURE 2.1**

**Number of approved operations: FINPYME Credit vs. regular SMEs (2006-2015)**

*Source:* IDEAS, OVE analysis

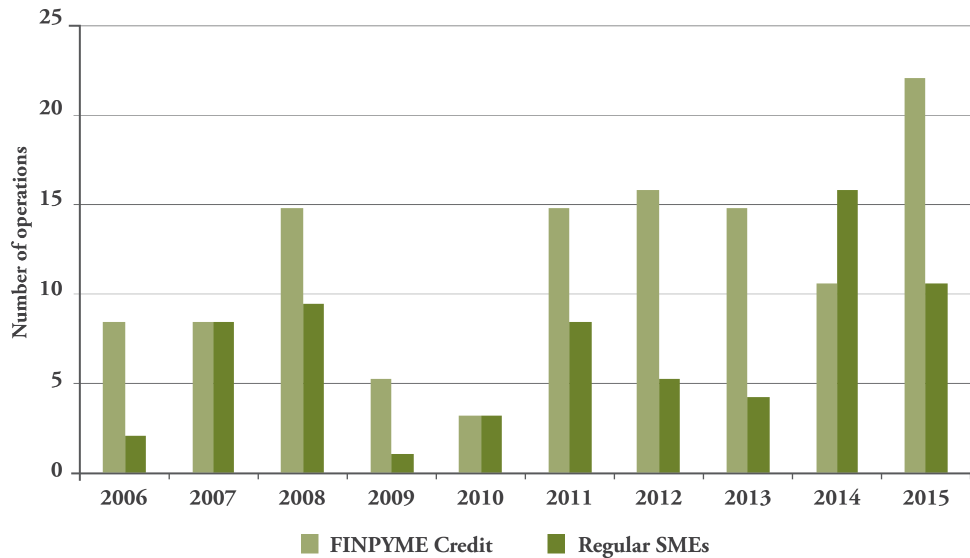
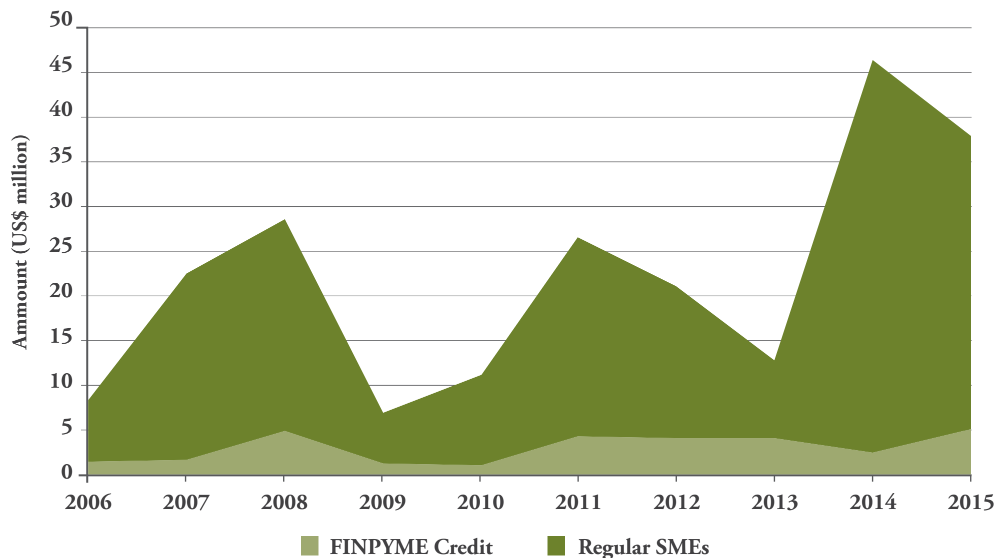



**FIGURE 2.2**

**Amount of approved operations: FINPYME Credit vs. regular SMEs (2006-2015)**

*Source:* IDEAS, OVE analysis




Amounts approved for SME financing via FIs[57] have greatly exceeded those for SME direct lending operations. In terms of number operations approved, IIC approved more direct SME operations than SME on-lending operations (via FIs) in 2008 and all years from 2011 on (Figures 2.3 and 2.4).

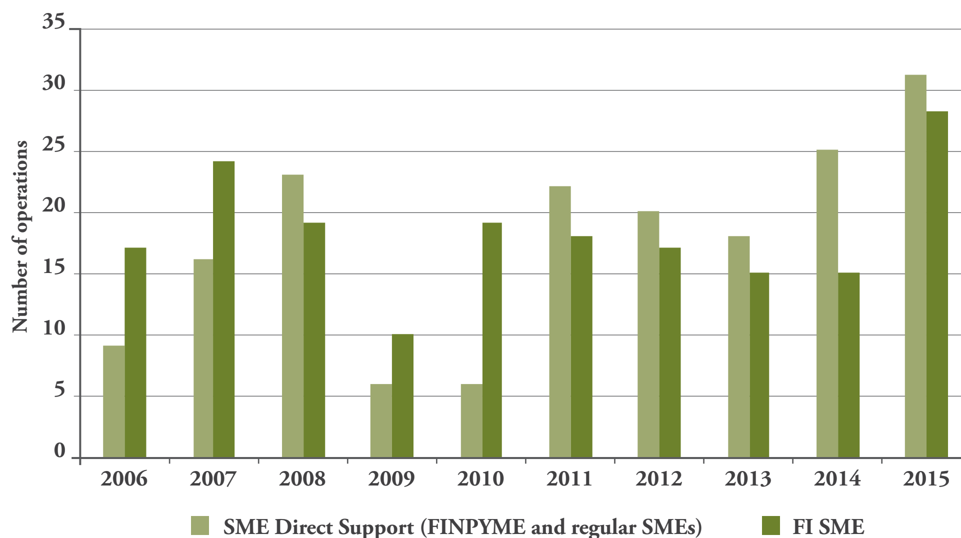



**Figure 2.3**

**Number of approved operations: SME Direct Support vs. FI SME (2006-2015)**

*Source:* IDEAS, OVE analysis

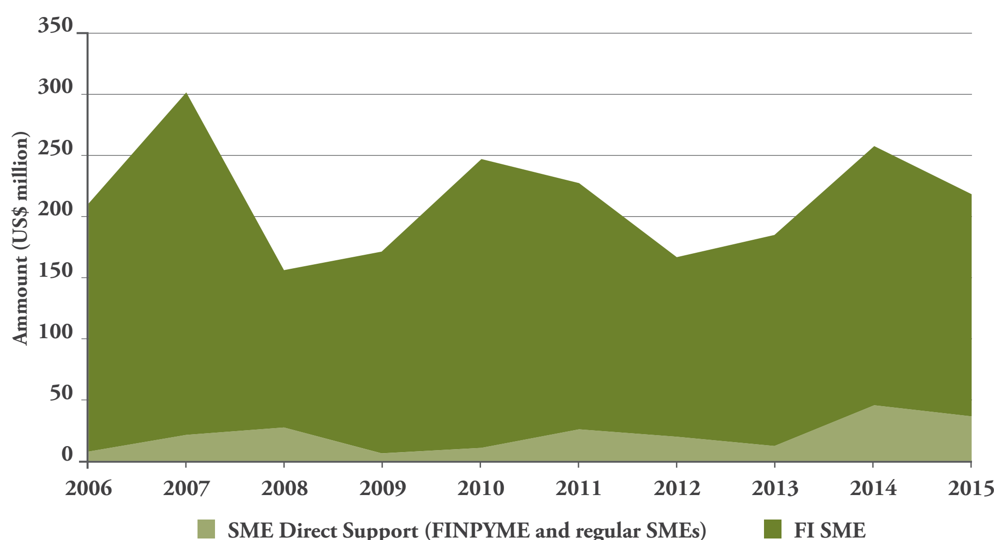



**Figure 2.4**

**Amount of approved operations: SME Direct Support vs. FI SME (2006-2015)**

*Source:* IDEAS, OVE analysis

## C. Technical assistance strategic programs

The first dedicated SME TA program was FINPYME Diagnostics. The program, created in 2000 with funding from Spain, consisted of a competitiveness assessment for SMEs,[58] and it was piloted in Bolivia and Chile before being expanded to other countries in 2007.[59] Additionally, the IIC provided direct TA, mostly on a case-by-case basis and supported by several trust funds, to companies being considered for IIC lending and investing (CII/GN-238). In 2005/2006, with the establishment of the US$40 million Korea-IIC SME Development Trust Fund, the IIC started to design specific long-term strategic programs to provide TA. Among those programs were FINPYME Diagnostics, Renewable Energy and Energy Efficiency, Transfer of Technology and Know-How for Private Sector Development, Promotion of

Good and Sound Practices for Governance of Family Owned SMEs, and General Consulting Services. In addition to the Korean funding, several other trust funds contributed to financing these strategic programs.[60]

In 2008, the IIC created a dedicated TA business support area called Technical Assistance and Strategic Partnerships (TASP).[61] The creation of TASP was intended to bolster the value-added offered by the IIC, following an OVE recommendation from the Fourth Independent Evaluation Report (CII/RE-7). TASP initially focused on four strategic programs that had been implemented previously,[62] but over time it expanded its programs to seven[63] and in 2010 rebranded all services under the FINPYME name. At the end of 2015 (prior to the merge out), the IIC's TA lines consisted of FINPYME Diagnostics, FINPYME Direct Technical Assistance, FINPYME ExportPlus, FINPYME Family Business, FINPYME Integrity, GREENPYME, and FINPYME Mujer Empresaria (Box 2.1).[64]

***Box 2.1. TA Strategic programs***

**FINPYME Diagnostics (2000).** A two-phase program, starting with an online competitiveness assessment, and then providing individual or group TA to improve identified areas of weakness.

**FINPYME Direct Technical Assistance - DTA (2000).** The program, formerly called Services for SMEs, finances specific consulting services for IIC financing operations (e.g., IIC due diligence costs that would otherwise be paid by the client) in areas such as environmental regulation compliance and financial, technical, and market reviews.

**FINPYME Family Business (2007).** The program, formerly called Promotion of Good and Sound Practices for Governance of Family Owned SMEs, offers individual and group TA for succession planning and operating protocols in family-owned businesses to increase their chances of long-term continuity.

**GREENPYME (2008).** The program, formerly Renewable Energy and Energy Efficiency, offers workshops for SMEs and financial institutions, and simple and detailed energy audits to reduce energy consumption.

**FINPYME ExportPlus (2009).** The program aims at improving SMEs' access to international markets through individual and group TA, specifically for certification, operational, and management processes.

**FINPYME Integrity (2011).** The program offers individual and group TA for improving SMEs' transparency and anticorruption practices.

**FINPYME Mujer Empresaria (2013).** The program is a version of FINPYME Diagnostics focusing exclusively on women-owned business.

Since then, the number and disbursed amounts of SME TAs increased dramatically. OVE estimates that the IIC disbursed a total of 2,520 TAs under the FINPYME umbrella between 2006 and 2015, amounting to a total of US$10.3 million (Figure 2.5). Direct Technical Assistance (37%), GREENPYME (21%), and Export Plus (17%) accounted for the highest disbursed amounts. TA operations include a wide variety of activities. They could take the form of individual TA (ITA, usually directed at individual firms), group TA (GTA, usually meaning a workshop or conference with several participating firms), training TA (usually for consultants), or virtual TA (VTA). Of the 2,520 disbursed operations, 71% were ITA (with a total amount of about US$7.4 million) and 29% were GTA or VTA (amounting to US$2.9 million).[65]

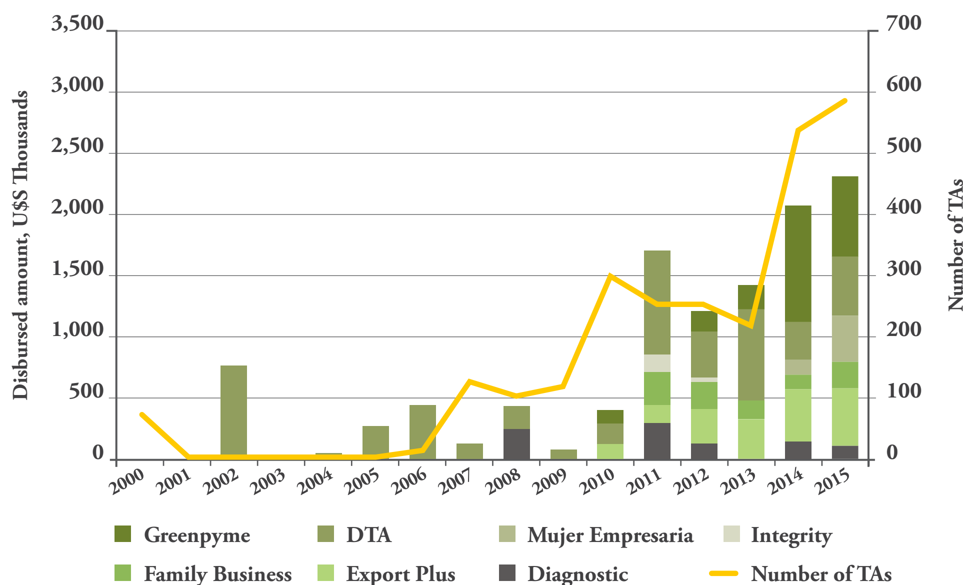



**Figure 2.5**

**Number and disbursed amounts of TAs, 2000-2015**

*Source:* Data provided by IIC staff, OVE analysis.

