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JAMAICA

CREDIT ENHANCEMENT PROGRAMME FOR MICRO, SMALL AND MEDIUM ENTERPRISES (MSME)

(JA-L1075)

LOAN PROPOSAL

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ABBREVIATIONS	
AFI	Approved Financial Institutions
BNDES	Brazilian Development Bank
BOJ	Bank of Jamaica
CAR	Capital Adequacy Ratio
CBA	Cost Benefit Analysis
CDB	Caribbean Development Bank
CEF	Credit Enhancement Facility
CPI	Consumer Price Index
CRF	Corporate Results Framework
DBJ	Development Bank of Jamaica
DIA	Development in the Americas
EA	Executing Agency
ESMR	Environmental and Social Management Report
ESMS	Environmental and Social Management System
FAAA	Financial Administration and Audit Act
FSC	Financial Services Commission
FY	Fiscal Year
GCI	Global Competitiveness Index
GCT	General Consumption Tax
GDP	Gross Domestic Product
IDB	Inter-American Development Bank
IMF	International Monetary Fund
JSE	Junior Stock Exchange
MIF	Multilateral Investment Fund
MSME	Micro, Small and Medium Enterprise
NFIS	National Financial Inclusion Strategy
NPV	Net Present Value
OC	Ordinary Capital
OG	Operational Guidelines
OR	Operating Regulations
PCR	Project Completion Report
PEU	Programme Executing Unit
SBA	Stand-By Arrangement
SME	Small and Medium Enterprise
US$	Dollars of the United States of America
WAL	Weighted Average Life
WB	World Bank

PROGRAMME SUMMARY

JAMAICA

CREDIT ENHANCEMENT PROGRAMME FOR MICRO, SMALL AND MEDIUM ENTERPRISES (MSME)

(JA-L1075)

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[a] Under the Flexible Financing Facility (FN-655-1), the Borrower has the option to request modifications to the amortization schedule as well as currency and interest rate conversions. In considering such requests, the Bank will take into account operational and risk management considerations.

[b] The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors during its review of the Bank's lending charges, in accordance with the relevant policies.

[c] SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

[d] GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. DESCRIPTION AND RESULTS MONITORING

A. Background, Problem Addressed and Justification

1.1 **Macroeconomic context.** With a population of approximately 2.8 million, Jamaica is a small, open economy, characterized by low growth and high debt and is classified as an upper-middle-income country. Since the year 2000, Jamaica has had an average economic growth rate of 0.8% which is below the 3.6% Latin American and Caribbean average. Sustained fiscal deficits, public enterprise borrowing, and financial sector interventions have contributed to rapid debt accumulation that affects growth. Low growth has further impacted Jamaica's fiscal position and the standard of living (real Gross Domestic Product (GDP) per capita has remained flat since the 1990s). In recent years, the economy has taken measures towards macro-economic stability, with growth projected at 1.6% in Fiscal Year (FY) 2016-2017 and expected to reach 2.8% by FY 2020-2021. Business-friendly reforms, the continuation of fiscal prudence under the current International Monetary Fund (IMF) Stand-By Arrangement and implementation of major infrastructure projects are expected to be growth positive.

1.2 While public debt fell significantly from 146.4% of GDP in March 2013 to an expected level of 118.3% of GDP in FY 2018-2019,[1] the path towards external debt sustainability will continue to rely on continued fiscal consolidation and external financing, while maintaining investor confidence. External downside risks include: a global economic slowdown; commodity price shocks; threats to tourism; financial intermediation; and natural disasters.

1.3 The monetary policy has been geared towards maintaining international reserves and containing inflation. Net international reserves were US$2.5 billion by the end of FY 2016-2017, while gross international reserves at US$3.1 billion were equivalent to 24.5 weeks of imports of goods and services. The current account deficit decreased to 2.4% in FY 2015-2016, compared to 13.5% in FY 2011-2012. It is projected to remain at around 3% of GDP, assuming oil prices remain at low levels.[2] Remittances continued to increase and represented 15% of GDP in 2016. The fiscal consolidation, improvements in competitiveness and positive inflows from tourism and remittances may contribute to a narrower current account deficit. Inflation in FY 2016-2017 was around 4.1%, while the decline in international fuel prices kept inflation contained, an increase over the medium term should keep the Consumer Price Index (CPI) in the range of 5% to 5.5%. The unemployment remains in double digits and reached 12.9% in 2016.

1.4 **The financial sector.** The Bank of Jamaica (BOJ) is the central bank which is responsible for promoting and maintaining the stability of the Jamaican financial system, supervising the activities of deposit taking financial institutions,[3] as well as providing regulatory oversight for foreign exchange traders and remittance companies. The Financial Services Commission (FSC) provides regulatory

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[1] Consolidated central government and public bodies' debt consistent with the Fiscal Responsibility Framework set out in the Financial Administration and Audit Act (FAAA).

[2] Forecasts from October 2016 IMF Stand-By Arrangement (SBA), assuming oil prices of US$44.9, US$51.3, and US$53.4 for FY 2016-2017 to FY 2018-2019.

[3] Comprised of commercial banks, primary dealers (securities brokers), merchant banks and finance houses, and building societies.

oversight to non-deposit taking financial institutions.[4] The sector, which is comprised of seven commercial banks and 36 credit unions,[5] has been performing adequately in recent years. 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. The average level of provisioning was high (117.2%) and liquidity stress tests performed by the BOJ showed continued resilience to shocks (for further information, please see Jamaica Financial System Overview).

1.5 Improvements in the country's credit rating and in business confidence indicators have underpinned Jamaica's interaction with the domestic and international financial markets.[6] Interest rates continue to be relatively high, therefore affecting the price and availability of resources for financing to the private sector. This has continued to influence the banks' elevated financial intermediation rate spreads, even though the BOJ has been lowering its policy rates since April 2015. Consequently, credit to the private sector is relatively low in Jamaica (30% of GDP in 2015), when compared to other Caribbean countries such as Trinidad & Tobago (37%), Belize (57%) and Bahamas (72%) (World Development Indicators, 2016). Moreover, when assessing access to finance for smaller firms, the reach of the financial system is estimated to cover less than 10% of all Micro, Small and Medium Enterprises (MSME).[7]

1.6 When reviewing Jamaica's performance in the updated Global Competitiveness Index (GCI) for 2016-2017,[8] the country positions itself favorably overall in financial market development (ranked 30th out of 138 countries) and more specifically in financing through local equity market (26th), soundness of banks (39th) and regulation of securities exchanges (32nd). Even more positive is the Doing Business 2017 report,[9] which positions Jamaica favorably in terms of getting credit (ranked 16th out of 190 countries), mainly due to the quality of its regulatory environment. However, and more critical to the financing needs of MSME, the country performs less favorably in the GCI on specific items of the financial services meeting business needs (67th out of 138 countries), affordability of financial services (91st), and ease of access to loans (81st).

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4 Comprised of insurance companies, securities firms and dealers, unit trusts, private pension funds, and mutual funds.

5 The supervisory framework for credit unions was more recently designated by the Minister of Finance and the Public Service as "specified financial institutions" under the BOJ Act, enabling the BOJ to obtain information on their operations, however a formal supervisory framework is pending approval from Parliament.

6 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.

7 The Caribbean Development Bank (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 MSME Development in the Caribbean: Towards A New Frontier. CDB, 2016.

8 World Economic Forum, "Global Competitiveness Report 2016-2017", September 2016. For comparison's sake, Barbados ranks 62nd overall in financial market development (76th in financial services meeting business needs, 77th in affordability of financial services, and 113th in ease of access to loans), Dominican Republic ranks 87th overall in financial market development (56th in financial services meeting business needs, 86th in affordability of financial services, and 58th in ease of access to loans), and Trinidad and Tobago ranks 61st overall in financial market development (73rd in financial services meeting business needs, 64th in affordability of financial services and 77th in ease of access to loans).

