PROJECT PROFILE

JAMAICA

I. BASIC DATA

Project Name:	Credit Enhancement Fund for Micro, Small and Medium Enterprises (MSME).
Project Number:	JA-L1075
Project Team:	Daniel Fonseca (IFD/CMF), Team Leader; Navita Anganu (CMF/CJA), Alternate Team Leader; Gloria Lugo, Isabelle Braly-Cartillier, Pablo Carrion and Cecilia Bernedo (IFD/CMF); Wayne Beecher (MIF/CJA); Brodrick Watson (CCB/CJA); Naveen Jainauth-Umrao and Rene Herrera (FMP/CJA); and Louis-François Chrétien (LEG/SGO).
Borrower:	Government of Jamaica (GOJ)
Executing Agency:	Development Bank of Jamaica Limited (DBJ)
Financial Plan:	IDB (OC): US$20 million
Safeguards:	Policies triggered: B.13 Classification: Not required

II. GENERAL JUSTIFICATION AND OBJECTIVES

A. Background and justification

2.1 **Macroeconomic context.**[1] Following several years of moderate growth and tight fiscal positions, Jamaica has made progress to implement policies that restore economic stability. Gross Domestic Product (GDP) growth for the current Fiscal Year (FY) 2016/17 is estimated to reach 1.7% (up from 1.0% in FY2015/16) and expectations are for a further acceleration to 2% and higher. Inflation is at historical lows (3% in 2016, down from 8.3% in 2014), Net International Reserves (NIR) have more than doubled, and the country has maintained its commitment to reduce its public debt.[2]

2.2 Although the emphasis on fiscal discipline and economic recovery is expected to continue, Jamaica's overall growth remains low, unemployment is high (12.9% as of October, 2016) and one-fifth of the population lives in poverty. At the root of these problems are a number of structural conditions: crime, the cost and limited availability of credit, rising cost of electricity, and informality of firms that increase lending risk and job creation in the country.[3] Moreover, as a tourism-based small open economy, Jamaica remains vulnerable to external shocks, including natural disasters, tourism downturn, and fluctuating oil prices.

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1 All macroeconomic figures were drawn from the most recent Caribbean Region Quarterly Report: Volume 5: Issue 4: December 2016.

2 At the beginning of the Extended Fund Facility with the IMF, public debt to GDP had reached 146.4% of GDP – one of the highest in the world. By March 2017, this ratio is estimated to have diminish to 124% (IMF, 2016).

3 Country Report No. 16/350, IMF 2016; Country Report No. 16/181, IMF 2016; Productive Development Policies in Jamaica, Inter-American Development Bank (IDB) 2010.

2.3 **The financial sector.** Upgrades in credit ratings and business confidence indicators have helped restore Jamaica's access to domestic and international financial markets.[4] Because the public financial needs have traditionally relied on the domestic financial system, interest rates continue to be relatively high, thus affecting the price and availability of resources for the private sector to access financing. While Jamaica's central bank has been lowering policy rates since April 2015, banks' financial intermediation rate spreads remain high. Credit to the private sector stands roughly at 30% of GDP (World Development Indicators, 2016), with higher projected growth rates expected in the next few years. The sector has been performing well: as of September 2016, banks' non-performing loans were at 3.0% of total loans with a Capital Adequacy Ratio (CAR) of 14.7%, above the 10% regulatory minimum. Its average level of provisioning was high (117.2%) and liquidity stress tests performed by the central bank showed continued resilience of the financial system to shocks.

2.4 While Jamaica's financial system is healthy in general terms, financial instruments that can be especially valuable for Micro, Small and Medium Enterprises (MSME) are scarce in the market and are estimated to reach less than 10% of the MSME market.[5]

2.5 **Micro, Small and Medium Enterprises (MSME): finance and productivity.** Across the Caribbean region, MSME are estimated to account for 70% to 85% of firms, contribute 60% to 70% of GDP and about 50% of employment.[6] In Jamaica, it is estimated that there are about 200,000 formal SMEs and between 200,000 and 400,000 micro-entrepreneurs, although no recent official estimates on the size and composition of the MSME sector exist.[7] According to the Ministry of Industry, Commerce and Agriculture and Fisheries (MICAF), MSME contribution in terms of jobs reaches levels of 90%.