3

Between 2006 and 2015, IIC supported SMEs in 20 sectors. The three sectors receiving the most support were agricultural products, food and beverage, and distribution, together accounting for 41% of SME approvals.

*© IDB*

# 3 Patterns of Direct SME Support

## A. Magnitude and reach

**The distribution of approved SME lending operations among countries reflects the fact that FINPYME Credit was operating only in selected C&D countries, which had become an important priority for the IIC (Table 3.1). In terms of number of operations, C&D countries accounted for 81% of total SME lending approvals, and A&B countries for 19%. However, there was a different distribution by volume - 50% each for C&D and A&B countries, reflecting the fact that FINPYME transactions had significantly smaller amounts than regular SME operations. In total, IIC supported 19 countries through SME direct lending.[66] For individual countries, Nicaragua accounts for the highest number of approvals (17%), followed by Bolivia (12%), Paraguay (11.8%), Costa Rica (10.2%), and Uruguay (10.2%). In terms of volume, Peru accounts for the highest approved amount (18.9%), followed by Colombia (11.5%) and Costa Rica (10.1%).**

For FINPYME Credit, the country distribution of approved operations is highly correlated with the presence of local investment officers (IOs). FINPYME Credit has four full-time dedicated IOs, located in Nicaragua, Bolivia, Uruguay, and El Salvador.[67] The countries with the highest number of approved operations were Nicaragua (24%), Bolivia (19%), Paraguay (15%), and Uruguay (12%). The relationship between locally based IOs and approved operations is also reflected in the fact that Nicaragua, Bolivia, and Uruguay have already reached the limit of US$2 million per country, and approval for new operations during the last years have depended on the repayment of older operations to free up quota. In contrast, most Caribbean countries (Barbados,

Belize, Dominican Republic, Guyana, Suriname, and Trinidad and Tobago) have not had any FINPYME Credit operations. In fact, Group I (non-Caribbean countries), with a limit of US$2 million approved amount for each of the 8 eligible countries, had 100 approved operations, while Group II, with a US$7 million limit for the entire group, had only 12 approved operations for US$3.4 million.

Table 3.1. Number of SME approved operations, 2006-2015

| Group | Country | SME - Lending Support | | | | Large Corporate |
|---|---|---|---|---|---|---|
| | | SME - Direct Lending | | | FIs - SMEs (*) | |
| | | FINPYME | SME | Total | | |
| A | Argentina | | 6 | **6** | 8 | 16 |
| | Brazil | | 1 | **1** | 18 | 4 |
| | Mexico | | 6 | **6** | 28 | 25 |
| | Venezuela | | | | | |
| B | Chile | | 4 | **4** | 7 | 11 |
| | Colombia | | 7 | **7** | 8 | 9 |
| | Peru | | 9 | **9** | 23 | 10 |
| C | Bahamas | 2 | 1 | **3** | | |
| | Barbados | 10 | | | | |
| | Costa Rica | 4 | 8 | **18** | 13 | 5 |
| | Jamaica | | | **4** | 1 | 6 |
| | Panama (**) | | | | 10 | 2 |
| | Suriname | | | | | 2 |
| | Trinidad and Tobago | | | | 1 | |
| | Uruguay | 13 | 5 | **18** | 4 | 7 |
| D | Belize | | 1 | **1** | | |
| | Bolivia | 21 | | **21** | 3 | 2 |
| | Dominican Republic | | | | 3 | 6 |
| | Ecuador (**) | | 3 | **3** | 12 | 22 |
| | El Salvador | 6 | 2 | **8** | 8 | 6 |
| | Guatemala | 3 | 1 | **4** | 5 | 3 |
| | Guyana | | | | 1 | |
| | Haiti | 6 | 3 | **9** | 1 | 1 |
| | Honduras | 3 | | **3** | 3 | 3 |
| | Nicaragua | 27 | 3 | **30** | 8 | 12 |
| | Paraguay | 17 | 4 | **21** | 13 | 7 |
| **Regional** | Regional | | 1 | 1 | 4 | 4 |
| | **Total** | **112** | **65** | **177** | **182** | **159** |

*Notes:* (*) FI operations whose use of proceeds was SME lending (based on the database gathered by OVE for the FI evaluation and IIC information).
(**) C&D countries not included in the FINPYME Credit Program.

Unlike FINPYME Credit, regular SME operations were not administered as a program, nor did they operate under differentiated approval criteria. The selection of operations was not restricted in terms of countries or groups. A&B countries accounted for 52% of all SME approved operations, and C&D countries for 48%. For individual countries, Peru (14%), Costa Rica (12%), and Colombia (11%) registered the highest

number of approved operations. A&B countries also accounted for a higher percentage by volume, with 57% of total approved amounts, while C&D countries had 41%. Peru (19%) and Colombia (12%) accounted for the highest approved amounts during the period.

The lack of a strategic approach is evidenced in the wide range of sectors and types of SME supported. Between 2006 and 2015, IIC supported SMEs in 20 sectors, ranging from oil, gas, and mining to services and education. The three sectors receiving the most support were agricultural products, food and beverage, and distribution, together accounting for 41% of SME approvals. For FINPYME Credit, the main criterion has been whether the company complied with the pre-established financial ratios and other business criteria,[68] but there has been no clear strategy or guidance in terms of priority sectors or types[69] of SMEs to be supported. In general, there is little evidence that the SME direct support was guided by a coherent and comprehensive SME strategy.

Through direct lending operations the IIC reached 120 SMEs[70] in LAC from 2006 to 2015, indicating the limited capacity of this approach to reach scale and have a systemic impact. In contrast, IIC reached approximately 26,000 SMEs indirectly through its support to FIs.[71]

FINPYME TAs were disbursed in all 26 IIC borrowing countries, benefiting approximately 7,200 enterprises.[72] Colombia accounted for the highest disbursed amount (14%), followed by Bolivia (9%), Peru (8%), and El Salvador (8%). The countries with the highest number of individual TAs were Colombia (16%), El Salvador (15%), Guatemala (9%), and Nicaragua (8%). Guatemala (13%), El Salvador (12%), Jamaica (7%), and Bolivia (6%) received the most group TAs.[73] The most recently approved programs (Integrity and Mujer Empresaria) were more geographically focused, the former providing TA specifically in Barbados, Jamaica, and Trinidad Tobago, and the latter in El Salvador and Peru.

Most TAs were not linked to loan operations, and in general SME advisory services have not been managed as a critical dimension of IIC's SME business. From the portfolio review, OVE found that only 2% of disbursed ITAs between 2006 and 2015 were linked to IIC loans[74]. One of the main reasons reported by IIC staff is that TA strategic program clients have been too small to bring business to the IIC. However, IIC did not consistently track beneficiary characteristics and determine whether enterprises met IIC's SME definition. Most ITAs linked to loans were provided under the Direct Technical Assistance program (86.7%), followed by the Family Business (6.7%) and Export Plus (6.7%) programs. These TAs mostly supported due diligence processes (48%), initiatives to improve business capabilities, including competitiveness (21%), corporate governance (12%) environmental support (12%), and financial and cost analysis (3%). Additionally, 15% of the loan clients surveyed reported having participated in GTAs, mainly related to family business and corporate governance.[75]

## B. Client and loan characteristics[76]

The IIC mainly supported SMEs that had been operating for several years, with a clear contrast between FINPYME Credit and regular SME operations. FINPYME Credit required a minimum of 3 years of operations. The desk review conducted by OVE showed that companies financed by the IIC were typically much older than this minimum: The median enterprise age at the time of approval was 15 years, and most companies had been operating between 11 and 29 years (Table 3.1). For regular SME operations, the median age was 7 years, half the age of FINPYME Credit recipients. However, this is partly because some clients were Special Purpose Vehicles (18% of SME projects reviewed), which at the time of approval had just been established. It is in any event questionable whether such clients should be classified as SMEs. Additionally, 70% of regular SME operations were owned by another firm or group. For FINPYME Credit enterprises, the median number of employees at the time of approval was 40 and the median sales US$1.7 million. For regular SME operations, the median number of employees was 54 and the median sales US$4.9 million (Table 3.1, Figures 3.1. and 3.2.).

Table 3.1. Client characteristics FINPYME Credit vs. Regular SMEs

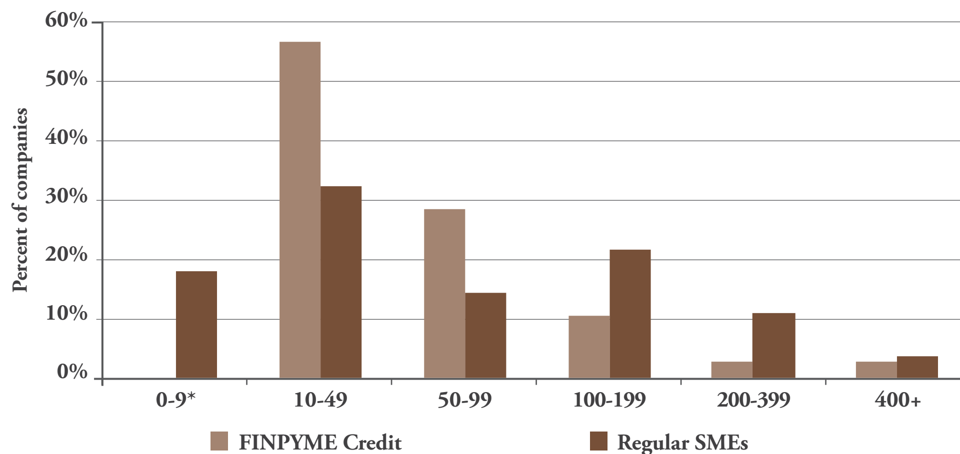
| Variable | FINPYME Credit | | | Regular SMEs | | |
|---|---|---|---|---|---|---|
| | Median | 25th percentile | 75th percentile | Median | 25th percentile | 75th percentile |
| Years of operation at approval | 15 | 11 | 29 | 7 | 1 | 16 |
| Employment at approval | 40 | 20 | 70 | 54 | 15 | 120 |
| Sales at approval (US$ million) | 1.7 | 1.2 | 3.2 | 4.9 | 3.9 | 5.7 |

*Source:* OVE's desk review of IIC loan documents.

Figure 3.1

**Distribution of number of employees at approval (%)**

*Note:* (*) Mainly Special Purpose Vehicles – not micro-enterprises.
*Source:* Desk review of relevant loan documents, OVE analysis.



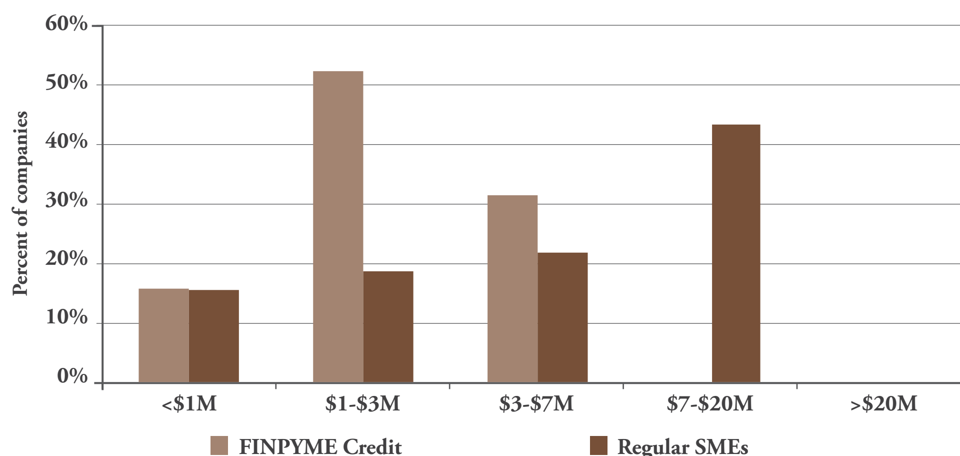



**Figure 3.2**

**Distribution of sales at approval (%)**

*Source:* Desk review of relevant loan documents, OVE analysis.