9 World Bank Group, "Doing Business 2017", October 2016.

1.7 **The link between credit and productivity.** While existing literature on the impact of credit access on MSME productivity is still limited, the problems related to access to credit for all types of firms, 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 MSME) and an increase in productivity.[10]

1.8 **MSME:[11] access to finance.** Across the Caribbean, MSME are estimated to account for 70% to 85% of the number of firms, contributing between 60% to 70% of GDP and about 50% of employment.[12] In Jamaica, it is estimated that there are about 200,000 formal Small and Medium Enterprises (SME) and between 200,000 to 400,000 microenterprises; although there are no recent official estimates related to the size and composition of the MSME sector.[13] MSME are an important source of jobs in Jamaica, as it is estimated that 82% of the country's workforce are employed by MSME.[14]

1.9 The low levels of finance to the private sector in Jamaica restrict opportunities for MSME to invest in the expansion of their businesses, thus limiting their growth perspectives and the means to improve their productivity. To carry out these investments, MSME require financing. However, MSME face important constraints to obtain this financing, due to: (i) its prohibitive cost; (ii) its unavailability for smaller firms; (iii) its short repayment period (when compared to the time needed to consolidate investment projects); and (iv) its collateral requirements (which MSME cannot provide for sufficiently). As a result, by not being able to improve their low levels of productivity, MSME have lower cash flows, limiting their capacity to repay their creditors and to access new loans.

1.10 The commercial banking sector in Jamaica typically does not prioritize MSME, preferring investment opportunities in low-risk instruments (such as government securities) that have low capital allocation. A high perception of risks (mainly due to lack of reliable information), coupled with high levels of informality and the absence of a secondary market for fixed assets, will cause banks to require high levels of collateral to offset their risk-weighting. 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 (productivity, technology and innovation) survey for Compete Caribbean, 2014), 30.5% of firms mention access to financing as a major or a very severe obstacle to business operations while the cost of credit was seen as a major

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[10] 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 Small Medium Enterprise (SME) and Financial Access and Supervision" (IDB, GN-2768). See also IDB (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' Productivity: an Application of the Quantile Treatment Effect"; Coelho, D. and Sousa, F.L. (2010) "The Effects of BNDES Financing on the Performance of Brazilian Industrial Companies".

[11] In Jamaica, MSME are defined as firms that have less than 150 employees and a turnover of approximately US$3 million or less.

[12] CDB, 2016.

[13] Financial Sector Assessment Program, Development Module, Jamaica, SME Finance Technical Note. World Bank, 2015.

[14] Compete Caribbean, "Private Sector Assessment of Jamaica", 2015.

challenge 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. Finally, almost all loans require collateral (80%) and the average value of collateral needed is 175% of the loan amount being sought.[15] Banks usually require land, buildings or cash, which is particularly onerous for MSME, and do not accept or significantly undervalue equipment or specialized assets in a market of a limited size.

1.11 The problem that the programme will seek to address is the lack of adequate financing for MSME investments to stimulate growth and productivity in Jamaica. More specifically, the programme will focus on addressing problems related to the limited collateral capacity of MSME, which has been identified as one of the main reasons preventing them from accessing financing.

1.12 To put the MSME perspective into context, a market study[16] was specifically commissioned to support the preparation of this programme in order to provide a literature review of the market failure and to obtain data directly from MSME and financial institutions in Jamaica so as to better diagnose the IDB's intervention. As part of the diagnosis, a survey of 96 MSME and 6 financial institutions was carried out to support the study's conclusions.

1.13 From the study's findings, 60% of the MSME interviewed responded that access to finance is extremely challenging, being the most commonly identified barrier experienced by those cited in the survey.[17] Most respondents prioritize their personal savings and retained earnings to finance long-term investments, with 34% of MSME interviewed able to significantly use commercial banks and less than 10% able to access microfinance institutions, credit unions and the Junior Stock Exchange (JSE). The lack of usage of external finance sources, however, is not due to a lack of willingness from MSME, as 80% of the respondents indicated that they had sought financing for their businesses.

1.14 To confirm why MSME demand for financing is not met, the survey focuses on the barriers encountered in accessing finance. The four most common issues identified by respondents in Jamaica as extremely challenging are: (i) the bureaucracy involved in accessing finance is more than desired (62%); (ii) the interest rates are too high (55%); (iii) the firm does not have the type of collateral required by financial institutions (50%); and (iv) the loan terms (other than interest rate are too onerous) (46%). Even more pressing, 79% of respondents identified that these financing challenges had increased in the past four years.

1.15 Each of these four challenges are not uncommon to other countries in Latin America and the Caribbean,[18] as they are recurring market failures that are

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

[16] David Tennant, "Market Diagnostic of the Development Bank of Jamaica's Credit Enhancement Facility", March 2017. For further information, please see Market Study.

[17] By comparison, the next highest rated barriers of cost of energy and tax rates were identified as extremely challenging by 45% and 44% of respondents, respectively.

[18] For more information on IDB interventions on these market failures, please see "Sector Framework Document for Support of SME and Financial Access and Supervision" (IDB, GN-2768-3).

addressed through public policy interventions in the region. This programme will focus directly on the lack of collateral as a barrier encountered by MSME in accessing finance in Jamaica. Complementarily, a Multilateral Investment Fund (MIF) programme Promoting Financial Inclusion in Jamaica through Mobile Money (ATN/ME-14598-JA) will support business development services for MSME to address the bureaucracy involved in obtaining financing. The remaining challenges may be indirectly addressed as the terms and conditions relative to financing MSME could vary over time.

1.16 The availability of collateral is a major barrier for accessing finance, as close to 70% of the survey's MSME respondents mentioned that they cannot meet the financial institutions' requirement or that the financial institutions significantly undervalued the assets they are able to provide as collateral. In parallel, the financial institutions who responded to the survey also identified collateral as one of the most frequent reasons preventing MSME from being approved for loans, and more specifically 79% of MSME loan applications can only be approved with a collateral or guarantee assistance.

1.17 The most common difficulty that MSME face when providing collateral relates to the acceptance of assets from financial institutions. While 59% of respondents own equipment and machinery to provide as collateral, only 24% believe that these will be accepted as collateral by financial institutions. In contrast, 55%, 68% and 85% respectively of respondents believe that financial institutions will accept motor vehicles, cash and marketable securities, and real estate, respectively, as collateral for a loan, whereas they clearly lack ownership of these assets (39%, 31% and 48%, respectively) to provide to financial institutions as collateral.

1.18 **Financial institutions: barriers to financing for MSME.** As mentioned previously, while the financial sector has demonstrated a sound financial standing, characterized by good asset quality indicators and strong liquidity, it has been lacking in the proportion allotted to credit to the private sector.

1.19 Commercial banks are widely considered the most important source of loans in Jamaica, representing 68% of the financial system loans supply as of 2015. Building societies, credit unions and merchant banks make up the remaining 20%, 10% and 2% of financial system loans as of 2015, respectively, however their market participation has diminished over time. There is a high degree of concentration in the banking system itself as the top three banks account for 61% of the total assets of deposit taking institutions in Jamaica.[19]

1.20 When analyzing credit in Jamaica, the overall proportion of credit to the private sector has decreased significantly over time, from 79% of total credit in 1980, to 55% in 2000, to 45% in 2015.[20] As a result, this trend has naturally tended to affect access to financing for the productive sector, thus impacting significantly on the country's economic growth.

1.21 More specifically, MSME loans have stagnated in number of loans, from a high of 62 thousand loans in 2008, to a low of 28 thousand loans in 2011 and hovering around 40 thousand loans during the three last observed years from 2013 to 2015. A similar trend can be observed in terms of average loan amount, which has

[19] Data obtained from the BOJ financial system statistics.
[20] David Tennant, "Market Diagnostic of the Development Bank of Jamaica's Credit Enhancement Facility", 2017.

ranged between the equivalent of US$900 and US$1,200 per loan between 2008 and 2015.[21] Taking these amounts as reference, loans to MSME can be estimated to be between US$36 million and US$48 million in terms of placements per year. Based on the survey findings, if 79% of MSME loans need collateral enhancement for them to be approved, the average demand for partial credit guarantees can be estimated to be between US$28 million and US$38 million per year and US$140 million and US$190 million over the course of a five-year period. With an estimate of US$28 million in demand per year and US$140 million over the course of five years, loan resources of US$20 million would respond to 14.3% of estimated demand.

1.22 It is also important to outline that because financing is difficult to obtain for MSME, there is unrealized demand that may not materialize. According to the survey, 71% of respondents did not pursue at least one investment project in the last four years. Moreover, looking to the future, 76% of respondents expect that at least one investment project will be forgone in the next two years due to lack of credit.

1.23 Beyond the scope of the current market dynamics, financial institutions have also seen their assignment of capital increase in response to a stronger set of prudential regulations in line with international standards aligning towards the adoption of Basel principles. In response, financial institutions have tended to: (i) prioritize loans to large and well established companies that carry lesser risk provisions due to their better credit rating; and (ii) prioritize retail loans that are more tolerant to higher interest rates and can therefore absorb the higher risk provisions. As a result, financial institutions have tended to drift away from loans to MSME, given their low tolerance for high interest rates, the difficulty of obtaining suitable financial information and business plans to properly assess their investments projects and sufficient collateral to provide coverage for a loan.