2.6 Throughout the region, the prevalence of underdeveloped financial markets restricts opportunities for MSMEs to become more productive and grow. When MSMEs invest in their businesses – for instance, by acquiring new equipment – they tend to improve their productivity, allowing them to increase the output per unit of input. But these investments require financing, the cost of which in many cases is prohibitive, nonexistent for smaller firms or requires collateral which MSMEs find difficult to provide. Low levels of productivity result in lower cash flows, in turn limiting the capacity of MSME borrowers to repay their creditors and to access new loans. The issue then translates into a "vicious cycle of low productivity, low revenue flows and the inability to access funding" (CDB, 2016).

2.7 The commercial banking sector typically does not prioritize MSMEs, preferring investment opportunities in low-risk instruments (such as government securities).

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4 In February 2017, Fitch confirmed Jamaica's sovereign credit rating of B (stable outlook). S&P and Moody's rate Jamaica in the B (stable outlook) and Caa2 (positive outlook) categories, respectively. For the evolution of Jamaica's credit rating see also Caribbean Region Quarterly Bulletin: Volume 4: Issue 3: October 2015.

5 The CDB carried out a country-based analysis on the regional availability of financial coverage in the market for MSME in different stages of their life cycle. For a list of the most significant financial instruments and mechanisms, see Micro, Small & Medium Enterprise Development in the Caribbean: Towards A New Frontier. Caribbean Development Bank (CDB), 2016.

6 CDB, 2016.

7 Financial Sector Assessment Programme, Development Module, Jamaica, SME Finance Technical Note. World Bank, 2015.

Moreover, high perceived risks (mainly due to lack of reliable information), high levels of informality and the absence of a secondary market for fixed assets, causes banks to require high levels of collateral in order to offset their risks. As a result, access to financing by banks is reduced only to those firms that have the capacity to meet these high collateral requirements. According to the latest Enterprise Survey of Jamaica (PROTEqIN survey for Compete Caribbean, 2014), 30.5% of firms mention access to financing as a major or very severe obstacle to business operations while the cost of credit was seen as a major or very severe obstacle by 36.6% of respondents. The survey also shows that while almost 100% of firms have a bank account, only 43% of firms have a bank loan or line of credit. Moreover, less than half of all firms who did not apply for a loan in the last fiscal year, said they did not require one, while the others cited issues such as high cost, high collateral requirement or the expectation that the loan would not be granted as reasons. Finally, almost all loans require collateral (80%) and the average value of collateral needed is 175% of the loan amount.[8] Banks usually require land, buildings or cash, which is particularly onerous for MSMEs.

2.8 The problem that the Credit Enhancement Fund (CEF) will address is the lack of adequate financing for MSME investments to stimulate growth and productivity in Jamaica. More specifically, the programme will focus in addressing problems related to the limited collateral capacity of firms, which has been identified as one of the main reasons preventing them from accessing financing. While existing literature on the impact of credit access on MSME productivity is still limited, the problems of access to credit, empirical evidence and the basis of correlations between credit and growth have been widely analyzed and some studies have broadly demonstrated the relationship between a higher level of credit to the private sector (including MSMEs) and an increase in productivity.[9]

B. Intervention proposed and programme objectives

2.9 The objective of the programme is to promote productive investments in MSMEs in Jamaica by enhancing their access to financing, particularly medium and long term loans. Under a single component, resources from the programme will be used to complement the capital of the CEF, an existing guarantee mechanism administered by the Development Bank of Jamaica (DBJ). The DBJ will act as Executing Agency, in order to facilitate access to financing for MSMEs through the approved financial institutions (AFI).

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[8] According to the 2013 PROTEqIN Survey, the minimum collateral was 100%, while the maximum was 400% of the loan amount; Caribbean Development Bank, *"Micro-Small-Medium Enterprise Development in the Caribbean: Towards a New Frontier",* 2016.

[9] A revision of this as well as a general description of financing programmes for productive development can be found in the "*Sector Framework Document for Support of SME and Financial Access and Supervision*" (IADB, GN-2768). See also IADB (2010). *Development in the Americas (DIA), "The Productivity Era: How to transform economies from its foundations"*; Eslava, M. et al (2009). "The Impact of Credit Markets on Productivity Behavior in Colombia"; *Centro de Estudios Tecnológicos del Instituto Tecnológico de Monterrey. "Integral Evaluation 2008-2009 of the Fund to Support Micro, Small and Medium Enterprises"*; Coelho, D. and De Negri, J. (2010) *"BNDES Financing Impact on Firms' Producitivity: an Application of the Quantilic Effect Treatment"*; Coelho, D. and Sousa, F.L. (2010) *"The Effects of BNDES Financing on the Performance of Brazilian Industrial Companies"*.