The IIC provided mostly loans denominated in US dollars. All FINPYME Credit operations were in US dollars. The program guidelines stated a preference for companies engaged in production for export and import substitution (to mitigate currency risk), but in practice the program provided support to many different types of companies that met the financial criteria. A few non-FINPYME SME operations were in local currency (e.g., Mexican pesos). In some countries (e.g., Bolivia and Uruguay) the lack of IIC loans in local currency has been identified by companies and IOs as a disadvantage compared to local FIs.

All senior IIC SME loans were secured with collateral; however, IIC also tried to offer collateral-free subordinated loans under the FINPYME Credit program. Most IIC senior SME loans (90% of the reviewed operations) were also secured with personal and/or fixed assets guarantees. In 2013 IIC decided also to provide subordinated loans that did not require collateral (known as FINPYME Credit Plus). To compensate for the lack of collateral and the subordination of the loans, IIC charged a higher average interest rate of 12%. However, only 6 subordinated loans were approved, and after a while the IIC stopped offering the product. Overall, these operations were not very successful, and the increase in the total written-off amounts of the FINPYME Credit program in 2014 and 2015 is partly explained by the negative financial performance of subordinated loans (see Financial Results section, Chapter V).

Loan conditions varied between FINPYME Credit and regular SME operations. FINPYME Credit operations had a median tenor of 60 months (5 years)[77] and a fixed interest rate of 7.6%. SME regular operations had a median tenor of 82 months (almost 7 years), and most of the projects had a variable interest rate with a median spread of 4.9% (Table 3.2).

Most SMEs used IIC proceeds to finance capital investment, which has been identified as an important constraint in LAC, especially for C&D countries. Of the FINPYME Credit operations reviewed by OVE, 83% involved capital investments,

54% working capital, and 21% debt restructure.[78] Of the regular SME operations reviewed, 87% involved capital investments, 50% working capital, and 50% debt restructure. On average, 81% of IIC's proceeds in SME direct lending operations were assigned to capital investments.

Table 3.2. Loan characteristics FINPYME Credit vs. Regular SMEs

| Variable | FINPYME Credit | | | Regular SMEs | | |
|---|---|---|---|---|---|---|
| | Median | 25th percentile | 75th percentile | Median | 25th percentile | 75th percentile |
| Interest fixed rate * | 7.6 | 7.2 | 8.4 | 7.5 | 7.2 | 7.8 |
| Spread (floating rate) ** | - | - | - | 4.9 | 3.9 | 5.7 |
| Tenor (months) | 60 | 58 | 60 | 82 | 59 | 96 |
| Grace period (months) | 0 | 0 | 6 | 12 | 6 | 24 |

*Notes:* * Only 16% of regular SME operations were structured with a fixed interest rate.
** Spread over the LIBOR rate.
*Source:* OVE's desk review of IIC loan documents.

## C. Operational procedures

Although FINPYME Credit lacked strategic selectivity, it is the only lending initiative that can be judged as a program with specific and differentiated procedures. FINPYME Credit introduced simplified procedures and documentation with the objective of increasing standardization and efficiency for SME lending. The simplified documents included the loan report, additionality questionnaire, risk classification, and a checklist on environmental, labor, and safety aspects. The program also implemented simpler and more standardized legal agreements adapted to local requirements by local law firms. Nearly all the operations were structured with only one disbursement, and for simplicity the fixed interest rate included all fees. The interest rate was updated and communicated to investment officers each month. While the program allowed for a repayment term of up to 10 years, in most countries loan tenors were limited to 5 years, based on considerations of risk and the type of investment financed. Overall, IOs recognize that there was little room for negotiating main loan conditions because of the standardized documents, loan criteria, and procedures established beforehand.

In general, OVE found that the FINPYME Credit program applied specific and standardized criteria for its investments, including application of minimum financial ratios. The criteria for selection of proposals in terms of financial history and ratios and security requirements were clearly defined and appear to have been more consistently applied than those of other MDB SME programs reviewed in the context of this evaluation.[79] FINPYME Credit also incorporated some best

practices identified in other MBD SME programs. Program staff were committed exclusively to the program and stayed with the program for several years, developing growing experience and expertise. The program was implemented by four IOs located in the field. The fact that loan origination and processing were carried out locally facilitated local knowledge, and subsequent supervision. The IOs who originated loans were also responsible for supervising them. Additionally, central management and oversight helped ensure quality control and consistency. Though there does not appear to be a marketing plan as such, marketing efforts were done by team members with local connections in each country.

Non-FINPYME SME loan operations have not been managed as part of a coherent program. Non-FINPYME SME operations represented 37% of all SME direct lending operations and 80% of the total direct SME lending amount approved by IIC between 2005 and 2016. These operations have followed the same procedures and documentation requirements as larger corporate operations. In 2013, the IIC introduced the "SME Direct" initiative for loans not exceeding US$3.9 million. However, it cannot be considered a separate program but is rather a convenient method of dealing with some smaller proposals, including small loans for big companies.[80] It includes streamlined internal IIC approval processes, but follows all the requirements of the Operational Policy and Operational Manual of the IIC and the same process for approval by the Executive Board.

Regular SME operations were not processed faster than other corporate operations, and processing times of SME operations can be considered high in comparison to commercial financing standards. The average number of months from the initial project inquiry to approval was significantly lower for FINPYME Credit operations (4.4 months) than regular SMEs operations (8.2 months) (Figure 3.3). This is not surprising, given the relatively simpler nature of FINPYME Credit operations and the simpler and more standardized procedures and documentation introduced. In fact, non-FINPYME SME operations following normal procedures are not significantly different in terms of approval times (8.2 months) than large corporate operations (9.5 months). Average times between approval and first disbursement did not vary significantly among the various IIC products – FINPYME Credit operations (3.8 months), regular SME loans (4.4 months), and large corporate loans (3.9 months) – which highlights the challenges that arise during the legal due diligence process for FINPYME Credit operations. OVE did not find faster processing times for operations under the "SME Direct" initiative.[81] While most clients surveyed value IIC's client service and professionalism (75%), they thought IIC could improve the approval and disbursement times of operations (20%) and procedures when requesting loans (7%).

FINPYME Credit had the highest rate of cancelled or dropped operations among all IIC loans. Between 2006 and 2015, 20.5% of approved FINPYME Credit operations were cancelled or dropped before disbursement (18.5% of the approved

While most clients surveyed value IIC's client service and professionalism (75%), they thought IIC could improve the approval and disbursement times of operations (20%) and procedures when requesting loans (7%).

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amount), a higher rate than those for other SME loans and large corporate loans (Table 3.3). IIC does not systematically record the reasons for cancelling or dropping operations. OVE's additional consultations with officials who originated operations found that the principal reason for cancelling FINPYME loans (56%) was issues arising with client guarantees discovered during the legal due diligence process following loan approval. In another 33% of cases, the client preferred an alternative financing mechanism or obtained local financing. In addition, OVE's desk review found that 34% of all disbursed SME operations were restructured.[82]

**Figure 3.3**

**Approval and disbursement times by client type (months), 2006-2015**

*Note:* Approval time is from Initial Project Inquiry date to Approval date; Disbursement time is from Approval Date to First Disbursement date. *Source:* IDEAS, OVE analysis.

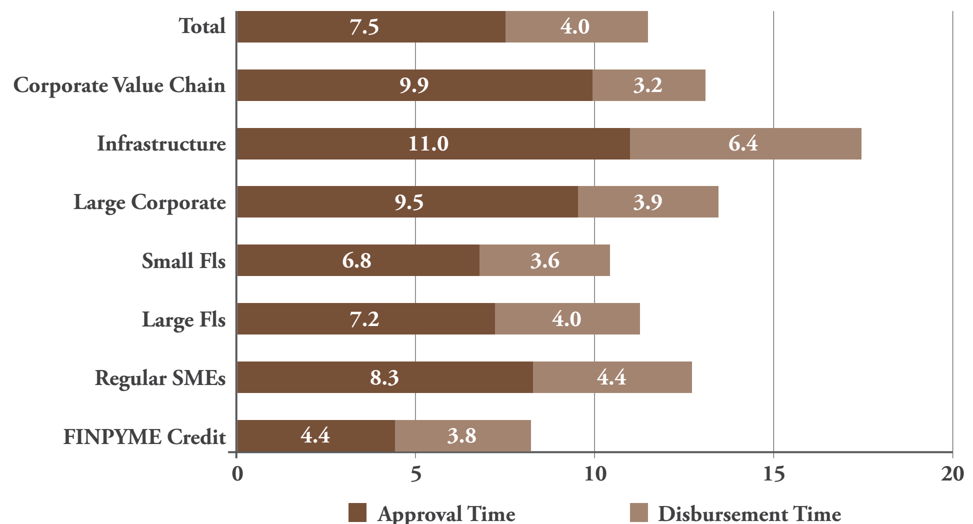

Table 3.3. Cancelled and dropped operations by type of client (2006-2015)

| Type of client | Cancelled and dropped operations (% of number of operations approved) | Cancelled and dropped operations (% of approved amount) |
|---|---|---|
| FINPYME Credit | 20.5 | 18.5 |
| Regular SMEs | 13.8 | 10.6 |
| Large corporate | 13.5 | 15.0 |
| Large FIs | 4.3 | 6.6 |
| Small FIs | 11.9 | 9.4 |
| **Total** | **12.7** | **9.7** |

*Notes:* Large corporate also includes infrastructure loans and corporate value chain operations.
*Source:* IDEAS, OVE analysis.

Despite significant growth over time, TA programs did not have procedures and systems to effectively manage the volume of operations. A TA manual was approved in November 2013, but significant problems remained in terms of lack of information systems or consistent tracking practices. For this evaluation, the numbers, amounts, and types of TAs, as well as other relevant data (including beneficiary types and names) had to be collected manually by the IIC's TA staff and OVE. Since the merge-out, the IIC has developed an Advisory Services manual that establishes a taxonomy and procedures (approval, execution, monitoring and evaluation) for advisory services.

The results of the client survey suggest that almost all SMEs had access to credit before the IIC loan, but the IIC sometimes provided longer tenors than alternative sources of financing.

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# 4 Financial Additionality and Results

## A. Financial additionality

**Operational documents provide little information on financial additionality. OVE's desk review found that 73% of the FINPYME Credit and 81% of the SME projects reviewed had obtained commercial financing before the IIC loan, though the conditions (e.g., tenor, interest rate, collateral) of those previous loans were documented in only 22% of the FINPYME Credit operations and 6% of the regular SME operations reviewed by OVE.**

The results of the client survey suggest that almost all SMEs had access to credit before the IIC loan, but the IIC sometimes provided longer tenors than alternative sources of financing. In the client survey 84% of respondents—78% of FINPYME Credit and 93% of regular SME borrowers—reported having access to credit before the IIC loan, mostly from commercial banks. The terms of those previous loans varied by the type of client. For FINPYME clients the median tenor of previous loans was 60 months, and the tenors ranged from 45 to 75 months. For regular SME operations, the median tenor of previous loans was 72 months, and the tenors ranged from 14 to 135 months (more than 11 years). For those clients with previous access to credit, the IIC provided longer tenors than alternative sources of financing for 36% of FINPYME Credit and 50% of regular SME clients.[83] The wide ranges for regular SME operations and the fact that most of these clients were owned by another firm or group that usually guaranteed the loan calls into question the financial additionality of these operations.