1.24 These financing concerns have led Jamaica to develop a series of public policies aimed at improving the access to finance conditions for productive development and more specifically centered on MSME,[22] including programmes developed through the Development Bank of Jamaica (DBJ), the National Export-Import Bank of Jamaica, the Micro-Investment Development Agency, the Self-Start Fund and the National Financial Inclusion Strategy (NFIS).[23] While these initiatives provide for a good basis for development, further support is needed to foster financing solutions for MSME in Jamaica.

1.25 The DBJ is a wholly owned government institution, created on April 1, 2000 under the name of National Investment Bank of Jamaica, following the merger of two national development entities, the Agricultural Credit Bank Limited and the National Development Bank, and ultimately adopting the DBJ name in 2006. With close to US$200 million in assets and US$80 million in equity, the DBJ is the only development financing organization in the country, dedicated to providing funding and technical cooperation to Jamaican companies, with particular emphasis on improving access to finance for MSME. To improve MSME access to financing,

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[21] David Tennant, "Market Diagnostic of the Development Bank of Jamaica's Credit Enhancement Facility", 2017.

[22] David Tennant, "Access to Financing for Productive Development in Jamaica", 2015.

[23] The NFIS is an initiative to improve the country's financial system by year 2020, to create the conditions to save and build up resilience against financial shocks, especially those related to climate risks, and to improve the capacity of MSME to invest, grow and generate greater levels of productivity. The strategy has set as one of its impact indicators, a goal of 11% in the percentage of total private-sector credit extended to MSME.

the DBJ created the Credit Enhancement Facility (CEF), which provides partial credit guarantees for Approved Financial Institutions (AFI) to provide loans to MSME, in order to compensate for the latter's inability to meet collateral requirements.

1.26 Established on September 16, 2009, the CEF is a trust fund managed by the DBJ, with an initial capital of close to US$2 million. 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 related investment projects), with a limit of up to approximately US$115,000. To operate, the CEF has dedicated staff to promote and to ensure proper processing of guarantees. In recent years, demand for the CEF has been steady, averaging close to 50 guarantees per year, however the guaranteed amount has been growing from an average amount per guarantee of US$33,000 in 2014-2015 to US$58,000 in 2016-2017. Following a technical analysis of the CEF's impact on credit risk for individual credit, the BOJ published a decree in December 2016 to reduce the risk-weighting for the CEF guaranteed portion on loans. By freeing up capital allocation, this measure is expected to increase demand by the AFI, thus justifying the need to further strengthen the CEF capital. Based on interviews carried out with AFI and MSME associations, there is sufficient demand for the CEF, which would be reinforced following the BOJ's publication.

1.27 The market study identified that there is sufficient demand from the private sector in Jamaica for the programme, given that the scheme will enhance access to credit by reducing the perceived risk to financial institutions. It is envisaged that the additional supply of financing to MSME will emerge from the existing MSME that demand credit but are currently excluded from the credit market due to high collateral requirements. Based on the General Consumption Tax (GCT) returns in 2015, there may over 7,325 businesses benefiting from the programme, which amounts to a total demand in the conservative scenario of US$57 million during the next five years.

1.28 **Programme justification.** The programme will consist of an investment loan to replenish the capital of an existing DBJ trust fund that in turn will provide partial guarantees to support loans to MSME investment projects. The programme will leverage the existing structure and provide enhancements based on the feedback obtained from financial institutions and MSME. It is expected that in the long term, the guarantees supporting MSME investment projects will have a demonstrative effect that will stimulate a higher risk appetite in commercial banks for MSME investment projects and lead to increased financing in this market segment.

1.29 The programme's operational guidelines and conditions will be described in detail in the Operating Regulations (OR) and have been designed based on the experience and lessons learned by the DBJ through the CEF, local financial institutions, and market participants. As a result, from feedback obtained from AFI, the partial guarantee will be able to gradually increase its maximum amount to approximately US$385,000 per individual loan and to increase its coverage to 90% of the loan amount, pending annual reviews and assessments to be carried out by the DBJ and validated by the IDB.

1.30 Based on the market study carried out during the preparation of the programme,[24] it has been concluded that there is sufficient demand for the programme resources. Assuming a coverage ratio on average of 70%, the CEF would expect to support at least 428 investment loans to MSME for a total amount of US$20 million.

1.31 There are several MSME guarantee fund experiences in the region (Chile,[25] Peru,[26] Colombia[27] and Barbados – 3389/OC-BA), of which the project team has used the positive experiences and lessons learned from the difficulties encountered in the design of the programme and its value added. These schemes have carried a positive influence for MSME to obtain suitable financing amounts, terms and conditions relative to their needs. While the interventions showed generally positive trends in investment, productivity, employment, and revenues, several lessons are applicable to Jamaica in order to improve the CEF's current operation the guarantee mechanism should: (i) focus on supporting medium- or long-term investment projects in order to optimize the impact on productivity, as a general purpose guarantee facility may focus on short-term working capital projects and therefore not achieve the intended objectives;[28] (ii) maintain a solid capital base available to respond to the outstanding guarantees if called, ensuring a credible scheme on which the participating financial institutions can rely upon in case of claims; (iii) be limited to a partial credit guarantee instrument, so that the participating financial institutions allocate part of their own capital, thus ensuring suitable due diligence, structuring and collateral mechanisms in each guaranteed loan; (iv) provide clear and transparent triggers and processes in the case of applications, claims and collections, so that the participating financial institutions have the specific knowledge of all requirements and can count on specific timeframes to build credibility in the mechanism; and (v) build institutional capacity that is instrumental to properly manage fiduciary, monitoring and accounting duties, since these programmes need to be efficient in order to be marketable to participating financial institutions, it is important to focus on streamlined processes and strong internal controls, as well as to generate a solid monitoring and evaluation function that will both provide portfolio information to guide management decisions as well as to generate a positive demonstration effect to further promote these types of programmes. Furthermore, the programme is complementary to the operations Competitiveness Enhancement Programme (1972/OC-JA), Competitiveness Enhancement Programme II (2297/OC-JA), Competitiveness Programme III (3147/OC-JA), and Financial System Reform Support Programme (3704/OC-JA), which have set an agenda of reforms to

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[24] David Tennant, "Market Diagnostic of the Development Bank of Jamaica's Credit Enhancement Facility", March 2017. For further information, please see Market Study.

[25] OECD, "Facilitating access to finance: discussion paper on credit guarantee schemes"; Juan José Llisteri et al; IDB, "*Sistema de garantías de crédito en América Latina: orientaciones operativas*", 2006; Cristian Larraín and Jorge Quiroz, *Banco del Estado de Chile*, "*Estudio para el fondo de garantía de pequeños empresarios*", March 2006; Kevin Cowan, Alejandro Drexler and Alvaro Yañez; and Central Bank of Chile Working Papers Nº254, "The effect of credit insurance on liquidity constraints and default rates: evidence from a governmental intervention", August 2009.

[26] IDB, "*Sistema de garantías de crédito en América Latina: orientaciones operativas*", 2006; Cristian Larraín and Jorge Quiroz; Javier Alvarado and Francisco Galarza, *Centro Peruano de Estudios Sociales, "Los fondos de garantía para el acceso al crédito en Perú: alcances y limitaciones*", October 2002.

[27] Irani Arraíz, Marcela Meléndez and Rodolfo Stucchi, Office of the Evaluation and Oversight, IDB, "Partial credit guarantee and firm performance: evidence from the Colombian National Guarantee Fund", September 2012.

[28] For example, in Chile beneficiaries registered an increase of 32% in sales and 24% in profits when compared to non-beneficiaries, while in Colombia beneficiaries showed a more modest increase of 6% in sales (due a higher proportion of short-term working capital guarantees).

strengthen the financial sector and foster the investment climate for MSME. While reforms take time to develop its full impact, this programme will directly facilitate lending by mitigating the collateral constraints of MSME.

1.32 More specifically, the programme will draw on the experience of 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 IDB in 2014. Since the launch of the fund in March 2016, the programme has authorized 14 guarantees, providing US$12 million in guarantees to support US$15 million in total loan amounts. During the first year, the programme disbursed 25% of the resources, exceeding the expected disbursement value for 2016. It is worthwhile to note that technical resources were allocated to support the promotion and the management information systems of the programme, both of which have enhanced the uptake from participating financial institutions and improved the internal controls.