2.10 The DBJ is a government owned institution focused on ensuring that low-cost funds are available to all viable enterprises in the productive sectors which include agriculture, agro-processing, services, manufacturing, mining and tourism. In response to the abovementioned credit constraints, the institution has implemented a number of initiatives to improve MSMEs access to credit.[10] One such initiative has been the CEF, in operation since 2009.[11] The CEF provides partial loan guarantees to approved AFIs for loans given to MSMEs which are unable to meet AFIs collateral requirements. The CEF also acts as an incentive to AFIs to increase their MSME loans portfolio by providing additional security coverage on loans issued by the AFI to MSMEs for projects geared towards growth and development. During its history, the CEF has provided over 300 guarantees, mobilizing close to US$9 million to cover US$18 million in loans (47% coverage on average). On an individual basis, the CEF can cover up to 50% of a loan amount (80% for climate friendly projects), with a limit of up to approximately US$115 thousand. To operate, the CEF has dedicated staff to promote and to assure proper processing of guarantees. The CEF's acceptance in the market is expected to be more attractive following the recent pronouncement by the Bank of Jamaica's decision to reduce the risk-weighting for the guaranteed portion of the loans.[12] This would ensure additional take up by the approved financial institutions. Based on preliminary interviews with the AFI and with representatives of MSME associations, there appears to be sufficient demand for the programme resources. The potential uptake from MSME firms will be validated during the project preparation through a market study.

2.11 The programme builds upon the DBJ's well-developed experience in operating and managing the CEF. Disbursement of funds to AFIs will be made periodically based on expected demand for guarantee issuances to be provided by the participating AFI. Specific end-beneficiaries of the loans will be deemed eligible over the basis of a number of conditions established in the Operating Regulations (OR), including a discussion on whether specific provisions may be considered for gender and climate change. The programme will apply the standard procedures established by the IDB for monitoring and evaluation of investment operations.

2.12 The Bank will draw on experiences in Latin America and the Caribbean (Chile, Peru, Colombia, Paraguay and Barbados, among others) in the design of this operation, applying the best practices and lessons learned in previous operations, including the more recent Enhanced Access to Credit for Productivity Project (3389/OC-BA), a guarantee fund to provide access to finance for MSME in Barbados that was approved by the Bank in 2014.

2.13 **Programme alignment.** The project is aligned with the IDBG Country Strategy with Jamaica 2016-2021 (GN-2868), in the strategic area of increasing private

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10 Across the LAC region, National Development Banks (NDB) have progressively increased their role in filling major financing gaps and in the development of long term financing to support investment. As NDB lending to MSMEs is usually intermediated, it can also contribute to the development of financial markets, mobilizing broader financial resources by leverage (from private financial intermediaries) while expanding the scope and access to adequately priced resources by all sectors of the economy

11 For more information on the CEF, please see the following link.

12 The Bank of Jamaica issued a pronouncement that would allow for deposit-taking institutions to apply a 20% risk weight on on-balance sheet claims in local currency that have been backed by guarantees of the CEF. The portion of the loan not guaranteed will continue to be weighted at 100%. This decision is valid up to December 2019, after which Bank of Jamaica will reassess the reduced risk-weighting to DBJ's guarantees.

sector productivity and growth. Additionally, it is aligned with the development challenge of the Update to the IDB Institutional Strategy 2010-2020 (AB-3008) of productivity and innovation. The project is also consistent with the National Financial Inclusion Strategy (NFIS) of the Government of Jamaica (GOJ). The programme will be complementary to the Multilateral Investment Fund (MIF) group programme "Promoting Financial Inclusion in Jamaica through Mobile Money" (ATN/ME-14592-JA), which will provide support to the business development services of MSME provided by the DBJ and the Policy Based Loan (PBL) for the "Financial System Reform Support Programme" (3704/OC-JA), which supported financial market reforms destined to promote access to credit for MSME. The programme will also coordinate with the World Bank "Access Finance Project", which is expected to also support and enhance the work of the CEF through a loan to its capital and technical assistance to improve its corporate governance and management. The details related to the World Bank project will be addressed during the preparation phase of the IDB programme and will be reflected in the programme design.

III. TECHNICAL ISSUES AND SECTOR KNOWLEDGE

3.1 The proposed programme will use US$20 million from IDB's Ordinary Capital (OC) in the form of an investment loan. The borrower will be the GOJ and the Executing Agency will be the DBJ.