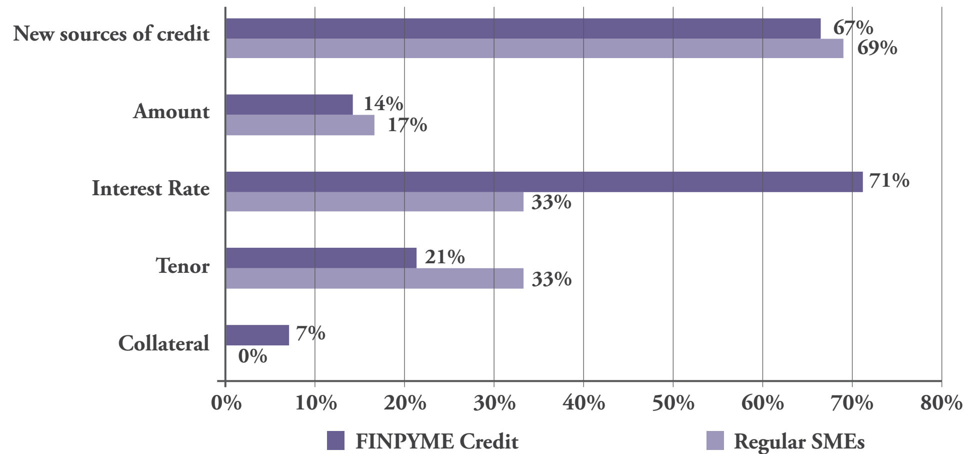
Most clients surveyed reported that the IIC loan helped them access new sources of credit, but most of them reported similar credit conditions before and after IIC's support. While results cannot necessarily be attributed to IIC support, two-thirds of FINPYME Credit clients and 69% of SME clients reported new sources of credit after IIC's support. While 71% of FINPYME Credit clients reported better interest

rate after the IIC loan, most of them reported similar credit conditions as before the IIC engagement in terms of loan amounts, tenor, and collateral requirements. The majority of regular SME clients did not report improvements in loan amounts, tenor, interest rate, or collateral requirements after the IIC credit (Figure 4.1).

**Figure 4.1**

**Improvements in credit conditions after IIC loan (% clients) ***

*Note:* (*) Only includes clients with previous access to credit.
*Source:* Surveys of clients, OVE analysis.




## B. Development results

One reason often given for working directly with SMEs is the high developmental impact of these operations, but in practice IIC has focused little on tracking development outcomes. Almost 80% of regular SME operations and 56% of FINPYME Credit operations reviewed had clearly defined objectives. Most operations aimed to increase sales, production, and employment (Figure 4.2), but operations rarely explicitly included specific indicators (results frameworks) to measure progress toward these objectives. OVE built a database of baselines and targets for basic business performance indicators (sales and employment) from different sources.[84] OVE was able to identify baselines and targets for employment and sales in 86% and 90%, respectively, of FINPYME Credit operations, and in 81% and 93%, respectively, of regular SMEs operations.

IIC supervision reports focused almost exclusively on clients' financial performance. Though IIC did not consistently track and report progress on basic business performance indicators, OVE built a database on performance (monitoring indicators) from different sources.[85] OVE found sales information for most operations reviewed (78% of FINPYME Credit operations and 81% of regular SMEs operations), and employment information for only 25% of FINPYME Credit operations and 63% of regular SME operations.[86] Overall, regular SME clients increased sales more than FINPYME clients (Figure 4.3). A little more than half of FINPYME Credit clients (54%) increased annual sales, but the limited information does not allow to assess increases in employment. Most non-FINPYME SME clients increased both sales and employment (81% and 84%, respectively). However, these results cannot necessarily be attributed to IIC support.

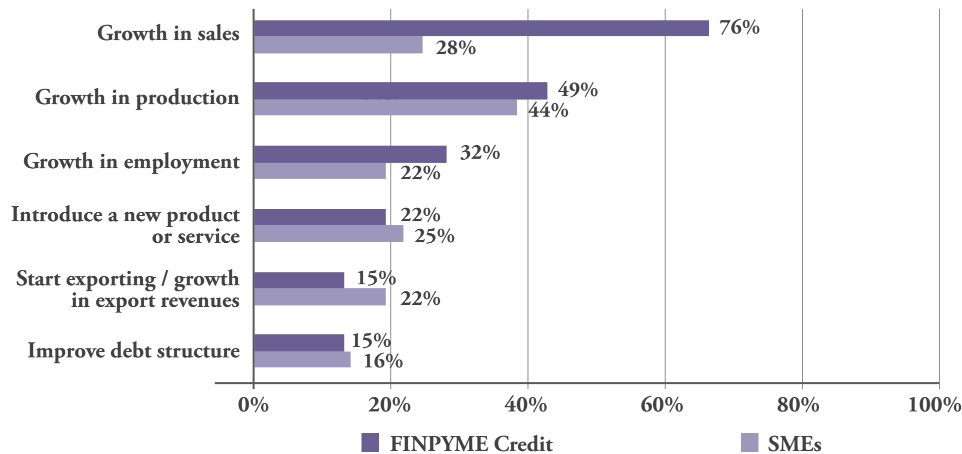



**Figure 4.2**

**Typical objectives for operations (% of operations)***

*Note:* (*) Operations including the objective. An operation may have more than one objective.
*Source:* Desk review of relevant loan documents, OVE analysis.

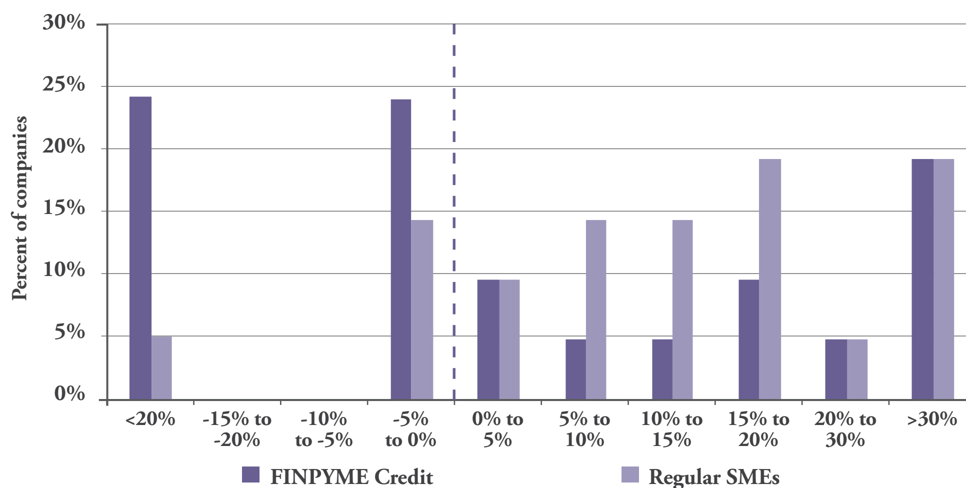



**Figure 4.3**

**Distribution of annual increases in sales (%)**

*Source:* Desk review of relevant loan documents, OVE analysis.

Most clients surveyed by OVE reported having achieved the objectives pursued with the IIC loan. In line with the findings from OVE's desk review, the most common objective clients reported was increasing production and/or sales, and 74% of clients reported having fully achieved this (and an additional 10% having partially achieved it). The few who reported not achieving the objective cited the negative impact of exogenous factors pertaining to the sector or country. A few thought the project needed more structure or more time to see results.

Given the almost total absence of clear objectives and monitoring and evaluation systems, it is not possible for IIC to know whether the objectives it intended to achieve through the TA strategic programs were met. No strategic program has established results frameworks or defined outcome indicators to allow measuring the effectiveness of TA. Monitoring activities are almost exclusively limited to disbursements, and reporting is not consistent among programs. Most reports on TA programs just describe activities and provide testimonials, with little discussion of outputs or outcomes achieved. IIC has not implemented independent evaluations of TA activities or mechanisms to manage the knowledge generated though TA activities.

Two strategic programs have done more systematic monitoring and evaluation. The GREENPYME program has supported 850 energy audits since 2006, although only 25% of the simple audits and 49% of the detailed audits have at least one monitoring report.[87] For those that have a monitoring report, 67% of the beneficiaries reported implementing some of the recommendations provided in the TA. The Mujer Empresaria program supported 100 competitiveness diagnostics of women-owned SMEs, 50 each in Peru and El Salvador.[88] The program had two self-evaluations carried out by the executing agencies of the program. Surveyed companies reported increases in sales, number and diversification of clients, and employment, though these changes were not necessarily attributable to the TA. OVE was not able to validate the results. IIC does not have access to the survey databases and did not independently validate the results of the self-evaluations.

***Box 4.1. OVE survey of selected TA programs***

OVE collected information from 30 TAs, most of them tied to the Export Plus program (40%), Mujer Empresaria (30%), and GREENPYME (30%).

Most surveyed firms reported that they used the products, tools, or techniques provided by the IIC fully or partially, more in GREENPYME (83%) than Export Plus (67%) or Mujer Empresaria (50%). However, implementation was the responsibility of the client in almost all cases.

Most Export Plus clients (82%) reported not having access to finance before receiving the TA, while most Mujer Empresaria (67%) and GREENPYME clients (60%) claimed they had had access to credit. Yet few clients from any program reported improvements in their access to finance, whether sources or conditions. In the case of Export Plus, 55% reported not having more sources of financing, and just one client (9%) reported not only new sources of financing but also better rates and fewer requirements. TA recipients reported that they frequently fund investments with their own resources.

Export Plus recipients reported an increase in the number of clients (91%), sales (82%), and access to new markets (72%). In addition, 72% introduced new products or services, and more than half (55%) claimed that the program helped them increase their export sales.

Almost all firms reported being fully (80%) or partially (15%) satisfied with the TA provided. Some clients (33%) would like to see more clarity with respect to the goals and scope of the TA. Clients also suggested short and medium-term follow-up on implementation (25%). Other suggestions included choosing TA advisors located near the client, and increasing the duration of workshops. Clients highlighted the value of experts' and advisors' knowledge.

*Source:* TA Client Surveys, OVE analysis.

## C. Financial results

IIC's own financial analyses by product suggest that profitability is largely correlated with transaction size. IIC has emphasized that SME direct lending is not self-sustaining and requires revenue sources from other business activities to be viable (IIC/GN-281). IIC performed profitability analyses in 2012 and 2013 for its main products, using revenue projections over the life of a typical investment as well as historical data for funding costs, provisions, and write-offs. Since operating expenses are not tracked separately by product, origination and supervision expenses were derived from surveys in which employees reported the number of hours dedicated to originating and supervising each product. Results were indicative, but they suggested that FINPYME Credit roughly broke even between income and expenses.[89] However, the results should be taken with caution. Revenue projections of approved loans do not consider that an important proportion of operations are cancelled or dropped (20.5%), and operational expenses do not include all indirect administrative costs. Notably, legal fees for FINPYME loans (approximately US$5,000 per operation) have been covered by donor trust funds, without which the program would have incurred losses.

FI and large corporate loans are the most significant sources of revenue for IIC. OVE's analysis found that the contribution to total IIC revenue (before financial costs and operating expenses) of SME operations is approximately 7.4% (FINPYME Credit: 0.8%; regular SMEs operations: 6.6%), while the contribution of large corporate loans is 34% and of FI loans is almost 60%. Although financial margins for FI loans are thinner, the larger total approved amount explains their higher contribution to total IIC revenues.

Regarding financial costs, loan loss provisions are higher for FINPYME Credit operations, reflecting the higher risk of these operations (Box 4.2). OVE's analysis indicates that between 2006 and 2015 the average loan loss provision (as a percentage of the amount of outstanding loans) for FINPYME Credit operations was 12.3% and for other SME operations 8.5%. In contrast, the average loan loss provision for corporate operations was 6% and for FIs 2.8%. Loan loss provisions increased during the global financial crisis but then declined (Figure 4.4), except for the FINPYME Credit program, which has doubled its total provisions since 2012 because it has more operations with worse risk ratings.

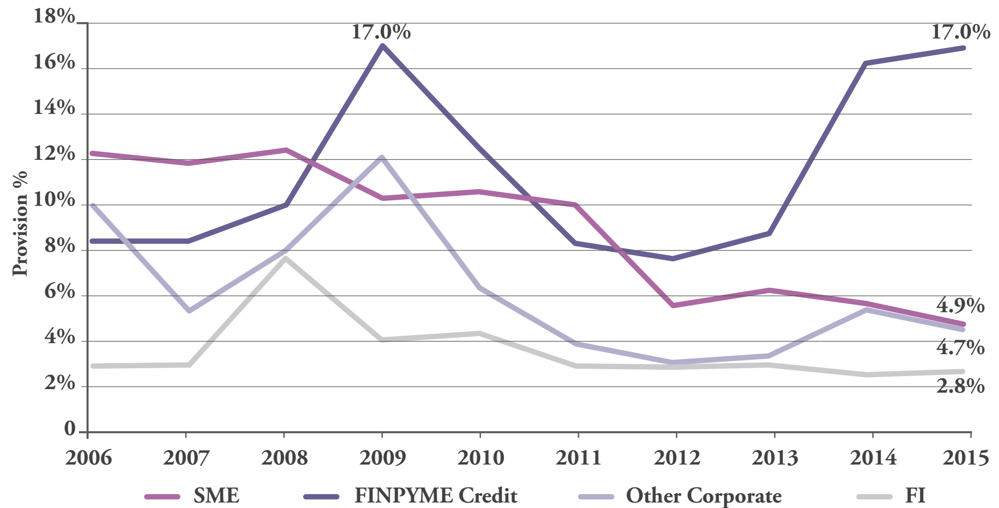
In addition, the number and amount of write-offs of FINPYME Credit operations has been higher than those of other IIC products (Table 4.1), and has increased during recent years. Between 2006 and 2015, more than 30% of closed[90] FINPYME Credit operations were written off. FINPYME's average written-off amount accounted for 4% of its average outstanding portfolio during the period. IIC management reported that the loan principal was later recovered for seven FINPYME Credit operations, approximately 50% of the total amount written-off

(IIC/PP-185). There is no information about recovery costs, but, given the small sizes of the loans (averaging US$260,000), it is likely that they are high compared to the value recovered. Write-offs increased significantly in 2014 and 2015 (Figure 4.5), partly because of the negative financial performance of the subordinated loans introduced in 2013. The rising financial costs of the program (in loan loss provisions and write-offs) calls into question its profitability and financial sustainability.