1.33 **Alignment with the IDB's strategies and policies.** The project is aligned with the IDB Group Country Strategy with Jamaica 2016-2021 (GN-2868), in the strategic area of increasing private sector productivity and growth. Additionally, the programme is consistent with the Update to the Institutional Strategy (UIS) 2010-2020 (AB-3008) and is strategically aligned with the development challenges of (i) productivity and innovation through the promotion of productive investments in MSME by enhancing their access to medium and long term financing; and (ii) social inclusion through the inclusion of all segments of the population and firms (particularly MSME) in the financial markets and segments. The programme is also included in the 2017 Jamaica Country Program Document and the 2017 Operational Program Report (GN-2884). Additionally, the programme will contribute to the Corporate Results Framework (CRF) 2016-2019 (GN-2727-6) through MSME financed. The programme is also aligned with the approved version of the sector framework document "Support to SME and Financial Access and Supervision" (GN-2768-3), in terms of developing risk mitigation instruments and widening the financing frontier for the productive sector.

1.34 The programme will be complementary to the MIF Group programme "Promoting Financial Inclusion in Jamaica through Mobile Money for Microfinance" (ATN/ME-14598-JA), which will provide support to the business development services of MSME provided by the DBJ and the PBL "Financial System Reform Support Programme" (3704/OC-JA), which supported financial market reforms designed to promote access to credit for MSME. The programme will also coordinate with the World Bank's (WB) work with the DBJ, which is expected to also support and enhance the work of the CEF through a loan to augment the DBJ's capital resources and technical assistance to improve its corporate governance and management. The project team has maintained close collaboration with the WB project team and the programme design and OR reflect the common understanding among all relevant stakeholders. The project is also consistent with the NFIS of Jamaica.

1.35 The programme is expected to address gender and climate change issues in Jamaica. A study on three Caribbean countries,[29] including Jamaica, suggests that

[29] Claudia Piras, Andrea Presbitero and Roberta Rabellotti, IDB, "Definitions matter – measuring the gender gaps in firms' access to credit", 2013.

there is no gender gap in access to credit by businesses, however there are indications that looking more closely, women-led businesses are more likely to be credit rationed. A more recent study[30] illustrated that there may be a gender gap in access to finance to businesses, based on a smaller sample of Caribbean countries (Presbitero et. Al. (2014)). However, this information may not be conclusive based on the sample size of the survey and warrants further analysis to better understand the Jamaican context. The programme will seek to capture data on the access to finance for women-led MSME under the CEF, with a long-term view to support future decisions on how to engage a specific gender strategy. Additionally, there may be a positive impact on the labor force of Jamaica since the investment projects is focused on MSME development.

1.36 From the perspective of climate change, Jamaica's natural resources have suffered a decline in quantity and quality over time, impacted by the many natural hazards that have affected the island. Over the past decades, Jamaica has experienced an increase in the frequency of natural events, primarily floods related to inclement weather, tropical depressions, tropical storms, hurricanes, droughts and landslides. The adverse impacts of hurricanes included a decline in the health of coral reefs, loss of seagrass beds, severe beach erosion, and loss of forested areas. The island will continue to be affected by increased frequency and intensity of tropical weather systems, which will have a significant impact on the economy, the quality of the country's natural environment, and the livelihoods of thousands of people. While the CEF already includes an incentive for energy loans focused on energy conservation, energy efficiency and renewable energy, the programme will seek to develop data on this type of financing, with a long-term view to support further decisions on how to engage a specific climate change strategy.

B. Objective, Components and Costs

1.37 The objective of the programme is to promote productive investments in MSME 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 DBJ.

1.38 **Beneficiaries.** The programme is intended to benefit Jamaican MSME that are eligible to qualify for financing from local financial institutions, but are constrained due to a lack of collateral to support their applications. As mentioned previously, Jamaica is estimated to have between 200,000 and 400,000 MSME.

1.39 The programme will build upon the DBJ's well-developed experience in operating and managing the CEF. Disbursement of funds will be made periodically based on expected demand for partial guarantees to be provided by the participating AFI (please see ¶3.8). Specific end-beneficiaries of the loans will be deemed eligible based on a number of conditions established in the OR (please see ¶3.5). The programme will apply the standard procedures established by the IDB for monitoring and evaluation of investment operations.

1.40 **Single component – MSME Guarantee Fund.** The programme will provide an investment loan for the CEF, a trust fund managed by the DBJ, to facilitate medium- to long-term AFI financing to MSME investment projects. The programme

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30 Winston Moore, Andrea Presbitero and Roberta Rabellotti, "The gender gap in the Caribbean: the performance of women-led firms", 2017.

will have a single component of US$19.8 million directed to the CEF. An amount of US$0.2 million will be set aside to cover the administrative and monitoring and evaluation cost of the programme.

1.41 The partial guarantees will be issued to eligible AFI to cover individual investments loans to be undertaken by eligible MSME. Each partial guarantee will not exceed US$385,000 (the equivalent of J$50 million) and will provide coverage of up to 90% of the MSME loan amount for up to ten years.[31] Eligible MSME will be entities incorporated in Jamaica and registered to operate in Jamaica, as well as businesses registered under the Registration of Business Names Act, and compliant with the necessary licenses and permits, and with up to 150 employees or US$3.3 million (the equivalent of J$425 million) in yearly revenues; these MSME will have undergone an appropriate credit risk assessment by a participating AFI to obtain a loan. The loans will be eligible to finance projects in the agriculture and agribusiness, business services, construction, energy, manufacturing, retail, tourism, trade and distribution, and for other activities not included in the OR's IDB Exclusion List, to finance investments related to the purchase of equipment and machinery, expansion projects and the increase in permanent capital (when tied to an investment loan).[32] The participating AFI will be incorporated commercial banks, credit unions, or other lenders operating in Jamaica and that qualify under the internal rating methodology employed by DBJ, provide periodic reports, and have a signed agreement with DBJ to participate in the CEF. The IDB will not require interest rate pricing on the guaranteed loans, this will be determined by the AFI considering its own pricing model.[33] The specific procedures, conditions and requirements of the CEF operations, the eligibility criteria for the participating AFI, and criteria for eligible projects of SME are described in the OR.

1.42 To complement the programme, the IDB is providing a Technical Cooperation (TC) aimed at Strengthening the Development Bank of Jamaica Institutional Capacity through the Digitalization of the Credit Enhancement Fund's management processes (JA-T1142) for US$250,000 in order to improve the internal controls of the CEF. The TC will also complement existing efforts by the IDB to promote the competitiveness of the Jamaica private sector.

C. Key Results Indicators

1.43 The main impact of the programme will be the increase in sales per MSME. The results will be an increase in: (i) total MSME loan amount leveraged in the programme; (ii) guaranteed loan tenor length; and (iii) non-performing MSME loans on total MSME loans in the programme. Finally, the expected products are the

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[31] The current limits are J$15 million (equivalent of US$115,500) and 50% per individual guarantee. The threshold per individual loan will not exceed the equivalent of US$385,000, unless DBJ obtains the prior written approval of the Bank.

[32] To the extent that imperfect capital markets and suboptimal levels of financial intermediation prevent the allocation of productive factors into those firms and sectors with the best opportunities and higher potential and actual productivity, the availability of the line to all these uses can generate productivity gains (even if not used exclusively in the most obvious destinies of implementation of new technologies, techniques, and processes). For a discussion on factor allocation and the impact on productivity see Restuccia, D., & Rogerson, R. (2008). Policy distortions and aggregate productivity with heterogeneous establishments. Review of Economic Dynamics, 11(4), 707-720; Hsieh, C. T., & Klenow, P. J. (2009). Misallocation and Manufacturing TFP in China and India. The Quarterly Journal of Economics, 124(4), 1403-1448.

[33] Indirectly, by virtue of having a guaranteed loan, any AFI that has a risk-based pricing model would be able to charge a lower interest rate vis-à-vis a non-guaranteed loan of similar characteristics. The IDB will track the evolution in financing conditions in the evaluation.

number of partial guaranteed loans for MSME derived from the programme. As part of the efforts to generate data on gender and climate related investments and with a long-term view to support DBJ's strategy in these fields, related milestones will be collected during the execution period. For further information, please see Results Matrix.