3.2 DBJ's funds are primarily channeled through AFIs, such as commercial and merchant banks, the National People's Co-operative Bank of Jamaica, credit unions and other private sector development finance institutions. These institutions provide the initial credit evaluation and loan supervision before on-lending to clients. Besides making funding available, the DBJ also promotes capacity building through the provision of technical assistance to MSMEs and supports the development of the microfinance industry by accrediting and providing funding to micro finance institutions.

3.3 The programme is conceived as an investment loan to support an existing guarantee fund to support MSME lending in Jamaica. Resources from the programme will help compensate for the lack of collateral that MSMEs face when trying to access loans from the approved financial institutions. It is expected that in the long term, the guarantees undertaken under the project will contribute to improve the way in which risks associated to MSMEs are perceived by commercial banks, and lead to increased financing in this market segment (demonstration effect).As such, the programme presents an opportunity to deliver comprehensive IDB Group solutions both on the public and private sector windows, by developing a market through public policy instruments that can be scaled up in time through complementary private sector interventions.

IV. ENVIRONMENTAL SAFEGUARDS AND FIDUCIARY SCREENING

4.1 According to Directive B.13 of the Environment and Safeguards Compliance Policy (OP-703), this programme does not require classification. Resources from the programme will be used for replenishing an existing guarantee fund to back sub-loans granted by the AFIs to eligible beneficiaries. Due to the sub-projects'

small size[13] and the profile of the Jamaican economy (with a strong predominance of services: 72.2% in 2015),[14] this operation is expected to be low risk (FI-3). Such classification will be confirmed during the due diligence process along with the Environmental and Social Management System (ESMS) to be put in place, including an exclusion list to be incorporated in the Operating Regulations.

4.2 There is a risk that deterioration in macroeconomic conditions in Jamaica could affect credit demand for the programme. While macroeconomic risk cannot be mitigated, the IDB is expected to negotiate that all disbursements to the programme will be advances, where the amount is determined by the expected demand pipeline for guarantees from the participating AFIs.

4.3 The Executing Agency has proven experience in the management and operation of such a fund. An institutional assessment of the DBJ would be carried out as part of the programme preparation and this would provide guidance on the implementation mechanism that needs to be in place for the programme's successful implementation.

V. RESOURCES AND TIMETABLE

5.1 Distribution of the Proposal for Operation Development (POD) for Quality and Risk Review (QRR) is expected on March 14, 2017, approval of the Draft Loan Proposal by OPC is expected by May 17, 2017, and consideration of the Loan Proposal by the Executive Board of Directors is expected by June 21, 2017. An estimated US$70,000 administrative budget and 0.825 FTEs is required to complete preparation of the programme, according to Annex V.

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[13] Maximum J$15m = US$115k.
[14] CIA World Factbook.

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Safeguard Policy Filter Report

Operation Information

Operation		
JA-L1075 Jamaica Credit Enhancement Facility (JCEF)		
Environmental and Social Impact Category	High Risk Rating	
B13	{Not Set}	
Country	Executing Agency	
JAMAICA	{Not Set}	
Organizational Unit	IDB Sector/Subsector	
Caribbean Group	BANKING MARKET DEVELOPMENT	
Team Leader	ESG Lead Specialist	
DANIEL FERNANDO FONSECA	{Not Set}	
Type of Operation	Original IDB Amount	% Disbursed
Loan Operation	$0	0.000 %
Assessment Date	Author	
15 Mar 2017	ceciliabe Project Assistant	
Operation Cycle Stage	Completion Date	
ERM (Estimated)	14 Feb 2017	
QRR (Estimated)	21 Mar 2017	
Board Approval (Estimated)	{Not Set}	
Safeguard Performance Rating		
{Not Set}		
Rationale		
{Not Set}		

Safeguard Policy Filter Report

Potential Safeguard Policy Items

[No potential issues identified]

Safeguard Policy Items Identified

B.1 Bank Policies (Access to Information Policy– OP-102)

The Bank will make the relevant project documents available to the public.

B.2 Country Laws and Regulations

The operation is expected to be in compliance with laws and regulations of the country regarding specific women's rights, the environment, gender and indigenous peoples (including national obligations established under ratified multilateral environmental agreements).

B.3 Screening and Classification

The operation (including associated facilities) is screened and classified according to its potential environmental impacts.

B.7 Supervision and Compliance

The Bank is expected to monitor the executing agency/borrower's compliance with all safeguard requirements stipulated in the loan agreement and project operating or credit regulations.