**FIGURE 4.4**

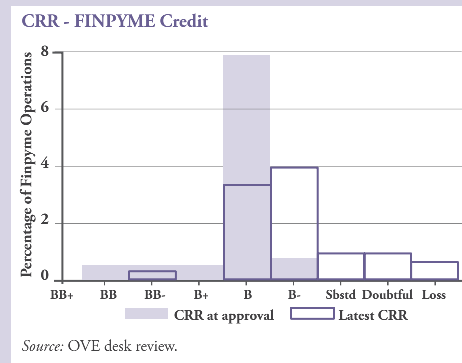
**Evolution of provisions (as % of loan outstanding) by type of client**

*Source:* Loan Provisions Reports, OVE analysis.

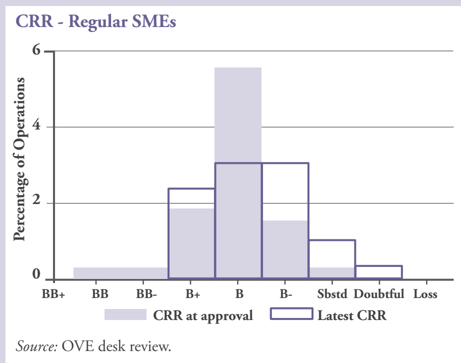



## *Box 4.2. Evolution of Credit Risk Ratings (CRR): FINPYME Credit and Regular SMEs*

OVE's desk review found that most operations had a better risk rating at approval than in the latest risk classification, and this shift was most pronounced for FINPYME Credit operations. At approval, 93% of FINPYME Credit operations had a risk classification of B or better, with only 7% at B- (see figure below left). In the latest risk classification, the proportion of operations with a B or better risk rating decreased by 56 percentage points, and the number of operations with a substandard or worse risk rating increased by 24 percentage points. About four-fifths of regular SME operations had a risk classification of B or better at approval, and this proportion subsequently decreased by 25 percentage points, while the share with substandard or worse ratings increased by 11 percentage points (see figure below right).




*Source:* OVE desk review.




*Source:* OVE desk review.

Table 4.1. Written-off operations by client type, 2006-2015

| Client type | Number (% of closed operations) | Average amount (% of average outstanding balance) |
|---|---|---|
| FINPYME Credit | 34 | 4.1 |
| Regular SMEs | 20 | 1.0 |
| Large corporate | 12 | 1.8 |
| FIs | 1.0 | 0.2 |

*Notes:* Written-off amounts do not include recoveries
*Source:* IDEAS and data provided by IIC staff, OVE analysis.

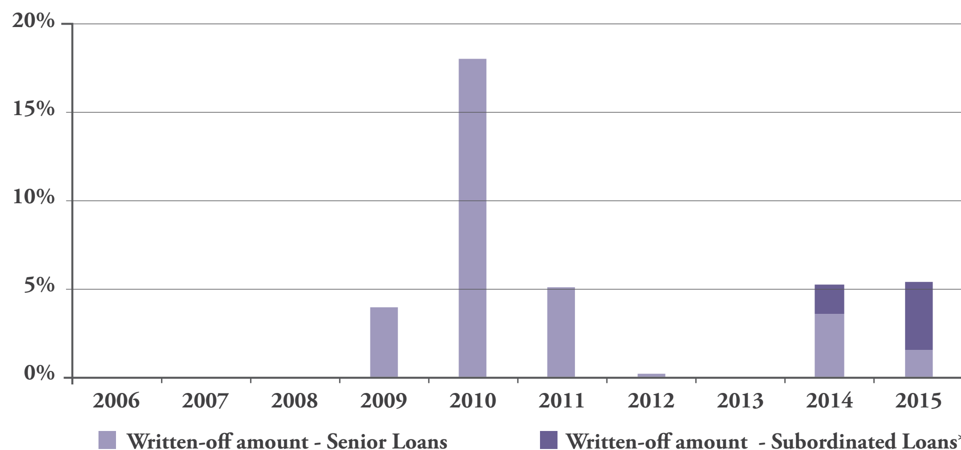
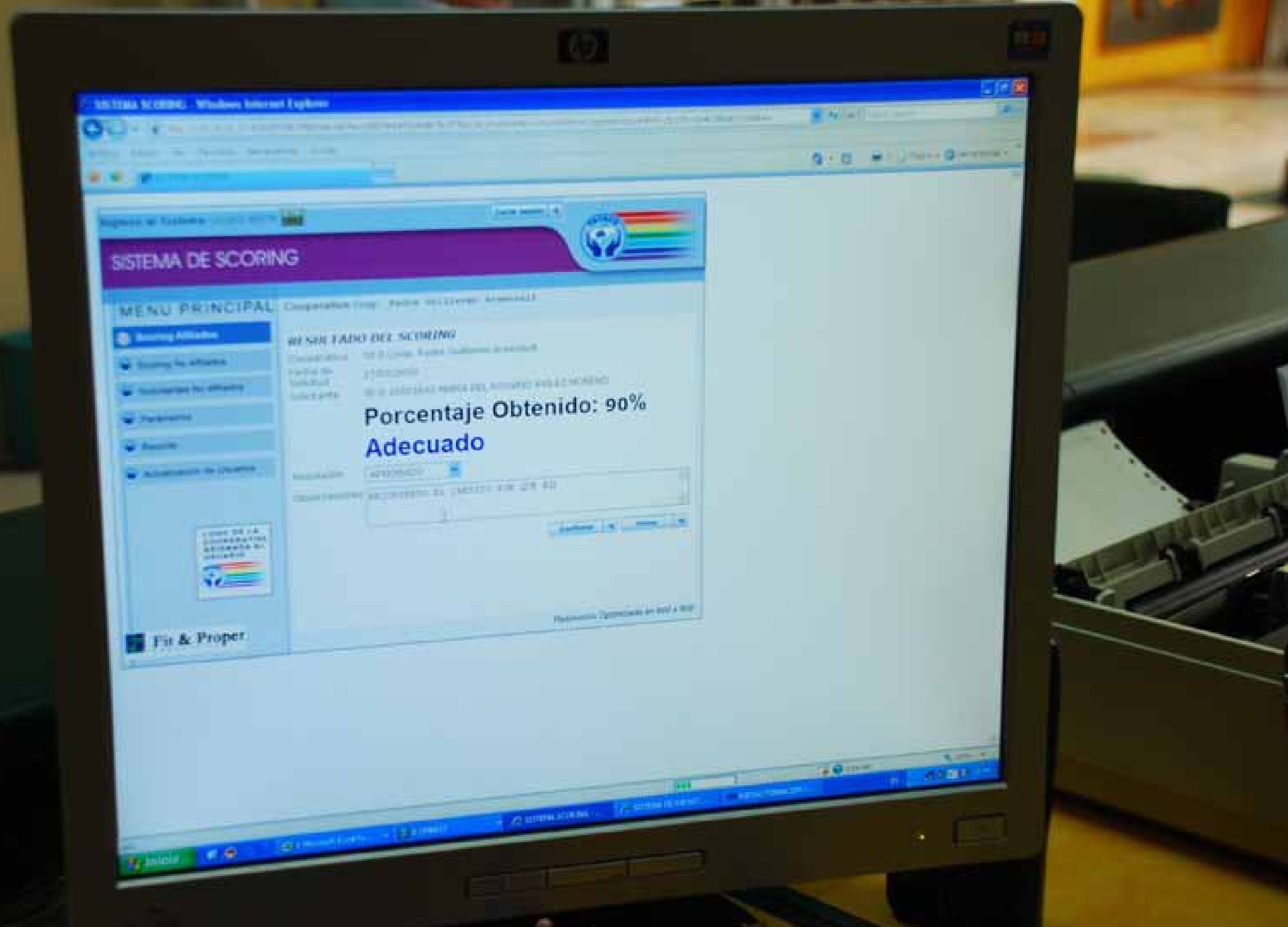



**Figure 4.5**

**Evolution of FINPYME Credit written-off amounts, 2006-2015 (% of outstanding portfolio)**

*Note:* * Only includes the IIC write-off amount. The subordinated operations had an additional written-off amount of US$362 million (China Fund). Written-off amounts do not include recoveries.
*Source:* IDEAS and data provided by IIC staff, OVE analysis.

OVE's profitability analysis indicates that neither FINPYME Credit nor regular SME support are financially sustainable, with estimated annual losses of about US$0.8 and US$3.6 million, respectively, after accounting for operating and overhead costs (Table 4.2 and Box 4.3). OVE's analysis of FINPYME Credit financial flows between 2006 and 2015 indicates that the average net financial income (interest revenues minus funding costs and write-offs) was approximately US$84,000 per year. Including the recoveries of write-offs, the average net financial income increases to approximately US$180,000 per year, but it is unclear what the costs associated with these recoveries were, and they were likely to be high. Adding in just the direct costs of origination and supervision,[91] the program has been loss-making during the evaluation period, with estimated annual losses of approximately US$250,000. For regular SME operations, the average net financial income (interest revenues minus funding costs and write-offs) was approximately US$1.4 million per year during 2006-2015. Assuming recoveries rates of write-offs similar to FINPYME Credit,[92] the average net financial income increases to approximately US$1.6 million per year. However, these operations have also been loss-making when direct costs of origination and supervision are considered, with annual losses of approximately US$700,000. Adding in overhead costs further increases the net losses of FINPYME Credit and regular SME support.




For those clients with previous access to credit, the IIC provided longer tenors than alternative sources of financing for 36% of FINPYME Credit and 50% of regular SME clients.

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### Table 4.2. Annual profit/losses of FINPYME Credit and regular SMEs, 2006-2015

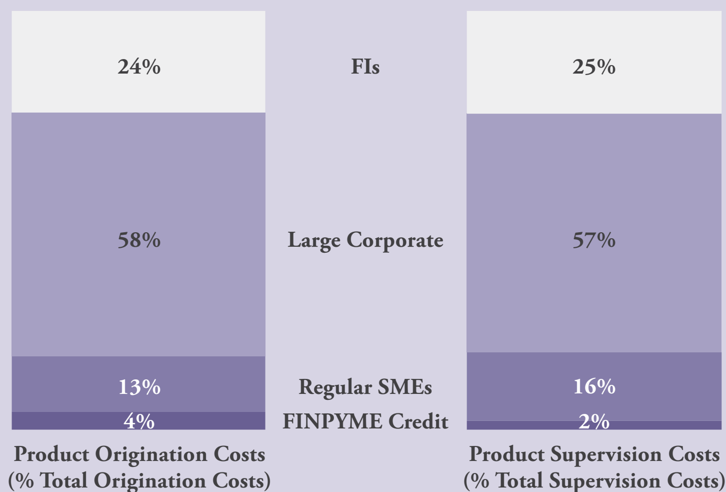
| | FINPYME Credit (US$'000) | Regular SMEs (US$'000) |
|---|---|---|
| Financial margin minus write-offs [/a] | 84 | 1,452 |
| Financial margin minus net write-offs [/b] | 179 | 1,645 |
| Direct Costs (Origination and Supervision) [/c] | (428) | (2,335) |
| **Profit/Losses (Excluding Overhead Costs)** | (249) | (690) |
| Overhead Costs [/d] | (548) | (2,988) |
| **Profit/Losses (Including Overhead Costs)** | (798) | (3,678) |

*Notes:* [/a]: Annual average 2005-2016. Financial margin: interest revenue minus funding costs. Average interest rate: FINPYME Credit: 7.6% (Desk review of operations); Regular SMEs: 5.8% (2014-2016 Business Plan). Funding costs: borrowing expenses / total outstanding portfolio. Annual average funding cost: 2%.
[/b]: Annual Average 2005-2016. Net write-offs: Total written-off amount minus recovery amount. Information of recovery costs was not available.
[/c]: Information is available for 2012 (2012-2016 Business Plan), 2013 (CII-PP141), and 2014 (Employee survey sent by the IIC). For 2006-2011 and 2015, OVE extrapolated costs using average origination and supervision costs (2012-2014), considering the annual volume of business (approvals and outstanding portfolio).
[/d]: Overhead Costs: administrative expenses minus direct costs of origination and supervision. Origination and supervision costs represented 44% of total administrative expenses (2012-2014). OVE allocated overhead costs in the same proportion as direct costs of origination and supervision.
*Source:* IDEAS, data provided by IIC staff, IIC profitability analyses (2012-2016 Business Plan, CI-PP-141), IIC internal employee survey (2014), OVE analysis.