1.44 **Economic analysis.** The Cost Benefit Analysis (CBA) is based on the profile of the typical firm expected to benefit from the partial government guarantee. Based on this profile, the CBA computes the expected change in value added resulting from the improved access to credit. The central result indicates that the expected Net Present Value (NPV) of the programme is US$32 million. The sensitivity analysis performed on key variables (productivity, non-performing loans, macroeconomic performance, and cost reductions) indicates that the programme's NPV remains positive for a wide range of scenarios, based on a discount rate of 12%.

II. Financing Structure and Main Risks

A. Financing Instruments

2.1 **Origin and use of resources.** The proposed programme will be financed through an investment loan of up to US$20 million from the IDB's Ordinary Capital (OC) resources to strengthen the existing capital of the CEF, a trust managed by the DBJ for the purpose of issuing partial credit guarantees to support access to credit for MSME. The investment modality for the programme will be a Global Credit Loan, since it will be granted to intermediary financial institutions and will finance multi-sector projects.

Table 1. Programme Costs (in US$)

Investment category	Amount
CEF capital resources	19,800,000
Administrative and monitoring and evaluation costs	200,000
Total	**20,000,000**

B. Environmental and Social Safeguard Risks

2.2 In accordance with Directive B.13 of the Environment and Safeguards Compliance Policy (OP-703), this programme does not require classification. The programme potential environmental and social risks and the institutional capacity of the DBJ were assessed during the project team's due diligence, leading to the confirmation that this operation is considered low risk (FI-3). To execute this programme, the DBJ will apply an Environmental and Social Management System (ESMS) that will incorporate an exclusion list to be incorporated in the OR. For further information, please see Environmental and Social Management Report (ESMR).

C. Fiduciary Risks

2.3 The IDB has carried out an updated institutional assessment of the Executing Agency (EA) and considers that there is a fiduciary risk classified as medium that can hinder project execution. While the DBJ as an institution possesses the necessary core competences in the areas of credit, lending and guarantee management of MSME, the assessment reveals that the DBJ does not possess sufficient operational and fiduciary capacity to manage the operation at the execution level. As such, there are opportunities to enhance its capacity to carry out its fiduciary duties related to the execution, financial management, monitoring and evaluation functions. Thus, the IDB and the DBJ will ensure the assignment of a programme coordinator and finance officer for the programme.

D. Other Key Issues and Risks

2.4 There is medium risk that changes in macroeconomic conditions in Jamaica or worldwide and its implications on fiscal sustainability could affect demand for the programme by AFI and MSME. The IDB will program disbursements through advances based on the expression of demand by the participating AFI. Any variation in the actual execution will be adjusted to the actual execution on the next disbursement date, thus ensuring that the CEF capital amount will be in line with the volume of outstanding guarantees.

2.5 There is a medium risk that the internal controls in the processing of guarantees could affect the execution of the programme. The processing of guarantees under the CEF is carried out manually and the database is managed in Excel, leading to a weakness in internal control when considering a larger scale of transactions and an opportunity to improve the portfolio management standards. The IDB will set specific internal control requirements in the OR, to ensure adequate programme execution in terms of internal controls. In addition, the IDB is requesting US$250,000 in technical cooperation to the Institutional Core Fund to support DBJ's efforts to implement a management information system that will further enhance the internal control function through a more streamlined operational flow.

2.6 The risk assessment is based on the preparation work for the programme, including discussions related to the current CEF Operational Guidelines (OG), the IDB's lessons learned in similar operations, ongoing discussions related to the OR and the institutional capacity assessment. Given that the CEF is currently operational, that the DBJ has a strong track record with the IDB and that the mitigation measures contemplated in the preparation of the programme will keep the medium risks controlled, the programme's overall risk is considered to be medium.

2.7 As mentioned previously, Jamaica is strongly committed to fostering the development of MSME, through several public policies that are ongoing and that will continue to be further expanded upon in the future. Because the CEF is currently in existence and has been identified to be scaled up, it is expected that the government's commitment to the CEF will go beyond the scope of the programme and carry on afterwards. The financial sustainability of the CEF is a priority for the government, which will be assessed over time by the DBJ and the BOJ (who in parallel consider this issue as relevant to the decision on the risk-weighting of guaranteed loans). Possible areas of intervention in the future may lead to more specific interventions related to gender and to climate change in MSME, so as to further advance the agenda in these areas. The information

collected through the programme will be instrumental to provide both the DBJ and the AFI with sufficient data to expand on this. Related to MSME financing, Jamaica will continue to develop its public policies in terms of strengthening the financial system regulations and supervision, collecting MSME supply-side data to better monitor financing activities, and improving the usage of the securities interests in personal property act to enhance credit access for MSME.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of Implementation Arrangements

3.1 **Borrower and EA**. Jamaica in its capacity as the Borrower will supervise and oversee the execution of the loan through the Ministry of Finance and Public Service. The DBJ will be the programme's EA and will provide the necessary administrative, fiduciary and control mechanisms to maintain an effective administration of the programme and the CEF (for further information, please see Annex III Fiduciary Arrangements).

3.2 **Execution and administration.** The DBJ's Loan Origination and Portfolio Department will manage the CEF operations and together with the programme coordinator will be responsible for coordinating the necessary arrangements for the execution of the programme, which will include: (i) preparation, implementation, coordination of the annual operating plans; (ii) preparation of budgets, project accounting, financial management, reports, and disbursement requests; (iii) preparation of the programme's procurement plan of consulting services for the programme; (iv) preparation of technical, progress and financial reports; (v) periodic monitoring and analysis of the programme's activities; (vi) evaluation at the end of the programme's execution; (vii) hiring of the external audit firm and implementation of its recommendations; and (viii) liaison for the programme with the IDB.

3.3 The OR will establish the provisions related to the programme's execution, the programme coordination responsibilities, the partial guarantees' characteristics, the eligibility criteria for MSME and AFI, environmental and social requirements, as well as the fiduciary obligations of the CEF, including monitoring and evaluation. In addition, the OR will reference and be linked with the CEF's OG. The DBJ will not be able to modify the OR and the OG without prior written consent from the IDB.

3.4 The DBJ will continue to use the trust to carry out CEF operations and the partial guarantees will be issued under the fund in accordance with the OR. Undisbursed resources accounted for in the CEF will be invested consistent with current practices and in line with the requirements indicated in the OR. The proceeds from these investments will be reinvested and used to provide guarantees through the CEF.

3.5 For the purpose of this programme, an MSME will be eligible if they fulfill the following criteria: (i) an entity incorporated in Jamaica and registered to operate in Jamaica, as well as businesses registered under the Registration of Business Names Act; (ii) have the necessary licenses and permits to operate under Jamaican law, or be in the process of obtaining the necessary licenses and permits; (iii) be creditworthy and meet the full criteria for borrowing in DBJ's and AFI's lending policy, except for the ability to provide collateral; (iv) report up to

approximately US$3.3 million (the equivalent to J$425 million) in turnover or up to 150 employees;[34] (v) be in operation for at least two years,[35] and (vi) have no more than approximately US$385 million (the equivalent to J$50 million) in aggregated outstanding loan amount guaranteed. To ensure that projects are focused on improving productivity for MSME and contributing towards their sustainability, the use of proceeds will be limited to the purchase of equipment and machinery, expansion projects, and permanent capital all directly related to the MSME's activity, as outlined in the OR. An AFI will be eligible if they fulfill the following criteria: (i) an incorporated entity registered to operate in Jamaica; (ii) have the necessary licenses and permits to operate under Jamaican law; and (iii) have signed and kept current the necessary agreements to participate under the CEF terms.

3.6 AFI participating in the CEF will be subject to oversight and monitoring by the DBJ, in accordance with the requirements stipulated in the OR. The AFI will be responsible for the following: (i) assess MSME subproject risk, presenting guarantee requests in accordance with the terms and conditions stipulated in the OR; (ii) maintain sound financial performance and continue to meet the minimum performance ratios used by DBJ in the accreditation process; (iii) provide the DBJ with annual audited financial statements, quarterly unaudited financial statements and periodic reports; (iv) maintain a rating between 1 and 5 in DBJ's financial analysis system; (v) maintain current the payment of all guarantee fees issued under the CEF; (vi) collect the proceeds from MSME loans partially guaranteed by the CEF; (vii) in case of a claim, pursue all reasonable efforts to collect the MSME loans to the full extent of the law and reimbursing the recovered proceeds to the DBJ in accordance with the rules established in the OR; and (viii) provide the DBJ with reports on outstanding guarantees and claimed guarantees, if applicable.