B.13. Noninvestment Lending and Flexible Lending Instruments

Ex-ante impact classification may not be feasible for this type of operation. This includes: policy-based loans, Financial Intermediaries (FIs) or loans that are based on performance criteria, sector-based approaches, and conditional credit lines for investment operations.

B.17. Procurement

Suitable safeguard provisions for the procurement of goods and services in Bank financed operations may be incorporated into project-specific loan agreements, operating regulations and bidding documents, as appropriate, to ensure environmentally responsible procurement.

Recommended Actions

Operation has triggered 1 or more Policy Directives; please refer to appropriate Directive(s). Complete Project Classification Tool. Submit Safeguard Policy Filter Report, PP (or equivalent) and Safeguard Screening Form to ESR.

Additional Comments

Safeguard Policy Filter Report

According to Directive B.13 of the Environment and Safeguards Compliance Policy (OP-703), this program does not require classification. Resources from the program will be used for replenishing an existing guarantee fund to back sub-loans granted by the AFIs to eligible beneficiaries. Due to the sub-projects small size and the profile of the Jamaican economy (with a strong predominance of services: 72.2% in 2015), we expect this operation to be low risk (FI-3). Such classification will be confirmed during the due diligence process along with the necessary Environmental and Social Management System (ESMS) to be put in place.

SOCIAL AND ENVIRONMENTAL STRATEGY

1. **Overview.** The Development Bank of Jamaica (DBJ) is a government owned institution focused on ensuring that low-cost funds are available to all viable enterprises in the productive sectors. In response to the credit constraints SMEs experience in the island, the institution has implemented a number of initiatives to improve SMEs access to credit. One such initiative has been a pilot Credit Enhancement Fund (CEF), in operation since 2009. The CEF provides partial loan guarantees to Approved Financial Institutions (AFIs) for loans given to SMEs which are unable to meet AFIs collateral requirements. The CEF also acts as an incentive to AFIs to increase their SME loans portfolio by providing additional security coverage on loans issued by the AFI to SMEs for projects geared towards growth and development.

2. The objective of the programme is to promote productive investments in SMEs in Jamaica by enhancing their access to finance, particularly medium and long term. Under a sole component, resources from the programme will be used to support the CEF, a guarantee mechanism administered by the DBJ, acting as Executing Agency, in order to facilitate access to financing for SMEs through the local commercial banks.

3. The programme builds upon the DBJ's well-developed experience in operating and managing the CEF. Disbursement of funds to AFIs will be made based on a scheduled portfolio or a portfolio undertaken by the DBJ. Specific end-beneficiaries of the loans will be deemed eligible over the basis of a number of conditions established in the Operating Regulations (OR).

4. **Environmental and Social Impacts and Risks.** Based on the Directive B.13 of the Environment and Safeguards Compliance Policy (OP-703), the proposed operation is classified as a Financial Intermediary (FI) and thus not categorized according to its potential environmental and social impacts and risks. Considering that the individual transactions contemplated in the proposed programme are expected to present low potential adverse environmental and social impacts (due to their small average size and the strong predominance of the services sector in the Jamaican economy), this operation is considered as a low-risk FI (FI-3).

5. **Strategy for Environmental and Social Due Diligence.** The IDB will confirm this FI-3 classification during the due diligence phase and will establish the Environmental & Social Management System (ESMS) applicable to this operation and to be included in the programme's OR. The due diligence will include the following:

   a. Analysis of the CEF existing and forecast portfolio of guarantees;

   b. assessment of DBJ internal capacity, policies and procedures to identify, evaluate and mitigate Environmental and Social liabilities, risks and impacts; and

c. development of an operation-specific ESMS including but not restricted to an exclusion list, the necessary compliance check with applicable local laws and regulations and IDB policies.

The results of the due diligence will be presented in an Environmental and Social Management Report (ESMR).

INDEX OF SECTOR STUDIES

Studies	Date	References and Links
Caribbean Development Bank, Micro, Small & Medium Enterprise Development in the Caribbean: Towards a New Frontier.	2016	Micro, Small & Medium Enterprise Development in the Caribbean: Towards A New Frontier
World Bank, Financial Sector Assessment Programme, Development Module, Jamaica, SME Finance Technical Note.	2015	Financial Sector Assessment Programme, Development Module, Jamaica, SME Finance Technical Note
Demand Analysis	In preparation	Sector Demand Analysis

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