***Box 4.3. Operating expenses***

IIC's operating expenses are not tracked separately by type of product, making it difficult to assess the actual cost of managing different IIC products. IIC has conducted internal surveys in which employees report time spent on originating and supervising (directly or supporting) each product, as well as on institutional activities. An analysis of the data from the last survey, in 2014, suggests that the direct costs of origination and supervision for FINPYME Credit were more than US$550,000 in that year. The cost for regular SME operations was approximately US$1.1 million. IIC Management has reported similar origination and supervision expenses for FINPYME Credit (US$504,000 in 2012; US$461,000 in 2013), but higher expenses for regular SMEs (US$3 million in 2012; US$2.5 million in 2013).[93] While the contribution to total IIC revenue (before financial costs and operating expenses) of all SME operations is less than 8%, these data indicate that the direct origination and supervision costs of these operations account for around 18% of total IIC origination and supervision costs during 2012-2014. In addition, it is important to note that origination and supervision costs represented on average 44% of total administrative expenses in 2012-2014 because a lot of people reported time spent on "institutional activities". Allocating these additional costs (overheads) in the same proportion as direct costs of origination and supervision, the total costs of managing the different products increases 1.28 times (FINPYME: to US$527,619; regular SMEs: to US$2,8 million).

**Direct origination and supervision costs by product (%) (2012-2014)**




*Source:* IIC profitability analyses (2012-2016 Business Plan, CI-PP-141), IIC internal employee survey (2014), OVE analysis.

5

A review of direct SME financing by other institutions has found that SME direct finance is difficult not only for MDBs, but also for national institutions with a development mandate.

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# 5 The Experience of Other DFIs with Direct Support to SMEs

**Other MDBs have focused almost exclusively on providing support to SMEs indirectly though FIs. One of the main reasons is that no MDB has managed to operate the direct SME financing business in a financially self-sustaining manner. IFC, the MDB with by far the most experience in direct SME lending, has migrated to an almost complete reliance on providing financial support to SMEs through FIs, realizing that it cannot reach scale and thus make a systemic difference through direct SME financing. Additionally, MDBs recognize that working with local FIs benefits from FIs' comparative advantages (See Chapter I).**

The experience of other MDBs indicates that indirect SME financing is much preferred. There may be instances when highly selective direct SME finance programs, properly executed and managed, can complement indirect support, but they will not be able to have systemic impact. In addition to SME financing through FIs, direct SME lending programs have been undertaken for various objectives, such as to increase an MDB's investments in a small country where otherwise there are none. IFC's experience showed that it is possible for an MDB to run a direct SME finance program, provided it accepts from the outset that the program will not be financially self-sustaining and that the smaller the SMEs being financed and the greater the depth of the TA that will need to be provided, the higher will be the cost of the program. The most essential features of a properly executed and managed program identified from this review are (i) definition and clarity of the target market; (ii) sustained focus on the SME activity; and (iii) availability of special skills, experience, and knowledge of SME financing. However, there is common acknowledgment that even under the best circumstances such programs can have effects on individual SMEs, but are highly unlikely to have a systemic impact on the SME environment.

## A. International Finance Corporation

Over the past 25 years IFC has experimented with a variety of models to provide direct financing to SMEs, deploying about a half-billion dollars in seven different programs. The main programs (aimed at commercial viability) were primarily related to delivering small-scale financing in the challenging markets of the poorest developing countries through, first, the AEF and later, the SEF. However, both programs were substantially loss-making. Only the relatively small and very selective Small Direct Investment (SDI) Program came close to financial sustainability, but it was aimed at medium-sized enterprises in the SME categorization. Recognizing that a direct SME finance program will not be financially self-sustainable, today IFC's only dedicated SME finance program (IFC Ventures) is mainly grant-funded for developmental objectives in its most challenging member countries.[94]

### i. Africa Enterprise Fund (AEF)

The AEF was the IFC's main initiative to provide direct financing to SMEs.[95] It began in 1989 with approval from the IFC Board to invest up to US$15 million in amounts from US$100,000 to US$1.5 million in Sub-Saharan Africa (SSA), given the shortage of finance from local banks. The US$15 million initial allocation was progressively raised by the IFC board to a cumulative total of US$250 million by 1999. The minimum investment size was (informally) increased to about US$500,000, and the upper limit was formally raised to US$2.5 million. The average amount per approval was approximately US$630,000. IFC was reluctant to put staff in the field to make these smaller operations, so it initially recruited commercial banks as its agents to make the AEF operations for a fee. This approach failed.[96] In 1991, IFC decided to recruit its own local staff for the program, but there was no central control of the program, and disparities were compounded since at the time SSA was covered by different regional departments. Consequently, there were many different approaches to the types of deals sought, and to the form of structuring the investment. There tended to be more equity in eastern and southern SSA, and more straight lending in the west.

By 2000 it had become quite evident that AEF was suffering major losses, and senior management decided its operations should cease. Initial reviews by the IFC had highlighted the program's operational and financial problems.[97] Financial projections were revised downwards to be more realistic, and remedial steps were then taken to reorient operations. The program was placed under a Small Business Division within the Africa Department, which by now had been consolidated into a single department for all of SSA. In 1995, it was considered whether AEF should be separated from IFC, instead of merely having its own, simpler procedures. However, this concept was rejected, and operations were expanded

in the following years. New managers with differing investment approaches took on the program, which became a volume business with a race to complete investments before year-end. The final phase recognized that the interest margin and other income from AEF investments would never be sufficient to cover costs, even without considering write-offs. The remedy was to seek to increase the volume of new AEF investments still further, in an effort to increase income against the same costs. This resulted in still lower criteria and standards. The AEF staffing was dismantled and relocated in 2000. However, no formal cessation was announced to the IFC Board, which continued to authorize resources for the program, although they were used very sparingly after 2000.

The program was costly and had mixed development results. There is no full retrospective report of IFC direct SME investing through AEF and of its results. The best data that exist are from an OEG evaluation of February 2000.[98] However, this study only covers up to 1999, when AEF investments were at their peak, and most had been recently made. From FY89 to FY99, US$194 million was approved for 307 projects in 30 countries. The average amount per approval was $630,000. Of the US$194 million approved, 80% was in loans, 10% in quasi-equity (called venture loans), 6% in equity, and 4% in guarantees. Of the 307 approvals, 28% in number and 25% in dollar amount were dropped after approval, or cancelled after commitment. The evaluation found that the results of the AEF were mixed. About half of the projects reviewed were rated as satisfactory in terms of development outcomes, with expansion projects and larger projects having better performance. However, one of the main contributions of IFC was its role of lender of last resort; most enterprises could not have secured financing for their projects without IFC participation. In terms of financial performance, the AEF required a cross-subsidy of about US$5 million per year to cover losses after operating expenses. As of FY99, 50% of the closed AEF loans were written off, with the IFC recovering less than 50% of the principal. Equity performance was particularly poor. As of FY99, AEF had disbursed US$8.6 million in equity in 35 companies, but only one investment was divested, with very modest capital gain.

### ii. Small Enterprise Fund (SEF)

IFC's second major direct SME finance program was the SEF, under which the IFC Board delegated approval authority to IFC management. The SEF was approved in 1996 at a time when the AEF was perceived to be successful, and it mirrored the processes of the AEF. It was approved with as a component of the larger Extending IFC's Reach program, which aimed at pushing IFC operations into newly emerging countries in the former Soviet Union and other frontier markets. EIR provided budget to open local offices in a number of countries that were selected for the difficulty of their business climate and their high need

for support. The intent was to increase the overall level of all of IFC's lines of business, and SME financing was to be one of these. The Board approved up to $125 million to finance equity operations and loans between US$100,000 and US$2.5 million. This amount was fully used in more than 100 investments in 21 countries.

As far as direct SME financing under SEF was concerned, the level of activity and performance varied greatly by region. By 2003, nearly all the SEF and AEF loans had been disbursed, and relatively few were to follow in subsequent years. Notably, the SEF experience in SECA, at 11% loss reserves, was much better than in the other regions, and the SEF activity was highest in that region (29 loans). Several of the selected entrepreneurs in SECA later received larger "mainstream" IFC loans. LAC had 25% loss reserves, but only five SEF operations. Overall, the SEF equity portfolio was better than the AEF's, though still weak and skewed by one successful investment. Between 1997 and 2005 SEF disbursed US$$11 million in 12 equity transactions, of which 9 failed, but one made a 50% return, giving a positive overall IRR for the SEF equity portfolio of 8% p.a. The regional success in SECA became the justification and the model for the SDI program.

### iii. Small Direct Investment (SDI)

The SDI was a small, highly selective program, and was essentially run to bring IFC into very challenging countries where it was not otherwise active at the time. The program ran from 2001 to 2010 and provided direct SME financing from US$1-5 million in frontier countries. The program was not considered inconsistent with IFC's prevailing strategy to provide finance to SMEs indirectly through FIs, as SDI did not provide financing if appropriate financing was locally available. In fact, in many smaller countries, only trade finance and short-term loans were available, and there was virtually zero long-term funding.

The SDI was the most carefully managed program, and was designed taking into consideration many of the lessons learned from the AEF and SEF (Box 5.1). SDI had centralized management in Washington to select and approve the operations, but processing was carried out by regional staff locally, under guidance from SDI's central management. This was an effort to apply experienced judgment to information sourced by local staff, and the central manager always met the applicant at his/her business. Additionally, the SDI operated with specific criteria for selecting operations, including a focus on entrepreneurs with a track record of good financial performance (avoiding start-ups), and a strong preference for straight loans (not equity). Complementary co-finance with local financial partners was always sought, and TA was usually integrated with the loans. It was usually possible to identify at least one candidate suitable in a selected country. However, there was deliberately never more than one SDI investment in a country per year.

**_Box 5.1. Main lessons learned from the AEF and SEF experience_**

- Define and clarify the target market.
- Operate only where long-term SME risk finance is not otherwise available.
- Promote integrity – focus on the entrepreneur(s).
- Look for a strong and ongoing business track record.
- Fund expansions only, not greenfield or start-up investments. These investments are small scale corporate finance rather than project finance; they move companies to a larger scale within an established business model, not to a new or different business.
- Back the best in its sector, or best upcoming.
- Integrate supporting TA with the investment plan. The program can and should bring these companies important additionality, such as improved corporate governance, standard setting, and best practice knowledge transfer.
- Seek complementary co-finance alongside a local FI wherever possible. This will usually be a short-term component of the financial plan with a commercial bank.
- Provide loans only, and take security in all cases. Do not invest in equity or even quasi-equity, which is much more complex. Interest rates should be fixed, both for simplicity and for differentiation in the market from short-term lenders.
- Adopt simplified procedures and documents.
- Process locally as far as possible, for local knowledge and subsequent supervision and to keep costs down; but manage centrally for quality control and application of consistent criteria.
- Be very selective, and do not apply pressure for volume.
- Lend in local currency if available. It is a major advantage for the program: most SMEs cannot prudently carry foreign exchange risk.

*Source:* Internal reviews of the programs by the IFC and interviews with IFC staff.

The SDI came close to financial sustainability in that it nearly broke even, but it was a small program, aimed toward the higher end of SME size. Between 2003 and 2010, SDI committed over US$50 million in 25 loans. The portfolio performed well, and SDI was profitable at the investment level. It was also profitable after charging the cost of funds and all direct costs, and it covered almost all of the full IFC overhead – meaning that the program was not entirely profitable overall. It was perceived as

evidence that IFC could mount and run at least a limited direct SME financing program at little net expense – but not as a money maker. It was also noticeable that the targets of the SDI program were at the larger end of the SME spectrum, with an average investment size of about US$2 million.