3.7 The IDB will have the right at all times to inspect the execution of the programme financial statements and the eligibility of programme expenses shall be audited annually by an independent auditing firm acceptable to the IDB, and hired and paid by the DBJ. The firm will report on the eligibility of the programme expenses, verify the existence of issued guarantees under the CEF, and carry out physical inspections of the projects guaranteed by the CEF to verify implementation of investments. The programme's audited financial statements will be submitted to the IDB within 120 days following the close of the EA's fiscal year in accordance with the accounting standards and principles acceptable to the IDB.

3.8 Programme disbursements shall be made based on a pipeline of guarantees under the CEF submitted to the DBJ by the AFI in accordance with the requirements and procedures stipulated in the OR. For the purpose of the justification of expenditures for the subsequent advances of funds, the object of the expenditure will be the partial guarantees issued under the CEF, in accordance with the eligibility criteria provided for in the OR.

B. Summary of Arrangements for Monitoring Results

3.9 **Reports.** The programme will be monitored through semiannual reports prepared by the EA and presented to the IDB within 60 days after the close of each semester, measuring progress on the results indicators (for further information see

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[34] In accordance with DBJ's adoption of the Jamaican MSME definition, which may be reviewed over time.
[35] Some exceptions may be approved by DBJ for startups based on special qualifications to be assessed.

Annex II Results Framework), and on the fulfillment of the eligibility criteria at project and programme levels.

3.10 **Evaluation.** The Borrower, through the EA and the IDB, will conduct a mid-term evaluation which will be due within 30 months from the date of the first disbursement or once 50% of the loan has been disbursed, whichever occurs first. The evaluation will assess the progress in accomplishing the programme objectives and outcomes based on the Results Framework, and if necessary, identify any corrective action required. The Borrower will provide the necessary information for the IDB to conduct a Project Completion Report (PCR) and final evaluation, to be completed within nine months after reaching 95% or more of total disbursements. Periodical monitoring meetings will also be scheduled. The Monitoring and Evaluation Plan contemplates an ex post economic analysis for the programme evaluation. It will use basic descriptive and inferential statistics to illustrate the results of the programme.

3.11 **Information.** The DBJ will compile and maintain all information, indicators and parameters, including all documentation required to prepare the PCR.

Development Effectiveness Matrix		
Summary		
I. Corporate and Country Priorities		
1. IDB Development Objectives	**Yes**	
Development Challenges & Cross-cutting Themes	**-Social Inclusion and Equality -Productivity and Innovation**	
Country Development Results Indicators	**-Micro / small / medium enterprises financed (#)***	
2. Country Development Objectives	**Yes**	
Country Strategy Results Matrix	**GN-2868**	**Facilitate access to finance for SMEs.**
Country Program Results Matrix	**GN-2884**	**The intervention is included in the 2017 Operational Program.**
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		
II. Development Outcomes - Evaluability	**Evaluable**	
3. Evidence-based Assessment & Solution	**8.4**	
3.1 Program Diagnosis	**3.0**	
3.2 Proposed Interventions or Solutions	**2.4**	
3.3 Results Matrix Quality	**3.0**	
4. Ex ante Economic Analysis	**10.0**	
4.1 The program has an ERR/NPV, a Cost-Effectiveness Analysis or a General Economic Analysis	**4.0**	
4.2 Identified and Quantified Benefits	**1.5**	
4.3 Identified and Quantified Costs	**1.5**	
4.4 Reasonable Assumptions	**1.5**	
4.5 Sensitivity Analysis	**1.5**	
5. Monitoring and Evaluation	**9.1**	
5.1 Monitoring Mechanisms	**2.5**	
5.2 Evaluation Plan	**6.6**	
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood	**Medium**	
Identified risks have been rated for magnitude and likelihood	**Yes**	
Mitigation measures have been identified for major risks	**Yes**	
Mitigation measures have indicators for tracking their implementation	**Yes**	
Environmental & social risk classification	**B.13**	
IV. IDB´s Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)		**Procurement: Information System, Methodology for Comparison of Prices**
Non-Fiduciary		
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Gender Equality	**Yes**	**Evidence has been established that women-led firms are less likely to ask for credit from a bank and consider access to finance as a severe obstacle to business activities, more than to other firms. The program will seek to develop data on the availability of access to finance for women-led MSME under the CEF, with a long-term view to support future decisions on how to engage a specific gender strategy.**
Labor	**Yes**	**An increase in jobs is expected as the MSMEs engage in productive investments.**
Environment		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	**Yes**	**Technical Cooperation JA-T1142 has been approved to support the institutional capacity in the processing of CEF guarantees, specifically by digitizing the process leading to more efficiency and better internal controls.**
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan	**Yes**	**In the Caribbean, there is scarce evidence on the impact of interventions that promote credit for productive investment. The project team has secured commitment from the executor on procuring data from a rejected group of loan applicants, which given the scoring scheme used to approve loans presents an opportunity for a discontinuity in regression design that could shed light on the impact of this type of program in Jamaica.**

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

The Credit Enhancement Program for Micro, Small, and Medium Enterprises (MSMEs) – JA-L1075 aims 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 program will be sued to complement the capital of the Credit Enhancement Facility (CEF), an existing guarantee mechanism administered by the Development Bank of Jamaica (DBJ).

The project's vertical logic is adequate. While the Jamaican financial sector has shown a solid financial position characterized by high asset quality indicators and strong liquidity, it has lagged behind in the proportion of credit allotted to the private sector, which stands at 30% of GDP and is estimated to cover less than 10% of MSMEs. In addition, although the country ranks favorably in the Global Competitiveness Index, it lags in its performance of financial services to meet business needs (67th of 138 countries) and their affordability and ease of access (91st and 81st places respectively). Finally, a diagnostic study commissioned by the program found that 60% of MSMEs found access to finance to be a challenge. Half of firms surveyed cited a lack of collateral as the most important barrier in accessing finance, and 70% of firms mentioned they could not meet this requirement. Only 31% and 48% of MSMEs surveyed owned liquid assets or real estate to serve as collateral. Almost all loans require collateral (80%) and the average value is 175% of the loan amount. The program will focus on addressing the limited collateral capacity of MSMEs. The guarantee mechanism will be enhanced with a higher partial guarantee ceiling and cap as a percentage of the loan amount.

The Cost/Benefit analysis and Monitoring and Evaluation plan are both adequate. Relying on the use of a score system to approve loans, the team will pursue a regression discontinuity design for an impact evaluation that will shed evidence on the impact of supporting this type of guarantee schemes in Jamaica and the Caribbean.

RESULTS MATRIX

Programme objective:	The objective of the programme is to promote productive investments in Micro, Small and Medium Enterprises (MSME) 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 Credit Enhancement Facility (CEF), an existing guarantee mechanism administered by the Development Bank of Jamaica (DBJ).

EXPECTED IMPACT

Indicators	Unit of measure	Baseline Value	Baseline Year	Year 1	Year 2	Year 3	Year 4	Year 5	End of Project	Means of verification	Observations
IMPACT #1											
Increased sales per MSME	%	0	2016	3.42	4.27	4.96	5.24	5.56	5.56	Development Bank of Jamaica (DBJ) and Survey.	Based on the enterprise survey data, demand market assessment, and dialogue with the counterpart.

EXPECTED OUTCOMES

Indicators	Unit of measure	Baseline Value	Baseline Year	Year 1	Year 2	Year 3	Year 4	Year 5	End of Project	Means of verification	Observations
OUTCOME # 1:											
Total MSME loan amount leveraged in the programme	Millions of US$	0	2016	4.16	4.16	5.54	6.93	6.93	6.93	DBJ	Based on an average coverage of 70%.
Guaranteed loan tenor length	Months	48	2016	48	51	54	57	60	60	DBJ	It is based on the average term of the guarantees in the last three years.
Non-performing MSME loans on total MSME loans in the programme	%	4.32	2016	4.32	4.32	4.32	4.32	4.32	4.32	DBJ	Non-performing loans have been estimated to be 20% higher than corporate loans.

OUTPUTS

Outputs	Unit of measure	Baseline Value	Baseline Year	Year 1	Year 2	Year 3	Year 4	Year 5	End of Project	Means of verification	Observations
COMPONENT #1 – MSME Guarantee Fund											
Number of guaranteed MSME loans by the programme.	Number	0	2016	64	64	86	107	107	428	DBJ	
• Milestone: Guaranteed women-owned MSME loans by the programme[1]	%	NA	NA							DBJ	The goal is to generate gender gap on access to credit data.
• Milestone: Guaranteed MSME Energy Loans by the programme.	%	NA	NA							DBJ	The goal is to generate data on climate change loans.

[1] Evidence on this area is not conclusive so we consider relevant to monitor how the programme behaves on this area. For instance, the Global Financial Inclusion (Findex) Database found in 2014 more percentage of male borrowers than female borrowers to start, operate, or expand a farm or business. In addition to the former data, the paper Measuring Gender Gaps in Firms' Access to Credit by C. Piras, A. Presbitero, and R. Rabellotti show that women-led businesses are more likely to be financially constrained than other comparable firms in Jamaica. However, conversations with the different stakeholder present us a different panorama.

FIDUCIARY ARRANGEMENTS

Country:	Jamaica
Project Number:	JA-L1075
Name:	Credit Enhancement Programme for Micro, Small and Medium Enterprises (MSME)
Executing Agency:	Development Bank of Jamaica (DBJ)
Prepared by:	Naveen Jainauth-Umrao, Financial Management Specialist (FMP/CJA); Rene Herrera, Senior Procurement Specialist (FMP/CJA); Leon Ferguson, Procurement Consultant (FMP/CJA); and Martin Nesbeth, Financial Consultant (FMP/CJA)

I. EXECUTIVE SUMMARY

1.1 Jamaica in its capacity as the borrower of the loan, will through the Ministry of Finance and the Public Service, supervise and oversee the execution of the Credit Enhancement Facility (CEF), an existing guarantee mechanism administered by the Development Bank of Jamaica Limited (DBJ). The DBJ will act as executing agency, in order to facilitate access to financing for MSME through the Approved Financial Institutions (AFI).

1.2 The fiduciary management evaluation of the programme was performed using the Institutional Capacity Assessment System (ICAS) methodology, as well as through a series of interviews with the management team and examination of records of Bank funded operations executed by DBJ. The evaluation indicates that the programme has a medium-low fiduciary risk, and as such, it is believed that the DBJ: (i) based on the current structures and fiduciary systems in place; and (ii) once it has the Programme Executing Unit (PEU) established, will have the capacity to execute the programme. However, considering the complex nature of the programme, there is need for an experienced team composition.

1.3 The Government of Jamaica continues, with assistance from major donors, to address key improvements to its fiduciary systems. The donor community is committed to working with Jamaica to determine the extent to which the country fiduciary systems can be used for the administration of donor-financed projects. In regard to the country procurement systems, the Bank has approved the use of the Jamaican Procurement Sub-system of Limited Tender/Restricted Bidding, for all contracts for works below the Bank's threshold for Price Comparison (up to US$150,000) and contracts for goods and non-consulting services that fall within the Bank's threshold for the said method (US$25,000).

1.4 For this programme, in the area of financial management, the Bank is recommending the use of a certified public accounting firm, approved by the Bank, for external control. Currently, the portfolio of the Bank is managed through the establishment of a special PEU for the majority of the projects. In addition, the Bank conducts a close operational supervision on these PEU, and provides

training as needed on Bank's policies and procedures. At the country's fiduciary management level the employment of the Fin Man accounting system is implemented for treasury and financial administration. However, the DBJ uses the Great Plains accounting software package, and it is expected that a "Project" or "Grant" version of this accounting software package will be used as the financial management and accounting system, providing it satisfies the financial administration requirement of the Bank, when examined.

1.5 The programme will be financed in its entirety by the Bank and does not include local counterpart. No subexecutors are envisaged. To complement the programme, the IDB is preparing a Technical Cooperation Strengthening the Development Bank of Jamaica Institutional Capacity through the Digitalization of the Credit Enhancement Fund's management processes (JA-T1142) for US$250,000 to support the internal controls of the CEF.

II. EXECUTING AGENCY'S FIDUCIARY CONTEXT

2.1 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 access to credit for MSME. One such initiative has been the CEF, in operation since 2009. The CEF provides partial loan guarantees to AFI for loans given to MSME which are unable to meet AFI collateral requirements. The CEF also acts as an incentive to AFI to increase their MSME loans portfolio by providing additional security coverage on loans issued by the AFI to MSME for projects geared towards growth and development. The CEF has been made more attractive recently by the Bank of Jamaica's decision to reduce the risk-weighting for the guaranteed portion of the loans. This would ensure additional take up by the AFI.

2.2 The programme builds upon the DBJ's well-developed experience in operating and managing the CEF. Disbursement of funds 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 on the basis of a number of conditions established in the Operating Regulations (OR). The programme will apply the standard procedures established by the IDB for monitoring and evaluation of investment operations.

2.3 The Executing Agency (EA) has a history of implementation of projects placed under their responsibility, inclusive of donors such as the World Bank, the CDB and the IDB. The DBJ is currently executing two Multilateral Investment Fund (MIF) funded operations, "Promoting Financial Inclusion in Jamaica through Mobile Money for Microfinance" (ATN/ME-14598-JA) and "Support the Development of An Entrepreneurial and Early Stage Ecosystem in Jamaica" (ATN/ME-15282-JA), and is associated with the loan "Adaptation Programme and Financing Mechanism for the Pilot Programme for Climate Resilience (PPCR) Jamaica" (3381/SX-JA).

2.4 The PEU will be established within the DBJ and will execute the programme under the responsibility of General Manager (GM) of the Strategic Services Department.

The GM reports to the Managing Director, who has the responsibility to report to the Board of Directors and by extension, Jamaica. The Loan Origination and Portfolio Management Department will provide technical support to the PEU, as well as being an integral part of the execution mechanism. The loan proposals will be assessed and analyzed by the Accounts Executives, of the Loan Origination and Portfolio Management Department, who will advise the PEU of the guarantees, and resulting funding required.

2.5 Taking into account the above, and considering the complexity of this operation, referring to the specialized functions, explained in 2.1, 2.2 and 2.4 above, required of the DBJ to successfully implement this operation, it is anticipated that additional personnel with the appropriate skill set would be required. Consequently, a programme coordinator, with the appropriate analytical skills, a financial officer and an environmental and social coordinator should be dedicated to provide the required institutional composition to the PEU.

III. FIDUCIARY RISK ASSESSMENT AND MITIGATING ACTIONS

3.1 The overall fiduciary risk of the programme, which is being evaluated using the ongoing ICAS methodology, is deemed to be low to medium. The fiduciary evaluation is being done mainly of the DBJ since the PEU for the programme has not yet been established. Notwithstanding this, there were a few risks as outlined below that were deemed medium-low risk and which could have an impact on the programme. These risks, however, do not affect the overall risk of the programme.

Table 1. Mitigation Risk and Rating

Risk	Risk rating	Mitigation measures
1. DBJ does not have sufficient operational and fiduciary capacity to manage the operation at the execution level	Medium	The required personnel, programme coordinator, financial officer, and environmental and social coordinator, should be assigned to the programme in a timely manner. Personnel should be suitably skilled and qualified and preferably with experience in managing donor funded projects. **Responsibility for implementation:** PEU/Borrower. **Timeline for implementation:** Prior to 1st disbursement of the loan.
2. Lack of experience and awareness regarding IDB fiduciary policies, procedures and, by extension IDB's requirements for loan operations	Low	Create capacity within the PEU through in house training on IDB's procurement, financial management procedures and requirements. **Responsibility for implementation:** IDB. **Timeline for implementation:** During programme design and throughout programme execution.

IV. Aspects to be considered in the Special Conditions of the Loan Contract

4.1 In order to facilitate the negotiation of the operation, outlined below are agreements and requirements which will be incorporated into the special conditions:

a. **Special conditions: precedent to first disbursement of the financing.** For the successful execution of the programme and to mitigate institutional capacity risks over the life of the programme, the EA will provide evidence, to the Bank's satisfaction: (i) of the entry into force of the amended CEF security sharing trust deed under which the CEF may receive the Bank's loan resources for the execution of the programme; (ii) of the entry into force of an agreement between the Borrower and the EA for the programme's execution and transfer of the Bank's loan resources to the EA; (iii) of the CEF's Board of Trustees approval of the programme's Operating Regulations (OR) and of the entry into force of such OR; and (iv) of the assignment or hiring by the EA of the personnel responsible for managing the programme, including its coordinator, a financial officer, and an environmental and social coordinator.

b. **Exchange rate agreed with the EA.** If the programme's expenditures have been incurred in local currency, the EA and the Bank will agree on the exchange rate to be used in the justification and reimbursement. For purposes of the justification of expenditures to the Bank (including reimbursement/recognition of expenditures, and local counterpart) the equivalent amount to be reported in the project or disbursement currency will be determined using the effect exchange rate used to convert the funds denominated in the programme's currency to the local currency.

c. **Financial statements and reports.** Annual Audited Financial Statements (AFS) of the programme are to be submitted to the Bank within 120 days after the close of each fiscal period, in addition to Final AFS, which are due for submission to the Bank within 120 days of the close (last disbursement date) of the programme. The AFS should report on the overall programme and internal controls, in the expressed currency of the Loan.

d. The AFS should include a report on the eligibility of costs associated to the fund, verify the existence of the issued guarantees and supporting documents, and that the funds disbursed to serve as guarantees have been disbursed in accordance with the terms and conditions of the OR for the CEF Guarantee mechanism.