## B. Other MDBs

Apart from IFC, only the European Bank for Reconstruction and Development (EBRD) has provided direct financing to SMEs. EBRD prefers to address the need for SME finance by supporting local FIs and the development of the local financial system. But it has also run a small direct financing program, and still provides some small loans. EBRD has fewer target countries than IFC and is encouraged by its Board to show activity in each of its member countries, but especially in smaller and less developed countries. Since in those countries there are often few prospects for larger operations, EBRD has been open to making smaller loans in those countries. Essentially, EBRD would decrease the size of the loans in a given country until it was able to achieve a satisfactory, or target, level of activity.[99] This implies that its program was not a direct SME finance program, but EBRD did make such smaller loans in certain countries as part of its overall country activities.

Differences from other investments lay mainly in less formal processing through authority delegated from the Board to management. For such loans, approval is simplified, carried out by an executive committee of five management members. One member of the executive committee is drawn from the EBRD Credit Department, who can therefore be outvoted. But if Risk is outvoted, that member has the right of appeal to senior management. As the small investments are part of the country programs, they have not been accounted for separately, but management reports indicated that their performance has been similar to that of mainstream deals, with about 6% of non-performing loans, some of which were subsequently recovered. Given its cost structure, EBRD estimates that no loans less than $2.5 million would cover its costs at its usual loan margins. Hence, EBRD has been essentially cross-subsidizing the smaller loans.

EBRD's strength in making smaller loans lies in its extensive local staff. It has a staff of 16 in its Tajikistan office, for example, most of whom are local hires, and a proportionately similar number of staff in other countries where it is willing to consider small proposals. Local staff identify most smaller proposals from their own contacts, and even though they are solely dedicated to small transactions, they also have the local knowledge to distinguish good prospects. Straight loans are preferred in smaller deals. No equity investments are made, but quasi-equity may be considered.

## C. National institutions

A review of direct SME financing by other institutions has found that SME direct finance is difficult not only for MDBs, but also for national institutions with a development mandate. There have been successful private companies in the SME business, including leasing companies, SME banks, and specialized venture capital firms. However, most development national institutions and programs that do SME risk capital are either mandated or subsidized. Among national institutions targeting a volume of SME customers for term risk capital, there are few financially successful ones, and even they were originally started with government or philanthropic funding.

The few financially successful institutions all started as new organizations, and have had a focus on the SME business only. Institutions like Business Partners Limited in South Africa and the Business Development Bank of Canada (BDC) did not come about as an offshoot of another organization, or as diversification of business into a new market. Organizationally, these institutions are not very different. They have a central office, as well as regional and branch offices to get closer to clients. The experience of Business Partners Limited and BDC indicates that the smaller the clients, the closer the branches should be. Types of products can range from straight loans to pure equity (occasionally). Documentation is usually simplified, and processes also are not that different: deals are sourced locally, there is an initial review at higher level of each deal, followed by appraisal, and then approval or decline again at a higher level, usually at the central office. However, while there is some decentralization, central controls are much stronger than those of commercial banks. Although simplified procedures are helpful and necessary, the crucial common elements that account for the successful longevity of these organizations are (i) extensive staff training; (ii) focus of the organization and staff on the SME business only; and (iii) tight control and discipline by experienced management.

# 6

SMEs account for a significant part of GDP and employment in developing countries; however, the contribution to employment growth has been a matter of debate of economic policy and research for decades.

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# 6 Conclusions and Recommendations

**SMEs account for a significant part of GDP and employment in developing countries; however, the contribution to employment growth has been a matter of debate of economic policy and research for decades. While much debated, the predominant view is that certain constraints faced by SMEs are due to market failures and that government and MDB intervention may in some cases be justified and potentially beneficial. SMEs cite many constraints to their growth, with access to finance featuring prominently. Several barriers explain these access to finance constraints in LAC, including the high levels of job informality, low bankability of SMEs, limited competition among FIs, and weakness in countries' regulatory environments and financial infrastructure.**

IIC is the only MDB with an explicit mandate to support SMEs, and it has provided such support both directly and indirectly via FIs. MDBs recognize that the reach is much greater through FIs, and working with local FIs draws on their comparative advantages, including local knowledge and networks, local currency finance, product cross-selling, and lower transaction costs. In addition, if SME support becomes a profitable business line for the local FI, this can have sustainable, long-term impacts well beyond the life of an individual operation.

Recognizing the advantages of FI operations, IIC nonetheless has continued to work directly with SMEs, citing the absence of longer-term financing and the high developmental impact of these operations. IIC has recognized that direct SME support on its own is not financially sustainable, and that it requires cross-subsidies from revenue sources from other business activities, a leaner organization, more local presence, and faster processing times. Additionally, while representing a limited volume of approvals, direct support allows IIC to operate in those member countries where opportunities for larger operations are limited.

IIC did recognize the need for more efficient and standardized procedures for lending to SMEs, though these procedures applied only to FINPYME Credit and not to other SME direct lending. FINPYME Credit applied specific and standardized criteria for its investments, and was more successful in applying financial standards than other MDB SME finance programs reviewed in the context of this evaluation. The program also incorporated some best practices identified in other MDB SME finance program: staff exclusively committed to the program, local processing, and central control and management to ensure quality control and consistency. However, processing times of SME operations can still be considered high in comparison to commercial financing standards.

Direct SME support has not been guided by a coherent and comprehensive SME strategy. IIC's local presence in certain C&D countries, coupled with active direct SME lending (particularly through the FINPYME Credit program), has contributed to increasing approvals in those C&D countries. The financing has largely supported capital investment, which has been identified as an important constraint in LAC. However, the lack of strategic approach is evidenced in the wide range of sectors and types of SMEs supported. The main eligibility criterion to select SMEs has been whether or not the company complied with the pre-established financial ratios and other business criteria. Through direct lending operations the IIC reached 120 SMEs in LAC from 2006 to 2015, indicating the limited capacity of this approach to reach scale and have a systemic impact.

IIC did not consistently identify or track development outcome indicators, making it difficult to assess the effectiveness of this support. IIC supervision reports focused almost exclusively on client's financial performance. The financial additionality is also difficult to assess, since IIC rarely documented the prior credit conditions of its SME clients. However, OVE found that almost all SMEs had prior access to term funding. Additionally, the fact that most non-FINPYME SMEs were owned by another firm or group that usually guaranteed the loans calls into question the financial additionality of these operations.

OVE's analysis indicates that SME direct lending is not financially sustainable. The financial cost of FINPYME Credit (measured by the loan loss provisions and written-off amounts) has been comparatively higher than that of other IIC products, reflecting the higher risk of these small operations. While the net financial margins were positive during the evaluation period, the consideration of operating and overhead costs indicate that SME direct lending has been loss making.

In addition to lending, IIC has actively used TA to reach a larger number of beneficiaries in the region; however, SME advisory services have not been managed as a critical dimension of IIC's SME business. The significant increase in the number and amounts of TA operations has not been accompanied by procedures and systems to effectively manage the volume of operations, and most TA activities have not been

linked to loan operations. In the almost total absence of monitoring and evaluation, it is not possible for IIC to know if the objectives it intended to achieve through its strategic TA programs have been met.

Other MDBs have focused almost exclusively on providing SME support indirectly though FIs. No MDB has managed to provide direct SME finance in a financially self-sustaining manner. IFC, the MDB with by far the most experience in direct SME lending, has moved to almost complete reliance on providing financial support to SMEs through FIs, realizing that it cannot make a systemic difference through direct financing.

Based on the findings of this evaluation, OVE has three recommendations for IIC management.

1. Do not continue providing direct loans to SMEs. The findings of this evaluation regarding development effectiveness, IIC additionality, and IIC financial performance do not provide support for a continuation of IIC's direct SME lending (whether FINPYME Credit or regular SME lending). Financial institutions and other intermediaries have clear comparative advantages in reaching a larger number of SMEs more efficiently and in ensuring more sustainable support. Therefore, if IIC identifies markets or segments with important financing gaps, supporting SMEs only indirectly through intermediaries is justified on grounds of both efficiency and effectiveness.

2. Coordinate with IDB to identify the most effective ways for the IDB Group to support SMEs, both in the aggregate (in an IIC SME strategy that is coordinated across the IDB Group) and at the industry, regional, country, and/or local level. This should include analysis of key barriers and related market failures limiting the growth of SMEs, and identification of the IDBG instruments best suited to address these barriers. IIC support (provided indirectly as noted in recommendation 1) should be used to address only those barriers for which IIC has a comparative advantage. The justification for IIC engagement should be clearly articulated and the results of such engagement regularly monitored and reported.

3. Reorient SME TA programs to address the key constraints limiting the growth of SMEs, and improve SME TA management. TA should be a key element in the new SME strategy, with a more strategic approach that focuses on addressing key barriers limiting the growth of SMEs, in line with recommendation 2. Types of TA should be delineated, with clear objectives and a results framework for each SME TA program. Procedures and systems should be put in place to consistently track and report on SME TA activities.

# Notes

[1] This refers to the IIC's mandate prior to the 2016 merge-out, which combined IDB and IIC private sector activities in an expanded IIC (AG-9/15; CII/AG-2/15). Most new activities assumed by the larger IIC had previously been performed by other IDBG private sector windows.

[2] FINPYME Credit operations were evaluated at neither the operation nor the program level. Some regular SME operations (non-FINPYME) have had Expanded Self-Assessment Reports (XASRs) validated by OVE, however the limited number of such reports and the absence of contrasting any findings of direct SME vs. other operations does not allow for drawing systemic conclusions.

[3] ILO 2015.

[4] IFC 2013; IFC 2010.

[5] ILO 2013. In this case, SMEs are defined as enterprises of 5-249 employees. When they are defined differently (5-99 employees), SMEs' formal employment share worldwide is 45%, and in LAC 30% (Ayyagari, Demirgüç-Kunt, and Maksimovic 2011; Saliola and Bert 2012).

[6] See, for example, Ayyagari, Demirgüç-Kunt, and Maksimovic 2014, DCED 2013, and De Kok et al. 2013.

[7] IFC 2010.

[8] Page and Söderbom 2012.

[9] Klapper, Love, and Randall 2015, ILO 2015, Liedholm 2002.

[10] ILO 2015; Liedholm and Mead 2012.

[11] DCED 2013; Pages 2010.

[12] ILO 2015, ILO 2013, Liedholm and Mead 2012.

[13] Beck, Demirgüç-Kunt, and Maksimovic 2005; Beck, Demirgüç-Kunt, Laeven, and Maksimovic 2006; Inter-American Development Bank 2004; IFC 2013; Schiffer and Weder 2001; ILO 2015.

[14] For example, barriers to market entry or exit, taxes and regulation, inflation, corruption and crime, informality, customs and trade regulations, access to land.

[15] Kurdyla 2013.

[16] For more detailed information, see OVE (2016).

[17] Over a quarter of SMEs in LAC went out of business between 2006 and 2010, a much higher rate than for large companies (15%). World Bank 2013 (Mapping Enterprises in LAC).

[18] OVE (2016).

[19] Except for a few LAC countries, there has been a reduction in the number of regulated FIs (and particularly banks), partly because of LAC regulators' interest in ensuring stability of the financial systems. Cross-border acquisitions by several emerging FI conglomerates have also contributed to higher concentration.

[20] For example, some countries still have outdated creditor protection and excessive capital requirements that discourage lending to small borrowers. In addition, there are weaknesses in financial infrastructure such as lack of: universal credit registries, transparent payment systems, and efficient collateral systems.

[21] For a discussion of the different issues involved, see, for example, Ibarrarán, Maffioli, and Stucchi 2009.

[22] Market failures commonly cited as a rationale for intervening are (i) information asymmetries, especially in access to finance for SMEs (restricting and misallocating funding, exacerbated by fixed costs in lending), to be overcome by intervention; and (ii) externalities (e.g., SMEs' role in job creation and increased competition).

[23] However, some critics argue that most SME policies are too insignificant to make a difference in the market, and that public interventions can generate distortions that result in the inefficient allocation of resources. (Ibarrarán, Maffioli, and Stucchi 2009; ILO 2015; Storey 2008).

# Notes

[24] This is likely due to the diffuse and hard-to-attribute effects of infrastructure improvements on SMEs specifically. However, in the 2014-2015 Development Effectiveness Report for Private Sector Operations, the Asian Development Bank specifically lists the provision of key infrastructure as one area of its SME support (Asian Development Bank 2016).