V. Requirements and Arrangements for Execution of Procurement

5.1 **Procurement execution.** Procurements for the proposed project will be carried out in accordance with the Policies for the Selection and Contracting of Consultants Financed by the IDB (GN-2350-9) of March 2011, with the provisions established in the Loan Contract and the Procurement Plan (PP).

a. **Procurement of consulting services.** The PP for the MSME covering the first 18 months of programme execution indicates the procedure to be used for the procurement of consultancy services, and the method of selecting consultants. The Borrower is responsible for preparing and implementing the programme, and therefore for preparing the Terms of Reference (TOR), short lists, selecting the consultants, and awarding and subsequently administering the contract, with Bank supervision.

Table 2. Country Threshold Table (US$ Thousands)
www.iadb.org/procurement

THRESHOLDS				
International Competitive Bidding Threshold *		National Competitive Bidding Range ** (Complex works and non-common goods)		Consulting Services
Works	Goods	Works	Goods	International Short List
≥1,500,000	≥150,000	150,000 – 1,500,000	25,000 -150,000	≥200,000

* When procuring simple works and common goods and their amount is under the International Competitive Bidding thresholds, Shopping may be used.

** When procuring complex works and non-common goods with amounts under the NCB range, Shopping shall be used.

5.2 **Procurement Plan (PP).** The PP indicates the procedure to be used for the procurement of goods, the contracting of works or services, and the method of selecting consultants, for each contract or group of contracts. It also indicates cases requiring prequalification, the estimated cost of each contract or group of contracts and the requirement for prior or post review by the Bank. The PP will be posted on the Bank's website (http://www.iadb.org/en/projects) and will be updated annually or whenever necessary, or as required by the Bank.

5.3 **Procurement supervision.** The Bank will conduct ex ante reviews of all procurement processes. If a procurement activity is moved to ex post, the ex post procurement supervision should take place at least once every 12 months, in accordance with the supervision plan of the programme.

5.4 **Records and files.** All records and files will be maintained by the PEU, according to accepted best practices, and be kept for up to three years beyond the end of the operation's execution period.

VI. FIDUCIARY MANAGEMENT

6.1 **Programming and budget.** Each year, the Ministry of Finance and the Public Service publishes a Budget Circular requesting the submission of estimates of income and expenditure from ministries and other agencies for inclusion in the National Budget for the following fiscal year, April to March.

6.2 The PEU will prepare annual estimates in the required format for the review and approval by the Trustees and Board of Directors (BoD) of the DBJ (or Group Managing Director or General Manager in the absence of a governing BoD). The estimates will consider the total cost of financing required for execution of the programme. The budget is presented to Parliament before the close of the fiscal

year. Once the budget is approved, amendments are made through the submission of Supplementary Budget by the Minister of Finance.

6.3 The borrower has committed to allocate, for each fiscal year of project execution, adequate fiscal space to guarantee the unfettered execution of the project; as determined by normal operative instruments such as the Annual Operating Plan, the Financial Plan and the PP.

6.4 **Accounting and information systems.** Project accounting will be performed using Great Plains accounting software package, in accordance with the Financial Administration and Audit Act (FAAA) and International Financial Reporting Standards (IFRS); IDB's financial management requirements; and the modified cash basis of accounting, which is a comprehensive basis of accounting other an IFRS. It is expected that the accounting system will facilitate the recording and classification of all financial transactions, provide information related to: planned vs. actual financial execution for the programme; the financial execution plan for the next 180 days that will be attached to each request for advance of funds. Additionally, the list of commitments will also accompany any request for advance of funds.

6.5 **Disbursements and cash flow.** A separate bank account will be established for the disbursement and management of resources disbursed to the CEF, and will be used to issue guarantees, disburse claims, collect fees and other activities related to the funds in accordance with the terms and conditions specified in the Operations Regulations.

6.6 The PEU commits to maintaining strict control over the utilization of the resources disbursed to ensure the easy verification and reconciliation of balances between the EA's records and IDB records (WLMS1).

6.7 Bank policies allow for the following disbursement methodologies will be used for the programme:

a. Reimbursement of payments made (will be predominantly used for the disbursements by the Bank to the designated account for the CEF).

b. Direct payment to supplier.

c. Advance of funds (only to provide for the liquidity needs, and to facilitate the day to day operations).

6.8 The project will provide adequate justification of the existing advance of funds balance, whenever 80% of said balance has been spent. Advances will normally cover a period not exceeding 180 days and no less than 90 days.

6.9 **The IDB will utilize the reimbursement of payments (direct payment to borrower)** methodology for the disbursement of the loan. The first material disbursement, which is intended to capitalize or guarantee the Fund and facilitate commencement of operations, will be made based on the approval of the OR and a list of preidentified pipeline of eligible guarantees. Subsequent disbursements

will be made on the basis of an actual pipeline of eligible guarantees provided by the CEF.

6.10 Generally, supporting documentation for justifications of advances and reimbursement of payments made will be kept at the office of the PEU. Supporting documentation for direct payments will be sent to the Bank for processing. In light of the experience garnered from the current and former operations the modality for disbursement will be ex post.

6.11 **Internal control and internal audit.** The management of the project, at the level of both the EA and the PEU, will assume the responsibility for designing and implementing a sound system of internal control for the project.

6.12 **External control and reports.** For each fiscal year during project execution, the DBJ will be responsible for submitting Audited Financial Statements for the programme. These Financial Statements will be audited by an independent public accounting firm approved by the Bank's country office. A final AFS is to be submitted to the Bank within 120 days from the date of last disbursement.

6.13 In addition, the DBJ is required to submit a copy of the entity's, (DBJ's) AFS, along with the project's audited financial statements, no later than 120 days after the end of the fiscal period.

6.14 **Financial supervision plan.** Financial supervision will be developed based on the initial and subsequent risk assessments carried out for the programme. Financial, accounting and institutional inspection visits will be performed at least once per year, covering, among others things, the following topics:

a. Review of the bank reconciliation and supporting documentation for advances and justifications.

b. Review of compliance with the ORs.

c. Conducting ex post Reviews.

6.15 **Execution mechanism.** The PEU will be established within the DBJ and will execute the programme under the responsibility of General Manager (GM) of the Strategic Services Department. The GM reports to the Managing Director, who has the responsibility to report to the Board of Directors and by extension, Government of Jamaica. The Loan Origination & Portfolio Management Department will provide technical support to the PEU, as well as being an integral part of the execution mechanism. The loan proposals will be assessed and analyzed by the Accounts Executives, of the Loan Origination & Portfolio Management Department, who will advise the PEU of the guarantees, and resulting funding required.

6.16 The PEU will have three strategic positions: one programme coordinator, one finance officer and one social and environmental coordinator. The programme coordinator will be responsible for managing the operation, enable smooth day-to-day functioning of the programme. The OR further describes the recommended PEU composition and their responsibilities. The PEU will be responsible for the administration of loan financing and procurement processes.

Specific PEU duties include: (i) preparation of semi-annual progress reports; (ii) preparation, and implementation of the Annual Operating Plans; (iii) preparation of budgets, and disbursements; (iv) preparation of the Project Profile; (v) financial administration of the programme according to accepted accounting principles and presenting audited financial statements; (vi) ensuring the quality and efficacy of procurement processes and their compliance with both the policies of the Bank and that of the Government of Jamaica; (vii) ensuring the consistent alignment of expected programme results with day-to-day programme implementation as well as continuous data collection to enable the measurement of the indicators included in the Results Matrix; and (viii) being programme liaison with the Bank.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-__/__

Jamaica. Loan ____/OC-JA to Jamaica
Credit Enhancement Programme
for Micro, Small and Medium
Enterprises (MSME)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with Jamaica, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a credit enhancement programme for micro, small and medium enterprises (MSME). Such financing will be for the amount of up to US$20,000,000 from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ______________)

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