[25] Many argue that DFIs should support only unserved financial markets, serving as a catalyst rather than competing with private funding (CGAP 2013; Nelson 2015; IFC 2008). However, reviews have found that DFI funding to FIs has often been concentrated in creditworthy and large institutions, and critics argue that this can result in some crowding out of private funding. (Von Stauffenberg and Rozas 2011).

[26] Bosma and Stam 2012; ILO 2015.

[27] ILO 2015.

[28] Lerner and Stern 2010.

[29] A review of DFI SME interventions (CGAP 2013) shows that the stated objectives of such interventions (accelerating growth, economic development, and job creation) are often at odds with the types of SMEs actually financed (predominantly mature SMEs).

[30] IFC, 2013; Ibarrarán, Maffioli, and Stucchi 2009.

[31] This is in part rooted in methodological challenges in evaluating SME interventions—for example, unclear definition of objectives, and issues with assembling and tracking valid control groups (see, for example, Lopez-Acevedo and Tinajero 2010).

[32] The Mexican government SME programs analyzed included a variety of activities, such as financing, guarantees, tax breaks, training, consultancy, elaboration of strategies, and analysis.

[33] World Bank 2007.

[34] Eslava, Maffioli, and Melendez Arjona 2012. Another evaluation of government-backed partial guarantees in Colombia found positive impacts on firms' growth (measured by output and employment), but did not find any effect on investment, productivity, or wages (Arraiz, Melendez, Stucchi, 2014).

[35] OVE 2014. Another evaluation of financing to SMEs through private banks in the province of San Juan (Argentina) found positive effects on outcomes such as sales, employment, and productivity. (Bueso-Merriam, Demichelis, Fernández Díez, Giuliodori, Rodríguez, and Stucchi, 2016).

[36] OVE 2016.

[37] For other evaluations of technical assistance and supplier development programs targeting SMEs in LAC, see Castillo, Maffioli, Rojo, and Stucchi (2013), and Arraiz, Henriquez, and Stucchi (2013).

[38] Other non-sovereign-guaranteed windows of the IDBG - the Opportunities for the Majority initiative and the Multilateral Investment Fund - have undertaken a total of 17 (loan, equity, and TA combined) direct operations with SMEs over the last 10 years. However, their work with SMEs was incidental and not part of their broader strategy. This evaluation therefore focuses on IIC, which accounts for the overwhelming majority of direct SME support within the IDBG.

[39] Group Technical TAs (e.g., workshops or conferences) were counted as one TA operation. For more detailed information, see Annex II and paragraphs 2.12. and 3.6.

[40] There is no global consensus as to what constitutes an SME. Most definitions employed by national authorities, financial institutions or international development finance institutions (DFIs) use one or more key enterprise size attributes, namely the number of employees, revenues, and/or assets, to differentiate SMEs from micro and large enterprises. Some DFIs also use the size of their loans or investments as a proxy for enterprise size. While discussing the motivation for, and the implications of, using different size variables and cutoff values exceeds the scope of this evaluation, extensive reviews of these topics can be found in CII/GN-225-1, IFC (2000), IFC/World Bank (2010) and Gibson and van der Vaart (2008), among many other studies.

[41] An exception to this rule is greenfield projects, for which only assets are considered.

42 For more detailed information, see Annex I on evaluation methodology.

43 Additionally, the operations of the Direct Technical Assistance (DTA) program that support loan preparation and implementation were analyzed in conjunction with the lending operation analysis.

44 See, for example, CII/AB-685 (1999); CII/GN-180-13 (2004); CII/GN-232-2 (2007); CII/GP-15 (2006); CII/DE-52/10 (2010); CII/GP-15-10 (2008); and CII/GN-281-1 (2013).

45 The Nuevo Leon Declaration was agreed by the Heads of State and Government of the Americas during the Special Summit in Monterrey, Mexico, on January 13, 2004.

46 The 75% limit remains in place after the merge-out of SCF and Opportunities for the Majority into the IIC.

47 See, for example, IIC documents CII/GN-224-2, CII/GN-189-4, CII/GN2428, and CII/GN-224-14.

48 See, for example, IIC documents CII/GN-152-3, CII/GN-180-13, and CII/GN-232-2.

49 See, for example, IIC documents CII/GN-281, CII/GN-224-14-13, and CII/PP-160.

50 The SLP was initially to operate in Bolivia, Costa Rica, and El Salvador, but was launched only in Bolivia.

51 The countries were divided in two groups, depending on whether the IIC had local presence and qualified investment officers to be in charge of origination (Table 2.1).

52 Other waivers to the IIC Operating Policy included the ability to finance up to 100% of project cost, and to be the sole source of funding.

53 A loan request through the SBRL was not supposed to take more than 10 working days following verification of eligibility, with final approval delegated from the Board to the IIC's General Manager or his/her designee.

54 A total of US$2.5 million (of the overall US$23 million program limit) can be used for subordinated loans, with an additional US$2.5 million funded by the sale of participations to the China-IIC SME Equity Investment Trust Fund for all transactions. Subordinated loans can have tenors of three to seven years (up to two years grace), require personal guarantees from the owner and/or main shareholder (but no collateral), and carry a fixed interest rate of 500 basis point above the FINPYME Credit reference rate (CII/GN-224-20/21).

55 This initiative did not replace or supersede the FINPYME Credit program; the programs work under different terms, especially those related to approval amounts, processes, and documentation. See Operational procedures section (Chapter II).

56 Group II operations would start once the IIC established a local presence in the area (CII/GN-224-2). Operations were initially permitted only where a qualified investment officer was stationed locally, but the eligibility criteria later changed to "when the IIC has an investment officer or qualified representative in place" (CII/GN-224-21).

57 For indirect support via FIs since 2006, OVE included only those FI operations that focused on general SME lending (based on the database gathered by OVE for the FI evaluation and IIC information).

58 FINPYME Diagnostics was intended to (i) bolster IIC's project pipeline, (ii) streamline project processing, and (iii) gather useful information on the business environment in which the private sector operates.

59 FINPYME Diagnostics is available to companies in Bahamas, Barbados, Belize, Brazil, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Trinidad and Tobago, and Venezuela.

60 Spanish Trust Fund (2000), Austrian Trust Fund (2002), Danish Trust Fund (2004). Italian Trust Fund (2005), Swiss Trust Fund (2008), Infrafund (2008), Norwegian Trust Fund (2010), Belgium/Wallonia Trust Fund (2011), Nordic Development Fund (2011), US Government (2013), China Technical Assistance Fund (2014), Netherlands Trust Fund (2014), and Clean Technology Fund (2015).

# Notes

[61] TASP was made possible primarily by the Korean Trust Fund, and the IIC also contributed US$5 million of its own resources (CII/GN-238).

[62] General Consulting Services for SMEs, FINPYME Diagnostics, Energy Efficiency and Renewable Energy, and Promotion of Good and Sound Practices for Governance of SMEs.

[63] Adding FINPYME ExportPlus and FINPYME Integrity (2009/2010), and FINPYME Mujer Empresaria (2013).

[64] For more detailed information about the programs, see Table 1.1 (Annex II).

[65] There were also two small online training (VTA) operations for US$59,700. For more detailed information about disbursed types of TA by strategic programs, see Table 1.2. (Annex II).

[66] Countries without direct loans: Barbados, Dominican Republic, Guyana, Panama, Suriname, Trinidad and Tobago, Venezuela.

[67] FINPYME IOs also originate and supervise operations in other countries. The program considered partnerships with institutions in some countries (e.g., in Central America countries, Jamaica, Bolivia) to identify clients; however, only Bolivia had better results in terms of number of operations. Once the alliance ended, the IIC hired an IO in the country.

[68] For other terms and eligibility requirements of FINPYME Credit (e.g. years in operation, collateral, counties), see Table 2.1.

[69] See also section of client's characteristics and financial additionality.

[70] This includes only disbursed SME operations, and excludes double-counting of repeated clients, either of renewed or multiple operations.

[71] This information is taken from the analysis included in the OVE's SME lending background paper from the Financial Intermediaries Evaluation (2016).

[72] As the same company could benefit from several TAs (by, for example, first participating in a workshop and then receiving individual TA or participating in several GTAs), this number is likely to contain considerable double-counting of unique beneficiaries. IIC did not consistently track beneficiaries.

[73] For more detailed information about disbursed operations by country and type of TA, see Table 1.3 (Annex II).

[74] For more detailed information about disbursed operations by country and type of TA, see Table 1.3 (Annex II).

[75] From the portfolio review, it was not possible to identify the individual beneficiaries of GTAs, as the lists of participants were not consistently tracked (they were sometimes collected manually and sometimes in pdf format, and sometimes the IIC did not have the name of the beneficiaries).

[76] This section is based on the document desk review of representative random samples of operations approved between 2006 and 2015.

[77] In most countries loan tenor where limited to 5 years. See Operational procedures section.

[78] This means that many SME loans had more than one use of proceeds.

[79] For detailed information of other direct SME programs, see Chapter 5.

[80] Since the initiative did not specify that it was exclusively directed to SMEs, any type of client that requested a small loan could benefit from this streamlined process.

[81] The objective of SME Direct was to reduce the time from eligibility to approval. IIC does not identify in its systems which operations were approved under this initiative. OVE identified seven SME operation approved under this initiative during 2013-2015. The average approval time was 12.7 months, and the average disbursement time was 4.3 months.

[82] Excluding dropped or cancelled operations, 28% of the reviewed FINPYME-Credit operations and 41% of the reviewed regular SME loans were restructured. Most restructured loans mainly changed their repayment plan and tenor.

[83] The median difference in months for these FINPYME clients was 18 months and for regular SME clients was 36 months.

[84] Loan proposals and contracts, DIAS Plus, additionality questionnaire (FINPYME Credit), financial models, client survey results, and financial statements provided by clients

[85] Supervision Reports, XASR (regular SMEs operations), DIAS Plus, financial models, client survey results, and financial statements provided by clients.

[86] These numbers exclude cancelled and dropped operations. Operations without information sales (progress) include some that were written-off or more recently approved.

[87] Information as of September 2016. Most monitoring reports were carried out in Colombia (100% of the audits have a monitoring report) and Bolivia (52%). In contrast, less than 1% of the audits in Guatemala, Costa Rica, and Honduras have a monitoring report. The program committed in 2015 to evaluate all new energy audits in two monitoring reports (6 months and 12 months following the audit). Therefore, some energy audits that took place before this date are not expected to have a monitoring report.

[88] Improvements in business models (65%), opening of new markets (45%), internal organization (38%), and finance (25%) were the areas most identified for potential improvements. Additionally, 28 companies in Peru and 37 in El Salvador received individual TA mainly to support the implementation of some measures identified in the competitiveness plans.

[89] For example, in 2012 the estimated net income per project (after financial costs and operating expenses) for a typical FINPYME Credit operation (average size of US$265,000) was US$4,316. For a typical regular SME operation (average size: US$3.4 million) it was US$96,013, and for a large corporate operation (average size: US$6.3 million) it was US$108,643. However, the results are indicative, do not fully account for overhead costs, and should be taken with caution.

[90] Operations with a status of repaid in full or written-off.

[91] This includes the direct cost of employees directly involved in the program (local investment officers and one program manager in Washington, DC) and other employees supporting the program (e.g., Special Assets Unit, Legal Department).

[92] Information of recovery amounts and costs for regular SME operations during the evaluation period was not available.

[93] *Source:* 2014-2016 Business Plan, 2014 Administrative and Capital Budget Proposal, and 2014 Funding Strategy; IIC's Financial Performance and Profitability Analysis (CII-PP-141)

[94] Other programs included the Mozambique SME Initiative, the Mekong Finance Lines, and the Pacific Islands Investment Facilities.

[95] Direct financing included loans, quasi-equity, equity, and guarantees.

[96] While the agent commercial banks performed due diligence and administration to their own standards, those standards were insufficient for the type of term lending being carried out with IFC's funds.

[97] An initial review was carried out by unrelated IFC staff in 1993. In 1995, there was another review by IFC's Operations Evaluation Group (OEG).

[98] Evaluation of IFC's Investments through the Africa Enterprise Fund.

[99] EBRD does not differentiate by client size, so some (but not all) of these smaller transactions are for SMEs. Hence, as a notional illustration, a small investment of US$250,000 might be considered in Kyrgyz Republic, but no investment smaller than US$500,000 would be considered in Bulgaria.

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